Clerk's Stamp

COURT FILE NO.	25-2832314
COURT	COURT OF KING'S BENCH OF ALBERTA
JUDICIAL CENTRE	CALGARY
MATTER	IN THE MATTER OF THE BANKRUPTCY OF HOME SOLUTIONS CORPORATION
APPLICANTS	ANDREW DAVIDSON AND JODY DAVIDSON
RESPONDENTS	HOME SOLUTIONS CORPORATION, BY ITS TRUSTEE IN BANKRUPTCY, MNP LTD., AND GRANT THORNTON LIMITED, IN ITS CAPACITY AS COURT-APPOINTED RECEIVER OF HOME SOLUTIONS CORPORATION
DOCUMENT	**BRIEF OF THE APPLICANTS**

ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT

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Commercial List Application Scheduled for Friday, June 16, 2023 at 2:00 p.m.
before The Honourable Justice Jones

Other interested parties:

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Trustee of the Bankrupt Estate of Home Solutions Corporation

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I. INTRODUCTION

1. Home Solutions Corporation, carrying on business as Simple Spaces ("**Home Solutions**" or the "**Bankrupt**") was a Calgary-based glass and closet supply and manufacturing company, primarily servicing commercial and residential clients in Alberta's new-build industry.

2. In early 2022, Home Solutions was suffering from a liquidity shortfall, but was actively pursuing a restructuring to allow it to carry on in business. One of its two secured creditors, an entity which, at all times, represented itself to Home Solutions as Private Debt Partners Senior Opportunities Fund GP Inc., doing business as Private Debt Partners ("**PDP**"), wanted to control that restructuring process.[1] PDP therefore entered into a binding agreement in which it obtained control of Home Solutions (by having the majority of the shares of Home Solutions transferred to it, having existing board resign, and having its own Managing Partner, Jeffrey Deacon, appointed as the sole director) and in which it promised, unconditionally, to put forward a bid to purchase the asset of Home Solutions, with the purchaser assuming all the secured debt owed to PDP and Home Solutions' other secured lender, The Toronto-Dominion Bank ("**TD**").

3. What PDP did not disclose to any of the parties was that it was unable to perform its (unconditional) contractual obligations, unless it first obtained significant financing from third parties. Mr. Deacon was given total control of Home Solutions, but when the necessary funding did not materialize, he bankrupted the company, just eight days later.[2] PDP egregiously breached its obligations to restructure Home Solutions, leaving the company with more than $9 million in liabilities, with little prospect for repayment.

4. The Applicants, Andrew and Jody Davidson, had previously (directly and through their company) guaranteed the obligations of Home Solutions to PDP and TD.[3] Mr. Davidson, in his role as the President and Chief Executive Officer and a director of Home Solutions (prior to stepping aside, at PDP's insistence), sought assistance from PDP and Mr. Deacon in the midst of Home Solutions' financial struggles, on the promises of already-secured funding and

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[1] Notwithstanding that all deadlines and agreements that Home Solutions had with PDP were with "Private Debt Partners Senior Opportunities Fund GP Inc.", the Applicant, Andrew Davidson, has recently become aware that there is no such entity in Canada: Affidavit of Andrew Davidson sworn on May 31, 2023 [**Davidson Affidavit**] at paras 4-6 and Exhibits "1" and "2".

[2] Davidson Affidavit at para 32.

[3] Davidson Affidavit at paras 10, 15, and Exhibits "3", "4" and "8".

the planned restructuring described above. Instead, PDP and Mr. Deacon exacerbated Home Solutions' financial struggles, breached multiple contractual and good faith obligations, and drove the company into irrevocable financial ruin, threatening the Applicants with personal and professional ruin in the process.[4]

5. The catastrophic actions of PDP and Mr. Deacon have caused significant damage to Home Solutions and its stakeholders (primarily its creditors, but also its employees, customers and others). As a result, Home Solutions has a substantial claim against PDP and Mr. Deacon. Home Solutions' trustee in bankruptcy, MNP Ltd. (the "**Trustee**"), has declined to pursue this claim[5] and, as a result, the Applicants intend to do so in the Trustee's stead, and at their own expense.

