Court File No. CV-13-10355-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

BETWEEN:

GE CANADA EQUIPMENT FINANCING G.P.

Applicant

- and -

I M B C BLOWMOLDING INC.

Respondent

BRIEF OF AUTHORITIES OF THE APPLICANT

(returnable December 10, 2013)

December 8, 2013

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ONTARIO
SUPERIOR COURT OF JUSTICE
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B E T W E E N :

GE CAPITAL CANADA EQUIPMENT FINANCING G.P.

Applicant

- and -

I M B C BLOWMOLDING INC.

Respondent

APPLICATION UNDER Section 243(1) of the *Bankruptcy and Insolvency* Act, R.S.C. 1985, c.B-3, as amended and Section 101 of the *Courts of Justice Act*, R.S.O. 1990, c.C-43, as amended

FACTUM OF THE APPLICANT
(Application returnable December 10, 2013)

PART II - INTRODUCTION

1. This Factum is being filed in support of an Application by GE Capital Canada Equipment Financing G.P. (**"GE Canada**") for an order: (a) appointing A. Farber & Partners Inc. ("**Farber" or "Proposed Receiver**") as receiver of the Respondent; (b) approving the Asset Purchase Agreement dated December 6, 2013 between Farber, as Proposed Receiver, and Plastique Micron Inc., as purchaser (the "**Purchaser**") (the "**Stalking Horse Offer**"), and (c) approving a stalking horse sale process ("**Sale Process**") to be conducted by Farber.

PART III - THE FACTS

2. The Respondent, I M B C Blowmolding Inc. ("**IMBC**") is an Ontario corporation located in the City of Orangeville, Province of Ontario. It carries on the business of manufacturing custom extrusion blowmolded plastic products for use in the health and beauty, automotive and other sectors. Robert Starr ("**Starr**") is the sole officer and director of IMBC.

Reference: Affidavit of Pisani, sworn December 6, 2013 ("**Pisani Affidavit**"), paras. 6, 7 & 8

Report of A. Farber & Partners Inc. as proposed court-appointed receiver of the Respondent dated December 6, 2013 (the "**Report**"), paras. 5&6

3. IMBC employs approximately 41 full-time non-unionized employees. It does not sponsor or contribute to any employee pension plans.

Reference: Pisani Affidavit, para. 9 & 10

4. IMBC operates 17 machines and 3 secondary production lines in its 70,000 square foot leased facility at 71/81 Centennial Road, Orangeville, Ontario (the "**Leased Premises**"). The owner of the Leased Premises is 1309742 Ontario Ltd. operating as Starr Properties ("**130**"), a company related to Starr.

Reference: Pisani Affidavit, para. 13

Report, Para 8

5. On October 17, 2013, Farber was engaged by 130 to review the business affairs of 130 and IMBC and to advise on potential sales of the assets of each. In

this capacity, Farber has been involved in the negotiation of the Stalking Horse APS described further below.

Reference: Report, Para 9

The GE Canada Loan and Security

6. Pursuant to an Equipment Loan and Security Agreement (the "**ELSA**") dated June 27, 2011, GE Canada financed the acquisition of certain equipment and related parts as more particularly described in the ELSA (the "**Equipment**") by IMBC.

Reference: Pisani Affidavit, para. 11

7. IMBC secured payment of its obligations by granting a purchase money security interest ("**PMSI**") in the Equipment pursuant the terms of the ELSA. In addition, IMBC granted a security interest in favour of GE Canada in respect to all of its personal property, both tangible and intangible, pursuant to a General Security Agreement dated June 27, 2011 (the "**GSA**"). GE Canada registered its security as against IMBC pursuant to the Personal Property Security Act ("**PPSA**").

Reference: Pisani Affidavit, paras 14 to 15.

8. In addition, 130 guaranteed all obligations and liabilities of IMBC to GE Canada pursuant to a guarantee and indemnity agreement dated June 27, 2011 (the "**Guarantee**"). The Guarantee is supported by a mortgage granted by 130 in favour of GE Canada (the "**Mortgage**") as against the Leased Premises.

Reference: Pisani Affidavit, paras. 12 to13

The Default

9. On November 7, 2013, IMBC defaulted in payment of the instalment due under the ELSA.

Reference: Pisani Affidavit, para. 16

10. In November, 2013, IMBC notified GE Canada that it had been negotiating with a prospective purchaser of its business as going concern. IMBC sought GE Canada's cooperation to facilitate a receivership to complete the transaction contemplated by the agreement as part of a stalking horse bidding process.

Reference: Pisani Affidavit, para. 17

11. On November 15, 2013, GE Canada demanded payment of all obligations and liabilities of IMBC and issued a corresponding notice under section 244 of the BIA in order to facilitate a receivership. As at November 15, 2013, the amount owing to GE Canada was approximately $1,097,602.77.

Reference: Pisani Affidavit, para. 18

12. In addition to GE, the following creditors have a perfected security interest against IMBC pursuant to the *Personal Property Security Act* ("*PPSA*"): Starr; Key Equipment Finance Canada Ltd.; National Leasing Group Inc.; Georgian Triangle

and Dufferin County Economic Development Corporation ("**EDC**"); and RPG Receivables Purchase Group Inc. ("**RPG**").[1]

Reference: Pisani Affidavit, para. 20

13. Pursuant to a Priorities Agreement dated June 30, 2011 between RPG, GE Canada, EDC and IMBC (the "**Priorities Agreement**"), the priorities have been defined as follows: (1) RPG holds a first ranking security interest over the assets, property and undertaking (the "**Assets**") of IMBC (other than the Equipment); (2) GE Canada has first priority with respect to the Equipment (and is in second position as against the Assets); (3) EDC holds a third ranking security interest as against the Assets of IMBC, including the Equipment.

Reference: Pisani Affidavit, para. 22

14. RPG has advanced funds pursuant to a master receivables purchase agreement and an inventory facility agreement. On December 5, 2013, RPG had an outstanding balance owing of approximately $487,000 (for factored receivables) and $151,000 (under an inventory facility). CBED is owed approximately $250,000.

Reference: Report, para 12 to 13

The Stalking Horse Offer

15. As set out in further detail in Paragraphs 16 through 18 of the Report, the Stalking Horse Offer provides, *inter alia*, that:

[1] No amounts are owed to Starr, National Leasing Group Inc. and Key Equipment Finance Ltd.: Report, para. 15.

(a) The Purchaser would acquire substantially all of IMBC's business and Assets, except for, *inter alia*, its accounts receivable, bank and prepaid deposits, any tax refunds and rebates and rights of action in favour of IMBC as against third parties;

(b) The purchase price is $1.25 million plus an amount equal to the cost of net realizable value of the inventory and $25,000 for equipment replacement parts, before taking into account the value of Assumed Liabilities (defined below) (collectively, the "**Purchase Price**");

(c) In addition, the Purchaser will assume certain liabilities, including obligations in respect of the majority of the employees that will be offered employment if the Stalking Horse Offer is accepted and with respect to certain contracts to be assumed (collectively, the "**Assumed Liabilities**");

(d) Payment of a $250,000 deposit to the Proposed Receiver at the time of submission of the Stalking Horse Offer;

(e) The Stalking Horse Offer is on an "as is, where is" basis;

(f) The closing date is the business day that is two (2) days following the date that an Approval and Vesting Order is granted;

(g) The Stalking Horse Offer is subject to being selected as the "**Winning Bid**" in accordance with the Stalking Horse Approval Terms (discussed

below) and the approval of the Court, representing the only material conditions precedent to the transaction.

(h) In the event that the Stalking Horse Offer is not selected as the Winning Bid pursuant to the Stalking Horse Approval Terms, the Stalking Horse Offer provides that the Purchaser is entitled to a break fee of $125,000, representing the Purchaser's expenses in connection with this transaction.

Reference: Pisani Affidavit, para. 25

Report, paras 16 to 23

Proposed Sale Process

16. As set out in detail in the Report, the proposed Receiver seeks this Court's approval of an orderly process for the marketing and sale of IMBC's business and Assets (the "**Sales Process**").

Reference: Report, para. 24 to 31

17. The Sale Process contemplates: (i) the placing of an advertisement alerting potential interested parties of the sale; (ii) providing prospective purchasers with access to a data room upon execution of a confidentiality agreement; (iii) bids to be delivered by January 7, 2014; (iv) qualified bidders shall be invited to participate in an auction; (v) the proposed Receiver would select the highest and/or best bid (the "**Winning Bid**"), subject to court approval; (vi) if there is no other qualified bidder, the Stalking Horse Offer will be the Winning Bid, subject to court approval; and (vii) the

Winning Bid or the Stalking Horse Offer is to be approved by the court by January 15, 2014, with a closing to follow by January 17, 2014.

Reference: Pisani Affidavit, para. 28
Report, paras. 24 to 31

18. The duration of the Sale Process to be conducted by the proposed Receiver would be for a period of approximately 3 weeks. Given IMBC's deteriorating financial position, the proposed Receiver is of the view that the further marketing by the Receiver of IMBC's business and assets during the proposed time period will provide ample opportunity for any interested parties to submit a superior bid.

Reference: Report, paras. 23 and 32

Financial Position

19. IMBC is suffering from a liquidity crisis and is unable to satisfy its obligations as they become due. The cash needs of the Company are so severe that operations cannot continue without additional funding in order to continue normal course operations until January 17, 2014, approximately $100,000 of additional funds would be required. The Proposed Receiver has been in discussions to secure necessary funding.

Reference: Pisani Affidavit, paras. 5 and 26

Report, para. 23

20. IMBC is in default of the terms of the ELSA. It is insolvent and does not have sufficient financing to continue its operations absent continuing financial support.

Such funding will only be extended to IMBC in the context of a court supervised restructuring and sale process to be conducted within the proposed receivership.

Reference: Pisani Affidavit, para. 3, 5

21. A sale of the business through a court-appointed receiver is the most viable option for preserving the enterprise value of IMBC for the benefit of GE Canada, RPG and other stakeholders including employees, customers and suppliers. It will preserve jobs and the continued supply of product for IMBC's customers. Further, a sale of the business carried out through the appointment of the Proposed Receiver and pursuant to the Sale Process will allow for the preservation of the enterprise value of IMBC for the benefit of GE Canada, RPG and other stakeholders including employees, customers and suppliers.

Reference: Pisani Affidavit, paras. 23 to 25
Report, para 32

22. If the proposed Transaction is not completed, IMBC will be unable to continue to operate as there will be no financing available for it to do so. The realizable value of IMBC and its Assets would be greatly diminished, resulting in a loss of employment for close to 41 employees and a substantial shortfall to GE Canada, RPG and EDC.

Reference: Pisani Affidavit, para. 24 to 25

23. GE Canada seeks the appointment of a receiver to protect the business of IMBC, ensure ongoing operations and preserve the value of IMBC's assets, including

the Equipment, with the goal of ultimately consummating a going concern purchase and sale transaction of substantially all of the assets of IMBC.

Reference: Pisani Affidavit, para. 5 and 24

PART IV - ISSUES AND THE LAW

A. Just and Convenient Test

24. Under section 243 of the *Bankruptcy and Insolvency Act* and Section 101 of the *Courts of Justice Act*, this court may appoint a receiver over all or substantially all of the assets of an insolvent person where is it just and convenient to do so, and on such terms as it may consider just.

Bankruptcy and Insolvency Act, R.S.C., 1985, c. B-3 ("**BIA**"), s. 243

Courts of Justice Act, R.S.O. 1990, c. C.43, s. 101

25. In *Bank of Nova Scotia v. Freure Village on Claire Creek*, Justice Blair noted as follows:

> "…where the security instrument permits the appointment of private receiver—and even contemplates, as this one does, the secured creditor seeing a court appointed receiver—and where the circumstances of default justify the appointment of a private receiver, the "extraordinary" nature of the remedy sought is less essential to the inquiry. Rather, the "just or convenient" question becomes one of the court determining, in the exercise of its discretion, whether it is more in the interests of all concerned to have the receiver appointed by the court or not. This, of course, involves and examination of all the circumstances…, including the potential costs, the relationship between the debtor and the creditors, the likelihood of maximizing the return in and preserving the subject property and the best way of facilitating the work and duties of the receiver-manager."

Reference: *Bank of Nova Scotia v. Freure Village on Claire Creek,* 1996 CanLII 8258 (ON SC) at para 12

26. Where a debtor has provided an express agreement to the appointment of a receiver in the event of default, the court should not ordinarily interfere with the contract between the parties.

Reference: *United Savings Credit Union v. F&R Brokers, Inc.*, 2003 BCSC 640 (CanLII) at para 16.

27. The appointment by the Court of a receiver and the imposition of a stay of proceedings will prevent precipitous creditor action that may undermine the realization process. The appointment of a receiver will also facilitate the orderly and efficient realization of assets, judicial determination of creditor claims and priorities, and the fair distribution of proceeds to creditors by reference to their legal rights.

Reference: *Pope & Talbot Ltd.* 2009 BCSC 1552 (CanLII) at para. 131

Reference: *Canada (Attorney General) v. Reliance Insurance Co.* 2007 CanLII 41899 at para 26.

28. The "just and convenient inquiry requires the court to determine whether it is in the interests of all concerned to have the receiver appointed by the court. The court should consider the following factors in making such a determination:

(a) the potential costs of the receiver;

(b) the relationship between the debtor and the creditors;

(c) the likelihood of preserving and maximizing the return on the subject property; and

(d) the best way of facilitating the work and duties of the receiver.

Reference: *Elleway Acquisitions Limited v The Cruise Professionals Limited*, 2013 ONSC 6866 (CanLII) at 28

29. In the circumstances of this case, it is respectfully submitted that the appointment of a Receiver by the Court is just and convenient for the following reasons:

(a) IMBC has defaulted on its obligations to GE Canada, giving rise to GE Canada's rights to appoint a receiver under its security;

(b) it will provide a vehicle through which necessary financing can be provided to support and continue IMBC's business operations, thereby maximizing value for all stakeholders;

(c) it will bring stability to IMBC's ongoing operations so as to facilitate an orderly restructuring and realization process;

(d) it will permit IMBC's business operations to continue, which will, among other things, preserve jobs and business opportunities in the interests of stakeholders generally, including employees, customers and suppliers;

(e) facilitate the conduct of the Sale Process and a going concern sale of IMBC's business, preserving the jobs of 41 employees and existing goodwill; and

(f) prevent IMBC's creditors from continuing with or commencing enforcement proceedings, which will interfere with an orderly realization process.

B. The Stalking Horse Offer and the Sale Process should be Approved

30. The Stalking Horse Offer is intended to establish a floor price and transactional structure for any potential subsequent bids from interested parties.

Stalking horse offers, combined with court-approved bidding procedures, are commonly used in insolvency scenarios to facilitate sales of businesses and assets.

Reference: *CCM Master Qualified Fund Ltd v. blutip Power Technologies,* 2012 ONSC 1750 (CanLII) at para. 7

31. The criteria to be applied when considering the approval of a sale by a Receiver are well established, and are summarized as follows:

(a) whether the Receiver has made a sufficient effort to get the best price and has not acted improvidently;

(b) whether the interests of all parties have been considered;

(c) the efficacy and integrity of the process by which offers are obtained; and

(d) whether there has been unfairness in the workout of the process.

Reference: *Royal Bank of Canada v. Soundair Corporation*, (1991) 4 O.R. (3d) 1 (Ont. C.A.)

32. Although made in the context of considering a stalking horse credit bid, Brown, J. in *CCM Master Qualified Fund Ltd. v. blutip Power Technologies* adopted the following comments:

> *"To be effective for such stakeholders, the credit bid had to be put forward in a process that would allow a sufficient opportunity for interested parties to come forward with a superior offer, recognizing that a timetable for the sale of a business in distress is a fast track ride that requires interested parties to move quickly or miss the opportunity. The court has to balance the need to move quickly, to address the real or perceived deterioration of value of the business during a sale process or the limited availability of restructuring financing, with a realistic timetable that encourages and does not chill the auction process."*

Reference: *CCM Master Qualified Fund Ltd v. blutip Power Technologies,* 2012 ONSC 1750 (CanLII) at para. 8

33. Courts have held that, in appropriate circumstances, an accelerated sale process satisfies the requirements of *Soundair*. For example, in *Laurentian Bank of Canada v. World Vintners Corp.*, the court granted a period of only six days to allow interested parties to complete the necessary due diligence and submit offers, despite the fact that there had been no previous marketing of the business by the debtor. In that case, the Honourable Mr. Justice Cumming stated as follows:

> "Considering all the circumstances, in my view it is reasonable to achieve some greater assurance that the sale process is seen to be fair by keeping the bidding process open for some further period of time . . .
>
> While this extension of six days is itself less than ideal, considering all the circumstances it is a fair balancing of interests of all the stakeholders given the present difficult situation."

Reference: *Laurentian Bank of Canada v. World Vintners Corp,* 2002 CanLII 49605 (ON SC)

34. In other cases, this court has approved immediate sales or flip transactions where a marketing process conducted by a party other than the receiver was fair and reasonable, and where the court was of the view that no purpose would be served by a further marketing process.

Reference: *Textron Financial of Canada Ltd. v. Beta Browns Ltd*. 2007 CanLII 297 (ON SC)

35. For example, in *Tool-Plas Systems, Inc.* the Honourable Mr. Justice Morawetz approved the appointment of a receiver for the purpose of implementing a "quick flip" transaction. In so doing, he stated as follows:

> "a "quick flip" transaction is not the usual transaction. In certain circumstances, however, it may be the best, or the only, alternative. In considering whether to approve a "quick flip" transaction, the court should consider the impact on various

> parties and assess whether their respective position and the proposed treatment they will receive in the "quick flip" transaction would realistically be any different if an extended sales process were followed"

Reference: *Tool-Plas Systems Inc*. (Re), 2008 CanLII 54791 (ON SC) at para. 15

36. A "quick flip" transaction will be approved pursuant to the *Soundair* principles where: there is evidence that the debtor has insufficient cash to engage in a further, extended marketing process; there is no basis to expect that such a process will result in a better realization on the assets; and delaying the process puts the continued business operations in jeopardy.

Reference: *Elleway Acquisitions Limited v. 4358376 Canada Inc*., 2013 ONSC 7009 (CanLII) at para. 36

37. Many of the same concerns are applicable in this context, although the Sale Process may serve to generate a superior offer than the existing Stalking Horse Offer. In this vein, it is respectfully submitted that the sale of IMBC's assets as contemplated by the proposed Stalking Horse Offer and Sale Process should be approved for the following reasons:

(a) The Stalking Horse Offer will prevent the loss of significant jobs, as the purchaser intends to offer employment to substantially all of IMBC's existing employees;

(b) If the Stalking Horse Offer is approved, the Purchaser would assume some of IMBC's liabilities; and

(c) Pursuant to this process, financing will be extended to IMBC for the purpose of financing IMBC's continued operations during the Sale Process;

(d) In the absence of the approval of the proposed Sale Process, IMBC will not have sufficient liquidity to continue to operate which will be to the detriment of all stakeholders, including employees, customers and suppliers.

PART V - ORDER REQUESTED

38. For the reasons set out above, GE Canada respectfully requests the following relief:

(a) an Order appointing A. Farber & Partners Inc. as Receiver of the property, assets and undertakings of IMBC; and

(b) an Order approving, authorizing and directing the Receiver to accept the Stalking Horse Offer and carry out the Sale Process as described in the Report.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

December 8, 2013

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SCHEDULE "A"
LIST OF AUTHORITIES

1. *Bank of Nova Scotia v. Freure Village on Claire Creek,* 1996 CanLII 8258 (ON SC)

2. *United Savings Credit Union v. F&R Brokers, Inc.*, 2003 BCSC 640 (CanLII)

3. *Pope & Talbot Ltd.* 2009 BCSC 1552 (CanLII)

4. *Canada (Attorney General) v. Reliance Insurance Co.* 2007 CarswellOnt 6391

5. *Elleway Acquisitions Limited v The Cruise Professionals Limited*, 2013 ONSC 6866 (CanLII)

6. *Royal Bank of Canada v. Soundair Corporation*, (1991) 4 O.R. (3d) 1 (Ont. C.A.)

7. *CCM Master Qualified Fund Ltd v. blutip Power Technologies,* 2012 ONSC 1750 (CanLII)

8. *Laurentian Bank of Canada v. World Vintners Corp,* 2002 CanLII 49605 (ON SC)

9. *Textron Financial of Canada Ltd. v. Beta Browns Ltd*. 2007 CanLII 297 (ON SC)

10. *Tool-Plas Systems Inc. (Re)*, 2008 CanLII 54791 (ON SC)

11. *Elleway Acquisitions Limited v. 4358376 Canada Inc.*, 2013 ONSC 7009 (CanLII)

SCHEDULE "B"
RELEVANT STATUTES

Courts of Justice Act, R.S.O. 1990, c C.43

Interlocutory Orders

Injunctions and receivers

101.(1)In the Superior Court of Justice, an interlocutory injunction or mandatory order may be granted or a receiver or receiver and manager may be appointed by an interlocutory order, where it appears to a judge of the court to be just or convenient to do so. R.S.O. 1990, c. C.43, s. 101 (1); 1994, c. 12, s. 40; 1996, c. 25, s. 9 (17).

Terms

(2)An order under subsection (1) may include such terms as are considered just. R.S.O. 1990, c. C.43, s. 101 (2).Bankruptcy and Insolvency Act, RSC 1985, c B-3

Bankruptcy and Insolvency Act, R.S.C. 1985, c B-3

Court may appoint receiver

243. (1) Subject to subsection (1.1), on application by a secured creditor, a court may appoint a receiver to do any or all of the following if it considers it to be just or convenient to do so:

(*a*) take possession of all or substantially all of the inventory, accounts receivable or other property of an insolvent person or bankrupt that was acquired for or used in relation to a business carried on by the insolvent person or bankrupt;

(*b*) exercise any control that the court considers advisable over that property and over the insolvent person's or bankrupt's business; or

(*c*) take any other action that the court considers advisable.

Restriction on appointment of receiver

(1.1) In the case of an insolvent person in respect of whose property a notice is to be sent under subsection 244(1), the court may not appoint a receiver under subsection (1) before the expiry of 10 days after the day on which the secured creditor sends the notice unless

(*a*) the insolvent person consents to an earlier enforcement under subsection 244(2); or

(*b*) the court considers it appropriate to appoint a receiver before then.

Definition of "receiver"

(2) Subject to subsections (3) and (4), in this Part, "receiver" means a person who

(*a*) is appointed under subsection (1); or

(*b*) is appointed to take or takes possession or control — of all or substantially all of the inventory, accounts receivable or other property of an insolvent person or bankrupt that was acquired for or used in relation to a business carried on by the insolvent person or bankrupt — under

(i) an agreement under which property becomes subject to a security (in this Part referred to as a "security agreement"), or

(ii) a court order made under another Act of Parliament, or an Act of a legislature of a province, that provides for or authorizes the appointment of a receiver or receiver-manager.

Definition of "receiver" — subsection 248(2)

(3) For the purposes of subsection 248(2), the definition "receiver" in subsection (2) is to be read without reference to paragraph (*a*) or subparagraph (*b*)(ii).

Trustee to be appointed

(4) Only a trustee may be appointed under subsection (1) or under an agreement or order referred to in paragraph (2)(*b*).

Place of filing

(5) The application is to be filed in a court having jurisdiction in the judicial district of the locality of the debtor.

Orders respecting fees and disbursements

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

Meaning of "disbursements"

(7) In subsection (6), "disbursements" does not include payments made in the operation of a business of the insolvent person or bankrupt.

1992, c. 27, s. 89;
2005, c. 47, s. 115;
2007, c. 36, s. 58.

GE CAPITAL CANADA EQUIPMENT FINANCING G.P.
Applicant

and

I M B C BLOWMOLDING INC.
Respondent

Court File No: CV-13-10355-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE

Proceeding commenced at Toronto

FACTUM AND BRIEF OF AUTHORITIES OF THE APPLICANT
(MOTION RETURNABLE DECEMBER 10, 2013)

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Lawyers for the Applicant

Ontario Supreme Court
Bank of Nova Scotia v. Freure Village of Clair Creek
Date: 1996-05-31

1996 CanLII 8258 (ON SC)

Bank of Nova Scotia

and

Freure Village on Clair Creek et al

Ontario Court of Justice (General Division – Commercial List) Blair J.

Judgment – May 31, 1996.

John J. Chapman and John R. Varley, for Bank of Nova Scotia.

J. Gregory Murdoch, for Freure Group (all defendants).

John Lancaster, for Boehmers, a Division of St. Lawrence Cement.

Robb English, for Toronto-Dominion Bank.

William T. Houston, for Canada Trust.

May 31, 1996. Endorsement.

[1] BLAIR J.: – There are two companion motions here, namely:

(i) the within motion by the Bank for summary judgment on the covenants on mortgages granted by "Freure Management" and "Freure Village" to the Bank, which mortgages have been guaranteed by Freure Investments; and

(ii) the motion for appointment by the Court of a receiver-manager over five different properties which are the subject matter of the mortgages (four of which properties are apartment/townhouse complexes totalling 286 units and one of which is an as yet undeveloped property).

This endorsement pertains to both motions.

The Motion for Summary Judgment

[2] Three of the mortgages have matured and have not been repaid. The fourth has not yet matured but, along with the first three, is in default as a result of the failure to pay tax arrears.

The total tax arrears outstanding are in excess of $850,000. The Bank is owed in excess of $13,200,000. There is no question that the mortgages are in default. Nor is it contested that the monies are presently due and owing. The Defendants argue, however, that the Bank had agreed to forebear or to stand-still for six months to a year in May, 1995 and therefore submit the monies were not due and owing at the time demand was made and proceedings commenced.

[3] There is simply no merit to this defence on the evidence and there is no issue with respect to it which survives the “good hard look at the evidence” which the authorities require the Court to take and which requires a trial for its disposition: see Rule 20.01 and Rule 20.04, *Pizza Pizza Ltd v. Gillespie* (1990), 75 O.R. (2d) 225 (Gen. Div.); *Irving Ungerman Ltd. v. Galanis* (1993) 4 O.R. (3d) 545 (C.A.).

[4] On his cross-examination, Mr. Freure admitted:

(i) that he knew the Bank had not entered into any agreement whereby it had waived its rights under its security or to enforce its security; and

(ii) that he realized the Bank was entitled to make demand, that the individual debtors in the Freure Group owed the money, that

they did not have the money to pay and the $13,200,000 indebtedness was “due and owing” (see cross-examination questions 46-54, 88-96, 233-243).

[5] As to the guarantees of Freure Investments, an argument was put forward that the Bank changed its position with regard to the accumulation of tax arrears without notice to the guarantor, and accordingly that a triable issues exists in that regard.

[6] No such triable issue exists. The guarantee provisions of the mortgage itself permit the Bank to negotiate changes in the security with the principal debtor. Moreover, the principal of the principal debtor and the principal of the guarantor – Mr. Freure – are the same. Finally, the evidence which is relied upon for the change in the Bank’s position – an internal Bank memo from the local branch to the credit committee of the Bank in Toronto – is not proof of any such agreement with the debtor or change; it is merely a recitation of various position proposals and a recommendation to the credit committee, which was not followed.

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[7] Accordingly, summary judgment is granted as sought in accordance with the draft judgment filed today and on which I have placed my fiat. The cost portion of the judgment will bear interest at the *Courts of Justice Act* rate.

Receiver/Manager

[8] The more difficult issue for determination is whether or not the Court should appoint a receiver/manager.

[9] It is conceded, in effect, that if the loans are in default and not saved from immediate payment by the alleged forbearance agreement – which they are, and are not, respectively – the Bank is entitled to move under its security and appoint a receiver-manager privately. Indeed this is the route which the Defendants – supported by the subsequent creditor on one of the properties (Boehmers, on the Glencairn property) – urge must be taken. The other major creditors, TD Bank and Canada Trust, who are owed approximately $20,000,000 between them, take no position on the motion.

[10] The Court has the power to appoint a receiver or receiver and manager where it is "just or convenient" to do so: the *Courts of Justice Act,* R.S.O. 1990, c. 43, s. 101. In deciding whether or not to do so, it must have regard to all of the circumstances but in particular the nature of the property and the rights and interests of all parties in relation thereto. The fact that the moving party has a right under its security to appoint a receiver is an important factor to be considered but so, in such circumstances, is the question of whether or not an appointment by the Court is necessary to enable the receiver-manager to carry out its work and duties more efficiently; see generally *Third Generation Realty Ltd. v. Twigg* (1991) 6 C.P.C. (3d) 366 (Ont. Gen. Div.) at pages 372-374; *Confederation Trust Co. v. Dentbram Developments Ltd.* (1992), 9 C.P.C. (3d) 399 (Ont. Gen. Div.); *Royal Trust Corp. of Canada v. D.Q. Plaza Holdings Ltd.* (1984), 54 C.B.R. (N.S.) 18 (Sask. Q.B.) at page 21. It is not essential that the moving party, a secured creditor, establish that it will suffer irreparable harm if a receiver-manager is not appointed: *Swiss Bank Corp. (Canada) v. Odyssey Industries Inc.* (1995), 30 C.B.R. (3d) 49 (Ont. Gen. Div. [Commercial List]).

[11] The Defendants and the opposing creditor argue that the Bank can perfectly effectively exercise its private remedies and that the Court should not intervene by giving the extraordinary remedy of appointing a receiver when it has not yet done so and there is no

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evidence its interest will not be well protected if it did. They also argue that a Court appointed receiver will be more costly than a privately appointed one, eroding their interests in the property.

[12] While I accept the general notion that the appointment of a receiver is an extraordinary remedy, it seems to me that where the security instrument permits the appointment of a private receiver – and even contemplates, as this one does, the secured creditor seeking a court appointed receiver – and where the circumstances of default justify the appointment of a private receiver, the "extraordinary" nature of the remedy sought is less essential to the inquiry. Rather, the "just or convenient" question becomes one of the Court determining, in the exercise of its discretion, whether it is more in the interests of all concerned to have the receiver appointed by the Court or not. This, of course, involves an examination of all the circumstances which I have outlined earlier in this endorsement, including the potential costs, the relationship between the debtor and the creditors, the likelihood of maximizing the return on and preserving the subject property and the best way of facilitating the work and duties of the receiver-manager.

[13] Here I am satisfied on balance it is just and convenient for the order sought to be made. The Defendants have been attempting to refinance the properties for 11/2 years without success, although a letter from Mutual Trust dated yesterday suggests (again) the possibility of a refinancing in the near future. The Bank and the debtors are deadlocked and I infer from the history and evidence that the Bank's attempts to enforce its security privately will only lead to more litigation. Indeed, the debtor's solicitors themselves refer to the prospect of "costly, protracted and unproductive" litigation in a letter dated March 21st of this year, should the Bank seek to pursue its remedies. More significantly, the parties cannot agree on the proper approach to be taken to marketing the properties which everyone agrees must be sold. Should it be on a unit by unit conversion condominium basis (as the debtor proposes) or on an en bloc basis as the Bank would prefer? A Court appointed receiver with a mandate to develop a marketing plan can resolve that impasse, subject to the Court's approval, whereas a privately appointed receiver in all likelihood could not, at least without further litigious skirmishing. In the end, I am satisfied the interests of the debtors themselves, along with those of the creditors (and the tenants, who will be caught in the middle) and the orderly disposition of the property are all better served by the appointment of the receiver-manager as requested.

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[14] I am prepared, in the circumstances, however, to render the debtors one last chance to rescue the situation, if they can bring the potential Mutual Trust refinancing to fruition. I postpone the effectiveness of the order appointing Doane Raymond as receiver-manager for a period of three weeks from this date. If a refinancing arrangement which is satisfactory to the Bank and which is firm and concrete can be arranged by that time, I may be spoken to at a 9:30 appointment on Monday, June 24, 1996 with regard to a further postponement. The order will relate back to today's date, if taken out.

[15] Should the Bank be advised to appoint Doane Raymond as a private receiver/manager under its mortgages in the interim, it may do so.

[16] Counsel may attend at an earlier 9:30 appointment if necessary to speak to the form of the order.

Motions granted.

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IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation: ***United Savings Credit Union v. F & R Brokers Inc. et al ,***
2003 BCSC 640

Date: 20030506
Docket: H021226
Registry: Vancouver

2003 BCSC 640 (CanLII)

Between:

UNITED SAVINGS CREDIT UNION,
(formerly United Civic Savings Credit Union)

PETITIONER

And

F & R BROKERS INC., EVERPARKS VENTURES INCORPORATED, MOO PARK, SANG WON PARK, J.T.S. MORTGAGE INVESTMENTS CORPORATION, LDS TRADEHOUSE INC., FRED CARLINE, WORKERS' COMPENSATION BOARD, HER MAJESTY THE QUEEN IN RIGHT OF THE PROVINCE OF BRITISH COLUMBIA, CITY OF VANCOUVER

RESPONDENTS

Before: The Honourable Mr. Justice Burnyeat

Reasons for Judgment
(From Chambers)

Counsel for the Petitioner	J.I. McLean
Counsel for J.T.S. Mortgage Investments	E.P. Morris
Date and Place of Trial/Hearing:	December 9, 2002 Vancouver, B.C.

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[1] This is an application by the first mortgagee, United Savings Credit Union ("United") for the appointment of a Receiver Manager of this hotel. The request is made despite the fact that United only has a mortgage charge against the land and building of the hotel. United also seeks an order that the Receiver Manager have the conduct of the sale of the hotel. These applications are made pursuant to the inherent jurisdiction of the Court, Rule 47 of the ***Rules of Court***, and s. 39 of the ***Law and Equity Act***, R.S.B.C. 1996, c. 253.

[2] The application is opposed by the second mortgagee, J.T.S. Mortgage Investments Corporation ("J.T.S.") on the basis that the Court is not in a position to appoint a Receiver Manager at the instigation of a land mortgagee. As to whether a Receiver should be appointed, J.T.S. submits that such an appointment is unnecessary as most of the income for the hotel is already being collected under an informal arrangement between J.T.S. and the owners of the hotel. J.T.S. also opposes the Receiver Manager having the conduct of the sale of the hotel as J.T.S. has already been granted the ability to offer the hotel for sale.

[3] J.T.S. obtained an order *nisi* in its own foreclosure proceedings. The redemption period in those proceedings will

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expire on January 17, 2003. On November 26, 2002, J.T.S. obtained an order for conduct of sale. J.T.S. contemplates listing the property at a listing price of 7% on the first $100,000 and 2-1/2% on the balance of the sale price over $100,000.

BACKGROUND

[4] This hotel operates in the Gastown area of Vancouver. It has a limited number of rooms which are mostly rented on a monthly basis. There is also a restaurant and pub within the building. These operations are leased to third parties. The information which is before me allows me to conclude that there are unpaid taxes of approximately $150,000, that only some of the room rents are being collected by J.T.S. who has exercised its right under its assignment of rents, and that the balance of the rents are either not being paid or are being paid to the current owners. There is no evidence that any funds being paid to the owners are being expended for the benefit of the property or for the benefit of those parties having claims against the equity of the owners in the property.

[5] As well, there is a very real danger that the property will be subject to a cease and desist order from the City by

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virtue of problems associated with the property. There are a number of judgments which have been registered against the property so that it is unlikely that the owners have any equity which they will want to protect.

STATUTORY PROVISIONS

[6] Section 39 of the ***Law and Equity Act*** provides:

> 39(1) An injunction or an order in the nature of mandamus may be granted or a receiver or receiver manager appointed by an interlocutory order of the court in all cases in which it appears to the court to be just or convenient that the order should be made.

[7] Rule 47 of the ***Rules of Court*** states:

> 47(1) The court may appoint a receiver in any proceeding either unconditionally or on terms, whether or not the appointment of a receiver was included in the relief claimed by the applicant.

THE "USUAL" FORM OF ORDER

[8] The Annotated Supreme Court Chambers Orders dealing with the appointment of a Receiver provides the following form of order where a Receiver is appointed under Rule 47:

> 1. *[name of receiver]* is appointed as receiver *[and, where applicable add: without bond or security]* of the rents and revenues of the property at *address]* (the "Property") with power and liberty to do any or all of the following things:

(a) to recover and enter forthwith into possession of the Property;

(b) to collect, get in, and receive any and all rents, revenues, security deposits, and prepaid rents of, from, and collected with respect to the Property, including rents in arrears, and to enforce payment to the receiver of any such rents, revenues, security deposits, or prepaid rents or any part thereof at such time or times as the receiver may think fit and may take such proceedings as the receiver considers necessary or advisable;

(c) to rent, re-rent, or enter into a lease or leases of the Property or any part thereof from time to time at such rentals and otherwise upon such terms as the receiver may consider necessary or advisable under the circumstances;

(d) to take whatever steps the receiver may consider advisable for repairing and preserving the Property or any other part thereof, including any buildings and improvements thereon, but the receiver shall not be liable for waste;

(e) to retain and employ some person or persons to assist in doing any of the things contemplated by this order and to assist generally in the receivership;

(f) to apply at any time or times to this court for directions as to the discharge of any of its duties as receiver or for the determination of any matter arising out of the receivership;

(g) to apply any money received by the receiver as rent or revenue of or from the Property in payment of the following items in the following order:

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(i) to the receiver in respect of the services as receiver a reasonable amount, either monthly or at such longer intervals as the receiver deems appropriate, which amount shall constitute an advance against the remuneration of the receiver when fixed;

(ii) any costs, charges, and expenses incurred in respect of carrying on any of the foregoing activities, and all operating expenses relating to the Property;

(iii) any charges for utilities or insurance premiums which relate to the Property;

and the balance, if any, in accordance with the further order of this court;

2. any person or person in occupation of the Property or any part thereof attorn and become tenants of the receiver and pay to the receiver rents, arrears of rents, and accruing rents so long as the receiver shall continue in office;

3. the respondent, *[name of party in possession]*, forthwith deliver over to the Receiver all keys necessary to gain access to the Property or any part thereof and all books, documents, papers, and records of every kind and nature relating thereto;

4. it shall not be necessary for the receiver to pay any money received by the receiver as rent or revenue arising from the Property into court and that the said receiver shall be liable to account only for money that actually comes into the receiver's hands or into the hands of any person or persons retained or employed by the receiver in the preservation or management of the Property;

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5. all monies properly expended and all costs and charges properly incurred by the receiver in respect of all the receivership shall be paid primarily out of the rents and profits of the Property, and in the event of the said rents and profits being insufficient for such purposes, such monies so expended and such costs and charges so incurred shall be and form a first charge on the Property in favour of the receiver;

6. all questions relating to the passing of the accounts of the receiver and the discharge of the receiver and the remuneration of the receiver shall be reserved until further order of this court.

