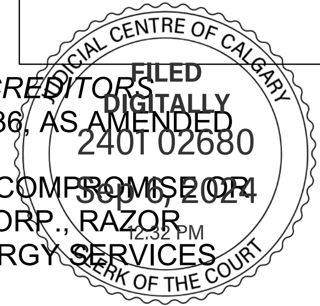
Clerk's Stamp



COURT FILE NUMBER	2401-02680
COURT	COURT OF KING'S BENCH OF ALBERTA
JUDICIAL CENTRE	CALGARY
APPLICANTS	IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED AND IN THE MATTER OF THE PLAN OF COMPROMISE OR ARRANGEMENT OF RAZOR ENERGY CORP., RAZOR HOLDINGS GP CORP., AND BLADE ENERGY SERVICES CORP.
DOCUMENT	**BOOK OF AUTHORITIES** **FOR BENCH BRIEF OF RAZOR ENERGY CORP., RAZOR HOLDINGS GP CORP., AND BLADE ENERGY SERVICES CORP.** **TO BE HEARD ON SEPTEMBER 11, 2024 AT 10:00 A.M.**
ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT	McCarthy Tétrault LLP 4000, 421 – 7th Avenue SW Calgary, AB T2P 4K9 Attention: Sean Collins, KC / Pantelis Kyriakakis / Nathan Stewart Tel: 403-260-3531 / 3536 / 3534 Fax: 403-260-3501 Email: scollins@mccarthy.ca / pkyriakakis@mccarthy.ca / nstewart@mccarthy.ca

LIST OF AUTHORITIES

PLEADINGS

1. Appendix "A" to the Fifth Report of the Monitor, dated July 12, 2024, being the Sixth Cash Flow Forecast for the period ending October 13, 2024;

STATUTES

2. *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, at section 11.01;

CASE LAW

3. *Agro Pacific Industries Ltd, Re*, 2000 BCSC 879;

4. *Allarco Entertainment Inc, Re*, 2009 ABQB 503;

5. *Arrangement relatif à Gestion Eric Savard Inc*, 2019 QCCA 1434;

6. *Lightstream Resources Ltd, Re*, 2016 ABQB 665;

7. *Royal Bank v Cow Harbour Construction Ltd*, 2012 ABQB 59;

8. *Smith Brothers Contracting Ltd (Re) (Trustee of)*, 1998 CanLII 3844 (BC SC);

9. *WCI Waste Conversion v ADI International Inc*, 2011 PECA 14;

10. *Williston Wildcatters Oil Corporation v Peat Marwick Thorne Inc*, 1995 ABCA 427; and,

11. *Woodward's Ltd, Re*, (1993), 77 BCLR (2d) 332 (BCSC).

TAB 1

Razor Energy Corp., Razor Royalties Limited Partnership, Razor Holdings GP Corp., and Blade Energy Services Corp. (the "Razor Entities")
Projected Cash Flow Forecast for the Period of July 8, 2024 to October 13, 2024

Cash Flow Forecast		Week 1	Week 2	Week 3	Week 4	Week 5	Week 6	Week 7	Week 8	Week 9	Week 10	Week 11	Week 12	Week 13	Week 14	Total
(C$ 000s)	Week Ending	14-Jul	21-Jul	28-Jul	4-Aug	11-Aug	18-Aug	25-Aug	1-Sep	8-Sep	15-Sep	22-Sep	29-Sep	6-Oct	13-Oct	
Receipts																
Net production revenue	1	$ -	$ -	$ 2,061	$ -	$ -	$ -	$ 1,820	$ -	$ -	$ -	$ -	$ 1,828	$ -	$ -	**$ 5,709**
Other receipts	2	15	15	1,115	65	15	15	15	65	15	15	15	15	65	15	**1,460**
Total - Receipts		**15**	**15**	**3,176**	**65**	**15**	**15**	**1,835**	**65**	**15**	**15**	**15**	**1,843**	**65**	**15**	**7,169**
Disbursements																
Operating expenses	3	(223)	(313)	(870)	(1,058)	(196)	(196)	(186)	(868)	(196)	(186)	(196)	(567)	(368)	(263)	**(5,685)**
Transportation and processing costs	4	(63)	-	-	(75)	-	-	-	(75)	-	-	-	(75)	-	-	**(288)**
Lease rentals	5	-	(53)	-	-	-	(51)	-	-	-	(51)	-	-	-	-	**(156)**
Insurance	6	(27)	-	-	-	-	(11)	-	-	-	(11)	-	-	-	-	**(50)**
Payroll	7	(150)	-	(150)	-	-	(150)	-	(150)	-	(150)	-	(150)	-	(150)	**(1,050)**
Professional & sales agent fees	8	(60)	-	(150)	-	-	-	-	(150)	-	-	-	-	(150)	-	**(510)**
G&A expense	9	(50)	(50)	(50)	(104)	(50)	(50)	(50)	(85)	(50)	(50)	(50)	(50)	(75)	(50)	**(814)**
Total - Disbursements		**(573)**	**(416)**	**(1,220)**	**(1,237)**	**(246)**	**(458)**	**(236)**	**(1,328)**	**(246)**	**(448)**	**(246)**	**(842)**	**(593)**	**(463)**	**(8,552)**
Net cash flow		**(558)**	**(401)**	**1,956**	**(1,172)**	**(231)**	**(443)**	**1,599**	**(1,263)**	**(231)**	**(433)**	**(231)**	**1,001**	**(528)**	**(448)**	**(1,383)**
Opening cash balance		**1,594**	**1,036**	**635**	**2,591**	**1,419**	**1,188**	**745**	**2,344**	**1,081**	**850**	**417**	**186**	**1,187**	**659**	**1,594**
Ending cash balance		**$ 1,036**	**$ 635**	**$ 2,591**	**$ 1,419**	**$ 1,188**	**$ 745**	**$ 2,344**	**$ 1,081**	**$ 850**	**$ 417**	**$ 186**	**$ 1,187**	**$ 659**	**$ 211**	**$ 211**

RAZOR ENTITIES
Per: Doug Bailey, President and CEO

Notes:

Management of the Razor Entities has prepared this Projected Cash Flow Forecast solely for the purposes of determining the liquidity requirements of the Razor Entities during the period of July 8, 2024 to October 13, 2024. This Projected Cash Flow Forecast is based on probable and hypothetical assumptions detailed in the notes below. Consequently, actual results will likely vary from actual performance and such variances may be material.

1 Net production revenue relates to the sale of Razor Energy Corp's petroleum and natural gas production and is based on forecast production volumes and third-party pricing. Further, it assumes no operated production can be sent to the Judy Creek Gas Plant and no additional net revenue received from non-operated production. Crown royalties for oil production are paid in kind.
2 Other receipts consist of the proceeds from the HWN Transaction, third-party road use fees, partner joint interest billings, the SHGPC payments, etc.
3 Operating expenses are based on the annual operating budget and relates to the costs associated with the operation of oil and natural gas wells.
4 Transportation and processing costs relate to transporting petroleum and natural gas production from well head to market and is based on projected production volumes and transportation rates.
5 Lease rentals are based on annual budget (excluding freehold).
6 Insurance is based on current policy premiums.
7 Payroll is based on recent payroll registers.
8 Professional fees include estimates for the Monitor, the Monitor's legal counsel, Razor Entities' legal counsel, and Sales Agent.
9 G&A expense includes overhead costs based on the annual budget, corporate contractors, and margin call expense on hedging contracts.

TAB 2

CANADA

CONSOLIDATION

Companies’ Creditors Arrangement Act

R.S.C., 1985, c. C-36

CODIFICATION

Loi sur les arrangements avec les créanciers des compagnies

L.R.C. (1985), ch. C-36

Current to June 19, 2024

Last amended on April 27, 2023

À jour au 19 juin 2024

Dernière modification le 27 avril 2023

Published by the Minister of Justice at the following address:
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OFFICIAL STATUS OF CONSOLIDATIONS

Subsections 31(1) and (2) of the *Legislation Revision and Consolidation Act*, in force on June 1, 2009, provide as follows:

Published consolidation is evidence

31 (1) Every copy of a consolidated statute or consolidated regulation published by the Minister under this Act in either print or electronic form is evidence of that statute or regulation and of its contents and every copy purporting to be published by the Minister is deemed to be so published, unless the contrary is shown.

Inconsistencies in Acts

(2) In the event of an inconsistency between a consolidated statute published by the Minister under this Act and the original statute or a subsequent amendment as certified by the Clerk of the Parliaments under the *Publication of Statutes Act*, the original statute or amendment prevails to the extent of the inconsistency.

CARACTÈRE OFFICIEL DES CODIFICATIONS

Les paragraphes 31(1) et (2) de la *Loi sur la révision et la codification des textes législatifs*, en vigueur le 1er juin 2009, prévoient ce qui suit :

Codifications comme élément de preuve

31 (1) Tout exemplaire d'une loi codifiée ou d'un règlement codifié, publié par le ministre en vertu de la présente loi sur support papier ou sur support électronique, fait foi de cette loi ou de ce règlement et de son contenu. Tout exemplaire donné comme publié par le ministre est réputé avoir été ainsi publié, sauf preuve contraire.

Incompatibilité — lois

(2) Les dispositions de la loi d'origine avec ses modifications subséquentes par le greffier des Parlements en vertu de la *Loi sur la publication des lois* l'emportent sur les dispositions incompatibles de la loi codifiée publiée par le ministre en vertu de la présente loi.

LAYOUT

The notes that appeared in the left or right margins are now in boldface text directly above the provisions to which they relate. They form no part of the enactment, but are inserted for convenience of reference only.

MISE EN PAGE

Les notes apparaissant auparavant dans les marges de droite ou de gauche se retrouvent maintenant en caractères gras juste au-dessus de la disposition à laquelle elles se rattachent. Elles ne font pas partie du texte, n'y figurant qu'à titre de repère ou d'information.

NOTE

This consolidation is current to June 19, 2024. The last amendments came into force on April 27, 2023. Any amendments that were not in force as of June 19, 2024 are set out at the end of this document under the heading "Amendments Not in Force".

NOTE

Cette codification est à jour au 19 juin 2024. Les dernières modifications sont entrées en vigueur le 27 avril 2023. Toutes modifications qui n'étaient pas en vigueur au 19 juin 2024 sont énoncées à la fin de ce document sous le titre « Modifications non en vigueur ».

limited to relief that is reasonably necessary for the continued operations of the debtor company in the ordinary course of business during that period.

2019, c. 29, s. 136.

de la compagnie débitrice dans le cours ordinaire de ses affaires durant cette période.

2019, ch. 29, art. 136.

Rights of suppliers

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

(a) prohibiting a person from requiring immediate payment for goods, services, use of leased or licensed property or other valuable consideration provided after the order is made; or

(b) requiring the further advance of money or credit.

2005, c. 47, s. 128.

Droits des fournisseurs

11.01 L'ordonnance prévue aux articles 11 ou 11.02 ne peut avoir pour effet :

a) d'empêcher une personne d'exiger que soient effectués sans délai les paiements relatifs à la fourniture de marchandises ou de services, à l'utilisation de biens loués ou faisant l'objet d'une licence ou à la fourniture de toute autre contrepartie de valeur qui ont lieu après l'ordonnance;

b) d'exiger le versement de nouvelles avances de fonds ou de nouveaux crédits.

2005, ch. 47, art. 128.

Stays, etc. — initial application

11.02 (1) A court may, on an initial application in respect of a debtor company, make an order on any terms that it may impose, effective for the period that the court considers necessary, which period may not be more than 10 days,

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

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

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

Suspension : demande initiale

11.02 (1) Dans le cas d'une demande initiale visant une compagnie débitrice, le tribunal peut, par ordonnance, aux conditions qu'il peut imposer et pour la période maximale de dix jours qu'il estime nécessaire :

a) suspendre, jusqu'à nouvel ordre, toute procédure qui est ou pourrait être intentée contre la compagnie sous le régime de la *Loi sur la faillite et l'insolvabilité* ou de la *Loi sur les liquidations et les restructurations*;

b) surseoir, jusqu'à nouvel ordre, à la continuation de toute action, poursuite ou autre procédure contre la compagnie;

c) interdire, jusqu'à nouvel ordre, l'introduction de toute action, poursuite ou autre procédure contre la compagnie.

Stays, etc. — other than initial application

(2) A court may, on an application in respect of a debtor company other than an initial application, make an order, on any terms that it may impose,

(a) staying, until otherwise ordered by the court, for any period that the court considers necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in paragraph (1)(a);

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

Suspension : demandes autres qu'initiales

(2) Dans le cas d'une demande, autre qu'une demande initiale, visant une compagnie débitrice, le tribunal peut, par ordonnance, aux conditions qu'il peut imposer et pour la période qu'il estime nécessaire :

a) suspendre, jusqu'à nouvel ordre, toute procédure qui est ou pourrait être intentée contre la compagnie sous le régime des lois mentionnées à l'alinéa (1)a);

b) surseoir, jusqu'à nouvel ordre, à la continuation de toute action, poursuite ou autre procédure contre la compagnie;

TAB 3

Citation: In the Matter of the Companies' Creditors Arrangement Act 2000 BCSC 879
Date: 2000606
Docket: L001146
Registry Vancouver

2000 BCSC 879 (CanLII)

IN THE SUPREME COURT OF BRITISH COLUMBIA

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

AND

IN THE MATTER OF THE *COMPANY ACT*
R.S.B.C. 1996, c. 62

AND

IN THE MATTER OF AGRO PACIFIC INDUSTRIES LTD.

PETITIONER

REASONS FOR JUDGMENT

OF THE

HONOURABLE MR. JUSTICE THACKRAY

Counsel for Agro Pacific Industries Ltd.: D.I. Knowles

Counsel for Archer Daniels Midland Company, Interag, Calhoun Agri Services Ltd., Market Laboratory Inc., United Agri Products, United Grain Growers Limited and Van Waters & Rogers Ltd.: S.R. McGladery

Counsel for the Monitor, KPMG Inc.:	R.J. Kearns
Counsel for National Bank of Canada:	M.A. Fitch, Q.C.
Counsel for Bank of Montreal:	J.I. McLean
Counsel for Barenbrug USA Export, Inc., Cargill Limited, International Raw Materials, J.R. Simplot Company, Hydro Agri North America, Inc., IMC Kalium Canada Limited:	S.C. Fitzpatrick
Counsel for Agrium Inc. and Pioneer Hi-Bred:	J.Lynch
Counsel for IGI Resources Inc.:	F.J. Weisberg
Counsel for James Richardson Int. Ltd., Buckerfield's Limited, Canbra Foods Ltd. and Topnotch Nutri Limited:	M. Watt
Counsel for 219 Cathedral Ventures Ltd.:	A. Brown
Appearing on behalf of Gramineae Holdings Limited:	A. Richardson
Date and Place of Hearing:	May 31, 2000 Vancouver, BC

2000 BCSC 879 (CanLII)

[1] Agro Pacific Industries Ltd. ("Agro"), the petitioning company, applied for an extension of the stay order until September 6, 2000.

[2] There are some changes requested to the initial order. The company wants the classification of creditors to be by

Court order. It further asks that if a division of Agro is to be sold, it must be done with Court approval. These are not opposed and are granted.

2000 BCSC 879 (CanLII)

[3] Agro also asks that a Key Employee Retention Program be approved. This plan offers to key employees a bonus of 25% of their monthly salary until such time as the restructuring is completed. There is no opposition to this plan and it is approved.

[4] The extension of the stay order has been agreed to by the three secured creditors. Mr. Colin Rogers, the Chief Restructuring Officer for Agro, deposed that National Bank of Canada ("NBC") and Bank of Montreal "have each agreed to support the application by Agro to apply for a 90 day extension." The third secured creditor, No. 219 Cathedral Ventures Ltd. ("Cathedral"), has similarly agreed. Their agreement is subject to several conditions.

[5] NBC funds a demand operating loan for the company. It has agreed to continue this loan at a reduced maximum of $10 million "to be reduced by the receipt by NBC of proceeds from any sale of assets outside of the ordinary course of business against which NBC has security". As well, "Agro's banker's acceptance option and option to borrow in US dollars is to be

eliminated" and "Agro's required margin surplus shall not be less the $5 million calculated on a daily basis."

[6] These conditions have been accepted by Agro and no opposition to them was raised at the hearing. They thereby have acceptance by the Court.

[7] So far so good. Now the problem. The secured creditors have demanded a "success fee" be agreed to by the company and have asked for Court approval. Agro has agreed but opposition to such a fee by Bank of Montreal and Cathedral is taken by the unsecured creditors represented on this application.

[8] Mr. Rogers described the success fee for NBC as being calculated on the basis of 1% of the Loan Authorization which is only payable on the earlier of repayment of the operating loan during the CCAA proceedings or normalization of the banking relationship between itself and Agro upon a successful CCAA plan being approved by the Court. This is to be increased by .5% per month of the Loan Authorization for any extension beyond the proposed 90 day extension.

[9] Bank of Montreal and Cathedral proposed that they receive a success fee on the same terms except the .5% increase will apply only to extensions beyond 180 days.

2000 BCSC 879 (CanLII)

Submissions

[10] The Monitor concluded that "the terms do not appear unreasonable." Those words reflect exactly the position taken by counsel for Bank of Montreal. He said that his client had been asked for a number of concessions to which it had agreed, consequently "the success fee is not unreasonable".

[11] The secured creditors represented by Ms. Fitzpatrick oppose the success fee to Bank of Montreal and to Cathedral. She submitted that the success fee "comes out of the unsecured creditors" and that Agro is "trying to buy peace."

[12] Mr. McLean, on behalf of Bank of Montreal, agreed that the success fee is an attempt "to buy peace" but contended that this is a business judgment and as such should be left to the business people. Counsel for Cathedral submitted that in that it is in "third place" its risk is greater and that this accounts for its need for a success fee.

[13] In that there was no opposition to a success fee being approved for his client, NBC, Mr. Fitch was content to remain mute. I cannot assume what position he would have taken towards the other secured creditors should there have been opposition to the success fee being granted to his client, but

2000 BCSC 879 (CanLII)

I will assume that he would have argued strongly in favour of a success fee to his client.

[14] Ms. Fitzpatrick said that "it falls upon Your Lordship's shoulders to be sure the proposal is fair. It isn't." In support of that submission, she pointed to the Monitor's third report wherein it said that it "recognized that the fees proposed represent a special benefit to [secured creditors] not available to the other creditors." Ms. Lynch on behalf of her clients supported the position taken by Ms. Fitzpatrick.

[15] Ms. McGladery said that her clients were prepared "to leave it in Your Lordship's hands."

Discussion and Conclusions

[16] The term "success fee" does not get this application off to a savoury start. Why should anyone be credited with the success of these proceedings? All parties in this matter face risks but the legislative scheme of the ***Companies' Creditors Arrangement Act***, R.S.C. 1985, c. C-36 is designed, as said in the reasons arising out of the application by the suppliers to trace and account for "their" goods, to allow a company to continue its business activities "in as normal a manner as possible while reorganizing." The legislation must be taken

2000 BCSC 879 (CanLII)

"as giving hope that reorganization, rather than bankruptcy, will eventually benefit all interested parties."

[17] In ***Re Woodward's Ltd.*** (1993), 77 B.C.L.R. (2d) 332 (S.C.), Tysoe J. traced the purpose of the stay under the CCAA. He noted that it was first summarized by Wachowich J. in ***Meridian Developments Inc. v. Toronto Dominion Bank***, [1984] 5 W.W.R. 215 (Alta. Q.B.). Tysoe J. continued his review of the legislative intent with reference to ***Quintette Coal Ltd. v. Nippon Steel Corp.*** (1990), 80 C.B.R. (N.S.) 98 (B.C.S.C.) and ***Alberta-Pacific Terminals*** (1991), 8 C.B.R. (3d) 99 (B.C.S.C.). He then authored what he saw to be the three objectives of maintaining the *status quo*, the first of which is:

> To suspend or freeze the rights of all creditors as they existed as at the date of the stay order (which, in British Columbia, is normally the day on which the CCAA proceedings are commenced). This objective is intended to allow the insolvent company an opportunity to reorganize itself without any creditor having an advantage over the company or any other creditor. [my underlining]

[18] Ms. Fitzpatrick used the term "level playing field" and said that Bank of Montreal and Cathedral are trying to manoeuvre. That is a way of referencing the *status quo* and of the call of Wachowich J. in ***Meridian*** "to prevent any

2000 BCSC 879 (CanLII)

manoeuvres" among creditors. He said that s.11 was designed "to prevent any manoeuvres for positioning among creditors during the interim period which would give the aggressive creditor an advantage to the prejudice of others who were less aggressive."

[19] I would extend that thought to say that the Courts must guard against allowing secured creditors to run the process. This is not in any way suggesting that the secured creditors must not have their position recognized. As I said in my earlier reasons, the secured creditors are the ones "who make the financial means available so that companies such as Agro can operate."

[20] However, it must be remembered that the relationships were made by the parties when they entered into commercial contracts, contracts that contemplated insolvency and litigation. Consequently, when that contemplation becomes reality, caution should be exercised in bettering the deal for specific creditors or classes of creditors. To do so alters commercial reality and might frustrate the legislative intent of maintaining the *status quo*.

[21] Counsel for the Monitor, Cathedral and Bank of Montreal focused on the size of the success fee rather than on the

2000 BCSC 879 (CanLII)

principle. They categorized the amount as "not unreasonable." That definition arises from a comparison of concessions relative to the size of the success fee. While I hesitate to rule in a manner adverse to that recommended by the Monitor, I came away with the feeling that the Monitor was less than enthusiastic about the whole concept of a success fee. Rather, it simply concluded that it was to become a reality.

2000 BCSC 879 (CanLII)

[22] As for Bank of Montreal and Cathedral, my opinion is that they don't want to be treated substantially differently than NBC. I did not hear anything from any of the secured creditors that bore upon principles. Indeed, I must reflect that the Court was not favoured with <u>any</u> material from the secured creditors.

[23] I hearken to what is often submitted in criminal sentence hearings. That is, that the major factor must be one of general deterrence. Regardless of the merit in the secured creditors' position, it is more important to let future contenders for favoured positions know that the Court is going to be most reluctant to move the goal posts.

[24] The extension is approved to September 6, 2000 but without the success fee requested by the secured creditors, including NBC. I have no way of knowing what will flow from

these reasons but if further appearances are necessary I will be in the Courthouse for the ceremony on behalf of the new Chief Justice on Friday June 9, 2000. I am prepared to hear any matters immediately thereafter.

[25] Mr. Richardson brought a motion on behalf of his company, Graminae Holdings Limited. His motion is dismissed, much for the same reasons that appear in the earlier reasons in this matter and in these reasons.

A.D. Thackray, J.
The Honourable Mr. Justice A.D. Thackray

2000 BCSC 879 (CanLII)

TAB 4

Court of Queen's Bench of Alberta

Citation: Allarco Entertainment Inc. (Re), 2009 ABQB 503

Date: 20090914
Docket: 0903 09146
Registry: Edmonton

2009 ABQB 503 (CanLII)

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

And in the Matter of Allarco Entertainment Inc. and Allarco Entertainment 2008 Inc. and Alliance Films Inc.

Memorandum of Decision
of the
Honourable Madam Justice J.B. Veit

Summary

[1] On June 16, 2009, the Allarco Entertainment companies, which operate Super Channel - a pay-per-view television channel - obtained protection from their creditors pursuant to the provisions of the *Companies' Creditors Arrangement Act*. As part of the initial, *ex parte*, order under the statute, Allarco Entertainment obtained a "pay-per-play" regime in relation to its obligations to Alliance Films Inc., a program supplier. Alliance Films now applies for a variation of the initial order: it argues that the court had no jurisdiction to grant what amounts to a major, unilateral, variation of its contracts with Allarco Entertainment. For an overall fee which was to be paid in instalments, the Alliance contracts allowed Allarco Entertainment to exhibit films and television series, including the right to exhibit through subscription video on demand, for a limited number of times over a specific time period. Alliance asserts that the contract fees are paid for the ongoing right to exhibit the films or series episodes, that there is no "pay-per-play" provision in the contracts, and that the courts should not have imposed such a variation on Alliance.

[2] Alternatively, Alliance argues that if the court does have jurisdiction to approve such contract variations, the court should not have exercised its discretion in favour of this variation because a "pay-per-play" regime constitutes a negative incentive on the debtor, Allarco Entertainment, to use the service provided by Alliance.

[3] Alliance Films Inc. brought this motion in July, 2009. The court adjourned the motion on the condition that Allarco Entertainment negotiate in good faith with Alliance. The resulting negotiations were unsuccessful. On August 17, 2009, Allarco Entertainment terminated its contracts with Alliance Films. In its amended motion, in addition to asking for a variation in relation to the "pay-per-play" term in the initial order, Alliance also now asks the court to invalidate Allarco Entertainment's terminations.

[4] *In its initial order, even if the court did have jurisdiction to vary the Allarco Entertainment/Alliance Film contracts by establishing a different payment structure than the one set out in the contracts, it should not have done so: a post-protection service provider usually has the right to maintain its contract prices.*

[5] The CCAA states that where, under licence agreements, a contractor provides new services to a debtor who has obtained creditor protection, that service provider is entitled to "immediate payment"; this is compared to the provider who provided services prior to the granting of creditor protection, whose right to enforce payment is stayed. The CCAA does not state the basis on which compensation is to be paid for post-protection services. Allarco Entertainment argues that the basis for compensation should be "what is just and reasonable"; here, the debtor claims that a "pay-per-play" payment scheme is fair because it will get rid of instalment payments to Alliance, the payment of which will hinder Allarco Entertainment's ability to re-organize. Alliance Films argues that, at this stage of the CCAA proceedings, the court does not have the right to make unilateral contract changes. At this stage of the proceedings, the broad wording of the CCAA, which is remedial legislation, does allow the courts to make some contracts between debtors and creditors: for example, with respect to utilities such as electricity, the court can allow the service provider to be paid not only the usual utility rate but also a security deposit: ***Hydro-Québec.*** Another example is the court's decision that some contract provisions relate to past services, and cannot therefore be enforced, and that other contract provisions relate to post-protection services for which the debtor incurs an obligation of immediate payment: ***Nortel***. These are examples of the limited way in which the courts have jurisdiction to vary contracts in an initial order under CCAA proceedings. It is not necessary to articulate the principle which applies to the jurisdiction of the court in relation to contracts, s. 11.3(a) of the CCAA, and initial orders, but if that were required, it may be that, in the initial order courts have only a limited jurisdiction to affect contractual rights and that contractual payment terms negotiated between debtors and creditors generally represent the payments which debtors are required to make if they use the services set out in those contracts post-protection as that scale of payment best represents both a fair and reasonable price for the services and business in the ordinary course. This principle arises from the common law's respect for contractual obligations. Generally, contracts cannot be varied by courts: contracts represent, in effect, a law which private parties have agreed applies to them. Court can interpret or rectify, but not vary, contracts. Even courts of equity generally limited themselves to deciding

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which contracts, or portions of contracts, would not be enforced by the justice system. Legislation could, of course, give to the courts the jurisdiction to vary or create contracts; however, given the clear state of the common law on this issue, explicit statutory provisions would be required to give courts a general jurisdiction to vary contracts. Such explicit authority is not given to courts in the CCAA at this stage of proceedings. The court's only authority in the situation here was to distinguish between those portions of the Alliance contracts which represent services that have already been performed, the enforcement of which is stayed, and those portions which deal with the provision of ongoing services, the payment for which Allarco Entertainment was required to make according to the contract if it wished to continue using Alliance's services.

[6] *Allarco Entertainment is, however, entitled to terminate its contracts with Alliance Films.*

[7] After the issuance of the initial order, Allarco Entertainment negotiated with Alliance in good faith. The granting of protection from creditors is designed to promote such negotiations. Alliance is not required to continue to provide services to Allarco Entertainment post-protection; on the other hand, Allarco Entertainment is entitled to terminate contracts. The court does have a general oversight jurisdiction to determine if the termination of a contract by a debtor is just and reasonable. On this motion, Allarco Entertainment has satisfied that test: among other important aspects of the statutory test, the evidence establishes that, during the negotiations, Alliance Films was attempting to obtain a security status for its contracts which did not exist in its original contracts. Granting new security to Alliance post-protection would have given Alliance an advantage over other Allarco Entertainment creditors. Allarco Entertainment was in fact prevented from acceding to these attempts by Alliance Films.

Cases and authority cited

[8] **By Alliance Film:** ***Thomson Knitting Inc., Re*** (1925), 1925 CarswellOnt 5 (Ont. S.C. in Bankruptcy, App. Div.) citing ***William Hamilton Mfg. Co. v. Hamilton Steel and Iron Co.*** (1911), 23 O.L.R. 270; ***Doman Industries Ltd., Re*** (2003), 2003 CarswellBC 538 (B.C.S.C.); ***Skeena Cellulose Inc., Re*** (2003), 2003 CarswellBC 1399 (B.C.C.A); ***Doman Industries Ltd., Re***, 2004 CarswellBC 1545 (B.C.C.A In Chambers); ***T. Eaton Co., Re*** (1999), 1999 CarswellOnt 3542 (Ont. S.C.J. [Commercial List]) citing ***Keddy Motor Inns Ltd., Re*** (1992), 13 C.B.R. (3d) 245 (N.S.C.A.); ***Doman Industries Ltd., Re*** 2004 CarswellBC 1262 (B.C.S.C.); ***Companies Creditors' Arrangement Act,*** R.S.C. 1985, c. C-36, as amended, s. 11.3; ***Stelco Inc., (Re)*** 2005 CarswellOnt 1537 (C.A.); ***In Re Enron Corp.*** 279 B.R. 695 (N.Y. Bankr. Gonzalez 2002); ***In Re Kmart Corporation*** 293 B.R. 905; ***In Re Thatcher Glass Corporation*** 59 B.R. 797 at 6 (Banker D. Conn. 1986).

[9] **By the Allarco Entertainment corporations:** ***Lehndorff General Partner Ltd., Re***, 9 B.L.R. (2d) 275 (Ont. Ct. J. (Gen. Div.)); ***T. Eaton Co., Re***, (1997) 46 C.B.R. (3d) 293 (Ont. Ct. J. (Gen. Div.)); ***Nortel Networks Corp., Re***, 2009 WL 1763447 (Ont. Sup. Ct.); ***In Re Kmart Corporation, et al., Debtors***, 293 B.R. 905 (Ill. Bankr. Sonderby 2003); ***In Re Enron Corp. et al. Debtors***, 279 B.R. 695 (N.Y. Bankr. Gonzalez 2002); ***Skeena Cellulose Inc., Re***, (2002), 43

C.B.R. (4th) 187 (B.C.S.C.); ***Blue Range Resource Corp., Re***, (2000), 192 D.R.R. (4th) 281 (Alta. C.A.); ***T. Eaton Co., Re***, (1999), 14 C.B.R. (4th) 288 (Ont. S.C.J.); ***Doman Industries Ltd., Re*** (2004), 29 B.C.L.R. (4th) 178 (S.C.); ***Blue Range Resource Corp., Re***, (1999), 245 A.R. 154 (Q.B.); ***New Skeena Forest Products Inc., Re***, 2005 BCCA 192; ***Woodward's Ltd., Re***, (1993), 100 D.L.R. (4th) 133 (B.C.S.C.); ***Campeau v. Olympia & York Developments Ltd.*** (1992), 14 C.B.R. (3d) 303 (Ont. Ct. J. Gen. Div.); ***Air Canada (Re)*** 66 O.R. (3d) 257, [2003] O.J. No. 2976 (C.A.); ***Sagecrest Dixon Inc. (Re)*** [2009] O.J. No. 1127 (Comm.List); ***Air Canada (Re)*** [2003] O.J. No. 6239 (Comm.List).

[10] **By the court:** ***Smith Brothers Contracting Ltd. (Re)*** [1998] B.C.J. No. 728 (B.C. Sup. Ct.); ***West Bay SonShip Yachts v Esau*** 2009 BCCA 31, [2009] B.C.J. No. 120; ***Smoky River Coal (Re)*** 2001 ABCA 209, [2001] A.J. No. 1006; ***Hydro-Québec c Fonderie Poitras ltée*** 2009 QCCA 1416, [2009 J.Q. no 7438; ***Les Boutiques San Francisco Incorporées*** [2004] Q.J. No. 2886.

[11] Appendix A: The payment scheme in the initial order

1. Background

[12] The following information is uncontested, or if contested, the court is able to come to a conclusion on the existence of a fact without ordering a trial of that issue.

a) Factual

[13] The Allarco Entertainment companies operate Super Channel, an English language general interest pay television channel, one of only 3 pay-per-view television channels in Canada. The business of the companies is licensed and regulated by the Canadian Radio-Television and Telecommunications Commission, CRTC. One of the licensing requirements is the delivery of a certain proportion of Canadian content programming, which requirement ensures greater value for programming packages which satisfy that requirement.

[14] The Allarco Entertainment companies rely on broadcasting distribution undertakings, BDUs, such as Rogers, Shaw and Bell TV, to sell Super Channel as a programming option. By law, the BDUs are obligated to treat all program networks equally, and not to unfairly encourage their customers to purchase the services of one program network in preference to others. Allarco Entertainment has an ongoing complaint about one of the BDUs, alleging that that distributor has not dealt fairly with Super Channel; this complaint is now the subject of a lawsuit, which is being case managed in Ontario. In a parallel mode, Allarco Entertainment has also laid its complaints against that BDU with the CRTC; there has not yet been a resolution of those complaints by the Commission.

[15] When they applied for an initial order under the CCAA, the Allarco Entertainment companies had approximately 425 outstanding program license agreements, PLAs, with various entertainment program suppliers. Although the Allarco Entertainment companies had their own form of PLA which it used whenever possible, some of the more well known program licensors

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required the Allarco Entertainment companies to enter into the licensors' standard form of PLA. Approximately $64,000,000.00 of programming has been delivered to the Allarco Entertainment companies, for which payment had not been made when those companies applied for protection from their creditors.

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[16] Allarco Entertainment's PLAs with Twentieth Century Fox are the most significant component of the Super Channel programming cost.

[17] Alberta Treasury Branch is the first secured creditor of the Allarco Entertainment companies; it holds general security agreements containing a charge over Allarco Entertainment's present and after acquired personal property. The ATB facility is currently fully drawn. ATB has agreed, on certain conditions, to reestablish the MasterCard facility for Allarco Entertainment. ATB has also indicated to Allarco Entertainment that it is prepared, on certain conditions, to forbear in pursuing recovery under the guarantee of the ATB facility.

[18] Alliance has 5 PLAs with Allarco Entertainment. The PLAs typically give to Allarco Entertainment the right to play the programs offered in a package on an exclusive basis. Moreover, the first time an individual program is broadcast, Allarco Entertainment can advertise the play as a premiere, which has added value over and above the rights of exclusive broadcast.

[19] When Alliance first brought this motion, it was concerned mainly with two of its program licence agreements with Allarco Entertainment, the January 15, 2008 PLA - Super Channel Q1 08 package - and the February 25th 2008 PLA - Super Channel Q2 08 package. Those agreements are similarly structured. However, there are at least two important terms which are found in the latter agreement which are not found in the former.

[20] The first of these terms is:

> Security Interest
>
> Licensee shall grant Licensor a security interest in respect of Licensee's payment obligations and Licensee shall execute and deliver documentation necessary to effect the foregoing.

Although Q2 2008 was agreed to and accepted by the parties on March 31st, 2008, by June 16, 2009, no security documents had been prepared by either Allarco Entertainment or Alliance Films. Alliance characterizes this contractual term as an equitable charge which has all the validity of a legal charge.

[21] The second of the terms is:

> Termination Rights
>
> In the event of default by Licensee (including failure to pay amounts when due and/or if assignment for the benefit of creditors, seeks relief under any bankruptcy law or similar

> law for the protection of debtors, or allows a petition of bankruptcy to be filed against it, or a receiver or trustee to be appointed for substantially all of its assets that is not removed with 30 days), Licensor shall be entitled to terminate or suspend Licensee's rights with respect to programming (i) licensed hereunder; and/or (ii) licensed to Licensee by Licensor pursuant to any other agreement. In the event Licensor decides to terminate Licensee's rights to programming, all rights will automatically revert to Licensor, free and clear of any and all encumbrances and Licensor shall be entitled to immediate possession of all related materials.

In its PLAs which contained termination rights, Alliance did not terminate its contracts with Allarco Entertainment once it knew that Allarco Entertainment had obtained an initial order under the CCAA.

[22] Alliance has 3 other PLAs with Allarco Entertainment. Alliance did not focus on these 3 PLAs because no payments are due at this time in relation to those agreements. Of those additional agreements: PLA 2007/2008 Allarco Package does not contain any security or termination clauses; PLA Super Channel Q4- 08 package does not contain a security clause but does contain a termination clause; and, PLA Super Channel Q3-08 Package contains both a security clause and a termination clause.

[23] In their applications before the Court, Allarco Entertainment has provided the court with this broad stroke explanation of what its Plan of Arrangement might entail:

- sale to a third party investor of a portion or all of the equity in the business, having in mind the value of the existing CRTC license;
- ongoing active involvement in the business by entities related to Charles R. Allard, the sole director of Allarco Entertainment Inc.;
- significant reduction in both the cost of programming and general overhead expense would allow a viable business at a much lower level of subscriber involvement;
- success in the claim against the BDU would increase the number of subscribers;
- injection of funding into the business either by way of equity or further loans.

[24] The Allarco Entertainment companies proposed, and in the initial order the court approved, PricewaterhouseCoopers Inc. as the Monitor under these proceedings. The Monitor has not, of course, taken a position on this application; however, the Monitor reports that, to date, it has not uncovered any abusive conduct by the Allarco Entertainment companies.

[25] Paragraph 16 of the initial order provided that payment under the PLAs between Allarco Entertainment and various program licensors was to be made in accordance with the terms set out in para. 43 of the affidavit of the President and Chief Operating Officer of the Allarco Entertainment companies. Those terms are set out in appendix A hereto.

[26] Since the granting of the initial order, Allarco Entertainment has continued to advertise access to Alliance programming, including subscription on demand, SVOD, rights.

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[27] The initial order has been extended by court order to September 30, 2009.

[28] There is a dispute between the parties about the proportion of the contract payments which Alliance Films has received, and would receive, since the protection order. That issue will be discussed further in relation to the termination by Allarco Entertainment of the Alliance contracts.

[29] There is a dispute between the parties concerning the content of the negotiations which preceded the termination by Allarco Entertainment of the Alliance contracts. This dispute will be referred to in the discussion of the termination issue hereunder.

[30] As of August 17, 2009, Allarco Entertainment repudiated its contracts with Alliance and noted, "Any damages suffered by Alliance as a result of such repudiation will be dealt with in the claims process in the CCAA proceedings".

[31] Although the PLA providers set out in the Appearances section hereunder have been given notice of this application, only MGM has provided evidence and submissions on the motion, although many of the other parties attended the hearing by telephone. MGM is owed in excess of $1,400,000.00 in outstanding claims for licensing fees not paid to it prior to the date of the initial order in these proceedings. MGM would have expected payments in excess of $2,000,000.00 between the date of the initial order and February 2010 in the ordinary course. MGM will continue to provide Allarco with new films, at a discounted price, while MGM defers certain other payments for films which have already been delivered to Allarco. MGM is of the view that the continuation of the CCAA process is in the best interest of MGM and likely in the best interest of many other programming suppliers in these proceedings.

b) Legislative

[32] Section 11 of the CCAA reads:

> 11. (1) Notwithstanding anything in the Bankruptcy and Insolvency Act or the Winding-up Act, where an application is made under this Act in respect of a company, the court, on the application of any person interested in the matter, may, subject to this Act, on notice to any other person or without notice as it may see fit, make an order under this section.
>
> (2) An application made for the first time under this section in respect of a company, in this section referred to as an "initial application", shall be accompanied by a statement indicating the projected cash flow of the company and copies of all financial statements, audited or unaudited, prepared during the year prior to the application, or where no such statements were prepared in the prior year, a copy of the most recent such statement.
>
> (3) A court may, on an initial application in respect of a company, make an order on such terms as it may impose, effective for such period as the court deems necessary not exceeding thirty days,

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(a) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (1);
(b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and
(c) prohibiting, until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company.

(4) A court may, on an application in respect of a company other than an initial application, make an order on such terms as it may impose,
(a) staying, until otherwise ordered by the court, for such period as the court deems necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (1);
(b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and
(c) prohibiting, until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company.

. . .

(6) The court shall not make an order under subsection (3) or (4) unless
(a) the applicant satisfies the court that circumstances exist that make such an order appropriate; and
(b) in the case of an order under subsection (4), the applicant also satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence.

[33] In 1997, the following amendment was made to s. 11 of the BCCA:

11.3 No order made under section 11 shall have the effect of
(a) prohibiting a person from requiring immediate payment for goods, services, use of leased or licensed property or other valuable consideration provided after the order is made; or
(b) requiring the further advance of money or credit.

(Emphasis added)

2. At this stage of the CCAA proceedings, does the court have the jurisdiction to approve unilateral contract changes proposed by Allarco Entertainment to Alliance Film contracts?

[34] The short answer to this question is, No.

[35] As a prelude to the discussion of the specific issue which is before the court, the court observes that the conclusion reached by Bauman J. in ***Smith Brothers***, a leading decision on the interpretation of s. 11.3 of the CCAA, to the effect that it is the use (emphasis in the original at

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para. 19) of “leased property, not the making of the lease itself, after the stay order, which is within the purview of s. 11.3(a)” also apply here. The implications of that finding are twofold: the Alliance contracts are “true” licenses within the meaning of ***Smith Brothers*** - which means on the one hand that they are not security documents - and, Alliance cannot be forced to provide the portions of those contracts which relate to the provision of services post-protection without an immediate claim for those services.

[36] The nature of the Alliance contracts is that they provide a service - the right to advertise and broadcast the availability of a package of programming - rather than the right to make a single broadcast. The advertising by Allarco Entertainment of the availability of the Alliance Films packages, including SVOB rights, constitutes “use” of the Alliance Films licensed property.

[37] Allarco argues that s. 11.3 (a) of the CCAA which entitles a service provider to require immediate payment for services provided after the initial order does not indicate the payment basis on which those services will be provided. Allarco Entertainment suggests that this gap in the legislation is one which the court has the jurisdiction to fill and that the test for determining payment should be what is a just and equitable basis for compensation. Alliance argues that there is no gap, or that if there is a gap, the terms of the contract relating to payment should be accepted as being the proper basis for the provision of post-protection services.

[38] To provide guidance in filling the gap, Allarco Entertainment proposes American jurisprudence pursuant to s. 503(b) of the *Bankruptcy Code* which allows a court to give priority treatment to “administrative expenses”. However, in order to do so, the court must conclude not only that the debt arises out of a transaction with the debtor in possession, but also that the payment of the debt is beneficial to the operation of the debtor’s business. Allarco notes that the concept of “beneficial” is narrowly interpreted, as is to be expected in a regime where those administrative expenses receive priority. For example, in ***Kmart Corporation***, the bankruptcy court asserted that “post-petition performance alone does not automatically translate into a benefit to the estate, even if there was inducement on the part of the debtor”; the same principle was also applied in ***Enron***.

[39] I agree with Allarco Entertainment that there is a gap in the CCAA relating to the payment for post-protection services.

[40] However, with respect, I disagree with Allarco Entertainment's proposed use of American jurisprudence. As the B.C. Court of Appeal emphasizes in ***West Bay SonShip***, although similar policy objectives inform Canadian and American insolvency legislation, and while certain American decisions might even be persuasive in certain Canadian insolvency situations, in each specific potential use of American jurisprudence care must be exercised to ensure that, in the particular case, both the American legislative scheme is similar to that in Canada and, in the absence of expert evidence on the state of American law, that the American reasoning in a particular case is not conflated with the state of American jurisprudence on the issue.

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[41] For example, here the Alliance Films PLAs are, in Canadian or Albertan parlance, executory contracts. However, American authorities are not helpful on the treatment of "executory contracts" in the CCAA partly because the specialized interpretation of that term in American bankruptcy law is different from the interpretation of that term in Alberta and perhaps in Canada:

> 31 In "A Joint Report of the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals - Joint Task Force on Business Insolvency Law Reform - March 15, 2002", the authors cited the following meanings for "executory contract":
>
> What is an executory contract? Neither the CCAA nor the BIA use the expression, but the United States Bankruptcy Code does in s. 365 ("Code, s. 365"). In general contract law, "executory contract" means a contract under which one or both parties still have obligations to perform. However, in U.S. bankruptcy law the expression is normally given a narrower meaning. According to the most widely accepted definition in the United States, an executory contract for the purposes of Code s. 365 is:
>
>> a contract under which both the obligations of the bankrupt ["A"] under the contract and the other party to the contract ["B"] are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other.
>> (Countryman, "Executory Contracts in Bankruptcy" (1974) 57 Minnesota Law Review 439 (Part 1), at 460).

[42] More pertinently in this particular case, while there is in the American *Bankruptcy Code* a priority for administrative expenses which include "the actual, necessary costs and expenses of preserving the estate", there is no such limitation in s. 11.3 of the CCAA. Here, all post-protection service providers are entitled to claim immediate payment for their services. Therefore, the American jurisprudence is not, in this particular case, helpful.

[43] In any event, however, no decision has been brought to my attention in which an American court has, other than in a utility situation which will be discussed later in the context of Canadian case law, itself calculated a price other than the contract price for the provision of post-protection services. Indeed, the weight of American jurisprudence on the issue appears to be that the contract price is assumed to be a reasonable price unless the debtor can show that the contract price is clearly unreasonable.

[44] In the circumstances here, rather than to rely on American jurisprudence for guidance, it is more appropriate to rely on Canadian law and on first principles. As has been noted in much of the jurisprudence which interprets the CCAA, there is jurisdiction in the statute for a court to work out arrangements that will maximize benefits to all affected parties. As our Court of Appeal put it in ***Smoky River Coal, (Re)***:

> 16 CCAA orders become the roadmap for the proceedings and the litigation which may follow. Orders must therefore be drafted with clarity and precision. The purpose of

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the CCAA must be kept at the forefront in both drafting and interpreting a CCAA order. The CCAA is remedial legislation. As was stated in Re Lehndorff General Partner Ltd. (1992), 17 C.B.R. (3d) 24 (Ont. Gen. Div):

> The CCAA is intended to facilitate compromises and arrangements between companies and their creditors as an alternative to bankruptcy and, as such, is remedial legislation entitled to a liberal interpretation. It seems to me that the purpose of the statute is to enable insolvent companies to carry on business in the ordinary course or otherwise deal with their assets so as to enable a plan of compromise or arrangement to be prepared, filed and considered by their creditors and the court.
>
> (Emphasis added)

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[45] The court's jurisdiction is not, however, unlimited. One limiting feature is the timing of the court's intervention. There is no doubt that, at the stage of the approval or failure of a plan, a court can impose terms on an unwilling creditor. We are not, however, at that stage.

[46] At this stage, that is the stage of the initial order, whatever services are provided post-protection are offered by service providers who are entitled to be paid for those services. Generally, two payment regimes will be adopted. One is that ongoing service providers will accept, at least until the presentation of a plan, some new, negotiated, plan. Obviously if the parties to a contract agree to a variation of the terms of that contract, that variation governs. However, a service provider is not required to provide post-protection services without the right to claim immediate payment. If a service provider will not agree to modify its contractual payment terms in order to provide post-protection services, then the debtor must either terminate the contract or pay the contractual amount. In reaching this conclusion, I rely on the fact that, at the stage of the initial order, it would be inappropriate for a court to attempt to draw up a contract for the parties. What the parties have negotiated in a contract should generally be presumed to be a fair and reasonable price for the services provided. Not only are courts not business experts, but the cost of attempting to bring the court up to speed on the reasons that a creditor and a debtor each have for advancing a payment proposal would exhaust the financial capacity of an already insolvent debtor. At the stage of the presentation of a plan, the situation is, of course, different: at that stage the court has much more information on which to rely, including the business acumen of all other creditors.