6. The Trustee has also been provided with Proofs of Claim for both of the Applicants, as well as ample documentation and evidence with respect to same, but has not made a determination on the status of the Applicant, Andrew Davidson, as a creditor of Home Solutions, citing, in part, that the relevant documents are no longer in the Trustee's possession.[6] The Trustee has partially disallowed the Proof of Claim of the Applicant, Jody Davidson, as a creditor of Home Solutions.[7]

7. The Applicants seek to resolve all of these issues by way of this Application. The Applicants seek an order pursuant to section 38 of the *Bankruptcy and Insolvency Act*,[8] allowing them to step into the Trustee's shoes and pursue the claim against PDP and Mr. Deacon on behalf of the estate. The Applicants also seek a declaration pursuant to sections 135 and 183 of the *BIA*, declaring that they are creditors of the Bankrupt, and quantifying their claims. Finally, the Applicants seek an order pursuant to Rule 5.13 of the Alberta *Rules of Court*,[9] ordering that they be provided with copies of all books and records currently in possession of the Receiver of Home Solutions, Grant Thornton Limited (the "**Receiver**"), relating to the proposed claim against PDP and Mr. Deacon.

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[4] Davidson Affidavit at paras 22-32.
[5] Davidson Affidavit at para 47 and Exhibit "30".
[6] Davidson Affidavit at paras 40-55 and Exhibits "23" to "37".
[7] Davidson Affidavit at para 54 and Exhibit "36".
[8] *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 [***BIA***]. [**TAB 1**]
[9] Alberta *Rules of Court*, Alta Reg 124/2010 [***Rules***]. [**TAB 2**]

II. STATEMENT OF FACTS

Parties

8. The Applicant Andrew Davidson is the former President, Chief Executive Officer and director of Home Solutions.[10] Mr. Davidson resigned from his position as a director at the insistence of PDP and pursuant to his obligations under the Forbearance Agreement (defined below).[11] As a further term of the Forbearance Agreement, Mr. Davidson was also terminated from his employment with Home Solutions on that date.[12]

9. The Applicant Jody Davidson, is Mr. Davidson's wife, and was also an employee of Home Solutions.[13] Mrs. Davidson was also terminated from her employment with Home Solutions as a term of the Forbearance Agreement.[14]

10. Home Solutions is a corporation incorporated pursuant to the laws of Alberta. At all material times, Home Solutions operated a Calgary-based glass and closet supply and manufacturing company, primarily servicing commercial and residential clients in Alberta's new-build industry.[15]

11. PDP is a private lender with its offices in Toronto, Ontario.[16] PDP would be a defendant in the proposed civil claim.

12. Mr. Deacon is the Managing Partner of PDP and is believed to reside in Toronto, Ontario.[17] Mr. Deacon would be a defendant in the proposed civil claim.

13. 2087212 Alberta Ltd. ("**208**") is a corporation incorporated pursuant to the laws of Alberta.[18] Mr. Davidson is the sole director of 208 and owns approximately 75% of the voting shares in 208; the other 25% are held by Mrs. Davidson.[19] From or about January 1, 2019 to May 11, 2022, 208 owned approximately 79% of the voting shares of Home Solutions.[20]

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[10] Davidson Affidavit at para 2.
[11] Davidson Affidavit at para 2.
[12] Davidson Affidavit at para 29, Exhibits "12" and "13".
[13] Davidson Affidavit at para 29.
[14] Davidson Affidavit at para 29, Exhibits "12" and "13".
[15] Davidson Affidavit at para 11.
[16] Davidson Affidavit at para 13.
[17] Davidson Affidavit at para 13.
[18] Davidson Affidavit at para 12.
[19] Davidson Affidavit at para 12 and Exhibit "6".
[20] Davidson Affidavit at para 12.

Background

14. On or about January 1, 2019, through a series of transactions, 208 and a number of minority shareholders purchased all outstanding shares of Home Solutions (the "**Share Purchase Transaction**") for approximately $13.3 Million. The Share Purchase Transaction was financed by way of:

(a) a $9.6 million term loan from TD. TD had been financing Home Solutions for approximately 30 years;

(b) a $1.6 million vendor-take-back mortgage granted by the previous owners of Home Solutions; and

(c) $2.1 million in funding from minority shareholders.[21]

15. Mr. Davidson and Mrs. Davidson provided unlimited guarantees to TD of Home Solutions' obligations.[22]

Financial Challenges and Refinancing

16. Following the Share Purchase Transaction, Home Solutions experienced a number of financial challenges and was limited in growth and working capital.[23]

17. In November 2019, TD transferred the administration of its loans to Home Solutions to the bank's "special loans" group, signifying that Home Solutions was in distressed circumstances and was potentially in need of restructuring or refinancing.[24] TD advised that it would continue to support Home Solutions via its existing operating line of credit, but would not provide the company with any further operating credit.[25]

18. In order to obtain alternative sources of financing, Home Solutions engaged Diamond Willow Advisory ("**Diamond Willow**") in mid-May 2021 to assist.[26] Diamond Willow contacted PDP, as well as other potential lenders. PDP conducted extensive due diligence and