DISCUSSION AND CASE AUTHORITIES: APPOINTMENT AS OF RIGHT?

[9] Prior to the ***Judicature Act*** of 1873, an English Court of Equity would only appoint a Receiver at the instigation of an equitable mortgagee who, unlike a legal mortgagee, had no right to possession. Subsequent to the passage of that ***Act***, the Court could appoint a Receiver at the instigation of a legal mortgagee in order to prevent the mortgagee from becoming a mortgagee in possession.

[10] The decisions in England are consistent in stating that such an Order will be made as a matter of course once default under a mortgage can be shown. The Court in ***Re Crompton & Co.***, [1914] 1 Ch. 954 stated:

> I think the right to the appointment of a Receiver is one of the ordinary rights which accrue to a

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> mortgagee, and especially to an equitable mortgagee who has no means of taking possession and whose security has become realizable as one of the steps in such realization. (at p. 967)

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[11] Similarly, in ***Truman v. Redgrave*** (1881), 18 Ch. 547, the Court was prepared to make an order appointing a "Receiver and Manager" if the principal and interest owing under a mortgage was in arrears. The ability to obtain the appointment of a Receiver and Manager was described as being a "... mere matter of course ...". (at p. 549) See also ***Prachett v. Drew*** [1924] 1 Ch. 280.

[12] In British Columbia, the English line of authorities was adopted in ***Eaton Bay Trust v. Motherlode Developments Ltd.*** (1984) 50 B.C.L.R. 149 (B.C.S.C.) where McTaggart, J. stated:

> In practice, the appointment of a Receiver in a mortgage proceeding is frequently made without proof of jeopardy (***Kerr*** on Receivers (15th ed.) (1979) pp. 6, 30 (***Crompton & Co. In Re: Player v. Crompton & Co.*** [1914] 1 Ch. 954).

[13] Of similar result is the decision in ***Royal Trust Corp. of Canada v. Exeter Properties Ltd.***, [1985] B.C.J. (Q.L.) No. 942 (B.C.S.C.). However, the decision of Huddart, J., as she then was, in ***Korion Investment Corp. v. Vancouver Trade Mart Inc.*** [1993] B.C.J. (Q.L.) No. 2352 (B.C.S.C.) is often cited as authority for the proposition that the appointment of a

Receiver or Receiver Manager will not be made as a matter of course.

[14] After noting that the indebtedness to the mortgagee represented only 6.6% of the assessed market value of the property, that the total indebtedness of the mortgagor represented only 29% of the value of the mortgaged assets, and that the mortgagor had offered to pay an amount equal to the monthly interest to the mortgagee during the remainder of the redemption period, Huddart, J. stated:

> ***Korion*** rests its application on the usual practice and its right to enjoy the profits from its property. ... .
>
> The willingness to appoint a receiver in a mortgage action, even post-judgment, seems to derive not so much from an analysis of the facts of an individual situation as from an accepted view of commercial reality. Kerr on Receivers, supra, says (at 6) that "[w]here there is an alternative legal remedy, as in the case of legal mortgages, the court has a discretion, but the appointment is now frequently made without proof of jeopardy" ... .
>
> Kerr suggests that "the appointment is made as a matter of course as soon as the applicant's right is established, and it is unnecessary to allege any danger to the property; for the appointment of a receiver is necessary to enable the applicant to obtain that to which he is entitled.
>
> It is on such a rule that ***Korion*** relies. However, it could not provide any B.C. authority for a presumption in favour of the appointment of a receiver in all mortgage foreclosure actions. In ***Citibank Canada v. Calgary Auto Centre*** (1909), 58

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D.L.R. (4th) 447 (Alta. Q.B.) McDonald J. adopted as correct this approach from Price and Trussler, Mortgage Actions in Alberta, (1985) at p. 309:

> Unless the mortgagor can point to reasons why the appointment of a receiver will prejudice his position, it is difficult to see why the mortgagee should not be entitled to a receiver, regardless of the equity position. The fact that there may be sufficient to pay the mortgage out if the property is ultimately sold is of little comfort to the mortgagee, who is faced with the prospect of no regular monthly return on his investment on which he may be budgeting, particularly where he holds the mortgage in trust for an investor. In addition, in considering what is "just and equitable" the Court must surely have regard to the mortgage covenant, which normally contains an express covenant agreeing to the appointment of a receiver in the event of default, and to the fact that although the mortgagor is receiving the rents, he is pocketing them or diverting them to other investments instead of paying the mortgage on the property as he has covenanted to do. In weighing the equities in this fashion, it is difficult to come down on the side of the defaulting mortgagor/landlord. Instead, it is "just and equitable" that a receiver be appointed.

I have some difficulty with the proposition that the appointment of a receiver after the order nisi will usually be appropriate. The appointment by a court of a receiver and particularly of a receiver-manager says to the world, including potential investors, that the mortgagor is not reliable, not capable of managing its affairs, not only in the opinion of the mortgagee, but also in the opinion of the court. That is a large presumption for a court to make when it is considering whether need or convenience or fairness dictates an equitable remedy even if the

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> contract at issue permits such an appointment by instrument. (at paras. 8-12)

[15] I am satisfied that the ***Korion*** decision must be limited to the facts which arose in that proceeding. First, counsel appears not to have drawn the long-established English practice to the attention of the Court. Second, the mortgagor appears to have established very good reasons why the appointment should not be made. In accordance with the English decisions and the decisions in ***Motherlode*** and ***Exeter,*** I am satisfied that, unless the mortgagor or charge holder can show that extraordinary circumstances are present, the appointment of a Receiver or Receiver Manager at the instigation of a foreclosing mortgagee should be made as a matter of course if the mortgagee can show default under the mortgage.

[16] The Court should not force a mortgagee to become a mortgagee in possession in order to exercise the rights of possession available to it under the mortgage. As well, where the mortgagor has provided an express covenant agreeing to the appointment of a Receiver or a Receiver Manager in the event of default, the Court should not ordinarily interfere with the contract between the parties. Also, it would be inappropriate for the Court to countenance a situation where default in

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payments continues while the mortgagor or some subsequent mortgagee has the benefit of the income which is available from a property charged by a mortgage ranking in priority ahead of the interests of those having the benefit of the income.

[17] A mortgagee is entitled to the appointment of a Receiver or Receiver Manager as a matter of course when the mortgage is in default. The Court should only exercise its discretion not to make such an appointment in those rare occasions where a mortgagor or subsequent charge holder can show compelling commercial or other reason why such an order ought not to be made. The onus will always be on the mortgagor or subsequent charge holder in that regard.

[18] In the case at bar, the second mortgagee, J.T.S. has shown no good reason why a Receiver Manager should not be appointed. The situation which would allow the owners of this hotel to continue to collect some of the income available should be unacceptable to all charge holders. Accordingly, it is appropriate that a Receiver or a Receiver Manager be appointed. The second question which arises is whether United should be entitled to the appointment of a Receiver Manager even though United has no charge against either the chattels

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which are used in the hotel operation or the goodwill of the company that owns the hotel.

DISCUSSION AND CASE AUTHORITIES: RECEIVER OR RECEIVER MANAGER?

[19] The text of s. 39 of the ***Law and Equity Act*** like similar provisions across Canada relating to the jurisdiction of courts to appoint a Receiver or Receiver Manager is based on s. 25(8) of the 1873 English ***Judicature Act***. The provision allowing such an appointment was introduced in British Columbia in 1879 when s. 3(8) of the ***Judicature Act*** 1879, c. 12 incorporated the exact words from the English legislation in effect at the time:

> A mandamus or an injunction may be granted or a Receiver appointed by an interlocutory Order of the Court in all cases in which it shall appear to the Court to be just or convenient that such Order should be made ... .

[20] That provision remained relatively unchanged in British Columbia until 1979 when the words "or Receiver Manager" were added after "Receiver". The explanation for this amendment provided in the explanatory notes to the first reading of Bill 29 (***Attorney General Statutes Amendment Act***, 1979) was:

> Amends section 30 of the ***Laws Declaratory Act*** to clarify that a person acting as a Receiver may also manage the assets he receives prior to distribution.

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[21] The current English statute does not contain the words "or Receiver Manager". The inclusion of the words "or a Receiver Manager" was made in the Ontario and Manitoba legislation after the 1979 amendment to the British Columbia legislation.

[22] I am satisfied that a Receiver Manager can be appointed at the instigation of a mortgagee in foreclosure proceedings even though the applicant has no charge against chattels or the goodwill of a company. Section 39 of the ***Law and Equity Act*** makes reference only to "all cases in which it appears to the Court to be just or convenient ...". There is no requirement that the case must involve the enforcement of security where the chattels and the goodwill of a company are charged.

[23] The addition of the words "receiver manager" in what was formerly known as the ***Laws Declaratory Act*** was a clear indication by the Legislature that the person appointed could not only receive rents and profits but could also manage. Provisions in the ***Law and Equity Act*** and formerly the ***Laws Declaratory Act*** are statutory declarations of what the law is and usually represent changes thought by the Legislature to be

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appropriate. I am satisfied that that was what was intended by the Legislature in 1979.

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[24] In the case of foreclosure proceedings where the mortgage is against a hotel or apartment, to allow a receiver to be appointed without the ability of that receiver to manage the property creates an illusory protection of the interests of a mortgagee. The "usual" form of order for an appointment under Rule 47 of the ***Rules of Court*** allows the management necessary to make effective the right of possession given to a mortgagee under a mortgage. The ability to enforce payment of rents, to re-rent, to repair and preserve, to employ assistants and to pay operating expenses gives effectiveness to the rights of the mortgagee. These rights are given to the mortgagee under the standard form of mortgage and it has become the practice of the Court to grant these powers to a Receiver appointed under Rule 47 of the ***Rules of Court*** even though that Rule only refers to the appointment of a "Receiver".

[25] In the case of a hotel or an apartment, these "usual" powers are required so that the ability to collect rents and profits is effective. In the case at bar, the ability to manage the hotel is the only effective way for United to

realize on its mortgage security and give effect to the contract agreed to by the mortgagor.

[26] The English authorities are consistent in establishing the proposition that a receiver of the rents and profits of a property appointed on the application of a mortgagee would also not be appointed manager of the business unless the business or its good will is expressly or impliedly included in the mortgage security: ***Whitley v. Challis***, [1892] 1 Ch. 64 (C.A.); ***Truman & Co. v. Redgrave*** (1881), 18 Ch. D.547 (C.A.); ***County of Gloucester Bank v. Rudry Merthyr Steam and House Coal Colliery Co.***, [1895] 1 Ch. 629 (C.A.); and ***Re Leas Hotel Co.***, [1902] 1 Ch. 332. However, these statements must be tempered by the fact that the British Columbia, Manitoba and Ontario legislation contains the words "or Receiver Manager" whereas the English legislation does not. As well, the ability of the Court in England to appoint a Receiver Manager is subject to the caveat that such an appointment can be made if it can be implied that a charge on the business or its good will is included in the mortgage security.

[27] ***Whitley*** has been applied in Canada in ***Big Country Holdings Ltd. v. Bodale Holdings Ltd.***, unreported, 20 March 1986, Supreme Court of British Columbia action number H860054

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(Vancouver Registry) and ***First Investors Corp. Ltd. v. 237208 Alberta Ltd. et al*** (1982), 20 Sask. R. 335 (Sask. Q.B.). In ***Big Country***, Leggatt, L.J.S.C., as he then was, refused to appoint a Receiver Manager where the mortgagee had only a chattel mortgage, an agreement for sale and where the chattel mortgage charged the "goods, personal chattels and personal property" of the mortgagor. However, I am satisfied that this decision must be limited in that Leggatt, L.J.S.C. found that: "... the charge does not cover good will and the chattels covered do not of necessity imply the business is included." The mortgage in question makes specific and repeated reference to chattels only and no where indicates that good will is covered by the charge." In ***First Investors***, Walker, J. refused the appointment of a Receiver Manager of a hotel and tavern where there was no chattel mortgage and there was no mention that the mortgage covered the business or good will of the mortgagor.

[28] However, a Receiver Manager of a hotel business was appointed in ***Brooks v. Westshores Inn Ltd.***, [1989] B.C.J. (Q.L.) No. 1633 (B.C.S.C.) despite the fact that the mortgage in question did not include a charge against the chattels and

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the good will of the mortgagor. In appointing a Receiver Manager, Houghton, L.J.S.C., as he then was, stated:

> In my opinion, the court should not put the petitioner in the position of running a risk of having the summer proceeds stripped without any payments being made. (at unnumbered paragraph 6).

[29] Even if I am wrong in concluding that the change in 1979 made it clear that a Receiver Manager could be appointed even if the security of a plaintiff or a petitioner did not include a charge against chattels or the good will of the company, I am satisfied in the case at bar that the mortgage of United impliedly includes a charge against the chattels on the premises and the business and good will of the mortgagor. The definition of "lands" includes "all buildings, improvements and fixtures located on the land". Additionally, under paragraph 15.01 of the mortgage, any "receiver" appointed by United may: "(c) lease out the Lands or any parts of Lands on any terms the receiver decides; (d) collect all income from the Lands; ... (g) manage the Lands and maintain them in good condition; ... (i) carry on any business which the Mortgagor conducted on the Lands."

[30] I am satisfied that the agreement by the mortgagor to allow any receiver appointed to carry on the business that the mortgagor conducted on the lands is sufficient evidence of an

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intention the mortgage charge would also charge the business and the good will of the mortgagor so as to permit the appointment of a Receiver Manager even though United did not have a General Security Agreement.

[31] Accordingly, a Receiver Manager is appointed. The third question which arises is whether the Receiver Manager should be entitled to offer the property for sale even though an order for conduct of sale has already been granted to J.T.S.

DISCUSSION: SHOULD THE RECEIVER MANAGER BE GRANTED THE ABILITY TO OFFER THE HOTEL FOR SALE?

[32] Despite the fact that J.T.S. was granted an order for conduct of sale on November 26, 2002, I am satisfied that the Receiver Manager should be granted the power to offer the hotel for sale as an ongoing operation.

[33] First, the Receiver Manager will have the best access to the actual income and expense figures which will be relied upon by any prospective purchaser. That information would not necessarily be available to J.T.S. from the current owners. As well, the figures that were formerly available will not necessarily reflect any improvements to the income and any reductions in the expenses which can be occasioned by the Receiver Manager.

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[34] Second, the Receiver Manager will be charging on a time basis whereas any agent employed by J.T.S. will insist upon the payment of a negotiated real estate commission. Even if the "usual" rate of 7% on the first $100,000 and 2-1/2% on the balance of any sale price above $100,000 can be reduced by negotiation, I am satisfied that any negotiated fee would be far in excess of the fees charged on a time basis for the Receiver Manager to market the property. Third, I cannot be satisfied that the efforts of the Receiver Manager will be any less effective than any real estate agent that might be retained by J.T.S. In the circumstances of this case, I am satisfied that the Receiver Manager should be granted the ability to offer the property for sale.

"G.D. Burnyeat, J."
The Honourable Mr. Justice G.D. Burnyeat

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IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation: *Pope & Talbot Ltd. (Re),*
2009 BCSC 1552

Date: 20091112
Docket: S077839
Registry: Vancouver

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

AND IN THE MATTER OF THE RECEIVERSHIP OF POPE & TALBOT LTD. and others

Before: The Honourable Mr. Justice Walker

Reasons for Judgment

Counsel for Federal Insurance Company:	K.D. Kraft H.D. Edinger
Counsel for National Union Fire Insurance Company of Pittsburgh, PA:	G.M. Nijman
Counsel for XL Specialty Insurance Company:	D. Harris, Q.C. J.D. Hughes
Counsel for former Directors & Officers of Pope & Talbot	D.B. Kirkham, Q.C.
Counsel for PricewaterhouseCoopers Inc.	R.J.H. Berrow K. Jackson
Counsel for Ableco Finance LLC:	P. Rubin
Place and Date of Hearing:	Vancouver, B.C. October 14-15, 2009
Place and Date of Judgment:	Vancouver, B.C. November 12, 2009

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Introduction

[1] Three insurers who issued Directors and Officers liability ("D&O") policies in favour of directors and officers of Pope and Talbot Inc. ("P&T Inc.") and its subsidiaries, including Pope and Talbot Ltd. ("P&T Ltd."), seek a declaration that the proper law of those policies is the law of the State of Oregon.

[2] In addition, one insurer, National Union Fire Insurance Co. of Pittsburgh, Pennsylvania, maintains that a mediation and arbitration ("ADR") clause contained in its policy, which is an excess policy, is a condition precedent to any determination of coverage by this Court. As a result, it seeks a stay of proceedings of the upcoming hearing regarding the insurers' purported coverage obligations, insofar as its coverage obligations are concerned.

[3] The present application follows my decision concerning territorial competence and *forum conveniens* issued on July 27, 2009 and reported as *Pope & Talbot Ltd. (Re)*, 2009 BCSC 1014, 76 C.C.L.I. (4th) 212. The history of the insolvency proceedings, brought initially in Canada pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"), is also set out in those reasons for judgment.

[4] P&T Ltd. is currently in receivership. PricewaterhouseCoopers Inc. ("PWC") is the receiver. Proceedings under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*") are stayed. Previously, P&T Ltd. applied for and received protection from its creditors pursuant to the *CCAA.* The Directors Charge established by the Order of Chief Justice Brenner on November 21, 2007 (during the *CCAA* proceedings), to respond to certain types of claims that may be brought against the directors and officers of, *inter alia*, P&T Ltd. and its parent company, P&T Inc., remains to be drawn upon. Insolvency proceedings brought in Delaware on behalf of P&T Inc. have been deferred to the current Canadian insolvency proceedings by the US Bankruptcy Court for the District of Delaware. That insolvency is akin to Canadian *CCAA* proceedings as opposed to proceedings under the *BIA*.

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[5] The Directors Charge may only be drawn upon “to the extent that they [directors and officers] do not have coverage under any directors’ and officers’ insurance policy, or to the extent that such coverage is insufficient to pay amounts indemnified” by, *inter alia*, P&T Inc. and P&T Ltd.

[6] PWC has asked for a determination of whether any of the policies cover certain wage claims made by former employees of P&T Ltd. pursuant to s. 119 of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 (*“CBCA*”). That determination will be made at a subsequent hearing. The submissions made on behalf of P&T Inc. and P&T Ltd. on this application were made by PWC.

[7] The insurers assert that the proper law of the policies is the law of Oregon. The insureds, which in this case are P&T Inc., P&T Ltd., and the directors and officers of those companies, argue that the proper law of the policies is the law of British Columbia. They say that this a case where the language of the policies calls for the application of *dépeçage* (a principle which recognizes more than one proper law of a contract), or alternatively, if there is only one proper law of these policies, it is the law of British Columbia.

<u>Background Facts</u>

[8] The insurers are Federal Insurance Company, National Union, and XL Specialty Insurance Company. They carry on business in the United States. They are not registered in BC as they do not directly carry on business in this province or elsewhere in Canada.

[9] Federal is incorporated in the State of Indiana, and has its head office in New Jersey. National Union is incorporated in the State of Pennsylvania; its principal place of business, as well as its head office for underwriting purposes, is located in New York City. XL is incorporated in the State of Connecticut; its head office is located in Stamford.

[10] The decision to underwrite the Federal policy was made by its underwriters who were, at the time, located in Portland and Los Angeles. As well, persons in

Federal's legal department (located in New Jersey) were consulted. Confirmation of coverage was sent by Federal out of its Portland office. Although the evidence does not disclose where its policy was actually issued, the Declarations page states the following address in its header:

> Chubb Group of Insurance Companies
> 15 Mountain View Road
> Warren, New Jersey 07059

[11] The National Union policy was underwritten in New York City and its policy was issued out of that office. XL's underwriting was done at its head office in Stamford; its policy was issued from there as well.

[12] Federal's D&O policy is primary. National Union's policy is follow form and sits as the first excess layer in a multi-layered tower. XL issued a form of drop down policy known as a "Cornerstone Policy", which drops down to respond if other underlying insurance does not cover or pay. Even where it does not drop down, that policy also acts as an excess policy.

[13] In addition, XL issued a follow form excess policy that sits in the coverage tower two levels above National Union's. That policy was not put in issue on this application.

[14] The premiums charged for each policy were in US dollars. The policies do not contain a choice of forum clause or a clause stipulating the proper law of the contract. They are all claims made policies, which means that coverage is provided for claims made during the policy term for a "wrongful act" (a defined term in each policy). This is in contrast to a comprehensive general liability policy, which usually provides coverage for fortuitous events that occur during the policy period as opposed to when the claim is made.

[15] The three policies were issued to be in force for one year, effective July 30, 2007. *CCAA* proceedings were first brought almost three months later, on October 29, 2007.

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[16] Federal had provided coverage to P&T Inc. and its global operations (collectively, "Pope & Talbot Group") for some 22 years. Although its policy was issued as a renewal, it was not a simple renewal as it resulted from considerable negotiations. In fact, Federal (on the letterhead of its parent company Chubb Insurance) sent a notice of non-renewal to P&T Inc.'s risk manager on April 24, 2007. Ultimately, following negotiations, which included policy terms and endorsements, Federal went on risk again for a further one year period, although policy limits were reduced in half (to $5 million) and the premium charged doubled (from $17,500 to $35,000 per million).

[17] P&T Inc. is a North American forest products company that sells wood products and pulp. It was founded in 1849. It was incorporated in the State of Delaware, and has its corporate headquarters in Portland, Oregon. It also has an office in Delaware.

[18] The majority of head office functions for both its wood products and pulp operations take place in Portland, Oregon. P&T Inc. is a public company that was, until July 2007, traded on the New York Stock Exchange.

[19] At the time the policies were made (which in this case means when they were issued), the bulk of P&T Inc.'s operations were located in BC, and were owned and operated by its subsidiary P&T Ltd. P&T Ltd. is a federally incorporated Canadian company. It maintains its registered and records office in Toronto, Ontario. Although P&T Inc. owned other subsidiaries, P&T Ltd. was the primary operating company for P&T Inc. at that time.

[20] The revenue stream for the Pope & Talbot Group was derived mainly from its pulp and wood products operations in BC. P&T Ltd. owned seven mills in BC and the US, for both its wood products and pulp operations. In respect of its pulp operations, P&T Ltd. operated three mills: two in BC (in Mackenzie and near Nanaimo) and one in Oregon (in Halsey). In respect of its wood products operations, it operated four mills: three in BC (in Fort St. James, Castlegar, and Grand Forks) and one in South Dakota (in Spearfish). The bulk of the employees

(the broker identified a total of 2,373 prior to the policies being issued) working for the Pope & Talbot Group did so for P&T Ltd. Federal's underwriters had this information available to them prior to issuing its policy in July 2007.

[21] In addition, and as a result of meetings and communications with representatives of P&T Inc. (that included the broker), underwriters were aware, at the time the insurers went on risk on July 30, 2007, of P&T Inc.'s Canadian subsidiary, P&T Ltd., including its various operations. The evidence shows that of the insurers, at least Federal's underwriters were also aware of:

(a) the revenue and income of the Pope & Talbot Group, including the Canadian operations; and

(b) the deteriorating financial condition suffered by the Pope & Talbot Group, particularly the revenue stream and indebtedness of the various Canadian operations, including:

(i) rapidly diminishing liquidity;

(ii) significant outstanding bond debt;

(iii) plunging stock price when it was announced that covenants relating to long term debt had been breached;

(iv) efforts made to sell assets to satisfy debt;

(v) the significant detrimental effect caused by a then strong Canadian dollar;

(vi) increasing inventory levels over the previous four years;

(vii) the costs of goods were $1.13 for every $1 collected;

(viii) gross and operating margins were at a five year low;

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(ix) the interest coverage ratio was negative for the first time since 2003;

(x) debt/equity ratios were at a four year high; and

(xi) bankruptcy had been considered (although it was reported to be "the last option").

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[22] As part of the application for coverage submitted by the broker (on behalf of the insureds) along with a formal request to renew the Federal policy, Federal's underwriters were also advised of the nature of the business of the Pope & Talbot Group at that time:

> Business Summary: Based in Portland, Or, Pope & Talbot is focused in two lines of business, market pulp and softwood lumber, and has industry leading earning leverage to price changes in both commodities. Pope & Talbot, Inc. operates in North America. The Pulp segment manufactures and sells northern bleached softwood kraft chip and sawdust pulp used in various end products, including newsprint, tissue, and coated and uncoated paper, as well as in specialty products, such as fiber cement siding for residential applications and non-woven fabric for surgical gowns. The Wood Products segment manufactures and sells specialty lumber for residential and light construction, and residential repair and remodeling; and produces machine stress rated, long-length, wide-width or premium pine appearance grade lumber. This segment also sells residual wood chips and other by-products from its lumber mill operations. The company sells its products to wholesalers, distributors, remanufacturers, and builders in the United States, Canada, Italy, northern Europe, China, and Japan.

[23] Federal asked some very pointed questions before deciding to go on risk again. The evidence discloses that in respect of one "D&O Underwriting Meeting" that was scheduled to take place on June 20, 2007 and postponed to July 3, 2007, Federal asked the following questions:

> Please provide a business and financial overview for the pulp and wood products segment. What is the outlook for each business?
>
> Please provide an overview of your discussions with your lenders. What changes, if any, will be made to the credit agreement? Have you talked to any outside lenders about the potential of opening a new credit facility?
>
> Please give an overview of any discussion with the rating agencies.
>
> Do you expect any changes to your weighted average cost of capital?

> Has the board had any discussions about asset sales/ voluntarily going into bankruptcy?
>
> What factors will keep the company from going into bankruptcy over the next 12 months. What does the company view as its risk of default over the same time period?
>
> Have you entertained any offers to be purchased?
>
> Please discuss the effects of the Canadian dollar on your business.
>
> ...
>
> Please discuss the senior management and board changes that have occurred over the past 18 months. Are there any more expected changes in the next 12 months? What adjustments has the company gone through as a result of the management changes?

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[24] Federal's underwriting analysis, prepared as part of its underwriters' analysis when considering whether to renew the policy (and if so, on what terms and price), reveals that Federal well anticipated the possibility of insolvency for the Pope & Talbot Group:

> Pope and Talbot is a troubled company that is going through a very difficult time. There is significant concern that the company may go backrupt [sic] in the next year. The company is seeking alternatives including the sale of a division and the taking on of a private equity interest. I view the private equity buy as the most likely (only because I think that is what management really wants) and the sale of the division as the second most likely outcome (because they have an offer on the table). Bankruptcy will only happen if/when the company makes a mistake and does not enter into one of the two above transactions quickly enough. Regardless, I feel that our risk has increased dramatically as a result of that we must reduce our capacity from 10 M to 5 M and incrase [sic] the rate from $17,500 per million to $35,000 per million.

[25] As well, and prior to binding the risk, one of Federal's underwriters advised the broker that it was aware of the prospect of Canadian environmental claims and bankruptcy in the United States. With that knowledge, Federal was prepared to provide coverage to the directors and officers of the Pope & Talbot Group on a worldwide basis that included defence costs cover for Canadian claims and derivative securities coverage that was described by Federal's underwriter as "including the US". Materials presented on behalf of P&T Inc. to Federal's underwriters on July 3, 2007, disclose that there were seven directors of P&T Inc.

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Evidence tendered by Federal and National Union show that two of them lived in BC. There were six directors of P&T Ltd., four of whom lived in BC.

[26] Following negotiations, Federal submitted an insurance proposal to P&T Inc. and the broker for the policy renewal. The premium to be charged by Federal was $150,000.

[27] Coverage was ultimately provided on a worldwide basis to the directors and officers of the Pope & Talbot Group as well as to those companies in circumstances where they are required to indemnify the directors and officers.

[28] The evidence does not make clear the extent to which National Union and XL were aware of all of the information that Federal possessed concerning the risk. Those insurers did not argue that there was a disparity in knowledge or that the issue even mattered to them.

Determining the Proper Law of a Contract

[29] The starting point is to determine the intentions of the parties by examining the contract as a whole: *Consolidated Bathurst Export Limited v. Mutual Boiler and Machinery Insurance Company*, [1980] 1 S.C.R. 888, 112 D.L.R. (3d) 49; and *Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada*, 2009 BCCA 129, 90 B.C.L.R. (4th) 297.

[30] In *Progressive Homes,* at para. 45, the Court of Appeal adopted the approach to interpretation of insurance policies (which are, of course, contracts) described by Professor Denis Boivin in his text, *Insurance Law* (Toronto: Irwin Law, 2004), at p. 191:

> The main rules of interpretation were established by the Supreme Court of Canada in *Consolidated Bathurst Export Ltd. v. Mutual Boiler & Machinery Insurance Co.* First, the words used in the contract must be given their ordinary meaning, with the exception of expressions that have acquired a technical meaning within the industry. ... Second, the contract must be interpreted contextually, having regard to all sections of the agreement. Third, the objective of interpreting the contract is to give effect to the parties' true intentions. Hence, courts should avoid using a literal approach when the result would frustrate the reasonable expectations of either the insurer or the

> insured. Finally, any ambiguity must be resolved against the interests of the party that wrote the agreement – *contra proferentem.* In other words, ambiguities must be resolved in favour of the insured.

[31] Resort to the doctrine of "reasonable expectations" is made when there is an ambiguity in an insurance policy: *Non-Marine Underwriters, Lloyd's of London v. Scalera*, 2000 SCC 24, [2000] 1 S.C.R. 551 at para. 71; *Reid Crowther & Partners Ltd. v. Simcoe & Erie General Insurance Co.* [1993] 1 S.C.R. 252, 99 D.L.R. (4th) 741; and *Progressive Homes*, at paras. 44 to 51. Where there is no ambiguity, courts should give effect to the clear language in the contract when reading it as a whole. In *Scalera*, Mr. Justice Iacobucci wrote, at para. 71:

> Where a contract is unambiguous, a court should give effect to the clear language, reading the contract as a whole [citations omitted]. Where there is ambiguity, this Court has noted "the desirability...of giving effect to the reasonable expectations of the parties" [citations omitted].

[32] One way of considering the reasonable expectations of the parties is to take "industry practise" into account: *Progressive Homes*, at para. 51. No such evidence was adduced in this case.

[33] The proper law of the contract is determined by the expressed intention of the parties. When no express choice is made, courts determine whether the proper law of a contract can be inferred from the circumstances, or failing this, determine the system of law which has the closest and most substantial connection with the subject matter: *Herman v. Alberta (Public Trustee)*, 2002 ABQB 255, 2 Alta. L.R. (4th) 132, at para. 6; *Cansulex Limited v. Reed Stenhouse Limited* (1986), 70 B.C.L.R. (1st) 273, 18 C.C.L.I. 24 (S.C.); and J.–G. Castel, *Canadian Conflict of Laws*, 4th ed. (Toronto: Butterworths, 1997) at p. 593.

[34] The proper law of a contract is "the law that the parties intended to apply": *Vita Food Products Inc. v. Unus Shipping Co. Ltd.,* [1939] 1 All E.R. 513, [1939] A.C. 277 (P.C.). According to Lord Wright, at p. 521, that intention "is objectively ascertained".

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[35] The proper law of a contract is determined as at the time the contract is made. Circumstances not existing at the time the contract is formed are not relevant to determining proper law: *Armar Shipping Co Ltd v. Caisse Algérienne d'Assurance et de Réassurance; The Armar*, [1981] 1 All E.R. 498, 1 WLR 207 (C.A. Civ. Div.); *Amin Rasheed Shipping Corp v. Kuwait Insurance Co*, [1983] 2 All ER 884, [1984] A.C. 50 (H.L.); and *Herman v. Alberta (Public Trustee)*.

[36] As Lord Diplock explained in *Amin Rasheed*, at p. 891, contracts do not exist in a "legal vacuum":

> My Lords, contracts are incapable of existing in a legal vacuum. They are mere pieces of paper devoid of all legal effect unless they were made by reference to some system of private law which defines the obligations assumed by the parties to the contract by their use of particular forms of words and prescribes the remedies enforceable in a court of justice for failure to perform any of those obligations; and this must be so however widespread geographically the use of a contract employing a particular form of words to express the obligations assumed by the parties may be.

[37] Where the choice of law is expressly made in the contract, courts may not interfere, unless that choice is unlawful or contrary to public policy. In *Vita Food,* Lord Wright explained, at p. 521:

> That intention is objectively ascertained, and, if not expressed, will be presumed from the terms of the contract and the relevant surrounding circumstances ...but, where the English rule that intention is the test applies and where there is an express statement by the parties of their intention to select the law of the contract, it is difficult to see what qualifications are possible, provided the intention expressed is *bona fide* and legal, and provided there is no reason for avoiding the choice on the ground of public policy.

[38] In *Imperial Life Assurance Co. of Canada v. Colmenares*, [1967] S.C.R. 443, 62 D.L.R. (2d) 138, Ritchie J. stated, at p. 448:

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

[39] Determining the circumstances which constitute the closest and most substantial connection is an inherently fact-specific exercise. Ritchie J. outlined a

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number of factors that may assist a court in making this determination, citing *Cheshire on Private International Law*, 7th ed., at p. 448:

> [T]he domicil and even the residence of the parties; the national character of a corporation and the place where its principal place of business is situated; the place where the contract is made and the place where it is to be performed; the style in which the contract is drafted, as, for instance, whether the language is appropriate to one system of law, but inappropriate to another; the fact that a certain stipulation is valid under one law but void under another; the economic connexion of the contract with some other transaction; the nature of the subject matter or its *situs*; the head office of an insurance company, whose activities range over many countries; and, in short, any other fact which serves to localize the contract.

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[40] In *Cansulex,* however, McEachern C.J.S.C. placed less emphasis on the location where the insurance contract was made in determining the applicable law. In that case, the insurance policy was made in the United States on an American policy form, yet BC law applied, due primarily to the fact that the shipping operation was based in Vancouver. McEachern C.J.S.C. noted, at p. 18, that while older case law placed much weight on where the contract was formed, “modern law seems to focus more on other matters... What seems to be most important is the subject of the contract” (at p. 289). He concluded at p. 290 that the factors to be considered in determining the closest and most substantial connection are, in ascending order of importance:

(a) the policy is deemed to be made in BC as a result of s. 5 of the *Insurance Act*, R.S.B.C. 1996, c. 226;

(b) Aetna underwrote the risk on an American form;

(c) both parties operate worldwide from their respective countries;

(d) the subject matter of the contract is liability insurance; and

(e) claims might be expected to arise for which coverage might be furnished by the policy in Alberta, BC, or worldwide, but not in the United States.

In that case, only factor (b) favoured the application of US law; the other factors were either equal or favoured BC law, particularly (d) and (e). Thus, BC was found to have a much closer connection with the contract than the US (or Alberta, which also was argued).

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[41] Thus, the analysis prescribed in *Cansulex* is highly-fact specific and contextual. It will by necessity involve the weighing of unique factors in order to determine which system of law has the closest and most substantial connection to the contract in dispute.

[42] Section 5 of the *Insurance Act* deems a contract to be made in this province, and says that it must be construed accordingly where it insures a person domiciled or resident in BC at the date of it, or has as its subject matter, property, or an interest in property located in BC.

[43] Section 5 is not conclusive: *Cansulex*, at p. 288. It only provides that a policy insuring a person domiciled or resident in the province shall be deemed to be made in the province and shall be construed accordingly; that is to say, it shall be construed in accordance with the proper law of the contract, which may be the law of another jurisdiction. The place where a contract is made is but one of the factors to be considered in determining the proper law of the contract.

[44] Section 5 differs from its counterparts in some other provincial statutes. For example, in Ontario, s. 123 of its *Insurance Act*, R.S.O. 1990, c. I.8, makes application of Ontario law mandatory:

> Where the subject-matter of a contract of insurance is property in Ontario or an insurable interest of a person resident in Ontario, the contract of insurance, if signed, countersigned, issued or delivered in Ontario or committed to the post office or to any carrier, messenger or agent to be delivered or handed over to the insured or the insured’s assign or agent in Ontario shall be deemed to evidence a contract made therein, and the contract shall be construed according to the law thereof, and all money payable under the contract shall be paid at the office of the chief officer or agent in Ontario of the insurer in lawful money of Canada.

According to Janet Walker, *Canadian Conflict of Laws*, 6th ed., looseleaf (Markham, Ont.: LexisNexis, 2005) at 31.8.b, unlike s. 5 of the BC *Insurance Act*, this section "indicate[s] that the law of [Ontario] is the proper law a contract of insurance made or deemed to be made in that province, and in such a case the parties are not free to oust the application of that law by an express choice of law clause".

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[45] Normally, the obligations of parties to a contract will be governed by the same proper law. There are circumstances, however, where the proper law of a contract may be different for different contractual matters or issues. According to J.–G. Castel, at 607:

> While most contractual issues are governed by the proper law, the parties can agree that different contractual issues may be governed by different laws. This is called *dépeçage*. There is no authority to prevent the court from deciding that the objectively ascertained proper law varies according to the contractual issues involved. However, the court will not do this readily or without good reason.
>
> Apart from express or implied agreement to the contrary, the obligations of both parties will be governed by the same proper law.

[46] The insurers urge upon me the *obiter dicta* of Davies J. in *Teck Cominco Metals Ltd. v. Lloyd's Underwriters,* 2006 BCSC 1276, 60 B.C.L.R. (4th) 261, aff'd 2007 BCCA 249, 67 B.C.L.R. (4th) 101, aff'd 2009 SCC 11, [2009] 1 S.C.R. 321, where he said, at para. 215, that the policy must expressly provide for application of more than one system of law:

> ... I agree with the submission of counsel for Lloyd's that it would not be efficient to have contracts of insurance that may have application in more than one jurisdiction interpreted in accordance with more than one system of law unless the particular policy under consideration expressly provides otherwise.