[47] Two exceptions to the general rule that contract terms govern have been identified in the jurisprudence. First, there are utility contracts: see ***Hydro-Québec***. Even though the original contract for service did not contain any form of security payment, a court approved a security deposit as a term of post-protection provision of services. The provision of utilities is, however, a unique form of contract. On the one hand, utility contracts are contracts of adhesion whose payment terms are typically regulated by government or government-established commissions, and, on the other, the debtor does not typically have any choice in service providers. In those circumstances, it is appropriate for a court to set the terms of payment for post-protection services since a utility provider should not be required to provide post-protection services which require the advance of further credit: see s. 11.3(b). It appears that American jurisprudence takes

a similar view with respect to utilities: see ***Thatcher Glass***. The crucial nature of utility services requires the intervention of the court where the parties cannot agree on a fee for post-protection services; in other circumstances, a service provider can protect itself by refusing to provide services. These principles are usefully addressed by the Court of Appeal in ***Hydro-Québec***:

> 80 L'alinéa a) de l'article 11.3 de la LACC établit un principe clair : pendant la période de suspension, le fournisseur a droit d'être payé pour les services qu'il rend au fur et à mesure de leur utilisation.
>
> 81 Voici d'ailleurs les commentaires du professeur Richard H. McLaren au sujet de cet article:
>
>> Section 11.3 acts as an exemption to the stay provisions of s. 11 of the CCAA. It appears the section is meant to balance the rights of creditors with debtors. The section addresses the concern that judges had too much discretion in issuing stays. Under s. 11.3(a), if a person supplies goods or services or if the debtor continues to occupy or use leased or licensed property, the court will not issue a stay order with respect to the payment for such goods or services or leased or licensed property. In essence, s. 11.3(a) will not permit the court to prohibit these individuals from demanding payment from the debtor for goods, services or use of leased property, after a court order is made.16
>
> 82 Ce principe connaît cependant des limites pratiques. Il arrive parfois que la réalité s'oppose à ce que le fournisseur soit payé immédiatement pour les services qu'il fournit à une compagnie débitrice. La fourniture d'électricité en est un exemple patent : il s'agit d'un service continu qu'il est impossible de facturer au fur et à mesure de la consommation.
>
> 83 En pareilles circonstances, il est juste et équitable pour le fournisseur de services de demander des garanties de paiement. Commentant la décision Re Smoky River Coal Ltd17, les auteurs Houlden, Morawetz et Sarra déclarent:
>
>> Under its inherent powers, the court can create a security for creditors who supply goods and services to the debtor after the filing of a CCAA petition and can provide for the priority and ranking of such a security interest with respect to other security holders. If the plan under the CCAA fails, the court can determine who are entitled to share in the proceeds of the security interest.18
>
> . . .
>
> 87 Au sujet du droit applicable, le juge Rolland s'exprime en ces termes:
>
>> [13] Il découle de ce qui précède qu'un fournisseur ne peut exiger d'être payé d'avance pour un service à fournir.
>> [14] Ainsi, un créancier peut exiger d'être payé immédiatement lors de la livraison, mais pas de recevoir un paiement d'avance pour des services à fournir.

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> [15] La situation est relativement simple lorsqu'il s'agit d'un bien individualisé, vendu et livré.
> [16] Cela peut être plus compliqué dans les cas d'un approvisionnement continu d'un service comme l'électricité, le téléphone ou le gaz.
> [17] Exiger de la débitrice qu'elle paie un mois d'avance comme le demande Gaz Métro, alors qu'elle entend fermer plus de 30 locaux au cours des prochains jours ou semaines, a pour effet de créer un fardeau trop onéreux pour la débitrice.
> [18] La LACC ne fait pas exception quant aux créanciers qu'il s'agisse de fournisseur d'un service continu par opposition à un fournisseur de biens.
> [19] Le tribunal a discrétion pour établir une procédure permettant au fournisseur de ne pas être préféré ou pénalisé par rapport aux autres créanciers.
> (je souligne)

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[48] In that particular case, the court concluded that a $42,000.00 guarantee was reasonable in the circumstances.

[49] The second exception from the obligation to pay the contract price for post-protection service, an exception which constitutes a lesser intrusion on the freedom of contract than the outright establishment of new payment terms, is the selection by a court from amongst the provisions of one contract of certain services for which the debtor must pay the contract price while other provisions are identified as ones for which the debtor is not immediately required to pay: ***Nortel***. In that case, the contract - a collective agreement - included both payments to persons who were no longer providing service to the debtor and payments to persons who were providing post-protection service to the debtor. The union advanced two arguments in support of its claim that all contract payments should be made post-protection. The first was that the services that had been provided in the past were part of the consideration for services that were being provided post-protection. The second was that, because of a statutory requirement, the union did not have the freedom which most service providers have, to refuse to provide ongoing service to a debtor which has received protection from its creditors. (On this latter point, there is a certain analogy between the union - which could not, for legislative reasons, withdraw its services despite the wording of s. 11.3(a) - and Alliance, which cannot withdraw the services which it provided in three contracts because those contracts grant licences to Allarco Entertainment without termination rights arising on insolvency.) The ***Nortel*** court rejected both arguments. Although the court decided which portions of the contract had to be paid, it did not purport to vary the contractual basis for payment; it merely decided which portions of the contract were eligible for payment post-protection.

[50] It appears that a similar approach was taken in ***Les Boutiques San Francisco***: the debtor could either decide to terminate the contract for display shelves, or pay the contract price for those units.

[51] There may be other exceptions to the general rule but I have not been provided with any Canadian case law which has identified any such exceptions.

[52] The two exceptions to the rule that post-protection services are to be paid according to the contract price reenforce the generality of the rule. Generally, contracts cannot be varied by

courts: they can be interpreted or rectified but not varied. Even courts of equity limited themselves to remedies which recognized the basic authority of contracts: a court of equity might, for example, require a contracting party to render proper accounts even though that was not a term of the contract if the rendering of accounts was necessary to enforce the contract. Similarly, a court of equity might grant relief from the consequences of certain contracts - such as contracts that were unconscionable. In other cases, a court might decide that, for public policy reasons, certain contracts, such as gambling contracts, would not be enforced by the justice system.

[53] Legislation could, of course, give to the courts a broad jurisdiction to create or vary contracts or to over-ride them. An example of the latter is the *Divorce Act* which provides that a court should taken into account any contract between the parties in relation, for example, to spousal support, but that the court is not limited in making a spousal support order by the terms of the contract between the parties.

[54] Given the respect for contracts in the common law, explicit statutory provisions are required to give courts the jurisdiction to impose unilateral variations in contracts. Such explicit authority is not given to courts in the CCAA at the initial order stage.

[55] Moreover, as was noted at the outset, it is important to correctly identify the nature of the Alliance PLAs: these are not pay-per-play contracts, but rather contracts which allow Allarco Entertainment to advertise the availability of Alliance product without in fact broadcasting Alliance product. The effect of imposing a pay-per-play payment term on Alliance at this stage would be to impose upon Alliance the obligation to provide a continuing service - allowing Allarco Entertainment to continue to advertise the availability of Alliance programming - without providing payment for that service. Indeed, as Alliance has emphasized, Allarco Entertainment's web-site continued, post-protection, to advertise Alliance programming. It is not necessary on this application to determine whether forcing Alliance to continue to provide its services to Allarco Entertainment can also be characterized as requiring Alliance to make a further advance of credit to Allarco.

[56] For the reasons set out above, having now heard argument from the party affected, this court varies para. 16 of its initial, *ex parte*, order by removing the reference to para. 43(b) of the Knox affidavit and replacing it with a reference to the contractual payments due to Alliance.

3. Should the court invalidate Allarco Entertainment's termination of the Alliance Films contracts?

[57] The short answer to this question is, No.

[58] Alliance correctly states that the statutory right of a debtor which has obtained protection from its creditors to terminate contracts is subject to judicial oversight. Alliance argues that it is not reasonable for Allarco Entertainment to terminate its contracts because:

- Allarco was able to obtain a "pay-per-play" clause and they should therefore be required to honour the contracts;

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- the exchanges between Allarco and itself establish that Allarco was intent on obtaining a "pay-per-play" provision to give itself additional, inappropriate, power in its negotiations with Alliance;
- it is not appropriate for Allarco Entertainment to defend its actions by starting from the proposition that it has only so much cash available; rather, Allarco should be required to raise additional funds;
- Allarco Entertainment did not negotiate in good faith.

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[59] For the purpose of this application, the court sets the following test which Allarco Entertainment must meet for termination of its contracts with Alliance Films: the termination must be fair, appropriate, reasonable, and must have been issued after good faith negotiations. I have concluded that Allarco Entertainment meets that test.

[60] In coming to that conclusion, the most important of the reasons considered by the court is the evidence that Alliance attempted, during the negotiations, to become a secured creditor, an effort that would have given Alliance an unfair advantage over other Allarco Entertainment creditors. The fact that Alliance was negotiating for such security benefits is acknowledged by Alliance; it takes the position, however, that this was not a "new" feature since some of its contracts contained provision for granting security. With respect, this is not defensible. Each contract must be enforced on its own; three of the Alliance contracts did not contain a security clause. With respect to those agreements, the addition of a security clause would be "new". Moreover, even with respect to those two contracts which did contain a security clause, no security documents had been executed.

[61] In addition to the grave concern about Alliance attempting to improve its position relative to other debtors, there are other factors which the court weighs in Allarco Entertainment's favour in concluding that it should not invalidate Allarco's termination of Alliance contracts:

- while it is true that, during the negotiations, Allarco Entertainment was the beneficiary of a "pay-per-play" regime and had thus obtained what it wanted relative to Alliance as a creditor, Allarco Entertainment was also aware that Alliance had attacked the legitimacy of that provision. While on this motion Allarco valiantly argued in favour of the "pay-per-play" regime relative to Alliance, it is not unreasonable to assume that Allarco also came to an informed decision that it was at least vulnerable on that issue;

- there was a reasonable business basis for Allarco Entertainment's original application for a "pay-for-play" regime relative to Alliance. It appears to me that the main business argument in Allarco's failure is that substantial ongoing payments to Alliance throughout the year as opposed to what the evidence describes as the overwhelming position in other contracts which provide for payments at the beginning and at the end of the licence period, or at the beginning, after 12 months and at the end of the licence period seriously hamper Allarco's attempts to establish a plan which would allow them to go forward rather than to fall into bankruptcy;

- there is a dispute between Allarco Entertainment and Alliance about the cost to Alliance of the "pay-per-play" provision: Allarco states that it had paid more than 5 cents on the dollar of contractual obligations. Alliance states that termination of its contracts will place it in a worse

position that the PLA providers with whom Allarco has been able to reach an accommodation. While it may be true that termination will be less advantageous to Alliance than going forward on some accommodation basis, part of the point of the CCAA is to allow for the termination of some contracts so long as the test for termination is met;

- similarly, it is a reasonable business concern of Allarco's to have fresh programming to offer potential subscribers and that such programming not consist solely of leftovers from other potential licensees;

- it would not make sense to impose upon an insolvent company the obligation to borrow more money in order to meet all its debts before it terminated certain of its contracts. Such an inflexible rule would make an effective reorganization impossible. On the evidence on this motion, at this stage of the CCAA proceedings, Allarco Entertainment has made reasonable arrangements with its banker and guarantor;

- there is no evidence that Allarco negotiated in bad faith. Rather, the evidence suggests that Allarco was attempting to make reasonable accommodations with Alliance. For example, it is not reasonable that Allarco should be required to take only that programming which has been refused by all other potential licensees. Nor is it the case that Alliance is irrevocably linked to Allarco: Alliance has other markets to which it can offer its programming;

- finally, the opinion of MGM - a creditor which is roughly in the same position relative to Allarco Entertainment as is Alliance - that there have been significant changes in the business of all affected companies which legitimizes the writing down of entertainment packages for the purposes of the development of a CCAA plan supports the general approach which Allarco Entertainment has taken in the negotiations.

[62] Although Alliance Film's notice of motion requests an order invalidating Allarco Entertainment's termination of the Alliance Films contract, at the hearing Alliance suggested that what it really wanted was a determination of the variation agreement first. If that issue were resolved in its favour, Alliance then hoped that further negotiations with Allarco Entertainment would be possible. Alliance suggested that even if Allarco Entertainment were to maintain its termination of the contracts, then Alliance may require some additional evidence to support its position that the termination should not be approved. With respect, I cannot adopt that approach. The determination about whether a termination at this stage meets the required test should be made as close as possible to the date of termination in order to ensure that the court has the same overall perspective as did the parties as of the date of termination.

4. Costs

[63] If the parties are not agreed on costs, I may be spoken to within 30 days of the release of this decision.

Heard on the 2nd, 3rd, 8th and 9th days of September, 2009.
Dated at the City of Edmonton, Alberta this 14th day of September, 2009.

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J.B. Veit
J.C.Q.B.A.

2009 ABQB 503 (CanLII)

Appearances:

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for Allarco Entertainment Inc. and Allarco Entertainment 2008 Inc.

Richard T.G. Reeson, Q.C., Miller Thomson LLP
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for Pricewaterhouse Coopers Inc.

David Ullmann, Minden Gross LLP
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Marc-Andre Morin, McMillan
for Twentieth Century Fox/Incendo Television Distribution Inc. and
Incendo Media Inc.

Harry Fogul, Aird & Berlis LLP
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Eric Vallieres, McMillan
for TVA Films, a division of TVA Group Inc.

Patrick Roche, Heenan Blaikie
for Maple Pictures Corp.

Roger P. Simard, Fraser Milner Casgrain LLP
for National Bank of Canada

Andre Bennett, President & CEO, Cinema Esperanza International Inc.
for Cinema Esperanza International Inc.

Danny M. Nunes, ThorntonGroutFinnigan LLP
for NBC Universal

Bertrand Langlois, CA, VP Finance, Christal Films Distributions Inc.
for Christal Films Distributions Inc.

Alan H. Brown, Boughton Law Corporation
for Starz Media LLC

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Appendix A

The following are the portions of para. 43 of Mr. Knox's first affidavit which are incorporated by reference in para. 16 of the initial court order:

> (a) For those existing Program License Agreements in which the fee for delivery of a single broadcast, such as a prize fight, must be paid upon delivery of that Program, the cash flow contemplates such payment as each Program is delivered;
>
> (b) In the case of those existing Program License Agreements with fixed terms and with a limited number of Exhibition Days, and where the license window is already open, the Cash Flow Projections have been prepared based upon a formula where the overall cost of the Contract is divided by the total number of Exhibition Days permitted, with that Exhibition Day rate being applied for the number of Exhibition Days the Business actually runs that program during the Cash Flow Projection period;
>
> (c) For existing Program Licensing Agreements which provide for monthly payments, those payments falling due during the CCAA proceedings will be paid;
>
> (d) As a license window opens during the CCAA Proceedings on a Licensing Agreement now in existence, license fees shall be paid in accordance with that Licensing Agreement; and
>
> (e) For Programming which is obtained by the Business during the CCAA Proceedings under Licensing Agreements not now in existence, the licensing fees shall be paid in accordance with the terms of each such Program License Agreement.
>
> (Emphasis added)

The only program licence agreements which come within the terms set out in para. (b) above are the Alliance Films Inc. PLAs.

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TAB 5

COUR D'APPEL

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CANADA
PROVINCE DE QUÉBEC
GREFFE DE QUÉBEC

N[os] : 200-09-009672-178
200-09-009673-176
(200-11-024040-175)

DATE : 27 AOÛT 2019

CORAM : LES HONORABLES FRANÇOIS DOYON, J.C.A.
SIMON RUEL, J.C.A.
JOCELYN F. RANCOURT, J.C.A.

N° 200-09-009672-178
(200-11-024040-175)

FONDS DE FINANCEMENT D'ENTREPRISES FIERA FP S.E.C.
APPELANTE
c.

RAYMOND CHABOT INC.
INTIMÉE – Contrôleur demanderesse
et

GESTION ÉRIC SAVARD INC.
MISE EN CAUSE – Débitrice
et

OPTICAL VISION OF CANADA LTD.
9130217 CANADA INC.
ANTRANIK KECHICHIAN
BANQUE DE NOUVELLE-ÉCOSSE
CORPORATION FCHT HOLDINGS (QUÉBEC) INC./FCHT HOLDINGS (QUÉBEC) CORPORATION INC.
SOCIÉTÉ DE GESTION PLACE LAURIER INC.
INTERVENANTS – Mis en cause

N° 200-09-009673-176
(200-11-024040-175)

OPTICAL VISION OF CANADA LTD.
9130217 CANADA INC.
ANTRANIK KACHICIAN
APPELANTS – Mis en cause
c.

RAYMOND CHABOT INC.
INTIMÉE – Contrôleur demanderesse
et

BANQUE LAURENTIENNE DU CANADA
DELL FINANCIAL SERVICES CANADA LTD
NATIONAL LEASING GROUP INC.
BANQUE DE MONTRÉAL
ECN FINANCIAL INC.
ECN COMMERCIAL FINANCE LP
CLE CAPITAL INC.
EQUIREX LEASING CORP.
CWB MAXIUM FINANCIAL SERVICES INC.
RCAP LEASING INC.
INDCOM LEASING INC.
MISES EN CAUSE – Mises en cause
et

GESTION ÉRIC SAVARD INC.
MISE EN CAUSE – Débitrice
et

LA BANQUE DE NOUVELLE-ÉCOSSE
FONDS DE FINANCEMENT D'ENTREPRISES FIERA FP S.E.C.
CORPORATION FCHT HOLDINGS (QUÉBEC) INC/FCHT HOLDINGS (QUÉBEC) CORPORATION INC.
SOCIÉTÉ DE GESTION PLACE LAURIER INC.
INTERVENANTES – Mises en cause

ARRÊT

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[1] La Cour est saisie de deux pourvois formés contre un jugement rendu le 30 novembre 2017 par la Cour supérieure, district de Québec (l'honorable Guy de Blois), conformément aux dispositions de la *Loi sur les arrangements avec les créanciers des compagnies*[1], lequel comprend les conclusions suivantes :

> [40] **DÉCLARE** que seuls les créanciers ayant exécuté une prestation au bénéfice des débitrices en fournissant des marchandises, services, biens loués ou autres depuis le prononcé de l'Ordonnance initiale, dont BNE, pour les intérêts sur ses prêts ainsi que les locateurs, pour le loyer dû depuis l'Ordonnance initiale ainsi que pour la période de 30 jours couverte par le préavis de résiliation, détiennent une créance post dépôt contre les débitrices;
>
> [41] **DÉCLARE** que la somme de 750 000 $ conservée en fiducie par le Contrôleur provenant du prix de vente des transactions autorisées par le Tribunal aux termes de l'Ordonnance prorogeant l'ordonnance initiale et autorisant la cession de biens des débitrices soit distribuée comme suit :
>
> - premièrement, les Créances postérieures à l'Ordonnance initiale, soit depuis le 18 mai 2017;
> - deuxièmement, les créances garanties de créanciers détenant une sûreté sur les biens vendus, et ce, selon leurs rangs aux termes de la loi et des ordonnances prononcées par le tribunal;
> - troisièmement, le cas échéant, les créances prioritaires mentionnées à l'article 136 de la *Loi sur la faillite et l'insolvabilité*; et
> - quatrièmement, le cas échéant, les autres créances.[2]

1. CONTEXTE

[2] Gestion Éric Savard inc. et des sociétés à numéro (les débitrices) exploitent sous différentes bannières un réseau de 48 cliniques d'optométrie, dont 12 sont détenues par des franchisés.

[3] L'expansion des débitrices est fulgurante, notamment depuis l'acquisition des cliniques d'Optique Laurier au Québec et en Ontario, appartenant à Optical Vision of Canada Ltd., 9130217 Canada inc. et Antranik Kechichian (« groupe OVC »), en octobre 2016.

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[1] *Loi sur les arrangements avec les créanciers des compagnies*, L.R.C. 1985, ch. C-36.
[2] *Arrangement relatif à Gestion Éric Savard inc.*, 2017 QCCS 6194 [Jugement entrepris].

[4] Les débitrices rencontrent des problèmes de trésorerie à la suite de cette acquisition. Incapables de faire face à leurs obligations financières, elles sollicitent la protection de la *Loi sur les arrangements avec les créanciers des compagnies* (« *L.a.c.c.* ») en mai 2017.

[5] L'ordonnance initiale est prononcée le 18 mai 2017[3]. Elle contient des dispositions qui autorisent les débitrices à emprunter 4 500 000 $ provenant de Fonds de financement d'entreprises Fiera FP s.e.c. (« Fiera »). En contrepartie, cette dernière obtient une charge et une sûreté à titre de garanties (charge du prêteur temporaire) qui primeront sur les droits des autres créanciers garantis des débitrices, en application de l'article 11.2 *L.a.c.c.*, sauf pour des droits hypothécaires concernant deux autres sociétés. Il convient de reproduire ici les conclusions pertinentes de l'ordonnance initiale se rapportant à la charge du prêteur temporaire :

> [20] **DÉCLARE** que tous les biens des Requérantes soient par les présentes grevés d'une charge et d'une sûreté jusqu'à concurrence d'un montant total de 5 750 000,00 $ (cette charge et sûreté constituent la « **Charge du Prêteur temporaire** ») en faveur du Prêteur temporaire, à titre de garantie pour toutes les obligations des Requérantes envers le Prêteur temporaire relativement à toutes les sommes dues (incluant le capital, les intérêts, et les Dépenses du Prêteur temporaire) et qui découlent ou se rapportent aux Modalités du financement temporaire et aux Documents du financement temporaire, de sorte que la Charge du Prêteur temporaire primera sur les droits hypothécaires des autres créanciers garantis des Requérantes dans le cadre de l'application de l'article 11.2 de la LACC, sujet toutefois aux droits suivants : […].
>
> [24] **ORDONNE** que sous réserve d'une ordonnance ultérieure de ce tribunal, aucune ordonnance ayant pour effet de modifier, d'annuler ou autrement affecter les paragraphes [17] à [23] des présentes ne puisse être rendue, à moins a) qu'un avis de la requête en vue de ladite ordonnance soit signifié au Prêteur temporaire par la partie qui la présente dans les sept (7) jours suivant le moment où ladite partie a reçu signification de cette Ordonnance ou b) que le Prêteur temporaire demande ladite ordonnance ou y consente.
>
> […]
>
> [42] **DÉCLARE** que chacune des Charges en vertu de la LACC est de rang supérieur et prioritaire à celui de tous autres hypothèques, gages, sûretés, priorités, charges ou garanties de quelque nature que ce soit (collectivement, « **Sûretés** ») grevant l'un ou l'autre des Biens affectés par ces Charges, sujet toutefois aux droits suivants : […].[4]

[3] *Arrangement relatif à Gestion Éric Savard inc.*, 2017 QCCS 4733.
[4] *Id.*, paragr. 20, 24 et 42.

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[6] Depuis le prononcé de l'ordonnance initiale, des créanciers élèvent la voix. Ils se plaignent de fournir une prestation de services et de ne pas être payés. Parmi eux, des locateurs d'espaces immobiliers, Corporation FCHT Holdings (Québec) inc. et Société de gestion Place Laurier inc., la Banque de Nouvelle-Écosse en sa qualité de prêteuse d'équipements ainsi que le groupe OVC.

[7] Le 31 août 2017, le juge Jean-François Émond de la Cour supérieure est saisi d'une demande du contrôleur pour approuver des transactions de vente de certains biens hors du cours normal des affaires. Aucune allégation concernant le financement temporaire n'est incluse dans la demande présentée au juge Émond. Certains créanciers détenant apparemment des créances nées après le dépôt des procédures se plaignent de ne pas être payés pour les services fournis. Après des observations de ces créanciers post-dépôt, le juge Émond prononce une ordonnance qui comporte notamment les conclusions suivantes, lesquelles se trouvent au cœur du présent litige :

> [18] **PREND ACTE** de l'engagement du Contrôleur de conserver en fiducie une somme de 750 000 $ (la « Somme en Fiducie ») provenant du prix de vente des transactions à être autorisées par le tribunal afin d'assurer la disponibilité des sommes nécessaires au paiement des créances postérieures à l'émission de l'Ordonnance initiale, le cas échéant.
>
> [19] **DÉCLARE** que les droits et recours des parties ne sont pas compromis, altérés ou modifiés par le dépôt de la Somme en Fiducie.
>
> [20] **DÉCLARE** que la Somme en Fiducie ne pourra être versée à quiconque à moins d'un jugement du tribunal, toute partie intéressée pouvant s'adresser au tribunal afin d'obtenir un jugement autorisant la distribution, en tout ou en partie, de la Somme en Fiducie.[5]

[8] Depuis le prononcé de l'ordonnance, la Cour supérieure approuve la vente d'actifs de certaines succursales. Des créanciers post-dépôt demandent alors au contrôleur de procéder à la distribution de la somme détenue en fidéicommis à leur bénéfice. Le contrôleur présente ainsi le 11 octobre 2017 une demande au tribunal pour obtenir des « directives relatives aux fonds détenus en fiducie à la suite de vente d'actifs hors du cours normal des affaires ».

[9] Le contrôleur propose deux questions litigieuses auxquelles il suggère les réponses. Dans un premier temps, il demande au tribunal de définir les créanciers détenant une créance post-dépôt contre les débitrices. Dans un second temps, il sollicite une directive du tribunal sur la façon de distribuer la somme en fidéicommis. Il propose que les créanciers garantis soient les premiers, suivis des créanciers

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5 *Arrangement relatif à Gestion Éric Savard inc.*, 2017 QCCS 4254, paragr. 18-20.

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prioritaires mentionnés à l'article 136 de la *Loi sur la faillite et l'insolvabilité*[6] et, en dernier lieu, les autres créances incluant les créanciers post-dépôt, au prorata.

[10] Dans son rapport du 22 janvier 2018 portant sur l'état des affaires et des finances des débitrices, le contrôleur précise que le montant des avances versées par l'appelante se chiffre à 5 400 000 $ et que des remises partielles de 3 750 000 $ ont été effectuées les 8 septembre 2017 (2 000 000 $), 15 novembre 2017 (850 000 $), 29 novembre 2017 (500 000 $) et 7 décembre 2017 (400 000 $). Le solde du prêt intérimaire affiché au 13 janvier 2018 est donc de 1 650 000 $ avant les intérêts et les frais courus.

2. JUGEMENT ENTREPRIS

[11] Saisi de cette demande, l'honorable Guy de Blois rend jugement le 30 novembre 2017. Il définit la créance post-dépôt comme « une créance qui prend naissance après le prononcé de l'Ordonnance initiale »[7]. Selon lui, cette créance peut naître « à la suite de l'exécution d'une prestation au bénéfice des débitrices par la fourniture de marchandises, location d'un espace, prestations de services, vente ou location de biens meubles, prêt d'argents ou intérêts sur prêts ainsi qu'en raison de dommages à la suite de la résiliation d'un contrat pendant la période de restructuration »[8].

[12] Une fois ce concept défini, le juge de première instance estime, d'une part, que les locateurs détiennent une créance post-dépôt pour les loyers impayés depuis le 18 mai 2017, en incluant la période du préavis de résiliation de 30 jours. D'autre part, il est d'avis que seuls les intérêts accumulés depuis l'ordonnance initiale sur les prêts consentis par la Banque de Nouvelle-Écosse constituent une créance post-dépôt par opposition à la dette relative aux sommes dues en capital qui a pris naissance avant le prononcé de l'ordonnance initiale[9].

[13] Quant à la distribution de la somme détenue en fiducie par le contrôleur, le juge de première instance écarte la prétention de Fiera qui faisait valoir la priorité de sa charge de prêteur temporaire sur toute autre créance. Il fonde sa décision sur le libellé de l'ordonnance du juge Émond qui énonce que la somme est placée en fiducie « afin d'assurer la disponibilité des sommes nécessaires au paiement des créances postérieures à l'émission de l'Ordonnance initiale ». Ce faisant, il conclut que les

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6 *Loi sur la faillite et l'insolvabilité*, L.R.C. 1985, ch. B-3.
7 Jugement entrepris, paragr. 21.
8 *Id.*, paragr. 23.
9 *Id.*, paragr. 24-28.

créances post-dépôt doivent être payées « en priorité à tout autre paiement »[10]. Il établit par conséquent le rang des créanciers de la façon suivante :

> [39] La Somme en Fiducie doit donc être distribuée afin d'acquitter :
>
> - premièrement, les Créances Post, soit depuis le 18 mai 2017;
> - deuxièmement, les créances garanties de créanciers détenant une sûreté sur les biens vendus, et ce, selon leurs rangs aux termes de la loi et des ordonnances prononcées par le tribunal;
> - troisièmement, le cas échéant, les créances prioritaires mentionnées à l'article 136 de la *Loi sur la faillite et l'insolvabilité*; et
> - quatrièmement, le cas échéant, les autres créances.[11]

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3. QUESTIONS EN LITIGE

[14] Dans le dossier 200-09-009672-178, Fiera se pourvoit contre le jugement entrepris et plaide que le juge a commis des erreurs dans la qualification du but de la réserve de la somme en fiducie et des créances post-dépôt ainsi que dans l'établissement de l'ordre de distribution en écartant sa priorité.

[15] Dans le dossier 200-09-009673-176, le groupe OVC interjette appel contre le volet du jugement qui statue que seuls les intérêts payés à la Banque de Nouvelle-Écosse se qualifient comme une créance post-dépôt. Le groupe OVC soutient que le juge a erré en concluant que les versements en capital effectués depuis le prononcé de l'ordonnance initiale ne constituaient pas des créances post dépôt.

4. ANALYSE

4.1. Appel de Fiera (dossier 200-09-009672-178)

[16] La Cour est d'avis que l'appel de Fiera est bien fondé. Le juge de première instance était appelé à interpréter l'ordonnance du juge Émond[12]. Il conclut qu'une priorité a été accordée aux créanciers post-dépôt quant à la somme de 750 000 $ conservée en fiducie par le contrôleur. Ainsi, il commet une erreur révisable.

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[10] *Id.*, paragr. 34.
[11] *Id.*, paragr. 39.
[12] Une des causes de l'imbroglio provient du fait que des juges distincts ont traité l'affaire, ce qui n'est pas souhaitable en pareilles circonstances.

[17] En vertu de l'article 11.02 *L.a.c.c.*, le prononcé de l'ordonnance initiale a pour effet de suspendre les procédures entreprises contre la compagnie qui recherche la protection de ladite loi ainsi que l'introduction de toute autre procédure contre elle.

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[18] L'alinéa 11.01 *L.a.c.c.* prévoit toutefois à l'égard des fournisseurs :

11.01. L'ordonnance prévue aux articles 11 ou 11.02 ne peut avoir pour effet :	**11.01.** No order made under section 11 or 11.02 has the effect of
a) d'empêcher une personne d'exiger que soient effectués sans délai les paiements relatifs à la fourniture de marchandises ou de services, à l'utilisation de biens loués ou faisant l'objet d'une licence ou à la fourniture de toute autre contrepartie de valeur qui ont lieu après l'ordonnance;	**(a)** prohibiting a person from requiring immediate payment for goods, services, use of leased or licensed property or other valuable consideration provided after the order is made; or
b) d'exiger le versement de nouvelles avances de fond ou de nouveaux crédits.	**(b)** requiring the further advance of money or credit.

[19] Il est important de noter que cette disposition n'attribue aucune priorité en soi aux créanciers post-dépôt[13]. Il appartient alors à ces créanciers d'obtenir un jugement qui modifiera l'ordonnance initiale s'ils souhaitent obtenir une sûreté judiciaire[14], ce qui n'a pas été fait en l'espèce. Dans l'arrêt *Hydro-Québec c. Fonderie Poitras ltée*, la Cour écrit ce qui suit à l'égard de cette disposition (alors désignée comme étant l'article 11.3) :

> [80] L'alinéa a) de l'article 11.3 de la *LACC* établit un principe clair : pendant la période de suspension, le fournisseur a droit d'être payé pour les services qu'il rend au fur et à mesure de leur utilisation.
>
> [81] Voici d'ailleurs les commentaires du professeur Richard H. McLaren au sujet de cet article :
>
> > Section 11.3 acts as an exemption to the stay provisions of s. 11 of the CCAA. It appears the section is meant to balance the rights of creditors with debtors. The section addresses the concern that judges had too much discretion in issuing stays. Under s. 11.3(a), if a person supplies goods or services or if the debtor continues to occupy or use leased or licensed property, the court will not issue a stay order with respect to the payment for such goods or services or leased or licensed property. In

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[13] David E. Baird, *Baird's Practical Guide to the Companies' Creditors Arrangement Act*, Toronto, Carswell, 2009, p. 275.

[14] *ICR Commercial Real Estate (Regina) Ltd. v. Bricore Land Group Ltd.*, 2007 SKCA 72, paragr. 44.

> essence, s. 11.3(a) will not permit the court to prohibit these individuals from demanding payment from the debtor for goods, services or use of leased property, after a court order is made.

> [82] Ce principe connaît cependant des limites pratiques. Il arrive parfois que la réalité s'oppose à ce que le fournisseur soit payé immédiatement pour les services qu'il fournit à une compagnie débitrice. […]

> [83] En pareilles circonstances, il est juste et équitable pour le fournisseur de services de demander des garanties de paiement. Commentant la décision *Re Smoky River Coal Ltd*, les auteurs Houlden, Morawetz et Sarra déclarent :

>> Under its inherent powers, the court can create a security for creditors who supply goods and services to the debtor after the filing of a *CCAA* petition and can provide for the priority and ranking of such a security interest with respect to other security holders. If the plan under the *CCAA* fails, the court can determine who are entitled to share in the proceeds of the security interest.[15]

[Soulignements ajoutés]

[20] Il est également possible pour les créanciers post-dépôt de voir leurs créances garanties par une priorité si la débitrice obtient une ordonnance du tribunal les déclarant fournisseurs essentiels de la compagnie, conformément à l'article 11.4 *L.a.c.c.* Comme le souligne l'auteur Kevin P. McElcheran :

> Such suppliers can only gain priority over existing secured creditor claims if they are declared to be critical suppliers under section 11.4 or are granted security by court order in the CCAA proceedings. Certainly, neither section 11.01 nor section 19 create a priority for post-filing supply.[16]

[21] Ici, aucune demande en ce sens n'a été présentée à la Cour supérieure.

[22] Une telle priorité ne peut être accordée implicitement. À cet égard, la Cour d'appel de l'Alberta souligne à bon droit dans l'affaire *Smoky River Coal Ltd.* que :

> [15] CCAA orders become the roadmap for the proceedings and the litigation which may follow. Orders must therefore be drafted with clarity and precision. […]

> [16] It is particularly important that the terms and scope of any charge created by an order be clearly defined. Creditors need to know from the outset whether or not they are entitled to benefit in any charge or other priority created by the order. Those extending credit, be it trade credit or otherwise, should not be forced to

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[15] *Hydro-Québec c. Fonderie Poitras ltée*, 2009 QCCA 1416, paragr. 80-83.

[16] Kevin P. McElcheran, *Commercial Insolvency in Canada*, 3e éd., Toronto, LexisNexis, 2015, p. 149, no 3.233.

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> participate in litigation after the CCAA proceeding to discover whether or not they hold some form of security or are entitled to a super-priority.[17]

[23] Plus récemment, la Cour du Banc de la Reine de cette même province citait avec approbation les propos précités et ajoutait que :

> [8] While the Court was referring to the scope of a charge, it is equally important that any provision in an order that purports to create a priority for a creditor over other creditors be clearly delineated and set out with precision.[18]

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[24] Malgré les commentaires prononcés séance tenante par le juge Émond, reproduits dans le mémoire de l'appelante, on ne peut interpréter son ordonnance comme attribuant une priorité aux créanciers post-dépôt et ainsi modifier les priorités prévues dans l'ordonnance initiale en créant des garanties en faveur de ces derniers. Cela ne lui était pas demandé dans la demande dont il était saisi. En outre, son ordonnance prévoyait expressément une déclaration selon laquelle « les droits et recours des parties ne sont pas compromis ou altérés par le dépôt de la somme en fiducie »[19].

[25] En conséquence, puisque l'ordonnance initiale n'a pas été amendée pour modifier les priorités, qu'aucune sûreté n'a été attribuée aux créanciers post-dépôt et qu'aucune déclaration de fournisseur essentiel n'apparaît au dossier, le juge de première instance ne pouvait modifier l'ordre de collocation des créances garanties. Il y a donc lieu d'accueillir l'appel de Fiera et de revoir le dispositif du jugement entrepris, afin que celle-ci puisse faire valoir ses droits découlant de sa super-priorité de prêteur temporaire.

[26] Vu la solution à laquelle la Cour arrive sur l'ordre de collocation de la somme en fidéicommis et compte tenu du fait que le solde affiché du prêt temporaire au 13 janvier 2018 était supérieur à 1 650 000 $, il n'est pas nécessaire de se pencher sur les moyens d'appel portant sur la qualification des créances post-dépôt, comme le juge de première instance l'a fait.

4.2. Appel du groupe OVC (dossier 200-09-009673-176)

[27] Le même raisonnement s'applique à l'égard de la non-reconnaissance comme créance post-dépôt des mensualités versées par le groupe OVC à la BNE pour les contrats de financement de ses biens et équipements. Compte tenu de la solution

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17 *Montreal Trust Co. of Canada Ltd. v. Smoky River Coal Ltd.*, 2001 ABCA 209, paragr. 15-16.
18 *Sanjel Corporation (Re)*, 2017 ABQB 69, paragr. 8, requête pour permission d'appeler rejetée, 19 avril 2017, 2017 ABCA 120.
19 *Arrangement relatif à Gestion Éric Savard inc.*, 2017 QCCS 4254, paragr. 19.

retenue pour l'ordre de collocation des créances en regard de la somme détenue en fidéicommis, il n'est pas nécessaire d'aborder la question de savoir si le juge a commis une erreur en qualifiant uniquement les intérêts accumulés sur lesdits contrats de financement de créance post-dépôt.

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[28] L'appel du groupe OVC est en conséquence rejeté.

POUR CES MOTIFS, LA COUR :

Dans le dossier 200-09-009672-178

[29] **ACCUEILLE** l'appel;

[30] **INFIRME** le jugement de première instance;

[31] **MODIFIE** le paragraphe [41] du jugement de première instance afin qu'il soit rédigé ainsi :

> [41] **DÉCLARE** que la somme de 750 000 $ conservée en fiducie par le Contrôleur provenant du prix de vente des transactions autorisées par le Tribunal aux termes de l'Ordonnance prorogeant l'ordonnance initiale et autorisant la cession de biens des débitrices soit distribuée aux créanciers garantis détenant une sûreté sur les biens vendus, et ce, selon leurs rangs aux termes de la loi et des ordonnances prononcées par le tribunal;

[32] Avec les frais de justice, tant en première instance qu'en appel.

Dans le dossier 200-09-009673-176

[33] **REJETTE** l'appel;

[34] Avec les frais de justice, tant en première instance qu'en appel.

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____
FRANÇOIS DOYON, J.C.A.

____
SIMON RUEL, J.C.A.

____
JOCELYN F. RANCOURT, J.C.A.

Me Ari Y. Sorek
Me Roger P. Simard
Dentons Canada LLP
Pour Fonds de financement d'entreprises Fiera FP s.e.c.

Me Alain N. Tardif
McCarthy, Tétrault
Pour Raymond Chabot inc.

Me Alexandre Forest
Gowling WLG (Canada)
Pour Corporation FCHT Holdings (Québec) inc. / FCHT Holdings (Québec) corporation inc. et Société de gestion Place Laurier inc.

Me Roberto T. De Minico
De Minico, Petit Guarnieri
Pour La Banque de Nouvelle-Écosse

Me Laurent Debrun (absent)
Spiegel Sohmer inc.
Me Olivier J. Brault, avocat conseil
Allali, Brault
Me Ohannes Kechichian
Pour Optical Vision of Canada Ltd., 9130217 Canada inc. et Antranik Kechichian

Date d’audience : 2 octobre 2018

TAB 6

Court of Queen's Bench of Alberta

Citation: Lightstream Resources Ltd (Re), 2016 ABQB 665

2016 ABQB 665 (CanLII)

Date: 20161125
Docket: 1601 12571
Registry: Calgary

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 Lightstream Resources Ltd, 1863359 Alberta Ltd, LTS Resources Partnership, 1863360 Alberta Ltd and Bakken Resources Partnership

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Decision of the
of the
Honourable Mr. Justice A.D. Macleod

Introduction

[1] Lightstream Resources Ltd and its subsidiaries ("Lightstream") are under creditor protection pursuant to the *Companies' Creditors Arrangement Act* ("CCAA") by virtue of an Order of this Court dated September 26, 2016. Lightstream is an oil producer which sought creditor protection because of protracted low oil prices which it, like many others, has found financially challenging.

[2] On October 11, 2016 a comeback hearing took place and with respect to claims by Mudrick Capital Management ("Mudrick") and FrontFour Capital Corp ("FrontFour") I directed that this hearing be held, the purpose of which is to answer two preliminary questions related to their claims. Mudrick and FrontFour are sophisticated investment firms.

[3] Their oppression claims invoke Section 242 of the *Alberta Business Corporations Act,* RSA 2000, c B-9 (the "*ABCA*"). They are both asking this Court to order an exchange of securities with Lightstream as if they had participated in an earlier transaction with two other creditors who had exchanged unsecured notes for secured notes and provided $200 million US dollars to Lightstream in July 2015 (the "Secured Notes Transaction").

[4] Mudrick and FrontFour seek the Order pursuant to subsection (3)(e) of section 242 which provides that, to rectify oppressive conduct, the Court may order an issue or exchange of securities.

[5] The two questions are:

1. In the context of CCAA proceedings is there jurisdiction in the Court to recognize the Plaintiffs' claim as secured claims after the granting of the Initial Order and to make an order varying the Secured Notes Transaction and requiring Lightstream to issue additional Secured Noted to remedy alleged oppressive conduct?

2. If there is jurisdiction to make an Order recognizing the Plaintiffs' claim as a secured claim and varying the Secured Notes Transaction, would the Court exercise its discretion to do so based upon the facts as pleaded and supplemented to represent the highest and best factual case of the Plaintiffs?

[6] Some of the ground work necessary to achieve a compromise and an arrangement under the *CCAA* had been done prior to commencing the *CCAA* proceedings. Secured creditors had tentatively agreed to an arrangement which might see Lightstream survive provided that certain matters fell into place by the end of December 2016. Accordingly, time is in short supply as it often is in proceedings of this type.

[7] The oppression proceedings had been commenced in July of 2015 and documents have been produced and questioning is complete. The matter was virtually ready for trial at the time of the Stay Order.

[8] It is useful at this stage to review the chronology of events which give rise to the claim for oppression. When reviewing the chronology as it relates to Lightstream's representations, it is important to understand that it is primarily the evidence of Mudrick and FrontFour because for the purpose of this application I am to take the best view of the Plaintiffs' cases. Lightstream witnesses take issue with much of the evidence alleging misrepresentation but that evidence is left out of the chronology. If I answer both of the questions put forward in the affirmative, a trial will take place in December 2016 in which I will have a full opportunity to assess all of the evidence.

Chronology

[9] On January 30, 2012 Lightstream issued $900 million in unsecured notes pursuant to an Indenture agreement. Lightstream repurchased $100 million in unsecured notes in 2014, leaving $800 million outstanding.

[10] FrontFour met with Lightstream in January of 2014 to discuss the unsecured notes and the state of Lightstream's balance sheet. In December of 2014 an internal email in FrontFour discussed the risk of being "primed" (which means having secured debt added to Lightstream's

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balance sheet, which would rank ahead of the unsecured notes) FrontFour believed the risk was minimal.

[11] On January 21, 2015, Lightstream held a conference call with Mudrick in which Lightstream explained that it had the capacity to carry $1.5 billion in total secured debt, but that liquidity was not an issue, so Lightstream did not need or intend to restructure its debt at that time.

[12] On January 22, 2015 Mudrick purchased a series of Lightstream's unsecured notes on the secondary market. All told, Mudrick purchased $32,200,000 of unsecured notes between January 22, 2015 and the date of the July 2015 exchange transaction.

[13] FrontFour followed suit with its first purchase of unsecured notes on February 2, 2015. FrontFour currently holds $31,750,000 worth of unsecured notes.

[14] On February 3, Lightstream's CFO prepared an internal email identifying a number of transaction alternatives to restructure Lightstream's debt, including an exchange transaction involving unsecured notes. In respect of the exchange transaction, the CFO noted that such a transaction "might require to be a tender for fairness to all note holders".

[15] On February 11, 2015, FrontFour held a conference call with Lightstream in which the parties discussed the possibility of a third party unsecured note holder initiating an exchange transaction. Lightstream advised that, while they had the capacity to issue additional debt securities, no such transaction had been contemplated and Lightstream had ample liquidity.

[16] Mudrick met with Lightstream on February 18, 2015 to discuss Lightstream's liquidity situation. Lightstream maintained that they had sufficient liquidity.

[17] In an internal email dated February 22, 2015, FrontFour managers discussed a conversation with Lightstream's CFO advising that nothing in the Indenture prevented Lightstream from issuing additional senior unsecured notes.

[18] On March 8, 2015 an internal memorandum circulated FrontFour which stated that Lightstream's ability to issue senior debt securities was "limited" and that the current trading price of the unsecured notes presented an opportunity for "equity-like returns".

[19] In early March of 2015, unsecured note holders, Apollo Management LP ("Apollo") and GSO Capital Partners ("GSO"), approached Lightstream about a possible exchange transaction of their unsecured notes for secured notes.

[20] On March 13, 2015 FrontFour met with Lightstream. FrontFour emphasized that if Lightstream was planning on an exchange transaction of unsecured notes for secured notes with selective note holders, all unsecured note holders should have the opportunity to participate in the transaction. Lightstream maintained that it did not intend a debt exchange because of its favorable liquidity situation, and if a transaction were to occur, the transaction would be offered to all unsecured noteholders.

[21] In May of 2015, Lightstream retained a division of Royal Bank of Canada ("RBC") as financial advisor for the purposes of a potential debt exchange transaction.

[22] On May 9, 2015, Apollo sent Lightstream a term sheet proposal containing the proposed terms for a secured notes exchange transaction. Apollo and GSO both advised Lightstream that they were not prepared to have other unsecured noteholders participate in any exchange

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transaction, beyond certain follow-on exchanges. Apollo and GSO collectively held $465 million in unsecured notes, and Lightstream's view was that any transaction without their participation would not likely have a material upside for Lightstream.

[23] Lightstream held its Annual General Meeting on May 14, 2015. Lightstream executives were asked about the company's capacity to layer secured debt on top of the unsecured notes. Lightstream stated that it would be possible to layer additional secured debt, but that this debt would have a higher cost, and at this point Lightstream was not "enamoured" about adding on additional debt to add liquidity that was not necessary.

[24] On May 19, 2015 an internal FrontFour email circulated acknowledging an awareness that Lightstream was in talks with its creditors. The email posed the question: "shouldn't we work to insert ourselves into creditor talks?"

[25] On May 26, 2015, RBC told Lightstream that it would need to seek incremental liquidity in 2016 and that Lightstream should consider the Apollo and GSO transaction against the importance of maintaining senior secured financing flexibility.

[26] Lightstream spoke to Mudrick on May 27, 2015 to the effect that it was comfortable with its liquidity. Lightstream also said that any issuance of secured notes in exchange for the existing unsecured notes was unlikely. After this meeting, Mudrick circulated an internal email indicating that although Lightstream did not say an exchange transaction was likely, Lightstream did seem more inclined to do one than before.

[27] On May 29, 2015 an internal email at FrontFour outlined secured note issuances carried out in the energy sector in recent months, and posed the question "how much debt can be put ahead of us in [Lightstream]?"

[28] By the end of May, Mudrick considered selling its position in the unsecured notes to avoid the negative consequences of an exchange transaction of unsecured for secured notes. Based on assurances from Lightstream, Mr. Kirsch, a managing director of Mudrick decided not to sell. FrontFouralso says that it did not sell its position as a result of the assurances it had received from Lightstream that such an exchange transaction would not occur without them.

[29] In June 2015 all the parties were in New York and FrontFour and Mudrick each received assurances that while the company had been receiving more reasonable financing offers, that there was no contemplated debt exchange, and if there were such an exchange, Lightstream would offer it to all of the unsecured noteholders. Indeed Mudrick was assured that to do otherwise would be an "un- Canadian" way of doing business.

[30] On June 4, 2015, RBC emailed Lightstream a presentation in which it addressed Apollo and GSO's proposal for an exclusive secured note exchange. The presentation highlighted some of Lightstream's 2017 liquidity issues, and advised that Lightstream make efforts to rectify the liquidity shortfall.

[31] On June 5, 2015, Lightstream emailed Apollo and GSO its comments respecting the proposed exchange transaction. The parties agreed on June 10, 2015 that the terms for any follow-on deal could not be offered on terms more favorable than those accepted by Apollo and GSO.

[32] On June 10, 2015, Mudrick emailed Lightstream and asked that he be kept apprised of any debt exchange proposals so that Mudrick could participate in the discussions. That same day,

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Mudrick circulated an internal email indicating Mudrick's confidence in Lightstream but also with an awareness of the risk to the value of Mudrick's position if a debt exchange transaction were to occur.

[33] On June 11, 2015 RBC provided Lightstream with an assessment of the proposed exchange transaction by Apollo and GSO. They concluded that the deal would provide liquidity through 2016, and up to the end of 2017. Later that day, Lightstream sent Apollo and GSO a signed letter of agreement with the final term sheet.