[21] Davidson Affidavit at para 14.
[22] Davidson Affidavit at para 15.
[23] Davidson Affidavit at para 16.
[24] Davidson Affidavit at para 16.
[25] Davidson Affidavit at para 17.
[26] Davidson Affidavit at para 17.

expressed an interest in refinancing Home Solutions.[27] On January 12, 2022, PDP provided Home Solutions with a demand-term loan in the amount of $9,135,000 (the "**Loan**"). The proceeds were used to pay out TD's existing term loan and TD's existing demand loan, with the remainder used as working capital by Home Solutions.[28]

19. At the time of the Loan, Mr. Davidson provided to PDP a personal guarantee, dated January 11, 2022, which was limited to 15% of the obligations of Home Solutions to PDP.[29] At the same time, 208 also provided an unlimited guarantee of the Loan to PDP, and pledged its shares in Home Solutions as security for that guarantee.[30]

Continued Challenges for Home Solutions

20. After receiving the Loan, Home Solutions commenced reporting to PDP in accordance with the terms of the Credit Agreement, including providing information about the company's financial circumstances and performance, including its continued struggles.[31] Pursuant to the Credit Agreement between the parties, PDP agreed to keep confidential all information it received from Home Solutions.[32]

21. Beginning (as far as is known to the Applicants) in March 2022, and in breach of the Credit Agreement, PDP began taking steps to undermine Mr. Davidson's position at Home Solutions and sought to appropriate economic benefits from Home Solutions for its own gain.[33] PDP communicated with investors, previous owners, and unknown parties regarding Home Solutions to the exclusion of Mr. Davidson, 208, and the other minority shareholders, including disclosing confidential information.[34] PDP also threatened lawsuits and the imposition of personal liability.[35] PDP eventually demanded Mr. Davidson's resignation.[36]

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[27] Davidson Affidavit at para 18.
[28] Davidson Affidavit at para 19.
[29] Davidson Affidavit at para 10, Exhibit "3".
[30] Davidson Affidavit at para 10, Exhibit "4".
[31] Davidson Affidavit at para 21.
[32] Davidson Affidavit at para 20.
[33] Davidson Affidavit at para 22.
[34] Davidson Affidavit at para 23.
[35] Davidson Affidavit at paras 24-25.
[36] Davidson Affidavit at para 24.

The Forbearance Agreement and Aftermath

22. Between May 7 and May 9, 2022, PDP and Home Solutions negotiated a forbearance agreement (the "**Forbearance Agreement**") which provided, *inter alia*:

(a) 208 would transfer its shares in Home Solutions, representing a 79% interest in Home Solutions, to PDP;

(b) the directors of Home Solutions would sign a resolution, *inter alia*, terminating Mr. and Mrs. Davidson's employment with Home Solutions, appointing Mr. Deacon as a director of Home Solutions, and resigning their positions as directors, leaving Mr. Deacon as the sole director (the "**Resolution**");

(c) Mr. Deacon would cause Home Solutions to engage a Chief Restructuring Officer ("**CRO**") and file a Notice of Intention to Make a Proposal, pursuant to the *BIA*, in which Home Solutions would conduct a sale process for its business and assets;

(d) the parties would assist in maximizing the value of Home Solutions, for the benefit of its stakeholders;

(e) PDP would submit a stalking horse bid in the NOI sale process, in which it would offer to purchase Home Solutions or its assets, and fully assume Home Solutions' debt owed to PDP and TD; and

(f) PDP would forbear from enforcing the Loan, as well as the guarantees given by Mr. Davidson and 208, for six months.[37]

23. Mr. Deacon made a number of representations in conjunction with the execution of the Forbearance Agreement, including that PDP had investors prepared to inject $4 to $5 million in capital into Home Solutions; that Home Solutions would have access to the necessary liquidity to sustain operations via PDP and Mr. Deacon; that the NOI and CRO would be in place by May 24, 2022; and that the NOI would be orderly and result in a court-ordered sale, perhaps via PDP's stalking horse bid.[38] Mr. Deacon and PDP also represented that they would

[37] Davidson Affidavit at para 26 and Exhibit "11".
[38] Davidson Affidavit at para 27.

fully assume the debts owed to PDP and TD via the NOI.[39] Unfortunately, the representations made by PDP and Mr. Deacon were untrue.[40]

24. On May 11, 2022, the Resolution was passed by Home Solutions' board of directors and the Forbearance Agreement was executed.[41] In accordance with the Forbearance Agreement and the Resolution, the Applicants were terminated from their employment, Mr. Davidson and the other directors of Home Solutions resigned, and Mr. Deacon was appointed as the sole director of Home Solutions.[42]