[47] As I read these remarks, they come at the end of the decision and follow a detailed analysis of the issues before him, i.e., territorial competence and *forum conveniens.* It is noteworthy that the remarks of J.–G. Castel – that the agreement of the parties as to the proper law may also be implied – were not put before Davies J. nor were the decisions reached by other courts consistent with that approach.

[48] In *Gerling Global General Insurance Co. v. Canadian Occidental Petroleum Ltd.*, 1998 ABQB 714, 64 Alta. L.R. (3d) 174, the court looked at the policy "as a whole". Romaine J. concluded that the policy did not disclose an intention that more than one law govern:

> [68] ...Although there may be exceptional circumstances where it may be inferred that a contract is to be governed by the law of more than one jurisdiction, the courts in Canada are reluctant to split the proper law of a contract without good and compelling reason. Even in situations where the contract may be peformed in more than one place, the more usual determination is that the substance of the contract is to be determined by one law only, although the method and manner of performance may be regulated by the law of the place of performance (Montreal Trust Co. (supra), Kenton Natural Resources Co. v. Burkinshaw (1983), 47 A.R. 321 (Q.B.))...
>
> [69] The Policy does not disclose an intention that more than one law govern the substantive obligations under it, although it anticipates in some clauses the effect of local government action. Nor does it disclose an intention that more than one law govern by providing for payment of premiums in different currencies or in expressing deposit premiums in Canada or U.S. funds. On the contrary, the Policy provides that all deductibles and liability limits are expressed in Canadian funds, regardless of the location of the risk. The mere fact that the locations of the insured properties are in different countries is no indication of an intention to split the proper law of the Policy.

[49] In *Commonwealth Insurance Co. v. Canadian Imperial Bank of Commerce* (2005), 21 C.C.L.I. (4th) 226, [2005] O.J. No. 1167 (QL) (S.C.J.), aff'd 142 A.C.W.S. (3rd) 72, [2005] O.J. No. 3656 (QL) (C.A.), at para. 68, Wilton-Siegel J. looked for and did not find an "indication in the Policy of an intention to split the proper law of the Policy" (at para. 68), and then proceeded to adopt the approach taken in *Gerling Global.*

[50] This same approach to determining if the parties intended more than one proper law, albeit in a banking as opposed to an insurance context, has been taken by the Queen's Bench Division (Commercial Court) in England. In *Libyan Arab Foreign Bank v. Manufacturers Hanover Trust Co. (No. 2)*, [1989] 1 Lloyd's L.R. 608, Hirst J. viewed the matter as a "question of mixed fact and law". At p. 619, he said:

> Since, however, this is a question of mixed fact and law, it is necessary for me to consider the proper law on the alternate hypothesis that there was one single contract. The legal position is well established that an English Court

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> will not split the proper law of a contract readily and without good reason, but that it is open for the parties to agree that one aspect be governed by the law of one country and another aspect by the law of another country (Dicey and Morris Conflict of Laws 11th ed., p. 1163). This is based on a very well-known passage in the dissenting judgment of Lord MacDermott in *Kahler v. Midland Bank Ltd*., [1950] A.C. 24 at p. 42, as follows:
>
>> Though there is no authority binding your Lordships to the view that there can be but one proper law in respect of any given contract, it is doubtless true to say that the courts of this country will not split the contract in the sense readily and without good reason. In my opinion, however, there is a good ground for so doing in the somewhat unusual and, as I think compelling circumstances of the present case.

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[51] In that case, the court implied the intention to split proper law, and distinguished between the law to be applied to a London bank account from the law to be applied to a bank account in New York, in determining the parties' obligations. Hirst J. then determined the proper law, which was not expressly stated, based upon a "substantial connection" test by application of factors similar to some applied in *Cansulex*.

[52] One English case has recognized that the proper law of a contract may be split even in the absence of express or implied intention, where a severable part has a closer connection with one jurisdiction than another. PWC cited the decision of the English Court of Queen's Bench in *Libyan Arab Foreign Bank v. Bankers Trust Co.*, [1989] 1 Q.B. 728. There, Staughton J. recognized, at p. 747, that, "It is possible, although unusual, for a contract to have a split proper law...: see *Dicey & Morris The Conflict of Laws,* 11th ed. (1987), p. 1163 and *Chitty on Contracts,* 25th ed. (1983), para. 2081", and went on to accept a European Economic Union Convention on the Law Applicable to Contractual Obligations:

> Article 4 of the E.E.C. Convention of 19 June 1980 on the Law Applicable to Contractual Obligations (Official Journal 1980 No. L.266, p. 1) (as I write not yet in force) provides:
>
> "1. To the extent that the law applicable to the contract has not been chosen in accordance with article 3, the contract shall be governed by the law of the country with which it is most closely connected. Nevertheless, a severable part of the contract which has a closer connection with another country may by way of exception be governed by the law of that other country."

> That such a solution is not necessarily unacceptable to businessmen is shown by one of the Australian printed forms of charterparty, which adopts it.
>
> Mr. Sumptom argues that difficulty and uncertainty would arise if one part of the contract was governed by English law and another by New York law. I do not see that this would be so, or that any difficulty which arose would be insuperable.

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In essence, Staughton J. concluded that an English court may sever a portion of a contract and apply a different proper law to it than that which it found applies to the rest of the contract, on the basis that such portion has a "closer connection" to a different legal regime (as opposed to first trying to determine the contractual intent).

[53] Determination of proper law in the case at bar, however, may be made on a construction of the terms of the policies. Policy language contained in the instant policies shows that the parties intended the application of *dépeçage*.

Analysis and Disposition – Proper Law

Dépeçage:

[54] This is not a case where previous insurance policies were simply renewed. The policies issued effective July 30, 2007 resulted from specific negotiations between the parties. The evidence also shows that in Federal's case, significant adjustment was made to the premium and policy limits in view of the poor financial circumstances of the Pope and Talbot Group. In this case, the proper law of the insurance contracts must be determined based on the intention of the parties at the time the subject policies were issued and not in relation to pre-existing policies. Even if I were inclined to consider prior policies in determining proper law, I am not able to do so as none of them are in evidence.

[55] A careful review of each of the policies as a whole demonstrates that the parties allowed for the insurers' various coverage obligations to be determined by different legal regimes. The contractual language makes it clear that the principle of *dépeçage* applies to the proper law issue. Each of the three insurance policies expressly provides for the application of different legal regimes to different matters

and issues. In fact, Federal and XL acknowledged as much at the conclusion of their oral submissions when they conceded that their policies split the proper law insofar as punitive and exemplary damages are concerned.

Federal's policy:

[56] Federal's policy contains two separate "coverage sections":

(a) "Executive Protection Portfolio Executive Liability and Entity Securities Liability Coverage Section"; and

(b) "Executive Protection Portfolio Outside Directorship Liability Coverage Section".

Specific endorsements were added to both sections; some were included in one coverage section but not in the other.

[57] Federal's coverage is liability coverage in favour of the directors and officers of the Pope & Talbot Group on a worldwide basis for claims for "wrongful acts" (a defined term) made within the policy period.

[58] Federal's policy contains choice of law language in a number of places.

[59] The first place it is found is in the definition of "Loss". Federal's obligation to pay punitive and exemplary damages is drafted in such a way as to favour the insureds. Further, Federal did not limit the proper law to that of one jurisdiction. It defined proper law in relation to the jurisdiction most favourable to the insurability of such damages that, at the same time, "has a substantial relationship" to "relevant insureds". The use of the plural is significant since there are multiple insureds residing or domiciled in different jurisdictions having their own legal regimes.

[60] The definition of "Loss" in the first coverage section provides, *inter alia*:

> **Loss** means:
>
> (a) the amount that any **Insured Person** (for the purposes of Insuring Clauses 1 and 2) or the **Organization** (for purposes of Insuring Clause 3) becomes legally obligated to pay on account of any covered **Claim**, including but not limited to damages (including punitive or

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> exemplary damages, if and to the extent that such punitive and exemplary damages are insurable under the law of the jurisdiction most favourable to the insurability of such damages provided such jurisdiction has a substantial relationship to the relevant **Insureds**, to the Company, or to the **Claim** giving rise to the damages), judgments, settlements, pre-judgment and post-judgment interest and **Defense Costs**;
>
> [Bold emphasis in original; underline emphasis added]

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[61] In the first coverage section, an "Insured Person" is defined to mean a director, officer, manager, or in-house general counsel to any "Organization" that is "chartered in the United States of America" or "equivalent to any [such] position ... that is chartered in any jurisdiction other than the United States of America". The definition in the second coverage section is somewhat broader as it includes an employee of an "Organization".

[62] Contractual intent is clear – the parties intended a multi-faceted approach to the law applicable to Federal's obligation to pay punitive and exemplary damages, one that permits various legal regimes to apply depending on the nature of the claim and the relationship of a jurisdiction to an "Insured Person", as well as the law applicable to such damages in that jurisdiction.

[63] Federal's policy language also acknowledges the potential for a different proper law to apply to each coverage section. Federal excluded from the definition of "Loss", which is covered, any amount not insurable under the law pursuant to which the particular coverage section of the policy, as opposed to the policy itself, is construed:

> **Loss** does not include:
>
> > ... any amount not insurable under the law pursuant to which this coverage section is construed, except as provided above with respect to punitive or exemplary damages;
>
> [Bold emphasis in original; underline emphasis added]

The definition of "Loss" in the second coverage section is the same in substance; notably, though, it does not provide coverage for "Organizations".

[64] Thus, Federal's policy recognizes that more than one legal regime may govern the interpretation of the coverage sections therein.

[65] That Federal intended to distinguish between coverage sections and the whole of the policy is also demonstrated in the language contained in Endorsement no. 2 to the "General Terms and Conditions" (which are stated to apply to the entire policy). That endorsement concerns termination of the policy and purports to limit Federal's right to terminate the policy or either or both coverage sections for non-payment of premium. There, Federal wrote:

> In consideration of the premium charged, it is agreed that, notwithstanding any provision to the contrary in this policy or any endorsement thereto, the Company [Federal] shall only have the right to terminate this policy or any coverage section for non-payment of premium; accordingly, any reference to paragraph (a) of Subsection 11, Termination of Policy or Coverage Section, in this policy or any endorsement thereto, is deleted. [Emphasis added]

[66] Federal added four endorsements to its General Terms and Conditions, as well as sixteen and three to its first and second coverage sections, respectively. They cover a wide range of subjects including waiver of subrogation, termination of policy or coverage section, compliance with applicable trade laws, whistleblowers, exclusion for non-common law countries, reporting, securities claims, public offerings, representations, changes in exposure, non-entity employment practices, bankruptcy, claims for bodily injury and mental anguish, other insurance, severability, and pollution.

[67] Federal specifically referred to the law of Oregon in three endorsements.

[68] The first one is Endorsement no. 3 to the General Terms and Conditions (which concerns termination of the policy or coverage sections). It states that it supersedes and takes precedence over other policy provisions unless they comply with applicable insurance laws of Oregon. The wording is not clear inasmuch as the endorsement could be interpreted to apply to policy provisions added by endorsement, or, to the policy as a whole:

> **OREGON AMENDATORY ENDORSEMENT TO THE GENERAL TERMS AND CONDITIONS SECTION**

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> ...
>
> The regulatory requirements set forth in this Amendatory Endorsement shall supersede and take precedence over any provisions of the policy of any endorsement to the policy, whenever added, that are inconsistent with or contrary to the provisions of this Amendatory Endorsement, unless such policy or endorsement provisions comply with the applicable insurance laws of the state of Oregon.
>
> [Bold emphasis in original; underline emphasis added]

I have underlined the words that create confusion.

[69] The heading to the endorsement offers no assistance by virtue of clause 14 of the General Terms and Conditions:

> 14. The descriptions in the headings and sub-headings of this policy are solely for convenience, and form no part of the terms and conditions of coverage.

[70] In addition, clause 2 of the General Terms and Conditions stipulates that where any provision in the General Terms and Conditions is inconsistent or in conflict with the terms and conditions of any coverage section, then the terms and conditions of "such coverage section shall control for the purpose of that coverage section".

[71] The lack of clarity is amplified because Endorsement no. 3 immediately follows Endorsement no. 2. Endorsement no. 3 sets out a list of seven bases upon which Federal may terminate the policy or any coverage section. Yet, Endorsement no. 2, which does not mention Oregon law, confines the insurer's right to termination ("notwithstanding any provision to the contrary in this policy or any endorsement thereto") for non-payment of premium.

[72] Even though I was not, on the application, directed to or asked to resolve the possible inconsistency between the two endorsements, or the drafting issues arising from Endorsement no. 3, I point them out as instances where Federal turned its mind to the prospect of stipulating Oregon law as the proper law for the entire policy. If Endorsement no. 2 supersedes no. 3, which I think it does (especially given that

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the language of no. 3 is so unclear), then Federal's right to terminate is limited to non-payment of premium and Oregon law does not apply.

[73] The second endorsement referring to Oregon law is no. 7 to the first coverage section. It is titled:

> **OREGON AMENDATORY ENDORSEMENT TO THE EXECUTIVE LIABILITY AND ENTITY SECURITIES LIABILITY COVERAGE SECTION**

This endorsement concerns, *inter alia*, the effect of misrepresentations contained in the application for insurance. Unlike Endorsement no. 3 to the General Terms and Conditions, Federal made it clear that Oregon law applied to matters dealt with by this specific endorsement:

> The regulatory requirements of this Amendatory Endorsement shall supersede and take precedence over any provisions of the policy or any endorsement to the policy, whenever added, that are inconsistent with or contrary to the provisions of this Amendatory Endorsement, unless such policy or endorsement provisions comply with the applicable insurance laws of the state of Oregon.

[74] The third endorsement referring to Oregon law is no. 2 to the second coverage section, which also deals with the effect of misrepresentations in the application, and contains the same reference to Oregon law as in Endorsement no.7.

[75] Federal's policy also shows that Federal contemplated different types of claims being made against directors and officers as well as "Organizations" (their companies) in various jurisdictions (including non-common law jurisdictions). For example, in the first coverage section:

(a) the definition of "Insured Person" shows that Federal contemplated claims against directors, officers, or managers of an "Organization" "chartered in any jurisdiction other than the United State of America";

(b) the definition of "Securities Claim" includes a claim that "alleges that an **Organization** or any of its **Insured Persons**...violated a federal, state, local or foreign securities law" [Emphasis in original];

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(c) Federal excluded coverage for violations of certain statutes such as the Employee Retirement Income Security Act of 1974, claims made for an account of profits from the purchase or sale of securities within the meaning of "Section 16(b) of the Securities Exchange Act of 1934 or...any similar provision of any federal, state, or local statutory law or common law anywhere in the world", and the "Sarbanes-Oxley Act of 2002, or any similar 'whistleblower' protection provision of an applicable federal, state, local or foreign securities law";

(d) in Endorsement no. 6, Federal agreed not to seek allocation of defence costs arising from a "Securities Claim" attributable to alleged violations of ss. 11 or 12 of the Securities Act of 1933; and

(e) separate treatment is given, in Endorsement no. 2 (concerning "non-common law countries") to claims "not venued in the United States of America, Canada, Australia or any other common law jurisdiction".

[76] In summary, contemplating claims made in jurisdictions beyond the US and Canada, Federal turned its mind to the proper law governing different provisions and coverage sections of its policy, including those added by endorsement. It specifically added three endorsements referring to Oregon law, yet chose not to include a choice of law clause to govern the entire policy. Instead, Federal used contractual language that demonstrates the parties' intention that the laws from various jurisdictions could govern their rights and obligations under the policy.

[77] In my opinion, Federal's submission that its Oregon Amendatory Endorsements show contractual intent that Oregon law is the proper law of the policy is undermined by Federal's specific treatment of punitive damages, the definition of "Loss" in its policy, the effect of Endorsement no. 2 of the General Terms and Conditions, the lack of clarity in Endorsement no. 3 to the General Terms and Conditions, clause 2 of the General Terms and Conditions, and the specific language set out in Endorsements no. 7 and no. 2 to the first and second coverage sections, respectively.

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National Union's policy:

[78] National Union's policy is follow form to Federal's, which means that the provisions contained in Federal's policy are also contained in National Union's policy. As a result, my determination of the proper law issue for Federal's policy applies to National Union's policy unless National Union has specifically added language that expressly or impliedly stipulates a different result.

[79] Even though National Union added specific endorsements that identify a legal regime, it did not add a choice of law clause.

[80] National Union added nine endorsements dealing with cancellation of the policy, reliance on representations contained in the application for underlying insurance, exhaustion of limits and erosion, notice of change in circumstances (e.g., receivership or sale), when underlying coverage is no longer in effect, and payments. Of those, only two refer to specific jurisdictions.

[81] The first, Endorsement no. 1, contains a reference to a jurisdiction, and only in its heading, which reads:

> **OREGON CANCELLATION/NON-RENEWAL AMENDATORY ENDORSEMENT**

There is no reference to choice of law, nor does that endorsement include the type of language used by Federal in its two endorsements (nos. 7 and 2 to the first and second coverage sections, respectively).

[82] The second endorsement, no. 8, stipulates that performance of one of its obligations, i.e., payment of loss, "shall only be made in full compliance with all United States of America economic or trade sanction laws or regulations, including, but not limited to, sanctions, laws and regulations administered and enforced by the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC")".

[83] The drafters of the National Union policy intended the application of a specific legal regime – the rules of the American Arbitration Association – to apply to the performance of mediations and arbitrations of disputes under the ADR clause. As

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well, National Union turned its mind to and added a choice of forum clause stipulating that mediation or arbitration may be held in any one of several jurisdictions.

[84] In its ADR clause, National Union's policy stipulates that non-binding mediation is to be administered by the American Arbitration Association, and that arbitration conducted pursuant to the policy is also to be submitted to that Association and conducted in accordance with its "then-prevailing commercial arbitration rules".

[85] With the exception of the ADR clause contained in its policy, National Union's policy is silent as to the choice of any legal regime governing the contract or performance of its obligations.

[86] National Union relies upon the ADR clause to stay determination of its coverage obligations. The clause is lengthy. In it, National Union sets out the law to be considered by the mediator or arbitrator when construing or interpreting the policy. As well, the ADR clause contains a choice of forum in respect of mediation or arbitration. It provides, *inter alia*:

> It is hereby understood and agreed that all disputes or differences which may arise under this policy, whether arising before or after termination of this policy, including any determination of the amount of Loss, shall be subject to the dispute resolution process ("ADR") set forth in this clause.
>
> Either the Insurer and the Insureds may elect the type of ADR discussed below; provided, however, that the Insureds shall have the right to reject the Insurer's choice of ADR at any time prior to its commencement, in which case the Insured's choice of ADR shall control.
>
> The Insurer and Insureds agree that there shall be two choices of ADR: (1) non-binding mediation administered by the American Arbitration Association, in which the Insurer and Insureds shall try in good faith to settle the dispute by mediation under or in accordance with its then-prevailing Commercial Mediation Rules; or (2) arbitration submitted to the American Arbitration Association under or in accordance with its then-prevailing commercial arbitration rules, in which the arbitration panel shall be composed of three disinterested individuals. In either mediation or arbitration, the mediator(s) or arbitrators shall have knowledge of the legal, corporate management, or insurance issues relevant to the matters in dispute.
>
> The mediator(s) or arbitrators shall also give <u>due consideration to the general principles of the law of the state where the Named Insured is incorporated in</u>

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> the construction or interpretation of the provisions of this policy; provided however, that the terms, conditions, provisions and exclusions of this policy are to be construed in an even-handed fashion in the manner most consistent with the relevant terms, conditions, provisions or exclusions of the policy. In the event of arbitration, the decision of the arbitrators shall be final and binding and provided to both parties... In the event of mediation, either party shall have the right to commence a judicial proceeding; provided, however, that no such judicial proceeding shall be commenced until the mediation shall have been terminated and at least 120 days shall have elapsed from the date of the termination of the mediation...
>
> Either choice of ADR may be commenced in either New York, New York; Atlanta, Georgia; Chicago, Illinois; Denver, Colorado; or in the state indicated in Item 1 of the Declarations page as the mailing address for the Named Insured [P&T Inc].
>
> [Emphasis added]

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[87] That clause means, therefore, that a mediator or arbitrator involved with or hearing a dispute pursuant to the ADR clause would have to, when considering the construction of the insurance policy, give “due consideration” to the law of the State of Delaware since that is where P&T Inc. was incorporated, unless the laws of that State were not even-handed or consistent with the relevant terms of the policy.

XL’s policy:

[88] XL’s Cornerstone Policy expressly provides for the application of different legal regimes to determine its coverage obligations.

[89] The starting point is the definition of “Loss”, which is one of the bases for XL’s obligation to pay claims. XL’s obligation is to pay for “Loss resulting from a Claim” made during the policy period “for a Wrongful Act”. The obligation to pay the various items comprising “Loss” is determined on the basis of their insurability.

[90] XL’s definition of “Loss” is more expansive than Federal’s: it speaks of awards that include pre- and post judgment interest and multiplied damage awards as well as punitive and exemplary damages. The awards set out in the parenthetical expression below are included in the definition of “Loss” where “insurable by law”:

> “**Loss**” means damages, judgments, settlements or other amounts (including pre- & post-judgment interest, punitive or exemplary damages, or the

> multiplied portion of any damage award, where insurable by law) and **Defense Expenses** that the **Insured Persons** are obligated to pay.
>
> [Bold emphasis in original; underline emphasis added]

[91] XL makes it clear, in a "Note" contained within the definition of "Loss", that the law governing its obligation to pay punitive, exemplary, or multiplied damages, fines, penalties, or taxes, but not pre- and post judgment interest, is the law of the jurisdiction most favourable to insurability (it "shall control"):

> Note: With respect to coverage for punitive, exemplary or multiplied damages or fines, penalties or taxes, the law of the applicable jurisdiction most favourable to the insurability of such amounts shall control.

[92] There is also a category excluded from the definition of "Loss" – "matters" uninsurable by the law "pursuant to which the policy is construed":

> **Loss** will not include:
>
> (1) matters which are uninsurable under the law pursuant to which this Policy is construed;...
>
> [Bold emphasis in original; underline emphasis added]

[93] "Matters" is not defined in the policy. Dictionary definitions show that this word has a broad meaning. *Black's Law Dictionary*, 8th ed. (2004) defines "matter" as follows:

> **matter**, *n*. **1**. A subject under consideration, esp. involving a dispute or litigation; ... **2**. Something that is to be tried or proved; an allegation forming the basis of a claim or defense.

The *Shorter Oxford Dictionary*, 6th ed. (2007) defines the word to mean, *inter alia*:

> **matter**, *noun*, ... **14 a** An event, circumstance, question, etc., which is or may be an object of consideration or practical concern; in *pl.*, events, circumstances, etc., generally... **15** A thing or things collectively of a particular kind or related to a particular thing, Usu. foll. by *for* or *of*, or with specifying word. ... **16** Material cause; elements of which something consists or out of which it arises.

[94] A third category relates to fines, penalties, or taxes imposed by law. They are not covered, as they are specifically excluded by the definition of "Loss", except

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where they are insurable by law and imposed in connection with an "Insured Person's" service to an entity that is financially solvent:

> **Loss** will not include:
>
> ...
>
> (2) fines, penalties or taxes imposed by law; provided, that this DEFINITION (K)(2) will not apply to fines, penalties or taxes that an **Insured Person** is obligated to pay if such fines, penalties or taxes are insurable by law and are imposed in connection with such **Insured Person's** service to an entity included within the definition of **Company** that is financially solvent.
>
> [Bold emphasis in original; underline emphasis added]

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[95] XL's policy also shows that the insurer contemplated different types of claims being made against the insureds in various jurisdictions. In fact, with the exception of coverage for "Defence Expenses" (a defined term), XL's policy excludes coverage for "Loss" in connection with any claim, *inter alia*, "brought and maintained in a non-common law jurisdiction outside the United States of America or its territories or possessions".

[96] Comparing all of the language contained in the definition of "Loss" makes it clear that the parties intended that while one legal regime would apply to the policy, other legal regimes may apply to XL's obligations to pay interest, punitive and exemplary damages, the multiplied portion of any damage award, and fines, penalties, and taxes.

[97] XL's policy also contains a term described as a "no action" clause, which purports to operate as a condition precedent to an "Insured Person" bringing an action against XL. Although XL previously relied on this clause as a basis to stay a coverage determination by this Court, during the hearing XL abandoned its reliance on that clause in this case for practical reasons. XL prefers to participate in the looming coverage determination hearing rather than sit on the sidelines; if it won its stay application, XL could be faced with allegations of *res judicata* and issue estoppel from its insureds.

Disposition:

[98] A careful review of the insurance policies shows that the parties anticipated *dépeçage*. The parties had ample opportunity to select one proper law, especially the law of Oregon. They chose not to do so. This fact alone, however, does not lead to the conclusion that the proper law of the policies is BC law.

[99] From examining each policy as a whole, and in particular, contractual language allowing for different policy sections, claims, and “matters” to be interpreted according to different legal regimes, it is clear that the parties intended the proper law to be determined in connection with the substance of the claim made (including relief sought) or matter at issue.

[100] The instant case is an exceptional one, created by the parties’ contractual intent, which is expressed through the use of specific language drafted by underwriters following lengthy negotiations.

[101] For example, in the Federal policy, the parties agreed that voidance of the policy for misrepresentation on the application for insurance is governed by the “applicable insurance laws” of Oregon.

[102] Another example is Federal’s obligation to provide coverage for punitive and exemplary damages is to be construed in accordance with a legal regime that may be different than the law which governs the coverage section within which that obligation is found.

[103] XL’s policy, for example, incorporates a definition of “Loss” that states its obligation to provide coverage for “matters” and certain specified claims (set out in the definition of “Loss”) is determined on the basis of their insurability by law. The drafters of its policy contemplated, at least for certain specific claims, that a legal regime (most favourable to insurability) may apply that is different than the legal regime by which the rest of the policy is construed.

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[104] My determination regarding the parties' intent does not mean that the policies exist in a vacuum. This is not a case, as was posited in *Armar Shipping* (at p. 505) where the proper law "float[s] until the carrier, unilaterally, makes a decision". Nor is this is a situation like that in *Amin Rasheed* (at p. 895), where the court was being asked to determine, based on the use of a Lloyd's form much used on an international scale, that the contract is "an internationalised, or floating, contract, unattached to any system of law". The policies in this case are, in fact, connected to more than one jurisdiction and legal regime, e.g., British Columbia, Ontario, Delaware, Oregon, Indiana, New Jersey, Pennsylvania, New York, and Connecticut. In my opinion, this is an extraordinary case, one where the parties intended that a court having taken jurisdiction over the claim or matter in dispute would determine the proper law according to its own laws.

[105] The facts in this case are more compelling than those in *Libyan Arab Foreign Bank (No. 2)*: here, the parties' intention to apply *dépeçage*, and to which subject matters, is manifest. Except for the application of Oregon insurance law to deal with misrepresentations contained in the application submitted to Federal, the parties did not specifically set out the laws from a specific jurisdiction(s) to govern their obligations. Proper law is left to be determined by the court hearing the dispute to find based on application of its own laws, taking into account directing language in the policies (e.g., concerning punitive and exemplary damages in Federal's policy and those same damages along with multiplied damage awards, fines, penalties, and taxes in XL's policy).

[106] Simply because a court takes jurisdiction, it does not necessarily follow that such jurisdiction's legal regime will be applied as the proper law. Nor does the prospect that more than one court can or does take jurisdiction to determine coverage obligations in the policies affect the analysis. Principles of conflict of laws are flexible enough to deal with fact patterns where more than one forum can take jurisdiction. In *Amin Rasheed*, at p. 888, Lord Diplock said:

> One final comment on what under English conflict rules is meant by "proper law" of a contract may be appropriate. It is the substantive law of the country which the parties have chosen as that by which their mutual legally

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> enforceable rights are to be ascertained, but excluding any renvoi, whether of remission or transmission, that the courts of that country might themselves apply if the matter were litigated before them. For example, if a contract made in England were expressed to be governed by French law, the English court would apply French substantive law to it notwithstanding that a French court applying its own conflict rule might accept a renvoi to English law as the lex loci contractus if the matter were litigated before it.

Thus, proper law may always be ascertained. Moreover, application of repugnant laws from a legal regime arguably connected to the policies may be avoided on the ground of public policy: *Vita Food*, p. 521.

[107] That the parties in the instant case intended a multi-faceted approach to the proper law of the contract at the time the policies were issued, tied to the substance of the claims, matters, or coverage sections in issue, is demonstrated by the circumstances existing at the time.

[108] D&O liability coverage was being provided on a worldwide basis at a time when the bulk of P&T Inc.'s revenue (and debt) was generated by its Canadian operations, through its subsidiary P&T Ltd. Although the majority of claims could thus be expected to arise from the Canadian operations, underwriters also expressed concern over possible bankruptcy proceedings in the US. Financial insolvency loomed large. An approach to proper law that is claim or matter dependent allowed the insurers to provide worldwide D&O and "Organization" liability coverage in a manner that made commercial sense to the parties having regard to the particular circumstances existing at the time the policies were issued. This does not mean that the policies exist in a legal vacuum until a claim is made against any or all of the insureds. For example, a dispute between Federal or National Union, on the one hand, and any or all of their insureds, on the other, concerning voidance for misrepresentation in the application will be determined by Oregon law (as per Endorsements no. 7 and no. 2). For the XL policy, the definition of "Loss" mandates that such a dispute would be determined according the law to which the entire policy is construed.

[109] Having taken jurisdiction, I must now determine the proper law to be applied. In BC, the approach to determining the proper law of a contract is set out in

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Cansulex. I propose to review the factors outlined by Chief Justice McEachern, in ascending order of importance, to determine the proper law to be applied to the policies:

(a) *Where the policy was made:*

The insurers did not suggest that each policy was made in a different jurisdiction, and instead asserted Oregon was the place where the policies were made. For the reasons set out in (c) below, I cannot find that the policies were made in Oregon. The mere fact that the head office of P&T Inc. and the broker's office were located in Portland and that Federal had an office in Oregon, does not mean that the contracts were made in Oregon. Section 5 of the *Insurance Act* deems them to have been made in BC, a presumption that I find the insurers have not rebutted. This factor favours BC law.

(b) *The form of the policy:*

No evidence was tendered to show that the insurance forms, all written in English, are American, or for that matter, unique to or derived from any particular jurisdiction. The liability concepts expressed in the policies are well known and widely used in D&O and organization claims made insurance policies issued in Canada.

The premium amounts and payment obligations of the insurers are expressed in US dollars, although the latter is expressed in terms of a conversion from foreign currency to US currency. It is not unheard of for non-American companies to do business in US currency.

In my opinion, this factor is neutral.

(c) *Where the parties' operations are located:*

The insurers' head offices and principal places of business are located in States other than Oregon (New York, New Jersey, Indiana,

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Pennsylvania, and Connecticut). Apart from Federal, there is no evidence to show that the other insurers had offices in Oregon. Federal's decision to accept the risk was made in several jurisdictions: Los Angeles, Portland, and New Jersey. National Union's decision to go on risk was made in New York City. All of XL's underwriting was carried out in Stamford, Connecticut. National Union's policy was issued out of its office in New York City; XL's policy was issued out of its office in Connecticut.

The bulk of the operations of the Pope & Talbot Group were located in British Columbia. Most of its employees were located, and I infer worked, in this jurisdiction. The head office of the parent, P&T Inc., was located in Portland. It was incorporated in Delaware, where its insolvency proceedings were commenced.

In its application for insurance, the strength of the Canadian dollar was cited as a significant reason for its adverse financial position. The remarks made by Federal's underwriters in their underwriting analysis demonstrate that the insurer was aware that the proportion of P&T Inc.'s operations in BC (through its Canadian subsidiary) were significant enough to result in considerable loss to the company when the high Canadian dollar made its products from BC less competitive.

The facts surrounding this factor favour British Columbia law. Nothing other than the location of an office for Federal, some aspect of underwriting by Federal, the location of P&T Inc.'s head office in Oregon, and a mill operated by P&T Ltd. in Halsey favours Oregon law. Having turned their minds to proper law, none of the parties chose Oregon law as the law of their contracts. This omission is telling.

(d) *The subject matter of the contract:*

The subject matter of the contract is worldwide liability insurance for the directors and officers of the Pope & Talbot Group as well as direct coverage for the "Organizations" comprising that Group. Without considering the nature and location of the operations of the Pope & Talbot Group, this factor is neutral. Once they are considered, the law of BC is favoured as the proper law since the majority of the operations of the Pope & Talbot Group, including its employees, were located in BC at the time the policies were made.

(e) *Where claims might be expected to arise:*

The nature and location of the operations of the Pope & Talbot Group at the time the policies were issued shows that, with the possible exception of bankruptcy proceedings in the US, most of the claims could be expected to arise from Canadian operations. This factor favours BC law.

[110] In the circumstances, I find that the policies have the closest and most substantial connection with BC.

[111] In my respectful view, it would be a facile approach to conclude there is only one proper law governing each policy, given the extraordinary language used in the policies. If I had to, then upon the application of the *Cansulex* factors, I would find the proper law of the policies to be BC law at the time they were made.

[112] As McEachern C.J.S.C. said in *Cansulex*, at p. 290*:* "This is not really a case like *Colmenares* because it was a reasonable inference in that case that a person applying in Toronto to an Ontario corporation for a policy on a Canadian form would be governed by Canadian law". The facts of this case are more complex than in *Colmaneres,* where a standard form life insurance policy issued by a Canadian insurer was in issue.

[113] In this case, the *CBCA* s. 119 claims, which have no equivalent in Oregon, are unique to the Canadian operations of the Canadian subsidiary of P&T Inc. They

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are brought pursuant to a Canadian statute. The proper law of the policies to determine the insurers' coverage obligations for those claims is BC law.

[114] During submissions, the parties referred to the doctrine of reasonable expectations of the parties to support their position on the proper law. I have determined that the policies are not ambiguous in terms of proper law. PWC argued that the policies were ambiguous insofar as the proper law issue is concerned. Even if it could be said that they are ambiguous – with the exception that in the Federal policy Oregon law is stipulated as the proper law for Endorsements nos. 7 and 2, which govern the consequences of misrepresentation – application of the doctrine of reasonable expectations of the parties leads to the same result in respect of the s. 119 claims.

[115] In terms of reasonable expectations, the circumstances extant at the time the policies were issued (which I have set out in these reasons for judgment) leads me to conclude that the parties expected BC law to apply to claims flowing out of the operations of P&T Ltd. For claims arising from operations of P&T Inc., the parties expected the proper law would be determined by the State in the United States taking jurisdiction. Federal and National Union are each part of a different group of companies having at least one other insurance company that carries on business in Canada. XL also has a related company that carries on business in this country. In my respectful view, the insurers, having chosen to underwrite coverage for P&T Ltd. and its directors and officers, must be taken to have been aware of s. 5 of the BC *Insurance Act* and other like provisions in other provincial insurance statutes, including Ontario (where P&T Ltd.'s registered and records office is located).

[116] The s.119 claims are unique to Canada and arise solely out of the BC operations. The parties would reasonably have expected BC law to apply to determine the insurers' coverage obligations under the policies.

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Analysis and Disposition – ADR clause

[117] National Union seeks to stay these proceedings until mediation takes place pursuant to the ADR clause. During submissions, National Union conceded that the clause was procedural and did not affect substantive rights, so that its application can be determined by the *lex fori.*

[118] In my previous decision (2009 BCSC 1014, 76 C.C.L.I. (4th) 212, at paras. 147 to 150), I referred to several decisions holding that the *BIA* confers jurisdiction on Canadian Superior Courts to disrupt private contractual rights: e.g. *GMAC Commerical Credit Corporation – Canada v. T.C.T. Logistics Inc.*, 2006 SCC 35, [2006] 2 S.C.R. 123, rev'g in part (2004), 71 O.R. (3d) 54, 238 D.L.R. (4th) 677 (C.A.); and *Sam Lévy & Associés Inc. v. Azco Mining Inc.*, 2001 SCC 92, [2001] 3 S.C.R. 978.

[119] The rationale underlying that point is well set out in the decision of Topolniski J., whose reasoning was affirmed by the Alberta Court of Appeal in *Residential Warranty Co. of Canada Inc. (Re)*, 2006 ABQB 236, 62 Alta. L.R. (4th) 168, aff'd 2006 ABCA 293, 65 Alta. L.R. (4th) 498:

> [25] A significant objective of the *BIA* is to ensure that all of the property owned by the bankrupt or in which the bankrupt has a beneficial interest at the date of the bankruptcy will, with limited exceptions, vest in the trustee for realization and ratable distribution to creditors. To further this objective, the *BIA* provides for practical, efficient and relatively inexpensive mechanisms for asset recovery, determination of the validity of creditor claims, and distribution of the estate. A fundamental tenet of *BIA* proceedings is that fairness should govern.

[120] Resort to inherent jurisdiction may be made to further the objects of the *BIA* where the *Act* does not provide a specific mechanism. In essence, failing specific provision in the statute, the "gap" may be filled by statutory construction, or failing that, then by resort to inherent jurisdiction. According to Topolniski J., the *BIA* expressly preserves the Bankruptcy Court's equitable and ancillary powers. Resort to inherent jurisdiction is "maintained and available as an important but sparingly used tool". At para. 26, he wrote:

The *BIA* expressly preserves the Bankruptcy Court's equitable and ancillary powers. Accordingly, inherent jurisdiction is maintained and available as an important but sparingly used tool. There are two preconditions to the Court exercising its inherent jurisdiction: (1) the *BIA* must be silent on a point or not have dealt with a matter exhaustively; and (2) after balancing competing interests, the benefit of granting the relief must outweigh the relative prejudice to those affected by it. Inherent jurisdiction is available to ensure fairness in the bankruptcy process and fulfilment of the substantive objectives of the *BIA*, including the proper administration and protection of the bankrupt's estate.