[34] On July 2, 2015 Lightstream entered into a note purchase and exchange agreement with Apollo and GSO. The deal exchanged $465 million of unsecured notes for $395 million of secured second lien notes, and issued an additional $200 million of secured notes. The press release associated with the exchange stated that the transaction would provide Lightstream with the ability to reduce its outstanding borrowing under its credit facility, give the company financial flexibility in the low-price commodity environment, and potentially accelerate its drilling program in the event commodity prices recover.

[35] On July 6, 2015 Mudrick circulated an internal email in which members of the firm stated that Lightstream "just did the exchange we thought might be coming."

[36] Before the end of July 2015, Mudrick and FrontFour both filed actions claiming oppression by Lightstream in relation to the debt exchange transaction executed with Apollo and GSO. Both Mudrick and FrontFour alleged that they were oppressed because it was improper to offer the debt exchange transaction exclusively to Apollo and GSO, and to leave them out, particularly in light of the alleged misrepresentations made by Lightstream management. In addition, the exchange transaction was allegedly in breach of the unsecured note Indenture agreement.

[37] Among the remedies sought by FrontFour and Mudrick to rectify the alleged oppression was an order by the court compelling Lightstream to allow FrontFour and Mudrick the opportunity to participate in the debt exchange transaction on the same terms negotiated by Apollo and GSO.

[38] Since then, Mudrick has purchased approximately $36 million US dollars worth of the unsecured notes on the market.

[39] On September 26, 2016 Lightstream brought an application seeking *CCAA* protection, including a stay of all proceedings against it. Mudrick and FrontFour brought an application seeking an order to exclude their claims against Lightstream from the stay, and to have the issues raised in their claims heard before any proceedings under the *CCAA*. This court granted the stay but on October 11 ordered the threshold issues referenced above be determined in the *CCAA* proceedings.

Framework of Analysis

[40] Because of the obvious time constraints under which we are working, this is a pragmatic exercise. We often refer to this as "real time litigation" which does not give us the luxury of time for extended reflection.

[41] While this was not framed as a summary dismissal application it proceeded like one. Lightstream, Mudrick and FrontFour along with Apollo and GSO put forward that part of the

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record upon which they rely. This included affidavits by representatives of Mudrick and FrontFour, excerpts from questioning, and documents produced as well as answers to undertakings. I received extensive briefs and was favored with oral presentations over two days.

[42] I think it is appropriate to apply the same test with respect to the two questions as the Court would apply in a summary judgment application. That test has been variously described as whether there is a genuine issue to be tried or whether the plaintiffs are bound to fail. As was appropriate, I am confident that each side put its best foot forward with respect to the existence or non-existence of material issues to be tried. ***Papaschase Indian Band No 136 v Canada (Attorney General)***, 2008 SCC 14 see also ***Windsor v Canadian Pacific Railway***, 2014 ABCA 108 and ***Pembina Pipeline Corp v CCS Corp***, 2014 ABCA 390.

[43] I will outline the requirements necessary to apply the oppression remedy recognizing this Court is being asked to grant a particular remedy in the context of ongoing *CCAA* proceedings.

[44] The function of the supervising judge in this context is to supervise matters during the course of the stay of proceedings and this includes adjudicating with respect to claims such as the ones advanced here by Mudrick and FrontFour. They argue that as of the date of the exchange transaction in July 2015 and before the *CCAA* proceedings they were entitled to the remedy sought, i.e. to participate in the secured notes transaction on the same basis as those which did. Implicit in their arguments is that, if successful on this application and the subsequent trial, their claims as secured creditors can be dealt with under section 19(1) of the *CCAA*.

CCAA Process

[45] The *CCAA* is a broadly worded remedial piece of legislation. The Supreme Court in ***Ted Leroy Trucking [Century Services] Ltd,*** 2010 SCC 60 wrote about the broad scope of the *CCAA* at paragraph 59:

> The remedial purpose I referred to in the historical overview of the Act is recognized over and over again in the jurisprudence. To cite one early example:
>
> > The legislation is remedial in the purest sense in that it provides a means whereby the devastating social and economic effects of bankruptcy or creditor initiated termination of ongoing business operations can be avoided while a court-supervised attempt to reorganize the financial affairs of the debtor company is made.
> >
> > (*Nova Metal Products Inc. v. Comiskey (Trustee of)* (1990), 41 O.A.C. 282 (Ont. C.A.), at para. 57, *per* Doherty J.A., dissenting)

[46] The *CCAA's* general language provides the Court with discretion to make orders to further the *CCAA's* purpose. The source of much of the Court's discretion originates from section 11 of the *CCAA* and is supplemented by other statutory powers that may be imported into the section 11 discretion by way of section 42: ***Re Stelco Inc***, [2005] OJ No 1171 (ONCA) at para 33.

[47] Section 11 states:

> **11** Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may,

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> subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.

[48] Under section 11, the court may issue any order that it considers appropriate in the circumstances. Our Supreme Court addresses appropriateness in this context in ***Century Services*** at para 70:

> Appropriateness under the *CCAA* is assessed by inquiring whether the order sought advances the policy objectives underlying the *CCAA*. The question is whether the order will usefully further efforts to achieve the remedial purpose of the *CCAA* — avoiding the social and economic losses resulting from liquidation of an insolvent company.
>
> ...

[49] The Ontario Court of Appeal addressed the scope of section 11 in ***Re Stelco***, at para 44. The Court acts as a referee and maintains a level playing field while the company and its creditors attempt to achieve a compromise. While the Court has much discretion, it is limited by the remedial object of the *CCAA* and the Court must not usurp the roles of the directors or management.

[50] The Ontario Court of Appeal revisited the discussion of the scope of section 11 in ***US Steel Canada Inc, Re***, 2016 ONCA 662 and made the following comment, at para 82:

> There is no support for the concept that the phrase "any order" in s. 11 provides an at-large equitable jurisdiction to reorder priorities or to grant remedies as between creditors. The orders reflected in the case law have addressed the business at hand: the compromise or arrangement.

[51] An essential element of negotiating a compromise or arrangement is the stay of proceeding associated with the initiation of a *CCAA* proceeding. This allows for a status quo as between creditors so that the insolvent company has an opportunity to reorganize itself without any creditor having an advantage over the company or any other creditor: ***Woodward's Ltd, Re***, [1993] BCWLD 769 (BCSC) at para 17. Any order under section 11 should be made with the view to facilitating a fair compromise or an arrangement.

The Oppression Remedy under the *CCAA*

[52] Section 42 of the *CCAA* allows for the import of remedies from other statutory schemes:

> **42** The provisions of this Act may be applied together with the provisions of any Act of Parliament, or of the legislature of any province, that authorizes or makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them.

[53] FrontFour and Mudrick take the position that the oppression remedy pursuant to section 242 of the *ABCA* may be imported into a *CCAA* proceeding by way of section 42 of the *CCAA*. ***Re Stelco*** describes this proposition in detail at paragraph 52:

> The CBCA is legislation that "makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them". Accordingly, the powers of a judge under s. 11 of the CCAA may be applied

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> together with the provisions of the CBCA, including the oppression remedy provisions of that statute. I do not read s. 20 [now s. 42] as limiting the application of outside legislation to the provisions of such legislation dealing specifically with the sanctioning of compromises and arrangements between the company and its shareholders. The grammatical structure of s. 20 [now s. 42] mandates a broader interpretation and the oppression remedy is, therefore, available to a supervising judge in appropriate circumstances. [emphasis added]

[54] While the Ontario Court of Appeal in ***Re Stelco*** addresses the *CCAA* in the context of the *CBCA*, the same logic applies to the *ABCA*. I also agree that, while the oppression remedy *can* be a tool under the *CCAA*, it should be utilized in only the appropriate circumstances. Circumstances that qualify as appropriate will be those that accord with the purpose and objectives of the *CCAA* process. Thus, while this Court has jurisdiction to apply the oppression remedies the exercise of this discretion is limited to cases in which the remedy serves the purpose and scheme of the Court's function under the *CCAA*. This analysis will usually involve two questions. Was the conduct oppressive and, if so, what is the appropriate remedy in the context of the *CCAA*?

The Oppression Claim

[55] FrontFour and Mudrick assert that because they held identical notes and they were so assured, they had a reasonable expectation that they would be included in the transaction executed among Lightstream and Apollo and GSO. FrontFour and Mudrick argue that by failing to include them in the exchange transaction, Lightstream acted oppressively.

[56] Under the *ABCA* the oppression remedy is set out in section 242. The Supreme Court of Canada in ***BCE Inc, Re***, 2008 SCC 69 provided a two-part framework for analysing an oppression claim (at para 68):

1. Does the evidence support the reasonable expectation asserted by the claimant?

2. Does the evidence establish that the reasonable expectation was violated by conduct, and falls within the terms "oppression", "unfair prejudice" or "unfair disregard" of a relevant interest?

[57] The Alberta Court of Appeal outlined three governing principles under which a court is subject to when exercising its broad equitable jurisdiction under the oppression remedy: ***Shefsky v California Gold Mining Inc***, 2016 ABCA 103, at para 22:

> • First: not every expectation, even if reasonably held, will give rise to a remedy because there must be some wrongful conduct, causation and compensable injury in the claim for oppression: *BCE* at paras 68, 89-94.
>
> • Second: not every interest is protected by the statutory oppression remedy. Although other personal interests may be connected to a particular transaction, the oppression remedy cannot be used to protect or advance, directly or indirectly, these other personal interests. "[I]t is only their interests as shareholder, officer or director as such which are protected": *Naneff v. Con-Crete Holdings Ltd.* at para 27. Furthermore, "the oppression remedy protects only the interests of a shareholder *qua* shareholder. Oppression remedies are not intended to be a

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substitute for an action in contract, tort or misrepresentation": *Stahlke v. Stanfield*, 2010 BCSC 142 (B.C. S.C.) at para 23, aff'd 2010 BCCA 603 (B.C. C.A.) at para 38, (2010), 305 B.C.A.C. 18 (B.C. C.A.).

• Third: courts must not second-guess the business judgment of directors of corporations. Rather, the court must decide whether the directors made decisions which were reasonable in the circumstances and not whether, with the benefit of hindsight, the directors made perfect decisions. Provided the directors acted honestly and reasonably, and made a decision in a range of reasonableness, the court must not substitute its own opinion for that of the Board. If the directors have chosen from one of several reasonable alternatives, deference is accorded to the Board's decisions: *Stahlke* at para 22; *Pente Investment Management Ltd. v. Schneider Corp.* (1998), 42 O.R. (3d) 177 (Ont. C.A.) at para 36, (1998), 44 B.L.R. (2d) 115 (Ont. C.A.); *BCE* at para 40.

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(i) Reasonable Expectations

[58] The claimant must identify the expectation they had and must demonstrate that such expectations are reasonable in all of the circumstances. Evidence of an expectation will depend upon the facts of each case. In the context of this case, the basis of FrontFour and Mudrick’s alleged reasonable expectation derives from Lightstream’s representations and assurance, and the Indenture agreement governing the unsecured notes.

[59] ***BCE*** sets out factors helpful in determining whether a reasonable expectation exists. These factors are:

- general commercial practice
- the nature of the corporation
- the relationship between the parties
- past practice
- steps the claimant could have taken to protect himself
- any representations and agreements, and
- the fair resolution of conflicts between corporate stakeholders

General Commercial Practice

[60] A departure from the general commercial business practice that has the effect of undermining or frustrating a complainant’s legal rights can give rise to a remedy: ***BCE*** at para 73.

[61] FrontFour and Mudrick argue that there is no evidence that debt exchanges done on a selective basis is the general commercial practice. It was their belief that such an exchange should be offered to all unsecured noteholders.

[62] Lightstream takes the position that the absence of a prohibition against selective debt exchanges is evidence that selective debt exchanges are permissible. Lightstream points to an internal email sent by FrontFour on May 29, 2015 which listed recent secured note issuances in the energy industry and posed the question "how much debt can be put ahead of us?" in respect of FrontFour's Lightstream unsecured notes. This, according to Lightstream, is evidence of FrontFour's knowledge that an exchange transaction was possible and in accordance with general commercial practice. There is little doubt that the Plaintiffs were aware that a selective exchange transaction was a possibility.

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The Nature of the Corporation

[63] This factor carries more weight in instances where a small, closely held corporation deviates from corporate formalities. In the context of this case, Lightstream is a large public company and it is presumed that such a company would comply with corporate norms and formalities.

[64] Lightstream takes the view that it is relevant to consider that FrontFour and Mudrick are also sophisticated firms that are in the business of managing significant amounts of money by, among other things, buying and trading securities on the secondary market. If FrontFour and Mudrick were nervous about a potential debt exchange, they could have sold their position.

Relationship between the Parties

[65] The parties had some familiarity with one another. FrontFour and Mudrick held a sizable enough position in Lightstream's unsecured debt that it allowed them access to Lightstream's CFO and other executives on a regular basis. FrontFour and Mudrick claim that such a relationship implied a reasonable expectation of honesty and candor. On the other hand, professional investors who work daily in a market rife with misinformation ought to beware.

Past Practice

[66] FrontFour and Mudrick claim that no transaction like the debt exchange transaction has occurred in the past. Lightstream points to the repurchase of $100 million in unsecured notes in 2014 as evidence of a transaction done selectively, and not on a pro-rata basis.

Preventative Steps

[67] FrontFour and Mudrick claim that by continually asking Lightstream for inclusion and any exchange transaction they took the appropriate preventative steps to avoid its loss.

[68] On the other hand, there is a significant amount of evidence which indicates that FrontFour and Mudrick were aware that in exchange transactions such as the one that took place was being considered by Lightstream. Despite that, they chose not to sell their notes, they say, because of the assurances both public and private

Representation and Agreements

[69] In addition to the assurances, FrontFour and Mudrick also claimed that the wording of the Indenture agreement supporting the original issue of the unsecured notes contributed to their reasonable expectation that they would participate in any exchange transaction.

[70] I was informed that if this issue does go to trial the interpretation of the Indenture agreement would be the subject of expert evidence. It is a complicated agreement with lengthy provisions and terms. In light of the fact the parties intend to call expert evidence, this hearing is

not the place to make a definitive finding as to what it says on this issue. Nevertheless, there is no evidence before me that anyone associated with the Plaintiffs ever raised the wording of the Indenture agreement with anyone associated with Lightstream prior to the exchange transaction in July 2015. Nor is there any evidence that either Plaintiff raised it internally. Finally, there is no evidence that anyone with Lightstream thought that the Indenture agreement was an obstacle to the transaction. Indeed, it is clear from the evidence that the Lightstream thought it could do so and so informed the Board of Directors in June 2015.

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[71] Finally, the Indenture agreement contains a “no action” clause which prescribes specific steps as preconditions to initiating an action relating to the Indenture or notes. It required the Trustee of the Indenture to be notified so that the Trustee could take carriage of the action on behalf of the class. I will return to this clause later.

Fair Resolution of Conflicting Interests

[72] Lightstream asserts that its decision to execute the debt exchange transaction was a business decision done in the best interest of the corporation. As an overture to FrontFour and Mudrick, Lightstream offered them the opportunity to participate in the exchange of unsecured to secured notes. FrontFour and Mudrick rejected this opportunity because the terms of the exchange were less favorable than the terms of the first exchange transaction. Nevertheless, Lightstream points to this as an attempt at a fair resolution for conflicting interests.

Was there a Reasonable Expectation?

[73] Arguably on the evidence, Mudrick and FrontFour were repeatedly told by Lightstream that no exchange transaction was contemplated, but if there was one, all of the unsecured note holders would be able to participate. At the same time, the evidence is that both Mudrick and FrontFour were aware that a selective exchange transaction was in play. However, they each say that they did not take steps to sell their positions because of the repeated assurances given to them by Lightstream management. Moreover, those assurances continued while the impugned transaction was being negotiated. In the absence of hearing the evidence from those witnesses involved, I cannot conclude that the Plaintiffs are bound to fail on this issue. In other words I think that whether or not there was a reasonable expectation and whether it caused a loss as alleged, are genuine issues for trial.

(ii) Oppression, Unfair Prejudice, or Unfair Disregard

[74] The second part of the framework examines whether the evidence establishes that the alleged reasonable expectation was violated by Lightstream conduct, and falls within the terms “oppression”, “unfair prejudice” or “unfair disregard” of a relevant interest?

[75] When a conflict between the interests of corporate stakeholders arises, it falls to the corporation to resolve the dispute in accordance with their fiduciary duty to act in the best interest of the company, viewed as a good corporate citizen: ***BCE*** at para 81.

[76] ***BCE*** also states, at paragraph 83:

> Directors may find themselves in a situation where it is impossible to please all stakeholders. The "fact that alternative transactions were rejected by the directors is irrelevant unless it can be shown that a particular alternative was definitely available and clearly more beneficial to the company than the chosen transaction": *Maple Leaf Foods* per Weiler J.A., at p. 192.

> There is no principle that one set of interests — for example the interests of shareholders — should prevail over another set of interests. Everything depends on the particular situation faced by the directors and whether, having regard to that situation, they exercised business judgment in a responsible way.

[77] FrontFour and Mudrick claim that Lightstream completely and unfairly disregarded their interests by going forward with the selective debt exchange transaction. They further assert that the exchange transaction was not necessary in light of Lightstream's available liquidity. To go forward with an unnecessary transaction to the exclusion of the rest of the unsecured noteholders qualifies as unfair disregard, according to FrontFour and Mudrick.

[78] Lightstream takes the position that the selective debt exchange transaction was a good faith business decision made with a view to the best interests of the corporation.

[79] Lightstream hired financial experts to evaluate the company's liquidity in the context of Apollo and GSO's term sheet. In May of 2015, the financial advisor made a presentation to Lightstream in which it recognized the need for incremental liquidity in 2016, and that the Apollo and GSO transaction should be viewed as a potential solution to this problem. On June 11, 2015, the financial advisor provided its assessment of the Apollo and GSO transaction and concluded that the deal would provide liquidity through 2016 and up to year end 2017.

[80] While there were representations made by Lightstream to FrontFour and Mudrick that it would be a fair business practice to offer the exchange transaction to all unsecured noteholders, Lightstream ultimately believed that there was no obligation to do so. At the June 11, 2015 meeting of Lightstream's Board of Directors, the meeting at which the debt exchange transaction was given the go-ahead, the directors discussed the need to offer the transaction to all unsecured noteholders. According to the meeting's minutes, "management confirmed that there was no requirement under either the unsecured note Indenture or applicable U.S. securities laws to make the same offer to all unsecured noteholders."

[81] Apollo and GSO held more than half of the outstanding unsecured notes. Apollo and GSO had said that they would proceed with the transaction only if it was done on a selective basis. The deal, according to Lightstream's financial advisors, would provide liquidity into 2017. Management of the company considered any obligation to offer the transaction to all unsecured noteholders and concluded that none existed.

[82] I would not second guess the Board of Directors on the issues of whether the transaction was necessary or whether it was in the best interest of Lightstream. I defer to their business judgment. Nevertheless, there is no evidence that the Board was told that Mudrick and FrontFour, holders of a significant amount of the unsecured notes, were repeatedly told by Lightstream that they would be included in the transaction. If indeed those assurances had been given, the Board should have been so informed. Had they been so informed the Board may have or maybe should have taken a different decision. Accordingly, on that issue too, I cannot conclude that the Plaintiffs are bound to fail.

Appropriate Remedy

[83] A finding of oppression may give rise to equitable remedies aimed at rectifying the oppression and putting the oppressed in the position they would have been had it not occurred. In this case the Plaintiffs assert that the oppression was the discriminatory way in which they were

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treated in the face of the Indenture, the representations and the assurances. They argue that they had the right to expect that they would be included in any exchange transaction. In the end the exchange transaction which occurred was only with Apollo and GSO. It is argued that the only just way to rectify the oppression is to order Lightstream to issue them their pro rata share of secured notes and they have filed an undertaking to contribute their share of cash to Lightstream.

[84] On the other hand, Lightstream and Apollo and GSO argue that even if there is a basis for granting an oppression remedy, it would clearly be a case for damages and in any event, an order directing Lightstream to issue securities and incur further debt is a remedy which is extraordinary, inappropriate and contrary to the function of this Court in supervising the *CCAA* proceedings. They argue that if this action were outside of the *CCAA* proceedings an adequate and thus appropriate remedy would be damages. They further argue that within the *CCAA* proceedings the remedy sought is contrary to the scheme of the *CCAA*.

[85] I have reviewed the very excellent briefs filed the by the parties and listened carefully to their arguments. I agree with the position advanced by Lightstream, Apollo and GSO to the effect that even if a claim for oppression is made out the appropriate remedy is damages. It would not include the equitable remedy sought. Moreover, in the context of the *CCAA* proceedings, it would be inappropriate to grant the relief sought.

[86] Damages are adequate to compensate the Plaintiffs for their loss. Both Plaintiffs claim that if they had known about the transaction they would have sold their notes. The market consensus at that time was that an exchange transaction with existing unsecured noteholders would adversely affect the market price of the remaining notes and the market price at the relevant times is ascertainable. The Plaintiffs claim that because of the assurances received from Lightstream, publicly and privately, they chose not to sell the notes. Accordingly, an award of damages is adequate to compensate the Plaintiffs for their loss. Investments have no intrinsic value beyond their financial return.

[87] If the transaction is found to be oppressive as against the Plaintiffs, it may also be oppressive as against the remaining unsecured notes, the value of which is approximately $150 million US dollars. The remedy sought would apply only to the Plaintiffs and thus the remedy may itself amount to oppression against the remaining unsecured note holders as well as a breach of the Indenture. In those circumstances, the Court would not grant the equitable remedy sought, particularly where the Plaintiffs failed to notify the Trustee of Indenture as required.

[88] Section 242(3)(e) of the *ABCA* empowers the Court to order an exchange of securities but in doing so, the Court should consider all of the factors affecting fairness. Here, the remedy would adversely affect Appollo and GSO because they insisted on exclusivity and insisted that others could participate only later and on less favorable terms. Neither Appollo nor GSO is alleged to have wronged the Plaintiffs. The remedy would also adversely affect the remaining unsecured note holders who have done nothing wrong. Finally, the remedy would impose debt upon Lightstream unilaterally.

[89] To grant the remedy sought would also be contrary to the scheme and object of the *CCAA*. I accept the argument that Lightstream's insolvency is an inappropriate reason to grant an equitable remedy in favor of two creditors particularly when it affects others and Lightstream. I agree with the Ontario Court of Appeal in ***Barnabe v Touhey***, [1995] OJ No 3456 where it said:

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> While a constructive trust, if appropriately established, could have the effect of the beneficiary of the trust receiving payment out of funds which would otherwise become part of the estate of a bankrupt divisible among his creditors, a constructive trust, otherwise unavailable, cannot be imposed for that *purpose*. This would amount to imposing what may be a fair result as between the constructive trustee and beneficiary, to the unfair detriment of all other creditors of the bankrupt.

[90] In other words, the appropriate remedy is damages and, accordingly, it would be contrary to the purpose of the *CCAA* to grant an equitable remedy which would adversely affect other creditors.

[91] The Plaintiffs argue that the policy of the *CCAA* argues in their favor because to not grant it will encourage aggressive creditors to jockey for position prior to *CCAA* proceedings. First of all, there is nothing before me to suggest what occurred before the exchange transaction in July 2015 was "jockeying" as opposed to a bona fide transaction. Indeed, no claim is made against Apollo or GSO. More importantly, what is being sought here by the Plaintiffs is an order of this Court that would put them in a better position than the remaining unsecured note holders. I am mindful of the words of Farley, J in ***Lehndorff General Partner Ltd (Re)***, [1993] OJ No 14 where he said at para 6:

> It has been held that the intention of the *CCAA* is to prevent any maneuvers for positioning among the creditors during the period required to develop a plan and obtain approval of creditors. Such maneuvers could give an aggressive creditor a advantages to the prejudice of others who are less aggressive and would undermine the company's financial position making it even less likely the plan will succeed...

In my view, that would be the effect of granting the order sought.

[92] In the result, I answer the questions as follows:

1. In the context of CCAA proceedings is there jurisdiction in the Court to recognize the Plaintiffs' claim as secured claims after the granting of the Initial Order and to make an order varying the Secured Notes Transaction and requiring Lightstream to issue additional Secured Noted to remedy alleged oppressive conduct?

   Yes. The Court has jurisdiction but a limited one. It is defined by the scheme of the CCAA. Whether oppression occurred and whether the Plaintiffs suffered a loss are triable issues.

2. If there is jurisdiction to make an Order recognizing the Plaintiffs' claim as a secured claim and varying the Secured Notes Transaction, would the Court exercise its discretion to do so based upon the facts as pleaded and supplemented to represent the highest and best factual case of the Plaintiffs?

   No. On this question, the Plaintiffs are bound to fail and there is no issue to be tried. To grant the remedy sought would be contrary to law.

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[93] The parties may speak to costs.

Heard on the 15th and 16th day of November, 2016.

Dated at the City of Calgary, Alberta this 25th day of November, 2016.

A.D. Macleod
J.C.Q.B.A.

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Appearances:

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for Lightstream

T. Pinos & C. Simard
S. Voudouris & S. Kerzne
for FrontFour & Mudrick

K. Kashuba
for First Lien Creditors

J. Wadden & D. Conklin
for Apollo Management LP & GSO Capital Partners

TAB 7

Court of Queen's Bench of Alberta

Citation: Royal Bank of Canada v. Cow Harbour Construction Ltd., 2012 ABQB 59

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Date: 20120123
Docket: 1003 11241, 1003 05560
Registry: Edmonton

Between:

Royal Bank of Canada

Plaintiff

- and -

Cow Harbour Construction Ltd. and 1134252 Alberta Ltd.

Defendants

And Between:

Docket: 1003 05560

BKCY Action No: 24-115359

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

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

And in the Matter of a Plan of Arrangement of Cow Harbour Construction Ltd.

Reasons for Judgment
of the
Honourable Mr. Justice K.D. Yamauchi

2012 ABQB 59 (CanLII)

I. Nature of the Matter

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

II. Procedural History

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

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

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

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

[6] Also on May 21, 2010, this Court directed Cow Harbour to pay over to the Monitor's counsel monies representing all monthly payments from April 1, 2010, that Cow Harbour would have paid to lessors under the Disputed Leases, or leases which had not yet been categorized

(Disputed Lease Funds). This Court directed the Monitor's counsel to hold the Disputed Lease Funds pending resolution of disputes pertaining to categorization of the Disputed Leases.

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

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

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

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

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

III. Issue

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

IV. Law

A. Legislation

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

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

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

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

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

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

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

B. General Legal Principles

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

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

[17] As noted in ***Re Smith Brothers Contracting Ltd.*** (1998), 53 BCLR (3d) 264 at para 3 (SC) [***Smith Brothers***], Parliament added what is now s. 11.01 to the *CCAA* as part of a set of

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amendments proclaimed in force on September 30, 1997. Suche J. in ***Re Winnipeg Motor Express Inc.***, 2009 MBQB 204, 243 Man R (2d) 31 [***Re Winnipeg***], leave to appeal to CA refused, 2009 MBCA 110, [2009] 12 WWR 224, suggested that Parliament may have added this provision to clarify the point made in ***Quintette Coal Ltd. v. Nippon Steel Corp.*** (1990), 51 BCLR (2d) 105 (CA) [***Quintette***], that a stay would never be used to enforce the continuous supply of goods or services without payment for current deliveries. She also commented that the amendment brought the *CCAA* in line with the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 [*BIA*], which contains a similar provision relating to proposals.

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

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

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

[20] While initially having questioned in oral reasons on August 25, 2010, whether it might be worthwhile to re-examine the approach that Bauman J. took in ***Smith Brothers***, this Court

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concluded the approach was sound, given that *CCAA* s. 11.01(a) is to be narrowly construed. The substance and not the form of the arrangement between the debtor corporation and the other contracting party is of importance and, unless there is a sound policy reason for doing so, the court should not give an advantage to one creditor over another.

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

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

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

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

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

> It would also produce a proper dovetailing of the federal insolvency provisions. For example, the insolvency statutes provide that a stay of proceedings does not prevent a lessor from requiring immediate payment for use of the leased property. This gives the lessor the ability to collect post-commencement lease payments. Courts have held that this provision only applies to true leases and not to security leases. The latter are treated in the same manner as other security interests and the debtor is able to retain possession of the goods without the need to satisfy the post commencement payments. This further demonstrates that the division between

> true leases and security leases that is produced by the application of the substance test of the *PPSA* is being recognized in insolvency law, and that an amendment of the definition of secured creditor to reflect this fact is the most sensible solution.

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

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

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

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

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

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

[31] ***Winnipeg Motor*** dealt with the proper distribution of interim financing and administrative charges incurred after the court granted an initial order under the *CCAA*. The monitor recommended that the charges be distributed among the secured creditors based on a *pro rata* recovery. Two parties claimed to be true lessors. The court referred to the distinction made in ***Smith Brothers*** between true leases and financing leases. It commented that the exclusion of financing leases from *CCAA* s. 11.01(a) makes perfect sense based on the notion of ownership, as a financing lessor cannot seek the benefits of ownership when it has given it away (assuming the lessee has been acquiring equity in the leased goods). It also suggested that the narrow construction of *CCAA* s. 11.01(a) as limiting the obligation of the debtor to make payments for "use" is consistent with the idea that a supplier cannot be expected to continue to provide its product without payment.

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

> It is difficult to know how this situation can be remedied, given that the whole point of the *CCAA* is to relieve a company of ongoing financial burden to allow it the opportunity to restructure. In this case, for example, [the debtor corporation] would not have succeeded had it been obliged to pay for its equipment during the entirety of the restructuring.
>
> On the particular facts of this case, this issue became somewhat easier to address given the nature of [the debtor corporation's] business. Equipment to a transportation company is akin to raw goods to a manufacturer, and I was of the opinion that if [the debtor corporation] was going to be viable, at a certain point it would have to demonstrate it could pay for the essential means of production. Otherwise, there would be no purpose to continue the stay. Accordingly, I ordered that financing leases would be paid as of August 1, 2008.
>
> I say all this not to justify or revisit the basis for my earlier decision, but to get to the point that in considering what is equitable, undue prejudice is a reason to adjust what would otherwise be a uniform approach. I am satisfied that equipment lessors in a business operation such as [the debtor corporation's] do suffer undue prejudice. In this case, however, the equipment lessors were paid as of August 1. Being financing leases, those payments were not just for use, but included some amount on account of equity. I conclude, then, that the undue prejudice suffered has been recognized, *albeit* not totally, perfectly or precisely, but, in my view, in an amount sufficient amount to justify the uniform application of the methodology proposed by the monitor.

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

[34] In ***Re Clayton Construction Co. Ltd.***, 2009 SKQB 397, 59 CBR (5th) 213 [***Clayton Construction***], the debtor corporation sought an extension of a *CCAA* stay of proceedings. Rothery J. granted the extension, but also allowed the payment of interest that the debtor

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corporation owed to nine of its equipment lessors as a means of compensating them for the use and depreciation of their equipment. The debtor corporation required the equipment to complete its contracts. The court determined that the monthly interest payments to the equipment lessors would not prejudice the other creditors. The major secured creditor had benefited from the accounts receivable generated by the debtor's use of the equipment and the unsecured creditors likely would not have received any benefit, had the equipment lessors withdrawn their support for the restructuring process.

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

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

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

[37] The problem, however, is that one creditor should not receive "an unfair advantage when compared to other creditors of the applicants, who are bound by the stay" (***PSINET*** at para 19).

If some creditors are to be bound by the stay of proceedings, all creditors must be bound. Any contrary approach invariably would lead to every creditor attempting to argue that its interests are being prejudiced by the stay of proceedings in one way or another, with the end result that the stay of proceedings would prove meaningless.

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

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

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

> 178(1) An order of discharge does not release the bankrupt from
> . . .
>
> (d) any debt or liability arising out of fraud, embezzlement, misappropriation or defalcation while acting in a fiduciary capacity
> . . .

[41] The question has arisen whether the words "while acting in a fiduciary capacity" qualify only the word "defalcation" or whether they qualify all of the listed factors, including fraud, embezzlement, misappropriation and defalcation. Courts have held that the latter is the proper interpretation (see *e.g*. ***Confederation Life Insurance Co. v. Waselenak***, [1998] 5 WWR 712, 57 Alta LR (3d) 38 (QB), affd 2000 ABCA 136; ***166404 Canada Inc. v. Coulter*** (1998), 4 CBR (4th) 1 (Ont CA), leave to appeal to SCC refused (1998), 223 NR 395 (note); ***Ross & Associates v. Palmer***, 2001 MBCA 17, 22 CBR (4th) 140; ***Re Brant*** (1984), 52 CBR (NS) 317 (Ont SC)).

[42] Including all pre-stay leases in the stay of proceedings would be in keeping with the broad and liberal interpretation that courts have given to the *CCAA*, which is to provide the debtor corporation with "breathing space" in which to determine whether it is in a position to restructure its affairs and to facilitate its survival. Including only post-stay leases under *CCAA* s. 11.01(a)

also would be in keeping with the narrow interpretation of transactions that are excepted from the stay of proceedings. It would simplify *CCAA* proceedings involving equipment leases.

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

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

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

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

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

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

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

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

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

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

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

[50] Professors Ronald CC Cuming and Roderick J. Wood in their *Alberta Personal Property Security Act Handbook*, 4th ed (Toronto: Carswell, 1998) at 53 [*Handbook*] emphasized the need to examine the relationship between the lessor and lessee to determine if it reflects indicia of a financing arrangement. They noted, however, that they were not referring to the traditional indicia prescribed by the common law, but rather those which would be relevant to someone examining the economic realities of the transaction.

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

> 1. Whether there was an option to purchase for a nominal sum;
>
> 2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment;
>
> 3. Whether the nature of the lessor's business was to act as a financing agency;

4. Whether the lessee paid a sales tax incident to acquisition of the equipment;

5. Whether the lessee paid all other taxes incident to ownership of the equipment;

6. Whether the lessee was responsible for comprehensive insurance on the equipment;

7. Whether the lessee was required to pay any and all licence fees for operation of the equipment and to maintain the equipment at his expense;

8. Whether the agreement placed the entire risk of loss upon the lessee;

9. Whether the agreement included a clause permitting the lessor to accelerate the payment of rent upon default of the lessee and granted remedies similar to those of a mortgagee;

10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease;

11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment;

12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a UCC financing statement;

13. Whether there was a default provision in the lease inordinately favourable to the lessor;

14. Whether there was a provision in the lease for liquidated damages;

15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor;

16. Whether the aggregate rental approximated the value of purchase price of the equipment. [See also ***PSINET*** at para 12.]

[52] Other courts have added that the right of the lessee to an “option to purchase” can be established through the course of conduct between the parties, if not expressly provided for in the document itself (***Philip Services*** at paras 4-5). As well, leases that are “bundled together” for financing purposes may be construed as financing transactions and not as true leases, because the

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transactions really involve payment for financing the acquisition of the assets rather than payment for use (***Philip Services*** at para 9).

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

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

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

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

[56] Topolniski J. in ***Re 843504 Alberta Ltd.***, 2011 ABQB 448 at para 63, 80 CBR (5th) 177 [***843504***] identified what Burke at 292-94 referred to as "primary factors:"

> (a) Relevance of the purchase option price - whether the purchase option price is nominal or reflective of fair market value.
>
> (b) Mandatory purchase options - whether there is a mandatory purchase option that obligates the lessee to purchase the equipment at the end of the term.
>
> (c) Open-end leases/guaranteed residual clauses - whether the lessee is liable for any deficiency in the sale of the equipment at the end of the term.

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

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

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

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

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

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

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

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

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

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

[59] On an application for leave to appeal this Court's assessment that a particular agreement at issue in these proceedings was a financing lease, the Alberta Court of Appeal in ***De Lage Landen Financial Services Canada Inc. v. Royal Bank of Canada***, 2010 ABCA 394 at para 60 [***De Lage Landen (CA)***], refusing leave to appeal 2010 ABQB 637, 37 Alta LR (5th) 82 [***De Lage Landen (QB)***] expressly rejected the suggestion that there should be a hierarchy of factors that a court

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should use to determine if a lease is a true lease or a financing lease. In denying the leave application, Ritter J.A. stated at para 15:

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

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

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

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

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

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

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

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

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

[64] GE argues that while the presence of one of Burke's "primary" factors is significant, absence or ambiguity in respect of a primary factor is not determinative. It simply means that other factors will be more important in the analysis. For example, GE submits that the presence of an option to purchase at nominal value is a primary factor, and while its presence likely will result in the agreement being characterized as a financing lease, the absence of such an option or, indeed, the presence of an option to purchase at fair market value, means that focus must be directed to the other factors. GE suggests that this approach is consistent with authorities which hold that agreements without an option to purchase may still be classified as financing leases when the other indicia of financing leases are present.

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

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

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

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

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

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

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

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

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

V. Specific Leases

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

1. <u>The leases</u>

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

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

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

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

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

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

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

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

2. <u>Lease-specific arguments of the parties</u>

(a) Scott Capital

[80] Scott Capital asserts that it did not structure its leases in such a way that Cow Harbour was financing its purchase of the equipment or accruing equity in the equipment over the lease term. Rather, Scott Capital structured the leases to ensure that the use, condition and value of the equipment were being controlled and maintained, as Scott Capital expected that Cow Harbour

would return the equipment to it at the end of the lease terms. As the affiant stated on cross-examination:

> A. You will see that the terms on these leases are different. And part of that is because we feel that certain equipment may be perhaps more abused. Certain equipment naturally has a different life than other equipment.
>
> But that type of an analysis is factored into whether or not we will enter into a 48-month lease or perhaps a 60-month lease. If we think that equipment will be used gingerly, then we will perhaps enter into a longer-term lease. If we think that equipment will be used harshly in harsh conditions, we want to put it on a shorter-term lease. There always has to be value on that equipment in the event that it's returned.

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

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

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

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

(b) Monitor

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

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leased equipment at the time Cow Harbour was to exercise the option may exceed the purchase option price.

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

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

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

(c) GE

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

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

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

[91] GE maintains that, if this Court accepts Scott Capital's assertion that the purchase price options in the Schedule 003, Schedule 004 and Schedule 005 leases were for fair market value, it would be accepting form over substance. Scott Capital's affiant confirmed that the amount of the security deposit that Cow Harbour paid in respect of each of these three leases at the outset of the

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leases was equal to Scott Capital's internal estimate of the remaining value of the equipment at the conclusion of the leases. Said differently, Cow Harbour, at the outset of the lease, paid what was estimated to be the equipment's remaining value at the conclusion of the lease, leaving Cow Harbour with a nominal purchase option.

3. Decision

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

1. Whether there was an option to purchase for a nominal sum - No, the purchase price was reflective of fair market value (see discussion below).

2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment - No.

3. Whether the nature of the lessor's business was to act as a financing agency - The affiant acknowledged financing leases are a small portion of its business.

4. Whether the lessee paid sales tax incidental to acquisition of the equipment - Yes.

5. Whether the lessee paid all other taxes incidental to ownership of the equipment -Yes.

6. Whether the lessee was responsible for comprehensive insurance on the equipment - Yes.

7. Whether the lessee was required to pay any licence fees for operation of the equipment at its expense - Yes.

8. Whether the agreement placed the entire risk of loss on the lessee - Yes.

9. Whether the agreement included a clause permitting the lessor to accelerate payment of rent on default by the lessee and granted remedies similar to those of a mortgage - Yes.

10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease - Yes.

11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment - Yes.

> 12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a UCC financing statement - Not applicable.
>
> 13. Whether there was a default provision in the lease inordinately favourable to lessor - Yes.
>
> 14. Whether there was a provision in the lease for liquidated damages - Yes.
>
> 15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor - Yes.
>
> 16. Whether the aggregate rentals approximated the value of the purchase price of the equipment - Yes.

[93] What do these results establish?

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

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

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

[96] In ***Re Ontario Equipment (1979) Ltd.*** (1981), 33 OR (2d) 648 at para 9 (HCJ), aff'd (1982), 35 OR (2d) 194 (CA), Henry J.considered the nature of the option to purchase to be a critical factor in distinguishing between true leases and financing leases in personal property security legislation cases, stating:

> The test in determining whether an agreement is a true lease or a conditional sale is whether the option to purchase at the end of the lease term is for a substantial sum or a nominal amount ... If the purchase price bears a resemblance to the fair market price of the property, then the rental payments were in fact designated to be in compensation for the use of the property and the option is recognized as a real one.

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> On the other hand, where the price of the option to purchase is substantially less than the fair market value of the leased equipment, the lease will be construed as a mere cover for an agreement of conditional sale.

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

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

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

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

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

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> other purpose (such as satisfying income tax authorities). This provides strong evidence that the parties recognize that by the time the option is exercised the lessor has been fully compensated through rental payments and that it matters little to either the lessor or the lessee that the option is or is not exercised.

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

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

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

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

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

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

[107] The Scott Master Lease s 13(f) contained a default clause allowing for liquidated damages to consist of the present value of rents owing to the end of the term, plus the present value of the residual value of the equipment "which Lessor expected to receive at the expiry of the term of the lease, which is equal to the Fair Market Value of the Equipment as set out in the Equipment Schedule ...," minus the net proceeds from a sale or lease of the equipment. The lease schedules

stated that if Cow Harbour defaulted in its obligations under the lease, Scott Capital would retain the security deposit as liquidated damages.

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

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

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

[110] According to Burke at 294:

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

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

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

> If a lessee is required to pay what is the equivalent of the original cost of the leased property (i.e., the lessor's capital investment), plus a finance charge based on the rate

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> existing at the date of the lease agreement, it does not necessarily follow that such an agreement is a security lease, especially if the lease contains a true fair market value purchase option.
>
> In such a lease, it is possible that the lessee has simply agreed to pay a premium for the use of the leased property.

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[113] The Schedule 003, Schedule 004 and Schedule 005 leases contain specific use limitations with corresponding excess use charges. In ***DaimlerChrysler***, the Chambers Judge found that excess kilometre charges and maintenance obligations were indicative of a true lease as they protected the lessor against reduction of market value on expiry of the lease term due to excess "wear and tear" (at para 25). Burke, however, considered such provisions equally consistent with a financing lease, as they suggest that the lessee bears some risks of ownership (at 296). This Court finds that those provisions are equivocal in the case of the Scott Capital leases.

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

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

> Q. And would I be correct in stating as well that typically if a purchaser or if a lessee does exercise an option to purchase the equipment at the end of the lease, the deposit will be utilized in some fashion to acquire the equipment?
>
> A. It depends on the customer. Some customers want us to reimburse in the form of a cheque their security deposit, and then they pay us a separate cheque for the full amount if they purchase it. And other customers just tell us to net it against their purchase option, making sure that the bill of sale records the correct gross purchase price and then with the reflection that the other amount has been applied.

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

A. There was no discussion with Cow Harbour.

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

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

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

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

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

B. Caterpillar Financial Services Limited (CFSL) Lease

1. <u>The Lease</u>

[120] Cow Harbour leased a Caterpillar off-highway truck from CFSL pursuant to a lease dated March 27, 2006. According to CFSL’s affiant, the original cost of the truck was $2,235,456. The amount shown in the floating rate addendum was $500 more, which CFSL’s affiant explained was a fee payable by Cow Harbour (transcript of the cross examination of Renee Bertha Fournier, 21

October 2011, p. 7, ll 32-41). The lease term was 60 months. The lease required Cow Harbour to pay irregular monthly payments pursuant to the terms of the irregular payment schedule attached to the CFSL lease (6 months at $100,000 and 54 months at $28,397.86). The aggregate amount of those rents was about $2,133,485.

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

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

2. Lease-specific arguments of the parties

(a) CFSL

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

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

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

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

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

- Cow Harbour was required to maintain certain minimum standards of repair with respect to the truck.

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

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[127] Cow Harbour was not required to make a residual payment at the end of the lease term or to guarantee residual value. Cow Harbour could exercise the option or return the truck to CFSL.
[128] CFSL asserts that the presence of other factors, such as the inability of Cow Harbour to exchange or replace the truck; a default provision favourable to CFSL; and the inclusion of the floating rate addendum, should be given less weight in comparison with the fair market value option to purchase. Equipment lessors are in the business of making money and the floating rate addendum simply reflects its cost of capital or a return of investment.

[129] CFSL relies on ***DaimlerChrysler*** in arguing that the acceleration of rent on default is equivocal.

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

(b) Monitor

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

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

(c) GE

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

- CFSL charged interest to Cow Harbour equivalent to its cost of acquiring the truck;

- the interest rate that CFSL charged fluctuated over the term of the lease, according to the cross-examination of CFSL's affiant (transcript of the cross-examination of Renee Bertha Fournier, 21 October 2011, p.6, ll 5-8);

- Cow Harbour had the option, at any time over the term of the lease, to lock into a fixed interest rate equal to the rate of interest charged to CFSL on fixed rate loans (transcript of the cross-examination of Renee Bertha Fournier, 21 October 2011, p.8, ll 30-41; p.9, ll 1-4);

- at the end of the lease, Cow Harbour's final rent payment was subject to a credit or debit adjustment on the interest rate fluctuation over the term of the lease.

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

3. <u>Decision</u>

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

1. Whether there was an option to purchase for a nominal sum - No, the purchase price was reflective of fair market value.

2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment - No.

3. Whether the nature of the lessor's business was to act as a financing agency - It acted as both a financing and a leasing company, according to its affiant.

4. Whether the lessee paid sales tax incidental to acquisition of the equipment - The lessee was to pay any taxes due on its exercise of the sale option.

5. Whether the lessee paid all other taxes incidental to ownership of the equipment - Yes.

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6. Whether the lessee was responsible for comprehensive insurance on the equipment - Yes.

7. Whether the lessee was required to pay any licence fees for operation of the equipment at its expense - Not specifically in the lease agreement
8. Whether the agreement placed the entire risk of loss on the lessee - Yes.

9. Whether the agreement included a clause permitting the lessor to accelerate payment of rent on default by the lessee and granted remedies similar to those of a mortgage - Yes.

10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease - Yes.

11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment - No.

12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a UCC financing statement - Not applicable.

13. Whether there was a default provision in the lease inordinately favourable to lessor - Yes.

14. Whether there was a provision in the lease for liquidated damages - Yes

15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor - Yes.

16. Whether the aggregate rentals approximated the value of the purchase price of the equipment - Yes, if interest payments are added to the rent.

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

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

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

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

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

[140] Some of the terminology that CFSL used in the floating rate addendum suggests that it is an addendum to a financing lease agreement. The terminology includes "principal balance," which is defined as "equal to the amount of credit extended of $2,235,956.00, as adjusted by amortization during the term of the Contract" (emphasis added). Also, "gross lease" was defined as meaning "the total Amount of Credit Extended and Aggregate Finance Charge(s) payable hereunder" (emphasis added). These definitions, however, are not definitive and this Court must look at the lease as a whole.

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

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

C. Wajax Industries (Wajax) Leases

1. The Leases

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

Lease number (Monitor's Report)	Date day/month /year	Initial Term (months)	Original Cost of Equipment	Monthly Rental	Option Price	Assessed Value June 2010
196	12/11/2008	6	$439,810	$16,500	$439,810,	$130,000

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					less a % of rent payments	
198	8/4/2009	6	$1,681,500	$40,000	$1,681,500, less a % rent payments	$450,000
197	8/4/2009	6	$991,860	$30,000	$991,860, less a % of rent payments	$175,000

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

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

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

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

2. <u>Lease specific arguments of the parties</u>

(a) Wajax

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

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

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

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

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

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

(b) Monitor

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

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

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

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(c) GE

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

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

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

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

3. <u>Decision</u>

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

1. Whether there was an option to purchase for a nominal sum - No, the option purchase price was reflective of fair market value.

2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment - Yes, but contingent on the option to purchase being exercised.

3. Whether the nature of the lessor's business was to act as a financing agency - No.

4. Whether the lessee paid sales tax incidental to acquisition of the equipment - Yes.

5. Whether the lessee paid all other taxes incidental to ownership of the equipment - Yes

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6. Whether the lessee was responsible for comprehensive insurance on the equipment - Yes.

7. Whether the lessee was required to pay any licence fees for operation of the equipment at its expense - Yes.

8. Whether the agreement placed the entire risk of loss on the lessee - Yes.

9. Whether the agreement included a clause permitting the lessor to accelerate payment of rent on default by the lessee and granted remedies similar to those of a mortgage - Yes, but only 30 percent of the aggregate rental charges for the unexpired portion of the term, as a pre-estimate of liquidated damages.

10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease - Wajax is the exclusive dealer for Hitachi equipment in Canada. The equipment was new when it provided the equipment to Cow Harbour.