25. Ultimately, Mr. Deacon and PDP were completely ill-equipped to manage Home Solutions.[43] Home Solutions was unable to perform its obligations under the Forbearance Agreement and Deacon and PDP caused the company to assign itself into bankruptcy on May 19, 2022, just eight days after taking over.[44] Mr. Deacon and PDP subsequently terminated the Forbearance Agreement, making unfounded (in the Applicants' submission) allegations that Mr. Davidson had breached it.[45] As a result, Mr. Davidson and 208 have been exposed to potential liability under the guarantees.[46]

Trustee Declines to Act

26. On December 21, 2022, counsel to the Applicants wrote to the Trustee, requesting that the Trustee commence litigation against PDP and Mr. Deacon in the name of Home Solutions.[47] The Applicants provided the Trustee with their Proofs of Claims,[48] along with various items of evidence and documentation.[49] On March 8, 2023 the Trustee advised counsel for the Applicants that it declined to take proceedings.[50]

27. Additionally, on March 20, 2023, the Trustee wrote to counsel to the Applicants, rejecting a portion of Mrs. Davidson's Proof of Claim, stating it had insufficient information to accept Mr. Davidson's Proof of Claim, and inquiring as to whether the Applicants intended

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[39] Davidson Affidavit at para 31.
[40] Davidson Affidavit at para 28.
[41] Davidson Affidavit at para 29, Exhibits "11" and "12".
[42] Davidson Affidavit at para 29, Exhibits "11", "12" and "13".
[43] Davidson Affidavit at para 31.
[44] Davidson Affidavit at para 32.
[45] Davidson Affidavit at para 34.
[46] Davidson Affidavit at paras 33-34.
[47] Davidson Affidavit at para 42.
[48] Davidson Affidavit at para 40, Exhibit "23".
[49] Davidson Affidavit at paras 40-52, Exhibits "23" to "34".
[50] Davidson Affidavit at paras 41-47.

to submit further information in support of the Proofs of Claim.[51] The Trustee advised that it had insufficient information to render a decision.[52] The Applicants' counsel provided clarification,[53] but the Trustee still had not rendered a decision on the Applicant Andrew Davidson's Proof of Claim at the time of filing this Application. On May 26, 2023, the Trustee issued a Notice of Partial Disallowance of the Proof of Claim of Mrs. Davidson, disallowing $14,167 of her Proof of Claim in the amount of $20,836 (and thus implicitly allowing $6,669 of Mrs. Davidson's Proof of Claim).[54]

28. Mrs. Davidson filed a Proof of Claim in the amount of $20,836, $6,669 of which has been accepted by the Trustee, while Mr. Davidson's Proof of Claim was for $402,454,[55] which has neither been accepted nor disallowed.

29. Notably, the Trustee informed counsel to the Applicants on March 30, 2023 that it was no longer in possession of a number of Home Solutions' records, which had been given to the Court-appointed Receiver.[56]

III. ISSUES

30. The issues for determination in this Application are:

(a) are the Applicants, and in particular, the Applicant Andrew Davidson, creditors of the Bankrupt and, if so, what is the quantum of their claims?;

(b) should this Court permit the Applicants to file the proposed claim against PDP and Mr. Deacon and proceed in the Trustee's stead, pursuant to section 38 of the *BIA*?; and

(c) should this Court order the Receiver to deliver copies to the Applicants of the books and records of the Bankrupt that concern or relate to the proposed civil claim?

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[51] Davidson Affidavit at para 48.
[52] Davidson Affidavit at para 48.
[53] Davidson Affidavit at paras 44-52, Exhibits "27" to "34".
[54] Davidson Affidavit at para 54 and Exhibit "36".
[55] Davidson Affidavit at para 56 and Exhibit "37".
[56] Davidson Affidavit at para 51.