[121] Topolniski J. also remarked that solutions to *BIA* issues will require judges to consider the realities of commerce and business efficacy:

> [27] Solutions to *BIA* concerns require consideration of the realities of commerce and business efficacy. A strictly legalistic approach is unhelpful in that regard. What is called for is a pragmatic problem-solving approach which is flexible enough to deal with unanticipated problems, often on a case-by-case basis.

[122] The same point was made by Farley J. in *Canada (Minister of Indian Affairs and Northern Development) v. Curragh Inc.* (1994), 114 D.L.R. (4th) 176, 27 C.B.R. (3d) 148 (Ont. Ct. J. (Gen. Div.)) at p. 185:

> While the *BIA* is generally a very fleshed-out piece of legislation when one compares it to the *CCAA*, it should be observed that s. 47(2)(c): "The court may direct an interim receiver ... to ... (c) take such other action as the court considers advisable" is not in itself a detailed code. It would appear to me that Parliament did not take away any inherent jurisdiction from the court but in fact provided, with these general words, that the court could enlist the services of an interim receiver to do not only what "justice dictates" but also what "practicality demands". It should be recognized that where one is dealing with an insolvency situation one is not dealing with matters which are neatly organised and operating under predictable discipline. Rather the condition of insolvency usually carries its own internal seeds of chaos, unpredictability and instability.

[123] Section 183(1) of the *BIA* invests Bankruptcy Courts with equitable jurisdiction:

> The following courts are invested with such jurisdiction at law and in equity as will enable them to exercise original, auxillary and ancillary jurisdiction in bankruptcy and in other proceedings authorized by this Act during their respective terms, as they are now, or may be hereafter, held, and in vacation and in chambers: ...
>
> ...

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(c) in the Provinc[e] of...British Columbia, the Supreme Court[.]

[124] Although the *BIA* permits Bankruptcy Courts to interfere with leases and creditor agreements in some circumstances, it makes no specific mention of interference with conditions precedent to an insurer's coverage obligations. Nor does the *Act* define what is meant by "auxiliary" or "ancillary" jurisdiction.

[125] Dictionary definitions offer little guidance. *Black's Law Dictionary* defines "auxiliary" to mean: "The incidental aid by an equity court to a court of law when justice requires both legal and equitable processes and remedies". The *Shorter Oxford Dictionary* defines it as: "Helpful: giving support or succour; ...subsidiary, additional, anciliary." The word "ancillary" is defined in *Black's Law Dictionary* to mean: "A court's jurisdiction to adjudicate claims and proceedings related to a claim that is properly before the court". The definition contained in the *Shorter Oxford Dictionary* reads: "Subservient, subordinate; auxiliary, providing support".

[126] I view the question, in the circumstances of this case, in terms of the Court's inherent jurisdiction to control its own process in order to promote the objects of the *BIA* rather than gap filling through statutory interpretation.

[127] The Alberta Court of Appeal, in *Residential Warranty*, added its own remarks concerning the scope of the Bankruptcy Court's reliance on inherent jurisdiction:

> [20] Inherent jurisdiction is not without limits, however. It cannot be used to negate the unambiguous expression of legislative will and moreover, because it is a special and extraordinary power, should be exercised only sparingly and in a clear case. ...
>
> [21] Further limitations are based on the nature of the *BIA* – it is a detailed and specific statute providing a comprehensive scheme aimed at ensuring the certainty of equitable distribution of a bankrupt's assets among creditors. ... However, inherent jurisdiction has been used where it is necessary to promote the objects of the *BIA:* [citations omitted]. It has also been used where there is no other alternative available: [citations omitted] and to accomplish what justice and practicality require: [citation omitted].
>
> ...
>
> [37] Generally, inherent jurisdiction should only be exercised where it is necessary to further fairness and efficiency in legal process and to prevent abuse.

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[128] In deciding whether inherent jurisdiction should be exercised, the Court of Appeal in *Residential Warranty* considered a number of factors at para. 37, including:

(a) the stage of the proceedings and the effect of such an order on them – "for example, the ability of the trustee to make distributions and their amount may depend on the determination of the issue";

(b) the need to maintain the integrity of the bankruptcy process – "[t]he equitable distribution of the bankrupt estate must remain at the forefront";

(c) the realistic alternatives in the circumstances;

(d) the impact on the trust claimants and the trust property as well as on other creditors; and

(e) the anticipated time and costs involved.

[129] Since my previous decision was handed down, Burnyeat J. of this Court has issued reasons for judgment in *Hayes Forest Services Limited (Re)*, 2009 BCSC 1169, [2009] B.C.J. No. 1725 (QL) where, at para. 22, he confirmed the broad jurisdiction of the Court in *CCAA* proceedings to "decide a dispute...under a [c]ontract...despite the provincial statutory authority and the terms of the [c]ontract". Burnyeat J. also reviewed other decisions from this Court, the Court of Appeal, and various provincial Superior Courts, all of which are to the same effect – a very broad discretion is afforded to courts dealing with *CCAA* proceedings to interfere with private contractual or statutory rights: *Luscar Ltd. v. Smoky River Coal Ltd.*, 1999 ABCA 179, 175 D.L.R. (4th) 703; *Landawn Shopping Centres Ltd. v. Harzena Holdings Ltd.* (1997), 44 O.T.C. 288, [1997] O.J. No. 4457 (QL) (Ont. Ct. J. (Gen. Div.)); *Re T. Eaton Co.* (1997), 46 C.B.R. (3d) 293, [1997] O.J. No. 6411 (Ont. Ct. J. (Gen. Div.); *Re Dylex Ltd.* (1995), 31 C.B.R. (3d) 106, [1995] O.J. No. 595 (Ont. Ct. J. Gen. Div.)); *Re Philip's Manufacturing Ltd.* (1991), 60 B.C.L.R. (2d) 311, 9 C.B.R. (3d) 1 (B.C.S.C.); *Re Playdium Entertainment Corp.* (2001), 31 C.B.R. (4th) 302, 18

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B.L.R. (3d) 298 (Ont. S.C.J.), add'l reasons at (2001), 31 C.B.R. (4th) 309, [2001] O.T.C. 828 (Ont. S.C.J.); *Armbro Enterprises Inc.* (1993), 22 C.B.R. (3d) 80, [1993] O.J. No. 4482 (QL) (Ont. Ct. J. (Gen. Div.)); *Skeena Cellulose Inc. v. Clear Creek Contracting Ltd.*, 2003 BCCA 344, 13 B.C.L.R. (4th) 236; *Gauntlet Energy Corp. (Re)*, 2003 ABQB 718, 336 A.R. 302; *Doman Industries Ltd. (Re)*, 2003 BCSC 376, 14 B.C.L.R. (4th) 153; and *Backbay Retailing Corporation v. Gray's Apparel Company Ltd.*, 2008 BCSC 1876, [2008] B.C.J. No. 2784 (QL).

[130] In *Skeena*, the Court of Appeal noted, at para. 37, that in the "exercise of their 'broad discretion' under the *CCAA*, it has become common for courts to sanction the indefinite, or even permanent, affecting of contractual rights".

[131] The approach taken by Burnyeat J. in *Hayes Forest Services*, and in the other cases he reviewed, is not confined to *CCAA* proceedings. Courts have interfered with private contractual rights in insolvency cases involving the *Winding-up and Restructuring Act*, R.S.C. 1985, c. W-11: *Canada (Attorney General) v. Reliance Insurance Co.* (2007), 87 O.R. (3d) 42, 36 C.B.R. (5th) 273 (S.C.J.); and *GMAC.* The rationale is explained in the text *Commercial Insolvency in Canada* by Kevin P. McElcheran (Markham, Ont.: LexisNexis Canada Inc., 2005) at p. 4:

> The primary statutory and judicial tool used to preserve value and promote order in the insolvency process is the stay of proceedings to suspend the exercise of individual creditor rights. Stays of proceedings are necessary to achieve many of the objectives of commercial insolvency law. Even in the context of a liquidation of the debtor's assets for distribution to its unsecured creditors under the *BIA* or *WURA*, the statutory stay of proceedings permits the orderly and efficient realization of the debtor's assets, the judicial determination of creditor claims and priorities and the fair distribution of proceeds to creditors by reference to their legal rights.

[132] National Union has neither denied nor confirmed coverage despite a demand being made in July 2008, yet wishes to pursue its contractual right to mediate. At one point in the proceeding, National Union submitted that because the claim value does not encroach upon its policy layer, is not necessary for it to provide its coverage position. At another point in the proceeding, National Union submitted that it wished to mediate with its insureds as it was concerned that the claim value might

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well exceed Federal's limits and encroach into its policy. In a brief written submission provided later, National Union said if there are s. 119 claims the value of which exceed Federal's layer (which, it said, "does not appear certain"), it would deny coverage "for the same reasons as stated by Federal".

[133] National Union has been provided with information concerning the underlying claims. Its decision to wait upon the value of the claims made against its insureds before taking a position on cover, especially in view of its potential obligation to advance defence costs in the event Federal's layer is exhausted, should not, in my respectful view, allow it to rely on its ADR clause which would, in effect, stand in the way of the resolution of the Pope & Talbot insolvency.

[134] Given National Union's position concerning coverage, there is no good reason for the ADR clause to stand in the way of an orderly and expeditious resolution of the insolvency proceedings.

[135] National Union's position is that it is not bound by this Court's determination of the coverage obligations of the other two insurers. PWC and the directors and officers disagree; they submit that National Union would be bound by the doctrine of issue estoppel. If National Union's position is correct, then forcing the parties to mediate will only add to the costs of the proceedings and cause delay. If the Federal and XL policies are found to respond to the s. 119 claims, then an additional hearing will be required to determine National Union's coverage obligations.

[136] If there is no coverage afforded by National Union's policy, then to adopt the words of Campbell J. at para. 39 of *Fiber Connections Inc. v. SVCM Capital Ltd.* (2005), 10 C.B.R. (5th) 192, [2005] O.J. No. 3899 (Ont. S.C.J.), leave to appeal to Ont. C.A. granted (2005) 10 C.B.R. (5th) 201, 139 A.C.W.S. (3d) (Ont. C.A.), appeal abandoned August 5, 2005, the resolution of the Pope & Talbot insolvency is "held hostage" by purported rights where there is no economic benefit to the party asserting them:

> For the purposes of this case, it is not in my view an extension of the concept of inherent jurisdiction, but rather the prevention of one shareholder, with no economic value of his equity, holding all the stakeholders hostages. In this respect, I conclude that the considerations expressed for the exercise of the

> Court's inherent jurisdiction under the CCAA are applicable under the BIA to the facts of this case. See Algoma Steel Inc., Re (2001), [2002] O.J. 66 (ont. S.C.J. [Commercial List]) at paragraph 5; Doman Industries Ltd., Re., [2004] B.C.J. No. 1402

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[137] At this stage of the proceedings, all of the parties and participants involved in the Pope & Talbot insolvency need to know whether D&O insurance coverage is available, and if so to what extent, in order to determine what amounts may be paid to claimants from the Directors' Charge (since that Charge is drawn upon only after claims are paid by existing insurance coverage). The integrity of the bankruptcy process is maintained through a stay order.

[138] National Union submits that its policy is with the directors and officers, who are not insolvent, so that there is no basis to interfere with private contractual rights. With respect, that submission overlooks the fact that coverage is also afforded to P&T Inc. and P&T Ltd. in circumstances where they indemnify directors and officers (and are permitted by law to do so). It also overlooks the fact that the s. 119 claims made against the directors and officers of P&T Ltd. arise from the insolvency of P&T Ltd., which is an insured under National Union's policy.

[139] I was told, during submissions, that National Union wishes to mediate its dispute with its insureds even though the value of the s.119 claims may not exceed Federal's or XL's policy limits. This presumes it will make an offer to its insureds. There is nothing to prevent National Union from doing that or from engaging in settlement discussions with its insureds at any time.

[140] In the circumstances, the operation of the ADR clause is stayed.

Summary

[141] The parties expressly intended the proper law of their policies to be determined in relation to the substance of the claims or matters in dispute, by the court that has taken jurisdiction doing so in accordance with its own laws. The insurers have drafted their policies in such a way as to incorporate the principle of *dépeçage.* Here, application of the *Cansulex* factors shows that BC law is the proper

law to be applied to determine the insurers' coverage obligations in relation to the *CBCA* s. 119 claims.

[142] National Union's ADR clause is stayed in order to permit the orderly, expedient, and effective resolution of the insolvency surrounding the Pope & Talbot Group.

[143] The parties may speak to the issue of costs.

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"The Honourable Mr. Justice Paul Walker"

The Attorney General of Canada v. Reliance Insurance Co.

[Indexed as: Canada (Attorney General) v. Reliance Insurance Co.]

87 O.R. (3d) 42

Ontario Superior Court of Justice,
Pepall J.
October 5, 2007

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Corporations -- Winding-up -- Orders being granted for winding-up of insurance company and appointment of liquidator -- Order and s. 21 of Winding-up and Restructuring Act imposing stay of proceedings against company and liquidator -- Liquidator moving for order directing that reinsurance amounts owed by moving parties to company be paid to liquidator without any reduction on account of set-off -- Moving parties taking position that reinsurance treaties provided for arbitration of issue of set-off and bringing motion to stay or dismiss liquidator's motion and to refer issue of set-off to arbitration -- Motion dismissed -- Arbitration constituting "proceeding" against company and liquidator -- Arbitration proceedings being stayed by s. 21 of Act and by court order -- Winding-up and Restructuring Act, R.S.C. 1985, c. W-11, s. 21.

RC carried on business in Canada as a branch of a foreign insurance company, RI. After RI became insolvent and was ordered to be liquidated by a Pennsylvania court, the Superintendent of Financial Institutions took control of the assets of RC in Canada and sought orders for the winding-up of RC and the appointment of a liquidator. The orders were granted. The order appointing the liquidator imposed a stay of proceedings against RC and the liquidator except with leave of the court. The moving parties had entered into reinsurance

agreements or treaties with RI (the "Treaties"). It was the liquidator's position that it was required by Canadian law to take custody and control of all amounts receivable in respect of RC's insurance business, including reinsurance receivables, and that amounts were owed by the moving parties to RC. The moving parties sought to set-off those amounts against amounts owed to them by RI. The liquidator moved for directions, including a request for an order declaring and directing that the reinsurance amounts be paid to the liquidator without any reduction on account of set-off. The moving parties brought motions seeking to stay or dismiss the liquidator's motion and to refer the issue of set-off to arbitration in accordance with the Treaties. [page43]

Held, the motions should be dismissed.

Section 21 of the Winding-up and Restructuring Act ("WURA") and the order appointing the liquidator stayed the arbitration proceedings. "Proceedings" includes extra-judicial proceedings such as arbitration. The moving parties had framed their motion as a request for a stay of the liquidator's set-off motion on the basis that the Treaties and the arbitration agreements contained therein should be enforced. This amounted to a proceeding against RC, RI and the liquidator. The moving parties were not precluded from advancing their arguments on set-off, but they were precluded from proceeding with arbitration. In the face of the winding-up and the stay, the agreements to arbitrate ceased to have effect for the future and were inoperative.

It would not be appropriate to lift the stay and grant leave to the moving parties so that the arbitrations could proceed. The object of the ("WURA") is the expeditious and inexpensive winding-up of companies to which it applies. A multiplicity of litigation that adds unnecessary costs and depletes what would otherwise be available to distribute to creditors should be discouraged. It made no sense to have a number of separate adjudicative bodies addressing the issue of set-off, and establishing the arbitral tribunals and obtaining an adjudication of the issue of set-off would involve delay.

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Cases referred to

Breakwater Co. (Re), [1914] O.J. No. 5, 33 O.L.R. 65 (H.C.); Cooprants, Mutual Life Insurance Society (Liquidator of) v. Dubois, [1996] 1 S.C.R. 900, [1996] S.C.J. No. 44, 133 D.L.R. (4th) 643, 196 N.R. 81, 39 C.B.R. (3d) 253; Dalimpex Ltd. v. Janicki (2003), 64 O.R. (3d) 737, [2003] O.J. No. 2094, 228 D.L.R. (4th) 179, 35 B.L.R. (3d) 41, 35 C.P.C. (5th) 55,(C.A.), supp. reasons [2003] O.J. No. 3301 (C.A.); Dominion Trust Co. (Liquidator of) v. LePage (1916), 53 S.C.R. 337, [1916] S.C.J. No. 29; Eagle River International Ltd. (Re), [2001] 3 S.C.R. 978, [2001] S.C.J. No. 90, 207 D.L.R. (4th) 385, 2001 CarswellQue 2725; J. McCarthy & Sons Co. of Prescott Ltd. (Re), [1916] O.J. No. 4, 38 O.L.R. 3, 32 D.L.R. 441 (Div. Ct.); Kortev v. Deloitte Haskins & Sells, [1996] A.J. No. 1062, 46 Alta. L.R. (3d) 16, 29 B.L.R. (2d) 78, 44 C.B.R. (3d) 259, 32 C.C.L.T. (2d) 265, 15 E.T.R. (2d) 296 (Q.B.); Luscar Ltd. v. Smoky River Coal Ltd., [1999] A.J. No. 676, 1999 ABCA 179; Meridian Developments Inc. v. Toronto-Dominion Bank, [1984] A.J. No. 986, 52 C.B.R. (N.S.) 109 (Q.B.); Prince George (City) v. McElhanney Engineering Services Ltd., [1995] B.C.J. No. 1474, [1995] 9 W.W.R. 503 (C.A.); Quintette Coal Ltd. v. Nippon Steel Corp., [1990] B.C.J. No. 2497, 51 B.C.L.R. (2d) 105, 2 C.B.R. (3d) 303 (C.A.); Smoky River Coal Ltd. (Re), [1999] A.J. No. 272, 1999 ABQB 202; Suidair International Airways Ltd (Re), [1951] 1 Ch 165, [1950] 2 All E.R. 920; Wood Gundy Inc. v. Northland Bank, [1989] M.J. No. 175, 73 C.B.R. (N.S.) 297, 60 Man. R. (2d) 29 (Q.B.)

Statutes referred to

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Insurance Companies Act, S.C. 1991, c. 47, Part XIII
International Commercial Arbitration Act, R.S.O. 1990, c. I.9, ss. 2(2), 8
Uncitral Model Law on International Commercial Arbitration, C. Gaz., 1986. I, vol. 120 (International Commercial Arbitration Act), Art. 8
Winding-up and Restructuring Act, R.S.C. 1985, c. W-11, as am.,

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ss. 10.1, 21, 73, 134, 161(7), (8)

Authorities referred to

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McElcheran, Kevin, Commercial Insolvency in Canada (Markham, Ont.: LexisNexis Butterworths, 2005)
Mustill, M.J. and S.C. Boyd, The Law and Practice of Commercial Arbitration in England, 2nd ed. (London: Butterworths, 1989)

2007 CanLII 41899 (ON SC)

MOTIONS for an order staying a motion by a Liquidator for directions on the issue of set-off and the referring issue of set-off for arbitration.

Paul Bates and Robert Grain, for moving parties Swiss Re Frankona Ruckversicherungs AG and Swiss Re Germany AG.

Thomas Donnelly, for moving parties Lloyd's of London Syndicates 340, 2341, 53 and 1121.

Graham Smith, for KPMG, the Liquidator of Reliance Canada.

[1] PEPALL J.: -- This case addresses the winding-up and restructuring statutory regime and related court orders and agreements to arbitrate contained in certain reinsurance agreements that are known as treaties.

Facts

[2] Reliance Insurance Company ("Reliance") is a property and casualty insurer that was incorporated in Pennsylvania, U.S.A. It established a branch office in Toronto to carry on insurance business in Canada. This branch is known as Reliance Canada.

[3] By the fall of 2001, Reliance was insolvent. At the

request of the Insurance Commissioner for the Commonwealth of Pennsylvania, on October 3, 2001, the Commonwealth Court of Pennsylvania ordered that Reliance be liquidated. That court also appointed a U.S. Liquidator.

[4] In Canada, Reliance Canada carried on business in Canada as a branch of a foreign insurance company pursuant to the federal Insurance Companies Act [See Note 1 below] and its predecessor statute. Together with other federal legislation, that Act provides a specific regime for a Canadian insurance branch such as Reliance Canada.

[5] Acting pursuant to the provisions of that Act, the Superintendent of Financial Institutions took control of the assets of Reliance Canada in Canada. In November 2001, it sought orders from this court for the winding-up of Reliance Canada and the appointment of a liquidator. In the materials filed in support of those applications, the Office of the Superintendent of Financial Institutions ("OSFI") described certain reinsurance contracts or treaties entered into by Reliance that reinsured Reliance Canada's liabilities [page45]and those of Reliance and other affiliates. OSFI described how Reliance Canada had been experiencing difficulties and delay in collecting reinsurance proceeds under such treaties and that some reinsurers had claimed set-off for amounts owing to Reliance Canada against amounts they claimed were owed to them by Reliance. On December 3, 2001, Farley J. ordered that, effective November 8, 2001, the insurance business in Canada of the respondent Reliance was to be wound-up and that no suit, action or other proceeding was to be proceeded with or commenced against Reliance Canada or Reliance, except with leave of the court. [See Note 2 below] Every judgment, sequestration, distress, execution or like process put into force against Reliance Canada or Reliance, or the estate or effects thereof, after the commencement of the winding-up was declared to be void and of no effect. Farley J. also appointed KPMG as the Liquidator "of the insurance business in Canada of the respondent including the assets in Canada of the respondent together with its other assets held in Canada under the control of its chief agent, including, without limitation, all amounts received or receivable in respect of its insurance business in Canada ('Reliance Canada')". [See Note 3

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below]

[6] The appointment order went on to say that "the amount recoverable from, due or owed by any reinsurer to Reliance Canada shall be paid to the Liquidator and shall not be reduced as a result of this Order or the winding-up order, notwithstanding any terms or contractual agreement to the contrary, and that any payment made directly by a reinsurer to an insured or other creditor or claimant of Reliance Canada or Reliance Insurance Company shall not diminish or reduce or affect such reinsurer's obligation to Reliance Canada". [See Note 4 below] Farley J. also appointed the US Liquidator of Reliance as an inspector to assist and advise KPMG in the winding-up of Reliance Canada. Paragraphs 26 and 28 of the order imposed a stay of proceedings against Reliance Canada and against KPMG as Liquidator except with leave of the court. They stated:

> This Court orders that, without limiting the generality of the foregoing, and except upon further order of this Court having been obtained on at least 7 days' notice to the Liquidator . . .
>
> (e) all Claimants are restrained from exercising any extra judicial remedies against Reliance Canada including, without limitation . . . any right of distress, repossession, or consolidation of accounts in relation to amounts due or accruing due in respect of [page46]or arising from any indebtedness or obligation of Reliance Canada as of the date thereof.
>
> . . . . .
>
> This Court orders that no suit, action or other proceeding shall be proceeded with or commenced against the Liquidator . . . except with leave of this Court and subject to such terms as this Court may impose.

[7] Paragraph 29 addressed the powers of the Liquidator which included, taking control of the estate and effects of Reliance

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Canada and bringing or defending any action, suit or prosecution or other legal proceeding, civil or criminal, in the Liquidator's own name as Liquidator or in the name or on behalf of Reliance Canada. Paragraph 39 provided that interested parties could apply to the court for advice and directions on seven day's notice to the Liquidator and the Inspectors, and that the Liquidator could at any time apply to the court for advice and directions.

[8] Swiss Re Frankona Ruckversicherungs AG and Swiss Re Germany (collectively referred to as "Swiss Re") and Lloyd's of London Syndicates 340, 2341, 53 and 1121 (collectively referred to as "Lloyd's Underwriters") (the "Moving Parties") had entered into reinsurance agreements or treaties with Reliance and others (the "Treaties"). It is KPMG's position that it is required by Canadian law to take custody and control of all amounts receivable in respect of Reliance Canada's insurance business including reinsurance receivables and that amounts are owed by the Moving Parties to Reliance Canada. The Moving Parties seek to set-off these amounts against amounts owed to them by Reliance. The Moving Parties take the position that the set-off provisions contained in the Treaties provide for this set-off and that this is standard practice.

[9] In the face of this disagreement, KPMG has brought a motion for directions including a request for an order declaring and directing that the reinsurance amounts be paid to the Liquidator without any reduction on account of set-off. It also requests facilitative enforcement orders. That motion is scheduled to be heard on October 19, 2007. Both KPMG and the U.S. Liquidator take the position that any amounts owing to the reinsurers by Reliance cannot be set-off against amounts owed by the Moving Parties to Reliance Canada.

[10] On being served with KPMG's motion, Swiss Re and Lloyd's Underwriters both brought motions seeking orders to stay or dismiss the motion and to refer the issue of set-off which is the subject matter of KPMG's motion to arbitration in Philadelphia and London, respectively, in accordance with the Treaties. With the exception of the governing law provisions, the Swiss Re and Lloyd's Underwriters' Treaties are

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substantially [page47]similar insofar as they relate to the issues on these motions. The Moving Parties state that the Treaties contain clauses that address set-off and that permit them to reduce the amounts owed to Reliance Canada by the amounts Reliance owes to them. They have choice of law provisions, Pennsylvania in the case of Swiss Re and the law of England in the case of Lloyd's Underwriters. The Treaties also contain arbitration clauses. In the case of Swiss Re, the arbitration clause states:

> Any and all disputes between Company and Reinsurer arising out of, relating to, or concerning this Agreement, whether sounding in contract or tort and whether arising during or after termination of this Agreement, will be submitted to the decision of a board of arbitration composed of two arbitrators and an umpire ("Board") meeting at a site in Philadelphia, Pennsylvania. The arbitration will be conducted under the Federal Arbitration Act . . .

Company is defined to include Reliance.

[11] In the case of Lloyd's Underwriters, the arbitration clause states:

> All matters in difference between the parties arising under, out of or in connection with this Contract, including formation and validity, and whether arising during or after the period of this Contract, shall be referred to an arbitration tribunal in the manner hereinafter set out . . .

The arbitration clause then goes on to specify that the arbitration is to be conducted in London, England. In both arbitration agreements, arbitrators with insurance industry expertise are to be appointed.

[12] It was agreed that no steps taken in this proceeding would constitute an attornment by the Moving Parties to the jurisdiction of Ontario or a waiver of their rights, if any, to rely on the law, jurisdiction and arbitration clauses contained in the Treaties. Lloyd's Underwriters have served a demand for arbitration upon KPMG. Swiss Re has not, but reserves its right

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to do so.

Issues

[13] The issues to be considered are:

(a) Do the provisions of the WURA and the related court orders stay the arbitration proceedings?

(b) If so, should leave be granted to the Moving Parties so that the arbitrations may proceed?

All counsel stressed that I should only deal with the issue of the arbitration proceedings. The issue of set-off is not to be addressed at this time. [page48]

Statutes

[14] There are a number of statutory provisions that are relevant to this motion. Section 21 of the Winding-up and Restructuring Act ("WURA") [See Note 5 below] states:

> 21. After a winding up order is made in respect of a company, no suit, action or other proceeding shall be proceeded with or commenced against the company, except with the leave of the court and subject to such terms as the court imposes.

[15] Section 73 of the WURA states:

> 73(1) The law of set-off, as administered by the courts, whether of law or equity, applies to all claims on the estate of a company, and to all proceedings for the recovery of debts due or accruing due to a company at the commencement of the winding-up of the company, in the same manner and to the same extent as if the business of the company was not being wound up under this Act.

Section 134 of WURA states:

> 134. A liquidator is subject to the summary jurisdiction

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of the court in the same manner and to the same extent as the ordinary officers of the court are subject to its jurisdiction, and the liquidator may be compelled to perform his duties by order of the court.

[16] Section 2(2) of the International Commercial Arbitration Act [See Note 6 below] ("ICAA") provides that the Model Law applies to international commercial arbitrations and awards. The Model Law on International Commercial Arbitration was adopted by the UN Commission on International Trade Law on June 21, 1985 ("Model Law"). The Model Law is attached as a schedule to the ICAA.

[17] Article 8 of the Model Law provides,

> 8(1) A court before which an action is brought in a matter which is the subject of an arbitration agreement shall, if a party so requests not later than when submitting his first statement on the substance of the dispute, refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed.
>
> (2) Where an action referred to in paragraph (1) of this article has been brought, arbitral proceedings may nevertheless be commenced or continued, and an award may be made, while the issue is pending before the court.

[18] Section 8 of the ICAA states:

> 8. Where, pursuant to article 8 of the Model Law, a court refers the parties to arbitration, the proceedings of the court are stayed with respect to the matters to which the arbitration relates. [page49]

[19] Section 106 of the Courts of Justice Act [See Note 7 below] provides for a stay of proceedings. It states:

> 106. A court, on its own initiative or on motion by any person, whether or not a party, may stay any proceeding in the court on such terms as are considered just.

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Positions of the Parties

[20] In brief, it is the position of the Moving Parties that the issue of the amounts owing under the Treaties is subject to arbitration in Pennsylvania and London respectively, and that this court does not have jurisdiction to hear KPMG's motion of October 19, 2007, and it should be stayed insofar as it relates to them. They rely on ss. 2 and 8 of the ICAA, Art. 8 of the Model Law, and s. 106 of the Courts of Justice Act. They rely on Dalimpex Ltd. v. Janicki [See Note 8 below] and state that s. 8 of the ICAA and Art. 8 of the Model Law are mandatory and that this court is obliged to refer the matter to arbitration and to stay the court proceedings. Furthermore, these provisions are consistent with the winding-up legislation in that the court may continue to maintain its supervisory role and make the appropriate order based on the results of the arbitration.

[21] KPMG's position is that, as Liquidator, it is mandated by the WURA to take control of property to which Reliance Canada is, or appears to be, entitled and this obligation is reflected in the winding-up and appointment orders. Its October motion flows from that obligation. Furthermore, and consistent with the winding-up regime, the WURA and the court orders impose a stay of proceedings and the stay extends to include arbitration proceedings. KPMG states that quite apart from that argument, the Moving Parties have failed to establish that the preconditions associated with the ICAA have been met. The subject matter of the arbitration agreement does not extend to a motion for advice and directions of this court; there is no action that can be referred to arbitration; and the arbitration agreement is inoperative or incapable of being performed as a result of the winding-up. Lastly, the order requested by the Moving Parties would result in three distinct proceedings to determine the issues rather than the one proceeding available under the WURA. There would be an arbitration in Pennsylvania and one in London and the October motion would have to proceed as against other reinsurers not involved in this motion. This would cause delay and additional [page50]expense for the Reliance Canada estate and there could be inconsistent decisions.

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[22] No one challenged the description of the arbitration as being international and commercial in nature and I do not propose to examine that issue in any detail. It should be noted that no one takes the position that the constitutional validity or constitutional applicability of the WURA, the ICAA or the Model Law is in question such that notice of a constitutional question was required. All counsel take the position that the statutes may co-exist. This issue was canvassed with counsel prior to proceeding with argument of the motion.

Discussion

(a) Stay of proceedings

[23] Turning firstly to the issue of the stay, the proceedings before me are brought in the matter of Reliance, the WURA and the Insurance Companies Act. Reliance Canada carried on business in Canada as a branch of a foreign insurance company under the Insurance Companies Act and its predecessor legislation. As such, to insure risks, it required an order of the Superintendent of Financial Institutions and pursuant to Part XIII of the Insurance Companies Act, as a branch, Reliance Canada was required to, amongst other things, maintain an adequate margin of assets in Canada over liabilities in Canada, vest in trust, in Canada, assets of a prescribed value, and maintain records for each customer in Canada, or claimant under a policy in Canada, the amount owing to the insurer and the nature of its liabilities to the customer or claimant. Reliance Canada's assets were therefore held in Canada and were available to back its liabilities under its insurance policies. Records were maintained by Reliance Canada in this regard.

[24] By November 8, 2001, two liquidation estates were created, one in the U.S. and one in Canada. The WURA specifically provides for a winding-up order in respect of the "insurance business in Canada of the foreign insurance company if the court is of the opinion that for any reason it is just and equitable". [See Note 9 below] There is, therefore, no issue that there was jurisdiction to make the winding up and appointment orders. As noted in Re Breakwater Co., [See Note 10

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below] the jurisdiction of the court to wind-up a company is not defeated because a winding-up order has already been made in the [page51]company's foreign country of origin. The court then administers the assets of the company that are within its jurisdiction: Re Suidair International Airways Ltd. [See Note 11 below]

[25] It is clear that under the WURA, the Liquidator is obliged to take into his or her custody property to which a company being wound-up is or appears to be entitled. The court orders in this case reflect this responsibility. In a wind-up of a Canadian branch, assets are defined as including amounts receivable in respect of an insurance business in Canada. [See Note 12 below] In s. 73 the WURA addresses the issue of set-off. The WURA also imposes a stay of proceedings except with leave of the court. [See Note 13 below] The court orders also impose this restriction. The appointment order stated that absent leave, all claimants were restrained from exercising any extra-judicial remedies against Reliance Canada including consolidation of accounts in relation to amounts due or accruing due in respect of or arising from any indebtedness or obligation of Reliance Canada as of the date of the order. [See Note 14 below] No suit, action or other proceeding was to be proceeded with or commenced against Reliance Canada or Reliance except with leave of the court. [See Note 15 below]

[26] In Commercial Insolvency in Canada, Kevin McElcheran describes the purpose of the stay of proceedings in the context of commercial insolvency:

> The primary statutory and judicial tool used to preserve value and promote order in the insolvency process is the stay of proceedings to suspend the exercise of individual creditor rights. Stays of proceedings are necessary to achieve many of the objectives of commercial insolvency law. Even in the context of a liquidation of the debtor's assets for distribution to its unsecured creditors under the BIA or the WURA, the statutory stay of proceedings permits the orderly and efficient realization of the debtor's assets, the judicial determination of creditor claims and priorities and the fair distribution of proceeds to creditors by reference

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to their legal rights. [See Note 16 below]

[27] Although dealing with the CCAA, numerous cases have interpreted "proceedings" broadly and to include extra-judicial proceedings such as arbitration: Luscar Ltd. v. Smoky River Coal Ltd., [See Note 17 below] [page52]Meridian Developments Inc. v. Toronto-Dominion Bank, [See Note 18 below] Quintette Coal Ltd. v. Nippon Steel Corp. [See Note 19 below]

[28] Section 134 of the WURA provides that the liquidator is subject to the summary jurisdiction of the Superior Court of Justice and the Liquidator acts as the officer of this court and subject to its approval and authorization. There is no other body that provides advice and directions to the Liquidator. Again these features are reflected in the court orders.

[29] In the face of these provisions, I am hard-pressed to see how this court does not have jurisdiction or is obliged to refer the issues that are the subject matter of KPMG's October motion as it relates to the Moving Parties to Pennsylvania and London for arbitration. The Moving Parties have framed their motion as a request for a stay of the Liquidator's set-off motion on the basis that the Treaties and the arbitration agreement contained therein should be enforced. In substance, this amounts to a proceeding against Reliance Canada, Reliance and the Liquidator and hence is encompassed by the court orders. The Treaties in which the arbitration agreement are contained are not invalidated, but arbitration proceedings are stayed as a result of s. 21 of the WURA and this court's orders. There is a sound basis for this. In Cooprants, Mutual Life Insurance Society (Liquidator of) v. Dubois, [See Note 20 below] the Supreme Court described the purpose of the WURA [at para. 37]:

> The purpose of the statute is to arrange for the closing down of the company's business in an orderly and expeditious manner while minimizing, as far as possible, the losses and harm suffered by both the creditors and other interested parties and by distributing the assets in accordance with the Act. The mechanism provided consists in requiring the court's leave for proceedings by the creditors (ss. 21 and 22) and

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giving responsibility for the company's affairs to a court-appointed liquidator, who acts as an officer of the court, under its control and in accordance with its directives (s. 19). The court and the liquidator must respect and give effect to the creditors' rights as much as possible, taking their nature into account and not disregarding the other interests involved. As Galipeault C.J.Q. stated in Maranda-Desaulniers v. Peckham, [1953] B.R. 163, at p. 172, the court has a discretionary power in this regard.

In a winding up proceeding as noted in Re J. McCarthy & Sons Co. of Prescott Ltd., [See Note 21 below] there may be numerous stakeholders [at paras. 29 and 34]:

> [A]s far as possible, all proceedings affecting the winding up of a company shall be taken in the winding up matter, and the bringing of an action should not be permitted unless some special circumstances make such an additional legal proceeding necessary or advisable for some very substantial reason . . .
>
> The purpose of the Act is to wind up, finally, the affairs of the company as inexpensively and speedily as possible, in the interests of the creditors, and all others concerned in it, primarily; and, for the common good, all are equally deprived of some of their ordinary rights, including a right of action and all that may follow upon that right, such as mode of trial, right of appeal, etc. and all are confined to the remedies which the Act provides or permits. [See Note 22 below]

[30] The merits of the public policy that favours "single control" or a single proceeding have been referred to by the Supreme Court in Dominion Trust Co. (Liquidator of) v. LePage [See Note 23 below] in the context of a winding-up and in Re Eagle River International Ltd. [See Note 24 below] in the context of bankruptcy. The Moving Parties are not precluded from advancing their arguments on set-off; they are simply precluded from proceeding with arbitration.

[31] There is also an issue as to whether the Moving Parties

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meet the requisite thresholds in the ICAA and more specifically, the Model Law. There is no need to address all of the thresholds as the agreements to arbitrate are inoperative or incapable of being performed. As noted by J. Brian Casey and Janet Mills in Arbitration Law of Canada: Practice and Procedure: [See Note 25 below]

> If a party is bankrupt or insolvent and under court protection then the arbitration agreement, as any other commercial contract, is affected. It becomes inoperative.