11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment - No. However, rent for the minimum rental period was payable before delivery of the equipment.

12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a UCC financing statement - Not applicable.

13. Whether there was a default provision in the lease inordinately favourable to lessor - No (see discussion below).

14. Whether there was a provision in the lease for liquidated damages - Yes (see discussion below).

15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor - Yes.

16. Whether the aggregate rentals approximated the value of the purchase price of the equipment - No.

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

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

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

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

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

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

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

1. The Leases

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

Lease number	**Date day/month/year**	**Initial Term (months)**	**Original Cost of Equipment**	**Monthly Rental**	**Option Price**
ZNCS1001	2/2/ 2010	66	$202,738.90	$4,122.95 (plus one	$20,268 at 60 months,

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				initial payment of $20,468)	FMV at 66 months
ZNEW1002	10/2/2010	66	$145,000.00	$2,979.99 (plus one initial payment of $14,700)	$14,500 at 60 months, FMV at 66 months
ZEX1002	2/2/ 2010	66	$101,369.00	$2,061.48 (plus one initial payment of $10,334)	$10,134 at 60 months, FMV at 66 months
ZNEY1002	10/2/2010	66	$101,369.00	$2,061.48 (plus one initial payment of $10,334)	$10,134 at 60 months, FMV at 66 months

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

2. Lease-specific arguments of the parties

(a) Kempenfelt

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

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

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

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(b) Monitor

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

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

(c) GE

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

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

3. <u>Decision</u>

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

1. Whether there was an option to purchase for a nominal sum - See discussion below.

2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment - No.

3. Whether the nature of the lessor's business was to act as a financing agency - Yes.

4. Whether the lessee paid sales tax incidental to acquisition of the equipment - Yes.

5. Whether the lessee paid all other taxes incidental to ownership of the equipment - Yes.

6. Whether the lessee was responsible for comprehensive insurance on the equipment - Yes

7. Whether the lessee was required to pay any licence fees for operation of the equipment at its expense - Yes.

8. Whether the agreement placed the entire risk of loss on the lessee - Yes.

9. Whether the agreement included a clause permitting the lessor to accelerate payment of rent on default by the lessee and granted remedies similar to those of a mortgage - Yes.

10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease - Yes.

11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment - The leases refer to a security deposit in clause 20.

12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a UCC financing statement - Not applicable.

13. Whether there was a default provision in the lease inordinately favourable to lessor - Kempenfelt was permitted to accelerate rent on default.

14. Whether there was a provision in the lease for liquidated damages - Yes.

15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor - Yes.

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16. Whether the aggregate rentals approximated the value of the purchase price of the equipment - Yes.

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

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

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

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

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

E. Concentra Financial (Concentra) Lease

1. The Leases

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

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

[182] Attached as part of an appendix to the Monitor's 13th Report was a Concentra lease credit approval relating to this equipment. Concentra approved a "loan" of $2,075,000, with an "origination fee" of $21,000 and contract initiation fee of $5,188. Monthly rental was shown as $35,224.78, with the term being 60 months. Approval was said to be subject to a "rental" payment in advance of $100,000. Also attached was a Capital City Savings amortization schedule for a $2,075,000 loan, at a nominal annual rate of 8.321 percent, compounded monthly, showing the

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payments noted above in the lease document, plus a $415,000 payment on February 20, 2011. The copies of these document that this Court reviewed were not signed and Concentra's affiant was not cross-examined on them.

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

2. Lease-specific arguments of the parties

(a) Concentra

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

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

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

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

(b) Monitor

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

[189] As well, the Monitor submits that lease 7958-1 overwhelmingly exhibits the ***Smith Brothers*** indicia of a financing lease. Specifically, ***Smith Brothers*** factors 3 to10 and 13 to16 are present. It notes that the equipment originally was valued at $2,335,456 plus applicable tax, while the total amount that Cow Harbour was to pay during the course of the lease term was $2,593,261.84 plus applicable tax. Therefore, the aggregate rental approximated the value of the purchase price of the equipment, factoring in interest and carrying costs.

(c) GE

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

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

3. <u>Decision</u>

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

1. Whether there was an option to purchase for a nominal sum - No option to purchase in lease 7958-1, but end of term resale value guaranteed; nominal option price for the Alter Moneta Corporation assigned lease.

2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment - No.

3. Whether the nature of the lessor's business was to act as a financing agency - Yes.

4. Whether the lessee paid sales tax incidental to acquisition of the equipment - Yes.

5. Whether the lessee paid all other taxes incidental to ownership of the equipment - Yes.

6. Whether the lessee was responsible for comprehensive insurance on the equipment - Yes

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7. Whether the lessee was required to pay any licence fees for operation of the equipment at its expense - Yes.

8. Whether the agreement placed the entire risk of loss on the lessee - Yes.

9. Whether the agreement included a clause permitting the lessor to accelerate payment of rent on default by the lessee and granted remedies similar to those of a mortgage - Yes.

10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease - Yes.

11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment - There was a down payment for both leases.

12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a UCC financing statement - Not applicable.

13. Whether there was a default provision in the lease inordinately favourable to lessor - Yes.

14. Whether there was a provision in the lease for liquidated damages - Yes.

15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor - Yes.

16. Whether the aggregate rentals approximated the value of the purchase price of the equipment - Yes, in terms of lease 7958-1, but the aggregate would not account for financing charges on the full amount. However, the aggregate was equal to a lesser amount with monthly compounded interest. Yes, in terms of the Alter Moneta Corporation assigned lease.

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

[194] Burke stated at 294 that:

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

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

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

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

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

F. Alter Moneta Corporation (Alter Moneta) Lease

1. The Lease

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

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

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

2. Lease-specific arguments of the parties

(a) Alter Moneta

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

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

(b) GE

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

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

3. <u>Decision</u>

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

1. Whether there was an option to purchase for a nominal sum - Yes, the option purchase price was $1 at the end of the term.

2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment - No.

3. Whether the nature of the lessor's business was to act as a financing agency - Yes.

4. Whether the lessee paid sales tax incidental to acquisition of the equipment - Yes.

5. Whether the lessee paid all other taxes incidental to ownership of the equipment - Yes.

6. Whether the lessee was responsible for comprehensive insurance on the equipment - Yes

7. Whether the lessee was required to pay any licence fees for operation of the equipment at its expense - Yes.

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8. Whether the agreement placed the entire risk of loss on the lessee - Yes.

9. Whether the agreement included a clause permitting the lessor to accelerate payment of rent on default by the lessee and granted remedies similar to those of a mortgage - Yes.

10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease - Yes.

11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment - There is a large down payment required, although it is referred to as “rent.”

12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a UCC financing statement - Not applicable.

13. Whether there was a default provision in the lease inordinately favourable to lessor - Yes.

14. Whether there was a provision in the lease for liquidated damages - Yes.

15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor - Yes.

16. Whether the aggregate rentals approximated the value of the purchase price of the equipment - Yes.

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

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

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

1. The Lease

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

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

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

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

2. Lease-specific arguments of the parties

(a) Key Equipment

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

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

(b) Monitor

[215] The Monitor submits that this lease was a financing lease since the end of term purchase option price (approximately 10 percent of the original value of the equipment) appears to be

arbitrary, rather than bearing some connection to what the actual value of the equipment might be at the time Cow Harbour could exercise the option.

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

(c) GE

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

3. <u>Decision</u>

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

1. Whether there was an option to purchase for a nominal sum - There was an option, but it was not for a nominal sum.

2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment - No.
3. Whether the nature of the lessor's business was to act as a financing agency - Yes.

4. Whether the lessee paid sales tax incidental to acquisition of the equipment - Yes.

5. Whether the lessee paid all other taxes incidental to ownership of the equipment - Yes.

6. Whether the lessee was responsible for comprehensive insurance on the equipment - Yes.

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7. Whether the lessee was required to pay any licence fees for operation of the equipment at its expense - Yes.

8. Whether the agreement placed the entire risk of loss on the lessee - Yes.

9. Whether the agreement included a clause permitting the lessor to accelerate payment of rent on default by the lessee and granted remedies similar to those of a mortgage - Yes.

10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease - Yes.

11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment - There was a substantial down payment.

12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a UCC financing statement - Not applicable.

13. Whether there was a default provision in the lease inordinately favourable to lessor - Yes.

14. Whether there was a provision in the lease for liquidated damages - Yes.

15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor - Yes.

16. Whether the aggregate rentals approximated the value of the purchase price of the equipment - Yes.

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

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

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leased property at the end of the term will likely be construed as effectively requiring the lessee to acquire the leased property.

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

VI. Conclusions

[221] This Court categorizes the Disputed Leases as follows:

A. Scott Capital's leases were true leases.

B. CFSL's lease was a true lease.

C. Wajax's leases were true leases.

D. Kempenfelt's leases were financing leases.

E. Concentra's lease was a true lease. The Alter Moneta lease assigned to Concentra was a financing lease.

F. Alter Moneta lease was a financing lease.

G. The Alter Moneta lease assigned to Key Equipment was a financing lease.

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

Heard on the 2nd and 3rd days of November, 2011.
Dated at the City of Edmonton, Alberta this 23rd day of January, 2012.

K.D. Yamauchi
J.C.Q.B.A.

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2012 ABQB 59 (CanLII)

TAB 8

Date: 19980331
Docket: 03189
Registry: Prince George

IN THE SUPREME COURT OF BRITISH COLUMBIA

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

AND

IN THE MATTER OF THE COMPANY ACT, R.S.B.C. 1996, c. 62

AND

IN THE MATTER OF SMITH BROTHERS CONTRACTING LTD. SMITH'S HEAVY HAULING LTD. COTTONWOOD RIVER HOLDINGS LTD. and T.R. GRADING LTD.

PETITIONERS

REASONS FOR JUDGMENT

OF THE

HONOURABLE MR. JUSTICE BAUMAN

Counsel for the Petitioners:	Mr. Jan Christianson
Counsel for Ford Credit Canada Ltd.:	Ms. B. J. Brown
Counsel for G. E. Capital Canada Equipment Financing Inc. and G. E. Capital Canada Leasing Services Inc.:	Mr. J. K. Dungate
Counsel for Toronto Dominion Bank:	Mr. M. J. Brecknell
Counsel for Bank of Nova Scotia:	Mr. D. Marcotte
Place and Date of Hearing:	Prince George, B.C. 2 February 1998

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I INTRODUCTION

[1] Ford Credit Canada Ltd. ("Ford Credit") brings this application in the context of proceedings commenced by the petitioners (collectively "Smith Brothers") under the ***Companies' Creditors Arrangement Act***, R.S.C. 1985, c. C-36 (the "CCAA").

[2] Ford Credit seeks leave of the court to terminate one conditional sales contract and eight "leases" held by Smith Brothers in respect of nine Ford trucks. I put "leases" in quotation marks because the characterization of these documents is at the heart of the controversy before me.

[3] The central issue involves the proper interpretation of s. 11.3(a) of the CCAA. This subsection was added to the ***Act*** as part of amendments proclaimed in force on 30 September 1997. It creates a specific exception to a s. 11 stay order. It reads:

> 11.3 No order made under s. 11 shall have the effect of
>
> (a) prohibiting a person from requiring immediate payment for goods, services, use of leased or licenced property or other valuable consideration provided after the order is made;

[4] By the date of hearing, Smith Brothers had voluntarily returned four of the leased vehicles to Ford Credit.

II RELIEF SOUGHT

[5] On 19 December 1997, Mr. Justice Meiklem made the initial stay order under s. 11 of the CCAA (the "Stay Order"). It was effective until 18 January 1998. It was extended to 26 January 1998 by the order of Mr. Justice R. D. Wilson on 12 January 1998. It was further extended until dismissal of the petition or further order of the court by the order of Mr. Justice Williamson made 26 January 1998.

[6] Two clauses in the Stay Order are potentially relevant on the facts before me.

[7] The first is at page 4, paragraph (i) of the Stay Order. In its essential terms this paragraph reads:

> (i) All persons having agreements with the petitioner (*sic*) whether written or oral for the supply of goods or services to the petitioner (*sic*) (including, without limitation, leases of goods, . . . equipment leases, . . .) are enjoined from accelerating, terminating, determining or cancelling such agreements and that such person shall continue to supply the goods or services pursuant to the provisions of such agreements so long as the petitioner pays the prices or charges under the agreements for such goods or services incurred . . . after the Filing Date concurrently with such supply . . .

[8] I conclude that the payment proviso in this paragraph, to the extent that it covers leased property, is simply a

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reflection of the limitation on any stay order found in s. 11.3(a) of the CCAA.

[9] The second relevant clause is paragraph (j) on page 5 of the Stay Order. It reads in part:

> (j) All persons having other agreements or other contracts with the Petitioner are restrained and enjoined from accelerating, terminating, determining or cancelling such agreements or acting upon any right or forfeiture (*sic*) (statutory, contractual or otherwise) without the consent of the petitioner, or leave of this court and that all such persons shall continue to perform and observe the terms, conditions and provisions contained in such agreements on their part to be performed or observed. . .

[10] The interplay between these clauses and s. 11.3(a), on the facts at bar, raises a number of possibilities. If Ford Credit can bring its agreements under s. 11.3(a), it may demand payment for the use of the vehicles after the Filing Date without leave of the court. This is so under s. 11.3(a) and it is buttressed (perhaps unnecessarily) by the payment proviso in clause (i) of the Stay Order.

[11] If, on the other hand, s. 11.3(a) is not engaged, in order to demand payment and thereafter seize the vehicles, Ford Credit would require the written consent of the petitioners or leave of the court under clause (j) of the Stay Order.

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[12] I say immediately that if Ford Credit is before the court under clause (j), I am not inclined to grant leave because that would tend to undermine Smith Brothers' efforts to rearrange its affairs under the CCAA before the merits of that arrangement have been considered. It would, as well, do so in a manner tending to favour Ford Credit -- only one of many creditors.

[13] I turn to Ford Credit's Notice of Motion.

[14] It seeks leave of the court permitting it to terminate "all contracts and vehicle leases with Smith Brothers Contracting Ltd." and to seize the vehicles. It seeks this relief "pursuant to the order of Mr. Justice Meiklem granted December 19, 1997 herein".

[15] This leads to a number of observations. First, if Ford Credit can bring itself within clause (i) of the Stay Order, leave of the court to do that which it proposes is not necessary in light of the payment proviso. Further, or perhaps more properly of initial importance, s. 11.3(a) precludes anything in the Stay Order from preventing Ford Credit, if it can bring itself within the terms of the section, from demanding payment for the use of the vehicles after the Filing Date. I interject to say that I construe s. 11.3(a) to mean that if one can require immediate payment for the use of leased property after the Stay Order is made, impliedly one is then

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entitled, in the absence of payment, to retake the goods (if, of course, that remedy is reserved to the lessor).

[16] Third, it follows that by seeking leave, Ford Credit must be doing so under clause (j) of the Stay Order. This is obviously not the basis upon which Ford Credit has put its case and accordingly I will consider its application as one seeking the direction of the court on the applicability of s. 11.3(a) (and clause (i) of the Stay Order) to the arrangements covering the vehicles. To the extent that Ford Credit is unable to bring itself within s. 11.3(a), I have considered the possibility of granting leave under clause (j) but choose not to for the reasons set out above.

III THE MERITS

[17] I can deal quickly with the conditional sales agreement covering the 1993 Ford F 350 Crewcab. It is neither in form nor substance a lease of property and accordingly it comes within clause (j) of the Stay Order. Leave is not granted in respect of this vehicle.

[18] The "leases" present an issue of considerable difficulty and require a consideration of the breadth of s. 11.3(a) of the CCAA, which, I am told by counsel, is a matter of first impression. My research has suggested this as well.

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[19] I will first deal with what is in the nature of a threshold issue, that is, whether s. 11.3(a) extends to a lease of property made before the stay order. I conclude that it does, in respect of payment for use of that property after the date of the stay order. If s. 11.3(a) was intended to apply only to leases entered into after the stay order, one would expect the section to read to the effect:

> 11.3 No order made under section 11 shall have the effect of
>
> (a) prohibiting a person from requiring immediate payment for goods, services, leased or licensed property or other valuable consideration provided after the order is made. (underlining added)

By instead wording the section as it has, Parliament, to my mind, is saying that it is the provision of the use of leased property, not the making of the lease itself, after the stay order, which is within the purview of s. 11.3(a).

[20] This view is supported by what scant academic writing on the section there is at this time. In ***L.W. Houlden and G.B. Morawetz*** Bankruptcy and Insolvency Law of Canada, 3rd Ed. (Toronto: Carswell), the learned authors note in their commentary on s. 11.3:

> (13) *Suppliers of Goods and Services or Rental of Property to the Debtor after the Filing of a Plan.*

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> If a person supplies goods and services or the debtor continues to occupy or use leased or licensed property, no stay order can be made in respect of such goods and services or leased or licensed property: s. 11.3.

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[21] It is the essential submission of Smith Brothers that a "lease" for the purposes of s. 11.3(a) should be narrowly construed. It is argued that an arrangement which may partake in part of a "lease" at law should not be so construed for the purpose of s. 11.3(a) if, upon close analysis, it is more than a true lease or rental agreement. This would be the case if, for example, it is essentially a financing arrangement facilitating the eventual acquisition of the vehicle.

[22] In pursuing this submission Smith Brothers cites cases considering the lease/conditional sales contract dichotomy in the context of personal property security legislation across Canada.

[23] For the purposes of this discussion I will use Professor R.C.C. Cuming's definition of a "true lease":

> . . . the term "lease" is used to refer to any transaction denominated a lease by the parties. A lease which is in substance a bailment contract is referred to as a true lease. A lease which is not a bailment, but a disguised security agreement is referred to as a security lease or security agreement. "True Leases and Security Leases Under Canadian Personal Property Security Acts" (1983) 7 Can. Bus. L.J. 251 at 256.

[24] Ford Credit responds by submitting that nothing in s. 11.3(a) requires the court to invoke a PPSA analysis in construing the phrase "leased property". There is nothing ambiguous, it is urged, about that term or about the concept of a "lease" at law. In particular, Ford Credit says that there is no reason to read down "lease" for the purposes of s. 11.3(a) of the CCAA, which, it is said, is effectively the submission of the petitioners.

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[25] Obviously the phrase "leased property" requires some construction and any arrangement which purports to be a lease of property must be analyzed to ensure that it is one within the meaning of s. 11.3(a). To hold otherwise would permit creditors to so arrange the form of their contracts to avoid one of the major objectives of the CCAA, that is:

> . . . to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors to the end that the company is able to continue in business [per Gibbs J.A. in ***Hongkong Bank of Canada v. Chef Ready Foods Ltd.*** (1990), 4 C.B.R. (3d) 311 (B.C.C.A.) at 315].

[26] In my view, one must have regard to the substance rather than simply the form of the arrangement in considering the application of s. 11.3(a).

[27] Having said what may be obvious, it is still necessary to consider whether s. 11.3(a) covers all leases or only those

which might be characterized as true leases. Is a lease which is more than that -- what I will call a "Lease Plus" -- excluded from the effect of s. 11.3(a) on a proper construction thereof?

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[28] The most common form of Lease Plus, and the one which is at bar, is a lease with an option to purchase.

[29] Smith Brothers says that it has historically acquired vehicles and equipment for its logging concern through a variety of methods. These include conditional sales agreements, term loans with chattel mortgages, and lease/option agreements. Each arrangement is essentially an alternative method of acquiring vehicles and equipment, although Smith Brothers admits that it has not always exercised its options to purchase leased property.

[30] If s. 11.3(a), properly construed, elevates form over substance, then anomalies arise under the CCAA. As in the case at bar, property acquired by way of lease/option can be lost to the debtor while that acquired by term loan or conditional sales agreement would not (at least not without the leave of the court).

[31] The critical issues, then, are whether s. 11.3(a) is to be construed as covering all leases, including all forms of Lease Plus, or whether it is to be confined to "true leases" and if

so, what are the criteria upon which certain forms of Lease Plus are to be excluded?

[32] Much PPSA litigation has of course concerned itself with whether a document in the form of a lease is nevertheless to be considered a financing agreement.

[33] However, it will be observed that the need and basis for segregating various types of leases is expressly dictated by the PPSA. That is, the legislation distinguishes between a true lease and one which creates a security interest, that is one which in reality secures payment or performance of an obligation.

[34] There is no express need to distinguish between forms of leases under s. 11.3(a) of the CCAA. Does a proper construction of the section imply that need?

[35] I approach the construction of s. 11.3(a) by considering the intention of Parliament and the object and scheme of the CCAA.

[36] The Court of Appeal considered the purposes of the CCAA in ***Chef Ready Foods Ltd., supra***.

[37] Mr. Justice Gibbs made reference to S. E. Edwards, "Reorganization Under the ***Companies' Creditors Arrangement Act***"

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(1947), 25 Can. Bar Rev. 587 as explaining "very well the historic and continuing purposes of the Act" (at 318):

> It is important in applying the C.C.A.A. to keep in mind its purpose and several fundamental principles which may serve to accomplish that purpose. Its object, as one Ontario judge has stated in a number of cases, is to keep a company going despite insolvency. Hon. C. H. Cahan when he introduced the bill into the House of Commons indicated that it was designed to permit a corporation, through reorganization, to continue its business, and thereby to prevent its organization being disrupted and its goodwill lost. It may be that the main value of the assets of a company is derived from their being fitted together into one system and that individually they are worth little. The trade connections associated with the system and held by the management may also be valuable. In the case of a large company it is probable that no buyer can be found who would be able and willing to buy the enterprise as a whole and pay its going concern value. The alternative to reorganization then is often a sale of the property piecemeal for an amount which would yield little satisfaction to the creditors and none at all to the shareholders.
>
> (Gibbs J.A. quoting Edwards)

[38] Mr. Justice Gibbs was considering whether the CCAA could operate to stay a bank's realization under a s. 178 ***Bank Act*** security. In holding that it could, Mr. Justice Gibbs noted that Canadian courts "have shown themselves partial to a standard of liberal construction which will further the policy objectives" of the CCAA (at 320). [On the purpose and object of the CCAA see also ***Re Repap British Columbia Inc.*** (9 January 1998), Vancouver A970588 (B.C.S.C.) and ***Re Starcom International Optics Corporation*** (6 March 1998), Vancouver A980298 (B.C.S.C).]

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[39] ***Chef Ready Foods Ltd., supra*** was considered by the Ontario Court of Appeal in ***Nova Metal Products Inc. v. Comiskey (Trustee of)*** (1990), 1 O.R. (3d) 289, 1 C.B.R. (3d) 101.

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[40] Finlayson J.A. (Krever J.A. concurring) said this of the purpose of the CCAA (at O.R. 297):

> It is well established that the CCAA is intended to provide a structured environment for the negotiation of compromises between the debtor company and its creditors for the benefit of both. Such a resolution can have significant benefits for the company, its shareholders and employees. For this reason the debtor companies, Elan and Nova, are entitled to a broad and liberal interpretation of the jurisdiction of the court under the CCAA.

Doherty J.A. dissented, but his views on the purpose and objects of the CCAA reflect those of Gibbs J.A. in ***Chef Ready Foods Ltd., supra*** Mr. Justice Doherty writes (at O.R. 306-307):

> The legislation is remedial in the purest sense in that it provides a means whereby the devastating social and economic effects of bankruptcy or creditor initiated termination of ongoing business operations can be avoided while a court supervised attempt to reorganize the financial affairs of the debtor company is made. . . . The Act must be given a wide and liberal construction so as to enable it to effectively serve this remedial purpose, ***Interpretation Act*** R.S.C. 1985, c. I-21, s. 12; ***Chef Ready Foods Ltd. v. HongKong Bank of Canada, supra*** *(sic)*, at p. 14 of the reasons.

[41] I approach s. 11.3(a) with that spirit, that is, with the perspective that a liberal construction which furthers the policy objectives of the ***Act*** will dictate a narrow construction of the types of arrangement which are excepted from a stay order under s. 11.3(a). I underline, however, that any such construction must be intellectually defensible on the basis of the words which Parliament has used in the section -- I am not to redraft the section in the guise of construing it.

[42] The decision of the Court of Appeal in ***Quintette Coal Ltd. v. Nippon Steel Corp.*** (1990), 51 B.C.L.R. (2d) 105 is also of assistance.

[43] There, certain Japanese corporate debtors of Quintette Coal Ltd. ("Quintette") sought to set off monies owing to them by Quintette against payments due Quintette for deliveries of coal. Quintette was then under CCAA protection and the issue centered on the scope of s. 11 and the jurisdiction to restrain the proposed setoff.

[44] Gibbs J.A. cited numerous decisions on s. 11 and concluded (at 113):

> To the extent that a general principle can be extracted from the few cases directly on point, and the others in which there is persuasive obiter, it would appear to be that the courts have concluded that under s. 11 there is a discretionary power to restrain judicial or extra judicial conduct against the debtor company the effect of which is, or would be, seriously to impair the ability of the debtor company to continue in business during the compromise

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> or arrangement negotiating period. The power is discretionary and therefore to be exercised judicially. It would be a reasonable expectation that it would be extremely unlikely that the power would be exercised where the result would be to enforce the continued supply of goods and services to the debtor company without payment for current deliveries, whereas it would not be unlikely when the result would be to enforce payment for goods thereafter taken from or services thereafter received from the debtor company, as is the case here. In cases not involving the supply or receipt of goods or services, no doubt judicial exercise of the discretion would produce a result appropriate to the circumstances.
>
> The order made by Mr. Justice Thackray was in accord with his understanding of the "overall intention of the Act" and consistent with the reported cases. It falls well within the "general principle" distilled from those cases. At p. 199, after considering the submissions of counsel for the Japanese companies, he said:
>
> > I must look to the overall intention of the Act, and, as has been put before me by Quintette, what is required within an order to allow Quintette the time to reorganize and make a proposal. Unless there is a sound legal principle for doing so, I must not carve out one portion of the order and give an advantage to one creditor over another. I have not acceded to the arguments of counsel for J.S.I. and consequently I cannot find the legal basis for compromising the effect of the ex parte order.

[45] It is interesting that Gibbs J.A. suggested that it would be unlikely that a court would exercise its s. 11 jurisdiction:

> . . . where the result would be to enforce the continued supply of goods and services to the debtor company without payment for current deliveries . . .

[46] Parliament has now precluded that by adding s. 11.3(a) to the CCAA. It is instructive to note, however, that the

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subsection has been added against the backdrop of jurisprudence which has underlined the very broad scope of the court's jurisdiction to stay proceedings under s. 11.

[47] To repeat the relevant portion of the section:

> 11.3 No order made under s. 11 shall have the effect of
>
> (a) prohibiting a person from requiring immediate payment for . . . use of leased or licenced property. . . provided after the order is made;

It is noted that the remedy which is preserved for creditors is a relatively narrow one; it is the right to require immediate payment for the use of the leased property.

[48] "Payment for use" is the essential basis of a true lease covering personal property. As Professor Cuming notes (in "True Leases", *supra*, at 263):

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

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[49] In the lease/option agreements at bar, the remedy which Ford Credit invokes is found in clause 21 of the Agreements. That clause reads:

> Default: If You Fail to make any payment under this Lease when it is due, or if You fail to keep any other agreement in this Lease, Dealer may terminate this Lease and take back the Vehicle. Dealer may go on your property to retake the Vehicle. Even if Dealer retakes the Vehicle, You must still pay at once the monthly payments for the rest of the lease term and any other amounts that You owe under this Lease. Dealer will subtract from the amount owed sums received from the sale of the Vehicle in excess of what Dealer would have had invested in the Vehicle at the end of the lease term. You must also pay all expenses paid by Dealer to enforce Dealer's rights under this Lease, including reasonable solicitors' fees as permitted by law, and any damages caused to Dealer because of your default. Dealer may sell the Vehicle at public or private sale with or without notice to You.

[50] Now I should say that Ford Credit does not indicate in its Notice of Motion that it expressly invokes clause 21, but I conclude that I must analyze the case on the basis that it seeks to pursue its contractual remedies. What else can it pursue but the remedies for which it has bargained?

[51] Ford Credit may say that it is prepared, at this time, to forego the benefit of the acceleration provision in clause 21. But this overlooks the fact that clause 21, regardless of whether it is fully invoked, nevertheless assists us in characterizing what the document is as a matter of law. Further, the invocation of clause 21 is not the unilateral decision of Ford Credit. The lessee is entitled to insist on

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the sale of the vehicle and the benefit of any credit in his or her favour as set out in the clause.

[52] Returning to the analysis, s. 11.3(a), by referring to "payment for use", evokes, as I have said, the notion of a true lease arrangement.

[53] Clause 21 of the lease/option agreements is hardly that. Not only is the lessee dispossessed of the vehicle on default, he or she is still liable for the monthly payments for the unexpired term. The lessee in that situation is of course credited with the amount, if any, which the dealer receives on a resale of the vehicle "in excess of what Dealer would have had invested in the Vehicle at the end of the lease term".

[54] Clause 21 is not limited to "payment for use". It goes far beyond that and secures the entire term of lease payments.

[55] The presence of the acceleration provision is itself telling. Once again, I refer to Professor Cuming's article (*supra*, at 279):

> Some American courts have recognized as an *indicium* of a security agreement a provision in a lease under which failure by the lessee to make one or more lease payments or to otherwise to perform his obligations under the contract permits the lessor to accelerate a payment date for all unpaid lease payments. An acceleration clause is important in an instalment debt transaction between a debtor and a creditor because it enables the creditor on default by his debtor to seek the payment of the entire debt rather

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> than having to wait until each instalment comes due. However, while the relationship between a lessor and a defaulting lessee may be one of creditor and debtor, an acceleration clause should, at least, in some cases, be viewed as foreign to the lessor -- lessee relationship. Unlike a defaulting buyer or borrower, a lessee is generally not obligated under the rules of damages to pay a specific predetermined sum to the lessor. The lessor may well be entitled to damages for breach of contract, but there is no certainty that those damages will be assessed as the equivalent of all rental payments owing under the lease with or without deduction of an amount realized from the sale of the leased chattels by the lessor. (footnotes omitted)

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

[57] To put the matter in a slightly different way: Ford Credit's lease does not simply require "payment for . . . use of leased or licenced property", clause 21 secures payments when the property will clearly not be <u>used</u> by the lessee after a default and a retaking by the lessor.

[58] Further, can one say that the leases here contemplate payments by the lessee only for the use of the vehicles? That after all is the epitome of a true lease -- that is, a contract of bailment. Once again, clause 21 assists. On a default, the lessee is liable for the lease payments for the unexpired term. However, it is contemplated that the dealer will sell the vehicle and:

> . . . will subtract from the amount owed sums received from the sale of the Vehicle in excess of what Dealer would have had invested in the Vehicle at the end of the lease term.

[59] I can only conclude that by crediting the lessee in these circumstances with the excess sum defined in clause 21, the document is implicitly (and fairly) ensuring that even a defaulting lessee will enjoy whatever equity he or she has effectively built up in the vehicle.

[60] From this perspective one can say that the lessee under these leases is not simply paying for use of the vehicle. He or she is potentially acquiring, as well, equity therein.

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

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[62] Having reached this conclusion, what are the criteria for exclusion of arrangements from the scope of s. 11.3(a)? It is here that the PPSA jurisprudence offers some useful guideposts.

[63] ***Re Bronson*** (1995), 34 C.B.R. (3d) 255 is a decision of Master Powers sitting as a Registrar in Bankruptcy. His decision was affirmed on appeal by Mr. Justice Lamperson, (1996), 39 C.B.R. (3d) 33 (B.C.S.C.).

[64] Master Powers' decision offers a thorough review of the law on when a lease/option agreement will be construed as a security agreement for the purposes of the seize or sue provision in s. 67 of the PPSA S.B.C. 1989, c. 36.

[65] Master Powers quotes this extract from R.C.C. Cuming and R.J. Wood, ***British Columbia Personal Property Act Handbook*** (Toronto: Carswell, 1990):

> If a transaction is one under which a party gives or recognizes that someone else has an interest in his or her property in order to secure payment or performance of an obligation, it is a security agreement. (p.31)
>
> If the commercial realities, *i.e.,* the substance of the transaction, point to a secured financing arrangement rather than to a bailment in the case of a lease, or an agency relationship in the case of a consignment, then the transaction is a security agreement even though it takes the form of a lease or consignment, and even though there is no provision vesting title in the lessee or consignee. Likewise the fact that a lease provides for a purchase option exercisable by the lessee does not by itself dictate (as it did under the sale of goods on conditions act)

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> that transaction is to be regarded as a security lease. (p. 31)
>
> The general approach is to examine carefully the relationship between the lessor and lessee in order to determine whether or not in that relationship the standard indicia of a secured credit arrangement are to be found. If the lessee is required to pay what is the equivalent of the lessor's capital investment plus a credit charge at the rate existing at the date of the agreement, there is strong evidence of a secured sale. A clause in a lease giving to the lessee the option to purchase the goods at less than their expected market value (as determined at the date of execution) indicates that the lessee has acquired an equity in the goods not unlike that which would have been acquired under an instalment purchase contract. However, the fact that at the end of a lease term roughly equivalent to the useful life of the goods the lessee can purchase the goods at their then market value does not prevent characterization of the transaction as a security agreement. Evidence that the lessee bears some of the obligations of ownership such as the requirement to repair and insure the goods provide some persuasive but not determinative indication of a security agreement. In one case, the court was prepared to look at the business activities of the lessor to determine whether or not it had a lessor's facilities and methods of operation and to take this into consideration in making the determination. (p.32-33)

[66] The learned Master also referred to a checklist prepared by Professor Cuming in September, 1991 wherein he summarized the considerations taken into account by American courts in determining whether a document is a true lease or a security agreement.

[67] These criteria are as follows:

1. Whether there was an option to purchase for a nominal sum;

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2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment;

3. Whether the nature of the lessor's business was to act as a financing agency;

4. Whether the lessee paid a sales tax incident to acquisition of the equipment;

5. Whether the lessee paid all other taxes incident to ownership of the equipment;

6. Whether the lessee was responsible for comprehensive insurance on the equipment;

7. Whether the lessee was required to pay any and all licence fees for operation of the equipment and to maintain the equipment at his expense;

8. Whether the agreement placed the entire risk of loss upon the lessee;

9. Whether the agreement included a clause permitting the lessor to accelerate the payment of rent upon default of the lessee and granted remedies similar to those of a mortgagee;

10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease;

11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment;

12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a U.C.C. financing statement (this would not apply in Canada);

13. Whether there was a default provision in the lease inordinately favourable to the lessor;

14. Whether there was a provision in the lease for liquidated damages;

15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor;

16. Whether the aggregate rental approximated the value of purchase price of the equipment.

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[68] In my opinion s. 11.3(a) does not, at a minimum, include arrangements which are closer to financing agreements than true leases as discussed in the cases on the PPSA legislation.

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[69] I turn to review these lease/option agreements before me:

> they disclose a "Retail Selling Price/Lease Price of Vehicle";
>
> they contemplate a cash "down payment" or trade-in;
>
> they include an annualized lease rate, that is, I take it, something akin to a financing charge;
>
> they include an option to purchase exercisable by the lessee at the end of the term;
>
> they require that the lessee insure the vehicle;
>
> they exclude warranties by Ford Credit;
>
> they include the default clause to which I have earlier referred;
>
> they require the lessee to pay all sales, use and other taxes;
>
> they require the lessee to pay all maintenance and operating costs.

[70] Counsel for Smith Brothers stresses the absence of warranties flowing from Ford Credit and submits that the essential function and responsibility of Ford Credit under the agreements is to provide financing.

[71] In earlier PPSA litigation, the fact that the option price reflected the approximate residual value of the vehicle at the

conclusion of the term, was thought to weigh heavily against a finding that the arrangement was in essence a financing agreement.

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[72] Here Ford Credit's Customer Service Representative deposes that by her estimate, Smith Brothers does not have equity in any of the leased vehicles and that each is worth significantly less than the current net payout figures.

[73] The president of the petitioner deposes that in his discussions with the manager of the initial vehicle supplier, she indicated that she was confident that they could, if permitted, sell the returned vehicles for a sum in excess of the outstanding amounts under the agreements.

[74] In an early leading case, Henry J. considered the question of the option price in ***Re Ontario Equipment (1976) Ltd.*** (1981), 33 O.R. (2d) 648 (Ont. H.C.J.), affirmed (1982), 35 O.R. (2d) 194 (Ont. C.A.).

[75] Henry J. adopted this practical distinction between a true lease and a lease by way of security (at 651):

> The test in determining whether an agreement is a true lease or a conditional sale is whether the option to purchase at the end of the lease term is for a substantial sum or nominal amount . . . if the purchase price bears a resemblance to the fair market price of the property, then the rental payments were in fact designated to be in compensation for the use of the property and the option is recognized as a

> real one. On the other hand, where the price of the option to purchase is substantially less than the fair market value of the leased equipment, the lease will be construed as a mere cover for an agreement of conditional sale (per Croake D. J. in ***Re Crown Cartridge Corp., Debtor*** (1962) 220 F. Supp. 914).

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[76] Later commentators have noted, however, that the fact that at the end of a lease term roughly equivalent to the useful life of the goods, the lessee can purchase the goods at their market value, does not prevent characterization of the transaction as a security agreement (per Cuming and Wood, quoted in ***Re Bronson, supra***).

[77] In any event, I should stress that it is not necessary for me to reach a conclusion on whether the lease/option agreements before me on this application are security agreements for the purposes of the PPSA. It is enough that I have concluded that s. 11.3(a) does not cover all types of lease arrangement and that, in particular, those at bar are within the class of arrangement not included within the ambit of the section.

[78] Smith Brothers submitted in the alternative that if s. 11.3(a) does apply, nevertheless, if these arrangements are to be properly construed as financing agreements for the purposes of the PPSA, the court enjoys the jurisdiction under s. 63 of that ***Act*** to stay the enforcement of Ford Credit's rights on default.

[79] Counsel for Ford Credit vigorously opposes any such conclusion and submits that on a division of powers analysis, the CCAA has constitutionally occupied the field to the exclusion of the provincial legislation in these circumstances.

[80] Because of the conclusion that I have reached, it is not necessary for me to deal with this submission.

[81] In the result, the motion is dismissed. The petitioners shall have their costs against Ford Credit on Scale 3.

"BAUMAN, J."
Bauman J.

March 31, 1998
Vancouver, B.C.

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TAB 9

PROVINCE OF PRINCE EDWARD ISLAND
PRINCE EDWARD ISLAND COURT OF APPEAL

Citation: WCI v. ADI 2011 PECA 14

Date: 20110713
Docket: S1-AD-1168
Registry: Charlottetown

BETWEEN:

ADI INTERNATIONAL INC.

APPELLANT

AND:

WCI WASTE CONVERSION INC.

RESPONDENT

Before: Chief Justice David H. Jenkins
Justice John A. McQuaid
Justice Michele M. Murphy

Appearances:
Kevin J. Kiley and Michael G. Drake, counsel for the Appellant

James W. Gormley, Q.C., and J. Michael P. McGonnell, counsel for the Respondent

Place and Date of Hearing: Charlottetown, Prince Edward Island, November 15, 16, 17, 18, 19, and 22, 2010

Place and Date of Judgment: Charlottetown, Prince Edward Island, July 13, 2011

Written Reasons by:
Chief Justice David H. Jenkins

Concurred in by:
Justice Michele M. Murphy

Dissented in by:
Justice John A. McQuaid

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CONTRACTS - Design-build - Joint venture - Wrongful termination - Assessment of damages

Per Jenkins C.J.P.E.I. (Murphy J.A. concurring): The parties carried out the design and construction of a central composting facility to serve the province. The province's Crown corporation issued a design-build-operate contract to ADI for the project, and ADI issued sub-contracts to WCI to design and build the composting system and then operate the facility. Near the end of the project, ADI gave notice of default to WCI and then terminated its sub-contracts. WCI sued ADI for breach of contract. ADI counterclaimed for negligence. Each claimed extensive damages against the other. The trial judge granted judgment to WCI and dismissed ADI's counterclaim. ADI appealed regarding both liability and damages. **HELD:** The majority of the Court of Appeal dismissed the appeal regarding liability, and also regarding all heads of damages except one. It allowed the appeal in part regarding damages for breach of the operating contract.

Per McQuaid J.A. (dissenting): The trial judge erred in law when he found the parties contracted to enter into a joint venture and, that in making its decision to terminate the contract, the appellant owed the respondent a fiduciary duty and a duty to act in good faith. A new trial should be ordered.

Authorities Cited:
By Jenkins C.J.P.E.I.:
CASES CONSIDERED: Housen v. Nicholaisen, 2002 SCC 33; ***H.L. v. Canada (Attorney General)***, 2005 SCC 25 ¶9; ***Rick v. Brandsema***,. 2009 SCC 10; ***Morin v. Prince Edward Island Regional Administrative Unit No. 3 School Board***, 2002 PESCAD 9; ***Kennedy v. Croken***, 2008 PESCAD 8; ***Weeks v. O'Connor***, 2009 PECA 13; ***Harris v. Beck Estate***, 2009 PECA 8; ***Ayangma v. French School Board***, 2010 PECA 16; ***Double N Earthmovers Ltd. v. Edmonton (City of)***, 2005 ABCA 104; applied in ***McCain Produce Inc. (c.o.b. McCain Fertilizers) v. P.E.I. Lending Agency***, 2010 PECA 4; ***White v. E.B.F. Manufacturing***, 2005 NSCA 167; ***MacDougall v. MacDougall***, [2005] O.J. No. 5171 (Ont.C.A.); ***Dow Chemical Canada Inc. v. Shell Chemicals Canada Ltd.***, 2010 ABCA 126; ***Waxman v. Waxman***, [2004] O.J. No. 1765 (Ont. C.A.); ***Woelk v. Halvorson***, [1980] 2 S.C.R. 430; ***Graham v. Central Mortgage and Housing Corporation and Bras D'Or Construction Ltd.*** (1973), 43 D.L.R. (3d) 686 (NSSCTD); ***S.G. Levy and Sons Ltd. v. Dover Financial Corp.***, [1996] N.S.J. No. 9 (N.S.C.A.); ***Design Services Ltd. v. Canada*** 2006 FCA 260; ***Cadbury Schweppes Inc. v. FBI Foods Ltd.***, [1999] 1 S.C.R. 142; ***Eli Lilly & Co. v. Novopharm Ltd.; Eli Lilly & Co. v. Apotex Inc.***, [1998] 2 S.C.R. 129; ***Wonsch Construction Co. v. Danzig Enterprises Ltd.*** (1990), 75 D.L.R. (4th) 732 (Ont.C.A.); ***Lac Minerals Ltd. v. International Corona Resources Ltd.***, [1989] 2 S.C.R. 574; ***Hodgkinson v. Simms***, [1994] 3 S.C.R. 377; ***Gateway Realty Ltd. v. Arton Holdings Ltd.***, [1991] N.S.J. No. 362 (NS

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S.C.); ***McKenna's Express Ltd. v. Air Canada***, [1992] P.E.I.J. No. 142, 102 Nfld. & P.E.I.R. 185 (P.E.S.C.T.D.); ***Messa Operating Ltd. v. Amoco Canada Resources Ltd.***, [1994] A.J. No. 201 (Alta. C.A.); ***Morin v. Board of School Trustees of Regional Administrative Unit #3***, [1995] P.E.I.J. No. 7; ***Standard Precast Ltd. v. Dywidag Fab Con Products Ltd.***, [1989] BCJ No. 129, (B.C.C.A.); ***McBride v. Johnston***, [1962] S.C.R. 202 (SCC)

TEXTS CONSIDERED: **Williston on Contracts**, 3rd ed. (1959); **Chitty on Contracts**, 30th Ed. (2011) (Sweet & Maxwell, Carswell 2008); **Goldsmith on Canadian Building Contracts**, 4th ed. Immanuel Goldsmith, Q.C. and Thomas G. Heintzman, Q.C. (Carswell, 1988); Ellis, Mark Vincent: **Fiduciary Duties in Canada** (Carswell 2004) (2-volume Looseleaf); Hall, Geoff R.: **Canadian Contractual Interpretation Law** , 1st Ed., (LexisNexis 2007); Fridman, Q.C., G.H.L.: **The Law of Contract - 5th Edition**, (Carswell 2006)

RULES CONSIDERED: Prince Edward Island Rules of Civil Procedure, Rule 25.06(1)

Authorities Cited:
By McQuaid J.A. (dissenting):
CASES CONSIDERED: McCain Produce v. P.E.I. Lending Agency, 2010 PECA 4; ***Double N Earthmovers Ltd. v. Edmonton (City)*** 2005 ABCA 104; ***Dow Chemical Canada Inc. v. Shell Chemicals Canada Ltd.***, 2010 ABCA 126; ***Housen v. Nikolaisen*** 2002 SCC 33; [2002] 2 S.C.R. 235; ***BG Checo International Ltd. v. British Columbia Hydro and Power Authority***, [1993] 1 SCR 12; ***UAP Inc. v. Oak Tree Auto Centre Inc.*** (1997) 149 Nfld. & P.E.I.R. 313 (PEISCAD); ***Central Mortgage & Housing Corp. v. Graham*** (1973), 43 D.L.R. (3d) 686 (N.S.S.C.T.D.); ***Visagie v. TVX Gold Inc.***, [2000] O.J. No.1992 (Ont. C.A.), (2000), 187 D.L.R. (4th) 193 (Ont. C.A.); ***Wonsch Construction Co. v. National Bank of Canada*** 1990 CarswellOnt 135; (1990), 75 D.L.R. (4th) 732; ***Cadbury Schweppes Inc. v. FBI Foods Ltd.***, [1999] 1 S.C.R. 142 (SCC); ***Blue Line Hockey Acquisition Co. v. Orca Bay Hockey Limited Partnership***, 2008 BCSC 27; [2008] B.C.J. No. 24, aff'd on appeal 2009 BCCA 34; [2009] B.C.J. No. 136; leave to appeal to the SCC denied; [2009] SCCA No. 176; ***Tercon Contractors Ltd. v. British Columbia (Transportation and Highways)*** 2010 SCC 4; [2010] 1 S.C.R. 69; ***Hodgkinson v. Simms***, [1994] 3 S.C.R. 377; ***Transamerica Life Canada Inc. v. ING Canada Inc.*** (2003), 68 O.R. (3d) 457; [2003] O.J. No. 4656 (Ont. C.A.); ***Gateway Realty Ltd. v. Arton Holdings Ltd.***, 1991 CarswellNS 320 (NSSC); ***McKenna's Express Ltd. v. Air Canada*** (1992), 102 Nfld. & P.E.I.R. 185 (PEISCTD); ***Greenberg v. Meffert*** (1985), 18 D.L.R. (4th) 548 (Ont. C.A.); ***Mesa Operating Ltd. Partnership v. Amoco Canada Resources Ltd*** (1992), 129 A.R. 177 (Alta Q.B.) aff'd (1994) 19 Alta L.R. 38 (Alta C.A.); ***LeMesurier v. Andrus*** (1986), 25 D.L.R. (4th) 424 (Ont. C.A.)

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STATUTES CONSIDERED: Mechanics Lien Act, R.S.P.E.I. 1988, Cap. M-5; ***Judicature Act***, R.S.P.E.I. 1988, Cap. J-2.1, s-s.21(2)

ARTICLES CONSIDERED: Shannon Kathleen O'Byrne: **The Implied Term of Good Faith and Fair Dealing: Recent Developments** (2007), 86 C.B.R. 193; Professor John McCamus: **"The Duty of Good faith Contractual Performance at Common Law**"

Reasons for judgment:

JENKINS C.J.P.E.I.:

Introduction

[1] ADI appeals from the judgment of the Supreme Court following reasons for judgment of Campbell J. in ***WCI v. ADI*** 2008 PESCTD 40. In consolidated proceedings leading up to the judgment, WCI sued ADI for damages based on breach of contract regarding WCI's involvement as ADI's subcontractor in the design-build contract and operating agreement for the new central compost facility for the province of Prince Edward Island; and ADI counterclaimed against and sued WCI for breach of contract and negligence. The trial judge found that ADI breached its contractual obligations to WCI, because it terminated WCI's contracts without authority. He assessed various heads of damages, and granted judgment to WCI substantially as claimed, for $2,066,280. regarding the design-build contract and $2,240,059. regarding the operating agreement, for the sum of $4,306,339. plus interest and costs. He dismissed ADI's action and counterclaim.