IV. ARGUMENT

1. The Applicants are Creditors of the Bankrupt

31. As noted above, to date, the Trustee has partially disallowed the Proof of Claim of the Applicant, Jody Davidson, in the amount of $6,669, but the Trustee has declined to make a final decision with respect to the Proof of Claim of the Applicant, Andrew Davidson. Section 135 of the *BIA* provides that a Trustee is required to examine Proofs of Claim, to determine whether they be allowed or disallowed, and to set a value for those claims. Section 135 states:

> **Trustee shall examine proof**
>
> 135 (1) The trustee shall examine every proof of claim or proof of security and the grounds therefor and may require further evidence in support of the claim or security.
>
> **Determination of provable claims**
>
> (1.1) The trustee shall determine whether any contingent claim or unliquidated claim is a provable claim, and, if a provable claim, the trustee shall value it, and the claim is thereafter, subject to this section, deemed a proved claim to the amount of its valuation.
>
> **Disallowance by trustee**
>
> (2) The trustee may disallow, in whole or in part,
>
> (a) any claim;
>
> (b) any right to a priority under the applicable order of priority set out in this Act; or
>
> (c) any security.
>
> **Notice of determination or disallowance**
>
> (3) Where the trustee makes a determination under subsection (1.1) or, pursuant to subsection (2), disallows, in whole or in part, any claim, any right to a priority or any security, the trustee shall forthwith provide, in the prescribed manner, to the person whose claim was subject to a determination under subsection (1.1) or whose claim, right to a priority or security was disallowed under subsection (2), a notice in the prescribed form setting out the reasons for the determination or disallowance.

> **Determination or disallowance final and conclusive**
>
> (4) A determination under subsection (1.1) or a disallowance referred to in subsection (2) is final and conclusive unless, within a thirty day period after the service of the notice referred to in subsection (3) or such further time as the court may on application made within that period allow, the person to whom the notice was provided appeals from the trustee's decision to the court in accordance with the General Rules.
>
> **Expunge or reduce a proof**
>
> (5) The court may expunge or reduce a proof of claim or a proof of security on the application of a creditor or of the debtor if the trustee declines to interfere in the matter.

32. In deciding the validity of a claim, certainty is not the test.[57] If the method used in calculating the amount of the claim is reasonable and the evidence in support of the claim is relevant and probative, the claim should be admitted.[58]

33. As is discussed further below, in order to bring a proceeding pursuant to section 38 of the *BIA*, the moving party must be a creditor of the bankrupt. The Applicants have informed the Trustee of their proposed claims against PDP and Mr. Deacon and the Trustee has declined to proceed. The Applicants subsequently informed the Trustee of their desire to pursue a section 38 application.

34. The Applicants' status as creditors of the Bankrupt should be uncontroversial. Both were terminated by Home Solutions following execution of the Forbearance Agreement. The Applicants provided the Trustee with their Proofs of Claim on December 14, 2022 (with a revised Proof of Claim on behalf of Mrs. Davidson provided on February 23, 2023). Mr. Davidson has claims in the amount of $402,454, while Mrs. Davidson has claims in the amount of $20,836, $6,669 of which has been allowed by the Trustee.

35. Mr. Davidson's creditor status arises by way of his termination as an employee of Home Solutions and the rights outlined in his Executive Employment Agreement.[59] He is owed:

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[57] Lloyd Houlden, Geoffrey Morawetz & Janis Sarra, *The 2022-2023 Annotated Bankruptcy and Insolvency Act* (Toronto: Thomson Reuters Canada Limited, 2022) [**Houlden and Morawetz**], §6:264 [**TAB 3**], citing *HDYC Holdings Ltd v (Trustee of)*, 35 CBR (3d) 294 [***HDYC***] at para 70, 1995 CanLII 488 (BCSC), rev'd on other grounds (1997), 50 CBR (3d) 85 [**TAB 4**]. See also, *Asian Concepts Franchising Corporation (Re)*, 2018 BCSC 1022 at para 64 [**TAB 5**].

[58] Houlden and Morawetz, §6:264, citing *HDYC* at para 70. [**TAB 3**]

[59] Mr. Davidson's Executive Employment Agreement is appended to his Proof of Claim, found in the Davidson Affidavit at Exhibit "32".

(a) two months of unpaid wages, at a rate of $15,833.33 per month, pursuant to section 6.3(a) of his Executive Employment Agreement, totaling $31,667, which had been owed by Home Solutions to Mr. Davidson since 2019;[60]

(b) accrued and unused vacation, in the amount of 13.66 weeks, pursuant to section 6.3(b) of his Executive Employment Agreement, totaling $54,071;

(c) a retiring allowance, amounting to 12 months' base salary, plus four extra months for 3.33 years of service at the Bankrupt, pursuant to section 6.3(c) of his Executive Employment Agreement, totaling $242,728;

(d) two times his annual bonus eligibility for 2021, pursuant to sections 5.2 and 6.3(d) of his Executive Employment Agreement, totaling $50,000; and

(e) an amount equal to 10% of the retiring allowance set out at section 6.3(c) to compensate Mr. Davidson for the loss of all other benefits and prerequisites of employment, pursuant to section 6.3(e) of his Executive Employment Agreement, totaling $23,750.