[32] In Re Smoky River Coal Ltd., [See Note 26 below] the court considered whether an agreement to arbitrate was "void, inoperative or incapable of being performed". Lovecchio J. determined that it was incapable of being performed as the debtor company lacked capacity in that it was being suspended by the court under the Companies' Creditors Arrangement Act. Although it took a different approach, the Alberta Court of Appeal did not overrule his decision in this regard. Prince George (City) v. McElhanney Engineering Services Ltd. [See Note 27 below] did not deal with a winding-up [page54]order, but the BC Court of Appeal examined the meaning of "null and void, inoperative or incapable of being performed". Although the court did not accept the motion judge's treatment of this provision, the court did refer to M.J. Mustill and S.C. Boyd, The Law and Practice of Commercial Arbitration in England [See Note 28 below] where the authors wrote:

> The expression "inoperative" has no accepted meaning in English law, but it would seem apt to describe an agreement which, although not void ab initio, has for some reason ceased to have effect for the future.

In the case before me, in the face of the winding up and the stay, the agreements to arbitrate cease to have effect for the future and may not be enforced. They are inoperative. Put differently, consistent with Re J. McCarthy & Sons Co. of Prescott Ltd., the Moving Parties are deprived of the opportunity to proceed by way of arbitration.

(b) Leave

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[33] Turning to the second issue, I must then consider whether the stay should be lifted and leave granted to the Moving Parties so that arbitrations may proceed in Pennsylvania and London. Firstly, as a matter of procedure, the notices of motion do not request leave nor a lifting of the stay. It is not enough to simply make this request as part of one's oral argument or in a factum. The same is true with respect to the suggestion contained in the Swiss Re factum that Farley J.'s appointment order should be amended.

[34] Secondly, and more substantively, even if leave had been properly requested, I would not have granted it. The object of the WURA is the expeditious and inexpensive winding-up of companies to which it applies: Kortev v. Deloitte Haskins & Sells. [See Note 29 below] A multiplicity of litigation that adds unnecessary costs and depletes what would otherwise be available to distribute to creditors should be discouraged: Wood Gundy Inc. v. Northland Bank. [See Note 30 below] It makes no sense to have three separate adjudicative bodies addressing the issue of set-off. The October motion must proceed in any event as there are reinsurer respondents other than the Moving Parties. Referral to arbitration would result in three separate adjudications on the issue of set-off with the attendant danger of inconsistent rulings. Participation in the arbitrations would involve [page55]tremendous expense for the Liquidator and hence for the estate. The arbitration agreements call for arbitral tribunals consisting of three arbitrators. While it is the case that the arbitral tribunal would be comprised of members with insurance industry experience, no persuasive argument was advanced that would suggest that this was material with respect to the issue of set-off.

[35] There is also the delay that would be associated with establishing the arbitral tribunals and obtaining an adjudication of the issue of set-off. The stay was imposed in 2001, and the Liquidator's motion was served some time ago and is ready to be argued in October in a summary fashion as prescribed by the WURA. There are no compelling reasons or special circumstances that justify granting leave. In all of the circumstances, had the request for leave properly been

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made, I have concluded that it would not have been granted. The Moving Parties' motions are dismissed. If the parties are unable to agree, they are to make written submissions on costs.

Motions dismissed.

Notes

Note 1: S.C. 1991, c. 47.

Note 2: Para. 5 of the Winding-up Order dated December 3, 2001.

Note 3: Para. 2 of the Appointment Order dated December 3, 2001.

Note 4: Para. 6 of the Appointment Order dated December 3, 2001.

Note 5: R.S.C. 1985, c. W-11, as amended.

Note 6: R.S.O. 1990, c. I.9.

Note 7: R.S.O. 1990, c. C. 43.

Note 8: (2003), 64 O.R. (3d) 737, [2003] O.J. No. 2094 (C.A.).

Note 9: Section 10.1 of WURA.

Note 10: [1914] O.J. No. 5, 33 O.L.R. 65 (H.C.).

Note 11: [1951] 1 Ch 165, [1950] 2 All E.R. 920, at p.173 Ch.

Note 12: Sections 161(7) and (8) of WURA.

Note 13: Section 21 of WURA.

Note 14: Paragraph 26(c) of the Appointment Order dated December 3, 2001.

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Note 15: Paragraph 5 of the Winding-up Order dated December 3, 2001.

Note 16: (Markham, Ont.: LexisNexis Butterworths, 2005) at p. 4.

Note 17: [1999] A.J. No. 676, 1999 ABCA 179.

Note 18: [1984] A.J. No. 986, [1984] 52 C.B.R. (N.S.) 109 (Q.B.).

Note 19: [1990] B.C.J. No. 2497, 2 C.B.R. (3d) 303 (C.A.).

Note 20: [1996] 1 S.C.R. 900, [1996] S.C.J. No. 44.

Note 21: [1916] O.J. No. 4, 38 O.L.R. 3 (Div. Ct.).

Note 22: Ibid, at pp. 8-9 O.L.R.

Note 23: (1916), 53 S.C.R. 337, [1916] S.C.J. No. 29, at p. 351 S.C.R.

Note 24: [2001] 3 S.C.R. 978, [2001] S.C.J. No. 90, 2001 CarswellQue 2725, at p. 20 (QL).

Note 25: (New York: Juris Publishing, Inc., 2005) at p. 69.

Note 26: [1999] A.J. No. 272, 1999 ABQB 202.

Note 27: [1995] B.C.J. No. 1474, [1995] 9 W.W.R. 503 (C.A.).

Note 28: 2nd ed. (London: Butterworths, 1989) at 465.

Note 29: [1996] A.J. No. 1062, 46 Alta. L.R. (3d) 16 (Q.B.) at para. 16.

Note 30: [1989] M.J. No. 175, 73 C.B.R. (N.S.) 297 (Q.B.).

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CITATION: Elleway Acquisitions Limited v. The Cruise Professionals Limited, 2013 ONSC 6866
COURT FILE NO.: CV-13-10320-00CL
DATE: 20131127

2013 ONSC 6866 (CanLII)

**SUPERIOR COURT OF JUSTICE – ONTARIO
(COMMERCIAL LIST)**

APPLICATION UNDER SECTION 243 OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, c.B-3, AS AMENDED

RE: **ELLEWAY ACQUISITIONS LIMITED, Applicant**

AND:

THE CRUISE PROFESSIONALS LIMITED, 4358376 CANADA INC. (OPERATING AS ITRAVEL2000.COM) AND 7500106 CANADA INC., Respondents

BEFORE: **MORAWETZ J.**

COUNSEL: **Jay Swartz and Natalie Renner, for the Applicant**

John N. Birch, for the Respondents

David Bish and Lee Cassey, for Grant Thornton, Proposed Receiver

HEARD & ENDORSED: **NOVEMBER 4, 2013**

REASONS: **NOVEMBER 27, 2013**

ENDORSEMENT

[1] At the conclusion of argument, the requested relief was granted with reasons to follow. These are the reasons.

[2] Elleway Acquisitions Limited ("Elleway" or the "Applicant") seeks an order (the "Receivership Order") appointing Grant Thornton Limited ("GTL") as receiver (the "Receiver"),

without security, of all of the property, assets and undertaking of each of 4358376 Canada Inc., (operating as itravel2000.com ("itravel")), 7500106 Canada Inc., ("Travelcash"), and The Cruise Professionals ("Cruise") and together with itravel and Travelcash, "itravel Canada"), pursuant to section 243 of the *Bankruptcy and Insolvency Act (Canada)* (the "BIA") and section 101 of the *Courts of Justice Act (Ontario)* (the "CJA").

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[3] The application was not opposed.

[4] The itravel Group (as defined below) is indebted to Elleway in the aggregate principal amount of £17,171,690 pursuant to a secured credit facility that was purchased by Elleway and a working capital facility that was established by Elleway. The indebtedness is guaranteed by each of itravel, Cruise and Travelcash, among others. The itravel Group is in default of the credit facility and the working capital facility, and Elleway has demanded repayment of the amounts owing thereunder. Elleway has also served each of itravel, Cruise and Travelcash with a notice of intention to enforce its security under section 244(1) of the BIA. Each of itravel, Cruise and Travelcash has acknowledged its inability to pay the indebtedness and consented to early enforcement pursuant to section 244(2) of the BIA.

[5] Counsel to the Applicant submits that the itravel Group is insolvent and suffering from a liquidity crisis that is jeopardizing the itravel Group's continued operations. Counsel to the Applicant submits that the appointment of a receiver is necessary to protect itravel Canada's business and the interests of itravel Canada's employees, customers and suppliers.

[6] Counsel further submits that itravel Canada's core business is the sale of travel services, including vacation, flight, hotel, car rentals, and insurance packages offered by third parties, to its customers. itravel Canada's business is largely seasonal and the majority of its revenues are generated in the months of October to March. itravel Canada would have to borrow approximately £3.1 million to fund its operations during this period and it is highly unlikely that another lender would be prepared to advance any funds to itravel Canada at this time given its financial circumstances.

[7] Further, counsel contends that the Canadian travel agent business is an intensely competitive industry with a high profile among consumers, making it very easy for consumers to comparison shop to determine which travel agent can provide services at the lowest possible cost. Given its visibility in the consumer market and the travel industry, counsel submits that it is imperative that itravel Canada maintain existing goodwill and the confidence of its customers. If itravel Canada's business is to survive, potential customers must be assured that the business will continue uninterrupted and their advance payments for vacations will be protected notwithstanding itravel Canada's financial circumstances.

[8] Therefore, counsel submits that, if a receiver is not appointed at this critical juncture, there is a substantial risk that itravel Canada will not be able to book trips and cruises during its most profitable period. This will result in a disruption to or, even worse, a complete cessation of itravel Canada's business. Employees will resign, consumer confidence will be lost and existing goodwill will be irreparably harmed.

[9] It is contemplated that if GTL is appointed as the Receiver, GTL intends to seek the Court's approval of the sale of substantially all of itravel Canada's assets to certain affiliates of Elleway, who will operate the business of itravel Canada as a going concern following the consummation of the purchase transactions. Counsel submits that, it is in the best interests of all stakeholders that the Receivership Order be made because it will facilitate a going concern sale of itravel Canada's business, preserving consumer confidence, existing goodwill and the jobs of over 250 employees.

[10] Elleway is a corporation incorporated under the laws of the British Virgin Islands. Elleway is an indirect wholly owned subsidiary of The Aldenham Grange Trust, a discretionary trust governed under Jersey law.

[11] itravel, Cruise and Travelcash are indirect wholly owned subsidiaries of Travelzest plc ("Travelzest"), a publicly traded United Kingdom ("UK") company that operates a group of companies that includes itravel Canada (the "itravel Group"). The itravel Group's UK operations were closed in March 2013. Since the cessation of the itravel Group's UK operations, all of the itravel Group's remaining operations are based in Canada. itravel Canada currently employs approximately 255 employees. itravel Canada's employees are not represented by a union and it does not sponsor a pension plan for any of its employees.

[12] The itravel Group's primary credit facilities (the "Credit Facilities") were extended by Barclays Bank PLC ("Barclays") pursuant to a credit agreement (the "Credit Agreement") and corresponding fee letter (the "Fee Letter" and together with the Credit Agreement, the "Credit Facility Documents") under which Travelzest is the borrower.

[13] Pursuant to a series of guarantees and security documents (the "Security Documents"), each of Travelzest, Travelzest Canco, Travelzest Holdings, Itravel, Cruise and Travelcash guaranteed the obligations under the Credit Facility Documents and granted a security interest over all of its property to secure such obligations (the "Credit Facility Security"). Travelzest Canco and Travelzest Holdings are direct wholly owned UK subsidiaries of Travelzest. In addition, itravel and Cruise granted a confirmation of security interest in certain intellectual property (the "IP Security Confirmation and together with the Credit Facility Security, the "Security").

[14] The Security Documents provide the following remedies, among others, to the secured party, upon the occurrence of an event of default under the Credit Facility Documents: (a) the appointment by instrument in writing of a receiver; and (b) the institution of proceedings in any court of competent jurisdiction for the appointment of a receiver. The Security Documents do not require Barclays to look to the property of Travelzest before enforcing its security against the property of itravel Canada upon the occurrence of an event of default.

[15] Commencing on or about April 2012, the itravel Group began to default on its obligations under the Credit Agreement.

[16] Pursuant to a series of letter agreements, Barclays agreed to, among other things, defer the applicable payment instalments due under the Credit Agreement until July 12, 2013 (the

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"Repayment Date"). Travelzest failed to pay any amounts to Barclays on the Repayment Date. Travelzest's failure to comply with financial covenants and its default on scheduled payments under the Repayment Plans constitute events of default under the Credit Facility Documents.

[17] Since 2010, Itravel Canada has attempted to refinance its debt through various methods, including the implementation of a global restructuring plan and the search for a potential purchaser through formal and informal sales processes. Two formal sales processes yielded some interest from prospective purchasers. Ultimately, however, neither sales process generated a viable offer for Itravel Canada's assets or the shares of Travelzest.

[18] Counsel submits that GTL has been working to familiarize itself with the business operations of Itravel Canada since August 2013 and that GTL is prepared to act as the Receiver of all of the property, assets and undertaking of itravel Canada.

[19] Counsel further submits that, if appointed as the Receiver, GTL intends to bring a motion (the "Sales Approval Motion") seeking Court approval of certain purchase transactions wherein Elleway, through certain of its affiliates, 8635919 Canada Inc. (the "itravel Purchaser"), 8635854 Canada Inc. (the "Cruise Purchaser") and 1775305 Alberta Ltd. (the "Travelcash Purchaser" and together with the itravel Purchaser and the Cruise Purchaser, the "Purchasers"), will acquire substantially all of the assets of itravel Canada (the "Purchase Transactions").

[20] If the Purchase Transactions are approved, Elleway has agreed to fund the ongoing operations of itravel Canada during the receivership. It is the intention of the parties that the Purchase Transactions will close shortly after approval by the Court and it is not expected that the Receiver will require significant funding.

[21] The purchase price for the Purchase Transactions will be comprised of cash, assumed liabilities and a cancellation of a portion of the Indebtedness. Elleway will supply the cash portion of the purchase price under each Purchase Transaction, which will be sufficient to pay any prior ranking secured claim or priority claim that is not being assumed.

[22] The Purchasers intend to offer substantially all of the employees of itravel and Cruise the opportunity to continue their employment with the Purchasers.

[23] This motion raises the issue as to whether the Court should make an order pursuant to section 243 of the BIA and section 101 of the CJA appointing GTL as the Receiver.

1. The Court Should Make the Receivership Order

a. The Test for Appointing a Receiver under the BIA and the CJA

[24] Section 243(1) of the BIA authorizes a court to appoint a receiver where such appointment is "just or convenient".

[25] Similarly, section 101(1) of the CJA provides for the appointment of a receiver by interlocutory order where the appointment is "just or convenient".

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[26] In determining whether it is just and convenient to appoint a receiver under both statutes, a court must have regard to all of the circumstances of the case, particularly the nature of the property and the rights and interests of all parties in relation to the property. See *Bank of Nova Scotia v. Freure Village on Clair Creek*, [1996] O.J. 5088 at para. 10 (Gen. Div.)

[27] Counsel to the Applicant submits that where the security instrument governing the relationship between the debtor and the secured creditor provides for a right to appoint a receiver upon default, this has the effect of relaxing the burden on the applicant seeking to have the receiver appointed. Further, while the appointment of a receiver is generally regarded as an extraordinary equitable remedy, courts do not regard the nature of the remedy as extraordinary or equitable where the relevant security document permits the appointment of a receiver. This is because the applicant is merely seeking to enforce a term of an agreement that was assented to by both parties. See *Textron Financial Canada Ltd. v. Chetwynd Motels Ltd*., 2010 BCSC 477, [2010] B.C.J. No. 635 at paras. 50 and 75 (B.C. S.C. [In Chambers]); *Freure Village, supra*, at para. 12; *Canadian Tire Corp. v. Healy*, 2011 ONSC 4616, [2011] O.J. No. 3498 at para. 18 (S.C.J. [Commercial List]); *Bank of Montreal v. Carnival National Leasing Limited and Carnival Automobiles Limited*, 2011 ONSC 1007, [2011] O.J. No. 671 at para. 27 (S.C.J. [Commercial List]. I accept this submission.

[28] Counsel further submits that in such circumstances, the "just or convenient" inquiry requires the court to determine whether it is in the interests of all concerned to have the receiver appointed by the court. The court should consider the following factors, among others, in making such a determination:

(a) the potential costs of the receiver;

(a) the relationship between the debtor and the creditors;

(b) the likelihood of preserving and maximizing the return on the subject property; and

(c) the best way of facilitating the work and duties of the receiver.

See *Freure Village, supra*, at paras. 10-12; *Canada Tire, supra*, at para. 18; *Carnival National Leasing, supra*, at paras 26-29; *Anderson v. Hunking*, 2010 ONSC 4008, [2010] O.J. No. 3042 at para. 15 (S.C.J.).

[29] Counsel to the Applicant submits that it is just and convenient to appoint GTL as the Receiver in the circumstances of this case. As described above, the itravel Group has defaulted on its obligations under the Credit Agreement and the Fee Letter. Such defaults are continuing and have not been remedied as of the date of this Application. This has given rise to Elleway's rights under the Security Documents to appoint a receiver by instrument in writing and to institute court proceedings for the appointment of a receiver.

[30] It is submitted that it is just and convenient, or in the interests of all concerned, for the Court to appoint GTL as the Receiver for five main reasons:

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(a) the potential costs of the receivership will be borne by Elleway;

(a) the relationships between itravel Canada and its creditors, including Elleway, militate in favour of appointing GTL as the Receiver;

(b) appointing GTL as the Receiver is the best way to preserve itravel Canada's business and maximize value for all stakeholders;

(c) appointing GTL as the Receiver is the best way to facilitate the work and duties of the Receiver; and

(d) all other attempts to refinance itravel Canada's debt or sell its assets have failed.

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[31] It is noted that Elleway has also served a notice of intention to enforce security under section 244(1) of the BIA. itravel Canada has acknowledged its inability to pay the Indebtedness and consented to early enforcement pursuant to section 244(2) of the BIA.

[32] Further, if GTL is appointed as the Receiver and the Purchase Transactions are approved, the Purchasers will assume some of itravel Canada's liabilities and cancel a portion of the Indebtedness. Therefore, counsel submits that the appointment of GTL as the Receiver is beneficial to both itravel Canada and Elleway.

[33] Counsel also points out that if GTL is appointed as the Receiver and the Purchase Transactions are approved by the Court, the business of itravel Canada will continue as a going concern and the jobs of substantially all of itravel Canada's employees will be saved.

[34] Having considered the foregoing, I am of the view that the Applicant has demonstrated that it is both just and convenient to appoint GTL as Receiver of itravel Canada under both section 243 of the BIA and section 101 of the CJA. The Application is granted and the order has been signed in the form presented.

Morawetz J.

Date: November 27, 2013

Royal Bank of Canada v. Soundair Corp., Canadian Pension Capital Ltd. and Canadian Insurers Capital Corp.

Indexed as: Royal Bank of Canada v. Soundair Corp. (C.A.)

4 O.R. (3d) 1
[1991] O.J. No. 1137
Action No. 318/91

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ONTARIO
Court of Appeal for Ontario
Goodman, McKinlay and Galligan JJ.A.
July 3, 1991

Debtor and creditor -- Receivers -- Court-appointed receiver accepting offer to purchase assets against wishes of secured creditors -- Receiver acting properly and prudently -- Wishes of creditors not determinative -- Court approval of sale confirmed on appeal.

Air Toronto was a division of Soundair. In April 1990, one of Soundair's creditors, the Royal Bank, appointed a receiver to operate Air Toronto and sell it as a going concern. The receiver was authorized to sell Air Toronto to Air Canada, or, if that sale could not be completed, to negotiate and sell Air Toronto to another person. Air Canada made an offer which the receiver rejected. The receiver then entered into negotiations with Canadian Airlines International (Canadian); two subsidiaries of Canadian, Ontario Express Ltd. and Frontier Airlines Ltd., made an offer to purchase on March 6, 1991 (the OEL offer). Air Canada and a creditor of Soundair, CCFL, presented an offer to purchase to the receiver on March 7, 1991 through 922, a company formed for that purpose (the 922 offer). The receiver declined the 922 offer because it contained an unacceptable condition and accepted the OEL offer. 922 made a

second offer, which was virtually identical to the first one except that the unacceptable condition had been removed. In proceedings before Rosenberg J., an order was made approving the sale of Air Toronto to OEL and dismissing the 922 offer. CCFL appealed.

Held, the appeal should be dismissed.

Per Galligan J.A.: When deciding whether a receiver has acted providently, the court should examine the conduct of the receiver in light of the information the receiver had when it agreed to accept an offer, and should be very cautious before deciding that the receiver's conduct was improvident based upon information which has come to light after it made its decision. The decision to sell to OEL was a sound one in the circumstances faced by the receiver on March 8, 1991. Prices in other offers received after the receiver has agreed to a sale have relevance only if they show that the price contained in the accepted offer was so unreasonably low as to demonstrate that the receiver was improvident in accepting it. If they do not do so, they should not be considered upon a motion to confirm a sale recommended by a court-appointed receiver. If the 922 offer was better than the OEL offer, it was only marginally better and did not lead to an inference that the disposition strategy of the receiver was improvident.

While the primary concern of a receiver is the protecting of the interests of creditors, a secondary but important consideration is the integrity of the process by which the sale is effected. The court must exercise extreme caution before it interferes with the process adopted by a receiver to sell an unusual asset. It is important that prospective purchasers know that, if they are acting in good faith, bargain seriously with a receiver and enter into an agreement with it, a court will not lightly interfere with the commercial judgment of the receiver to sell the asset to them.

The failure of the receiver to give an offering memorandum to those who expressed an interest in the purchase of Air Toronto did not result in the process being unfair, as there was no proof that if an offering memorandum had been widely

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distributed among persons qualified to have purchased Air Toronto, a viable offer would have come forth from a party other than 922 or OEL.

The fact that the 922 offer was supported by Soundair's secured creditors did not mean that the court should have given effect to their wishes. Creditors who asked the court to appoint a receiver to dispose of assets (and therefore insulated themselves from the risks of acting privately) should not be allowed to take over control of the process by the simple expedient of supporting another purchaser if they do not agree with the sale by the receiver. If the court decides that a court-appointed receiver has acted providently and properly (as the receiver did in this case), the views of creditors should not be determinative.

Per McKinlay J.A. (concurring in the result): While the procedure carried out by the receiver in this case was appropriate, given the unfolding of events and the unique nature of the assets involved, it was not a procedure which was likely to be appropriate in many receivership sales.

Per Goodman J.A. (dissenting): The fact that a creditor has requested an order of the court appointing a receiver does not in any way diminish or derogate from his right to obtain the maximum benefit to be derived from any disposition of the debtor's assets. The creditors in this case were convinced that acceptance of the 922 offer was in their best interest and the evidence supported that belief. Although the receiver acted in good faith, the process which it used was unfair insofar as 922 was concerned and improvident insofar as the secured creditors were concerned.

Cases referred to

Beauty Counsellors of Canada Ltd. (Re) (1986), 58 C.B.R. (N.S.) 237 (Ont. Bkcy.); British Columbia Development Corp. v. Spun Cast Industries Inc. (1977), 5 B.C.L.R. 94, 26 C.B.R. (N.S.) 28 (S.C.); Cameron v. Bank of Nova Scotia (1981), 38 C.B.R. (N.S.) 1, 45 N.S.R. (2d) 303, 86 A.P.R. 303 (C.A.); Crown Trust Co. v. Rosenberg (1986), 60 O.R. (2d) 87, 22 C.P.C.

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(2d) 131, 67 C.B.R. (N.S.) 320 (note), 39 D.L.R. (4th) 526 (H.C.J.); Salima Investments Ltd. v. Bank of Montreal (1985), 41 Alta. L.R. (2d) 58, 65 A.R. 372, 59 C.B.R. (N.S.) 242, 21 D.L.R. (4th) 473 (C.A.); Selkirk (Re) (1986), 58 C.B.R. (N.S.) 245 (Ont. Bkcy.); Selkirk (Re) (1987), 64 C.B.R. (N.S.) 140 (Ont. Bkcy.)

Statutes referred to

Employment Standards Act, R.S.O. 1980, c. 137
Environmental Protection Act, R.S.O. 1980, c. 141

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APPEAL from the judgment of the General Division, Rosenberg J., May 1, 1991, approving the sale of an airline by a receiver.

J.B. Berkow and Steven H. Goldman, for appellants.

John T. Morin, Q.C., for Air Canada.

L.A.J. Barnes and Lawrence E. Ritchie, for Royal Bank of Canada.

Sean F. Dunphy and G.K. Ketcheson for Ernst & Young Inc., receiver of Soundair Corp., respondent.

W.G. Horton, for Ontario Express Ltd.

Nancy J. Spies, for Frontier Air Ltd.

GALLIGAN J.A.:-- This is an appeal from the order of Rosenberg J. made on May 1, 1991 (Gen. Div.). By that order, he approved the sale of Air Toronto to Ontario Express Limited and Frontier Air Limited and he dismissed a motion to approve an offer to purchase Air Toronto by 922246 Ontario Limited.

It is necessary at the outset to give some background to the dispute. Soundair Corporation (Soundair) is a corporation

engaged in the air transport business. It has three divisions. One of them is Air Toronto. Air Toronto operates a scheduled airline from Toronto to a number of mid-sized cities in the United States of America. Its routes serve as feeders to several of Air Canada's routes. Pursuant to a connector agreement, Air Canada provides some services to Air Toronto and benefits from the feeder traffic provided by it. The operational relationship between Air Canada and Air Toronto is a close one.

In the latter part of 1989 and the early part of 1990, Soundair was in financial difficulty. Soundair has two secured creditors who have an interest in the assets of Air Toronto. The Royal Bank of Canada (the Royal Bank) is owed at least $65,000,000. The appellants Canadian Pension Capital Limited and Canadian Insurers Capital Corporation (collectively called CCFL) are owed approximately $9,500,000. Those creditors will have a deficiency expected to be in excess of $50,000,000 on the winding-up of Soundair.

On April 26, 1990, upon the motion of the Royal Bank, O'Brien J. appointed Ernst & Young Inc. (the receiver) as receiver of all of the assets, property and undertakings of Soundair. The order required the receiver to operate Air Toronto and sell it as a going concern. Because of the close relationship between Air Toronto and Air Canada, it was contemplated that the receiver would obtain the assistance of Air Canada to operate Air Toronto. The order authorized the receiver:

> (b) to enter into contractual arrangements with Air Canada to retain a manager or operator, including Air Canada, to manage and operate Air Toronto under the supervision of Ernst & Young Inc. until the completion of the sale of Air Toronto to Air Canada or other person ...

Also because of the close relationship, it was expected that Air Canada would purchase Air Toronto. To that end, the order of O'Brien J. authorized the receiver:

> (c) to negotiate and do all things necessary or desirable to complete a sale of Air Toronto to Air Canada and, if a sale

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to Air Canada cannot be completed, to negotiate and sell Air Toronto to another person, subject to terms and conditions approved by this Court.

Over a period of several weeks following that order, negotiations directed towards the sale of Air Toronto took place between the receiver and Air Canada. Air Canada had an agreement with the receiver that it would have exclusive negotiating rights during that period. I do not think it is necessary to review those negotiations, but I note that Air Canada had complete access to all of the operations of Air Toronto and conducted due diligence examinations. It became thoroughly acquainted with every aspect of Air Toronto's operations.

Those negotiations came to an end when an offer made by Air Canada on June 19, 1990, was considered unsatisfactory by the receiver. The offer was not accepted and lapsed. Having regard to the tenor of Air Canada's negotiating stance and a letter sent by its solicitors on July 20, 1990, I think that the receiver was eminently reasonable when it decided that there was no realistic possibility of selling Air Toronto to Air Canada.

The receiver then looked elsewhere. Air Toronto's feeder business is very attractive, but it only has value to a national airline. The receiver concluded reasonably, therefore, that it was commercially necessary for one of Canada's two national airlines to be involved in any sale of Air Toronto. Realistically, there were only two possible purchasers whether direct or indirect. They were Air Canada and Canadian Airlines International.

It was well known in the air transport industry that Air Toronto was for sale. During the months following the collapse of the negotiations with Air Canada, the receiver tried unsuccessfully to find viable purchasers. In late 1990, the receiver turned to Canadian Airlines International, the only realistic alternative. Negotiations began between them. Those negotiations led to a letter of intent dated February 11, 1991. On March 6, 1991, the receiver received an offer from Ontario

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Express Limited and Frontier Airlines Limited, who are subsidiaries of Canadian Airlines International. This offer is called the OEL offer.

In the meantime, Air Canada and CCFL were having discussions about making an offer for the purchase of Air Toronto. They formed 922246 Ontario Limited (922) for the purpose of purchasing Air Toronto. On March 1, 1991, CCFL wrote to the receiver saying that it proposed to make an offer. On March 7, 1991, Air Canada and CCFL presented an offer to the receiver in the name of 922. For convenience, its offers are called the 922 offers.

The first 922 offer contained a condition which was unacceptable to the receiver. I will refer to that condition in more detail later. The receiver declined the 922 offer and on March 8, 1991, accepted the OEL offer. Subsequently, 922 obtained an order allowing it to make a second offer. It then submitted an offer which was virtually identical to that of March 7, 1991, except that the unacceptable condition had been removed.

The proceedings before Rosenberg J. then followed. He approved the sale to OEL and dismissed a motion for the acceptance of the 922 offer. Before Rosenberg J., and in this court, both CCFL and the Royal Bank supported the acceptance of the second 922 offer.

There are only two issues which must be resolved in this appeal. They are:

(1) Did the receiver act properly when it entered into an agreement to sell Air Toronto to OEL?

(2) What effect does the support of the 922 offer by the secured creditors have on the result?

I will deal with the two issues separately.

I. DID THE RECEIVER ACT PROPERLY

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IN AGREEING TO SELL TO OEL?

Before dealing with that issue there are three general observations which I think I should make. The first is that the sale of an airline as a going concern is a very complex process. The best method of selling an airline at the best price is something far removed from the expertise of a court. When a court appoints a receiver to use its commercial expertise to sell an airline, it is inescapable that it intends to rely upon the receiver's expertise and not upon its own. Therefore, the court must place a great deal of confidence in the actions taken and in the opinions formed by the receiver. It should also assume that the receiver is acting properly unless the contrary is clearly shown. The second observation is that the court should be reluctant to second-guess, with the benefit of hindsight, the considered business decisions made by its receiver. The third observation which I wish to make is that the conduct of the receiver should be reviewed in the light of the specific mandate given to him by the court.

The order of O'Brien J. provided that if the receiver could not complete the sale to Air Canada that it was "to negotiate and sell Air Toronto to another person". The court did not say how the receiver was to negotiate the sale. It did not say it was to call for bids or conduct an auction. It told the receiver to negotiate and sell. It obviously intended, because of the unusual nature of the asset being sold, to leave the method of sale substantially in the discretion of the receiver. I think, therefore, that the court should not review minutely the process of the sale when, broadly speaking, it appears to the court to be a just process.

As did Rosenberg J., I adopt as correct the statement made by Anderson J. in Crown Trust Co. v. Rosenberg (1986), 60 O.R. (2d) 87, 39 D.L.R. (4th) 526 (H.C.J.), at pp. 92-94 O.R., pp. 531-33 D.L.R., of the duties which a court must perform when deciding whether a receiver who has sold a property acted properly. When he set out the court's duties, he did not put them in any order of priority, nor do I. I summarize those duties as follows:

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1. It should consider whether the receiver has made a sufficient effort to get the best price and has not acted improvidently.

2. It should consider the interests of all parties.

3. It should consider the efficacy and integrity of the process by which offers are obtained.

4. It should consider whether there has been unfairness in the working out of the process.

I intend to discuss the performance of those duties separately.

1. Did the receiver make a sufficient effort to get the best price and did it act providently?

Having regard to the fact that it was highly unlikely that a commercially viable sale could be made to anyone but the two national airlines, or to someone supported by either of them, it is my view that the receiver acted wisely and reasonably when it negotiated only with Air Canada and Canadian Airlines International. Furthermore, when Air Canada said that it would submit no further offers and gave the impression that it would not participate further in the receiver's efforts to sell, the only course reasonably open to the receiver was to negotiate with Canadian Airlines International. Realistically, there was nowhere else to go but to Canadian Airlines International. In doing so, it is my opinion that the receiver made sufficient efforts to sell the airline.

When the receiver got the OEL offer on March 6, 1991, it was over ten months since it had been charged with the responsibility of selling Air Toronto. Until then, the receiver had not received one offer which it thought was acceptable. After substantial efforts to sell the airline over that period, I find it difficult to think that the receiver acted improvidently in accepting the only acceptable offer which it had.

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On March 8, 1991, the date when the receiver accepted the OEL offer, it had only two offers, the OEL offer which was acceptable, and the 922 offer which contained an unacceptable condition. I cannot see how the receiver, assuming for the moment that the price was reasonable, could have done anything but accept the OEL offer.

When deciding whether a receiver had acted providently, the court should examine the conduct of the receiver in light of the information the receiver had when it agreed to accept an offer. In this case, the court should look at the receiver's conduct in the light of the information it had when it made its decision on March 8, 1991. The court should be very cautious before deciding that the receiver's conduct was improvident based upon information which has come to light after it made its decision. To do so, in my view, would derogate from the mandate to sell given to the receiver by the order of O'Brien J. I agree with and adopt what was said by Anderson J. in Crown Trust v. Rosenberg, supra, at p. 112 O.R., p. 551 D.L.R.:

> Its decision was made as a matter of business judgment on the elements then available to it. It is of the very essence of a receiver's function to make such judgments and in the making of them to act seriously and responsibly so as to be prepared to stand behind them.
>
> If the court were to reject the recommendation of the Receiver in any but the most exceptional circumstances, it would materially diminish and weaken the role and function of the Receiver both in the perception of receivers and in the perception of any others who might have occasion to deal with them. It would lead to the conclusion that the decision of the Receiver was of little weight and that the real decision was always made upon the motion for approval. That would be a consequence susceptible of immensely damaging results to the disposition of assets by court-appointed receivers.

(Emphasis added)

I also agree with and adopt what was said by Macdonald J.A.

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in Cameron v. Bank of Nova Scotia (1981), 38 C.B.R. (N.S.) 1, 45 N.S.R. (2d) 303 (C.A.), at p. 11 C.B.R., p. 314 N.S.R.:

> In my opinion if the decision of the receiver to enter into an agreement of sale, subject to court approval, with respect to certain assets is reasonable and sound under the circumstances at the time existing it should not be set aside simply because a later and higher bid is made. To do so would literally create chaos in the commercial world and receivers and purchasers would never be sure they had a binding agreement.

(Emphasis added)

On March 8, 1991, the receiver had two offers. One was the OEL offer which it considered satisfactory but which could be withdrawn by OEL at any time before it was accepted. The receiver also had the 922 offer which contained a condition that was totally unacceptable. It had no other offers. It was faced with the dilemma of whether it should decline to accept the OEL offer and run the risk of it being withdrawn, in the hope that an acceptable offer would be forthcoming from 922. An affidavit filed by the president of the receiver describes the dilemma which the receiver faced, and the judgment made in the light of that dilemma:

> 24. An asset purchase agreement was received by Ernst & Young on March 7, 1991 which was dated March 6, 1991. This agreement was received from CCFL in respect of their offer to purchase the assets and undertaking of Air Toronto. Apart from financial considerations, which will be considered in a subsequent affidavit, the Receiver determined that it would not be prudent to delay acceptance of the OEL agreement to negotiate a highly uncertain arrangement with Air Canada and CCFL. Air Canada had the benefit of an "exclusive" in negotiations for Air Toronto and had clearly indicated its intention to take itself out of the running while ensuring that no other party could seek to purchase Air Toronto and maintain the Air Canada connector arrangement vital to its survival. The CCFL offer represented a radical reversal of this position by Air Canada at the eleventh hour. However, it

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contained a significant number of conditions to closing which were entirely beyond the control of the Receiver. As well, the CCFL offer came less than 24 hours before signing of the agreement with OEL which had been negotiated over a period of months, at great time and expense.

(Emphasis added)

I am convinced that the decision made was a sound one in the circumstances faced by the receiver on March 8, 1991.

I now turn to consider whether the price contained in the OEL offer was one which it was provident to accept. At the outset, I think that the fact that the OEL offer was the only acceptable one available to the receiver on March 8, 1991, after ten months of trying to sell the airline, is strong evidence that the price in it was reasonable. In a deteriorating economy, I doubt that it would have been wise to wait any longer.

I mentioned earlier that, pursuant to an order, 922 was permitted to present a second offer. During the hearing of the appeal, counsel compared at great length the price contained in the second 922 offer with the price contained in the OEL offer. Counsel put forth various hypotheses supporting their contentions that one offer was better than the other.

It is my opinion that the price contained in the 922 offer is relevant only if it shows that the price obtained by the Receiver in the OEL offer was not a reasonable one. In Crown Trust v. Rosenberg, supra, Anderson J., at p. 113 O.R., p. 551 D.L.R., discussed the comparison of offers in the following way:

No doubt, as the cases have indicated, situations might arise where the disparity was so great as to call in question the adequacy of the mechanism which had produced the offers. It is not so here, and in my view that is substantially an end of the matter.

In two judgments, Saunders J. considered the circumstances in which an offer submitted after the receiver had agreed to a

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sale should be considered by the court. The first is Re Selkirk (1986), 58 C.B.R. (N.S.) 245 (Ont. Bkcy.), at p. 247:

> If, for example, in this case there had been a second offer of a substantially higher amount, then the court would have to take that offer into consideration in assessing whether the receiver had properly carried out his function of endeavouring to obtain the best price for the property.

The second is Re Beauty Counsellors of Canada Ltd. (1986), 58 C.B.R. (N.S.) 237 (Ont. Bkcy.), at p. 243:

> If a substantially higher bid turns up at the approval stage, the court should consider it. Such a bid may indicate, for example, that the trustee has not properly carried out its duty to endeavour to obtain the best price for the estate.