[2] ADI asks this Court to set aside the trial judgment, and to remit the ADI claims back to the Supreme Court for assessment of its damages against WCI. ADI bases its appeal on the trial judge having made errors in law and palpable and overriding errors in his assessment of the evidence as follows:

(1) concluding the relationship of the parties was one of joint venture, and not a contractor/subcontractor relationship;

(2) making an error of law by hearing and deciding a matter of law and fact not pleaded by WCI, in particular, the issue of joint venture in light of WCI's failure to plead the existence of a joint venture relationship;

(3) determining that ADI did not have the right to terminate the contract between the parties;

(4) concluding that WCI had not repudiated its contract;

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(5) concluding that $410,000. of PST was due and owing to WCI, and ADI had enjoyed a “secret profit” in that regard;

(6) in assessing the damages between the parties, regarding both the design-build contract and the operating agreement.

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[3] This is first and foremost a breach of contract case. The trial involved consideration of other legal issues too, in negligence, repudiation, fiduciary duty, and assessment of damages. The trial evidence was voluminous and complex. Each side presented and defended its version of events, mainly through evidence of its principals supported by expert opinions in various disciplines. This was accompanied by thousands of exhibits regarding the contract and contractual relationship between the parties, the project, composting, performance issues, breakdown of the relationship between the parties, ADI termination of the WCI contracts, PST savings, damages regarding excess leachate disposal fees, container deficiencies, remediation, and the operating agreement. The trial judgment involved a number of legal determinations and a multitude of findings of fact. The key issue for determination was whether or not ADI was justified in terminating WCI’s subcontracts on the compost facility project. It is from that determination that liability flows. That issue is the primary focus on this appeal.

[4] The key question on this appeal is whether the trial judge made a reversible error when he determined that ADI was not entitled to terminate the WCI design-build subcontract and operating agreement, and that WCI did not repudiate its contracts with ADI. This question engages appeal grounds three and four. Also in the question is whether the trial judge’s determinations regarding joint venture in appeal grounds one and two were based on a reversible error, and if so, what effect such error had on the ultimate issues of liability and damages. The grounds of appeal regarding entitlement to PST savings and various assessments of damages for breach of the design-build subcontract and the operating agreement each involve discrete considerations.

Standard of review

General principles

[5] In addressing all of these issues as they are raised by the appellant’s grounds of appeal, this Court must carry out appellate review according to the standard of review that is applicable to the particular trial decision or decision-making process under consideration.

[6] The Supreme Court of Canada has provided clear and consistent direction on standard of review in civil cases: ***Housen v. Nicholaisen***, 2002 SCC 33; ***H.L. v. Canada (Attorney General)***, 2005 SCC 25, at ¶9; ***Rick v. Brandsema***,. 2009 SCC

10, at ¶30-32. On questions of law, the standard of review is correctness, so that the appellate court is free to replace the opinion of the trial judge with its own. On questions of fact, or factual inferences, or of mixed fact and law to the extent the finding was not based on a readily extricable error of law, the standard of review is palpable and overriding error. This deferential standard recognizes that an appeal is not a retrial of the case. It respects that the trial judge, in his or her role of judicial historian, has already sifted through the record, watched and listened to the parties, and determined which version of events is the most reliable. As a result, such factual findings are not to be reversed unless there is palpable and overriding error, or a fundamental mischaracterization or misappreciation of the evidence.

[7] These directions on standard of review are applied on a consistent basis in this jurisdiction: ***Morin v. Prince Edward Island Regional Administrative Unit No. 3 School Board***, 2002 PESCAD 9, at ¶260-262; ***Kennedy v. Croken***, 2008 PESCAD 8, at ¶3; ***Weeks v. O'Connor***, 2009 PECA 13, at ¶71-72; ***Harris v. Beck Estate***, 2009 PECA 8, at ¶22-25; ***Ayangma v. French School Board***, 2010 PECA 16, at ¶46-53. Mitchell C.J.P.E.I. succinctly stated the deferential approach in ***Kennedy v. Croken, supra***:

> [3] Appellate courts must be cautious in finding that a trial judge erred in his or her determination of negligence. A trial judge's interpretation and assessment of the evidence as a whole is entitled to great deference. Appeal courts should not interfere unless it is established that the trial judge's finding of negligence was based on a clearly extricable error of law or on a palpable and overriding error in the fact finding process. Where the legal principle is not readily extricable, then the matter is one of 'mixed law and fact' and is subject to review on the more stringent standard of palpable and overriding error. See: ***Housen v. Nikolaisen***, [2002] 2 S.C.R. 235 at para. 36.

[8] In ***Ayangma, supra***, McQuaid J.A. added this explanation:

> [48] In ***Housen v. Nikolaisen*** 2002 SCC 33; [2002] 2 S.C.R. 235, the Supreme Court of Canada affirmed the above principle and gave policy reasons why adherence to the principle is essential for the proper functioning of the court system. The Court also confirmed the standards to be employed when a court of appeal is reviewing a trial judge's findings of fact as well as the inferences which a trial judge may have drawn from those findings.
>
> [50] A trial judge's finding of fact is not to be reversed by the appellate court unless the trial judge made a palpable and overriding error. If there is some evidence upon which the trial judge could base his or her decision, the Court of Appeal should not intervene. On the other hand, when there is no evidence to support a factual finding the trial judge's error is plain to see. It is therefore a palpable error. In this event, the Court of Appeal is entitled to intervene and

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> substitute a factual finding which it believes the evidence establishes on a balance of probabilities. See: ***Housen v. Nikolaisen***, at paragraphs 1, 4 and 5.

Contract cases

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[9] In the present case, the trial judge had to determine a variety of questions involving the contract. Determination of the contractual rights and obligations of the parties involved construction or interpretation of their contract. That is a question of law to which the standard of correctness applies. Application of the contract provisions to the events and circumstances that occurred between the parties is a question of mixed fact and law, which is subject to review for palpable and overriding error: ***Double N Earthmovers Ltd. v. Edmonton (City of)***, 2005 ABCA 104, at ¶16; applied in ***McCain Produce Inc. (c.o.b. McCain Fertilizers) v. P.E.I. Lending Agency***, 2010 PECA 4; also see ***White v. E.B.F. Manufacturing***, 2005 NSCA 167, at ¶60.

[10] In his text, **Canadian Contractual Interpretation Law**, 1st Ed. (LexisNexis 2007), at 3.15, Geoff R. Hall advises that it is no longer sufficient to say categorically that interpretation of contracts is a question of law. Hall advises that this approach does not recognize the reality that the factual matrix always plays a significant role. As a result, courts have concluded that contractual interpretation involves questions of law, questions of fact, and questions of mixed fact and law. Interpretation involves an interplay between the words of the contract and the context in which they arise. Context is determined from evidence, and the words and context cannot be clearly separated. The historical rule was based on the theory that the jury might not be able to understand the contract provisions, and so that it remained for the judge alone to interpret the contract. Courts now recognize that the construction of contracts is a question of mixed law and fact.

[11] Accordingly, Hall advises, the standard of appellate review depends on the nature of the question. The proper application of the principles of contract interpretation is a question of law reviewable on the standard of correctness. Determination of the factual matrix, consideration of the extrinsic evidence and consideration of the evidence as a whole is a question of fact reviewable on the deferential standard. Application of the legal principles to the language of the contract in the context of the relevant facts, or a question involving intertwining of fact and law, is a question of mixed fact and law and generally reviewable on the standard of palpable and overriding error: Hall at pp.107-109; ***MacDougall v. MacDougall***, [2005] O.J. No. 5171 (Ont.C.A.). Hall concludes that the new judicial approach accords well with the principles of contractual interpretation generally.

[12] This approach was recently explained in ***Dow Chemical Canada Inc. v. Shell Chemicals Canada Ltd.***, 2010 ABCA 126, leave to appeal to the Supreme

Court of Canada dismissed June 21, 2010, at ¶11-12:

> [11] The interpretation of a contract may invoke several standards of review. Some findings of fact may be required. In some cases the trial judge may have to determine which documents, promises, and consideration constitute the contract. There is a limited ability to introduce evidence regarding the circumstances surrounding the formation of the contract. Findings of fact on such issues will only be disturbed on appeal if they disclose palpable and overriding error: ***Double N Earthmovers v. Edmonton***, 2005 ABCA 104, 363 A.R. 201 at para. 16, aff'd, [2007] 1 S.C.R. 116, 2007 SCC 3; ***Jiro Enterprises Ltd. v. Spencer***, 2008 ABCA 87 at para. 10. A trial judge's determination of the factual matrix surrounding the contract in light of the evidence as a whole (including if appropriate extrinsic evidence) is a matter of fact, although the determination may be influenced by legal concepts: ***Diegel v. Diegel***, 2008 ABCA 389, 100 Alta. L.R. (4th) 1 at para. 20; ***Jiro Enterprises*** at para.10; ***Double N Earthmovers*** at para. 16.
>
> [12] Once the exact terms and nature of the contract, and the surrounding facts, have been established, the interpretation of the words of the contract is a matter of law. The interpretation and application of contract principles to a settled set of facts is a question of law reviewed for correctness: ***Diegel v. Diegel*** at para. 20; ***Alberta Importers and Distributors (1993) Inc. v. Phoenix Marble Ltd.***, 2008 ABCA 177, 88 Alta. L.R. (4th) 225, 432 A.R. 173 at para. 9; ***Fenrich v. Wawanesa Mutual Insurance Co.***, 2005 ABCA 199, 46 Alta. L.R. (4th) 207, 371 A.R. 53 at para. 6; ***McDonald Crawford v. Morrow***, 2004 ABCA 150, 348 A.R. 118 at paras. 5 and 43.

Complex commercial cases

[13] The trial judge had a lot of evidence before him. A constellation of factors entered into the determination of many **of** the main questions at issue. The Ontario Court of Appeal decision in ***Waxman v. Waxman***, [2004] O.J. No. 1765 (Ont. C.A.), is instructive in that regard. That was an appellate review of a trial judge's findings following exceptionally long, complex, and contentious commercial trial. The case involved sorting out the rights and obligations following a breakdown of a family business and ensuing litigation between the former partners or principals. The appellant attacked the findings of the trial judge on all fronts. The following comments in this very full appeal judgment provide helpful guidance in the present appeal.

[14] In ***Waxman***, as in the present case, the trial judge made very strong credibility findings which influenced her or his view of the case. The Court in ***Waxman, supra***, addressed the review of findings regarding credibility:

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> [277] The detailed and uncompromising credibility assessments made by the trial judge raise a very high hurdle for the appellants on these appeals. At every turn in their arguments, counsel for the appellants are met with credibility findings squarely against them. They cannot escape these pervasive credibility assessments by attacking these findings where they relate to specific issues in isolation from other credibility findings. The trial judge's finding that from the outset Chester's case was spun from dishonesty and greed hangs like a shroud over the appellants' submissions in this court.

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[15] These comments in ***Waxman*** are instructive regarding the approach to review of fact-finding generally:

> [288] In this part of our reasons, we address the appellants' challenges to the fact-finding of the trial judge on a general level with reference to some specific submissions to clarify our approach to these submissions and our response to them. Other specific submissions challenging findings of fact will be addressed in subsequent parts of these reasons. We do not pretend to address each and every factual argument made by the appellants. We are, however, satisfied that none of the arguments can prevail. To the very limited extent that any of these submissions demonstrate factual errors in the trial judge's reasons, those errors, considered separately or cumulatively, do not justify appellate intervention.
>
> . . . . .
>
> [292] The ‘palpable and overriding’ standard demands strong appellate deference to findings of fact made at trial. Some regard the standard as neutering the appellate process and precluding the careful second hard look at the facts that justice sometimes demands. This viewpoint is tenable only if facts found on appeal are more likely to be accurate than those determinations made at trial. If findings of fact were to be made on appeal they might be different from those made at trial. Most cases that go through trial and onto appeal will involve evidence open to more than one interpretation. Merely because an appellate court might view the evidence differently from the trial judge and make different findings is not, however, any basis for concluding that the appellate court's findings will be more accurate and its result more consistent with the justice of the particular case than the result achieved at trial.
>
> [293] Whatever may be the arguments in favour of more aggressive appellate review of fact-finding, the policy reasons justifying strong appellate deference are powerful and have been repeatedly accepted by our highest court: see ***Housen*** at 248-51. The wisdom of the policy favouring appellate deference on questions of fact is evident in a case like this one. The evidence at trial occupied over two hundred days. The documents fill thousands of pages. The trial judge saw the witnesses and heard the evidence unfold in a

> narrative with a beginning, a middle, and an end. Our system of litigation is predicated on the belief that it is through the unfolding of the narrative in the testimony of witnesses that the truth will emerge. This court is not presented with a narrative, but instead with a description or summary of that narrative from the trial judge in her reasons, and from counsel in their written and oral arguments. The descriptions provided by counsel are not designed to tell a story, but rather to support an argument. Of necessity, and in keeping with their forensic role, counsel's description of the narrative at trial is selective and focuses on parts of the narrative or on a particular interpretation of a part of the narrative.
>
> [294] In a case as lengthy and factually complex as this case, appellate judges are very much like the blind men in the parable of the blind men and the elephant. Counsel invite the court to carefully examine isolated parts of the evidence, but the court cannot possibly see and comprehend the whole of the narrative. Like the inapt comparisons to the whole of the elephant made by the blind men who felt only one small part of the beast, appellate fact-finding is not likely to reflect an accurate appreciation of the entirety of the narrative. This case demonstrates that the 'palpable and overriding' standard of review is a realistic reflection of the limitations and pitfalls inherent in appellate fact-finding.
>
> [295] Despite the benefit of detailed reasons for judgment, lengthy and effective argument by counsel, and many hours of study, we are entirely satisfied that we cannot possibly know and understand this trial record in the way that the trial judge came to know and understand it. Her factual determinations are much more likely to be accurate than any that we might make.

[16] My final reference to the standard of review treatise in ***Waxman*** is **to** the Court's description of the distinct function in a review for error of the qualifying adjectives "*palpable*" and *"overriding*":

> [296] The 'palpable and overriding' standard addresses both the nature of the factual error and its impact on the result. A 'palpable' error is one that is obvious, plain to see or clear: ***Housen*** at 246. Examples of 'palpable' factual errors include findings made in the complete absence of evidence, findings made in conflict with accepted evidence, findings based on a misapprehension of evidence and findings of fact drawn from primary facts that are the result of speculation rather than inference.
>
> [297] An 'overriding' error is an error that is sufficiently significant to vitiate the challenged finding of fact. Where the challenged finding of fact is based on a constellation of findings, the conclusion that one or more of those findings is founded on a 'palpable' error does not automatically mean that the error is also 'overriding.' The appellant must demonstrate that the error goes to the root of the challenged finding of fact such that the fact cannot safely stand in

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> the face of that error: ***Schwartz v. Canada,*** [1996] 1 S.C.R. 254 at 281.
>
> [298] For example, the trial judge found that by the late 1970s, Chester was trying to take control of IWS and push Morris out of the company. In connection with that finding, she analyzed evidence of a proposed trust drawn on Chester's instructions in connection with a potential estate freeze. The trial judge found that under the terms of the proposed trust, Chester would gain voting control of IWS and that Chester kept this fact from Morris. The appellants contend that the proposed trust did not give Chester voting control over IWS while Morris was alive. They submit that the trial judge misapprehended the effect of the document.
>
> [299] We think the appellants are correct in their interpretation of the trust document. However, the trial judge's conclusion that the relationship between Chester and Morris was changing and that Chester was forcing Morris out of the IWS operation in the late 1970s was based on many findings of fact. Her erroneous interpretation of the terms of the proposed trust cannot override all of the other relevant factual findings she made. This error may be 'palpable,' but is clearly not 'overriding.'
>
> [300] ***Housen*** provides a detailed analysis of the 'palpable and overriding' standard of review. Several specific points made in that analysis have direct application to the arguments advanced by the appellants. First and foremost, as indicated above, the 'palpable and overriding' standard applies to all factual findings whether based on credibility assessments, the weighing of competing evidence, expert evidence, or the drawing of inference from primary facts. This court cannot retry any aspect of this case.

[17] In ***Waxman***, the Ontario Court of Appeal also explained the value on appellate review of informing reasons for judgment:

> [308] While inadequate reasons may short-circuit effective appellate review of fact-finding and thereby justify appellate intervention, detailed reasons for judgment, which fully explain findings of fact, make the case for a rigorous application of the 'palpable and overriding' standard of review. Reasons for judgment which lay bare the fact-finding process at trial offer ample room for meaningful appellate review without resort to an evaluation of the reasonableness of the findings of fact made at trial.

Processing errors

[18] One of the appellant's channels of attack on the trial judgment is that the trial judge was so influenced by his finding of joint venture and associated fiduciary duties that his view of the ultimate issues was jaundiced, which resulted in conclusions that are perverse. This kind of processing error was considered by this Court in ***Weeks***

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v. O'Connor, supra at ¶70-72. Evidence must be both communicated to the decision-maker, and understood by the decision-maker. If there is a basic failure to communicate, then the facts as found will be fundamentally flawed. A serious misapprehension of the evidence can arise from a trial judge's grievous mishandling of the facts. However, a mistake is not necessarily vitiating. Materiality is critical to appellate intervention; an error must be "*overriding*." A review of the whole transcript in context in order to view a matrix of the evidence will reveal if the trial judge got it wrong.

Damages

[19] Regarding appellate review of assessment of damages, in ***Woelk v. Halvorson***, [1980] 2 S.C.R. 430, the Supreme Court of Canada held that an appellate court should not alter an award of damages made at trial unless there is no evidence to support the award or unless the trial judge acted on a wrong principle. An award should not be set aside because the court of appeal is of the opinion that on its view of the evidence it would have come to a different conclusion.

Summary of decision

[20] I have considered the appellant's grounds of appeal in accordance with the applicable standard of review principles. In summary, I find that the appellant has not shown that either of the trial judge's findings: (i) that ADI was not justified in terminating WCI's subcontracts, or (ii) that WCI did not repudiate its contract with ADI was based on a readily extricable error of law or a palpable and overriding error with respect to the interpretation or assessment of the evidence. Regarding the nature of the contractual relationship, in my opinion, the trial judge's statement of the law of contracts and joint venture and his construction of the parties' contract were both correct. The parties expressed their agreement that their working relationship would be based on the principles of a joint venture agreement, and their stated intention was effective. Regarding the PST savings, the trial judge based his finding that ADI was obliged to remit $410,000. to WCI on three stand-alone determinations, and none of those determinations involved a reversible error.

[21] There were four damages assessments. Regarding each of the three assessments relating to the ADI breach of the design-build subcontract – excess leachate disposal fees; container repairs; and post-termination remediation – there was evidence upon which the trial judge could rely in support of his conclusions, and no reversible errors were revealed in his reasoning, such that I conclude that each of these assessments should stand. However, my review of the trial judge's assessment of WCI's damages following ADI's wrongful termination of the operating agreement showed that his conclusion on projected compost sales is based on reversible error and must be set aside. That assessment of damages is not supported by the evidence, and ignores important compromising and contradicting

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evidence, evidence which the expert witness upon whose opinion the assessment was based acknowledged would materially affect his ultimate opinion.

[22] Therefore, I would dismiss the appeal on grounds one to five, and ground six regarding assessment of damages relating to the design-build contract. I would allow the appeal in part on ground six regarding the assessment of damages relating to WCI's losses following ADI's wrongful termination of the operating contract.

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[23] Following are my reasons for judgment regarding each of the appellant's grounds of appeal.

Ground 1: contractual relationship

[24] In its Notice of Appeal, ADI submits that the trial judge made errors of law and palpable and overriding errors in his assessment of the evidence when he concluded that the relationship between the parties was one of joint venture, and not a contractor/subcontractor relationship. In its submissions to the Court, the appellant went further and articulated its underlying contention and concern that the trial judge should not have imposed fiduciary duties on ADI.

[25] In my assessment, this ground of appeal does not succeed. It raises a couple of contentious points – about formation of joint venture agreements, and about imposing a fiduciary relationship into a joint venture scenario – but at the end of the analysis I view these issues as properly determined, and in any event without consequence. In my opinion, the trial judge correctly stated the law applicable to joint ventures in contract law; correctly construed the contract by finding the parties had agreed that joint venture principles would govern their relationship; and correctly held that the contracting parties have the right to arrange their contractual relationship as they see fit, and to have their chosen arrangement respected by the court. The trial judge's finding that the parties had achieved a joint venture agreement was not in the end a finding that was essential to the disposition of any issue, but was a finding of fact he could make. He was also entitled to find their relationship gave rise to certain fiduciary duties. There was no palpable and overriding error in the trial judge's findings of fact.

Contractual relationship

[26] The August MOU is quite clear on its terms about the intention of the parties. The trial judge correctly found that for the purpose of defining the legal relationship between the parties, the August 2001 MOU incorporating the May 2001 MOU formed part of the contract between the parties; and that the parties stated their contractual relationship in the opening provisions of the August MOU. It states:

Memorandum of Understanding

between

ADI International Inc. (ADI)

and

WCI Waste Conversion Inc. (WCI)

for the

PEI Composting Facility - Brookfield, PEI

> This Memorandum of Understanding is a follow-up to the MOU dated May 23, 2001 and further describes the terms of relationship between ADI International Ltd. and WCI Waste Conversion Inc., as well as proposal price allocation and respective scopes of work for the PEI Composting Project with the Island Waste Management Corporation.
>
> It is agreed that ADI will be the prime contracting party, with WCI engaged as a sub-contractor. ADI will provide the bonding and insurances as stipulated by the RFP. However, it is agreed that the actual working relationship will be based on the general principles of a joint venture agreement as summarized below.

[27] The August MOU actually governed the total contractual relationship between the parties. It set out their respective responsibilities and scope of work on the project, the financial terms including compensation and payment, and the terms upon which WCI would operate the composting facility for five years. It incorporated the design-build contract and the operating agreement between ADI and the Owner. Under General Premises, the August MOU stipulates the usual subcontract provisions that WCI will be bound by the same contractual responsibilities regarding its scope of the work as is ADI under the design-build contract with the Owner, all as defined in the RFP. In the MOU, the parties stated their contractual relationship: ADI would be the contractor with the Owner, with WCI engaged by ADI as design-build subcontractor for its scope of the work; subject to the proviso that their actual working relationship will be based on the general principles of a joint venture agreement.

[28] The appellant asked this Court to consider the conduct of the parties in support of its version of their contractual relationship. In my view, the surrounding circumstances leading to contract formation do not contradict the express terms of the contract between the parties.

[29] In June 2000, the Province's Crown corporation, Island Waste Management Corporation ("IWMC" or "Owner") issued a request for proposals ("RFP") for the design, building, and operation of a central composting facility to serve all of the

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province ("Project"). WCI had expertise in composting systems and wished to respond, but it could not do so alone. WCI approached ADI about making a proposal together. WCI knew ADI to be a professional engineering, full-service, capital projects delivery firm with a focus on environmental systems, and that ADI would also have the necessary bonding capability. The parties prepared a Pre-Qualification Submission together. ADI informed the Owner that the Pre-Qualification Submission was made by ADI "*in association with*" WCI, and referred to the proponents as "*our team*." The Owner issued a Request for Proposals ("RFP") in early 2001. The parties made their Technical Proposal to Design-Build-Operate a Compositing Facility ("Proposal") in March 2001. The Proposal was submitted by ADI, and stated on its face to have been prepared by ADI and WCI. In July 2001, the Owner awarded a design-build stipulated price contract for the Project (the "Design-Build Contract"), which included provision for a five-year operating agreement. The contract was awarded to ADI as "Design-Builder" and provided that WCI would be sub-contractor to ADI for performance of WCI's scope of the work.

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[30] In their communications with each other, the parties frequently referred to their bid for the Project as being "joint" and their actual relationship with each other as being based on the principles of a "joint venture agreement." The term "partner" was bandied about, more often by WCI, with varying reactions of enthusiasm and resistance by ADI. On the other hand, ADI made it clear to WCI that it alone was the prime contractor, and that it carried the associated rights and risks.

[31] The trial judge found that in their communications neither party was consistent in categorizing its relationship with the other.

[32] My review of the appellant's submissions, the judgment, and the trial record, does not reveal any misapprehension of the evidence by the trial judge. There is no demonstration in their conduct that the parties intended to contradict the contractual relationship that is expressed by the lead provisions of both versions of their MOU.

[33] The trial judge concluded that as between themselves the parties agreed to be joint venturers even though with respect to the Owner they agreed to present ADI as the contractor and WCI as the subcontractor in order to meet the requirements of the bid process. He found that the characterization of the respective relationships of the parties with the Owner is not determinative of the legal relationship between themselves. He concluded that they had agreed to be bound by the general principles applicable to joint ventures.

[34] That interpretation of the August MOU is not an error; it correctly interprets the language of the August MOU. The surrounding circumstances and communications between the parties from mid-2000 when the parties decided to pursue the Project until August 2001 when they finalized the formation of their contract only support that interpretation. No reversible error is shown.

[35] The appellant's argument is based on the proposition that WCI and ADI could not be both joint venturers and contractor/subcontractor. In my opinion, they could organize their contract as they purported to do, as contractor/subcontractor with all of the provisions of the Design-Build Contract applying to their subcontract regarding WCI's performance of the work, and still base their internal working relationship on the general principles of a joint venture.

[36] The appellant relies (in passing I believe) on the *contra proferentem* rule. In my view, it has no application in the circumstances. Both parties were fully involved in the contract formulation, and the August MOU appears to be a fairly typical commercial document of the kind ADI would have familiarity.

[37] There is a contradiction in the appellant's submissions regarding construction of the contract. ADI urges that the trial judge should not have gone outside the four corners of the contract for his interpretation; yet, on the other hand urges this Court to consider the parties' post-contract actions in support of its preferred interpretation. I see no error regarding consideration of pre-contract surrounding circumstances. The contract between the parties was comprised of more than one document. ADI urged an interpretation that would exclude giving any effect to the joint venture proviso that the parties had expressly included in the MOU. The circumstances did not invoke the parole evidence rule. The terms of the contract were not embodied in a writing to which both parties assented as a definite and complete statement of their agreement: Hall, **Canadian Contractual Interpretation Law, supra**, at §2.8. The trial judge's limited reference to parole evidence to find the terms and nature of the contract was appropriate. In any event the reference to parole evidence only confirmed, and did not change, the trial judge's interpretation based on the language of the August MOU. Regarding post-contract conduct, the trial evidence does not advise that the parties changed the terms of their contract, or that they abandoned the terms of their relationship as expressed by the August MOU. It is often the case that evidence of post-contract performance is given little weight for the purpose of contract constructions: **Hall, supra**, at §3.2.

[38] After determining the terms and nature of the contract, the trial judge carried on to state the law on the formation of joint ventures. He adopted the list of essential requisites that were stated long ago by **Williston on Contracts**, 3rd ed. (1959) and summarized in ***Graham v. Central Mortgage and Housing Corporation and Bras D'Or Construction Ltd.*** (1973), 43 D.L.R. (3d) 686 (NSSCTD) (***Graham v. CMHC***"). These include:

(a) A contribution by the parties of money, property, effort, knowledge, skill or other asset to a common undertaking;

(b) A joint property interest in the subject matter of the venture;

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(c) A right of mutual control or management of the enterprise;

(d) Expectation of profit, or the presence of 'adventure', as it is sometimes called;

(e) A right to participate in the profits;

(f) Most usually, limitation of the objective to a single undertaking or ad hoc enterprise.

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He found as a fact that all these requisites were satisfied, and that the relationship between the parties had all the hallmarks of a joint venture.

[39] The appellant challenged this finding, mainly on the basis that WCI was confined to its own scope of the work and was not entitled to share in the overall administration or profit.

[40] In my opinion, this does not demonstrate a reversible error. First, there was no legal error. The modern authorities do not treat the list of requisites as rigid; rather, they take a more nuanced approach. The Nova Scotia Court of Appeal has held that depending on the circumstances, the profits of the participants can be realized from separate domains rather than in sharing the overall profit, and sharing of overall profits is not essential: ***S.G. Levy and Sons Ltd. v. Dover Financial Corp.***, [1996] N.S.J. No. 9 (N.S.C.A.), at ¶54-60, citing ***Graham v. CMHC***. Pugsley J.A. observed in ***S.G. Levy*** that joint venture is not a term of art in English law and is not always capable of exact definition. In consequence, he advised that in approaching the *"so-called Williston prerequisites*," it is important to consider Williston's remarks as setting forth general principles that may be modified *"depending not only on what the parties have expressed, but also on their conduct, and on all the facts and circumstances*." The modern texts are consistent with this approach. Both **Chitty on Contracts**, 13th ed. 2008 at ¶37-017, and **Goldsmith on Canadian Building Contracts**, 4th ed. 2010 at ¶1§1(a)(i)(H), in their description of 'Joint Ventures' state that profit is distributable as agreed; and neither text now contains a list of prerequisites.

[41] The appellant referred to ***Design Services Ltd. v. Canada***, 2006 FCA 260, which found there was no joint venture where the parties had not met the preconditions of agreeing to share profits and losses. That case is distinguishable from the present case. ***Design Services*** was a subcontractor, seeking to reach beyond its relationship with the general contractor, Olympic, to claim directly against the owner, Canada, for breach of Contract A by awarding a construction contract to a high bidder, and bypassing Olympic. In ***Design Services***, the sub-contractor, Design Services, had no contract. Since Canada awarded no construction contract to the contractor Olympic, Olympic didn't enter into a sub-contract with Design Services. In

the present case, WCI's claim is between the contracting parties *inter se*, where terms have been agreed and expressed by the parties.

[42] Second, there was no palpable and overriding error. Although ADI was the Design-Builder in the relationship with the Owner and on the Project, WCI had autonomy in the management and profitability of its scope of the work, its work was integral to the Project, specialized, and separate from ADI's scope, and WCI's scope of the work was substantial, comprising over 30% of the stipulated price.

[43] In any event, the trial judge's subsequent finding rendered moot his finding that the relationship had all the hallmarks of a joint venture. The trial judge continued on to find that in addition, the parties expressly declared their intention that the general principles applicable to joint ventures would govern their relationship. That is what the parties stated in the August MOU. The intention of the parties would prevail. Contracting parties have the right to arrange their rights and duties: ***Cadbury Schweppes Inc. v. FBI Foods Ltd.***, [1999] 1 S.C.R. 142, at ¶36. Contract interpretation is for the most part an exercise in giving effect to the intention of the parties. Meaning is to be given to the words selected by the parties themselves to govern their relationship, understood within the context in which the words are used: Hall: **Canadian Contractual Interpretation Law**, Chapter 2; ***Eli Lilly & Co. v. Novopharm Ltd.; Eli Lilly & Co. v. Apotex Inc.***, [1998] 2 S.C.R. 129, ¶52.

Fiduciary duties

[44] The trial judge commenced his analysis of the legal relationship by observing that the nature and extent of the duties owed by one party to the other vary depending on the legal characterization of their relationship. Having found that the parties had agreed that the general principles applicable to joint venture would govern, he concluded his analysis by identifying how fiduciary duties apply to joint ventures. He cited ***Wonsch Construction Co. v. Danzig Enterprises Ltd.*** (1990), 75 D.L.R. (4th) 732 (Ont.C.A.), for the principle that joint venturers owe fiduciary duties to each other similar to those owed by partners. He stated that this generally involves reciprocal obligations of good faith and loyalty regarding the common interest and venture. Particular duties are for full disclosure, not to make secret profits, and not to compete with the business. Beyond that citation, the trial judge did not comment on how any of those particular fiduciary duties would apply to the relationship of the parties and determination of the issues in this case.

[45] The appellant contends that the trial judge should not have imposed fiduciary duties on ADI. That was not raised as a ground of appeal; however, it was part of the appellant's submissions, and I will address it.

[46] It should be pointed out that in any event fiduciary duty had limited impact on

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the judgment, and has limited impact on this appeal. The appellant says this determination is important regarding the determination of damages, particularly the PST savings. In my view, imposition of fiduciary duties is confined to the PST savings issue. It does not overtly enter into the trial judge's analysis on the other issues. The termination of contract issue is determined upon the application of general contract law to the evidence. On the PST issue, the trial judge found ADI liable based on each of three alternative grounds – secret profit; *contra proferentem*; and collateral contract. Fiduciary duty enters into the reasons only regarding the "*secret profit*" determination on that issue. The PST savings issue was a question of mixed fact and law, which I will address under Ground 5: PST. My conclusion under that ground is that all three of the trial judge's alternate determinations are sustainable.

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[47] Fiduciary duty is a broad and complex topic. The trial judge's broad statement delves into an area of the law which has spawned a lot of judicial debate. Care must be exercised in determining whether a particular joint venture relationship gives rise to fiduciary duties, and if so, then which fiduciary duties should be imposed. The joint exploration of a business opportunity is viewed in law as giving rise to a quasi-trust relationship; however, while partnership relationships are viewed as fiduciary per se so that fiduciary duties are automatically engaged, for joint ventures they are not automatically engaged, but they may be engaged, depending on the circumstances.

[48] Delineation between partnership and joint venture does not resolve the issue, and that is not essential. Some caselaw delineates, while other decisions identify the joint venture itself as a "*partnership*": Ellis: **Fiduciary Duties in Canada**, Chapter 13, at pp.13-2--13-4. **Ellis** advises fiduciary concepts can apply where there is a joint venture contract. Controversy arises not on whether joint venturers owe a fiduciary duty, but rather from an examination of the scope of the obligation that arises from the relationship. The theory that fiduciary principles do not usually apply is based on the parties having remedies in contract to fall back on. The judgments in ***Lac Minerals Ltd. v. International Corona Resources Ltd.***, [1989] 2 S.C.R. 574, do not preclude a finding of particular fiduciary duties owed by one joint venturer to another. They recognize the determination remains a question of fact. In its subsequent decision in ***Hodgkinson v. Simms***, [1994] 3 S.C.R. 377, at ¶28, the Supreme Court of Canada stated that the existence of a contract does not necessarily preclude the existence of fiduciary obligations between parties. Either the legal incidents of a contractual arrangement or the surrounding factual matrix may be such as to give rise to a fiduciary duty. The end point in each situation is to ascertain whether a party has the right to expect that the other party will act in the former party's interests or the mutual interests of the parties in the project to the exclusion of the other party's several interests.

[49] In the present case, although the trial judge overstated the relationship in law between fiduciary duties and joint ventures, the law as discussed would permit him to

impose the particular duties he imposed based on his findings of fact in the case. The evidence was such that the trial judge was entitled to find that ADI had scope for the exercise of discretion, which it could exercise so as to affect WCI's legal or practical interests, and WCI was peculiarly vulnerable to ADI's exercise of its discretion.

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[50] I would dismiss this ground of appeal.

Ground 2: Pleadings

[51] ADI submits that the trial judge made an error when he heard and decided matters of law and fact not pleaded by WCI. In particular, ADI cites the issue of joint venture in light of WCI's failure to plead the existence of a joint venture relationship.

[52] This is a breach of contract case. WCI pleaded the contract between the parties upon which it based its claim. WCI specifically pleaded the August MOU. Throughout the proceeding, the August MOU was at the heart of the discussion; as mentioned, it governed the total contractual relationship between the parties. In the August MOU, the terms of relationship were expressly stated front and center. Reciting the agreement of the parties on those terms was the first purpose of the August MOU.

[53] The trial judge rejected ADI's contention that WCI's claim should fail because it had not pleaded either joint venture or fiduciary duty. He found that both parties had pleaded the contract in their claims, and that one of the provisions of that contract declares their relationship would be governed by the general principles applicable to joint ventures. Based on that, he concluded the issue of joint venture was before the court. In my opinion, the trial judge's assessment is a proper interpretation and application of Rule 25.06(1). Pleading the contract also satisfied the objective of informing opposite party and the court of WCI's case. The contract having been pleaded, and the joint venture proviso being an express term in the foundational provision of the contract, the issue of joint venture was joined.

[54] Near the end of the trial, WCI's counsel addressed the absence of reference to joint venture in WCI's pleadings. He confessed that he could have drafted better pleadings, and then made an oral motion to amend so as to refer to the working relationship being based on the general principles of a joint venture agreement. ADI opposed this motion, claiming prejudice as a result of the lateness of the motion. The trial judge considered it unnecessary to decide the motion because the issue was already before the court. He stated that had it been necessary, he would have granted the motion, as there could be no prejudice to ADI since it was abundantly clear from the pleadings that ADI would be relying on that aspect of the contract. The trial judge made no reversible error in this disposition.

[55] I would dismiss this ground of appeal.

Ground 3: Termination of the Contracts

[56] ADI submits that the trial judge made errors in law and palpable and overriding errors in his assessment of the evidence when he determined that ADI did not have the right to terminate the contracts between the parties.

[57] This is the key question in this appeal. The trial judge found that WCI did not acknowledge default under the design-build subcontract in its correspondence to ADI dated November 21, 2002. He then referred to the Default Notice General Condition 7.1 of the Design Build Contract and found that neither of the pre-conditions for issuance of a Notice of Default had been met when ADI issued its Notice of Default in its letter to WCI dated November 26, 2002. Based on those two findings, he made the ultimate determination that ADI's subsequent termination of WCI's sub-contracts were invalid. As a result, he found ADI was in breach of contract to WCI.

[58] The trial judge viewed that conclusion as determinative for judgment. However, the trial judge went on to make three provisional findings if the Notice of Default pre-conditions did exist:

(1) He assessed WCI's response to ADI's Notice of Default, particularly WCI's correspondence to ADI dated November 29, 2002, including the three conditions set out in that letter. He found that WCI's response was both adequate and justified.

(2) He then found, provisionally, that if there was any default, it was corrected prior to termination.

(3) Finally, he found, again provisionally, that if WCI failed to correct the default within the specified time, then ADI did not have the authority to terminate WCI's contracts, because it did not satisfy its onus of ascertaining that the facts upon which it would be relying as the legal basis for termination continued to exist.

[59] The trial judge canvassed the evidence and made extensive factual findings at ¶60-183. This compendium describes with appropriate detail the roles of the parties on the Project; the composting process, in all its many components; the progressively deteriorating relationship between the parties, almost from the start of construction; the many issues during construction and supply of the Project that became sources of irritation; deficiencies and delays; payment issues; feedstock characteristics and related contract provisions.

[60] Upon that base, the trial judge introduced the experts and evaluated their

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opinions.

[61] He then addressed the question of whether the termination was valid (at ¶255-287). After stating the key question for consideration, he explained his understanding of the theory of each party's case regarding termination. He described the "main deliverable" of the contract, as described by ADI, as being to produce a compost plant capable of processing 30,000 tonnes per year of waste and to produce "Category A" compost; the "throughput capacity" necessary to achieve that goal being calculable and known to the parties. He summarized the positions of the parties as follows:

> [257] The volumes of feedstock being processed at the CCF were being measured and monitored on a daily basis. ADI claimed that WCI failed to meet the necessary throughput capacity and process the required tonnage and failed to produce the required Category A compost. ADI submits that the goods, materials, services and labour provided by WCI and its subcontractors were substandard and deficient and resulted in WCI failing to meet its contractual obligations to ADI. Further, ADI maintains that WCI owed a duty of care to ADI to ensure that the design was reasonably fit for the intended purpose and to exercise reasonable skill and care in the design process. They claim that WCI failed to discharge that duty, saying there were significant construction deficiencies within WCI's scope of work and its design was seriously flawed. In their post-trial brief, ADI states that 'WCI was more than a contractor; they were a 'design builder'.' ADI states that as such, WCI was to be held to a higher standard. They submit WCI breached the implied warranty in that the design they produced was not "proper" to meet the intended purpose.
>
> [258] WCI counters that ADI would only be entitled to terminate the contract if there had been a fundamental breach. It does not constitute a fundamental breach where the alleged deficiency was capable of being remedied within a period of time which would not destroy the commercial purpose of the contract. (See ***Standard Precast Ltd. v. Dywidag Fab Con Products Ltd. et al.*** (1989) Carswell BC 307 (B.C.C.A.)) WCI also maintains that, notwithstanding the delay in commencement of construction caused by IWMC; the failure of ADI to grant WCI sufficient set up and start up time with reduced volumes of feedstock as specified in the contract; and the failure of ADI to meet WCI's specifications with respect to various aspects of construction and the provision of equipment, by the date of termination, December 4, 2002, WCI was achieving the required throughput capacity. WCI submits that on the date of termination the parties were between the period of 'substantial performance' and 'total performance' and the production of Category A compost was only required at the point of 'total performance.' They claim that the contract termination was invalid.

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> The onus of proving they were justified in terminating the contract rests with ADI. (See ***McKenna's Express Ltd v. Air Canada*** (1992) CanLII 2849 (P.E.S.C.T.D))

The trial judge considered each of ADI's assertions – the time requirements regarding production of *Category A* compost; throughput capacity; and alleged WCI deficiencies and shortfalls. He assessed the abovementioned correspondence regarding default and the governing contract provisions regarding default.

[62] I see no utility in attempting to summarize all of the many descriptions and findings of the trial judge. The appellant raises no direct challenge regarding most of those matters.

[63] In reviewing a trial judgment for reversible error, the appeal court is guided by the appellant's assertions of error. ADI's description of this ground of appeal in its Notice of Appeal lists no particular errors. Its factum cites the trial judge's construction of the contract as an error of law, and the following findings of fact as palpable and overriding errors:

(1) that WCI did not acknowledge any default;

(2) that WCI did not fail to prosecute the work properly and to substantially comply with the Design-Build Subcontract; and in particular, that WCI had achieved throughput capacity;

(3) that WCI had corrected any deficiencies within the time frames set out in ADI's Notice of Default.

[64] During the appeal hearing, which took place over an exceptionally long period of six days, counsel for the parties travelled back and forth through the issues, and visited and revisited a lot of territory. My review of this hearing indicates the following particulars of ADI's list of issues and issues alluded to that should be addressed on this appeal:

(1) Errors of law regarding construction of the contract, in particular:

(a) failing to appreciate the complete nature of WCI's contractual obligations, and what "deliverable" WCI was obliged to produce;

(b) finding that ADI had the onus to determine whether default had been corrected within the specified time.

(2) Errors of fact, in failing to properly assess and appreciate the evidence respecting the contract and its termination, in particular:

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(a) finding that WCI did not acknowledge default in respect to the "principle objectives;"

(b) finding that WCI had no duty to make itself aware of the feedstock – feedstock around which it had agreed to design the compost facility;

(c) finding that WCI had not failed to prosecute the work properly or failed to comply with the requirements of the contract to a substantial degree, pursuant to General Condition 7 of the Design-Build Contract;

(d) finding that ADI had not given explicit notice on November 21, 2001, that WCI had failed to comply with the contract requirements;

(e) regarding the conditions WCI included in its letter of November 29, 2002, finding that WCI was acting within its rights when it made its performance conditional on:

i) IWMC and ADI acknowledging that the feedstock characteristics was a fundamental issue;
ii) WCI receiving support for their efforts; and
iii) having a discussion with respect to the impact of the problem on their contractual obligations.

(f) finding that WCI had corrected any default within the time frames set out in ADI's notice of default;

(g) finding that ADI had achieved "throughput capacity," which the trial judge considered to be "the principal objective of the contract," thereby ignoring WCI's obligations and agreed-upon deficiencies.

[65] ADI submits that it acted reasonably in terminating WCI's contracts, and that the Court of Appeal should vindicate its actions. That is not now the question for determination. This was very much a fact-driven case, and an appeal is not a second trial. The question for the trial judge was whether ADI acted reasonably, or was justified in terminating WCI's contracts. That was his role; he decided that ADI was not justified. The question on appeal is different. It is whether upon review it is shown that the trial judge made a reversible error as understood in the "standard of review" jurisprudence.

[66] Regarding ADI's assertion that the trial judge made an error of law regarding

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construction of the contract, in my opinion there is no demonstration or indication of any such error. The reasons for judgment demonstrate that the trial judge had a full appreciation of the complete nature of WCI's contractual obligations. He laid out clearly in his judgment the relationship of the parties; WCI's scope of work; the Project; the main deliverable, including the science and importance of the various composting components and ingredients; the RFP provisions, including the clauses regarding deleterious material in Section 2200 clause 1.2.2.4.3; the distinctive legal effect of a design-build obligation; the Design-Build Contract Default Notice Part 7 provision; the progressive stages for commissioning of the Project, including Substantial Completion and Total Completion. The appellant has not shown that the trial judge forgot, ignored, or misconstrued any contract provision.

[67] All of the errors asserted by ADI regard application of the contract provisions to the facts of the case. Those would be questions of mixed fact and law, and none show a readily extricable error of law. The trial judge did not make any error of law in construing the contract between the parties; all of the questions about his application of the contractual provisions to the facts and circumstances of the case can be addressed within my list of appellant assertions of factual errors.

[68] The trial judge found that WCI did not acknowledge default in respect to the "principle objective." My review of this finding reveals no palpable and overriding error. He fairly interpreted the message of WCI's letter. Throughput capacity was below expectations. WCI explained in frank terms its view of the source and extent of the problem, its ameliorative efforts and results, and its plans for addressing the problem. WCI invited more in-depth discussion on the issue and advised of its plans on moving forward. The trial judge evaluated WCI's letter and ADI's response. On his finding that WCI did not acknowledge default, he pointed out that matters must be viewed in context, and there were many factors that enter into the decision. This is an important statement (at ¶290):

> [290] It is my view that WCI did not acknowledge default under the contract in their correspondence of November 21, 2002. There is no question that their letter flagged serious issues. However, matters must be viewed in the context in which they were occurring. Given the numerous commissioning issues they had faced and were still facing, many of which were caused by ADI and IWMC, it is not surprising that WCI would have difficulty achieving optimal results in the short term. The letter did not communicate abandonment of the project but instead reflected the significant efforts to which they had already gone to both isolate and attempt to rectify an unanticipated problem in the composting process. They stated in the letter that 'the facility is <u>not yet realizing the full benefits of the container system</u> because of the initial inhibited energy release.' (Emphasis added.) The implication in that phrase is that the facility will, in the future, realize the full benefits of the container system. And at the time of writing that letter they were not required to realize the full benefits of the container system.

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Each of those factors mentioned by the trial judge was based on the evidence and was within the purview of the finder of fact.

[69] Timing is a significant factor. The issue was throughput capacity. Under the revised terms of the Design-Build Contract, ADI, and hence WCI under the design-build subcontract, the contractor did not have to demonstrate the throughput capacity specified in the RFP until Total Performance, which would not occur until February 1, 2003. The effect of Substantial Performance is important. The Owner accepted ADI's application for Substantial Performance effective October 1, 2001. At that time, concern was on the table that consistent ability to achieve pathogen reduction was not yet demonstrated. In the Substantial Performance job meeting, ADI advised that: (i) a high proportion of the containers, 13 out of 21 in Phase II, were by then achieving PFRP; and that if 50% of Phase II Containers are in PFRP, objectives are being met; (ii) the Plant can be operated at 30,000 tonnes annually, and produce Category "A" Compost, based on documentation reviewed and on site inspections; and (iii) there is a deficiency that could lead to capacity problems: it is not yet demonstrated that Class A compost can be produced in the specified period of 56 days. The Owner and ADI agreed to address the concerns over performance by postponing the requirement for performance and establishing a deficiency holdback. The Substantial Performance letter dated October 7, 2001 states that Substantial Performance is accepted: "*with the correction of the following additional deficiencies required to achieve Total Performance of the Contract.*" The list included the 'consistent pathogen reduction' requirement. It was thereby agreed that new deficiencies would be added to the deficiency list forming part of the application for Total Performance, upon ADI's agreement of an additional $500,000. holdback for construction and performance deficiencies.

[70] This change is important from three perspectives. First, as a result of the change, on November 21, 2001, WCI was not required to demonstrate throughput capacity; it had until Total Performance to do that. Where a contract provides a time within which the contract work must be completed, the contractor is entitled to the whole of that time for doing the work: **Goldsmith on Canadian Building Contracts, supra**, at 5§1(d). Second, ADI's statements made in the Substantial Performance job meeting suggest that the performance deficiency in issue was just that, a deficiency, and not a total failure of performance. Those ADI representations run contrary to its position taken when giving its Notice of Default. Third, the logical inference from the Owner's Substantial Performance letter and ADI's agreement with its terms is that both the Owner and ADI viewed WCI's performance deficiency as capable of being quantified in money terms, at no more than $475,000.; which suggests damages rather than termination of contract was viewed as the appropriate remedy for default.

[71] Based on the terms of the letter, the trial judge was entitled to conclude that

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WCI did not acknowledge default, and had not failed to prosecute the work properly.

[72] Implicit in ADI's assertion that the trial judge erred regarding the effect of WCI's letter of November 21, 2001 is its assertion that the trial judge made an error in finding that WCI had no duty to make itself aware of the feedstock before it designed the composting system for the Plant. In my opinion, the trial judge did not thereby make a reversible error.