36. Similarly, Mrs. Davidson's creditor status arises by way of the termination of her employment with Home Solutions and her rights pursuant to the Alberta *Employment Standards Code*.[61] She claims she is owed:

(a) two months of unpaid wages, at a rate of $7,083 per month, totaling $14,167, which had been owed by Home Solutions to Mrs. Davidson since 2019; the Trustee has disallowed this part of Mrs. Davidson's Proof of Claim;[62]

(b) vacation pay, pursuant to section 34.2(a) of the *Employment Standards Code*, in the amount of $3,400; and

(c) termination pay, pursuant to section 57(1) of the *Employment Standards Code*.

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[60] Davidson Affidavit, Exhibit "31".
[61] Alberta *Employment Standards Code*, RSA 2000, c E-9. [**TAB 6**]
[62] Davidson Affidavit, para 54, Exhibit "36".

37. These facts have been detailed for the Trustee, as have the disputes between the parties. The Trustee has been informed that the Applicants wish to pursue a section 38 application, and has been provided with extensive evidence and documentation in support of the Applicant Andrew Davidson's creditor status, but the Trustee has declined to render a decision as to the Applicant Andrew Davidson's claims in the bankruptcy.

38. Instead the Trustee has repeatedly stated it does not have enough information to accept Mr. Davidson's claims. The Trustee has opined, without support, that Mr. Davidson waived his outstanding wages by virtue of continuing to work at Home Solutions, and questioned the termination of Mr. Davidson's employment notwithstanding the fully-executed Resolution confirming that his and Mrs. Davidson's employment was terminated.[63] The Trustee has been informed of the inaccuracy of these positions, and has been directed to the relevant documentation, governing contracts and legislation, but the Trustee has continued to ask for additional information in support of Mr. Davidson's claim. The Trustee has, additionally, noted that some of the documentation relevant to the Applicants' claims is no longer in the Trustee's possession and, instead, has been turned over to the Receiver.

39. With respect to Mr. Davidson's claim for a retiring allowance plus 10% of that amount pursuant to sections 6.3(c) and (e) of his Executive Employment Agreement, the Trustee has taken the position that pursuant to section 5.2 of that agreement, a gross revenue threshold of $15 Million must have been achieved by Home Solutions in order for the executive (Mr. Davidson) to be entitled to those amounts.[64] Mr. Davidson submits that nothing in sections 6.3(c) or (e) of the Executive Employment Agreement specifies that the $15 Million gross revenue threshold must have been achieved in the year prior to the termination of the executive's employment in order for the executive to be entitled to the amounts set out in sections 6.3(c) or (e).[65]

40. If for some reason this Court determines that Mr. Davidson is not entitled to the Retiring Allowance and other amounts claimed pursuant to sections 6.3(b), (d) and (e) and 5.2 of Mr. Davidson's Executive Employment Agreement, there is no question that Mr. Davidson is entitled, at the very least, to two weeks' statutory termination pay pursuant to sections 56

[63] Davidson Affidavit, para 49, Exhibit "32".
[64] Davidson Affidavit, Exhibit "36".
[65] Davidson Affidavit, Exhibit "37", Executive Employment Agreement included with Proof of Claim of Andrew Davidson.

and 57(1) of the *Employment Standards Code*, as his employment (which began in January 2019) was terminated on May 11, 2022 without notice or payment in lieu of notice.[66]

41. This Court is vested with original, auxiliary and ancillary jurisdiction in bankruptcy by virtue of the *BIA*. Section 183 of the *BIA* provides:

> **Courts vested with jurisdiction**
>
> 183 (1) The following courts are invested with such jurisdiction at law and in equity as will enable them to exercise original, auxiliary 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:
>
> …
>
> (d) in the Provinces of New Brunswick and Alberta, the Court of Queen's Bench;

42. Section 183 provides the Court with the jurisdiction to do "what is right and equitable in the circumstances of a case".[67] Inherent jurisdiction has been used where it is necessary to promote the objects of the *BIA*, where there is no other alternative available, or to accomplish what justice and practicality require.[68]

43. As noted by Houlden and Morawetz in its commentary on section 183:

> If proceedings are taken to determine whether a person is a creditor of the bankrupt estate or the rights and obligations of a creditor, the court sitting in bankruptcy has jurisdiction.[69]

44. The *BIA* is intended to provide for the orderly and fair distribution of the property of a bankrupt, among his or her creditors, and to provide a complete set of rules for bankruptcy proceedings.[70] It is remedial legislation, to be given wide and liberal interpretation.