In Re Selkirk (1987), 64 C.B.R. (N.S.) 140 (Ont. Bkcy.), at p. 142, McRae J. expressed a similar view:

> The court will not lightly withhold approval of a sale by the receiver, particularly in a case such as this where the receiver is given rather wide discretionary authority as per the order of Mr. Justice Trainor and, of course, where the receiver is an officer of this court. Only in a case where there seems to be some unfairness in the process of the sale or where there are substantially higher offers which would tend to show that the sale was improvident will the court withhold approval. It is important that the court recognize the commercial exigencies that would flow if prospective purchasers are allowed to wait until the sale is in court for approval before submitting their final offer. This is something that must be discouraged.

(Emphasis added)

What those cases show is that the prices in other offers have relevance only if they show that the price contained in the offer accepted by the receiver was so unreasonably low as to demonstrate that the receiver was improvident in accepting it. I am of the opinion, therefore, that if they do not tend to

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show that the receiver was improvident, they should not be considered upon a motion to confirm a sale recommended by a court-appointed receiver. If they were, the process would be changed from a sale by a receiver, subject to court approval, into an auction conducted by the court at the time approval is sought. In my opinion, the latter course is unfair to the person who has entered bona fide into an agreement with the receiver, can only lead to chaos, and must be discouraged.

If, however, the subsequent offer is so substantially higher than the sale recommended by the receiver, then it may be that the receiver has not conducted the sale properly. In such circumstances, the court would be justified itself in entering into the sale process by considering competitive bids. However, I think that that process should be entered into only if the court is satisfied that the receiver has not properly conducted the sale which it has recommended to the court.

It is necessary to consider the two offers. Rosenberg J. held that the 922 offer was slightly better or marginally better than the OEL offer. He concluded that the difference in the two offers did not show that the sale process adopted by the receiver was inadequate or improvident.

Counsel for the appellants complained about the manner in which Rosenberg J. conducted the hearing of the motion to confirm the OEL sale. The complaint was, that when they began to discuss a comparison of the two offers, Rosenberg J. said that he considered the 922 offer to be better than the OEL offer. Counsel said that when that comment was made, they did not think it necessary to argue further the question of the difference in value between the two offers. They complain that the finding that the 922 offer was only marginally better or slightly better than the OEL offer was made without them having had the opportunity to argue that the 922 offer was substantially better or significantly better than the OEL offer. I cannot understand how counsel could have thought that by expressing the opinion that the 922 offer was better, Rosenberg J. was saying that it was a significantly or substantially better one. Nor can I comprehend how counsel took the comment to mean that they were foreclosed from arguing that

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the offer was significantly or substantially better. If there was some misunderstanding on the part of counsel, it should have been raised before Rosenberg J. at the time. I am sure that if it had been, the misunderstanding would have been cleared up quickly. Nevertheless, this court permitted extensive argument dealing with the comparison of the two offers.

The 922 offer provided for $6,000,000 cash to be paid on closing with a royalty based upon a percentage of Air Toronto profits over a period of five years up to a maximum of $3,000,000. The OEL offer provided for a payment of $2,000,000 on closing with a royalty paid on gross revenues over a five-year period. In the short term, the 922 offer is obviously better because there is substantially more cash up front. The chances of future returns are substantially greater in the OEL offer because royalties are paid on gross revenues while the royalties under the 922 offer are paid only on profits. There is an element of risk involved in each offer.

The receiver studied the two offers. It compared them and took into account the risks, the advantages and the disadvantages of each. It considered the appropriate contingencies. It is not necessary to outline the factors which were taken into account by the receiver because the manager of its insolvency practice filed an affidavit outlining the considerations which were weighed in its evaluation of the two offers. They seem to me to be reasonable ones. That affidavit concluded with the following paragraph:

> 24. On the basis of these considerations the Receiver has approved the OEL offer and has concluded that it represents the achievement of the highest possible value at this time for the Air Toronto division of SoundAir.

The court appointed the receiver to conduct the sale of Air Toronto and entrusted it with the responsibility of deciding what is the best offer. I put great weight upon the opinion of the receiver. It swore to the court which appointed it that the OEL offer represents the achievement of the highest possible value at this time for Air Toronto. I have not been convinced

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that the receiver was wrong when he made that assessment. I am, therefore, of the opinion that the 922 offer does not demonstrate any failure upon the part of the receiver to act properly and providently.

It follows that if Rosenberg J. was correct when he found that the 922 offer was in fact better, I agree with him that it could only have been slightly or marginally better. The 922 offer does not lead to an inference that the disposition strategy of the receiver was inadequate, unsuccessful or improvident, nor that the price was unreasonable.

I am, therefore, of the opinion that the receiver made a sufficient effort to get the best price and has not acted improvidently.

2. Consideration of the interests of all parties

It is well established that the primary interest is that of the creditors of the debtor: see Crown Trust Co. v. Rosenberg, supra, and Re Selkirk (1986, Saunders J.), supra. However, as Saunders J. pointed out in Re Beauty Counsellors, supra, at p. 244 C.B.R., "it is not the only or overriding consideration".

In my opinion, there are other persons whose interests require consideration. In an appropriate case, the interests of the debtor must be taken into account. I think also, in a case such as this, where a purchaser has bargained at some length and doubtless at considerable expense with the receiver, the interests of the purchaser ought to be taken into account. While it is not explicitly stated in such cases as Crown Trust Co. v. Rosenberg, supra, Re Selkirk (1986, Saunders J.), supra, Re Beauty Counsellors, supra, Re Selkirk (1987, McRae J.), supra, and Cameron, supra, I think they clearly imply that the interests of a person who has negotiated an agreement with a court-appointed receiver are very important.

In this case, the interests of all parties who would have an interest in the process were considered by the receiver and by Rosenberg J.

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3. Consideration of the efficacy and integrity of the process by which the offer was obtained

While it is accepted that the primary concern of a receiver is the protecting of the interests of the creditors, there is a secondary but very important consideration and that is the integrity of the process by which the sale is effected. This is particularly so in the case of a sale of such a unique asset as an airline as a going concern.

The importance of a court protecting the integrity of the process has been stated in a number of cases. First, I refer to Re Selkirk (1986), supra, where Saunders J. said at p. 246 C.B.R.:

> In dealing with the request for approval, the court has to be concerned primarily with protecting the interest of the creditors of the former bankrupt. A secondary but important consideration is that the process under which the sale agreement is arrived at should be consistent with commercial efficacy and integrity.
>
> In that connection I adopt the principles stated by Macdonald J.A. of the Nova Scotia Supreme Court (Appeal Division) in Cameron v. Bank of N.S. (1981), 38 C.B.R. (N.S.) 1, 45 N.S.R. (2d) 303, 86 A.P.R. 303 (C.A.), where he said at p. 11:
>
> In my opinion if the decision of the receiver to enter into an agreement of sale, subject to court approval, with respect to certain assets is reasonable and sound under the circumstances at the time existing it should not be set aside simply because a later and higher bid is made. To do so would literally create chaos in the commercial world and receivers and purchasers would never be sure they had a finding agreement. On the contrary, they would know that other bids could be received and considered up until the application for court approval is heard -- this would be an intolerable situation.

While those remarks may have been made in the context of a

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> bidding situation rather than a private sale, I consider them to be equally applicable to a negotiation process leading to a private sale. Where the court is concerned with the disposition of property, the purpose of appointing a receiver is to have the receiver do the work that the court would otherwise have to do.

In Salima Investments Ltd. v. Bank of Montreal (1985), 41 Alta. L.R. (2d) 58, 21 D.L.R. (4th) 473 (C.A.), at p. 61 Alta. L.R., p. 476 D.L.R., the Alberta Court of Appeal said that sale by tender is not necessarily the best way to sell a business as an ongoing concern. It went on to say that when some other method is used which is provident, the court should not undermine the process by refusing to confirm the sale.

Finally, I refer to the reasoning of Anderson J. in Crown Trust Co. v. Rosenberg, supra, at p. 124 O.R., pp. 562-63 D.L.R.:

> While every proper effort must always be made to assure maximum recovery consistent with the limitations inherent in the process, no method has yet been devised to entirely eliminate those limitations or to avoid their consequences. Certainly it is not to be found in loosening the entire foundation of the system. Thus to compare the results of the process in this case with what might have been recovered in some other set of circumstances is neither logical nor practical.

(Emphasis added)

It is my opinion that the court must exercise extreme caution before it interferes with the process adopted by a receiver to sell an unusual asset. It is important that prospective purchasers know that, if they are acting in good faith, bargain seriously with a receiver and enter into an agreement with it, a court will not lightly interfere with the commercial judgment of the receiver to sell the asset to them.

Before this court, counsel for those opposing the confirmation of the sale to OEL suggested many different ways

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in which the receiver could have conducted the process other than the way which he did. However, the evidence does not convince me that the receiver used an improper method of attempting to sell the airline. The answer to those submissions is found in the comment of Anderson J. in Crown Trust Co. v. Rosenberg, supra, at p. 109 O.R., p. 548 D.L.R.:

> The court ought not to sit as on appeal from the decision of the Receiver, reviewing in minute detail every element of the process by which the decision is reached. To do so would be a futile and duplicitous exercise.

It would be a futile and duplicitous exercise for this court to examine in minute detail all of the circumstances leading up to the acceptance of the OEL offer. Having considered the process adopted by the receiver, it is my opinion that the process adopted was a reasonable and prudent one.

4. Was there unfairness in the process?

As a general rule, I do not think it appropriate for the court to go into the minutia of the process or of the selling strategy adopted by the receiver. However, the court has a responsibility to decide whether the process was fair. The only part of this process which I could find that might give even a superficial impression of unfairness is the failure of the receiver to give an offering memorandum to those who expressed an interest in the purchase of Air Toronto.

I will outline the circumstances which relate to the allegation that the receiver was unfair in failing to provide an offering memorandum. In the latter part of 1990, as part of its selling strategy, the receiver was in the process of preparing an offering memorandum to give to persons who expressed an interest in the purchase of Air Toronto. The offering memorandum got as far as draft form, but was never released to anyone, although a copy of the draft eventually got into the hands of CCFL before it submitted the first 922 offer on March 7, 1991. A copy of the offering memorandum forms part of the record and it seems to me to be little more than puffery, without any hard information which a sophisticated

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purchaser would require in order to make a serious bid.

The offering memorandum had not been completed by February 11, 1991. On that date, the receiver entered into the letter of intent to negotiate with OEL. The letter of intent contained a provision that during its currency the receiver would not negotiate with any other party. The letter of intent was renewed from time to time until the OEL offer was received on March 6, 1991.

The receiver did not proceed with the offering memorandum because to do so would violate the spirit, if not the letter, of its letter of intent with OEL.

I do not think that the conduct of the receiver shows any unfairness towards 922. When I speak of 922, I do so in the context that Air Canada and CCFL are identified with it. I start by saying that the receiver acted reasonably when it entered into exclusive negotiations with OEL. I find it strange that a company, with which Air Canada is closely and intimately involved, would say that it was unfair for the receiver to enter into a time-limited agreement to negotiate exclusively with OEL. That is precisely the arrangement which Air Canada insisted upon when it negotiated with the receiver in the spring and summer of 1990. If it was not unfair for Air Canada to have such an agreement, I do not understand why it was unfair for OEL to have a similar one. In fact, both Air Canada and OEL in its turn were acting reasonably when they required exclusive negotiating rights to prevent their negotiations from being used as a bargaining lever with other potential purchasers. The fact that Air Canada insisted upon an exclusive negotiating right while it was negotiating with the receiver demonstrates the commercial efficacy of OEL being given the same right during its negotiations with the receiver. I see no unfairness on the part of the receiver when it honoured its letter of intent with OEL by not releasing the offering memorandum during the negotiations with OEL.

Moreover, I am not prepared top find that 922 was in any way prejudiced by the fact that it did not have an offering memorandum. It made an offer on March 7, 1991, which it

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contends to this day was a better offer than that of OEL. 922 has not convinced me that if it had an offering memorandum its offer would have been any different or any better than it actually was. The fatal problem with the first 922 offer was that it contained a condition which was completely unacceptable to the receiver. The receiver properly, in my opinion, rejected the offer out of hand because of that condition. That condition did not relate to any information which could have conceivably been in an offering memorandum prepared by the receiver. It was about the resolution of a dispute between CCFL and the Royal Bank, something the receiver knew nothing about.

Further evidence of the lack of prejudice which the absence of an offering memorandum has caused 922 is found in CCFL's stance before this court. During argument, its counsel suggested, as a possible resolution of this appeal, that this court should call for new bids, evaluate them and then order a sale to the party who put in the better bid. In such a case, counsel for CCFL said that 922 would be prepared to bid within seven days of the court's decision. I would have thought that, if there were anything to CCFL's suggestion that the failure to provide an offering memorandum was unfair to 922, it would have told the court that it needed more information before it would be able to make a bid.

I am satisfied that Air Canada and CCFL have, and at all times had, all of the information which they would have needed to make what to them would be a commercially viable offer to the receiver. I think that an offering memorandum was of no commercial consequence to them, but the absence of one has since become a valuable tactical weapon.

It is my opinion that there is no convincing proof that if an offering memorandum had been widely distributed among persons qualified to have purchased Air Toronto, a viable offer would have come forth from a party other than 922 or OEL. Therefore, the failure to provide an offering memorandum was neither unfair nor did it prejudice the obtaining of a better price on March 8, 1991, than that contained in the OEL offer. I would not give effect to the contention that the process adopted by the receiver was an unfair one.

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There are two statements by Anderson J. contained in Crown Trust Co. v. Rosenberg, supra, which I adopt as my own. The first is at p. 109 O.R., p. 548 D.L.R.:

> The court should not proceed against the recommendations of its Receiver except in special circumstances and where the necessity and propriety of doing so are plain. Any other rule or approach would emasculate the role of the Receiver and make it almost inevitable that the final negotiation of every sale would take place on the motion for approval.

The second is at p. 111 O.R., p. 550 D.L.R.:

> It is equally clear, in my view, though perhaps not so clearly enunciated, that it is only in an exceptional case that the court will intervene and proceed contrary to the Receiver's recommendations if satisfied, as I am, that the Receiver has acted reasonably, prudently and fairly and not arbitrarily.

In this case the receiver acted reasonably, prudently, fairly and not arbitrarily. I am of the opinion, therefore, that the process adopted by the receiver in reaching an agreement was a just one.

In his reasons for judgment, after discussing the circumstances leading to the 922 offer, Rosenberg J. said this [at p. 31 of the reasons]:

> They created a situation as of March 8, where the receiver was faced with two offers, one of which was in acceptable form and one of which could not possibly be accepted in its present form. The receiver acted appropriately in accepting the OEL offer.

I agree.

The receiver made proper and sufficient efforts to get the best price that it could for the assets of Air Toronto. It adopted a reasonable and effective process to sell the airline

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which was fair to all persons who might be interested in purchasing it. It is my opinion, therefore, that the receiver properly carried out the mandate which was given to it by the order of O'Brien J. It follows that Rosenberg J. was correct when he confirmed the sale to OEL.

II. THE EFFECT OF THE SUPPORT OF THE 922 OFFER BY THE TWO SECURED CREDITORS

As I noted earlier, the 922 offer was supported before Rosenberg J., and in this court, by CCFL and by the Royal Bank, the two secured creditors. It was argued that, because the interests of the creditors are primary, the court ought to give effect to their wish that the 922 offer be accepted. I would not accede to that suggestion for two reasons.

The first reason is related to the fact that the creditors chose to have a receiver appointed by the court. It was open to them to appoint a private receiver pursuant to the authority of their security documents. Had they done so, then they would have had control of the process and could have sold Air Toronto to whom they wished. However, acting privately and controlling the process involves some risks. The appointment of a receiver by the court insulates the creditors from those risks. But insulation from those risks carries with it the loss of control over the process of disposition of the assets. As I have attempted to explain in these reasons, when a receiver's sale is before the court for confirmation the only issues are the propriety of the conduct of the receiver and whether it acted providently. The function of the court at that stage is not to step in and do the receiver's work or change the sale strategy adopted by the receiver. Creditors who asked the court to appoint a receiver to dispose of assets should not be allowed to take over control of the process by the simple expedient of supporting another purchaser if they do not agree with the sale made by the receiver. That would take away all respect for the process of sale by a court-appointed receiver.

There can be no doubt that the interests of the creditor are an important consideration in determining whether the receiver has properly conducted a sale. The opinion of the creditors as

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to which offer ought to be accepted is something to be taken into account. But, if the court decides that the receiver has acted properly and providently, those views are not necessarily determinative. Because, in this case, the receiver acted properly and providently, I do not think that the views of the creditors should override the considered judgment of the receiver.

The second reason is that, in the particular circumstances of this case, I do not think the support of CCFL and the Royal Bank of the 922 offer is entitled to any weight. The support given by CCFL can be dealt with summarily. It is a co-owner of 922. It is hardly surprising and not very impressive to hear that it supports the offer which it is making for the debtors' assets.

The support by the Royal Bank requires more consideration and involves some reference to the circumstances. On March 6, 1991, when the first 922 offer was made, there was in existence an interlender agreement between the Royal Bank and CCFL. That agreement dealt with the share of the proceeds of the sale of Air Toronto which each creditor would receive. At the time, a dispute between the Royal Bank and CCFL about the interpretation of that agreement was pending in the courts. The unacceptable condition in the first 922 offer related to the settlement of the interlender dispute. The condition required that the dispute be resolved in a way which would substantially favour CCFL. It required that CCFL receive $3,375,000 of the $6,000,000 cash payment and the balance, including the royalties, if any, be paid to the Royal Bank. The Royal Bank did not agree with that split of the sale proceeds.

On April 5, 1991, the Royal Bank and CCFL agreed to settle the interlender dispute. The settlement was that if the 922 offer was accepted by the court, CCFL would receive only $1,000,000 and the Royal Bank would receive $5,000,000 plus any royalties which might be paid. It was only in consideration of that settlement that the Royal Bank agreed to support the 922 offer.

The Royal Bank's support of the 922 offer is so affected by

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the very substantial benefit which it wanted to obtain from the settlement of the interlender dispute that, in my opinion, its support is devoid of any objectivity. I think it has no weight.

While there may be circumstances where the unanimous support by the creditors of a particular offer could conceivably override the proper and provident conduct of a sale by a receiver, I do not think that this is such a case. This is a case where the receiver has acted properly and in a provident way. It would make a mockery out of the judicial process, under which a mandate was given to this receiver to sell this airline, if the support by these creditors of the 922 offer were permitted to carry the day. I give no weight to the support which they give to the 922 offer.

In its factum, the receiver pointed out that, because of greater liabilities imposed upon private receivers by various statutes such as the Employment Standards Act, R.S.O. 1980, c. 137, and the Environmental Protection Act, R.S.O. 1980, c. 141, it is likely that more and more the courts will be asked to appoint receivers in insolvencies. In those circumstances, I think that creditors who ask for court-appointed receivers and business people who choose to deal with those receivers should know that if those receivers act properly and providently their decisions and judgments will be given great weight by the courts who appoint them. I have decided this appeal in the way I have in order to assure business people who deal with court-appointed receivers that they can have confidence that an agreement which they make with a court-appointed receiver will be far more than a platform upon which others may bargain at the court approval stage. I think that persons who enter into agreements with court-appointed receivers, following a disposition procedure that is appropriate given the nature of the assets involved, should expect that their bargain will be confirmed by the court.

The process is very important. It should be carefully protected so that the ability of court-appointed receivers to negotiate the best price possible is strengthened and supported. Because this receiver acted properly and providently in entering into the OEL agreement, I am of the opinion that

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Rosenberg J. was right when he approved the sale to OEL and dismissed the motion to approve the 922 offer.

I would, accordingly, dismiss the appeal. I would award the receiver, OEL and Frontier Airlines Limited their costs out of the Soundair estate, those of the receiver on a solicitor-and-client scale. I would make no order as to the costs of any of the other parties or interveners.

MCKINLAY J.A. (concurring in the result):-- I agree with Galligan J.A. in result, but wish to emphasize that I do so on the basis that the undertaking being sold in this case was of a very special and unusual nature. It is most important that the integrity of procedures followed by court-appointed receivers be protected in the interests of both commercial morality and the future confidence of business persons in their dealings with receivers. Consequently, in all cases, the court should carefully scrutinize the procedure followed by the receiver to determine whether it satisfies the tests set out by Anderson J. in Crown Trust Co. v. Rosenberg (1986), 60 O.R. (2d) 87, 39 D.L.R. (4th) 526 (H.C.J.). While the procedure carried out by the receiver in this case, as described by Galligan J.A., was appropriate, given the unfolding of events and the unique nature of the assets involved, it is not a procedure that is likely to be appropriate in many receivership sales.

I should like to add that where there is a small number of creditors who are the only parties with a real interest in the proceeds of the sale (i.e., where it is clear that the highest price attainable would result in recovery so low that no other creditors, shareholders, guarantors, etc., could possibly benefit therefrom), the wishes of the interested creditors should be very seriously considered by the receiver. It is true, as Galligan J.A. points out, that in seeking the court appointment of a receiver, the moving parties also seek the protection of the court in carrying out the receiver's functions. However, it is also true that in utilizing the court process the moving parties have opened the whole process to detailed scrutiny by all involved, and have probably added significantly to their costs and consequent shortfall as a result of so doing. The adoption of the court process should in

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no way diminish the rights of any party, and most certainly not the rights of the only parties with a real interest. Where a receiver asks for court approval of a sale which is opposed by the only parties in interest, the court should scrutinize with great care the procedure followed by the receiver. I agree with Galligan J.A. that in this case that was done. I am satisfied that the rights of all parties were properly considered by the receiver, by the learned motions court judge, and by Galligan J.A.

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GOODMAN J.A. (dissenting):-- I have had the opportunity of reading the reasons for judgment herein of Galligan and McKinlay JJ.A. Respectfully, I am unable to agree with their conclusion.

The case at bar is an exceptional one in the sense that upon the application made for approval of the sale of the assets of Air Toronto two competing offers were placed before Rosenberg J. Those two offers were that of Frontier Airlines Ltd. and Ontario Express Limited (OEL) and that of 922246 Ontario Limited (922), a company incorporated for the purpose of acquiring Air Toronto. Its shares were owned equally by Canadian Pension Capital Limited and Canadian Insurers Capital Corporation (collectively CCFL) and Air Canada. It was conceded by all parties to these proceedings that the only persons who had any interest in the proceeds of the sale were two secured creditors, viz., CCFL and the Royal Bank of Canada (the Bank). Those two creditors were unanimous in their position that they desired the court to approve the sale to 922. We were not referred to nor am I aware of any case where a court has refused to abide by the unanimous wishes of the only interested creditors for the approval of a specific offer made in receivership proceedings.

In British Columbia Development Corp. v. Spun Cast Industries Inc. (1977), 5 B.C.L.R. 94, 26 C.B.R. (N.S.) 28 (S.C.), Berger J. said at p. 95 B.C.L.R., p. 30 C.B.R.:

> Here all of those with a financial stake in the plant have joined in seeking the court's approval of the sale to Fincas. This court does not having a roving commission to decide what

is best for investors and businessmen when they have agreed among themselves what course of action they should follow. It is their money.

I agree with that statement. It is particularly apt to this case. The two secured creditors will suffer a shortfall of approximately $50,000,000. They have a tremendous interest in the sale of assets which form part of their security. I agree with the finding of Rosenberg J., Gen. Div., May 1, 1991, that the offer of 922 is superior to that of OEL. He concluded that the 922 offer is marginally superior. If by that he meant that mathematically it was likely to provide slightly more in the way of proceeds it is difficult to take issue with that finding. If on the other hand he meant that having regard to all considerations it was only marginally superior, I cannot agree. He said in his reasons [pp. 17-18]:

I have come to the conclusion that knowledgeable creditors such as the Royal Bank would prefer the 922 offer even if the other factors influencing their decision were not present. No matter what adjustments had to be made, the 922 offer results in more cash immediately. Creditors facing the type of loss the Royal Bank is taking in this case would not be anxious to rely on contingencies especially in the present circumstances surrounding the airline industry.

I agree with that statement completely. It is apparent that the difference between the two offers insofar as cash on closing is concerned amounts to approximately $3,000,000 to $4,000,000. The Bank submitted that it did not wish to gamble any further with respect to its investment and that the acceptance and court approval of the OEL offer, in effect, supplanted its position as a secured creditor with respect to the amount owing over and above the down payment and placed it in the position of a joint entrepreneur but one with no control. This results from the fact that the OEL offer did not provide for any security for any funds which might be forthcoming over and above the initial downpayment on closing.

In Cameron v. Bank of Nova Scotia (1981), 38 C.B.R. (N.S.) 1, 45 N.S.R. (2d) 303 (C.A.), Hart J.A., speaking for the majority

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of the court, said at p. 10 C.B.R., p. 312 N.S.R.:

> Here we are dealing with a receiver appointed at the instance of one major creditor, who chose to insert in the contract of sale a provision making it subject to the approval of the court. This, in my opinion, shows an intention on behalf of the parties to invoke the normal equitable doctrines which place the court in the position of looking to the interests of all persons concerned before giving its blessing to a particular transaction submitted for approval. In these circumstances the court would not consider itself bound by the contract entered into in good faith by the receiver but would have to look to the broader picture to see that the contract was for the benefit of the creditors as a whole. When there was evidence that a higher price was readily available for the property the chambers judge was, in my opinion, justified in exercising his discretion as he did. Otherwise he could have deprived the creditors of a substantial sum of money.

This statement is apposite to the circumstances of the case at bar. I hasten to add that in my opinion it is not only price which is to be considered in the exercise of the judge's discretion. It may very well be, as I believe to be so in this case, that the amount of cash is the most important element in determining which of the two offers is for the benefit and in the best interest of the creditors.

It is my view, and the statement of Hart J.A. is consistent therewith, that the fact that a creditor has requested an order of the court appointing a receiver does not in any way diminish or derogate from his right to obtain the maximum benefit to be derived from any disposition of the debtor's assets. I agree completely with the views expressed by McKinlay J.A. in that regard in her reasons.

It is my further view that any negotiations which took place between the only two interested creditors in deciding to support the approval of the 922 offer were not relevant to the determination by the presiding judge of the issues involved in the motion for approval of either one of the two offers nor are

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they relevant in determining the outcome of this appeal. It is sufficient that the two creditors have decided unanimously what is in their best interest and the appeal must be considered in the light of that decision. It so happens, however, that there is ample evidence to support their conclusion that the approval of the 922 offer is in their best interests.

I am satisfied that the interests of the creditors are the prime consideration for both the receiver and the court. In Re Beauty Counsellors of Canada Ltd. (1986), 58 C.B.R. (N.S.) 237 (Ont. Bkcy.) Saunders J. said at p. 243:

> This does not mean that a court should ignore a new and higher bid made after acceptance where there has been no unfairness in the process. The interests of the creditors, while not the only consideration, are the prime consideration.

I agree with that statement of the law. In Re Selkirk (1986), 58 C.B.R. (N.S.) 245 (Ont. Bkcy.) Saunders J. heard an application for court approval for the sale by the sheriff of real property in bankruptcy proceedings. The sheriff had been previously ordered to list the property for sale subject to approval of the court. Saunders J. said at p. 246 C.B.R.:

> In dealing with the request for approval, the court has to be concerned primarily with protecting the interests of the creditors of the former bankrupt. A secondary but important consideration is that the process under which the sale agreement is arrived at should be consistent with the commercial efficacy and integrity.

I am in agreement with that statement as a matter of general principle. Saunders J. further stated that he adopted the principles stated by Macdonald J.A. in Cameron, supra, at pp. 92-94 O.R., pp. 531-33 D.L.R., quoted by Galligan J.A. in his reasons. In Cameron, the remarks of Macdonald J.A. related to situations involving the calling of bids and fixing a time limit for the making of such bids. In those circumstances the process is so clear as a matter of commercial practice that an interference by the court in such process might have a

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deleterious effect on the efficacy of receivership proceedings in other cases. But Macdonald J.A. recognized that even in bid or tender cases where the offeror for whose bid approval is sought has complied with all requirements a court might not approve the agreement of purchase and sale entered into by the receiver. He said at pp. 11-12 C.B.R., p. 314 N.S.R.:

> There are, of course, many reasons why a court might not approve an agreement of purchase and sale, viz., where the offer accepted is so low in relation to the appraised value as to be unrealistic; or, where the circumstances indicate that insufficient time was allowed for the making of bids or that inadequate notice of sale by bid was given (where the receiver sells property by the bid method); or, where it can be said that the proposed sale is not in the best interest of either the creditors or the owner. Court approval must involve the delicate balancing of competing interests and not simply a consideration of the interests of the creditors.

The deficiency in the present case is so large that there has been no suggestion of a competing interest between the owner and the creditors.

I agree that the same reasoning may apply to a negotiation process leading to a private sale but the procedure and process applicable to private sales of a wide variety of businesses and undertakings with the multiplicity of individual considerations applicable and perhaps peculiar to the particular business is not so clearly established that a departure by the court from the process adopted by the receiver in a particular case will result in commercial chaos to the detriment of future receivership proceedings. Each case must be decided on its own merits and it is necessary to consider the process used by the receiver in the present proceedings and to determine whether it was unfair, improvident or inadequate.

It is important to note at the outset that Rosenberg J. made the following statement in his reasons [p. 15]:

> On March 8, 1991 the trustee accepted the OEL offer subject to court approval. The receiver at that time had no other

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offer before it that was in final form or could possibly be accepted. The receiver had at the time the knowledge that Air Canada with CCFL had not bargained in good faith and had not fulfilled the promise of its letter of March 1. The receiver was justified in assuming that Air Canada and CCFL's offer was a long way from being in an acceptable form and that Air Canada and CCFL's objective was to interrupt the finalizing of the OEL agreement and to retain as long as possible the Air Toronto connector traffic flowing into Terminal 2 for the benefit of Air Canada.

In my opinion there was no evidence before him or before this court to indicate that Air Canada with CCFL had not bargained in good faith and that the receiver had knowledge of such lack of good faith. Indeed, on this appeal, counsel for the receiver stated that he was not alleging Air Canada and CCFL had not bargained in good faith. Air Canada had frankly stated at the time that it had made its offer to purchase which was eventually refused by the receiver that it would not become involved in an "auction" to purchase the undertaking of Air Canada and that, although it would fulfil its contractual obligations to provide connecting services to Air Toronto, it would do no more than it was legally required to do insofar as facilitating the purchase of Air Toronto by any other person. In so doing Air Canada may have been playing "hard ball" as its behaviour was characterized by some of the counsel for opposing parties. It was nevertheless merely openly asserting its legal position as it was entitled to do.

Furthermore there was no evidence before Rosenberg J. or this court that the receiver had assumed that Air Canada and CCFL's objective in making an offer was to interrupt the finalizing of the OEL agreement and to retain as long as possible the Air Toronto connector traffic flowing into Terminal 2 for the benefit of Air Canada. Indeed, there was no evidence to support such an assumption in any event although it is clear that 922 and through it CCFL and Air Canada were endeavouring to present an offer to purchase which would be accepted and/or approved by the court in preference to the offer made by OEL.

To the extent that approval of the OEL agreement by Rosenberg

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J. was based on the alleged lack of good faith in bargaining and improper motivation with respect to connector traffic on the part of Air Canada and CCFL, it cannot be supported.

I would also point out that, rather than saying there was no other offer before it that was final in form, it would have been more accurate to have said that there was no unconditional offer before it.

In considering the material and evidence placed before the court I am satisfied that the receiver was at all times acting in good faith. I have reached the conclusion, however, that the process which he used was unfair insofar as 922 is concerned and improvident insofar as the two secured creditors are concerned.

Air Canada had been negotiating with Soundair Corporation for the purchase from it of Air Toronto for a considerable period of time prior to the appointment of a receiver by the court. It had given a letter of intent indicating a prospective sale price of $18,000,000. After the appointment of the receiver, by agreement dated April 30, 1990, Air Canada continued its negotiations for the purchase of Air Toronto with the receiver. Although this agreement contained a clause which provided that the receiver "shall not negotiate for the sale ... of Air Toronto with any person except Air Canada", it further provided that the receiver would not be in breach of that provision merely by receiving unsolicited offers for all or any of the assets of Air Toronto. In addition, the agreement, which had a term commencing on April 30, 1990, could be terminated on the fifth business day following the delivery of a written notice of termination by one party to the other. I point out this provision merely to indicate that the exclusivity privilege extended by the Receiver to Air Canada was of short duration at the receiver's option.

As a result of due diligence investigations carried out by Air Canada during the month of April, May and June of 1990, Air Canada reduced its offer to 8.1 million dollars conditional upon there being $4,000,000 in tangible assets. The offer was made on June 14, 1990 and was open for acceptance until June

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29, 1990.

By amending agreement dated June 19, 1990 the receiver was released from its covenant to refrain from negotiating for the sale of the Air Toronto business and assets to any person other than Air Canada. By virtue of this amending agreement the receiver had put itself in the position of having a firm offer in hand with the right to negotiate and accept offers from other persons. Air Canada in these circumstances was in the subservient position. The receiver, in the exercise of its judgment and discretion, allowed the Air Canada offer to lapse. On July 20, 1990 Air Canada served a notice of termination of the April 30, 1990 agreement.

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Apparently as a result of advice received from the receiver to the effect that the receiver intended to conduct an auction for the sale of the assets and business of the Air Toronto Division of Soundair Corporation, the solicitors for Air Canada advised the receiver by letter dated July 20, 1990 in part as follows:

> Air Canada has instructed us to advise you that it does not intend to submit a further offer in the auction process.

This statement together with other statements set forth in the letter was sufficient to indicate that Air Canada was not interested in purchasing Air Toronto in the process apparently contemplated by the receiver at that time. It did not form a proper foundation for the receiver to conclude that there was no realistic possibility of selling Air Toronto to Air Canada, either alone or in conjunction with some other person, in different circumstances. In June 1990 the receiver was of the opinion that the fair value of Air Toronto was between $10,000,000 and $12,000,000.

In August 1990 the receiver contacted a number of interested parties. A number of offers were received which were not deemed to be satisfactory. One such offer, received on August 20, 1990, came as a joint offer from OEL and Air Ontario (an Air Canada connector). It was for the sum of $3,000,000 for the good will relating to certain Air Toronto routes but did not

include the purchase of any tangible assets or leasehold interests.

In December 1990 the receiver was approached by the management of Canadian Partner (operated by OEL) for the purpose of evaluating the benefits of an amalgamated Air Toronto/Air Partner operation. The negotiations continued from December of 1990 to February of 1991 culminating in the OEL agreement dated March 8, 1991.

On or before December, 1990, CCFL advised the receiver that it intended to make a bid for the Air Toronto assets. The receiver, in August of 1990, for the purpose of facilitating the sale of Air Toronto assets, commenced the preparation of an operating memorandum. He prepared no less than six draft operating memoranda with dates from October 1990 through March 1, 1991. None of these were distributed to any prospective bidder despite requests having been received therefor, with the exception of an early draft provided to CCFL without the receiver's knowledge.

During the period December 1990 to the end of January 1991, the receiver advised CCFL that the offering memorandum was in the process of being prepared and would be ready soon for distribution. He further advised CCFL that it should await the receipt of the memorandum before submitting a formal offer to purchase the Air Toronto assets.

By late January CCFL had become aware that the receiver was negotiating with OEL for the sale of Air Toronto. In fact, on February 11, 1991, the receiver signed a letter of intent with OEL wherein it had specifically agreed not to negotiate with any other potential bidders or solicit any offers from others.

By letter dated February 25, 1991, the solicitors for CCFL made a written request to the Receiver for the offering memorandum. The receiver did not reply to the letter because he felt he was precluded from so doing by the provisions of the letter of intent dated February 11, 1991. Other prospective purchasers were also unsuccessful in obtaining the promised memorandum to assist them in preparing their bids. It should be

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noted that exclusivity provision of the letter of intent expired on February 20, 1991. This provision was extended on three occasions, viz., February 19, 22 and March 5, 1991. It is clear that from a legal standpoint the receiver, by refusing to extend the time, could have dealt with other prospective purchasers and specifically with 922.

It was not until March 1, 1991 that CCFL had obtained sufficient information to enable it to make a bid through 922. It succeeded in so doing through its own efforts through sources other than the receiver. By that time the receiver had already entered into the letter of intent with OEL. Notwithstanding the fact that the receiver knew since December of 1990 that CCFL wished to make a bid for the assets of Air Toronto (and there is no evidence to suggest that at any time such a bid would be in conjunction with Air Canada or that Air Canada was in any way connected with CCFL) it took no steps to provide CCFL with information necessary to enable it to make an intelligent bid and, indeed, suggested delaying the making of the bid until an offering memorandum had been prepared and provided. In the meantime by entering into the letter of intent with OEL it put itself in a position where it could not negotiate with CCFL or provide the information requested.

On February 28, 1991, the solicitors for CCFL telephoned the receiver and were advised for the first time that the receiver had made a business decision to negotiate solely with OEL and would not negotiate with anyone else in the interim.

By letter dated March 1, 1991 CCFL advised the receiver that it intended to submit a bid. It set forth the essential terms of the bid and stated that it would be subject to customary commercial provisions. On March 7, 1991 CCFL and Air Canada, jointly through 922, submitted an offer to purchase Air Toronto upon the terms set forth in the letter dated March 1, 1991. It included a provision that the offer was conditional upon the interpretation of an interlender agreement which set out the relative distribution of proceeds as between CCFL and the Royal Bank. It is common ground that it was a condition over which the receiver had no control and accordingly would not have been acceptable on that ground alone. The receiver did not, however,

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contact CCFL in order to negotiate or request the removal of the condition although it appears that its agreement with OEL not to negotiate with any person other than OEL expired on March 6, 1991.

The fact of the matter is that by March 7, 1991, the receiver had received the offer from OEL which was subsequently approved by Rosenberg J. That offer was accepted by the receiver on March 8, 1991. Notwithstanding the fact that OEL had been negotiating the purchase for a period of approximately three months the offer contained a provision for the sole benefit of the purchaser that it was subject to the purchaser obtaining:

> ... a financing commitment within 45 days of the date hereof in an amount not less than the Purchase Price from the Royal Bank of Canada or other financial institution upon terms and conditions acceptable to them. In the event that such a financing commitment is not obtained within such 45 day period, the purchaser or OEL shall have the right to terminate this agreement upon giving written notice of termination to the vendor on the first Business Day following the expiry of the said period.