[73] He proceeded on a proper understanding of WCI's legal obligations under the contract. He expressed his understanding that:

(1) WCI was the composting specialist, and the composting system design was within its scope of the work;

(2) the Owner and ADI were reliant upon WCI's skill and judgment to ensure the composting system was suitable for the purpose for which it was intended;

(3) the RFP stipulated the minimum functional requirement of the Plant, which had to be accomplished;

(4) the RFP specified the biowaste that would be delivered to the Plant, and the particulars of acceptable biowaste; and

(5) operation of the provision regarding unacceptable biowaste at the RFP Section 02200 clause 1.2.4.3, which underscored WCI's letter of November 21st and which WCI specifically cited in its November 29th letter to ADI, requires both the Owner and ADI to agree that the feedstock is deleterious.

The reasons for judgment make clear the trial judge's understanding that WCI did not have the right to unilaterally declare the feedstock deleterious, that such a declaration required agreement in the opinion of the Owner and ADI as design-builder. The trial judge did not proceed on any wrong premise based on a misinterpretation of the design-build contract documents.

[74] The trial judge was entitled to find that by raising the concerns that it did about the quality of the feedstock WCI was not acknowledging default.

[75] A number of findings entered into this conclusion, and each of those findings were supported by the evidence upon which the trial judge could rely. For his findings that the feedstock was different than at the East Prince site, that the pH level of the feedstock arriving at the facility was significantly lower, and the low pH level rendered the feedstock '*deleterious*' to the composting process, he referred to the

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evidence of the Owner's compost specialist Heather Chowen.

[76] He found that RFP Section 0200 Clause 1.2.4.3 allowed WCI to raise the feedstock issue, and to proceed with the expectation that the Owner and ADI would be open to entertaining this expression of concern and making an objective determination of the issue. It is clear from the evidence that the theme of the Owner's position and ADI's response was that *'the feedstock is what the feedstock is.'* The trial judge understood the basis for their position. However, he was also entitled to incorporate into his decision-making process the evidence of WCI's corporate and expert witnesses that an audit of the East Prince feedstock would not have avoided the problem, that the low pH being experienced was exceptional to the point of being unheard of, that the system was properly designed, and a different design would not have avoided the problem either, and adjustments could be made to the system and the feedstock to address the issue.

[77] The trial judge's ultimate conclusion on this issue does not go too far. He stated only that the fact that the '*deleterious feedstock*' clause in contract "*may present significant problem to the Owner is no justification for the provision to be ignored or for its application to be rejected*." That involved a correct interpretation of the contract between WCI and ADI, and there is no palpable error in its application to the surrounding facts and circumstances.

[78] Being aware that my colleague has a different opinion on this particular issue, I would add this supplementary opinion. Even if the trial judge's conclusion about WCI's right to raise the feedstock issue is erroneous, it does not amount to a reversible error. It is not an overriding error. The larger question at this stage is whether WCI acknowledged default. The trial judge's finding that it did not was based on a constellation of factors, many of which have been discussed previously. Even viewed from ADI's vantage point of WCI's letter demonstrating that this ongoing performance problem remained unresolved; of WCI now questioning the feedstock which was central to its responsibility; and of the Owner pressing ADI to deal with the matter on an urgent basis, in my assessment the trial judge was still entitled to find that WCI did not acknowledge default. He considered everything in context, which included: the timing, which was half-way between Substantial Completion and Total Completion; WCI's continuing diligent efforts and progress toward amelioration; ADI's contributions to the commissioning problems; and WCI's continuing commitment to resolving the problem.

[79] There is no palpable error in the trial judge's analysis and conclusion that the condition in Default Notice provision 7.1.2 had not occurred. The evidence supports his finding that ADI did not show that WCI had failed to prosecute the work properly or otherwise fail to comply with the requirements of the contract to a substantial degree. He understood that throughput capacity was the issue, that it was below expectations, the past experience regarding feedstock assessment and amendment

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and adjustments to the aeration system. The trial judge posed the right question of whether the situation permitted ADI to invoke Section 7.1.2 of the Design-Build Contract. He assessed the issue by analyzing WCI's progress or level of achievement in the context of the overall objectives of the contract with consideration of the contractual milestones. He examined the degree of progress, and the information that was made available to the parties. I do agree with ADI's submission that its actions should be judged on the information made available at the time, and not on a post-termination polynomial regression analysis in an expert opinion. However, the trial judge had evidence that the daily container reports that were provided showed adequate progress was being made. The evidence also supported the trial judge's finding that the facility was in use and processing the biowaste that was arriving on a regular basis.

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[80] The trial judge took into consideration all the factors he should have, and carried out a logical analysis. The conclusion he made – that the levels of performance on November 26, 2002, were not such that one could conclude that WCI had neglected to prosecute the work properly or had failed to comply with the requirements of the contract to a substantial degree – was within his purview. No palpable error is revealed. Based on that, the trial judge was entitled to conclude that ADI's Notice of Default was null and void.

[81] Notice of Default being a precondition to termination, the trial judge was entitled to then determine that ADI's subsequent termination of contract was invalid and constituted a breach of contract.

[82] ADI asserts that the trial judge found its Notice of Default was not explicit. In my view, this does not raise an issue. In assessing ADI's Notice of Default, the trial judge evaluated whether General Condition 7.1.2 was invoked. Within his analysis he merely noted that the Notice of Default did not specify the particular default. He did not disqualify the Notice on that basis. He went on to deduce the issues and failure of performance upon which the Notice was based. He decided the issue on the merits, without reliance upon any shortcoming in the specifics of the Notice of Default.

[83] Resolution of the foregoing issues was viewed by the trial judge as conclusive on liability. I agree with that assessment. Under the Design-Build Contract Section 7.1, notice of default followed by a five-day opportunity to cure is prerequisite to termination of the contract. Absent a valid notice of default, there could be no valid termination. It was helpful for our full consideration on this appeal that the trial judge went on to make provisional findings regarding the subsequent events including WCI's response to ADI's Notice of Default. In the circumstances, appellate review of those matters is also unnecessary; however, I will address ADI's submissions.

[84] WCI's letter of November 29, 2002 was its response to ADI's Notice of

Default. This was a very full response. WCI denied default and negligence, reiterated and amplified its view of the feedstock and PFRP issue and how those issues came about, stated its progress, and expressed continuing confidence in its system and the composting principles upon which it was based. It supported the response with extensive objective information. The response referred specifically to RFP provision 1.2.2.4.3 regarding deleterious feedstock, and stated the feedstock coming to the facility fell within that category with its profoundly low pH. WCI took the position that WCI was not responsible for the quality of the feedstock, and therefore could not be held accountable for the implications of deleterious feedstock. WCI restated its commitment to working with the feedstock to improve its characteristics. This commitment was stated to be conditional.

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[85] The trial judge assessed each of WCI's conditions. He concluded that WCI was acting within its rights under the contract by asking for acknowledgment that the feedstock characteristics was a fundamental issue, because the feedstock was in fact deleterious to the composting process. His reasoning was that ADI could decline to provide an acknowledgment and leave the question to be determined under the contract dispute provisions, but WCI having raised the issue was not a ground upon which ADI could rely for issuing Notice of Default.

[86] There is no error in the reasoning that WCI did not thereby make a material demand to which it was not entitled under the contract. The WCI assertion that the feedstock was a fundamental issue was shown to be true. ADI had been asserting that WCI's aeration system was the issue. The pH problem and resultant microbial suppression was eventually shown to be the source of the heat-up into PFRP issue. The contract made provision for addressing the issue of feedstock that is deleterious to the composting system.

[87] Regarding the second condition, the trial judge did not make a palpable error in interpreting WCI's purpose as an endeavour to obtain payments of invoices WCI considered to be outstanding on both the Design-Build Subcontract and the operating agreement. The evidence supports the view that WCI needed cashflow to work through the performance issues, and it could make a good case for payments overdue under its contracts.

[88] The third condition raised by WCI was to have a discussion with respect to the impact of the problem on WCI's contractual obligations. One can appreciate how the Owner and ADI would view this as ominous. However, the trial judge entertained this matter in the full context of the situation. He made no palpable error in finding that **in** asking for a discussion of who should bear the cost of amendments to avoid rejection of deleterious compost WCI was not off-side. Having found the feedstock to be deleterious, that the profoundly low pH was without precedent, and that amending materials would ameliorate, it cannot be said that the trial judge was wrong in declining to find this WCI request to be repudiatory.

[89] The trial judge proceeded on to make a provisional finding that if there was a WCI default, it was corrected within the specified or required time. For this finding, he accepted the evidence of WCI's Phil Kerrigan. Performance results were available to ADI in the form of daily container reports. Phil Kerrigan informed Tim O'Neill of ECS and WCI internally on December 2, 2002 that he had good news; which was that the aeration regime changes seemed to be working very well and with the result that most containers (except 41-48) were getting into the 50°C range within 24-36 hours, and into PFRP quite a bit sooner and more reliably than before. Although WCI considered this to be their "Eureka moment," a finding that this was effectively communicated to ADI is not readily implied from the trial judgment. But in the end any such shortcoming does not matter, because the evidence shows that WCI was making at least very good progress in resolving throughput capacity, and the full contract requirement did not have to be achieved until Total Performance.

[90] ADI did not cite WCI's obligation to produce *Category A* compost in its Notice of Default; but it alluded to it in its submissions during the appeal hearing. There can be no question of the trial judge having made an error in that regard. First, not having relied upon this in its Notice of Default, ADI could not later on rely upon it for justification. Second, the time period for fulfillment of this contractual requirement ran until Total Performance, on February 1, 2003. Third, the outstanding underlying issue to production of *Category A* compost was the delay in heat-up to PFRP in the containers, which would inhibit the ability to achieve design capacity, and the trial judge found that issue was being adequately addressed.

[91] ADI was indeed somewhat caught between the Owner's concerns and its composting sub-contractor's performance issues. Upon receiving WCI's letter of November 21st, IWMC expressed its concern and instructed ADI to make a formal response to WCI. However, the Owner did not control ADI's actions, and it did not instruct ADI to issue a Notice of Default. Also noteworthy is that the Owner did not issue a notice of default against ADI under General Condition 7.1 of the Design-Build Contract.

[92] In my opinion, the trial judge did not make an error in determining that ADI had the onus of determining whether default had been corrected within the specified time before giving notice of termination. It should generally be expected that, absent circumstances to refute, a party who has terminated the contract of another has the onus of justifying its actions: ***McKenna Express Ltd. v. Air Canada, supra***, at p.10. In ***Standard Precast Ltd. v. Dywidag Fab Con Products Ltd.***, [1989] BCJ No. 129, (B.C.C.A.), the termination of a sub-contract was set aside when it was found that the contractor had not satisfied the onus of demonstrating that the defective nature of the sub-contractor's product resulted from causes which the sub-contractor was incapable of remedying within a period which would not amount to frustration of the contract. In the present case, the terms of General Condition 7 do

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not advise a different approach.

[93] The question of onus of proof is moot. It arose only in connection with the trial judge's third provisional finding. It is superceded by the determinations that ADI could not give the Notice of Default under the contract because the conditions of default thereunder had not occurred.

[94] I mentioned that the trial judge stated that these matters must be viewed in context. That is true. It is important to appreciate that the termination, and the performance problems and exchanges between the parties leading to termination, were multi-faceted. The trial judge had before him a myriad of factors, and evidence from various sources. He had to evaluate and weigh the factors into the balance. This was primarily a fact-based dispute. Within the fact-finding exercise, evaluation involved important credibility findings, regarding both corporate witnesses and expert opinions. The trial judge found ADI's evidence wanting on many occasions. This was regarding both veracity and reliability respecting understanding of the engineering and science involved in composting. Unlike some contract cases, in this case no one factor was decisive. The trial judge had to sift through exceptionally long and complicated evidence. His resolution of the fact-based dispute largely determined the outcome of the trial. I have followed all of the paths of review as requested by ADI. This exercise has not revealed a reversible error. The trial judge did not seriously misapprehend the evidence regarding any issue, and he did not make any findings in the absence of evidence upon which he could base a particular conclusion. In such a complex trial decision, it can be expected that contentious findings would occur. However, an appeal is not a retrial, and to the very limited extent that any of ADI's submissions demonstrate factual errors in the trial judge's reasons, this case is akin to ***Waxman, supra***: those errors, considered separately or cumulatively, do not justify appellate intervention.

[95] I would dismiss this ground of appeal.

Ground 4: Repudiation of the design-build sub-contract

[96] ADI submits the trial judge made errors of law and a palpable and overriding error in his assessment of the evidence when he concluded that WCI had not repudiated its contract.

[97] ADI did not plead repudiation. However, the trial judge elected to deal with repudiation because the parties had addressed it at some length in their submissions. Having been put in play, ADI could raise it as a ground of appeal.

[98] I do not accept ADI's submission that the trial judge made an error of law. He referred to and recited the applicable law to be applied to the facts and circumstances of the case.

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[99] The trial judge properly applied the law to the facts. He explored whether WCI either by its words or its conduct indicated an intention not to perform its obligations in some essential respect. Many of the considerations involved in this evaluation were addressed by the trial judge, and in this appeal decision, under Ground 3 - Termination. I will not repeat those matters here.

[100] On the face of its correspondence, WCI denied repudiation. It denied default and negligence, and reiterated its commitment to seeing its obligations through to completion.

[101] The trial judge understood that repudiation can be triggered by a party demanding something to which it is not entitled under the terms of the contract. He evaluated and validated each of the conditions that WCI introduced.

[102] He was correct in stating that repudiation is not lightly to be inferred from a party's conduct, where prior to the time for performance that party has repeated its intention to carry out the contract: ***McBride v. Johnston***, [1962] S.C.R. 202, at pp.208-210, applied in ***Standard Precast Ltd. v. Dywidag, supra*** at ¶6; and that one must inquire whether deficiencies are capable of being remedied in a period that would not destroy the commercial purpose of the contract: ***Standard Precast Ltd. v. Dywidag***, at ¶16.

[103] In his analysis of the questions of wrongful termination and repudiation of contract, the trial judge adopted the principle that parties are required to exercise their contractual rights honestly, fairly and in good faith. He referred to the decision of Kelly J. in ***Gateway Realty Ltd. v. Arton Holdings Ltd.***, [1991] N.S.J. No. 362 (NS S.C.), which was applied in ***McKenna's Express Ltd. v. Air Canada***, [1992] P.E.I.J. No. 142, 102 Nfld. & P.E.I.R. 185 (P.E.S.C.T.D.). Kelly J. observed that the concept that one party should not act in such a way as to deprive the other party of the anticipated benefits of the contract is not a new one, and that numerous examples of judicial insistence on business probity exists in Canadian law. In my opinion, the trial judge's statement was an oversimplification.

[104] The question of whether contracts should be interpreted as requiring good faith in the performance of contractual obligations is very unsettled: Hall, **Canadian Contractual Interpretation Law, supra**, at Chapter 9, p.289. The statement in ***Gateway Realty*** **has** been referred to with varying degrees of qualification and acceptance by appellate courts. Fortunately, it is not necessary to decide here this contentious issue of jurisprudence. There is broad acceptance that a duty of good faith performance exists in some particular circumstances, which include the exercise of discretionary power: **Hall, supra**, at pp.289-290. In ***Messa Operating Ltd. v. Amoco Canada Resources Ltd.***, [1994] A.J. No. 201 (Alta. C.A.), Kerans J.A. observed that a good faith obligation can arise in fact based on the parties'

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agreement. Its source is not in law but on interpretation of the intention of the parties. Kerans J.A. stated:

> [19] In any event, it is not necessary for this case that I go further into this difficult area. This is because this case turns on a rule founded in the agreement of the parties, not in the law. In my view, as a matter of fact, this contract created certain expectations between the parties about its meaning, and about performance standards. If those expectations are reasonable, they should be enforced because that is what the parties had in mind. They are reasonable if they were shared. Of course, those expectations must also, to be reasonable, be consistent with the express terms agreed upon. This contract should be performed in accordance with the reasonable expectations created by it.

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[105] As I see it, that statement can be applied in the present case. The trial judge was entitled to imply from the terms of the August MOU a duty of good faith. ADI was in a position where it could exercise its discretion, and WCI was correspondingly dependent on that discretion being exercised in good faith.

[106] The trial judge considered the conduct and circumstances of the parties as a whole. While some of his factual findings about ADI's tactics and motivations are debatable, they are findings that the trial judge could make on the evidence. They were not founded on a processing error, or necessarily viewed as being the product of an unjustifiably jaundiced view of ADI's principals and their motivations. The trial judge's conclusion was one of mixed fact and law within which there was no readily extricable error of law. There was no palpable error; or if one or more occurred then there was no palpable error or errors that alone or cumulatively amounted to an overriding error. The trial judge was entitled to find, as he did, that WCI did not by its words or conduct repudiate; that, in any event, the time for correction of the deficiencies in question was not exhausted; and, in the circumstances of the status of the deficiencies, ADI did not show that WCI was incapable of performing its part of the contract.

[107] I would dismiss this ground of appeal.

Ground 5: PST savings

[108] ADI submits the trial judge made an error of law and a palpable and overriding error in his assessment of the evidence when he concluded that $410,000. of PST was due and owing to WCI, and that ADI had enjoyed a "*secret profit*" in that regard.

[109] The trial judge made an accurate statement of the facts and evidence regarding this issue at ¶32-36 and ¶368-375 of his reasons for judgment. I will mention only the salient points for this appeal.

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[110] The Owner's RFP called for detailed budgets and specified they were to include PST. In response, in their bid, the parties added PST to most of their price. ADI carried WCI's submission with full PST, at $6.34 million, comprised of the price of $5.77 million plus PST of $577,000. In July, the Owner awarded the Design-Build Contract for the Project to ADI for $17,575,000. This included PST on most items submitted by both ADI and WCI.

[111] Prior to this contract award, the parties made some internal price adjustments. The May MOU, which the trial judge found was the initial agreement between the parties, did not mention financial terms. Upon request, ADI then advised WCI in writing that WCI would be compensated for its scope of the work in accordance with the pricing WCI provided for the Proposal, which was WCI's work plus "PST @ 10%." Following up on the Owner's direction to reduce the price, and then pursuing changes on its own initiative, ADI sought and obtained two price reductions from WCI. These related to unanticipated savings because the parties learned that WCI's processing equipment would be tax exempt, adjustments regarding Operating Agreement start date conditions which enabled WCI to transfer an amount from its design-build budget, and winter conditions. The first credit was $705,000. This was stated to reduce WCI's price from $6.34 million to $5.64 million. A writing between the parties in the form of a draft revised MOU that was never signed stated this new price was all-inclusive and covered WCI's work "*and 10% PST*." During the summer, WCI conceded a second credit, for $441,660. At this time, ADI revised the abovementioned agreement regarding compensation. The revised provision became part of the August MOU. It stated that compensation was reduced from $5.76 million and would now be as follows:

> Compensation in the amount of $5,324,918.00 plus provincial sales tax and HST as applicable (in accordance with pricing provided by WCI to ADI during preparation of the proposal submitted on March 30, 2001 of $5,766,578.00 less $441,660.00 credit for changing the start date of the operating agreement to Date of Substantial Performance and adjustment for additional costs for odour monitoring and winter conditions), subject to cost adjustments with IWMC during execution of the work, satisfactory performance by WCI in respect of its scope of work to the standards required under the design-build agreement, and other costs adjustments that may be mutually agreed by ADI and WCI. The price is all inclusive and covers all work by WCI including equipment supply and installation, professional fees and expenses, start-up costs, contingency allowance and mark-up for overhead and profit.

[112] At this point the evidence becomes contentious.

[113] WCI maintains that it was concerned about the new language '*PST as applicable*' as it was new and ADI's intentions in that regard were unclear. WCI states that the August MOU was only signed after its representative Joe Kennedy

and ADI's representative David Beattie reached a verbal agreement that the parties would share, on a pro rata basis, the savings that would be generated as a result of PST exemptions. WCI considered this to be significant because the price that the Owner had already agreed to pay for the Project, $17,575,000. plus Value Added Taxes (GST) of 7% included PST on all WCI items and most ADI items. In the result, PST savings would be a windfall to be shared.

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[114] ADI had more than one position in response to WCI's claim. CEO Hollis Cole denied the existence of any WCI right to share in PST savings. His evidence is to the effect that the August MOU terms are clear, and that the parties should be able to go by their agreement. ADI was contractor and WCI was sub-contractor. ADI was obliged to reimburse WCI for PST paid, i.e. to remit "*PST as applicable*." If WCI did not have to pay PST on an item, then there was no basis for reimbursement on that item and no loss to WCI. Mr. Cole readily acknowledged that the turn of events concluded by the revised compensation provision of the August MOU had the effect of moving the PST savings from WCI to ADI's revenue – that was the business deal the parties had made, both fully aware, and WCI knew that it was a condition of ADI being prepared to carry out the Project. His theory was that parties should expect to be bound by the agreement they have made.

[115] During the negotiation and construction period, David Beattie was the ADI contact with WCI's Joe Kennedy on this matter. He too denied the existence of a collateral contract as asserted by WCI. However, in the appeal there was more than one view of his position. ADI's submission on the appeal is that there was no deal, and no reason for David Beattie to have made a side deal that would have jeopardized his relationship with Hollis Cole. This corporate denial is qualified by ADI's qualifying statement that David Beattie did offer to pay $120,000. of PST savings to WCI, which would be payable at the end of the Project when savings were determined and realized. ADI submits that this offer did not amount to an obligation, because WCI never accepted it. Although David Beattie himself stated there was no side deal, there is a lot of references in the evidence of him agreeing on behalf of ADI to divide PST savings with WCI pro rata. In email correspondence, he acknowledged that the team of ADI and WCI would save some taxes, and he proposed splitting the savings pro rata to ADI and WCI's scope of the work; and referred WCI to ADI's accountant for further specifics. Later on, Mr. Beattie acknowledged Joe Kennedy's assertion of a deal. The job meeting minutes from October 2001 to January 2002 refer to this arrangement too. The minutes of the January 28, 2002 meeting state:

> 12.1 PST savings will be split between ADI and WCI on a pro rata basis and DIB indicated that the distribution would occur at the end of the project.

Through David Beattie, ADI involved WCI in its meetings and correspondence with the provincial tax office regarding PST exemptions, and provided WCI with a detailed

list of exempt items and potential tax savings. In trial cross-examination, David Beattie acknowledged both his email correspondence with WCI and that he was authorized by Mr. Cole at the time to make that deal.

[116] In addition to the differences over the existence of an agreement to share, there were serious differences regarding the amount of savings to be shared. In 2001, as the Project got underway, the parties progressively became aware that the PST savings would be larger than first anticipated. The initial substantiation of the stake at $393,000., in which WCI's pro rata participation would have yielded approximately $120,000., grew commensurately as the parties became aware that virtually all of WCI's items and also its allowance for performance testing and a lot of ADI's items too would be PST exempt. The trial judge found that when the accounting was all done, $410,000. of the $532,000. (originally $577,000.) PST relating to WCI's scope of the work that was payable by the Owner to ADI for the Project was not required for that purpose.

[117] The trial judge found that ADI was obliged to remit PST savings of $410,000. to WCI. His determination was based on three stand-alone determinations. ADI's appeal addresses two of those determinations.

Contra proferentem

[118] ADI's appeal on Ground Five must fail. It did not appeal the trial judge's stand-alone determination based on his interpretation of the compensation provision of the August MOU against ADI in accordance with the *contra proferentem* rule. The trial judge determined the words '*as applicable'* were ambiguous and uncertain in the context in which they appeared, and in accordance with the *contra perferentem* rule he interpreted them against the author, and found that they relate to PST specified with respect to each party's scope of work and submissions prepared in furtherance of their joint submission to the Owner.

[119] The circumstances permitted the trial judge to employ the *contra proferentem* rule; the prerequisites were present: Hall, **Canadian Contractual Interpretation Law, supra** at §2.9. The amending language in the compensation clause was introduced by ADI, was ambiguous, and WCI could not obtain clarification before signing from ADI regarding the new language "*as applicable.*" While the rule is usually a last resort, and is not often resorted to where the parties are both astute commercial operators, the trial judge was within his latitude to employ the rule in this case. *Contra proferentem* operates to protect one party to a contract from deviously ambiguous or confusing drafting on the part of the other party, by interpreting any ambiguity against the drafting party: ***Eli Lilly, supra***, at ¶53. The trial judge did not make any reversible error in that determination.

[120] Although that is determinative of the PST savings issue, I will address the

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appellant's submissions.

Duty of loyalty

[121] It is regarding the PST issue that the trial judge referred to the joint venture proviso in the August MOU. He found that ADI showed neither loyalty regarding a common interest nor good faith when it attempted to convert monies earned in respect to WCI's portion of the contract for its own use; and that by adding the words "*as applicable*" ADI failed to fully disclose WCI the impact ADI intended to derive from that change. The trial judge was entitled to make that finding. He had already decided that the parties had expressed their agreement that their working relationship would be based on the principles of a joint venture relationship. Application of particular fiduciary obligations and related findings of discretion, vulnerability, and appropriation became for the trial judge mostly questions of fact. There was ample evidence upon which the trial judge could base his conclusion.

Collateral contract

[122] The trial judge also found that the parties had made a collateral contract at the time of executing the August MOU. He correctly determined the prerequisites for formation of a collateral contract:; ***Morin v. Board of School Trustees of Regional Administrative Unit #3***, [1995] P.E.I.J. No. 7, at ¶20. His determination that the prerequisites were present was supported by the evidence. In the face of contradictory evidence, he had good reason to prefer the evidence of Joe Kennedy which was consistent with surrounding circumstances and documents over the evidence of David Beattie, which was not. In any event, the documentary evidence and David Beattie's subsequent acknowledgments are all objective and corroborating evidence upon which the trial judge could rely for his conclusion. The agreement found by the trial judge – verbal agreement to share the tax savings pro rata to the parties' scope of work – does not contradict the compensation clause read as a whole in the written agreement.

Agreement

[123] I view as vacuous ADI's submission that since WCI did not accept its offer of $120,000. there was no agreement and consequently no ADI obligation. If the parties made an agreement, they were bound. It was when the savings were anticipated to be $393,000., that ADI offered $120,000. ADI calculated WCI's share on a pro rata basis. Later on, it became known to the parties that the stake was larger. An agreement having been made and recognized along the way, a dispute later on over the amount payable followed by refusal of the receiving party to acquiesce to the paying party's unilateral determination of amount due does not absolve the paying party from its contractual obligation.

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Amount

[124] The trial judge decided the amount payable based on the evidence. There is no reversible error regarding this matter. The items and work within WCI's scope which were PST exempt amounted to the sum **of** $4,019,330. PST on that would be $402,000. Hollis Cole acknowledged this list on an item-by-item basis during cross-examination. In addition to the list, WCI had included PST on its contingency and margin, which were also PST exempt. This yielded an additional PST savings of $94,000. There was no reversible error affecting ADI in this determination.

[125] I would dismiss this ground of appeal.

Ground 6: Assessment of damages

[126] ADI submits that the trial judge made errors of law and a palpable and overriding error in his assessment of damages between the parties. At trial, the trial judge was called upon to determine numerous claims for adjustments and damages between the parties. Under the design-build contract, a broad range of considerations came into play. Some claims fell under the determination of the question of ADI's right to terminate WCI's contracts, some stood independently as change orders and contract adjustments, and for some claims there was a question whether and to what extent liability and damages were interrelated.

[127] The trial judge ordered the various adjustments to WCI in the form of WCI damages and a few to ADI in the form of deductions from WCI damages. He denied most of ADI's claims. Some of the assessments are accepted by ADI; some are appealed. ADI's notice of appeal lists no particulars of the assessments of damages that it challenges or of the errors the trial judge made regarding those assessments. In its factum, ADI identifies three of its claims for damages. It submits the trial judge failed to properly assess its claims for the cost of: i) container repairs; ii) leachate disposal fees; and iii) remediation following removal of WCI from the project. Under the remediation head, ADI challenges 14 different assessments.

[128] Regarding the operating contract, the trial judge ordered damages to WCI for loss of earnings, and denied ADI's claim for losses resulting from WCI's alleged non-performance. ADI claims that the trial judge erred in this assessment, as it was unsupported by and contrary to the evidence.

[129] I will deal with each of ADI's four submissions separately.

6.1 Leachate disposal fees

[130] The contract specifications stipulated that the compost facility was to be neutral with respect to leachate generation. However, substantial volumes of excess

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leachate collected in the underground storage tank which had to be trucked away for safe disposal. This involved considerable expense. The problem existed from the time commissioning in mid-2002 onward until 2005, although it was largely ameliorated following: (i) the replacement of the underground storage tank in December 2002 and (ii) various ongoing remediation efforts through 2003. ADI incurred significant expenses for disposal of the excess leachate, for which it claimed recovery against WCI in the amount of $699,278.

[131] ADI has categorized this claim as an appeal of an assessment of damages. The issue at trial and on appeal seems to me to be more than that. The amount of the claim and inputs into the total claim are not the contentious issue. The dispute between the parties centers on determination of responsibility for the problem of excess leachate or leachate-contaminated water. The issue is liability for the cost of off-site excess leachate disposal. If, as ADI contends, the source of the problem was in the design of the compost system, such that the excess leachate was coming from the containers, that being within WCI's scope it would be its responsibility. On the other hand, if the source of the excess volume was infiltration of condensate or water from sources within ADI's scope, namely a crack in the inner wall of the underground storage tank that allowed infiltration of water from an outside source or sources, excess condensation from the exhaust ducts, or water from the floor drains, then the expense would be properly borne by ADI.

[132] The trial judge found there were two sources of excess leachate. One was condensate produced during the composting process running into the leachate storage tank and becoming leachate-contaminated, which he attributed to the ductwork not being insulated; the other was a major crack in the underground storage tank. Both sources fell within ADI's scope of the work. He denied ADI's claim.

[133] The trial judge's determination was totally a finding of fact. The circumstances involved made his finding especially challenging. He had before him competing theories of the source of the problem, which called for an understanding of the facility engineering and design, and he had conflicting evidence regarding what was taking place in the plant. Compounding the challenge, much of what was happening was underground, within and around the storage tank. Water was coming into the leachate storage tank from various sources. Assumptions and inferences had to be made by the parties, as well as by others affected, including representatives of the Owner and the Department of the Environment, and the trial judge had to evaluate that kind of evidence. In his assessment of the competing theories and conflicting evidence, the trial judge sometimes had to assess credibility. All these circumstances combine to present a high hurdle for an appellant on appeal.

[134] My review does not show palpable and overriding error. The reasons for judgment demonstrate that the trial judge understood the issue, the responsibilities of each party, and the functioning of the central composting facility. He entertained

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each party's theory and their evidence. I do not see that he made any finding in conflict with the evidence, or misapprehended either material evidence or the consequences of particular evidence in the overall mix.

[135] For the period of time when WCI was on-site, he could find that excess condensate running into the tank and mixing with the leachate in storage added materially to the volume of contaminated liquid. He could find that this occurred over a long time, both before and after December 4, 2002. As well, he could find that in September 2002, excess condensate was accumulating during a week period when condensate was not being released from the composting containers. He could also find that the underground storage tank developed a major crack in its inner wall, through which water from some outside source infiltrated, by hydrostatic pressure or other unknown source, and bled into the stored leachate, again increasing the volume of the contaminated liquid in the tank.

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[136] The fact-finding exercise for the period after WCI was removed from the site was even more challenging at trial, and for review on appeal. ADI was then solely in control of the facility, and was undertaking remediation. This involved more than one change. This circumstance raises a question as to how it could subsequently be proved that WCI's design was the cause of the problem. In challenging the trial judge's reasoning, ADI pointed out that the problem continued even after the storage tank was replaced, and attributes its system modifications to resolving the problem. In the circumstances, it was open to the trial judge to find that in late 2002 condensate was the major source of the excess, and in March 2003 condensate continued to be a substantial contributor such that approximately 50% of the excess leachate then being produced was from condensate from the curing building, and that later on in early 2004 ADI was attributing the liquid component of potato processor industrial waste as a contributing factor. It may well be true, as ADI asserts, that its repairs and modifications to the containers and the curing building worked to reduce the production and accumulation of leachate. Its changeover from negative to positive intermittent aeration is especially notable. However, the trial judge was entitled to consider all of the evidence, including WCI's evidence that the problem was attributable to ADI, and to find that in any event the problem is still not fully resolved.

[137] Viewed in the total context, it cannot be concluded on appellate review that the trial judge's findings were wrong and should be set aside, and that instead ADI has proven that WCI's system design was the cause of the excess leachate problem.

[138] I would dismiss this ground of appeal.

6.2 Container repairs

[139] Composting containers were an integral component of the composting

system, and within WCI's scope. The 48 containers were manufactured and supplied under sub-contract by a U.S. company Green Mountain Technologies International Inc. ("GMT"). GMT involved a local fabricator DME in the finish work. During plant commissioning, deficiencies were revealed, involving rust and extensive corrosion. Some steps were taken between WCI and GMT to address the problem, and GMT committed to honour its warranty. Due to the onset of winter, the plan was to put over major rectification until the following spring. Upon ADI removing WCI from the project, GMT extended its warranty to ADI.

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[140] GMT's estimate of the cost of repairs to resolve the deficiencies was $3,000. per container, all in, for a total of $144,000. In ADI's view, more extensive repairs and modifications were required. ADI and GMT addressed this issue, and in May 2003, ADI obtained a bid from GMT for $498,750. ADI obtained a competing bid for this work from another contractor, Allain, for $656,708. (This is referred to in the trial judgement as $631,863. and in the Allain bid as $667,680.; the distinction is of no consequence on this appeal.) For various business reasons, which it explained, ADI declined to involve GMT, either under the warranty or on its bid for the more extensive modifications and repairs, and instead issued a contract to Allain. At trial, ADI claimed recovery of the full amount of $656,708. against WCI.

[141] The trial judge found that the repairs required for rectification of the contract deficiencies could have been done under the GMT warranty, and that the proper quantum of damages was $144,000. He found that ADI did not show it was necessary to reject the option of relying on the manufacturer GMT, and to instead have the work covered by the warranty and additional work carried out by Allain.

[142] On this appeal, ADI asserts that the trial judge misapprehended the evidence of what was involved in GMT's warranty work compared to what GMT was proposing and what was required by spring of 2003 to correct the deficiencies to the Owner's satisfaction. ADI seeks the balance of the expenditure it made to Allain, of ($656,708. - 144,000.) $512,708.

[143] In my view, ADI has not shown that the trial judge made a palpable and overriding error in his assessment of the evidence regarding any material element that contributed to his conclusion, or in the conclusion itself. He understood the particulars and extent of the contract deficiencies, the required repairs, what the manufacturer GMT was offering under its warranty and under its subsequent bid, and what ADI was seeking. In particular, he appears to have had a good appreciation of the evidence of GMT's President, Michael Bryan-Brown, regarding the scope and estimated cost of the proposed warranty work, and how this corresponded with the corrosion problem and the extent of the contract deficiency. He understood the relationship between GMT and WCI regarding the litigation. It is not shown that the trial judge did not appreciate or understand the position being put forward by the Owner's project manager as to the minimum requirement for rectification of the

deficiencies, or the important consideration of whether GMT's proposed warranty work matched the Owner's expectation for rectification under the contract.

[144] There was evidence upon which the trial judge could make his findings. Mr. Bryan-Brown explained in detail what work it would have done by its sub-contractors, and the various components that went into the $3,000. per container estimate. He explained too how his subsequent bid went beyond his warranty work, and responded to ADI's request for additional work to modify the containers and expand container capacity. His price of $498,750. was to retrofit the containers, and covered significant additional work that would substantially increase the price. As well, something in the range of $160,000. - $180,000. out of that amount was attributable to the manufacture of four additional containers that would be used during the repair process.

[145] Although the reasons for judgment do not expressly say so, it can be deduced that the trial judge accepted WCI's submission that ADI commissioned extra work on retrofitting the containers that went beyond rectifying defects for which WCI had responsibility. The evidence of Mr. Bryan-Brown is clear in that regard.

[146] The trial judge did not make a palpable error in the findings he made along the way to his conclusion. The evidence supported the contention that in designing the containers to tolerate only pH levels of 4.8 and higher, WCI did not commit a design error such that modifications made to tolerate lower pH levels should be attributed to WCI. He had the evidence of the experience with a composting project in Maine for comparison. Once ADI was solely in charge of the facility, it controlled the composting process, and it was solely its decision to reduce or eliminate amendment of the feedstock by the addition of lime.

[147] Nor was it an error not to adopt ADI's decision to accept the higher bid from Allain due to contractual and payment between GMT and its sub-contractor DME.

[148] ADI did not show that the trial judge made an error in finding that WCI is not responsible for the additional work to repair the 48 containers, or the manufacture of four additional containers. I would dismiss this ground of appeal.

6.3 Post-termination remediation

[149] After ADI terminated WCI's design-build sub-contract, it incurred significant expenses for remediation of the facility in its efforts to satisfy the performance requirements of the Design-Build Contract. At trial ADI claimed damages for reimbursement of its various outlays. The trial judge recognized the claim for container repairs and assessed that particular claim. He also dealt specifically with ADI's claim for leachate disposal fees which he denied. Within his reasons for judgment, the trial judge discussed to varying degrees some of ADI's claims. Later

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on, under Assessment of Damages, he dismissed all such claims. He did that through a fairly general statement that did not address most of the claims individually.

[150] The trial judge found that ADI's overall remediation of the facility was an unnecessary and expensive mistake, and that the cost of that error must be borne by ADI. In his blanket rejection of the claims, he stated they fell into four categories. They were either: i) within ADI's scope of work; ii) within the amounts budgeted for contingencies relating to such matters; iii) formed part of the unnecessary modifications ADI undertook, or iv) resulted from problems that were the fault of ADI, not WCI. He provided examples of his reasoning regarding two items – humidification of exhaust air, and the supply of items that he stated were properly chargeable to various contingencies budgeted for such items. A majority of ADI's claims for remediation are for expenses it incurred for modifying the facility design. The trial judge stated that none of ADI's expenditures for *"modifying, remodifying, redesigning, retrofitting, remediating, remodeling, reconditioning, refining, and replacing various aspects of the composting system*" were necessary.

[151] On this appeal, ADI made submissions under the category of remediation and rectification regarding 14 items or claims, which amount in aggregate to approximately $1.37 million. I will identify these ADI claims, and refer to them in three categories:

- Modifications to facility undertaken by ADI:

6.4.1	Modifications to biofilters The filters were plugged. ADI replaced the screens with material having a larger opening in the pattern.	$ 10,725.
6.4.2	Remediation of the container composting system and aerated static pile ADI employed construction services to retrofit, repair and modify the mechanical and controls of the systems to make them operational.	355,180.
6.4.3	Remodel the post-process feed hopper ADI made modifications to the discharge of the post-processing line feed hopper; which it considered necessary because the hopper was incapable of discharging material without bridging and requiring constant attention of the loader operators to keep it operational.	19,200.
6.4.5	System remodifications – related expenses	8,260.
6.4.9	Modifications to prepossessing-line ADI changed the prepossessing-line from positive pick to negative pick; which decreased the amount of rejects/waste	

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leaving the facility by 20%.	31,500.
6.4.11 Related ADI group time and expenses ADI expense to respond to WCI's inability to operate.	79,011.
6.4.12 Related engineering and technical service ADI expense to retrofit system provided by WCI.	173,404.
6.4.13 Management of the redesign and retrofit ADI management of retrofit in 6.4.12.	91,730.
	$ 769,010.

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- Unexpected expenditures on facility resulting from WCI failures:

6.4.4	Tools and consumables ADI purchased tools, equipment and consumables during mid-2003; these were within WCI's scope but WCI failed to identify them as necessary for the facility.	$ 26,290.
6.4.6	Cat Skid Steer ADI added this mobile equipment as a complement to the two loaders that it considered necessary to deal with the facility demands. Design and specification of the loaders was within WCI's scope, but WCI failed to identify the need for this complementary component. This resulted from WCI's lack of understanding of the daily feedstock cycle, quantity and make up.	48,500.
6.4.7	Bandit Beast Grinder ADI purchased a grinder in October 2003. This was within WCI's scope, but WCI failed to identify that it would be needed. This failure resulted from WCI's lack of understanding of the annual feedstock cycles and materials that would be received seasonally such as Christmas trees.	125,000.
		$ 199,790.

- Facility operations

6.4.8	Trucking and disposal fees for a non-conforming compost and rejects This is ADI's cost as operator to have rejects removed from the site and disposed of, which occurred from commencement of plant operation until May 2003. It resulted from WCI not being able to produce *Category A* compost.	$ 335,833.

6.4.10 Replace auger replacement in shear shredder and

	reline mixer In December 2003 the auger wore out prematurely and ADI had to replace it, and reline the walls of the mixer. This was within WCI's scope, and resulted from totally inappropriate material being used to construct the rotors.	67,000.
		$ 402,833.
6.4	Total ADI claims for remediation	$1,371,633.

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[152] It is a premise of ADI's claim for reimbursement of the cost of remediation that the trial judge made an error in holding that it did not have the right to terminate WCI's sub-contract. It follows from that underlying premise that upon termination ADI had no choice but to undertake significant and expensive remediation efforts. ADI asserts that the trial judge's conclusion that its remediation was unnecessary and ill-advised was made without regard to the evidence and based on his manifest understanding of the term "*Category A* compost" as set out in the CCME Guidelines.

[153] Analysis of this claim on appeal presents a considerable challenge. As a threshold inquiry, I ask myself whether ADI's claim for remediation is dependent on its right to terminate the design-build sub-contract or, alternatively, whether ADI's claims for remediation stand independently. The trial judge linked the two issues. He found that ADI didn't understand WCI's composting system, that WCI was on the right track and making such progress toward resolution, and that if left to carry out its work it may well have achieved its contractual obligations by Total Performance. In essence, the trial judge found that by acting unilaterally and precipitously, ADI pursued a course of action which is solely its responsibility and the cost of which should not be attributed to WCI.

[154] The alternative view would be this: Accepting that ADI's termination of WCI's contracts was not authorized, in any event contract performance issues existed that had to be addressed – as evidenced by WCI's letter to ADI dated November 21, 2002 – which were WCI's responsibilities, which ADI corrected, and for which WCI should in any event be required to reimburse ADI.

[155] ADI submits that the trial judge did not consider its evidence in any meaningful way. My reading of the reasons for judgment indicates that regarding some claims he did; and regarding others, one cannot tell. Clearly, the trial judge made two findings: 1) ADI's termination of WCI was not authorized; and 2) ADI's remediation of the facility was unnecessary and ill-advised. Both of these findings were supported with extensive reasons. The results for the various ADI claims for reimbursement for

ADI expenses for remediation followed from there. Those basic findings were the basis of the trial judge's blanket denial, and explanation that the items fell into one of four categories.

[156] Earlier in this decision, I found that the trial judge's determination that ADI wrongfully terminated WCI's sub-contracts should stand. It follows that I would adopt that underlying premise and review the decision on assessment of damages on that basis. The question still remains whether claims for particular expenditures are extricable from or intertwined with the termination of contract issue. For the most part, they appear to me to be inexorably intertwined. Since ADI terminated WCI's on-site involvement, it will never be known what kind or amount of expense would have been necessarily incurred if WCI had been allowed its full time to demonstrate performance. On the other hand, WCI would surely have incurred some expense. If such expense was avoided by WCI, and was incurred by ADI, then this would raise an expectation that perhaps WCI should reimburse ADI. It is to be remembered that the trial judge determined WCI's damages based on payment of the full contract price, including whatever was left of the contingency allowance following pre-contract final negotiations. However, such expectations are qualified by two consequences of ADI's own breach of contract. First, WCI was thereby denied the opportunity to remediate at its expense. Second, such avoided expenses can no longer be identified because ADI embarked on a different course. It would seem to follow that ADI's appeal regarding these claims should be denied.

[157] I have considered ADI's claim for remediation both in the aggregate and by consideration of the particular claims. Even upon the passing the initial hurdle of showing a claim could be justified on its own notwithstanding the wrongful termination of contract, intervening events make it difficult at the appeal stage to isolate an individual claim for remediation and make an award. Following termination, ADI acted on its own to introduce changes to the facility that were different from the contract specifications prepared by WCI. The trial judge made extensive findings and conclusions by which he basically accepted WCI's design methodology and explanations and dismissed ADI's course of action as ill-advised. A finding in favour of ADI on individual claims at this stage would involve finding that the trial judge's analysis and conclusions were wrong. I have already found the trial judge did not make a palpable and overriding error in his assessment of the main deliverables and WCI's performance in that regard.

[158] I am afraid that the exercise that ADI asks this Court to perform is a quintessential application of the parable of the blind men and the elephant mentioned in the ***Waxman, supra*** standard of review analysis. The Ontario Court of Appeal stated:

> Counsel invite the court to carefully example isolated parts of the evidence.

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> But the court cannot possibly see and comprehend the whole of the narrative. Like the inapt comparisons to the whole of the elephant made by the blind men who felt only one part of the beast, appellate fact-finding is not likely to reflect an accurately appreciation of the entirety of the narrative.

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The disputes between ADI and WCI resulted in a lengthy and factually complex case. The trial judge heard the full case; this appeal court did not. The trial judge had the full narrative before him; this court was confined to precise descriptions of claims and alleged failures that were designed to support individual arguments for damages. The present evaluation is occurring at the appeal stage. The question is no longer simply whether a modification, repair, or piece of equipment was necessary. The question now is whether the trial judge made a reversible error regarding a particular matter. As well, the particular damages claim does not usually stand alone. Reversal of the trial judge's finding on a particular claim would usually involve rejection of the trial judge's findings of fact that led to his conclusion of the underlying issue of termination of contract.

[159] The situation here is that the claimant has been found to have breached the contract. This is obviously distinguishable from the situation in most assessment of damages authorities, in which the damages suffered by the innocent party are being assessed. This distinction and the practical limits on the ability of the appeal court to assess damages is tacitly acknowledged by ADI itself. Its notice of appeal asks this court to reverse the trial decision and refer the case back to trial for assessment of its damages. All the damages ADI seeks under its claim for post-termination remediation are subject to that constraint.

[160] ADI's eight claims for system modification all meet the same roadblock. There are four claims for system modification, remediation and remodeling, and related claims for engineering, management, and overhead. The trial judge found that ADI didn't understand the compost engineering discipline being employed by WCI, and in any event should have waited until Total Performance, after which it could have sought compensation for any continuing deficiencies. However, the trial judge found that by acting precipitously, ADI took matters into its own hands and embarked on a course of remediation that was unnecessary, ill-advised and ineffective. This finding is supported by full reasons that withstand appellate scrutiny. There was evidence, including expert evidence, to support the premises upon which the trial judge made his conclusion. Within this context, the trial judge's assessment and conclusions about *Category A* compost and the need to be available for use in any application is also supported and not a palpable error.

[161] The three claims for unexpected expenditures really reflect the parable of the blind man and the elephant. In the face of the trial judge's finding that the facility had a far greater likelihood of achieving Total Performance with WCI as the operator than

ADI, and his forceful rebuffing of ADI's theories and credibility, this appellate court is not in a position to override the trial judge and now find WCI at fault for not specifying particular items of equipment in the contract submission. An award of damages on any of those three claims would involve a finding that WCI had under-designed the facility. Such a determination cannot be extricated from the rest of the case on appeal. That said, one matter did raise a concern for me. The trial judge stated that the claims for the provision of some additional items are "*properly chargeable to various contingencies budgeted for such items.*" He then based his calculation of WCI's damages on the total design-build contract price, which would include WCI's contingency allowance. In that scenario, it may well be that WCI has received the contingency allowance and ADI is left to incur the cost of the supplementary equipment. However, I do not see that this court has the means at this stage to make the necessary isolation of particular items. In all the circumstances, it is not clearly proven that the expenditures were necessitated by WCI's failure to properly specify.

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[162] The claims for additional expenses on facility operations also cannot be attributed to WCI at this stage. They too are interrelated with other findings by the trial judge. In addition, they occurred after WCI was removed from the site and ADI was solely involved in operating the facility.

[163] I would dismiss this ground of appeal.

6.4 Wrongful termination of the Operating Agreement

[164] Under the Design-Build Contract with the Owner, ADI was to be the operator of the facility for a term of five years. Under the MOU between ADI and WCI, this role was to be sub-contracted to WCI. When WCI commenced operations, ADI issued it only an interim operating agreement. On December 4, 2001, ADI terminated all of WCI's rights under the MOU and the design-build sub-contract, including its right to enter into an operating agreement to operate the facility for a term of five years, and it contemporaneously terminated the interim operating agreement and instructed WCI to vacate the site.