45. The Applicant, Andrew Davidson, has provided substantial documentation and evidence in support of his claims. In spite of this, the Trustee has suggested that it has inadequate evidence to render a decision on his Proof of Claim, and also claims that the

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[66] Alberta *Employment Standards Code*, RSA 2000, c E-9. [**TAB 6**]
[67] *Sellathamby (Re)*, 2020 BCSC 1567 at para 73. [**TAB 7**]
[68] *Kingsway General Insurance Company v Residential Warranty Company of Canada Inc (Trustee of)*, 2006 ABCA 293 at para 21. [**TAB 8**]
[69] Houlden and Morawetz, §8.9. [**TAB 3**]
[70] *Re Lalonde* (1952), 32 CBR 191 at 120, 1952 CanLII 2 (SCC). [**TAB 9**]

Applicant's evidence does not match the estate's records (but has not produced the estate records in question, and has also advised that certain of the Bankrupt's records are not in its possession). The Trustee has produced no evidence contradicting the Proof of Claim of the Applicant, Andrew Davidson, and has neither accepted, nor disallowed, his Proof of Claim.

46. Without a decision on his status as a creditor, the Applicant, Andrew Davidson, is unable to advance his proposed civil claim pursuant to section 38 of the *BIA*. Practically speaking, not only has the Trustee declined to pursue the Applicants' damages on behalf of the estate, but its failure to make a determination on the Applicant Andrew Davidson's Proof of Claim risks preventing Mr. Davidson from pursuing the action on behalf of the estate via section 38.

47. Mr. Davidson therefore submits that it is appropriate for this Court to exercise its jurisdiction pursuant to section 183 of the *BIA* to declare that Mr. Davidson is a creditor of the Bankrupt estate and that he has all of the rights and obligations of creditors. Mr. Davidson has advanced a meritorious position as to his status as creditors and the evidence in support of those claims is relevant and probative. His claim should therefore be admitted; certainty is not required, although the repeated attempts by the Trustee to request even more documentation suggest that the Trustee is seeking that very high level of assurance.

48. Given the Trustee's failure to accept the Mr. Davidson's Proof of Claim, it is necessary for this Court to exercise its jurisdiction pursuant to section 183 of the *BIA* to promote the objects of the *BIA* and do what justice and practicality require: declare that Mr. Davidson is a creditor of the Bankrupt's estate, in the amount of $402,454.00 claimed by him, and that Mrs. Davidson is a creditor of the Bankrupt's estate, in the amount of $6,669.

2. A Section 38 Order is Appropriate in the Circumstances

49. Section 38 of the *BIA* exists to ensure that a bankrupt's assets are preserved for the benefit of creditors. It provides a mechanism for creditors to proceed with an action when the trustee refuses or fails to act.[71]

50. Section 38 states:

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[71] *Toyota Canada Inc v Imperial Richmond Holdings Ltd*, 1994 ABCA 261 at para 6, leave to appeal to SCC refused (24273). [**TAB 10**]

Proceeding by creditor when trustee refuses to act

38(1) Where a creditor requests the trustee to take any proceeding that in his opinion would be for the benefit of the estate of a bankrupt and the trustee refuses or neglects to take the proceeding, the creditor may obtain from the court an order authorizing him to take the proceeding in his own name and at his own expense and risk, on notice being given the other creditors of the contemplated proceeding, and on such other terms and conditions as the court may direct.

Transfer to creditor

(2) On an order under subsection (1) being made, the trustee shall assign and transfer to the creditor all his right, title and interest in the chose in action or subject-matter of the proceeding, including any document in support thereof.

Benefits belong to creditor

(3) Any benefit derived from a proceeding taken pursuant to subsection (1), to the extent of his claim and the costs, belongs exclusively to the creditor instituting the proceeding, and the surplus, if any, belongs to the estate.

Trustee may institute proceeding

(4) Where, before an order is made under subsection (1), the trustee, with the permission of the inspectors, signifies to the court his readiness to institute the proceeding for the benefit of the creditors, the order shall fix the time within which he shall do so, and in that case the benefit derived from the proceeding, if instituted within the time so fixed, belongs to the estate.[72]

51. According to the Court of Appeal of Alberta, four criteria must be satisfied in order to obtain a section 38 order:

(a) the applicant must be a creditor of the bankrupt estate;

(b) the applicant must have requested that the trustee undertake the proceeding which the applicant now seeks permission to undertake itself;

(c) the trustee must have refused or neglected to undertake the requested proceeding; and

[72] *BIA*, ss 38(1)-(4). [**TAB 1**]

(d) there is threshold merit to the proposed proceeding (i.e. it is not obviously spurious).[73]