The purchaser was also given the right to waive the condition.

In effect the agreement was tantamount to a 45-day option to purchase excluding the right of any other person to purchase Air Toronto during that period of time and thereafter if the condition was fulfilled or waived. The agreement was, of course, stated to be subject to court approval.

In my opinion the process and procedure adopted by the receiver was unfair to CCFL. Although it was aware from December 1990 that CCFL was interested in making an offer, it effectively delayed the making of such offer by continually referring to the preparation of the offering memorandum. It did not endeavour during the period December 1990 to March 7, 1991 to negotiate with CCFL in any way the possible terms of purchase and sale agreement. In the result no offer was sought from CCFL by the receiver prior to February 11, 1991 and thereafter it put itself in the position of being unable to

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negotiate with anyone other than OEL. The receiver, then, on March 8, 1991 chose to accept an offer which was conditional in nature without prior consultation with CCFL (922) to see whether it was prepared to remove the condition in its offer.

I do not doubt that the receiver felt that it was more likely that the condition in the OEL offer would be fulfilled than the condition in the 922 offer. It may be that the receiver, having negotiated for a period of three months with OEL, was fearful that it might lose the offer if OEL discovered that it was negotiating with another person. Nevertheless it seems to me that it was imprudent and unfair on the part of the receiver to ignore an offer from an interested party which offered approximately triple the cash down payment without giving a chance to the offeror to remove the conditions or other terms which made the offer unacceptable to it. The potential loss was that of an agreement which amounted to little more than an option in favour of the offeror.

In my opinion the procedure adopted by the receiver was unfair to CCFL in that, in effect, it gave OEL the opportunity of engaging in exclusive negotiations for a period of three months notwithstanding the fact that it knew CCFL was interested in making an offer. The receiver did not indicate a deadline by which offers were to be submitted and it did not at any time indicate the structure or nature of an offer which might be acceptable to it.

In his reasons Rosenberg J. stated that as of March 1, CCFL and Air Canada had all the information that they needed and any allegations of unfairness in the negotiating process by the receiver had disappeared. He said [p. 31]:

> They created a situation as of March 8, where the receiver was faced with two offers, one of which was in acceptable form and one of which could not possibly be accepted in its present form. The receiver acted appropriately in accepting the OEL offer.

If he meant by "acceptable in form" that it was acceptable to the receiver, then obviously OEL had the unfair advantage of

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its lengthy negotiations with the receiver to ascertain what kind of an offer would be acceptable to the receiver. If, on the other hand, he meant that the 922 offer was unacceptable in its form because it was conditional, it can hardly be said that the OEL offer was more acceptable in this regard as it contained a condition with respect to financing terms and conditions "acceptable to them".

It should be noted that on March 13, 1991 the representatives of 922 first met with the receiver to review its offer of March 7, 1991 and at the request of the receiver withdrew the inter-lender condition from its offer. On March 14, 1991 OEL removed the financing condition from its offer. By order of Rosenberg J. dated March 26, 1991, CCFL was given until April 5, 1991 to submit a bid and on April 5, 1991, 922 submitted its offer with the interlender condition removed.

In my opinion the offer accepted by the receiver is improvident and unfair insofar as the two creditors are concerned. It is not improvident in the sense that the price offered by 922 greatly exceeded that offered by OEL. In the final analysis it may not be greater at all. The salient fact is that the cash down payment in the 922 offer constitutes approximately two-thirds of the contemplated sale price whereas the cash down payment in the OEL transaction constitutes approximately 20 to 25 per cent of the contemplated sale price. In terms of absolute dollars, the down payment in the 922 offer would likely exceed that provided for in the OEL agreement by approximately $3,000,000 to $4,000,000.

In Re Beauty Counsellors of Canada Ltd., supra, Saunders J. said at p. 243 C.B.R.:

> If a substantially higher bid turns up at the approval stage, the court should consider it. Such a bid may indicate, for example, that the trustee has not properly carried out its duty to endeavour to obtain the best price for the estate. In such a case the proper course might be to refuse approval and to ask the trustee to recommence the process.

I accept that statement as being an accurate statement of the

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law. I would add, however, as previously indicated, that in determining what is the best price for the estate the receiver or court should not limit its consideration to which offer provides for the greater sale price. The amount of down payment and the provision or lack thereof to secure payment of the balance of the purchase price over and above the down payment may be the most important factor to be considered and I am of the view that is so in the present case. It is clear that that was the view of the only creditors who can benefit from the sale of Air Toronto.

I note that in the case at bar the 922 offer in conditional form was presented to the receiver before it accepted the OEL offer. The receiver in good faith, although I believe mistakenly, decided that the OEL offer was the better offer. At that time the receiver did not have the benefit of the views of the two secured creditors in that regard. At the time of the application for approval before Rosenberg J. the stated preference of the two interested creditors was made quite clear. He found as a fact that knowledgeable creditors would not be anxious to rely on contingencies in the present circumstances surrounding the airline industry. It is reasonable to expect that a receiver would be no less knowledgeable in that regard and it is his primary duty to protect the interests of the creditors. In my view it was an improvident act on the part of the receiver to have accepted the conditional offer made by OEL and Rosenberg J. erred in failing to dismiss the application of the receiver for approval of the OEL offer. It would be most inequitable to foist upon the two creditors who have already been seriously hurt more unnecessary contingencies.

Although in other circumstances it might be appropriate to ask the receiver to recommence the process, in my opinion, it would not be appropriate to do so in this case. The only two interested creditors support the acceptance of the 922 offer and the court should so order.

Although I would be prepared to dispose of the case on the grounds stated above, some comment should be addressed to the question of interference by the court with the process and

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procedure adopted by the receiver.

I am in agreement with the view expressed by McKinlay J.A. in her reasons that the undertaking being sold in this case was of a very special and unusual nature. As a result the procedure adopted by the receiver was somewhat unusual. At the outset, in accordance with the terms of the receiving order, it dealt solely with Air Canada. It then appears that the receiver contemplated a sale of the assets by way of auction and still later contemplated the preparation and distribution of an offering memorandum inviting bids. At some point, without advice to CCFL, it abandoned that idea and reverted to exclusive negotiations with one interested party. This entire process is not one which is customary or widely accepted as a general practice in the commercial world. It was somewhat unique having regard to the circumstances of this case. In my opinion the refusal of the court to approve the offer accepted by the receiver would not reflect on the integrity of procedures followed by court-appointed receivers and is not the type of refusal which will have a tendency to undermine the future confidence of business persons in dealing with receivers.

Rosenberg J. stated that the Royal Bank was aware of the process used and tacitly approved it. He said it knew the terms of the letter of intent in February 1991 and made no comment. The Royal Bank did, however, indicate to the receiver that it was not satisfied with the contemplated price nor the amount of the down payment. It did not, however, tell the receiver to adopt a different process in endeavouring to sell the Air Toronto assets. It is not clear from the material filed that at the time it became aware of the letter of intent, it knew that CCFL was interested in purchasing Air Toronto.

I am further of the opinion that a prospective purchaser who has been given an opportunity to engage in exclusive negotiations with a receiver for relatively short periods of time which are extended from time to time by the receiver and who then makes a conditional offer, the condition of which is for his sole benefit and must be fulfilled to his satisfaction unless waived by him, and which he knows is to be subject to

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court approval, cannot legitimately claim to have been unfairly dealt with if the court refuses to approve the offer and approves a substantially better one.

In conclusion I feel that I must comment on the statement made by Galligan J.A. in his reasons to the effect that the suggestion made by counsel for 922 constitutes evidence of lack of prejudice resulting from the absence of an offering memorandum. It should be pointed out that the court invited counsel to indicate the manner in which the problem should be resolved in the event that the court concluded that the order approving the OEL offer should be set aside. There was no evidence before the court with respect to what additional information may have been acquired by CCFL since March 8, 1991 and no inquiry was made in that regard. Accordingly, I am of the view that no adverse inference should be drawn from the proposal made as a result of the court's invitation.

For the above reasons I would allow the appeal with one set of costs to CCFL-922, set aside the order of Rosenberg J., dismiss the receiver's motion with one set of costs to CCFL-922 and order that the assets of Air Toronto be sold to numbered corporation 922246 on the terms set forth in its offer with appropriate adjustments to provide for the delay in its execution. Costs awarded shall be payable out of the estate of Soundair Corporation. The costs incurred by the receiver in making the application and responding to the appeal shall be paid to him out of the assets of the estate of Soundair Corporation on a solicitor-and-client basis. I would make no order as to costs of any of the other parties or interveners.

Appeal dismissed.

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CITATION: CCM Master Qualified Fund v. blutip Power Technologies, 2012 ONSC 1750
COURT FILE NO.: CV-12-9622-00CL
DATE: 20120315

2012 ONSC 1750 (CanLII)

SUPERIOR COURT OF JUSTICE – ONTARIO

COMMERCIAL LIST

RE: CCM Master Qualified Fund, Ltd., Applicant

AND:

blutip Power Technologies Ltd., Respondent

BEFORE: D. M. Brown J.

COUNSEL: L. Rogers and C. Burr, for the Receiver, Duff & Phelps Canada Restructuring Inc.

A. Cobb and A. Lockhart, for the Applicant

HEARD: March 15, 2012

REASONS FOR DECISION

I. Receiver's motion for directions: sales/auction process & priority of receiver's charges

[1] By Appointment Order made February 28, 2012, Duff & Phelps Canada Restructuring Inc. ("D&P") was appointed receiver of blutip Power Technologies Ltd. ("Blutip"), a publicly listed technology company based in Mississauga which engages in the research, development and sale of hydrogen generating systems and combustion controls. Blutip employs 10 people and, as the Receiver stressed several times in its materials, the company does not maintain any pension plans.

[2] D&P moves for orders approving (i) a sales process and bidding procedures, including the use of a stalking horse credit bid, (ii) the priority of a Receiver's Charge and Receiver's Borrowings Charge, and (iii) the activities reported in its First Report. Notice of this motion was given to affected persons. No one appeared to oppose the order sought. At the hearing today I granted the requested Bidding Procedures Order; these are my Reasons for so doing.

II. Background to this motion

[3] The Applicant, CCM Master Qualified Fund, Ltd. ("CCM"), is the senior secured lender to Blutip. At present Blutip owes CCM approximately $3.7 million consisting of (i) two

convertible senior secured promissory notes (October 21, 2011: $2.6 million and December 29, 2011: $800,000), (ii) $65,000 advanced last month pursuant to a Receiver's Certificate, and (iii) $47,500 on account of costs of appointing the Receiver (as per para. 30 of the Appointment Order). Receiver's counsel has opined that the security granted by Blutip in favour of CCM creates a valid and perfected security interest in the company's business and assets.

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[4] At the time of the appointment of the Receiver Blutip was in a development phase with no significant sources of revenue and was dependant on external sources of equity and debt funding to operate. As noted by Morawetz J. in his February 28, 2012 endorsement:

> In making this determination [to appoint a receiver] I have taken into account that there is no liquidity in the debtor and that it is unable to make payroll and it currently has no board. Stability in the circumstances is required and this can be accomplished by the appointment of a receiver.

[5] As the Receiver reported, it does not have access to sufficient funding to support the company's operations during a lengthy sales process.

III. Sales process/bidding procedures

A. General principles

[6] Although the decision to approve a particular form of sales process is distinct from the approval of a proposed sale, the reasonableness and adequacy of any sales process proposed by a court-appointed receiver must be assessed in light of the factors which a court will take into account when considering the approval of a proposed sale. Those factors were identified by the Court of Appeal in its decision in *Royal Bank v. Soundair*: (i) whether the receiver has made a sufficient effort to get the best price and has not acted improvidently; (ii) the efficacy and integrity of the process by which offers are obtained; (iii) whether there has been unfairness in the working out of the process; and, (iv) the interests of all parties.[1] Accordingly, when reviewing a sales and marketing process proposed by a receiver a court should assess:

(i) the fairness, transparency and integrity of the proposed process;

(ii) the commercial efficacy of the proposed process in light of the specific circumstances facing the receiver; and,

(iii) whether the sales process will optimize the chances, in the particular circumstances, of securing the best possible price for the assets up for sale.

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[1] (1991), 7 C.B.R. (3d) 1 (C.A.).

[7] The use of stalking horse bids to set a baseline for the bidding process, including credit bid stalking horses, has been recognized by Canadian courts as a reasonable and useful element of a sales process. Stalking horse bids have been approved for use in other receivership proceedings,[2] *BIA* proposals,[3] and *CCAA* proceedings.[4]

[8] Perhaps the most well-known recent example of the use of a stalking horse credit bid was that employed in the Canwest Publishing Corp. *CCAA* proceedings where, as part of a sale and investor solicitation process, Canwest's senior lenders put forward a stalking horse credit bid. Ultimately a superior offer was approved by the court. I accept, as an apt description of the considerations which a court should take into account when deciding whether to approve the use of a stalking horse credit bid, the following observations made by one set of commentators on the Canwest *CCAA* process:

> To be effective for such stakeholders, the credit bid had to be put forward in a process that would allow a sufficient opportunity for interested parties to come forward with a superior offer, recognizing that a timetable for the sale of a business in distress is a fast track ride that requires interested parties to move quickly or miss the opportunity. The court has to balance the need to move quickly, to address the real or perceived deterioration of value of the business during a sale process or the limited availability of restructuring financing, with a realistic timetable that encourages and does not chill the auction process.[5]

B. The proposed bidding process

B.1 The bid solicitation/auction process

[9] The bidding process proposed by the Receiver would use a Stalking Horse Offer submitted by CCM to the Receiver, and subsequently amended pursuant to negotiations, as a baseline offer and a qualified bid in an auction process. D&P intends to distribute to prospective purchasers an interest solicitation letter, make available a confidential information memorandum to those who sign a confidentiality agreement, allow due diligence, and provide interested parties with a copy of the Stalking Horse Offer.

[10] Bids filed by the April 16, 2012 deadline which meet certain qualifications stipulated by the Receiver may participate in an auction scheduled for April 20, 2012. One qualification is that the minimum consideration in a bid must be an overbid of $100,000 as compared to the

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[2] *Re Graceway Canada Co*., 2011 ONSC 6403, para. 2.
[3] *Re Parlay Entertainment Inc.*, 2011 ONSC 3492, para. 15.
[4] *Re Brainhunter* (2009), 62 C.B.R. (5th) 41 (Ont. S.C.J.), para. 13; *Re White Birch Paper Holding Co*., 2010 QCCS 4382, para. 3; *Re Nortel Networks Corp.* (2009), 55 C.B.R. (5th) 229 (Ont. S.C.J.), para. 2, and (2009), 56 C.B.R. (5th) 74 (Ont. S.C.J.); *Re Indalex Ltd*., 2009 CarswellOnt 4262 (S.C.J.).
[5] Pamela Huff, Linc Rogers, Douglas Bartner and Craig Culbert, "Credit Bidding – Recent Canadian and U.S. Themes", in Janis P. Sarra (ed.), *2010 Annual Review of Insolvency Law* (Toronto: Carswell, 2011), p. 16.

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Stalking Horse Offer. The proposed auction process is a standard, multi-round one designed to result in a Successful Bid and a Back-Up Bid. The rounds will be conducted using minimum incremental overbids of $100,000, subject to reduction at the discretion of the Receiver.

B.2 Stalking horse credit bid

[11] The CCM Stalking Horse Offer, or Agreement, negotiated with the Receiver contemplates the acquisition of substantially all the company's business and assets on an "as is where is" basis. The purchase price is equal to: (i) Assumed Liabilities, as defined in the Stalking Horse Offer, plus (ii) a credit bid of CCM's secured debt outstanding under the two Notes, the Appointment Costs and the advance under the Receiver's Certificate. The purchase price is estimated to be approximately $3.744 million before the value of Assumed Liabilities which will include the continuation of the employment of employees, if the offer is accepted.

[12] The Receiver reviewed at length, in its Report and in counsel's factum, the calculation of the value of the credit bid. Interest under both Notes was fixed at 15% per annum and was prepaid in full. The Receiver reported that if both Notes were repaid on May 3, 2012, the anticipated closing date, the effective annual rate of interest (taking into account all costs which could be categorized as "interest") would be significantly higher than 15% per annum - 57.6% on the October Note and 97.4% on the December Note. In order that the interest on the Notes considered for purposes of calculating the value of the credit bid complied with the interest rate provisions of the *Criminal Code*, the Receiver informed CCM that the amount of the secured indebtedness under the Notes eligible for the credit bid would have to be $103,500 less than the face value of the Notes. As explained in detail in paragraphs 32 through to 39 of its factum, the Receiver is of the view that such a reduction would result in a permissible effective annual interest rate under the December Note. The resulting Stalking Horse Agreement reflected such a reduction.

[13] The Stalking Horse Offer does not contain a break-fee, but it does contain a term that in the event the credit bid is not the Successful Bid, then CCM will be entitled to reimbursement of its expenses up to a maximum of $75,000, or approximately 2% of the value of the estimated purchase price. Such an amount, according to the Receiver, would fall within the range of reasonable break fees and expense reimbursements approved in other cases, which have ranged from 1.8% to 5% of the value of the bid.[6]

C. Analysis

[14] Given the financial circumstances of Blutip and the lack of funding available to the Receiver to support the company's operations during a lengthy sales process, I accept the Receiver's recommendation that a quick sales process is required in order to optimize the

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[6] *Re Parlay Entertainment*, 2011 ONSC 3492, para. 12; *Re White Birch Paper Holding Co.*, 2010 QCCS 4915, paras. 4 to 7; *Re Nortel Networks Corp.* (2009), 56 C.B.R. (5th) 74 (Ont. S.C.J.), para. 12.

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prospects of securing the best price for the assets. Accordingly, the timeframe proposed by the Receiver for the submission of qualifying bids and the conduct of the auction is reasonable. The marketing, bid solicitation and bidding procedures proposed by the Receiver are likely to result in a fair, transparent and commercially efficacious process in the circumstances.

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[15] In light of the reduction in the face value of the Notes required by the Receiver for the purposes of calculating the value of the credit bid and the reasonable amount of the Expense Reimbursement, I approved the Stalking Horse Agreement for the purposes requested by the Receiver. I accept the Receiver's assessment that in the circumstances the terms of the Stalking Horse Offer, including the Expense Reimbursement, will not discourage a third party from submitting an offer superior to the Stalking Horse Offer.

[16] Also, as made clear in paragraphs 7 and 8 of the Bidding Procedures Order, the Stalking Horse Agreement is deemed to be a Qualified Bid and is accepted solely for the purposes of CCM's right to participate in the auction. My order did not approve the sale of Blutip's assets on the terms set out in the Stalking Horse Agreement. As the Receiver indicated, the approval of the sale of Blutip's assets, whether to CCM or some other successful bidder, will be the subject of a future motion to this Court. Such an approach is consistent with the practice of this Court.[7]

[17] For those reasons I approved the bidding procedures recommended by the Receiver.

IV. Priority of receiver's charges

[18] Paragraphs 17 and 20 of the Appointment Order granted some priority for the Receiver's Charge and Receiver's Borrowings Charge. However, as noted by the Receiver in section 3.1 of its First Report, because that hearing was brought on an urgent, *ex parte* basis, priority over existing perfected security interests and statutory encumbrances was not sought at that time. The Receiver now seeks such priority.

[19] As previously noted, the Receiver reported that Blutip does not maintain any pension plans. In section 3.1 of its Report the Receiver identified the persons served with notice of this motion: (i) parties with registered security interests pursuant to the *PPSA*; (ii) those who have commenced legal proceedings against the Company; (iii) those who have asserted claims in respect of intellectual property against the Company; (iv) the Company's landlord, and (v) standard government agencies. Proof of such service was filed with the motion record. No person appeared on the return of the motion to oppose the priority sought by the Receiver for its charges.

[20] Although the Receiver gave notice to affected parties six days in advance of this motion, not seven days as specified in paragraph 31 of the Appointment Order, I was satisfied that

[7] *Re Indalex Ltd.*, 2009 CarswellOnt 4262 (S.C.J.), para. 7; *Re Graceway Canada Co.,* 2011 ONSC 6403, para. 5; *Re Parlay Entertainment Inc.*, 2011 ONSC 3492, para. 58.

secured creditors who would be materially affected by the order had been given reasonable notice and an opportunity to make representations, as required by section 243(6) of the *BIA*, that abridging the notice period by one day, as permitted by paragraph 31 of the Appointment Order, was appropriate and fair in the circumstances, and I granted the priority charges sought by the Receiver.

2012 ONSC 1750 (CanLII)

[21] I should note that the Appointment Order contains a standard "come-back clause" (para. 31). Recently, in *First Leaside Wealth Management Inc. (Re)*, a proceeding under the *CCAA*, I wrote:

> [49] In his recent decision in *Timminco Limited (Re)* ("Timminco I") Morawetz J. described the commercial reality underpinning requests for Administration and D&O Charges in *CCAA* proceedings:
>
> > In my view, in the absence of the court granting the requested super priority and protection, the objectives of the CCAA would be frustrated. It is not reasonable to expect that professionals will take the risk of not being paid for their services, and that directors and officers will remain if placed in a compromised position should the Timminco Entities continue *CCAA* proceedings without the requested protection. The outcome of the failure to provide these respective groups with the requested protection would, in my view, result in the overwhelming likelihood that the *CCAA* proceedings would come to an abrupt halt, followed, in all likelihood, by bankruptcy proceedings.
>
> …
>
> [51] In my view, absent an express order to the contrary by the initial order applications judge, the issue of the priorities enjoyed by administration, D&O and DIP lending charges should be finalized at the commencement of a *CCAA* proceeding. Professional services are provided, and DIP funding is advanced, in reliance on super-priorities contained in initial orders. To ensure the integrity, predictability and fairness of the *CCAA* process, certainty must accompany the granting of such super-priority charges. When those important objectives of the *CCAA* process are coupled with the Court of Appeal's holding that parties affected by such priority orders be given an opportunity to raise any paramountcy issue, it strikes me that a judge hearing an initial order application should directly raise with the parties the issue of the priority of the charges sought, including any possible issue of paramountcy in respect of competing claims on the debtor's property based on provincial legislation.[8]

[22] In my view those comments regarding the need for certainty about the priority of charges for professional fees or borrowings apply, with equal force, to priority charges sought by a

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[8] 2012 ONSC 1299 (CanLII).

receiver pursuant to section 243(6) of the *BIA*. Certainty regarding the priority of administrative and borrowing charges is required as much in a receivership as in proceedings under the *CCAA* or the proposal provisions of the *BIA*.

[23] In the present case the issues of the priority of the Receiver's Charge and Receiver's Borrowings Charge were deferred from the return of the initial application until notice could be given to affected parties. I have noted that Blutip did not maintain pension plans. I have found that reasonable notice now has been given and no affected person appeared to oppose the granting of the priority charges. Consequently, it is my intention that the Bidding Procedures Order constitutes a final disposition of the issue of the priority of those charges (subject, of course, to any rights to appeal the Bidding Procedures Order). I do not regard the presence of a "come-back clause" in the Appointment Order as leaving the door open a crack for some subsequent challenge to the priorities granted by this order.

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V. Approval of the Receiver's activities

[24] The activities described by the Receiver in its First Report were reasonable and fell within its mandate, so I approved them.

[25] May I conclude by thanking Receiver's counsel for a most helpful factum.

(original signed by)
D. M. Brown J.

Date: March 15, 2012

Ontario Supreme Court
Laurentian Bank of Canada v. World Vintners Corp.
Date: 2002-07-19

In the Matter of the Bankruptcy and Insolvency Act, R.S.C. 1985, c.B-3, Section 47(1), as Amended

Laurentian Bank of Canada, (Applicant)

and

World Vintners Corporation, Wine Art Ltd., The Ultimate Winery Systems Inc. and Wine Kitz Franchise Corp., (Respondents)

2002 CanLII 49605 (ON SC)

Ontario Superior Court of Justice Cumming J.

Heard: July 19, 2002

Judgment: July 19, 2002

Docket: 02-CL-4591

A. Kauffman, K. McEachern, for Laurentian Bank

Mahesh Uttamchandani, for KPMG Inc.

Fraser Hughes, for Franchisees

Roger Jaipargas, for Rudolf Keller, Paklab Products Inc.

P. Shea, for First Ontario Labour Sponsored

Graham Smith, for names Respondents (World Vintners Group)

Stephen Schwartz, for Business Development Corporation (“BDC”), Bank of Montreal Credit Corporation (“BMCC”)

Howard Manis, for Mosti Mondiale Inc. (“Mondiale”)

John Chapman, for Wine Kitz Prairies Inc.

***Cumming J.*:**

The Application

1 The Bank is the primary secured creditor under a GSA of the respondent group of companies ("Vintners"). Vintners' business manufactures kits for individuals to make their own wine or beer, with 87 franchise stores and 26 corporate stores owned directly. Vintners has been in default under loan facilities with the Bank since at least March 22, 2002.

2 KPMG was engaged March 6, 2002 by the Bank to review the affairs of Vintners. The Bank was advised by KPMG April 17, 2002 that Vintners was experiencing a liquidity crisis and had exhausted their operating line. The draft financial statements for the fiscal year ending January 31, 2002 indicate a net loss of about $2.8 million.

3 KPMG reported that an immediate cash injection was required. Discussions took place amongst the various stakeholders with a view to restructuring the indebtedness. These discussions were unsuccessful. Vintners has now literally run out of capital. The indebtedness to the Bank was $2,499,627.16 as of July 4, 2002. The Bank states that to preserve the value of the business it is necessary that an Interim Receiver be appointed and that the assets and undertaking be sold forthwith.

4 Hence, the Bank applies for (1) the appointment of KPMG as an Interim Receiver and (2) approval of the terms and conditions of an agreement of purchase and sale, vesting title in the purchased assets from Newco, free and clear of all claims.

5 The application was signed July 10, 2002, returnable July 12, 2002. There was significant opposition to the proposed sale evidenced July 12. This included subordinated creditors BDC and BMCC. The subordinated creditors claims totaled about $3,784,000 as of July 4, 2002.

6 Paklab/Keller, an unsecured trade supplier, is owed some $1,691,838.93. It is apparent from the record that Paklab/Keller and other trade creditors were taken by complete surprise by the Application. Paklab/Keller learned of the Application by happenstance through corporate searches July 11, 2002.

7 The payables of Vintners total some $4.9 million as at June 30, 2002. KPMG reports that Vintners switched suppliers several times in the last year and owes about $3 million to companies Vintners no longer does business with.

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8 The proposed purchase price of $3,410,000. would meet the payroll and rent obligations of $465,000. and the indebtedness to the Bank The present indebtedness to the Bank is about $2.715 million.

9 KPMG estimates the net realizable value of assets on liquidation to be only $2.1 to $2.9 million. The costs of an interim receivership, if there is an immediate sale, are estimated to be about $150,000. Understandably, Newco's offer is supported by the Bank who may otherwise incur a shortfall of up to $1 million.

10 The Bank emphasizes the continuing, rapid financial deterioration of Vintners, that Vintners has now run out of sugar and wine concentrate and expresses the concern of understandably nervous employees and franchisees. The Bank states that it will oppose any third party funding of a 'going concern' Interim Receivership with the Receiver's certificate ranking in priority to the Bank's position as, in the Bank's view, there is not adequate protection with respect to the Bank's debt.

11 When the application was first returned July 12, Epstein J. adjourned it until 2:30 p.m. today, July 19, to give interested parties further time, until 2:00 p.m. July 18, to offer to purchase the assets.

12 An affidavit sworn July 18, 2002 by a solicitor for some nine franchisees attaches a letter to KPMG of that date in which a long list of asserted grievances are asserted against Vintners' existing management and litigation by a franchisee in Alberta is referred to.

13 The second report as proposed Interim Receiver, KPMG, states that seven parties expressed potential interest in purchasing the assets. Four of these parties, including Newco, executed a confidentiality agreement, and the three outside parties inspected the premises.

14 Newco is the only party to come forward with an offer. This present, revised offer provides for a purchase price of $3,335,000, with $2,765,000 of the purchase price being payable in cash and the balance through certain assumed liabilities. The offer is conditional upon the granting of the vesting order.

15 KPMG recommends approval of the sale.

Disposition

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16 This hearing commenced at 2:30 p.m. and adjourned at 8:00 p.m. There is no question that given the record that KPMG is to be appointed as an Interim Receiver. Indeed, there is no opposition to the motion in this regard.

17 The contentious issue relates to the proposed immediate sale to Newco.

18 The creditor, Paklab/Keller has made submissions. That firm has sent a representative from Italy to conduct its due diligence before deciding as to whether to make an offer to purchase. It is clear that the firm has gone to some considerable expense and been making best efforts to determine its position as a prospective purchaser but has simply not had sufficient time to do so. Hence, it was unable to make an offer within the past six day time period.

19 The secured creditors BDC and BMCC have made submissions to extend the time further for offers. The nine franchisees and the regional franchisee present also submit that there should be an extension of time.

20 First Ontario Labour Sponsored Investment Fund Ltd., a creditor, advises that it is taking an equity position in Newco together with existing management but that Newco will not extend its present offer beyond today. That is, Newco will not hold open its offer for a further period of time.

21 The Bank and the proposed Interim Receiver state that the proposed immediate sale should be approved. Alternatively, they submit there should be an immediate liquidation. I disagree.

22 The Bank could have appointed KPMG as an Interim Receiver under its GSA in March or April. Instead, it has observed a continually, rapidly deteriorating financial situation over three or four months and only at the point in time when Vintners is completely out of money and there is a crisis asks the Court to approve a sale to existing management on two days notice.

23 Existing management has seen the continually, rapidly deteriorating financial situation over several months but, so far as the record shows, has not tried at all itself to find an arms-length purchaser for the business in the marketplace. The proposed sale would extinguish the claims of at least $5 or $6 million of existing creditors.

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24 The process for the sale of a business by an Interim Receiver must be seen to be fair and commercially reasonable. The existing process does not meet that criterion.

25 Paragraph 29 of the requested approval order put forward by the Bank reads:

> This Court orders and declares that the purchase price set out in the Asset Purchase Agreement is fair and commercially reasonable and was arrived at in a commercially reasonable manner.

26 This Court does not agree that the process followed supports the statement that there can be any confidence that the purchase price offered by Newco is fair and was arrived at in a commercially reasonable manner. I say this because the only path to confidence in a 'going-concern' sale is through a competitive bidding process in the marketplace with a reasonable opportunity for informed arms-length purchasers to bid.

27 In *Royal Bank. v. Soundair Corp.* (1991), 4 O.R. (3d) 1 (Ont. C.A.) at 17, Galligan J.A. contrasts the situations of a creditor acting privately in appointing a receiver and thus controlling the process of a sale of assets, albeit with certain risks, and that of the appointment of a receiver by a court with a subsequent receiver's sale. The process of a sale of assets by a court-appointed receiver *is within the control of the Court.*

28 In effect, the Bank and management of Vintners ask the Court that they, not this Court, control the process of the sale and that the Court simply sanction the inadequate and unseemly process they have established. I say this because it is their own actions or inaction that have created the present dire situation. They then submit that because this situation is critical the only choice for the Court is to choose the probable least disadvantageous course of action presently available and approve the sale to Newco, the existing management. They say in effect that because it is now very improbable, given the financial condition of Vintners, that anyone other than the Bank can ever recover anything at all through a third party purchase of assets after a normative process of solicitation of offers and a sale, that the Court should simply hold its nose and approve the Newco offer. Newco compounds this difficulty by insisting that its present offer be immediately accepted or it is off the table today.

29 Considering all the circumstances, in my view it is reasonable to achieve some greater assurance that the sale process is seen to be fair by keeping the bidding process open for some further period of time. Paklab/Keller, BDC, BMO, Mondiale (a new prospective purchaser) and the franchisees present all agree that a further six days to 2:00 p.m. on

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July 25, 2002 is reasonable and that due diligence for the interested parties present can be completed by then. KPMG can also immediately advise all those known parties who previously indicated some interest of the extended period for offers.

30 KPMG is to be given limited terms of reference as Interim Receiver. The Bank refuses to fund the Interim Receiver for this extended period. KPMG will have to borrow monies for some matters, such as to purchase supplies for franchisees and corporate stores and to pay employees. Any such borrowing by KPMG, together with its fees and any disbursements it makes as Interim Receiver shall constitute a first charge against the assets of Vintners. While this extension of six days is itself less than ideal, considering all the circumstances it is a fair balancing of the interests of all the stakeholders given the present difficult situation.

31 For the reasons given, the Order signed is to issue forthwith. The Application is adjourned to July 26, 2002 at 2:00 p.m. While the final disposition of the Application remains, of course, within the discretion of the Court, the expectation at this time, given the above course of events, is that an offer recommended for acceptance by KPMG will be approved or, if there is no offer to be so recommended, that KPMG's terms of reference will be expanded to those seen in a normative order for an Interim Receiver and Vintners will proceed to a liquidation.

Application granted in part.

2002 CanLII 49605 (ON SC)

COURT FILE NO.: 06-CL-6820
DATE: January 12, 2007

SUPERIOR COURT OF JUSTICE – ONTARIO (Commercial List)

2007 CanLII 297 (ON SC)

RE: TEXTRON FINANCIAL CANADA LIMITED (Applicant) v. BETA LIMITEE/BETA BRANDS LIMITED (Respondent)

BEFORE: LAX J.

COUNSEL: *Patrick E. Shea*, for the Applicant, Textron Financial Canada Limited

Jeffrey J. Simpson, for Proposed Receiver, Mintz & Partners Limited

Steven Weisz, for Sun Beta LLC, Sole Shareholder, Beta Brands Limited

Sam Babe & Steven Graff, for Proposed Purchaser, Bremner, Inc.

Michael Klug & Steven Bosnick, for The Bakery, Confectionary, Tobacco and Grain Millers International Union, Local 242G

HEARD: January 3 and 5, 2007.

ENDORSEMENT

[1] The applicant, Textron Financial Canada Limited ("Textron") is the major secured creditor and operating lender of the respondent, Beta Limitee/Beta Brands Limited ("Beta Brands"). It moved under sections 100 and 101 of the *Courts of Justice Act*, R.S.O. 1990, c.C.43 and section 67 of the *Personal Property Security Act*, R.S.O. 1990, c. P.10 for an order appointing Mintz & Partners Limited ("Mintz") as receiver and receiver manager of the assets of Beta Brands and for an order authorizing the Receiver to complete a sale of a portion of its assets ("the bakery business") to a purchaser, Bremner, Inc. and vesting the assets in Bremner. The Bakery, Confectionary, Tobacco and Grain Millers International Union, Local 242G ("the Union") strenuously opposed both orders. At the end of a lengthy hearing on January 3, I granted the receivership order, substantially in the form of the Commercial List standard form Order.

[2] The Bremner transaction was scheduled to close on January 4. During the course of the hearing on January 3, I was advised that the closing had been extended to January 5. On January 4 and 5, the parties attempted to negotiate terms of an order approving the sale. These negotiations were unsuccessful and commencing on the late afternoon of January 5 and extending well into the evening, I heard the motion for approval. At its conclusion, I indicated that I was satisfied that the proposed sale was in accordance with the principles in *Royal Bank of Canada v. Soundair Corporation* (1991), 4 O.R. (3d) 1 (Ont. C.A.) and granted the requested order with reasons to follow.

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Background

[3] Beta Brands is a manufacturer of bakery and confectionary products for the Canadian and U.S. markets with its head office and manufacturing facilities located in a 5-storey building on Dundas Street East in London, Ontario. The company has operated from these premises since 1913, originally as the McCormick Manufacturing Co. Ltd and from 1997, by Beta Brands. Its sole shareholder is Sun Beta, LLC., a Delaware corporation. The company's assets consist of the Dundas Street plant and land, intellectual property, including various trademarks and formulas, accounts receivable, and inventory and equipment. The company currently has about 295 unionized employees and 30 salaried employees.

[4] Beta Brands carries on three distinct manufacturing, marketing and sales businesses: (a) baked goods; (b) confectionary goods; and (c) panned chocolate products. Beta Brands also manufactured Breath Savers brand hard candies, but this division was sold in May 2006. A subsidiary, Beta Brands U.S.A. Ltd., carries on business in the United States marketing Beta Brands' products to U.S. customers, but Beta USA does not have assets or carry on business in Canada.

[5] Pursuant to a Loan and Security Agreement dated as of December 17, 2004, Textron and Beta Brands entered into financing arrangements, which were amended as of August 29, 2005 and June 20, 2006. Pursuant to a Participation Agreement made as of August 29, 2005 and amended as of June 20, 2006, Sun Beta, LLC purchased from Textron an interest in certain of the advances made by Textron to Beta Brands. Almost from the beginning of the relationship

between Textron and Beta Brands, the company found it difficult to operate within the Loan Facilities. The amendments and the Participation Agreement were intended to assist Beta Brands in overcoming its financial difficulties, but it continued to default on the financial covenants contained in the Loan and Security Agreements.

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[6] In August 2005, Beta Brands, in consultation with Sun Beta, determined that it needed to restructure its operations and considered the possibilities of selling its business to a third party in whole or parts, completing a strategic acquisition, moving to leased premises using existing or new equipment, or an orderly liquidation of the assets of the company. On September 19, 2005, it engaged Capitalink, L.C. of Coral Gables, Florida to investigate several of these options, most notably, marketing the business and/or each of its divisions to potential acquirers throughout North America and Europe.

[7] The efforts of Capitalink resulted in the sale of the Breath Savers business in May 2006 for about $1.2 million. It was also successful in generating a proposal in March 2006 from Ralcorp Holdings, Inc. of St. Louis, Missouri, to purchase certain of the assets of the bakery business at a purchase price of US$3 million. The Ralcorp proposal was not pursued at that time as the company decided to focus on a restructuring in an attempt to preserve the business and continue operations. Several restructuring alternatives were explored, but none were completed. No further proposals were received for the bakery business or for the other divisions.