[165] In the ensuing proceedings, each party claimed against the other for consequential losses. WCI claimed for the loss of profit it would have earned as operator had ADI not terminated its right to be the operator of the facility for five years. ADI claimed for the losses it incurred as a result of the inability of WCI to operate the facility, and ADI having to be the operator in WCI's stead. Each party supported its claim on opinion from a chartered accountant. For WCI, Stan H. MacPherson, FCA, calculated its total damages to be $2,326,359. This is comprised of loss of earnings before income tax of $2,005,398., adjusted for pre-December 4, 2001 termination actual experience by $104,325., to the amount of $2,109,723., plus interest on loss of earnings before income tax of $216,636. For ADI, Brian Dunstan,

C.A., calculated ADI's net loss from operating the facility in accordance with the terms of the operating agreement specified by the Design-Build Contract as outlined in the MOU between ADI and WCI to be $616,500. This is comprised of: (i) fees due from WCI to ADI under the MOU plus interest $357,500.; (ii) ADI operating losses $186,000.; and (iii) interest on financing $73,000.

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[166] The trial judge accepted WCI's submission in its entirety. This was entirely based on the MacPherson FCA opinion. The trial judge found that Mr. MacPherson's testimony was clear and direct, and he was unshaken on cross-examination. He awarded damages to WCI for the five-year operating period ending September 30, 2007, the full amount of $2,326,359. He does not consider the Dunstan C.A. opinion beyond mentioning it.

[167] ADI submits that the trial judge made reversible errors when he: (i) accepted the MacPherson FCA opinion on its face, despite serious inconsistencies and errors and key assumptions being inaccurate, inflated, and unsubstantiated by any evidence; and (ii) by ignoring in its entirety the Dunstan C.A. opinion, which provided relevant and material evidence.

[168] On this ground, I would allow the appeal in part. The compost sales component of the assessment of damages is not supported by the evidence, and ignores important compromising and contradicting evidence, which the expert witness MacPherson, FCA, upon whose opinion the assessment was based, himself acknowledged would materially affect his ultimate opinion. In particular, upon a full consideration of the evidence, in my opinion there is no evidence upon which the trial judge could base an opinion that there would be revenue from "*compost sales*" of $1,604,673. over five years.

[169] I am careful to respect the narrow scope for review on an assessment of damages, as stated by the Supreme Court of Canada in ***Woelk v. Halvorson, supra***. In the case of other significant items that enter into the revenue side of the operator's income statement, such as conversion rate and sales price, although those matters appear quite debatable, there is evidence upon which the trial judge could have made his findings, such that this court should not set aside the trial judge's findings even if we should be of the opinion that on our view of the evidence we would have come to a different conclusion. However, sales volume was a key and critical assumption, and there had to be evidence upon which that particular opinion could be based. During cross-examination of his opinion Mr. MacPherson acknowledged that upon factoring in important information that was not made available to him, a key assumption upon which he based his projected sales volume was no longer valid.

[170] While the reasons for judgment are thorough regarding the many and complex issues involving liability and damages in connection with the design-build sub-

contract, the reasons regarding losses regarding the operating contract are not. Only nominal reasons are provided, and no insight is provided into the trial judge's conclusion on the MacPherson FCA opinion or on the impact of new information revealed to him during cross-examination. The trial judge's brief reasons describe the issue, Mr. MacPherson's role, definition of loss, source of information, and overall methodology. However, they do not provide any insight into the trial judge's view of what Mr. MacPherson described as key assumptions regarding projected compost sales. His statement that Mr. MacPherson's assumptions were reasonable and realistic ignores consideration of Mr. MacPherson's own acknowledgments of the negative impact external events would have on the market place. I accept the trial judge's statement that there is no reason on this appeal to question the accuracy of the expert's calculations. They are a matter of arithmetic. Nor is there any reason to question the trial judge's observation that Mr. MacPherson's credibility was maintained by his scrupulously independent approach. But that does not address an essential point. Accuracy and integrity, while always necessary components of credibility, cannot substitute for the complementary requirement of reliable evidence upon which the opinion must be based.

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[171] The need for reasons sufficient for appellate review is apparent. The emphasis in ***Housen*** on the application of the 'palpable and overriding' standard to the process by which findings of fact are made moves reasons for judgment to the centre of the appellate review stage. Reasons for judgment can be so cryptic or incomplete as to provide little or no insight into the fact-finding process: ***Waxman, supra***, at ¶307.

[172] WCI submits that compost sales revenue is a matter of (1) the amount of compost available for sale, and (2) the price paid for the compost. There is a third element, which is essential: market. Mr. MacPherson acknowledged this; however, his opinion presented at trial assumed all *Category A Compost* produced by the facility would be sold into the marketplace.

[173] Regarding projected conversion rate, Mr. MacPherson used 60%. He acknowledged this was a soft figure, difficult to determine, and aggressive. He provided a researched basis for his number. There was competing evidence that would support a much lower rate of 40-42%, and also evidence of ADI experience of a 60% rate at some point. He acknowledged the sensitivity, such that a lower rate would mean proportionately less compost available for sale. He acknowledged that a 42% conversion rate would result in sales revenue of $1.23 million rather than $1.6 million, and recalled that 42% was WCI's predicted outcome from its facility design.

[174] Regarding projected price, Mr. MacPherson used slightly over $20. per ton or $10. per cubic yard. He based this on National Compost Council information. He did not research the Island market, or the market in Atlantic Canada. He was not made aware of WCI's marketing plan, which used lower pricing. There was also

competing evidence of local experience showing much lower pricing in the range of $10. per ton.

[175] The conversion rate and pricing have a direct and significant impact on projected sales revenue. Although Mr. MacPherson's assumptions for those revenue components appear to me to be aggressive, I would decline ADI's request to set aside these key assumptions because acceptance of the expert's evidence on those matters is not a palpable error. There was evidence upon which the trial judge could adopt those components of the calculation.

[176] Projected compost sales is a different matter. In Mr. MacPherson's opinion, projected compost sales over the five years are stated to be:

Year	**Sales ($)**
2002 (3 months)	- - - - -
2003	300,250.
2004	323,695.
2005	343,579.
2006	335,274.
2007 (9 months)	301,785.
TOTAL - 5 years	**1,604,673.**

[177] Section 9 of the Operating Agreement made pursuant to the Design-Build Contract specified that the Operator shall be responsible for the handling and marketing of compost in accordance with the RFP. This included disposal of the compost at its own cost, in a manner acceptable to the Owner. In support of that obligation, Section 9.3 required the Operator to provide the Owner with a complete and acceptable business and marketing compost created in the facility and to update the plan annually. The Operating Agreement provided for the Operator to bear all expenses of operation, and for full and current accounting to the Owner regarding its activity on disposal of compost.

[178] Facility operation was within WCI's scope on the project. Accordingly, in March 2001, WCI prepared an operating budget that became part of the RFP. Here, WCI projected five-year sales from compost to be $1,215,056., as follows:

Year	**Sales ($)**
1	92,500.
2	199,180.
3	249,717.
4	306,164.
5	367,495.
TOTAL - 5 years	**1,215,056.**

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Mr. MacPherson was aware of this proforma when he prepared his opinion.

[179] Later on, in November 2002, WCI produced a draft marketing plan. This plan adopted the projected sales, year-by-year and aggregate of $1,215,056. from the operating budget that became part of the RFP.

[180] The marketing plan contained other information that is pertinent to evaluation of the market for compost from the facility: The assumed price would be $10./Tonne for bulk and $100./Tonne for bagged compost. Surveys revealed skepticism in the marketplace resulting from the Waste Watch program. The majority of end users were adamant that they would not try the product until it had been demonstrated and proven successful. To address this, WCI would carry out an Island-wide education campaign in conjunction with compost demonstration projects. These would involve among other things government incentive programs for the agricultural sector, trial projects with municipalities, garden centres, golf courses. WCI's short term strategy would be directed at the market segments of landscapers, golf courses, municipal parks, land rehabilitation, agricultural applications, and sod farms. Initially the product would be sold in bulk. Schools would hold fundraisers; bulk distribution centres would be set up across the Island. The longer term strategy would involve refined products for nursery and greenhouse use and bagged product for the home gardeners. In order to promote development, WCI would share sales revenues beyond its threshold 50/50 with others involved in market development.

[181] Regarding customer segments, the marketing report categorized only agriculture as large, and most of the other market segments as medium. It stated the estimated market segment sizes as:

Market Segment		Estimated Market Size (tonnes/yr)
1.	Landscapers	1300
2.	Golf Courses	1335
3.	Public Parks and Playing Fields	5000
4.	Agriculture	3 488 400
5.	Land Rehabilitation	10 000
6.	Sod Farms	30
7.	Nurseries/Greenhouses	2000
8.	Retail Chain Stores/Garden Centres	2000
	TOTAL	**3 510 065**.

[182] WCI's marketing plan did not enter into Mr. MacPherson's analysis, because he was not made aware of its existence. It was first brought to his attention during cross-examination at trial. Mr. MacPherson prepared his opinion without this information.

[183] The evidence also indicates that in August 2002, WCI informed ADI about

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market limitations. Mr. Kennedy stated there was currently no market for the compost product from the facility and that WCI did not know what the quality of the compost would be.

[184] Mr. MacPherson assumed that compost sales would have begun five months after commencing operations, which was March 2002, and the price would move up gradually from $10./cu.yd. in year one to $12./cu.yd. ($24.14/Tonne) in year five. He used actual tippage fees based on ADI facility experience to estimate the biowaste entering the plant, and applied his assumed conversion rate of 60% to determine volume and sales revenue. He recognized that sales fluctuate with highest volume in the spring months, and stated that he calculated revenues simply by the amount of compost produced. He assumed all compost produced would be sold. He assumed his projected sales would be on-Island, and based his expense estimates on that assumption too.

[185] Mr. MacPherson acknowledges his sales revenue was substantial. Asked for his assumption as to market segments for sales, he stated that he wasn't exactly sure where it would be sold, but he agreed that the agricultural sector was the reasonable place to put it, being certainly the biggest segment of the market. Upon being referred to the market segment statistics in WCI's marketing plan, he categorized the agricultural sector, which was 99.37%, as a high proportion of the total market. In his opinion, if there was some problem selling into that sector, there would be a significant problem with sales.

[186] There was a problem in selling compost from the facility into the agricultural sector, that arose from an external source. The Owner's compost specialist Heather Myers testified that very shortly after the facility began to have compost available for sale, Cavendish Farms contacted their growers and asked them not to use the compost product. When she inquired, Cavendish Farms informed her that their reason for not wanting the compost product that they were fearful there would be some foreign content, specifically sharp foreign matter content, that may be within the compost product. Heather Myers stated this is a real potential, and it could not be guaranteed against. She stated that Cavendish Farms was already subject to strict rules, and did not want to take on additional risk. The other potato processor, McCains, followed suit with Cavendish Farms, and asked its growers not to use the product. Ms. Myers then learned that the problem was national in scope, and affected composters "*right across Canada*." She considered the problem to be *"a very unfortunate thing to have happen*" as it put some fear in people's heads as to whether or not the compost product would be safe to use. She stated that event certainly impacts on the ability to market the product. Her reference point to amelioration of the problem was ADI's subsequent ability to find markets for the product (which amounted to less than $100,000. over five years), and purchases by IWMC for sale to the general public in the amount of two to three thousand tons per year (which at $20./tonne would equal $40,000.-$60,000. per year).

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[187] Mr. MacPherson did not consider this turn of events in his report. When he submitted his expert opinion, he had not been made aware of the Cavendish and McCains directions or the consequence in the agricultural sector. Once informed during cross-examination, he agreed that would certainly have knocked an awful lot out of their market. He recognized the importance of potatoes in the agricultural sector, and categorized Cavendish as the biggest contract, the biggest processing plant on the Island. Regarding McCains having given the same instruction to its growers, Mr. MacPherson stated it would diminish the P.E.I. markets. He estimated that perhaps 60% of the potatoes grown on the Island go to McCains or Cavendish; and postulated that other growers once informed might or might not be affected, but acknowledged that if a grower ever wanted to grow for those processors, he probably would not use the product.

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[188] It is manifestly clear that these events which Mr. MacPherson did not consider in his opinion were very significant, and would have materially affected his opinion of compost sales and hence revenue.

[189] On the appeal, WCI countered that there were remaining markets, and it was not shown that there was no evidence upon which the trial judge could base his assessment. I do not accept that submission. The evidence of Don Jardine of sales from the East Prince composting facility is in only general terms and it is not quantified. It speaks of some being sold and some given away, of people coming in the spring for quarter-ton truck loads, of a lot of farmers using it at the time, and nurseries, greenhouses, and government departments using it a bit.

[190] The WCI draft marketing reports recognizes that market is not unlimited, and as well, that it is undeveloped and uncertain. A calculation shows that the projected revenue in Mr. MacPherson's opinion is based on something in the range of 16,000 tonnes ($1.6 million/5 years/$20./tonne = 16,000) per year going into an assumed market of 3.5 million tonnes. If 60% of the agricultural sector is taken away, the Island market would be reduced from 3.5 million tonnes by almost 2.1 million tonnes to just over 1.4 million tonnes. Without the entire agricultural sector, the remaining market would be negligible at approximately 22,000 tonnes. The WCI marketing report stated adamant resistence in these market sectors.

[191] Upon consideration of all the evidence, it is not reasonable to assume that the market would absorb total facility production. In re-direct examination, Mr. MacPherson stated that the facility capacity of 18,000 tons of compost is not very much in a market of 3.5 million tons. However, upon these important factors being before the court, he gave no confirming opinion of his initial assumption that facility production would be absorbed into the market place, or any revised opinion of market demand and projected sales. The market was untested and uncertain. The Owner's representative indicated the experience of it buying up 2,000-3,000 tonnes per year

for distribution. After 2004, that IWMC market, while motivated and perhaps captive, could account for up to a fifth of projected sales.

[192] ADI informed the Owner in September 2003 that due to changed conditions and factors beyond ADI's control, there was no longer any expectation of being able to sell any significant amount of finished compost on the Island (which would also add to the expense side of facility operations). The year 2003 was the only year that ADI had sales of any significance. That year sales were $68,000. ADI's aggregate sales for the five-year operating period was reported to be $80,000., and referred to at trial to being approximately $100,000. WCI submits that ADI's plight resulted not from market conditions but from it not producing *Category A* Compost. I would avoid intruding on the trial judge's findings of fact in that regard. Accordingly, ADI sales do not provide a reference point.

[193] Setting aside the ADI sales issue, it is plain and obvious that the sales estimate in the MacPherson FCA expert opinion was vitiated. Mr. MacPherson acknowledged as much himself. He acknowledged that following the Cavendish and McCains directions to their growers, his assumption on sales was no longer reasonable and realistic. This, combined with the absence of input from WCI's own market projections, which were a quarter lower than Mr. MacPherson's, and made with many reservations about the market place, result in there being no evidence upon which the trial judge could base his opinion. On that basis, the judge's opinion should be set aside.

[194] It remains to be determined the amount of loss WCI suffered as a result of ADI wrongfully terminating its contractual right to operate the facility for five years.

[195] Proceeding on the basis that ADI wrongfully terminated WCI's contracts, WCI's damages from loss of opportunity to operate the facility need to be measured. ADI's real dispute on that count is that the key assumption for projected sales is unfounded. In all the circumstances, it is my view that the line item Compost Sales can be subjected to reassessment, and the rest of the MacPherson FCA report can be allowed to stand. I will explain.

[196] First of all, the Dunstan CA report does not stand to undermine the MacPherson FCA report regarding the issue that ADI puts into contention. The Dunstan report was prepared for a different purpose – to measure ADI's losses as a result of WCI's breach – and to that extent it is rendered irrelevant by the trial judge's determination that ADI was the party who breached the contract. As well, its statement of actual sales revenue is rendered unhelpful by the trial judge's finding of fact that ADI was producing an inferior product that was not *Category A* compost.

[197] In any event, some information in the Dunstan CA report is useful for comparison. On the revenue side, tippage fees are by far the largest item. Both

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experts used actual experience as reported to them. Both come to approximately the same number – five-year revenue from guaranteed and additional tippage of approximately $7.3 million. For the period up to the end of 2006, it was based on actual expenses as reported by ADI's accountants Grant Thornton in unaudited financial statements; and 2007 was based on a pro-rated average based on the years 2006 and 2006.

[198] While certain expense items were put in issue by WCI during the appeal, ADI did not appeal Mr. MacPherson's projected expenses; and the differences in expenses in the Dunstan CA report resulting from major items of professional fees and leachate and other disposal costs are not in issue for this particular assessment.

[199] ADI did appeal other elements that were the basis for Mr. MacPherson's sales revenues – conversion rate and price – but I have already stated that the trial judge's findings regarding these assumptions while contentious were sustainable. Their importance is also marginalized if the market is found to be limited by demand.

[200] It is appropriate for this court to decide this issue rather than remit it back to the trial judge for reassessment. The case is closed, and this court has all the information on this issue that the trial judge had or would have.

[201] The appellant has satisfied me that the sales projection is unfounded such that it does not provide a valid basis for sales revenue, and the trial judge's assessment of damages should be set aside. At this subsequent stage where this court is conducting an assessment, the onus is on the party claiming the loss of income to prove its claim. This assessment is a challenging exercise. Mr. MacPherson did not give an opinion on WCI's five-year revenue from compost sales in the diminished market that resulted from the Cavendish and McCains directives to their growers. The initial evidence of projected sales was the WCI marketing plan and Mr. MacPherson's original assumption. The marketing plan was insufficient on its own as a basis to quantify sales. It also projected substantially less sales, and raised concerns about market resistance and need for market development; and it pre-dated the Cavendish and McCains directives. At conclusion of the evidence, the MacPherson FCA opinion no longer has a sales projection that could form the basis for assessment. The Dunstan CA report, which is based on ADI sales experience, and ADI's evidence regarding sales, is not helpful, except as a floor or base.

[202] In the absence of evidence, it would involve speculation and an arbitrary decision making to substitute some mid-range figure for projected sales. Fridman, **The Law of Contract**, 5th ed., at pp.757-759, advises regarding the balance to be struck. Once a loss of opportunity resulting from the other party's wrongdoing has been established, to the extent there is some evidence the court must do the best it can to make a reasonable estimate of the plaintiff's loss. The fact that it may be

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difficult, if not virtually impossible, to assess or measure accurately the loss is not itself an answer to a claim for damages. Loss that is difficult to assess is still a loss. However, truly speculative loss is not recoverable, since it is not a loss that can be traced to the defendant's breach of contract, nor necessarily a loss that the plaintiff has suffered.

[203] These observations can be made from the evidence: (1) It was initially MacPherson's assumption that all the compost produced would be sold into the market; however, he indicated his figure was based on facility production, and his assumption was stated without any expressed consideration of market demand. (2) If, as Mr. MacPherson acknowledged, 60% of the originally-assumed market was lost following the Cavendish/McCains directives, then one could speculate that 40% may remain. On proportionate basis (a reference point of dubious value and assuming a conversion rate of 60% and price of $20./tonne), five-year sales would then be approximately $640,000. (3) Applying the evidence of Heather Myers, if IWMC took up to 2000-3000 tonnes per year from 2004 onward, that would generate sales revenue of $40,000-$60,000. per year for the five-year revenue up to $293,000. based on 2003 actual at $68,000. and $60,000. per year (3000 tonnes @ $20. for the three years nine-month period 2004-2007). (4) While ADI's reported five-year income from compost sales is approximately $80,000., the explanations in the Dunstan CA report pose some questions. ADI reported no income from compost sales in 2006, and its reported five-year "other income," in the same category in which it included compost sales, amounts to $373,000. ADI's facility manager Chris Snively testified there was some compost sales every year, including 2006, regardless of what the financial statements say, although he could not substantiate a particular sum of significance. From 2005 onward, Mr. Dunstan advised this other income is either "miscellaneous" or unexplained. The only function of the facility being compost production, absent explanation this other income could be attributed to compost sales.

[204] All of this leaves a challenging circumstance. Absent a reliable opinion, there is no real basis upon which to include compost sales revenue. However, the experience was that there was some revenue, in the range of $100,000., and there was some indication of potential for more. The evidence that IWMC would buy up some compost was soft and general, but it was independent. Without a supporting opinion, adoption of a sales figure higher than any of these indicators would be arbitrary. It is to be remembered, as Mr. MacPherson noted, the sales aspect of the loss of income calculation is in any event necessarily hypothetical being based entirely on projections.

[205] I would assess substantial damages, and give WCI the benefit of the greater of the maximum value of the evidence of a captive market in IWMC and ADI's aggregate five-year other income. On that basis, I would find that WCI's projected five-year compost sales to be $373,000.

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[206] I would use Mr. MacPherson's Projected Statement of Earnings and Calculation of Damages contained in his opinion as re-stated by the trial judge, with the only adjustment being substituted Compost Sales Total, and I would also adjust the interest proportionately. This is demonstrated as follows:

	MacPherson FCA Report	**Assessment on Appeal**
WCI Projected Statement of Earnings:		
Tippage fees (guaranteed and Additional)	$7,328,816.	$7,328,816.
Compost Sales	**1,604,673.**	**373,000.**
Total Revenue	$8,933,489.	$7,701,816.
Expenses	(6,928,091.)	(6,928,091.)
Earnings before income tax	$2,005,398.	$ 773,725.
Adjustments for pre-December 4, 2002 operations	104,325.	104,325.
Earnings before income tax, after adjustments	**$2,109,723.**	**$ 878,050**.
Interest on loss of earnings	216,636.	90,162.
Loss of earnings with interest	$2,326,356.*	$ 968,212.
Less deduction for container load-out system and interest (trial judgment ¶414-415 and 417)	(86,297.)	(86,297.)
TOTAL DAMAGES - operating agreement	**$2,240,059.**	**$ 881,915.**

*Correct figure is $2,326,359.

[207] I would allow this ground of appeal in part, set aside the trial judge's assessment of damages for WCI's loss following wrongful termination of the operating agreement of $2,240,859., and assess those damages in the amount of $881,915.

Costs

[208] Costs should generally follow the result. The court has a discretion regarding costs; however, it should be the reasonable expectation of the parties that the general rule will be followed. In this appeal, both parties have achieved some success. WCI has successfully responded to ADI's appeal of the judgment for

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wrongful termination of the contracts and related issues. This involved five grounds of appeal regarding liability and three assessments of damages, and preserved judgment in the amount of $2.07 million. Termination of contract was the most complex and time consuming issue. ADI has successfully appealed the assessment of damages for WCI's losses regarding the operating agreement, which resulted in a reduction from the trial judgment of $2.24 million by the amount of $1.36 million. While the amounts preserved and successfully appealed are both substantial, most of the case on appeal was concentrated on liability and related issues. In awarding costs, I would recognize the success of each party and the other mentioned factors. About 10:1 appears to me as a fair ratio for this determination. I would therefore set-off the costs awarded to each party, with the net effect of WCI being awarded 90% of its partial indemnity costs on the appeal.

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[209] I would not disturb the trial judge's award of costs. He presided over a lengthy and complex trial. While ADI successfully challenged the assessment of damages on the operating agreement, it remained partially intact. While amounts sought and recovered were factors for him, and matters which could reasonably be expected to result in some adjustment on this appeal, his full reasons for judgment on costs advise that he considered the complexity of reconstructing the relationship of the parties and obtaining an understanding of the composting facility to be important. He also awarded some additional costs to compensate WCI for incremental counsel attendances that he attributed to ADI's lack of organization at trial.

[210] Counsel and the parties should seek agreement on costs on the appeal. If they are unable to agree, then the court will assess the costs. For that purpose, WCI's

counsel shall file and serve a submission and bill of costs within two months of this judgment, and ADI shall file and serve its response within the next month.

____
Chief Justice David H. Jenkins

I AGREE: ____
Justice Michele M. Murphy

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McQUAID J.A. (dissenting):

INTRODUCTION

[211] When Island Waste Management Corporation (IWMC) decided to construct a central composting facility in Prince Edward Island, it issued a Request for Proposals (RFP) for the design, construction and operation of the facility. Paragraph 5.2 of the RFP provided that the "… Limited Company or other legal entity submitting the proposal…" would be the signatory to a contract to perform the work, as well as the signatory to all legal instruments required under that contract, and it would be the principal which would supply the necessary security by way of various bonds. As provided in paragraph 16.1 of the RFP, the form of the agreement between IWMC and the successful proponent was "CCA Document No. 14 - 1997 Design-Build Stipulated Price Contract, as amended herein." IWMC was to pay the successful proponent a fixed price to design and build the facility.

[212] The successful proponent was also obligated to enter into an operating agreement to operate the facility. The operating agreement was to incorporate the terms set forth in Appendix B of the RFP.

[213] The appellant and the respondent decided to participate in the proposal process. The appellant had the expertise necessary to manage the construction of the physical plant while the respondent possessed expertise in the design of the composting process and the construction of the equipment required to complete the process. Because only the appellant, singularly, had the financial means to post the security required by the RFP, the appellant would be the signatory to the contract with IWMC and thus the prime contractor.

[214] The proposal was submitted in March 2001. The introduction states that it is submitted by the appellant "in association" with the respondent. The appellant is described as the "prime contractor" with responsibility for the design and construction of the facility. The respondent is described as the "specialist subcontractor" with responsibility for the composting technology design, the layout of the facility and the supply of "propriety equipment and operations."

[215] The parties agreed that the best way to meet the requirements of the RFP would be to proceed in the above manner. Their roles were complimentary and consistent with their area of expertise.

[216] Because of their individual areas of expertise, the parties worked closely in formulating the response to the RFP. They worked on the pricing as well as the details of the construction and acquisition of the equipment necessary to conduct the composting process. The appellant would be ultimately responsible to IWMC for the design, construction and operation of the facility.

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[217] In the course of preparing the response to the RFP, the respondent indicated that it would like to have the arrangement between it and the appellant reduced to writing. Accordingly, the appellant and the respondent embarked upon the negotiation of an agreement that would set forth the terms of their relationship should their response to the RFP be accepted by IWMC. The negotiations are chronicled by the trial judge in his reasons. See: ***WCI Waste Conversion Inc. v. ADI International Inc.*** 2008 PESCTD 40; (2008), 283 Nfld. & P.E.I.R. 254; [2008] P.E.I.J. No. 45, at paragraphs 14 to 36.

[218] Construction commenced and was declared substantially complete on October 7, 2002 (revised October 10, 2002) subject to a substantial holdback.

[219] The relationship between the parties faltered from time to time during the course of construction and eventually deteriorated to the point where the appellant terminated the contract with the respondent to design and build the composting process as well as the contract to operate the facility.

[220] A number of actions were commenced in the Supreme Court.

[221] The respondent filed a mechanics lien and commenced an action pursuant to the provisions of the ***Mechanics Lien Act***, R.S.P.E.I. 1988, Cap. M-5.

[222] The appellant commenced an action against the respondent alleging breach of contract and negligence. In this action, the respondent commenced third party proceedings against a company it had subcontracted to design the composting containers to be used at the facility. The third party commenced fourth party proceedings against two companies it contracted to manufacture the containers. The fourth party proceedings were eventually discontinued.

[223] The respondent also commenced an action against the appellant alleging breach of the operating agreement.

[224] Finally, the appellant commenced an action against an associated company of the respondent as well as a principal of the respondent alleging negligence in the design of the composting process.

[225] Prior to trial, all of these actions were consolidated into the action commenced by the respondent pursuant to the ***Mechanics Lien Act***.

[226] Over 38 days Campbell J. conducted the trial in the Supreme Court. A significant number of documentary exhibits were introduced into evidence. The trial judge found that the appellant and the respondent entered into a joint venture agreement to design-build and to operate the compost facility. He also found that

both contracts were wrongfully terminated by the appellant. The appellant was found liable for the respondent's damages as the result of the breach. Damages were assessed at $4,306,339. plus costs. In the result, the trial judge dismissed all claims commenced by the appellant against the respondent, its principal, Mr. Kennedy, and its related entities. See: ***WCI Waste Conversion Inc. v. ADI International Inc., supra***.

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[227] The appellant appealed to this Court from the order of the trial judge on six grounds, and they are set forth in the reasons of the Chief Justice. Except for a brief reference to the second ground of appeal, I will address only grounds (1) and (3). They are:

> (1) did the trial judge err in concluding the relationship between the appellant and the respondent was one of joint venture and not a contractor/subcontractor relationship? and
>
> (3) did the trial judge err in determining that the appellant did not have the right to terminate the contract between the appellant and the respondent?

[228] For purposes of addressing the two grounds upon which this appeal turns and because these two grounds raise questions of law, it will not be necessary to extensively review the evidence and the factual findings of the trial judge.

DISPOSITION

[229] It is my opinion the trial judge erred in law on both of the above grounds. For the reasons which follow, I would allow the appeal, set aside the trial judge's order and order a new trial.

ISSUE

[230] The fundamental issue in this appeal is the nature of the contractual relationship between the appellant and the respondent.

[231] Was the nature of the relationship between the parties such that it imposed upon the appellant fiduciary obligations and a duty of good faith in its contractual relationship with the respondent? The answer to this question will provide the foundation in law upon which a court should assess the decision of the appellant to terminate its contractual relationship with the respondent. The answer to the question is found in the interpretation of the contract entered into between the appellant and the respondent.

STANDARD OF REVIEW

[232] In ***McCain Produce v. P.E.I. Lending Agency***, 2010 PECA 4, at para.17, this Court held that the interpretation of a contract is a question of law. The Court relied upon a decision of the Alberta Court of Appeal in ***Double N Earthmovers Ltd. v. Edmonton (City)*** 2005 ABCA 104, at paras. 16 and 17. In that case, the Court held that the interpretation of the words of a contract is a question of law reviewable on the standard of correctness.

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[233] On the other hand, as this Court also held in ***McCain Produce***, when it is necessary to consider the factual circumstances surrounding the making of the contract to ascertain its essential terms, those findings of fact are reviewed on a standard of palpable and overriding error.

[234] Furthermore, as stated by the Alberta Court of Appeal in ***Dow Chemical Canada Inc. v. Shell Chemicals Canada Ltd.*** 2010 ABCA 126 at para. 12:

> The interpretation of contract principles to the facts is a question of law reviewed for correctness.

[235] All questions of law are reviewed by this court on a standard of correctness. See: ***Housen v. Nikolaisen*** 2002 SCC 33; [2002] 2 S.C.R. 235.

[236] The trial judge's finding as to what constituted the contract between the parties as well as the interpretation of that contract both raise questions of law. The interpretation and application of principles relating to contracts to a settled set of facts is also a question of law.

ANALYSIS

a. the contract

[237] The trial judge found that as of May 23, 2001, the appellant and respondent entered into an agreement by way of a Memorandum of Understanding (MOU). He also found that the parties subsequently agreed to amend the terms of this MOU in relation to the amount of compensation to be paid to the respondent and scope of the work to be undertaken by both parties. These amendments were included in another MOU signed by the appellant on August 3, 2001, and by the respondent on August 23, 2001. This MOU (the "August MOU") states that it incorporates the terms of the MOU adopted in may and specifically provides that it "… is a follow-up to the MOU dated May 23, 2001…". The trial judge found the August MOU to be "…valid and binding and forms part of the contract between the parties." (my emphasis) See: para.42 of the trial judge's reasons.

[238] It is to be noted that the trial judge found the August MOU to be only a "part"

of the contract between the two parties. Therefore, it is unclear what the trial judge found to constitute the terms of the contract between the parties - the written MOU signed by the appellant on May 23, 2001 and found by the trial judge to have been agreed to by the respondent by way of e-mail on the same date - the MOU signed by both parties in August, 2001- a combination of both documents - the drafts of all proposed agreements as well as the verbal communications between the parties? The reasoning of the trial judge in this respect allows for considerable fluidity in interpreting first, what the parties actually agreed to and, secondly, the nature of that agreement.

[239] The trial judge appeared to accept the written MOU's of May and August as the contract; however, at paragraphs 43 to 46 he recounts the negotiations between the parties and relies on them in reaching the conclusion as to what constituted the contractual relationship. In the result, the trial judge found the contract to be all of the above and from this he determined the nature of the relationship between the two parties.

[240] The trial judge found that "for purpose of the proposal" to IWMC, the parties were in a contractor-sub-contractor relationship while between themselves they were parties to a joint venture agreement.

[241] The trial judge erred in law in not identifying the contract between the parties as being the August MOU. The parties negotiated an agreement and it was reduced to writing. The trial judge erred in law by going outside the terms of that written agreement to determine the terms of the contract between the parties when the August MOU sets them forth in detail.

[242] The August MOU constituted the contract between the parties, and it must be interpreted in accordance with the rules applicable to the interpretation of contracts.

b. the interpretation of the contract

[243] In ***BG Checo International Ltd. v. British Columbia Hydro and Power Authority***, [1993] 1 SCR 12, La Forest J. and McLachlin C.J. stated:

> [9] It is a cardinal rule of the construction of contracts that the various parts of the contract are to be interpreted in the context of the intentions of the parties as evident from the contract as a whole: K. Lewison, **The Interpretation of Contracts** (1989), at p. 124; **Chitty on Contracts** (26th ed. 1989), vol. 1, at p. 520. Where there are apparent inconsistencies between different terms of a contract, the court should attempt to find an interpretation which can reasonably give meaning to each of the terms in question. Only if an interpretation giving reasonable consistency to the terms in question cannot be found will the court rule one clause or the other ineffective: **Chitty on Contracts, supra**, at p. 526; **Lewison,**

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> **supra**, at p. 206; ***Git v. Forbes*** (1921), 62 S.C.R. 1, per Duff J. (as he then was), dissenting, at p. 10, rev'd [1922] 1 A.C. 256; ***Hassard v. Peace River Co-operative Seed Growers Association Ltd.***, [1954] 2 D.L.R. 50 (S.C.C.), at p. 54. In this process, the terms will, if reasonably possible, be reconciled by construing one term as a qualification of the other term: ***Forbes v. Git***, [1922] 1 A.C. 256; ***Cotter v. General Petroleums Ltd.***, [1951] S.C.R. 154. A frequent result of this kind of analysis will be that general terms of a contract will be seen to be qualified by specific terms -- or, to put it another way, where there is apparent conflict between a general term and a specific term, the terms may be reconciled by taking the parties to have intended the scope of the general term to not extend to the subject-matter of the specific term.

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[244] The following principles can be extracted from this passage: (i) various provisions of a contract are to be interpreted based on a consideration of the intentions of the parties as reflected in the contract as a whole; (ii) if different provisions of a contract are inconsistent the court should search for an interpretation which gives reasonable meaning to each provision; (iii) inconsistent terms should, if reasonably possible be reconciled by construing one as the qualification of another; and (iv) if a general term and a specific term are in conflict, they may be reconciled by imputing to the parties an intention that the scope of the general term would not extend to the scope of the specific term.

[245] The trial judge found that the parties had agreed "… to be bound by the general principles applicable to joint ventures." See: para.48 of the trial judge's reasons. However, this is not exactly what they agreed to. The August MOU provides "… that ADI will be the prime contracting party, with WCI engaged as a subcontractor. …" The parties also agreed that their "actual working relationship will be based on the general principles of a joint venture agreement as summarized below." (emphasis added). As noted, the contract also provides their relationship would be that of contractor/subcontractor.

[246] There is an apparent inconsistency in the agreement between the parties as to the nature of their relationship. On the one hand, the contract could be construed as fixing their legal relationship as that of contractor and sub-contractor. On the other hand, the contract provides their working relationship is to be based on the general principles of a joint venture. This latter reference to a working relationship based on the general principles of a joint venture might be construed as setting their legal relationship as that of parties to a joint venture agreement. On a reading of the contract as a whole, the court is obligated to search for an interpretation which gives meaning to both provisions.

[247] The respondent takes the position on this appeal as it did at the conclusion of the trial that it contracted with the appellant to enter into a joint venture. Therefore,

according to the respondent's position, the nature of the legal relationship was that of a joint venture and in terminating the relationship, the appellant was bound to apply the principles which govern such a relationship.

[248] The appellant took the position throughout all proceedings that it contracted with the respondent as a sub-contractor. The terms of this relationship is, according to the appellant's argument, guided by the terms of the August MOU and the design-build contract as well as the operating contract the appellant entered into with IWMC, both of which are incorporated by reference into the August MOU. The appellant also takes the position the contract with the respondent did not include an implied term to act in good faith nor did it impose upon the appellant fiduciary duties.

[249] The pleadings filed by the respondent are at odds with the position that it now takes and which it took at the conclusion of the trial. In the statement of claim initially issued by the respondent against the plaintiff claiming a mechanics lien against the property of IWMC for monies due and owing under the agreement by the appellant, the respondent pleads in paragraph13 that the agreement between the parties was the August MOU and that the appellant was the general contractor and the respondent was a subcontractor. In the many pleadings filed thereafter in all the proceedings which I referred to above, the respondent continued to take this position.

[250] At the conclusion of the trial, counsel for the respondent moved to amend the pleadings to the effect that the parties had contracted to form a joint venture. The trial judge did not decide the motion. He held the respondent could rely on this position without a formal amendment to the pleadings.

[251] The appellant relies on this decision of the trial judge as the second ground of appeal. Because I am of the view that the contract between the parties did not create such a relationship, regardless of the state of the respondent's pleadings at trial, this ground of appeal does not need to be addressed to resolve the fundamental issue in this appeal.

[252] Nevertheless, I agree with the appellant. The trial judge erred by not denying the motion of the respondent to amend its pleadings. Furthermore, he erred when he proceeded to decide the case based on the respondent's position that the parties agreed to enter into a joint venture. A position that had not been properly set forth in the pleadings.

[253] From the first of the many pleadings it filed in the various proceedings that have been consolidated into this proceeding and throughout the entire trial, the respondent took the position that the contract between the two parties established a contractor/subcontractor relationship. In all its evidence both documentary and *viva voce*, the respondent continued to take this position. The appellant, as the defendant in the consolidated proceeding, structured its defence with this position clearly before

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the court. At the conclusion of the trial when all the evidence from both parties was adduced, the respondent's counsel moved to amend the pleadings and to assert the legal relationship between the parties was that of a joint venture with all the attendant and additional obligations such a relationship would allegedly impose on the appellant.

[254] The trial judge found that an amendment to the pleadings was not necessary, because the August MOU had been pleaded and it contained reference to a joint venture relationship as noted above. So it did; however, the respondent had pleaded its interpretation of the contract was that the respondent was a subcontractor of the appellant. Furthermore, the respondent had taken this position in the evidence it adduced.

[255] The appellant would have been completely surprised by the motion and the trial judge's decision. With no opportunity to adduce evidence which might address the revised position of the respondent, the appellant was seriously prejudiced. In effect, the trial judge allowed the respondent to plead, after the trial was complete that the legal relationship between it and the appellant was that of a joint venture. The trial judge then proceeded to decide the case on the basis that the parties had contracted to form a joint venture.

[256] The trial judge's decision to allow the respondent to effectively plead this position at the conclusion of the trial seriously impacted on the fairness of the trial. The trial judge should have denied the motion and adjudicated the case on the pleadings as filed by the respondent.

[257] Returning to the fundamental issue in the appeal, the court is left with the apparent inconsistency in the wording of the contract. The inconsistency must be resolved on a reading of the contract as a whole bearing in mind the court is obligated to find an interpretation which would give meaning to both provisions that create the inconsistency.

c. joint venture or contractor/subcontractor

[258] In ***UAP Inc. v. Oak Tree Auto Centre Inc.*** (1997), 149 Nfld. & P.E.I.R. 313 (PEISCAD), this court found a contract between the parties to enter into a joint venture. Applying ***Central Mortgage & Housing Corp. v. Graham*** (1973), 43 D.L.R. (3d) 686 (N.S.S.C.T.D.), the court held that a joint venture must have a contractual basis. It is an association between two or more parties based on a contract to combine their money, property, knowledge, skills, experience, time or other resources to the completion of a single project or undertaking. A joint venture must have some of these essential elements, although its existence will depend on the circumstances of each case.

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[259] To summarize, a joint venture is a group of individuals or corporations who agree by contract to undertake a project for joint profit by the utilization of their individual resources. They have a joint property interest in the subject matter of the contract, there is a right of mutual control and management and they have the right to participate in the profits of the undertaking.

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[260] Applying these factors to the terms of the agreement between the appellant and the respondent does not disclose there was an agreement to embark upon a joint venture.

[261] The appellant contracted with the owner IWMC to design and build a composting facility. This contract is referred to in the August MOU as the "prime contract." The appellant's contract with IWMC was for a fixed price. The respondent was not a party to the prime contract and the respondent was not obligated to IWMC in any manner.

[262] The respondent contracted with the appellant as a subcontractor to do certain work in relation to the prime contract. In the August MOU, the appellant and the respondent agreed on a fixed price to be paid to the respondent for the completion of its scope of work. Each party profited from the terms of their respective contracts. The parties did not agree to share profits from the total contract price agreed to between the appellant and IWMC. Furthermore, they did not agree to share profits from the operation of the facility. They did not have a joint property interest in the project.

[263] The appellant was responsible for the design, supply and construction of all buildings, site work and waste pretreatment and post treatment equipment. The respondent was responsible for the design, supply and installation of composting systems and bio-filters, including commissioning, warranties and guarantees. The respondent was to be involved with decisions relating to the scope of its work, and in this regard, it was to receive the relevant correspondence between the appellant and IWMC and to attend meetings when the subject matter related to the work of the respondent. The parties agreed that any communication between the owner and the respondent would take place through the appellant.

[264] Each party entered into sub-contracts with other individuals and corporations to complete their individual scope of work. For example, the respondent contracted with Green Mountain Technologies and Diversified Metal Engineering for the construction of the containers to be used at the facility as well as the leachate tanks. The appellant was not party to these contracts. The respondent commenced legal proceedings against each of these companies separate and apart from any proceedings it commenced against the appellant.

[265] The RFP did not, to use the trial judge's words, "require that ADI sign the

contract." The contract could be signed by any legal entity as long as that legal entity could meet the security requirements of IWMC. The appellant and the respondent agreed the appellant could meet those requirements, and the parties agreed that the appellant would sign as prime contractor and solely bear the risk associated with that position. The respondent agreed, freely and voluntarily, to this arrangement.

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[266] The respondent was not vulnerable. The appellant and the respondent entered into a contract to protect each of their positions - the appellant with the owner and the respondent with the appellant. Any vulnerability to which either may have been exposed flowed from the terms of the contract which each party negotiated as a strictly commercial arms length transaction where each party came to the table with equal bargaining power. This is not the kind of vulnerability that will give rise to a fiduciary relationship. There is nothing in the relationship between the parties as evidenced by their agreement that the respondent 'surrendered itself or rendered itself vulnerable to a discretion…' that was conferred on the appellant. See: ***Visagie v. TVX Gold Inc.***, [2000] O.J. No.1992 (Ont. C.A.) at paras. 27 & 29.

[267] The appellant agreed with IWMC to operate the facility for a period of five years. The respondent, in turn, agreed with the appellant that it would operate the facility in accordance with the terms of the August MOU and the operating agreement made between the appellant and IWMC which was also incorporated by reference into that MOU.

[268] The base fees payable by IWMC to the appellant under the operating agreement were to be paid directly to the respondent's bank account, less payment to the appellant of a fee of $25,000. in the first year and $75,000. per year in each of the remaining four years of the contract. The respondent was responsible for the operating costs. It was entitled to all other revenues from the operation such as the revenue from the sale of the finished compost. The respondent was to absorb any losses from the operation of the facility as well as the benefit of any profits. The two parties did not share either profit or loss from the operation of the facility. The above fee payable to the appellant annually was not contingent or varied in any manner by the extent of a profit or loss from the operation.

[269] The respondent contracted with the appellant to be a subcontractor providing a highly specialized service in relation to the overall scope of work that the appellant contracted to complete for IWMC. The respondent and the appellant, because of their specialized fields of expertise both of which were necessary for the completion of the project, worked closely together to prepare the proposal to IWMC. At the conclusion of this process it was clear the parties agreed that the appellant would be the prime contractor and the respondent would be the subcontractor.

[270] After the proposal was accepted, the appellant and the respondent agreed, because of their specialized areas of expertise, that their working relationship would

be based on principles of a joint venture. In the context of the August MOU, read as a whole, this meant they would work in close cooperation with each other to carry out their specialized duties as contractor and subcontractor, all with a view to completing the contract which the contractor (the appellant) had with the owner (IWMC). Reliance on joint venture principles was for purposes of facilitating the proper functioning of their working relationship as contractor and subcontractor.

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[271] The statement that they would govern their working relationship on joint venture principles is the only indication from the entire contractual arrangement between them that they were in a joint venture. There is nothing else in their contractual arrangement which would indicate they agreed to enter into a joint venture. As I have pointed out, the contract when read in its entirety indicates the contrary. The statement standing by itself in the contract did not make their legal relationship that of parties to a joint venture.

d. the implications of the trial judge’s finding there was a joint venture

[272] When the trial judge concluded the appellant and the defendant had agreed to form a joint venture, the trial judge utilized this conclusion to support the imposition of fiduciary obligations as well as duties of loyalty and good faith on the appellant. Accordingly, he then applied these obligations and duties to the conduct of the appellant when assessing the appellant's decision to terminate the contracts with the respondent. The trial judge's conclusion that these duties governed the relationship was the reason he ultimately found, based on the evidence he accepted, that the appellant wrongfully terminated the contracts with the respondent. See: the trial judge's reasons at paras.57 and 58.

[273] Even if there was a finding of a joint venture relationship between the parties, I note that it is unlikely in the context of the relationship between the parties, fiduciary obligations would arise. Judicial authority is now settled that fiduciary duties and obligations do not arise within a joint venture embarked upon for a commercial purpose. In this respect, the decision of the Ontario Court of Appeal in ***Wonsch Construction Co. v. National Bank of Canada***, 1990 CarswellOnt 135; (1990), 75 D.L.R. (4th) 732 has been overtaken by ***Cadbury Schweppes Inc. v. FBI Foods Ltd.***, [1999] 1 S.C.R. 142 (SCC) which was applied in ***Visagie v. TVX Gold***, [2000] O.J. No. 1992; (2000), 187 D.L.R. (4th) 193 (Ont. C.A.) at paras. 25 to 27. Also see: ***Blue Line Hockey Acquisition Co. v. Orca Bay Hockey Limited Partnership***, 2008 BCSC 27; [2008] B.C.J. No. 24 at paras. 75 to 76, aff'd on appeal; 2009 BCCA 34; [2009] B.C.J. No. 136; leave to appeal to the SCC denied; [2009] SCCA No. 176.

[274] That being said, I will set forth some examples of the trial judge's application of these principles to the facts he found from the evidence adduced at trial.

[275] At paragraph 292 of his reasons, the trial judge interpreted the provision of the RFP which provided for the rejection of feedstock by the owner and the operator in the event it was found deleterious. The trial judge concluded that in the interests of the respondent, the appellant and the owner were obligated to interpret the clause objectively and in good faith. This provision required that IWMC also agree to the declaration of the feedstock as deleterious. The evidence is clear that IWMC was not prepared to do so. Therefore, it was contrary to the provisions of all contract documents to impute to the appellant an obligation to act in good faith and to bear a duty to compel IWMC to agree that the feedstock was deleterious. The appellant could not compel the owner IWMC to act in good faith even if it was obligated to do so itself.

[276] In any event, there was no implied or explicit term of the contract between the appellant and the respondent which required this provision to be interpreted on the basis that the appellant and the respondent owed each other a duty of good faith. This provision, even if it applied to the relationship between the appellant and the respondent, was to be interpreted as written, without reliance on implied terms.

[277] At paragraphs 346 to 347 of his reasons, the trial judge applied good faith principles to the design-build contract between the appellant and the defendant. Applying these principles, he concluded that the concerns which the respondent was raising with respect to the feedstock quality should have been accepted in good faith by the appellant out of loyalty to its joint venture partner and should not have been considered by the appellant as an admission that it was defaulting on its contract to carry out its scope of work. Based on his initial finding of a joint venture, he concluded that the specific provisions of the design-build contract between the appellant and the respondent should be "applied honestly, fairly and in good faith."

[278] Also, in addressing the issue as to the reimbursement of money that might accrue for the benefit of the two parties as the result of certain equipment being sales tax exempt, the trial judge applied principles applicable to a joint venture relationship in finding that the appellant was obligated to pay the respondent approximately $400,000. At paragraph 377 he stated that:

> Having bound themselves to the principles governing joint venture relationships, ADI cannot escape the duties that arise in connection with that relationship.

[279] And further at paragraph 379, he stated:

> A party cannot sign a contract expressing it will govern itself by principles of fairness, loyalty, good faith, full disclosure and more and then proceed to undermine every one of those principles in its dealings with its contracting partner.

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[280] With respect, the trial judge, in this one sentence, effectively re-wrote the design-build subcontract between the appellant and the respondent.