[8] In November 2006 and in the face of a pending liquidity crisis, company management resurrected discussions with Ralcorp with respect to the sale of the bakery business. Ralcorp was prepared to honour its March 2006 proposal and to complete the transaction through its subsidiary, Bremner. Also in November 2006, the company retained Mintz as its consultant to review the company's financial position, its short-term cash flow forecasts and to conduct a security position review. Mintz concluded that the realizations from the company's assets would be significantly lower if the Bremner transaction was not completed.

[9] Textron has valid, perfected security over the property of the company and delivered the notices required under s. 244 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B.3 in late November. On December 13, 2006, an Asset Purchase Agreement ("APA") was executed

between Beta Brands and Bremner. On the same day, the company entered into a Forbearance Agreement with Textron whereby Textron agreed to forbear on enforcing its security and provide Beta Brands with financing to complete the sale to Bremner.

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Appointment of Receiver

[10] The subordinated creditors did not appear and take no position. The Union opposed the appointment of the Receiver and submitted that its true purpose was to avoid or eliminate the contractual and/or legislative obligations for severance and termination pay, which are substantial.

[11] In its materials, the Union indicated its intention to exercise its rights under the collective agreement and in the event of a sale to Bremner, to file an application before the Ontario Labour Relations Board under section 69 of the *Labour Relations Act, 1995*, alleging that there has been a "sale of a business" to the Receiver and/or Bremner and to confirm that the current collective agreement is binding on them. There is no reasonable prospect that a privately-appointed receiver could effectively and efficiently carry out its duties and obligations in the face of this. The Union will exercise its rights as it sees fit, but the appointment of a receiver whose activities will be supervised by the court is necessary to protect the interests of all creditors. It provides the greatest likelihood of maximizing the recovery for all creditors and will permit all stakeholders to have input into the best process to achieve this: see, *Bank of Nova Scotia v. Freure Village on Clair Creek*, 1996 CarswellOnt 2328 (Gen. Div.) at paras. 11 and 13.

Sale to Bremner

[12] Bremner is purchasing the trademarks associated with the bakery business, customer lists, and some, but not all of the equipment involved in bakery production. As well, the APA requires that Beta Brands deliver approximately $750,000 of inventory at cost to permit Bremner to service bakery customers while equipment is moved and production re-established at Bremner's facilities. Bremner is not purchasing the accounts receivable, any assets associated with the candy or panned chocolate businesses, the remaining equipment for the bakery business, the land or building.

[13] The Union opposed the sale to Bremner on the basis that it eliminates or curtails the possibility of the sale of the entire business as a going concern and the prospect of recovery for the substantial severance and termination pay claims of its members. It objected to what it described as the "quick flip" nature of the transaction and the fact that it was left out of the process that culminated in the Bremner offer on December 13.

[14] I accept that the Union was brought into this late in the day. It was short-served with notice of the application, but once served, it was provided with documentation and information regarding the company's attempts to restructure and market its divisions in an attempt to satisfy the Union that the sale process was the best option available to all parties. Before returning to court on January 5 for an order approving the sale, considerable efforts were made to achieve a resolution on terms acceptable to the Union, the purchaser and the secured creditors whose funds are at risk. The secured creditors were not prepared to forego the Bremner sale in the faint hope that a third party purchaser can be found who is willing to operate the business and continue the employment relationship. The Receiver and the purchaser do not plan to fulfill this role. The gap could not be bridged.

[15] The Union has received assurances that it will have a place at the table in formulating a strategy for the company's remaining assets. Beta Brands no longer has any ability to carry on operations or to fund a marketing effort. The proposed sale to Bremner will generate cash proceeds, some portion of which can be allocated to fund future marketing efforts. The Receiver intends to explore every reasonable option to market the remaining assets of Beta Brands and to maximize recovery for its creditors, and, will attempt to realize sufficient proceeds such that unsecured creditors, including employees, receive some payments of amounts owing to them. There is no evidence that any alternative purchaser for the bakery division or the company as a whole exists. Capitalink's marketing process, discussed more fully below, demonstrates that one is unlikely to surface. The employees stand the best chance of recovering as creditors if the Bremner sale is approved. Without it, there will be a shortfall in the millions of dollars.

[16] Courts have looked to the four-part test in *Soundair* for guidance where the court is being asked to approve a realization process, whether or not there is a marketing process and sale

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conducted by a receiver: *Fund 321 Ltd. Partnership v. SAMSys Technologies*, 2006 CarswellOnt 2541 (S.C.J.) at para. 37; *Re Canadian Red Cross Society/Société canadienne de la Croix-Rouge*, 1998 CarswellOnt 3346 (Ont. Gen. Div.) at para.47. The court's duty is to consider:

(a) whether the receiver has made a sufficient effort to get the best price and has not acted improvidently;
(b) whether the interests of all parties have been considered;
(c) the efficacy and integrity of the process by which offers are obtained;
(d) whether there has been unfairness in the working out of the process.

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[17] From approximately September 2005 until November or December 2006, Capitalink engaged in a marketing process of the company's assets, including the bakery division. Potential purchasers were solicited for offers to purchase the entire company, but Capitalink also prepared separate confidential information memoranda ("CIM") for each division. Attached as an Appendix to the Receiver's First Report is a schedule provided to the Receiver by Capitalink that describes the parties Capitalink contacted and the discussions and meetings it held in its efforts to seek purchasers for Beta Brands, including its bakery business. The strategy employed by Capitalink was no different than the strategy typically utilized by receivers in selling assets of a business. As a result of its initial targeting of potentially interested parties, the bakery division CIM was distributed to nine different interested parties. The Ralcorp proposal in March 2006 was the only offer received.

[18] The Receiver was not in a position to verify the recorded entries in the schedule provided by Capitalink and it was pointed out that two of the nine potentially interested parties who are believed to have received CIM'S are not referred to at all in the schedule, which is otherwise quite detailed. Nonetheless, based on its review of the schedule as well as other documents provided to it by the company and/or Capitalink and on the basis of discussions with company management, the Receiver believes that the marketing process as a whole conducted by Capitalink was fair and reasonable and that the assets were exposed to the market for a sufficient period of time.

[19] The purchase price of $US3 million in the Bremner transaction is the same as proposed by its parent corporation in March 2006. This suggests that the purchase price is closer to true

going concern rather than liquidation value. The equipment being purchased appears to be above appraised value. The Receiver is not satisfied that further marketing of the bakery division assets will result in higher net realizations or result in a reasonable chance of locating alternative willing purchasers or what alternative marketing efforts have not already been undertaken by Capitalink. I am satisfied that the Receiver would have proceeded no differently than Capitalink did and a further marketing effort would not be productive. I conclude that sufficient efforts were made to obtain the best price following a marketing process that was fair and reasonable and that it produced a provident sale.

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[20] Apart from the Union, all parties support the proposed sale. The Receiver recommends it. As the major secured creditors, Textron and Sun Beta have the largest financial stake and their support for the transaction is highly significant, even though Sun Beta *qua* shareholder may not see a penny from it. The realization schedules prepared by Mintz in its consulting capacity show that there is the potential to pay a portion of the unsecured claims with the Bremner sale and none without it. The company explored reasonable alternatives over a six-month period before reviving the Bremner transaction. I am satisfied that there was proper consideration of the interests of all parties and that there was no unfairness in the process.

[21] It is true that the Union was given little time to attempt to bring forward other options, but it is also true that it brought forward no concrete proposals or offered any protection to the secured creditors in the event the sale was not approved and the purchaser walked away. There was some suggestion that a Brazilian candy company was prepared to purchase the entire business. When the Receiver investigated this suggestion, the Receiver learned that the possible purchaser had never presented an offer and in discussions with Capitalink, had indicated that it might be interested in purchasing the entire company, but for the same amount that Bremner was prepared to pay for only the bakery business.

[22] The terms of the Bremner transaction contemplate an uninterrupted flow of products to assist in an orderly transition of the business. If the transaction is not completed and the company's operations are shut down, the perishable inventory, valued at approximately $750,000, is at risk of spoilage. More importantly, any interruption in supply will likely result in

customers sourcing products from other suppliers, thereby significantly impairing value for the bakery trademarks and customer supply relationships in any potential future purchase as well as jeopardizing the value of the accounts receivable. Time is therefore of the essence. Any disruption to the timely and orderly removal of the purchased equipment and inventory will harm the creditors and seriously impair the best chance of maximizing value for all stakeholders.

[23] While a going concern sale of Beta Brands would undeniably be in the best interests of the company's employees, a secured creditor is not required to continue to fund a business to satisfy a union's need for an employer. Embarking on a process to attempt to locate one is, in the opinion of the Receiver, not in the interest of creditors and the Receiver does not recommend this for reasons I have already discussed. The court must place a great deal of confidence in the Receiver's expert business judgment for reasons elaborated by Farley J. in *Skyepharma PLC v. Hyal Pharmaceutical Corp.*, 1999 CarswellOnt 3641 (S.C.J.) at paras. 3-8. On this basis, the material filed and the comprehensive submissions of counsel, I am satisfied that all of the *Soundair* principles are met in this case, that the sale is advantageous to the creditors and other stakeholders of Beta Brands and that it should be approved.

[24] A final comment on procedure. On the initial attendance, the Union disputed that the application should be heard on the Commercial List in Toronto. In my view, there was sufficient connection to Toronto to make it appropriate to hear it, particularly in view of its urgency. A number of members of the Union travelled from London to Toronto on January 3 and again on January 5. Textron acknowledged the burden this placed on them, on the Union and on the Union's counsel who are all from London. While consent, unopposed, and purely administrative matters in this receivership will continue to be heard on the Commercial List in Toronto, any proceeding that involves the Union and is opposed by it is to be heard in London. I appreciate the co-operation of the Regional Senior Justice in West Region for facilitating this. Counsel have been informed how to schedule these matters.

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LAX J.

DATE: January 12, 2007

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COURT FILE NO.: CV-08-7746-00-CL
DATE: 20081024

2008 CanLII 54791 (ON SC)

SUPERIOR COURT OF JUSTICE – ONTARIO
(COMMERCIAL LIST)

RE: **IN THE MATTER OF THE RECEIVERSHIP OF TOOL-PLAS SYSTEMS INC. (Applicant)**

AND IN THE MATTER OF SECTION 101 OF THE *COURTS OF JUSTICE ACT*, AS AMENDED

BEFORE: **MORAWETZ J.**

COUNSEL: **D. Bish, for the Applicant, Tool-Plas**

T. Reyes, for the Receiver, RSM Richter Inc.

R. van Kessel for EDC and Comerica

C. Staples for BDC

M. Weinczok for Roynat

HEARD
& RELEASED: **SEPTEMBER 29, 2008**

E N D O R S E M E N T

[1] This morning, RSM Richter Inc. ("Richter" or the "Receiver") was appointed receiver of Tool-Plas, (the "Company"). In the application hearing, Mr. Bish in his submissions on behalf of the Company made it clear that the purpose of the receivership was to implement a 'quick flip' transaction, which if granted would result in the sale of assets to a new corporate entity in which the existing shareholders of the Company would be participating. The endorsement appointing the Receiver should be read in conjunction with this endorsement.

[2] The Receiver moves for approval of the sale transaction. The Receiver has filed a comprehensive report in support of its position – which recommends approval of the sale.

[3] The transaction has the support of four Secured Lenders – EDC, Comerica, Roynat and BDC.

[4] Prior to the receivership appointment, Richter assessed the viability of the Company. Richter concluded that any restructuring had to focus on the mould business and had to be concluded expeditiously given the highly competitive and challenging nature of the auto parts business. Further, steps had to be taken to minimize the risk of losing either or both key customers – namely Ford and Johnson Controls. Together these two customer account for 60% of the Company's sales.

[5] Richter was also involved in assisting the Company in negotiating with its existing Secured Lenders. As a result, these Lenders have agreed to continue to finance the Company's short term needs, but only on the basis that a sale transaction occurs.

[6] Under the terms of the proposed offer the Purchaser will acquire substantially all of the assets of the Company. The purchase price will consist of the assumption or notional repayment of all of the outstanding obligations to each of the Secured Lenders, subject to certain amendments and adjustments.

[7] The proposed purchaser would be entitled to use the name Tool-Plas. The purchaser would hire all current employees and would assume termination and vacation liabilities of the current employees; the obligations of the Company to trade creditors related to the mould business, subject to working out terms with those creditors; as well as the majority of the Company's equipment leases, subject to working out terms with the lessors.

[8] The only substantial condition to the transaction is the requirement for an approval and vesting order.

[9] The Receiver is of the view that the transaction would enable the purchaser to carry on the Company's mould business and that this would be a successful outcome for customers, suppliers, employees and other stakeholders, including the Secured Lenders.

[10] The Receiver recommends the 'quick flip' transaction. The Receiver is of the view that there is substantial risk associated with a marketing process, since any process other than an expedited process could result in a risk that the key customers would resource their business elsewhere. Reference was made to other recent insolvencies of auto parts suppliers which resulted in receivership and owners of tooling equipment repossessing their equipment with the result that there was no ongoing business. (Polywheels and Progressive Moulded Tooling).

[11] The Receiver is also of the view that the proposed purchase price exceeds both a going concern and a liquidation value of the assets. The Receiver has also obtained favourable security opinions with respect to the security held by the Secured Lenders. Not all secured creditors are being paid. There are subordinate secured creditors consisting of private arms-length investors who have agreed to forego payment.

[12] Counsel to the Receiver pointed out that the transaction only involved the mould business. The die division has already been shut down. The die division employees were provided with working notice. They will not have ongoing jobs. Suppliers to the die division will not have their outstanding obligations assumed by the purchaser. There is no doubt that

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employees and suppliers to the die division will receive different treatment than employees and suppliers to the mould business. However, as the Receiver points out, these decisions are, in fact, business decisions which are made by the purchaser and not by the Receiver. The Receiver also stresses the fact that the die business employees and suppliers are unsecured creditors and under no scenario would they be receiving any reward from the sales process.

[13] This motion proceeded with limited service. Employees and unsecured creditors (with the exception of certain litigants) were not served. The materials were served on Mr. Brian Szucs, who was formerly employed as an Account Manager. Mr. Szucs has issued a Statement of Claim against the Company claiming damages as a result of wrongful dismissal. His employment contract provides for a severance package in the amount of his base salary ($120,000) plus bonuses.

[14] Mr. Szucs appeared on the motion arguing that his Claim should be exempted from the approval and vesting order – specifically that his claim should not be vested out, rather it should be treated as unaffected. Regretfully for Mr. Szucs, he is an unsecured creditor. There is nothing in his material to suggest otherwise. His position is subordinate to the secured creditors and the purchaser has made a business decision not to assume the Company's obligations to Mr. Szucs. If the sale is approved, the relief requested by Mr. Szucs cannot be granted.

[15] A 'quick flip' transaction is not the usual transaction. In certain circumstances, however, it may be the best, or the only, alternative. In considering whether to approve a 'quick flip' transaction, the Court should consider the impact on various parties and assess whether their respective positions and the proposed treatment that they will receive in the 'quick flip' transaction would realistically be any different if an extended sales process were followed.

[16] In this case certain parties will benefit if this transaction proceeds. These parties include the Secured Lenders, equipment and vehicle lessors, unsecured creditors of the mould division, the landlord, employees of the mould division, suppliers to the mould division, and finally – the customers of the mould division who stand to benefit from continued supply.

[17] On the other hand, certain parties involved in litigation, former employees of the die division and suppliers to the die division will, in all likelihood, have no possibility of recovery. This outcome is regrettable, but in the circumstances of this case, would appear to be inevitable. I am satisfied that there is no realistic scenario under which these parties would have any prospect of recovery.

[18] I am satisfied that, having considered the positions of the above-mentioned parties, the proposed sale is reasonable. I accept the view of the Receiver that there is a risk if there is a delay in the process. I am also satisfied that the sale price exceeds the going concern and the liquidation value of the assets and that, on balance, the proposed transaction is in the best interests of the stakeholders. I am also satisfied that the prior involvement of Richter has resulted in a process where alternative courses of action have been considered.

[19] I am also mindful that the Secured Lenders have supported the proposed transaction and that the subordinated secured lenders are not objecting.

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[20] In these circumstances the process can be said to be fair and in the circumstances of this case I am satisfied that the principles set out in *Royal Bank of Canada v. Soundair Corp*., (1991), 4 O.R. (3d) 1 (C.A.) have been followed.

[21] In the result, the motion of the Receiver is granted and an Approval and Vesting Order shall issue in the requested form.

[22] The confidential customer and product information contained in the Offer is such that it is appropriate for a redacted copy to be placed in the record with an unredacted copy to be filed separately, under seal, subject to further order.

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MORAWETZ J.

DATE: October 24, 2008

CITATION: Elleway Acquisitions Limited v. 4358376 Canada Inc., 2013 ONSC 7009
COURT FILE NO.: CV-13-10320-00CL
DATE: 20131203

2013 ONSC 7009 (CanLII)

SUPERIOR COURT OF JUSTICE – ONTARIO
(COMMERCIAL LIST)

IN THE MATTER OF AN APPLICATION PURSUANT TO SECTION 243 OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, c.B-3, AS AMENDED, AND SECTION 101 OF THE *COURTS OF JUSTICE ACT*, R.S.O. 1990, c.C.43, AS AMENDED.

RE: **ELLEWAY ACQUISITIONS LIMITED, Applicant**

AND:

4358376 CANADA INC. (OPERATING AS ITRAVEL 2000.COM), THE CRUISE PROFESSIONALS LIMITED (OPERATING AS THE CRUISE PROFESSIONALS), AND 7500106 CANADA INC. (OPERATING AS TRAVELCASH), Respondents

BEFORE: **MORAWETZ J.**

COUNSEL: **Jay Swartz and Natalie Renner, for the Applicant**

John N. Birch, for the Respondents

David Bish and Lee Cassey, for Grant Thornton, Proposed Receiver

HEARD
&ENDORSED: NOVEMBER 4, 2013

REASONS: DECEMBER 3, 2013

ENDORSEMENT

[1] At the conclusion of argument on November 4, 2013, the motion was granted with reasons to follow. These are the reasons.

[2] On November 4, 2013, Grant Thornton Limited was appointed as Receiver (the "Receiver") of the assets, property and undertaking of each of 4358376 Canada Inc., (operating as itravel2000.com ("itravel")), 7500106 Canada Inc., (operating as Travelcash ("Travelcash")), and The Cruise Professionals Limited, operating as The Cruise Professionals ("Cruise" and, together with itravel2000 and Travelcash, "itravel Canada"). See reasons reported at 2013 ONSC 6866.

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[3] The Receiver seeks the following:

(i) an order:

(a) approving the entry by the Receiver into an asset purchase agreement (the "itravel APA") between the Receiver and 8635919 Canada Inc. (the "itravel Purchaser") dated on or about the date of the order, and attached as Confidential Appendix I of the First Report of the Receiver dated on or about the date of the order (the "Report");

(b) approving the transactions contemplated by the itravel APA;

(c) vesting in the itravel Purchaser all of the Receiver's right, title and interest in and to the "Purchased Assets" (as defined in the itravel APA) (collectively, the "itravel Assets"); and

(d) sealing the itravel APA until the completion of the sale transaction contemplated thereunder; and

(ii) an order:

(a) approving the entry by the Receiver into an asset purchase agreement (the "Cruise APA", and together with the itravel APA and the Travelcash APA, the "APAs") between the Receiver and 8635854 Canada Inc. (the "Cruise Purchaser"), and together with the itravel Purchaser and the Travelcash Purchaser, the "Purchasers") dated on or about the date of the order, and attached as Confidential Appendix 2 of the Report;

(b) approving the transactions contemplated by the Cruise APA; and

(c) vesting the Cruise Purchaser all of the Receiver's right, title and interest in and to the "Purchased Assets" (as defined in the Cruise APA) (the "Cruise Assets", and together with the itravel Assets and the Travelcash Assets, the "Purchased Assets"); and

(d) sealing the Cruise APA until the completion of the sales transaction contemplated thereunder; and

(iii) an order:

(a) approving the entry by the Receiver into an asset purchase agreement (the "Travelcash APA") between the Receiver and 1775305 Alberta Ltd. (the "Travelcash Purchaser") dated on or about the date of the order, and attached as Confidential Appendix 3 of the Report;

(b) approving the transactions contemplated by the Travelcash APA;

(c) vesting in the Travelcash Purchaser all of the Receiver's right, title and interest in and to the "Purchased Assets" (as defined in the Travelcash APA) (collectively, the "Travelcash Assets"); and

(d) sealing the Travelcash APA until the completion of the sale transaction contemplated thereunder.

[4] The Receiver further requests a sealing order: (i) permanently sealing the valuation reports prepared by Ernst & Young LLP and FTI Consulting LLP, attached as Confidential Appendices 4 and 5 of the Report, respectively; and (ii) sealing the Proposed Receiver's supplemental report to the court dated on or about the date of the order (the "Supplemental Report"), for the duration requested and reasons set forth therein.

[5] The motion was not opposed. It was specifically noted that Mr. Jonathan Carroll, former CEO of itravel, did not object to the relief sought.

[6] The Receiver recommends issuance of the Orders for the factual and legal bases set forth herein and in its motion record. The purchase and sale transactions contemplated under the APAs (collectively, the "Sale Transactions") are conditional upon the Orders being issued by this court.

General Background

[7] Much of the factual background to this motion is set out in the endorsement which resulted in the appointment of the Receiver (2013 ONSC 6866), and is not repeated.

[8] The Receiver has filed the Report to provide the court with the background, basis for, and its recommendation in respect of the relief requested. The Receiver has also filed the Supplemental Report (on a confidential basis) as further support for the relief requested herein.

[9] In the summer of 2010, Barclays Bank PLC ("Barclays") approached Travelzest and stated that it no longer wished to act as the primary lender of Travelzest and its subsidiaries, as a result of certain covenant breaches under the Credit Agreement. This prompted Travelzest to consider and implement where possible, strategic restructuring arrangements, including the divestiture of assets and refinancing initiatives.

[10] In September 2010, Travelzest publicly announced its intention to find a buyer for the Travelzest business.

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Travelzest's Further Sales and Marketing Processes

[11] In the fall of 2011, a competitor of itravel Canada contacted Travelzest and expressed an interest in acquiring the Travelzest portfolio. Negotiations ensued over a period of three months. However, the parties could not agree on a Purchase Price or terms, and negotiations ceased in December 2011.

[12] In early 2012, an informal restructuring plan was developed, which included the sale of international companies.

[13] The first management offer was received in April 2012. In addition, a sales process continued from May to October 2012, which involved 50 potential bidders within the industry. Counsel advised that 14 parties pursued the opportunity and four parties were provided with access to the data room. Four offers were ultimately made but none were deemed to be feasible, insofar as two were too low, one withdrew and the management offer was withdrawn after equity backers were lost.

[14] In September 2012, a second management offer was received, which was subsequently amended in November 2012. The second management offer did not proceed.

[15] In January 2013, discussions ended and the independent committee was disbanded.

[16] In March and April 2013, three Canadian financial institutions were approached about a refinancing. However, no acceptable term sheet was obtained.

[17] In May 2013, Travelzest entered into new discussions with a prior bidder from a previous sales process. Terms could not be reached.

[18] In May 2013, a third management offer was received which was followed by a fourth management offer in July, both of which were rejected.

[19] In July 2013, a press release confirmed that Barclays was not renewing its credit facilities with the result that the obligations became payable on July 12, 2013. However, Barclays agreed to support restructuring efforts until August 30, 2013.

[20] In August 2013, a fifth management offer was made for the assets of itravel Canada, which included limited funding for liabilities. This offer was apparently below the consideration offered in the previous management offers. The value of the offer was also significantly lower than the Barclays' indebtedness and lower than the aggregate amount of the current offer from the Purchasers.

Barclays' Assignment of the Indebtedness to Elleway

[21] On August 21, 2013, a consortium led by LDC Logistics Development Corporation ("LDC"), which included Elleway (collectively, the "Consortium") submitted an offer for

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Barclays debt and security, as opposed to the assets of Itravel Canada. On August 29, 2013, Elleway and Barclays finalized the assignment deal, which was concluded on September 1, 2013.

[22] The consideration paid by Elleway was less than the amount owing to Barclays. Barclays determined, with the advice of KPMG London, that the sale of its debt and security, albeit at a significant discount, was the best available option at the time.

[23] itravel Canada is insolvent. Elleway has agreed pursuant to the Working Capital Facility agreement to provide the necessary funding for itravel Canada up to and including the date for a court hearing to consider the within motion. However, if a sale is not approved, there is no funding commitment from Elleway.

Proposed Sale of Assets

[24] The Receiver and the Purchasers have negotiated the APAs which provide for the going-concern purchase of substantially all of the itravel Canada's assets, subject to the terms and conditions therein. The purchase prices under the APAs for the Purchased Assets will be comprised of a reduction of a portion of the indebtedness owed by Elleway under the Credit Agreement and entire amount owed under the Working Capital Facility Agreement and related guarantees, and the assumption by the Purchasers of the Assumed Liabilities (as defined in each of the Purchase Agreements and which includes all priority claims) and the assumption of any indebtedness issued under any receiver's certificates issued by the Receiver pursuant to a funding agreement between the Receiver and Elleway Properties Limited. The aggregate of the purchase prices under the APA is less the amount of the obligations owed by itravel Canada to Elleway under the Credit Agreement and Working Capital Facility Agreement and related guarantees.

[25] Pursuant to the APAs, the Purchasers are to make offers to 95% of the employees of itravel Canada on substantially similar terms of such employees current employment. The Purchasers will also be assuming all obligations owed to the customers of itravel Canada.

[26] In reviewing the valuation reports of FTI Consulting LLP and Ernst & Young LLP and considering the current financial position of itravel Canada, the Receiver came to the following conclusions:

(a) FTI Consulting LLP and Ernst & Young LLP concluded that under the circumstances, the itravel Canada companies' values are significantly less than the secured indebtedness owed under the Credit Agreement;

(b) Barclays, in consultation with its advisor, KPMG London, sold its debt and security for an amount lower than its par value;

(c) the book value of the itravel Canada's tangible assets are significantly less than the secured indebtedness; and

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(d) Elleway has the principal financial interest in the assets of itravel Canada, subject to priority claims.

[27] The Receiver is of the view that the Sale Transactions with the Purchasers are the best available option as it stabilizes itravel Canada's operations, provides for additional working capital, facilitates the employment of substantially all of the employees, continues the occupation of up to three leased premises, provides for new business to itravel Canada's existing suppliers and service providers, assumes the liability associated with pre-existing gift certificates and vouchers, allows for the uninterrupted service of customer's travel arrangements and preserves the goodwill and overall enterprise value of the Companies. In addition, the Receiver believes that the purchase prices under the APAs are fair and reasonable in the circumstances, and that any further marketing efforts to sell itravel Canada's assets may be unsuccessful and could further reduce their value and have a negative effect on operations.

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[28] The Receiver's request for approval of the Orders raises the following issues for this court.

A. What is the legal test for approval of the Orders?

B. Does the legal test for approval change in a so-called "quick flip" scenario?

C. Does partial payment of the purchase price through a reduction of the indebtedness owed to Elleway preclude approval of the Orders?

D. Does the Purchasers' relationship to itravel Canada preclude approval of the Orders?

E. Is a sealing of the APAs until the closing of the Sale Transactions contemplated thereunder and a permanent sealing of the FTI Consulting LLP and Ernst & Young LLP valuation and the Supplemental Report Warranted?

A. What is the Legal Test for Approval of the Orders?

[29] Receivers have the powers set out in the order appointing them. Receivers are consistently granted the power to sell property of a debtor, which is, indeed, the case under the Appointment Order.

[30] Under Section 100 of the *Courts of Justice Act (Ontario)*, this Court has the power to vest in any person an interest in real or personal property that the Court has authority to order be conveyed.

[31] It is settled law that where a Court is asked to approve a sales process and transaction in a receivership context, the Court is to consider the following principles (collectively, the "*Soundair* Principles"):

a. whether the party made a sufficient effort to obtain the best price and to not act improvidently;

b. the interests of all parties;

c. the efficacy and integrity of the process by which the party obtained offers; and

d. whether the working out of the process was unfair.

Royal Bank of Canada v. Soundair Corp. (1991), 4 O.R. (3d) 1 (C.A.); *Skyepharma PLC v. Hyal Pharmaceutical Corp*. (1999), 12 C.B.R. (4th) 87 (Ont. S.C.J., appeal quashed, (2000), 47 O.R. (3d) 234 (C.A.)).

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[32] In this case, I am satisfied that evidence has been presented in the Report, the Jenkins Affidavit and the Howell Affidavit, to demonstrate that each of the *Soundair* Principles has been satisfied, and that the economic realities of the business vulnerability and financial position of itravel Canada (including that the result would be no different in a further extension of the already extensive sales process) militate in favour of approval of the issuance of the Orders.

B. Does the Legal Test for Approval Change in a So-called "Quick Flip" Scenario?

[33] Where court approval is being sought for a so-called "quick flip" or immediate sale (which involves, as is the case here, an already negotiated purchase agreement sought to be approved upon or immediately after the appointment of a receiver without any further marketing process), the court is still to consider the *Soundair* Principles but with specific consideration to the economic realities of the business and the specific transactions in question. In particular, courts have approved immediate sales where:

(a) an immediate sale is the only realistic way to provide maximum recovery for a creditor who stands in a clear priority of economic interest to all others; and

(b) delay of the transaction will erode the realization of the security of the creditor in sole economic interest.

Fund 321 Ltd. Partnership v. Samsys Technologies Inc. (2006), 21 C.B.R. (5th) 1 (Ont. S.C.J.); *Bank of Montreal v. Trent Rubber Corp*. (2005), 13 C.B.R. (5th) 31 (Ont. S.C.J.).

[34] In the case of *Re Tool-Plas*, I stated, in approving a "quick flip" sale that:

> A "quick flip" transaction is not the usual transaction. In certain circumstances, however, it may be the best, or the only, alternative. In considering whether to approve a "quick flip" transaction, the court should consider the impact on various parties and assess whether their respective positions and the proposed treatment that they will receive in the "quick flip" transaction would realistically be any different if an extended sales process were followed.

Tool-Plas Systems Inc., Re (2008), 48 C.B.R. (5th) 91 (Ont. S.C.J.).

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[35] Counsel submits that the parties would realistically be in no better position were an extended sales process undertaken, since the APAs are the culmination of an exhaustive marketing process that has already occurred, and there is no realistic indication that another such process (even if possible, which it is not, as itravel Canada lacks the resources to do so) would produce a more favourable outcome.

[36] Counsel further submits that a "quick flip" transaction will be approved pursuant to the *Soundair* Principles, where, as in this case, there is evidence that the debtor has insufficient cash to engage in a further, extended marketing process, and there is no basis to expect that such a process will result in a better realization on the assets. Delaying the process puts in jeopardy the continued operation of itravel Canada.

[37] I am satisfied that the approval of the Orders and the consummation of the Sale Transactions to the Purchasers pursuant to the APAs is warranted as the best way to provide recovery for Elleway, the senior secured lender of itravel Canada and with the sole economic interest in the assets. The sale process was fair and reasonable, and the Sale Transactions is the only means of providing the maximum realization of the Purchased Assets under the current circumstances.

C. Does Partial Payment of the Purchase Price Through a Reduction of the Indebtedness Owed to Elleway Preclude Approval of the Orders?

[38] Partial payment of the purchase price by Elleway reducing a portion of the debt owed to it under the Credit Agreement and the entire amount owned under the Working Capital Facility Agreement does not preclude approval of the Orders. This mechanism is analogous to a credit bid by a secured lender, but with the Purchasers, instead of the secured lender, taking title to the purchased assets. As noted, the Receiver understands that following closing of the transactions contemplated under the APAs, that Elleway (or an affiliate thereof) will hold an indirect equity interest in the Purchasers. It is well-established in Canada insolvency law that a secured creditor is permitted to credit bid its debt in lieu of providing cash consideration.

Re White Birch Paper Holding Co. (2010), 72 C.B.R. (5th) 74 (Qc. C.A.); *Re Planet Organic Holding Corp*. (June 4, 2010), Toronto, Court File No. 10-86699-00CL, (S.C.J. [Commercial List]).

[39] This court has previously approved sales involving credit bids in the receivership context. See *CCM Master Qualified Fund, Ltd., v. Blutip Power Technologies Ltd.* (April 26, 2012), Toronto, Court File No. CV-12-9622-00CL, (S.C.J. [Commercial List]).

[40] It seems to me that, in these circumstances, no party is prejudiced by Elleway reducing a portion of the debt owed to it under the Credit Agreement and the entire amount owed under the Working Capital Facility Agreement as part of the Purchasers' payment of the purchase prices, as the Purchasers are assuming all claims secured by liens or encumbrances that rank in priority to Elleway's security. The reduction of the indebtedness owed to Elleway will be less than the total amount of indebtedness owed to Elleway under the Credit Agreement. As such, if cash was paid in lieu of a credit bid, such cash would all accrue to the benefit of Elleway.

[41] Therefore, it seems to me the fact that a portion of the purchase price payable under the APAs is to be paid through a reduction in the indebtedness owed to Elleway does not preclude approval of the Orders.

D. Does the Purchasers' Relationship to itravel Canada preclude approval of the Orders?

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[42] Even if the Purchasers and itravel Canada were to be considered, out of an abundance of caution, related parties, given that LDC is an existing shareholder of Travelzest and part of the Consortium or otherwise, this does not itself preclude approval of the Orders.

[43] Where a receiver seeks approval of a sale to a party related to the debtor, the receiver shall review and report on the activities of the debtor and the transparency of the process to provide sufficient detail to satisfy the court that the best result is being achieved. It is not sufficient for a receiver to accept information provided by the debtor where a related party is a purchaser; it must take steps to verify the information. See *Toronto Dominion Bank v. Canadian Starter Drives Inc.*, 2011 ONSC 8004 (Ont. S.C.J. [Commercial List]).

[44] In addition, the 2009 amendments to the BIA relating to sales to related persons in a proposal proceedings (similar amendments were also made to the *Companies' Creditors Arrangement Act* (Canada)) are instructive. Section 65.13(5) of the BIA provides:

> If the proposed sale or disposition is to a person who is related to the insolvent person, the court may, after considering the factors referred to in subsection (4), grant the authorization only if it is satisfied that:
>
> (a) good faith efforts were made to sell or otherwise dispose of the assets to persons who are not related to the insolvent person; and
>
> (b) the consideration to be received is superior to the consideration that would be received under any other offer made in accordance with the process leading to the proposed sale or disposition.

[45] The above referenced jurisprudence and provisions of the BIA (Canada) demonstrate that a court will not preclude a sale to a party related to the debtor, but will subject the proposed sale to greater scrutiny to ensure a transparency and integrity in the marketing and sales process and require that the receiver verify information provided to it to ensure the process was performed in good faith. In this case, the Receiver is of the view that the market for the Purchased Assets was sufficiently canvassed through the sales and marketing processes and that the purchase prices under the APAs are fair and reasonable under the current circumstances. I agree with and accept these submissions.

[46] The Receiver requests that the APAs be sealed until the closing of the Sale Transactions contemplated thereunder. It is also requesting an order permanently sealing the valuation reports prepared by Ernst & Young LLP and FIT Consulting LLP and, attached as Confidential Appendices 4 and 5 of the Report, respectively.

[47] The Supreme Court of Canada in *Sierra Club of Canada v. Canada (Minister of Finance)*, held that a sealing order should only be granted when:

(a) an order is needed to prevent serious risk to an important interest because reasonable alternative measures will not prevent the risk; and

(b) the salutary effects of the order outweigh its deleterious effects, including the effects on the right to free expression, which includes public interest in open and accessible court proceedings.

Sierra Club of Canada v. Canada (Minister of Finance), 2002 SCC 41, [2002] 2 S.C.R. 522, at para. 53; *Re Nortel Networks Corporation* (2009), 56 C.B.R. (5TH) 224, (Ont. S.C.J. [Commercial List]), at paras. 38-39.

[48] In my view, the APAs subject to the sealing request contain highly sensitive commercial information of itravel Canada and their related businesses and operations, including, without limitation, the purchase price, lists of assets, and contracts. Courts have recognized that disclosure of this type of information in the context of a sale process could be harmful to stakeholders by undermining the integrity of the sale process. I am satisfied that the disclosure of the APAs prior to the closing of the Sale Transactions could pose a serious risk to the sale process in the event that the Sale Transactions do not close as it could jeopardize dealings with any future prospective purchasers or liquidators of itravel Canada's assets. There is no other reasonable alternative to preventing this information from becoming publicly available and the sealing request, which has been tailored to the closing of the Sale Transactions and the material terms of the APAs until the closing of the Sale Transactions, greatly outweighs the deleterious effects. For these same reasons, plus the additional reason that the valuations were provided to Travelzest on a confidential basis and only made available to Travelzest and the Receiver on the express condition that they remain confidential, the Receiver submits that the FTI Consulting LLP and Ernst & Young LLP valuations be subject to a permanent sealing order. Further, the Receiver submits that the information contained in the Supplemental Report also meets the foregoing test for the factual basis set forth in detail in the Supplemental Report (which has been filed on a confidential basis). I accept the Receiver's submissions regarding the permanent sealing order for the valuation materials. For these reasons, (i) the APA is to be sealed pending closing, and (ii) only the valuation material is to be permanently sealed.

Disposition

[49] For the reasons set forth herein, the motion is granted. Orders have been signed to give effect to the foregoing.

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MORAWETZ J.

Date: December 3, 2013

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GE CAPITAL CANADA EQUIPMENT FINANCING G.P.
Applicant

and

I M B C BLOWMOLDING INC.
Respondent

Court File No: CV-13-10355-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE

Proceeding commenced at Toronto

FACTUM AND BRIEF OF AUTHORITIES OF THE APPLICANT
(MOTION RETURNABLE DECEMBER 10, 2013)

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