[281] The appellant argued that in the negotiations with the respondent on the sales tax reimbursement issue it was simply engaged in hard bargaining. The trial judge addressed this position and found that the time for hard bargaining had passed when the parties were engaged in these negotiations. He held the two parties were no longer two independent parties but rather, they were parties to a joint venture relationship and they were bound by the principles he had set out at the earlier in his reasons and which govern parties in such a relationship. See: para.382 of the trial judge's reasons.

e. is there an implied term to act in good faith?

[282] Even though the parties did not enter into a joint venture and contract to assume the obligations which go with that relationship, it remains necessary to consider whether the agreement between the appellant and the respondent included an implied term to act in good faith. I am mindful of the cautionary signs posted by many courts of appeal across the country, as well as by the Supreme Court of Canada, not to infer duties of good faith into commercial all contracts; however, the parties did agree that their working relationship was to be guided by principles of a joint venture relationship. This might signal an implied covenant within their entire contractual relationship that they would act in good faith. Again, the entire contractual matrix needs to be considered.

[283] The August MOU provided, in addition to its specific terms, that with respect to the design and construction of the composting process the terms of the design-build contract between the appellant and IWMC was incorporated by reference into the agreement between the appellant and the respondent. Similarly, the parties also agreed that, in addition to the specific terms of the MOU, the operating agreement between the appellant and IWMC was also incorporated by reference into their agreement whereby the respondent would operate.

[284] The trial judge did not make any distinction between the design-build subcontract and the operating subcontract when he was considering whether the appellant was justified in terminating both contracts. At paragraph 287 of his reasons, the trial judge states that the terms of the contract between the appellant and IWMC were incorporated into the contract between the appellant and the respondent and that is correct. He goes on to refer to those terms in the design-build subcontract contract but he does not refer to the terms of the operating agreement and in particular he does not refer to the termination provisions of that agreement.

[285] Therefore, I will address the issue as to whether there was a good faith provision implied in each of those agreements – the agreement to design build and

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the agreement to operate.

(i) the design-build subcontract

[286] Interpreting the design-build contract as applicable to the relationship between the appellant and the respondent, the appellant is the owner and the respondent is the design-builder.

[287] Paragraph 7.1.2 of the design-build contract provides that if the respondent did not prosecute the work properly or otherwise failed to comply with the requirements of the contract to a substantial degree, the appellant could notify the respondent that it was in default of its obligations and give the respondent five days notice to correct the default. Paragraph 7.1.4 provides that if the respondent did not correct the default within the time specified in the notice of default, the appellant was entitled to terminate the respondent's right to continue with its work.

[288] Paragraph 7.1.5 goes on to provide the options available to the appellant on termination.

[289] Pursuant to this clause, the appellant terminated the contract with the respondent and requested that it discontinue the work. The issue is whether in addition to complying with those specific termination provisions of the contract there was an implied duty on the appellant to act in good faith.

[290] There are certain contracts where a duty of good faith is recognized at law. Franchise agreements and employment contracts are two examples. Also, in the tendering process a term will usually be implied obligating the owner to act fairly and in good faith in the contract formed between the two when the contractor submits a bid to the owner. See: ***Tercon Contractors Ltd. v. British Columbia (Transportation and Highways)*** 2010 SCC 4; [2010] 1 S.C.R. 69. For as complete discussion of the application of good faith provisions in various contracts, see the article by Shannon Kathleen O'Byrne "**The Implied Term of Good Faith and Fair Dealing: Recent Developments**" (2007), 86 C.B.R. 193.

[291] In ***Hodgkinson v. Simms***, [1994] 3 S.C.R. 377 at 380, La Forest J. pointed out that parties to a commercial transaction, acting at arm's length pursue their objectives from the perspective of self-interest and when courts are asked to impose fiduciary duties and duties of good faith they do so with circumspection. Also, as Binnie J. noted in ***Cadbury Schweppes Inc. v. FBI Foods Ltd. supra***, at para.30, the majority of the Court in ***Hodgkinson v. Simms*** made it clear that where the ingredients of a fiduciary duty are otherwise present, the duty will not be denied simply because the relationship is in the commercial context.

[292] Generally, the implied obligation of good faith has not been broadly applied by

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the courts of this country to all types of contracts. It is only in situations where the performance and enforcement of the contract relies on the sole discretion of one party, with little or no guidance within the contract as to the parameters of the discretion, that courts have implied a duty of good faith. On the other hand, where the contract sets forth criteria which might trigger the right to terminate a contract Canadian courts are cautious in the use of the principle of good faith obligations primarily because the application of these principle can create rights and impose obligations that were not part of the bargain between the parties.

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[293] In ***Transamerica Life Canada Inc. v. ING Canada Inc.*** (2003), 68 O.R. (3d) 457; [2003] O.J. No. 4656 (Ont. C.A.), O'Connor A.C.J.O. summarized the types of cases where the duty of good faith is applied. At paras. 51 to 53 he wrote:

> [51] It is fair to say that Canadian courts have proceeded cautiously in recognizing duties of good faith in the performance and enforcement of contracts. Interestingly, when Canadian courts have referred to duties of good faith, they have done so in circumstances where the result of the case has been determined by the application of other, more established, legal principles. In a helpful article, Professor John McCamus describes the somewhat tenuous judicial underpinnings of the doctrine of good faith duties in Canadian jurisprudence and the cautious approach adopted by Canadian courts to the implication of duties of good faith as a separate doctrine in contract law. See John D. McCamus, "**The Duty of Good Faith Contractual Performance at Common Law**" (Paper presented to the N.J.I.: Civil Law Seminar, Contract Law: From Form to Remedies, Osgoode Hall Law School, 17 May 2000) [unpublished].
>
> [52] Unlike the situation in the United States where the duty of good faith in the performance of enforcement of commercial contracts has been broadly recognized, Canadian courts have not developed a comprehensive and principled approach to the implication of duties of good faith in commercial contracts. As Professor McCamus points out, many questions about the nature and scope of such duties have yet to be resolved. Indeed, it remains an open question whether implied duties of good faith add anything to the other available common law doctrines that apply to contracts.
>
> [53] I agree with Transamerica that Canadian courts have not recognized a stand-alone duty of good faith that is independent from the terms expressed in a contract or from the objectives that emerge from those provisions. The implication of a duty of good faith has not gone so far as to create new, unbargained-for, rights and obligations. Nor has it been used to alter the express terms of the contract reached by the parties. Rather, courts have implied a duty of good faith with a view to securing the performance and enforcement of the contract made by the parties, or as it is sometimes put, to ensure that parties do not act in a way that eviscerates or defeats the objectives of the agreement that they

> have entered into: see ***GATX, supra***; ***Greenberg, supra***; ***Gateway Realty, supra.***

[294] ***Gateway Realty Ltd. v. Arton Holdings Ltd.***, 1991 CarswellNS 320 (NSSC), is a case where the duty of good faith was implied as the term of a the contract between the parties. In its absence, the enforcement of the terms of the contract would have been, to use the words of O'Connor A.C.J.O., "eviscerated."

[295] In ***Gateway Realty***, the plaintiff was the developer/landlord of a shopping mall, and it entered into a lease with a major retailer as its anchor tenant. The tenant was permitted to assign the lease without any right of the landlord to terminate and without the consent of the landlord. The applicable clause in the lease also contemplated that the tenant might cease to carry on business on the property, continuing to pay rent without any reciprocal right of the landlord to terminate the lease.

[296] The defendant subsequently developed another commercial property in competition with the plaintiff. The defendant approached the plaintiff's tenant to be its anchor tenant. They entered into a lease and the anchor tenant assigned its lease in the plaintiff's property to the defendant. The defendant, therefore, had possession of the anchor store premises in the plaintiff's mall without any obligation to occupy the premises or sub-let it to an active business. The parties entered into an agreement whereby the defendant agreed to use its "best efforts" to sublet the property.

[297] The space remained empty, and the defendant did not make any good faith efforts to re-assign the lease to an operating tenant. The plaintiff commenced an action requesting an order that the defendant be ordered to give up its right to possession of the property. The plaintiff's position was that the assignment was voided either when it was made or when the defendant failed to take any positive action to permit the property to be used by a commercially active tenant. The plaintiff also took the position that the defendant breached its obligation to use its best efforts to sub-let the property.

[298] The plaintiff's position was based on the principle that the relationship of landlord and tenant in a commercial enterprise like a shopping mall is a special one requiring good faith, and that the assignment is void because the defendant acted in bad faith. The court agreed holding that the "best efforts" clause was an enforceable term and that the actions of the defendant were in breach of that provision. The court also applied and enunciated principles of good faith which have been applied in many similar cases.

[299] One of those cases was in this jurisdiction. In ***McKenna's Express Ltd. v. Air Canada*** (1992), 102 Nfld. & P.E.I.R. 185 (PEISCTD), the plaintiff was contracted by the defendant to carry goods by truck from Charlottetown to Moncton and return.

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The defendant, Air Canada, terminated the contract pursuant to a provision in their contract which permitted Air Canada to terminate the contract if it, "… **in its sole opinion**, deems the services performed hereunder to be unsatisfactory…"(emphasis added). Pursuant to this provision, the contract could be terminated immediately and without penalty. DesRoches J., relying on ***Gateway Realty***, found that a provision in a contract allowing for the exercise of broad discretion in terminating the contract imposed on the party exercising the discretion a duty of honesty and good faith.

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[300] DesRoches J. also relied upon ***Greenberg v. Meffert*** (1985), 18 D.L.R. (4th) 548 (Ont. C.A.), a decision cited by O'Connor A.C.J.O. in the ***Transamerica*** case referred to above. In ***Greenberg***, the court found that the words in a contract "at the sole discretion of the company" meant that the party exercising the discretion had to act reasonably in the exercise of that discretion, as well as honestly and in good faith.

[301] In a paper referred to by O'Connor A.C.J.O. in ***Transamerica*** **"The Duty of Good faith Contractual Performance at Common Law**," Professor John McCamus discusses cases, including ***Gateway Realty***, where the duty of good faith has been applied. In particular he notes that courts have implied the duty where there has been an alleged abuse of discretionary power. These cases are: ***Mesa Operating Ltd. Partnership v. Amoco Canada Resources Ltd***. (1992), 129 A.R. 177 (Alta Q.B.) aff'd (1994) 19 Alta L.R. 38 (Alta C.A.); ***LeMesurier v. Andrus*** (1986), 25 D.L.R. (4th) 424 (Ont. C.A.); ***Greenberg v. Meffert supra***.

[302] These cases are examples of contracts where the bargain between the parties as to performance and enforcement could be clearly eviscerated or rendered meaningless, if the exercise of the remedies agreed to, were not carried out in good faith.

[303] As Kelly J. noted in ***Gateway Realty*** at para.60, the principle of good faith applies where the action of one party essentially nullifies the bargain made between the parties thereby causing significant harm to one of the parties. The application of the principle and a finding as to whether there was bad faith is dependent on the terms of the contract and the circumstances of each case.

[304] Construction contracts such as the standard design-build contract do not fall into the same category of contracts as those like franchise agreements and agreement made at the Contract A stage of the tendering process. Furthermore, the contract does not provide for termination based on the exercise of broad unfettered discretion like the contract in ***McKenna's Express***. The contract does not include a "best efforts" clause like the contract under consideration in ***Gateway Realty***, and it is also unlike the contract under consideration in ***Greenberg v. Meffert***. In contrast, the design-build contract provided for specific conditions upon which termination

would be justified.

[305] Pursuant to the provisions of the design-build contract, the appellant could only terminate the contract with the respondent in the event the respondent neglected "… to prosecute the Work properly or otherwise fails to comply with the requirements of the Contract to a substantial degree …". If the appellant is of the view these conditions have been met, it has to note the respondent in default under the provisions of the contract and the respondent is entitled to correct the default within five days of receiving notice. If the default cannot be corrected within five days, the respondent could be in compliance with the appellant's notice if it commences the work, provides the appellant with an acceptable schedule for correction and if corrected the default in accordance with the schedule Para 7.1.3.

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[306] If the default is not corrected, the respondent could correct and charge the costs back to the respondent or terminate the contract.

[307] Therefore, before the contract can be terminated there must be a determination made that the respondent is not properly carrying out the scope of the work it undertook to do under the contract or that it failed to comply with some other term of the contract. There must be a proper notice of default provided and the respondent has a number of options as to how it is allowed to respond to the notice of default.

[308] The decision of the appellant to terminate is not contingent on the exercise of broad discretion in the absence of certain specified conditions being met and certain specified events occurring. The decision of the appellant to terminate is guided by very specific obligations which are open to an objective assessment. Did the respondent fail to prosecute the work properly? Did the respondent fail to respond to the default as requested? Was the notice of default a proper one? There is no chance that by the appellant's exercise of discretion, the termination provisions can completely eviscerate the enforcement and performance terms of the bargain struck between the parties. The action taken by the appellant to terminate the design-build contract is capable of objective measurement without resort to implied terms of good faith, the application of which have the effect of inserting subjective provisions into the contract – provisions to which the parties did not agree.

[309] The imposition of an implied provision to act in good faith is not necessary to protect against the negation of the performance and enforcement terms of the contract. The contract as negotiated and agreed to between the parties adequately protects against this occurrence by the inclusion of terms which provide for a controlled method of termination, absent the exercise of an unfettered discretion.

(ii) the operating subcontract

[310] In accordance with RFP, IWMC and the appellant entered into an Operating Agreement in November 2001. The agreement was to become effective and the appellant was to operate the facility when the engineer acting for IWMC declared the work under the design-build contract substantially complete. Paragraph 6.2 of the operating agreement provided for early termination in the sole discretion of IWMC, on three months notice. At the expiration of the notice period and if the appellant had fulfilled its obligations under the agreement, IWMC was obligated to pay the appellant a termination fee of $200,000. in addition to any money owing in accordance with the terms of the agreement.

[311] The August MOU provided that the contract documents defined in the operating contract between IWMC and the appellant was included by reference. In furtherance of this, the August MOU provided that the respondent would be responsible for the operations of the facility in accordance with the terms of the operating agreement between IWMC and the appellant. The respondent was entitled to receive the fees as provided for in the operating contract between the appellant and IWMC, less the payment of an annual fee to the appellant over the five years of the contract. The operating fees were to be paid directly into the bank account of the respondent. Finally, in the event that IWMC terminated the contract early and the termination fee was payable to the appellant under the terms of the agreement with IWMC, that fee would be paid in full to the respondent.

[312] By letter dated November 1, 2002, the appellant informed the respondent that the operating agreement between it and IWMC was in place. The letter went on to say there was no agreement between the appellant and the respondent for the latter to operate the facility. The appellant further advised it was not prepared to enter into an operating agreement with the respondent because of the deficiencies that were outstanding with respect to the performance and capacity of the facility. The appellant took the position these were issues which were solely within the respondent's scope of work under the design-build subcontract.

[313] The appellant suggested that in the interim and until the deficiencies were corrected and until the parties entered into an operating agreement, the appellant was prepared to advance operation funds it received from IWMC through to the respondent, provided the funds were held in trust. The evidence at trial was that the respondent did undertake the operation of the facility and operational funds were advanced to it by the appellant.

[314] On November 26, 2002, the appellant gave notice to the respondent pursuant to the provisions of the design-build contract - General Condition 7.1 - that the respondent had neglected to carry out the scope of its work properly and that it was in default under the terms of the design-build contract. The respondent was given five days to rectify the default.

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[315] On December 4, 2002, the appellant terminated the design-build subcontract. On the same date the appellant advised the respondents that by the letter of November 1, 2002, the two parties had entered into an "interim operating arrangement" and because the respondent had defaulted on the design-build subcontract, the appellant was cancelling the "interim operating agreement."

[316] I am unable to agree that the appellant and the respondent did not enter into a contract to operate the facility. The August MOU sets forth their agreement with respect to the operation of the facility and it incorporated by reference the terms of the operating agreement between the appellant and IWMC. This latter agreement became effective when the facility was declared substantially complete pursuant to the terms of the design-build contract. Neither the August MOU nor the operating agreement between the appellant and IWMC contemplated a qualified substantial completion with a substantial holdback. Therefore, when substantial completion was declared by the IWMC engineer, the operating agreement became effective. It was not open to the appellant on November 1, 2001, to unilaterally declare the parties were now entering into an "interim operating arrangement" and to further declare there was no operating agreement.

[317] With respect to termination, the agreement between the appellant and IWMC provides that IWMC could terminate in its sole discretion, on three months notice and upon the payment of a termination fee of $200,000. plus any revenues outstanding provided that the appellant had lived up to its obligations under the agreement. The termination provisions would also apply to the termination of the subcontract between the respondent and the appellant. Because the operating contract could be terminated on the sole discretion of the appellant, there is an implied term of the contract that in exercising that discretion, the appellant was obligated to act in good faith.

[318] I am not making a finding as to whether the appellant acted in good faith in terminating the operating contract. That is for the trial judge to determine after the conclusion of the new trial. Suffice it to say the contract provides the appellant could terminate the operating contract on three months notice upon the payment of the termination fee and other revenues that are found due and owing to the respondent under the operating agreement. In exercising this discretionary right to terminate the operating agreement, the appellant was required to act in good faith.

CONCLUSION AND REMEDY

[319] In conclusion, I would allow the appeal and set aside the order of the trial judge.

[320] As for a remedy, the Court has three options pursuant to s. 21(2) of the ***Judicature Act***, R.S.P.E.I. 1988, Cap. J-2.1. The Court may make an order that the

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trial judge could have made, order a new trial or make any order it considers just.

[321] To make an order the trial judge could have made or to make an order the court might consider just, would involve the court of appeal undertaking a reassessment of the evidence on liability and damages. While there is a very complete and extensive record at trial complete with a large number of documentary exhibits, I am mindful from reading this material and the trial judge's reasons that there are issues of credibility. A panel of the Court of Appeal is not in as good a position as a trial judge to rule on these issues.

[322] Because of the passage of time since the dispute arose and considering the passage of time prior to another trial being completed, I am reluctant to order a new trial; however, in the circumstances of this case, I am satisfied that this is the remedy which would be most fair to both parties. In this way a different trial judge, applying the correct legal principles to the relationship between the appellant and the respondent, will be in a position to assess the evidence and reach a just result. Accordingly, I would order that the consolidated proceeding be referred back to the Supreme Court for a new trial.

COSTS

[323] I would award the appellant its costs of the appeal as well as its costs of the trial, both on a partial indemnity basis. I would order that the costs of the appeal be assessed by this Court. As for the costs of the trial, I would order that because of the exceptional circumstances (the case being referred back to the Supreme Court for a new trial) they should be assessed by the Prothonotary.

Justice John A. McQuaid

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TAB 10

In the Court of Appeal of Alberta

Citation: Williston Wildcatters Oil Corporation v. Peat Marwick Thorne Inc., 1995 ABCA 427

Date: 19951123
Docket: 95-16143 & 95-16144
Registry: Calgary

1995 ABCA 427 (CanLII)

Between:

Deloitte & Touche Inc., Trustee of the Estate of Williston Wildcatters Oil Corporation, A Bankrupt

Appellant

- and -

Peat Marwick Thorne Inc., Court Appointed Monitor of Williston Wildcatters Oil Corporation, Williston Wildcatters Oil Corporation, and Unsecured Debenture Holders of Williston Wildcatters Oil Corporation

Respondents

Canadian Fracmaster Ltd.

Appellant

- and -

Peat Marwick Thorne Inc., Court Appointed Monitor of Williston Wildcatters Oil Corporation, and Unsecured Debenture Holders of Williston Wildcatters Oil Corporation

Respondents

The Court:

The Honourable Mr. Justice Kerans
The Honourable Mr. Justice O'Leary
The Honourable Madam Justice Hunt

Memorandum of Judgment
Delivered from the Bench

COUNSEL:

L.B. Robinson, for the Appellant.

F.R. Dearlove, for the Respondents

G.B. Davison, for the Appellant

F. dearlove for the Respondents

MEMORANDUM OF JUDGMENT
DELIVERED FROM THE BENCH

KERANS J.A.:

[1] Madam Justice Hunt will give what will be our unanimous decision.

HUNT J.A. (for the Court):

[2] This is an appeal from an order of the Chambers Judge, dated October 13, 1995, in which he terminated the responsibilities of a monitor appointed pursuant to a stay order under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 ("the CCAA"). In so doing, he directed that the trustee in bankruptcy (who had not yet been appointed but who was to be and indeed was-appointed later the same day in Saskatchewan pursuant to a consent order) remit to the monitor enough of Williston's future revenues to pay the claims of unpaid post-CCAA creditors.

[3] On October 30, 1995, the trustee sought to have the Chambers Judge vary or set aside the direction. This he refused to do on the ground that he was *functus officio.* The appellants (the trustee and some 60 other creditors) argue that he lacked jurisdiction to give the direction, or, if he had jurisdiction, he should not have given the direction in this case, because it would alter the priorities under the *Bankruptcy and Insolvency Act,* R.S.C. 1985, c. B-3. The respondents (the post-CCAA creditors) take the position that the jurisdiction to make such a direction does exist, whether the direction is made at the beginning, during, or at the end of the CCAA stay period.

[4] The appeal is allowed and the order below is vacated to the extent that it obligates the trustee or the monitor to pay money from post-bankruptcy receipts to unpaid post-CCAA creditors.

[5] The order in question was made on the very day of the bankruptcy order, when it was evident to all that bankruptcy was imminent. There is no jurisdiction under the CCAA to bind a trustee in bankruptcy, not yet appointed, in this way. Moreover, it was inappropriate at that stage of the proceedings, in effect, to create a charge that would prefer one group of creditors over another --particularly since the stay order itself (which had been amended at least twice) had specifically created a charge in favour of certain creditors (through paragraph 11 of the stay order, which created a charge in favour of

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Williston's lenders during the stay period). In our view, if a charge was to be created, it should have been done earlier in the proceedings and not on the very day of the bankruptcy.

[6] A further factor in this case is that the list of post-CCAA creditors is still somewhat undetermined; the list in materials before the Court contains a great variety of types of creditors, including trade creditors, royalty owners, lawyers for a creditors' committee, to mention just a few. It is not easy at this stage of the proceedings to be confident that all these creditors deserve the kind of preference that would have resulted from the order below.

[7] The creation of charges in CCAA proceedings should not be routine, but should be determined within the context of each case. Judges who consider stay applications (whether in the form of proposed consent orders or otherwise) should address themselves to these questions within the merits of each case. In particular, they should consider providing security for those creditors whose claims will arise during the stay period and without whose provision of goods and services the business would not otherwise be able to continue.

[8] For these reasons, the appeal is allowed to the extent set out above.

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TAB 11

Date of Release: January 14, 1993

No. A924791
Vancouver Registry

IN THE SUPREME COURT OF BRITISH COLUMBIA

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

- AND -

IN THE MATTER OF THE COMPANY ACT, R.S.B.C. 1979, c. 59

IN THE MATTER OF WOODWARD'S	)	REASONS FOR JUDGMENT
LIMITED, WOODWARD STORES	)	OF THE HONOURABLE
LIMITED AND ABERCROMBIE &	)	MR. JUSTICE TYSOE
FITCH CO. (CANADA) LTD.	)	(IN CHAMBERS)

Counsel for Woodward's Limited, Woodward Stores Limited and Abercrombie & Fitch Co. (Canada) Ltd.:	M.A. Fitch, R.A. Millar and J.K. Irving
Counsel for Transcontinental West, a division of Trans-Continental Printing Inc.:	C.M. Trower
Counsel for Accord Business Credit Inc. and others:	D.B. Hyndman
Counsel for Dale's Industries and others:	N.E. Kornfeld
Counsel for Cosmair Canada Inc. and others:	A.L. Edgson
Counsel for Matsushita Electric of Canada Limited:	A.S. Wilson
Counsel for Restwell Manufacture Ltd.:	S.J. Gaerber
Counsel for Palmer Jarvis Advertising:	G.S. Snarch
Counsel for Cambridge Shopping Centres Limited:	D.I. Knowles and C.W. Caverly

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Counsel for Gesco Industries Inc.: L.H. Koo

Counsel for Ernst & Young Inc., the Monitor herein: W.D. Riley

Dates and place of hearing: January 11 and 12, 1993 Vancouver, B.C.

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On December 11, 1992 I granted an interim stay Order pursuant to the ***Companies' Creditors Arrangement Act*** (the "***CCAA***") in favour of Woodward's Limited, Woodward Stores Limited and Abercrombie & Fitch Co. (Canada) Ltd. (collectively, "Woodward's"). Shortly thereafter a number of Woodward's suppliers of goods and services made applications for various forms of relief. The item of relief that was pursued at the hearing of the applications was the creation of a trust fund for the benefit of the suppliers.

The interim stay Order was granted on an *ex parte* basis and it was expressed to expire at 6 p.m. on January 8, 1993, the day on which the hearing of the Petition in this matter was intended to take place. The applications of the suppliers first came on for hearing at 4 p.m. on December 17, 1992. The relief requested at that time included (i) the setting aside or varying of the interim stay Order, (ii) the payment of the amounts owing to the suppliers, (iii) the return of the goods provided by the suppliers and (iv) the creation of the trust fund. Time did not permit the hearing of the applications on that day and the earliest they could be heard was one week later. I adjourned the

applications for one week but as I did not want the adjournment to prejudice any rights that the suppliers may have, I made an interim Order that the proceeds from the sale of any goods after December 17 would stand in the place and stead of such goods. When the matter came back on for hearing on December 24, the parties agreed that the applications could be adjourned until January 8 and heard concurrently with the hearing of the Petition.

The hearings began on January 8 and when it became clear that these and other applications would take several days to be heard, I extended the interim Orders until further Order of the Court with the intent that they would continue until I made my determinations on the various issues to be decided. There appears to be little doubt that there will be an extension of the stay Order and it is the terms of the continuing stay Order and the related applications that are in dispute. I will approach the present applications on the basis that the ***CCAA*** stay is going to be extended and the issue to be determined is how the suppliers should be treated within this context.

Woodward Stores Limited operates a chain of 59 full line and junior department stores in British Columbia and Alberta. Abercrombie & Fitch Co. (Canada) Ltd. operates two stores in Ontario. Each of these companies is a subsidiary of Woodward's Limited.

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Woodward's has been carrying on business for 100 years. Until January 8, 1993 when it terminated 1,200 employees as part of its downsizing strategy, Woodward's had approximately 6,000 employees. Woodward's has been an important part of the economy of Western Canada for a long period of time and every effort should be made to facilitate its financial reorganization, which is the stated purpose of the ***CCAA***.

Woodward's suppliers generally support its reorganization but they do not feel that they have been treated fairly in all of the circumstances. The principal complaints of the suppliers are that Woodward's purchased a substantial amount of inventory in the period preceding the commencement of these ***CCAA*** proceedings and that Woodward's is proceeding with its reorganization under the ***CCAA*** rather than the ***Bankruptcy and Insolvency Act (the "B & I Act").***

On December 17 I directed that the Monitor appointed by the interim stay Order report to the Court regarding the inventory purchased by Woodward's during the period prior to the commencement of these proceedings. The Monitor has reported that in the 30 day period prior to December 11 Woodward's received goods having an aggregate cost of approximately $30.4 million, of which $27.3 remains unpaid. The Monitor estimates that approximately $4.3 million worth of the goods for which payment has not been made can be identified and were unsold by Woodward's at the time these

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proceedings were commenced. Identification of goods appears to be a major difficulty because the Monitor believes that less than $8 million of the $30.4 worth of goods received within the 30 day period preceding December 11 can be identified by way of Woodward's inventory control system. The suppliers say that they will be able to assist in identifying the goods that were supplied by them.

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The reason for the importance of the 30 day period preceding the commencement of these proceedings is s. 81.1 of the ***B & I Act*** which came into effect on November 30, 1992. Section 81.1 gives rights of repossession to suppliers of goods similar to the revendication rights that suppliers have previously enjoyed by virtue of the ***Civil Code of Lower Canada*** in effect in Quebec. In brief terms, s. 81.1(1) provides that suppliers are entitled to the return of goods supplied by them within 30 days of a written demand for repossession that can be given if the purchaser of the goods has gone into bankruptcy or receivership. Two important qualifications are that the goods have not been resold and that the goods are identifiable.

Section 81.1(4) is also relevant because it deals with a situation analogous to these ***CCAA*** proceedings; namely, a situation where the purchaser of the goods has filed a notice of intention to file a proposal under the ***Bankruptcy & Insolvency Act***. The section provides that the time between the filing of the notice of intention and the date on which the purchaser goes into bankruptcy

or receivership is not counted as part of the 30 day period following delivery of the goods within which the supplier must make its demand of repossession. Hence, if the purchaser of the goods files a notice of intention to file a proposal 20 days after the goods are delivered, the supplier can make the written demand for repossession within the first 10 days of a subsequent bankruptcy or receivership even though the reorganization attempt by means of the proposal may have taken several months. The statute is silent with respect to the resale of goods by the purchaser during the period of reorganization and, all other things being equal, the supplier will lose its right of repossession if the goods are sold during this period.

The suppliers submitted that if Woodward's had proceeded under the ***B & I Act*** rather than the ***CCAA***, they could have taken one of two steps to protect their rights. First, they say that an application could have been made for the appointment of an interim receiver under s. 47.1 of the ***B & I Act*** and that upon the appointment of the interim receiver the suppliers could exercise their rights under s. 81.1. Second, they say that an application could be made under s. 81.1(8) which allows the Court to make any order it considers appropriate if a supplier is aggrieved by an act of the purchaser of the goods and that such an order could direct the creation of a trust fund. The suppliers conclude this aspect of their argument by saying that it would be an abuse if the rights under s. 81.1 could be frustrated by allowing the insolvent company

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to choose the **CCAA** over the ***B & I Act*** and that the suppliers should therefore be given the protection of the trust fund.

In addition to the potential rights under the ***B & I Act***, the suppliers argued that the trust fund should be created to redress an inequity. They say that other creditors such as Woodward's banker had advance warning that Woodward's would be commencing these proceedings and that they took steps to ensure payment of the indebtedness owing to them. Although the evidence does not support an allegation that Woodward's purchased additional inventory with the knowledge that it would be commencing these proceedings, the suppliers say that Woodward's purposely choose the December 11 date to obtain the stay Order because the aggregate of all unpaid amounts for the purchase of inventory would be at its highest on or about that date. An Affidavit was filed to the effect that some of Woodward's directors first consulted the Monitor about the possibility of commencing ***CCAA*** proceedings in October, 1992.

There was not a consensus among the suppliers as to the exact nature to the trust fund that they were requesting be established. All of the suppliers did want the Court to make the determination that they were entitled to the monies in the trust fund if Woodward's is not successful in its reorganization effort. Most of the suppliers suggested that the fund be equal to the total cost of the purchases during the 30 day period preceding December

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11. One supplier wrote a letter requesting that the fund be equal to 90 days worth of purchases. One supplier of services was represented during the hearing and had filed its own Notice of Motion. It wanted the fund to provide for services that were purchased by Woodward's as well as the inventory.

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The purpose of the stay under s. 11 of the ***CCAA*** was first summarized by Wachowich J. in ***Meridian Developments Inc. v. Toronto Dominion Bank*** [1984] 5 W.W.R. 215 (Alta. Q.B.). At p. 219 Wachowich J. said:

> The legislation in intended to have wide scope and allows a judge to make orders which will effectively maintain the status quo for a period while the insolvent company attempts to gain the approval of its creditors for a proposed arrangement which will enable the company to remain in operation for what is, hopefully, the future benefit of both the company and its creditors.

And at p. 220 he stated:

> This order is in accord with the general aim of the Companies' Creditors Arrangement Act. The intention was to prevent any manoeuvres for positioning among creditors during the interim period which would give the aggressive creditor an advantage to the prejudice of others who were less aggressive and would further undermine the financial position of the company making it less likely that the eventual arrangement would succeed.

In ***Quintette Coal Limited v. Nippon Steel Corporation*** (1990), 80 C.B.R. 98 (B.C.S.C.) the stay Order authorized Quintette to pay its trade creditors who were owed less than $200,000 on the basis that these creditors were mostly small local businesses which would face insolvency themselves if they were not paid. Trade creditors which were owed in excess of $200,000 complained that the

Order did not maintain the status quo and they applied to be paid the first $200,000 of the debt owed to them by Quintette. In dismissing the application Thackray J. said the following about the status quo at p. 109:

> While it is a compelling argument to suggest that the status quo should be maintained between *classes* of creditors, I do not believe that I should be blinkered by such a narrow view. The overall design of the C.C.A.A. is to preserve the debtor as a viable operation and to reorganize its affairs to the benefit of not only the debtor but also its creditors. With that design in mind, I do not believe that Wachowich J. was suggesting that every detail of the status quo would be maintained. Indeed he went on to note that [p.220] "The intention was to prevent any manoeuvres for positioning among creditors during the interim period".
>
> What is meant by maintaining the status quo is that the debtor will be able to stay in business, and that they will have breathing space in which to develop a proposal during which time there will be a stay under any bankruptcy or winding-up legislation, a restraint of all actions against the company, and no realization of guarantees or other rights against the company. In this case the order also restrained creditors from exercising any right of set-off.

An unusual case relating to the maintenance of the status quo is ***Re Alberta-Pacific Terminals Ltd.*** (1991), 8 C.B.R. (3d) 99 (B.C.S.C.). In that case the owner of the facilities at which the insolvent company carried on business made application for an Order compelling the insolvent company to make the ongoing monthly payments under the operating agreement between the parties. The payments were the equivalent of rental payments under a lease. The insolvent company did not have sufficient funds to make the payments, in part because it was making the interest payments on the pre-stay debt of one of its lenders. The company had agreed to

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make the interest payments in exchange for the agreement of the lender to continue providing an operating credit facility. Huddart J. dismissed the application and she said the following about the status quo at p. 105:

> The status quo is not always easy to find. It is difficult to freeze any ongoing business at a moment in time long enough to make an accurate picture of its financial condition. Such a picture is at best an artist's view, more so if the real value of the business, including goodwill, is to be taken into account. Nor is the status quo easy to define. The preservation of the status quo cannot mean merely the preservation of the relative pre-stay debt status of each creditor. Other interests are served by the CCAA. Those of investors, employees, and landlords among them, and in the case of the Fraser Surrey terminal, the public too, not only of British Columbia, but also of the prairie provinces. The status quo is to be preserved in the sense that manoeuvres by creditors that would impair the financial position of the company while it attempts to reorganize are to be prevented, not in the sense that all creditors are to be treated equally or to be maintained at the same relative level. It is the company and all the interests its demise would affect that must be considered.

This case is unusual because one would normally expect during a reorganization period that ongoing rental payments would be made and that interest on pre-stay debt would not be paid. However, the particular circumstances of the case meant that the preservation of the status quo produced a different result. The payment of the interest was considered to be a preservation of the status quo because the company required the continuation of the operating credit facility in order to survive and attempt to reorganize. The non-payment of the monthly amounts under the operating agreement was considered to be a preservation of the status quo because the company did not have sufficient funds and

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could not have continued if it had been required to make the payments.

It is my view that the maintenance of the status quo is intended to attempt to accomplish the following three objectives:

1. To suspend or freeze the rights of all creditors as they existed as at the date of the stay Order (which, in British Columbia, is normally the day on which the ***CCAA*** proceedings are commenced). This objective is intended to allow the insolvent company an opportunity to reorganize itself without any creditor having an advantage over the company or any other creditor.
2. To postpone litigation in which the insolvent company is involved so that the human and monetary resources of the company can be devoted to the reorganization process. The litigation may be resolved by way of the reorganization.
3. To permit the insolvent company to take certain action that is beneficial to its continuation during the period of reorganization or its attempt to reorganize or, conversely, to restrain a non-creditor or a creditor with rights arising after the stay from exercising rights that are detrimental to the continuation of the company during the period of reorganization or its attempt

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> to reorganize. This is the objective recognized by ***Quintette*** and ***Alberta-Pacific Terminals.*** The first case to recognize that the maintenance of the status quo could affect the rights of non-creditors was ***Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.*** [1989] 2 W.W.R. 566, 72 C.B.R. (N.S.) 20 (Alta. Q.B.). This is the objective that takes into account the broad constituency of interests served by the ***CCAA***. As the overriding intent of the ***CCAA*** is to facilitate reorganizations, this is the overriding objective of maintaining the status quo and it may produce results that are not entirely consistent with the other objectives. The most common example of an inconsistency is a situation where the giving of effect to this objective results in an unequal treatment of creditors.

There are exceptions to the maintenance of the status quo but they are not relevant to this case.

Apart from consideration of s. 81.1 of the ***B & I Act***, there is no justification for the creation of the trust fund. It would not serve to maintain the status quo. To the contrary, it would give the suppliers an advantage over other creditors of Woodward's. It would not be beneficial to the continuation of Woodward's business during the reorganization period or Woodward's attempt to

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reorganize. Indeed, it was the position of Woodward's on these application that the creation of a trust fund in the amount of $30 million would make any reorganization impossible.

I am not prepared to order the creation of the trust fund on the basis of the allegations of events that took place prior to the commencement of these proceedings or on the basis of the timing of the commencement of these proceedings. There is no evidence in this case of fraud that could justify the preservation of assets by way of the creation of a trust fund. If the allegations were proven, it could possibly be argued that there has been an abuse of process or that Woodward's has not come to Court with clean hands. But these would not justify the creation of a trust fund for the benefit of the suppliers. The likely result would be that the Court would decline to exercise its discretion to afford Woodward's the protection it requires to reorganize and no one is suggesting that Woodward's should not be given an opportunity to attempt to reorganize its business and financial affairs.

That brings me to s. 81.1 of the ***B & I Act***. In order to decide whether the creation of a trust fund will preserve rights of the suppliers, I must consider the rights that exist as a result of s. 81.1. I am reluctant to make definitive comments regarding s. 81.1 because I am not required to make a decision under that section and I do not wish to constrain another judge who is required in the future to make such a decision. I am particularly

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sensitive because s. 81.1 has only been in force for 1½ months and I am not aware of any cases that have considered it. However, I must make some comments about the likelihood of the Courts making certain Orders in relation to s. 81.1 because I must determine what rights are to be preserved.

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I begin by making the observation that on December 11 when these proceedings were commenced, the suppliers had no rights under s. 81.1 that could have been acted upon because Woodward's was not in bankruptcy or receivership. In ***Re Westar Mining Ltd.*** (unreported, June 16, 1992, B.C. Supreme Court Action No. A921164, Vancouver Registry) Macdonald J. was faced with an argument by the Crown that he should not have created a charge against Westar's assets to secure credit being extended during the reorganization period by Westar's suppliers because it would alter the priorities that would prevail in a bankruptcy of Westar. Macdonald J. rejected this argument in the following manner at p. 9:

> But, the Company was not in bankruptcy on June 10 when the charge was created. The Crown claims which are not afforded the protection of a statutory lien are not yet preferred. The June 10 order creating the charge does not purport to alter the priorities which will apply between the claims of the Crown and the unsecured trade creditors as at May 14.

The suppliers argue that the rights that I must preserve are the right to crystallize their position under s. 81.1 by way of the appointment of an interim receiver and the right to have the Court make an Order for the creation of a trust fund pursuant to s.

81.1(8). I must therefore consider the likelihood of the Court appointing an interim receiver or making an Order for the creation of a trust fund in the event that Woodward's had filed a notice of intention to file a proposal under the ***B & I Act***.

I agree with the submission of Mr. Fitch that s. 81.1 was intended to give suppliers the right to repossess goods that they had sold to the insolvent company if the company is to be liquidated by way of a bankruptcy or a receivership. Parliament directed its mind to the possibility that an insolvent company may first attempt to reorganize its affairs and it enacted subsection (4) of s. 81.1. Parliament decided that the period of the attempted reorganization should not be counted as part of the 30 day period under subsection (1) of s. 81.1. Parliament was silent as to the potential appointment of an interim receiver so that the suppliers could exercise their repossession rights during the reorganization period. Parliament was also silent as to the creation of a trust fund to be held for the benefit of the suppliers in the event that the reorganization is not successful. It must therefore be inferred in my view that Parliament intended that the insolvent company could continue to sell its goods in the ordinary course of business and utilize the sale proceeds to continue carrying on business pending its reorganization attempt.

It is my view that the likelihood of a Court appointing an interim receiver for the purpose of enabling suppliers to repossess

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the goods they supplied during the preceding 30 day period is low. The repossession of such goods would be counter-productive to the company's reorganization effort because it would deprive the company of assets it requires to continue carrying on business and to make a viable reorganization proposal. I can envisage a case where the Court may be willing to take such a step if it is concerned that the reorganization attempt may not be bona fide and the Court wishes to have an interim receiver to oversee the collection and disbursement of funds and to preserve the rights of suppliers if it is proven that the reorganization attempt was not bona fide. In this case there is no suggestion that Woodward's attempt to reorganize is not bona fide. In addition, I have reservations about whether an interim receiver is a receiver within the meaning of s. 243(2) of the ***B & I Act***. An interim receiver is very different from a (permanent) receiver.

Similarly, I believe that the likelihood of a Court making an Order under s. 81.1(8) for the creation of a trust fund is low. This would again be counter-productive to the attempt of the company to reorganize. I also doubt that it was intended by Parliament that the filing of a notice of intention to file a proposal would be considered to be an act aggrieving a supplier within the meaning of s. 81.1(8) unless, possibly, the filing was not bona fide.

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I was referred to two Quebec decisions dealing with the ***CCAA*** and the revendication rights of suppliers in Quebec. The first case was ***Century Industries Inc. v. Enterprises Union Électrique Ltée.*** (unreported, April 29, 1992, Que. S.C. Action No. 500-05-005804-925). I have been provided with a translation of the decision. Archambault J. ordered that the proceeds from the sale of any merchandise delivered in the 30 days prior to the service of the application before him be deposited in a trust account and that the monies in the trust account not be disbursed without further Court Order. The paragraph containing the reasoning of Archambault J. reads as follows (at p. 9):

> Le tribunal doit s'assurer que le statu quo est maintenu. Si une ordonnance n'était pas rendue, la requérante pourrait, si les marchandises étaient vendues dans l'intervalle par Union Électrique, perdre ses droits quant a la revendication des marchandises qui furent vendues et livrées a Union Électrique dans les derniers 30 jours. De plus, il serait fondamentalement injuste de permettre a Union Électrique de continuer de vendre ces marchandises qui ne lui appartiennent peut-être pas, au détriment des personnes qui en sont véritablement les propriétaires.

The translation for this paragraph with which I have been provided reads as follows:

> The Court must ensure that the statue quo is maintained. If no order were given, the Applicant might, if the merchandise was sold by Union Électrique in the interim, lose its rights of revendication of the goods which were sold and delivered to Union Électrique within the last 30 days. Moreover, it would be fundamentally unjust to permit Union Électrique to continue to sell merchandise which perhaps does not belong to it, to the detriment of those who are the true owners.

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I do not believe that the last sentence of the above paragraph relates to the right of revendication. In addition to merchandise that had been delivered within the previous 30 days, the applicant had sold goods to Union Électrique by way of conditional sale and title to these goods had not passed to Union Électrique.

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I am not familiar with the details of a supplier's right of revendication in Quebec but I think that there is an important distinction between it and the right afforded by s. 81.1 of the ***B & I Act***. The distinction is that the right of revendication is not dependent upon the bankruptcy or receivership of the purchaser of the goods. Thus, the applicant in the ***Union Électrique*** case had an existing right to repossess the goods supplied by it at the time the ***CCAA*** were commenced. Archambault J. was preserving that right when he made the Order that he did. In the present case, the suppliers did not have a right to repossess the goods supplied by them at the time these proceedings were instituted.

The second Quebec case took a different approach. In ***Steinberg Inc. v. Colgate-Palmolive Canada Inc.*** (1992) 13 C.B.R. (3d) 139 a supplier made application for leave under s. 11 of the ***CCAA*** to exercise its right of revendication with respect to goods delivered to the insolvent company within the previous 30 days. The Quebec Superior Court dismissed the application. The headnote,

which is consistent with the translation of the decision provided to me, reads as follows:

> The power conferred on the judge under the Act applies to all proceedings likely to affect the survival of a company. The individual interest of any creditor must be weighed against the objects of the Act and must yield to the collective interests of all creditors. Granting the application would impose on the court an obligation to do the same for all 30-day suppliers. Therefore, an arrangement proposal submitted to the judge at the time of the order might fail before it was presented to all creditors, and might cause the debtor to go bankrupt. It followed that the goods in question should not be allowed to be seized prior to judgment.

This reasoning is similar to my reasoning in concluding that it is unlikely that a Court would appoint an interim receiver or order the creation of a trust fund when an insolvent company is attempting to reorganize pursuant to the ***B & I Act***.

The result in the ***Steinberg*** case is also consistent with the decision of the B.C. Court of Appeal in ***Chef Ready Foods Ltd. v. Hongkong Bank of Canada*** (1990), 51 B.C.L.R. (2d) 84 where the issue involved security under s. 178 of the ***Bank Act***. Section 178 security creates a security interest in inventory and the bank has the right to seize and sell the inventory. The right of the bank is therefore similar to the right of revendication enjoyed by a Quebec supplier. If the goods covered by s. 178 security are sold during the period of reorganization, the bank will be prejudiced in the same fashion as a supplier whose 30 day goods are sold during the period of reorganization (except to the extent that proceeds from the sale of inventory are utilized to purchase new inventory

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which would become covered by the bank's s. 178 security). In ***Chef Ready Foods*** the B.C. Court of Appeal held that the enforcement of s. 178 security can be stayed by an Order under s. 11 of the ***CCAA***. Gibbs J.A. said the following at p. 92:

> It is apparent from these excerpts and from the wording of the statute that, in contrast with ss. 178 and 179 of the Bank Act which are preoccupied with the competing rights and duties of the borrower and the lender, the C.C.A.A. serves the interests of a broad constituency of investors, creditors and employees. If a bank's rights in respect of s. 178 security are accorded a unique status which renders those rights immune from the provisions of the C.C.A.A., protection afforded that constituency for any company which has granted s. 178 security will be largely illusory. It will be illusory because almost inevitably the realization by the bank on its security will destroy the company as a going concern. Here, for example, if the bank signifies and collects the accounts receivable, Chef Ready will be deprived of working capital. Collapse and liquidation must necessarily follow. The lesson will be that where s. 178 security is present a single creditor can frustrate the public policy objectives of the C.C.A.A. There will be two classes of debtor companies: those for whom there are prospects for recovery under the C.C.A.A.; and those for whom the C.C.A.A. may be irrelevant dependent upon the whim of the s. 178 security holder. Given the economic circumstances which prevailed when the C.C.A.A. was enacted, it is difficult to imagine that the legislators of the day intended that result to follow.

The above passage contains persuasive reasoning why the Court is unlikely to appoint an interim receiver or to create a trust fund under the ***B & I Act*** if an insolvent company files a notice of intention to file a proposal. The ability to reorganize would be illusory for companies which deal with goods provided on credit by suppliers.

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Subject to the point on which I will subsequently invite further submissions, I have concluded that there is likely to be no difference in the approach of the Court when dealing with a proposal under the ***B & I Act*** from the approach of the Court when dealing with a reorganization under the ***CCAA*** as they relate to the rights of suppliers. Therefore, there is no special right of suppliers that needs to be preserved by the creation of a trust fund and there is no abuse in Woodward's choosing the ***CCAA*** over the ***B & I Act***. In addition, I repeat that the suppliers did not have any right to repossess the goods supplied by them at the time of the commencement of these proceedings. Accordingly, I dismiss the application of the suppliers for an Order creating a trust fund for their benefit.

Subsection 81.1(4) of the ***B & I Act*** does attempt to preserve the potential rights of suppliers by providing that the period of reorganization does not count in the computation of the 30 day period under s. 81.1(1). This is consistent with the status quo objective of suspending the rights of creditors during the period of reorganization. No submissions were made to me by the parties as to whether I can make an Order in these proceedings that has the same effect as s. 81.1(4). It may be possible that I could order that the period during which Woodward's is attempting to reorganize will not be counted as part of the 30 day period under s. 81.1(1) with the result that if Woodward's reorganization attempt is not successful and it goes into bankruptcy or

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receivership, the suppliers would still have the right to repossess goods supplied by them within the 30 day period preceding the commencement of these proceedings that have not been sold by Woodward's in the meantime. I invite counsel to make submissions in this regard.

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As I have concluded that there are no rights of the suppliers that should be preserved other than a potential postponement of the running of the 30 day period under s. 81.1 of the ***B & I Act***, my interim Order of December 17 should be set aside as it relates to the proceeds from the sale of goods after December 17. Counsel for several of the suppliers has requested that he have the opportunity to seek instructions regarding an appeal before the Order is set aside. Counsel for Woodward's does not object. I therefore set aside my December 17 Order as it relates to the sale proceeds effective 4:00 p.m. on January 18, 1993 or such later time as I may order.

January 14, 1993 " D. Tysoe, J. "

Vancouver, B.C.