52. The threshold merit criterion emanates from the implicit gatekeeping function assigned to the court under section 38(1).[74] The applicant must demonstrate a *prima facie* case, supported by evidence and not mere allegations. The threshold is not particularly high, and requires the applicant show that the claim is not "obviously spurious".[75]

53. Strict interpretation of the requirements of section 38 has been replaced by a more flexible approach; failure to comply with steps set out by section 38 can be excused by the court under section 187(9), provided the failure did not prejudice any party.[76]

54. As noted above, the Applicants seek this Court's declaration that they are creditors of the Bankrupt estate. Additionally, the Applicants have requested that the Trustee undertake the proposed action and the Trustee has declined.[77] The only issue that remains is whether the Applicants' proposed civil claim has threshold merit; put another way, the Applicants' proposed proceeding cannot be obviously spurious.

55. The Applicants have demonstrated that the conduct of PDP and Mr. Deacon caused significant damage to the Bankrupt. Home Solutions was bankrupted just eight days after PDP and Mr. Deacon took control from Mr. Davidson, causing irreparable financial harm to the company. PDP breached, *inter alia*, its clear and unconditional obligations pursuant to the Credit Agreement, the Forbearance Agreement, and numerous private contracts with suppliers and contractors. PDP and Mr. Deacon were negligent, and committed breaches of common law and statutory duties, including the duty of honest and good faith performance, and those obligations arising from Mr. Deacon's position as a director of the Bankrupt. Mr. Deacon also owed obligations to Home Solutions as a director of the corporation and those claims are Home Solutions' claims, and no one else's, to pursue.

56. Among the breaches, PDP and Mr. Deacon:

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[73] *Smith v PricewaterhouseCoopers*, 2013 ABCA 288 at para 16 [**Smith**]. [**TAB 11**]
[74] *Smith* at para 18. [**TAB 11**]
[75] *Smith* at para 19 [**TAB 11**]. Canadian Abridgment Words & Phrases defines a spurious argument as one that is seriously flawed, even though it may have an apparent air of legitimacy about it. (W&P 25951)
[76] *Jaston & Co v McCarthy* (1998), 168 DLR (4th) 415 at paras 53-54, 59 BCLR (3d) 168. [**TAB 12**]
[77] Davidson Affidavit at paras 36-51.

(a) failed to obtain the promised investment for Home Solutions;

(b) failed to engage a CRO or cause Home Solutions to initiate NOI proceedings;

(c) failed to ensure that sufficient funding was in place to meet Home Solutions' liquidity needs;

(d) breached confidentiality pursuant to the Credit Agreement;

(e) breached agreements with suppliers and contractors; and

(f) reneged on submitting a stalking horse bid in an NOI sale process, in the process assuming the debts owed by Home Solutions and the Applicants to PDP and TD.

57. As a result of these breaches, Home Solutions was unable to obtain new ownership, maintain sufficient liquidity, preserve business relations with suppliers and contractors in order to sustain necessary cash flow and, ultimately, stay in business. Home Solutions was subsequently bankrupted by Mr. Deacon, its sole director, the loans guaranteed by the Applicants went unpaid and were not assumed, and the Bankrupt and Applicants have suffered significant damages.

58. The evidentiary record for the allegations in the proposed civil claim is substantial.[78] The Applicants therefore submit that they have demonstrated that the proposed action is *prima facie* meritorious, and all prerequisites for a section 38 order have therefore been satisfied.

3. The Proposed Defendants Are Not Entitled to Notice or Standing

59. In serving the Trustee with notice of this Application, the Applicants have taken all procedural steps necessary in pursuing a section 38 application. Only the Trustee need be served with notice of a section 38 Application; the proposed defendant need not be served.[79] Even if the proposed defendant has notice of the section 38 application, the proposed defendant

[78] See Davidson Affidavit.
[79] Houlden and Morawetz, §2:147. [**TAB 3**]

has no standing to appear on the hearing of the application, not can the proposed defendant cross-examine on the material filed in support.[80]

60. The Trustee was informed on December 21, 2022 that the Applicants intended to pursue a section 38 application if the Trustee declined to take proceedings against PDP and Mr. Deacon on behalf of Home Solutions. On March 8, 2023, the Trustee confirmed it would not proceed against PDP and Mr. Deacon. The Trustee will be served with this Application, the Davidson Affidavit, and this Brief. All procedural steps have therefore been or will have been satisfied by the Applicants.

61. The Applicants have also served the Receiver with notice of this Application, due to the Application for production by the Receiver of books and records relevant to the proposed civil claim. The Receiver does not have standing in relation to the relief the Applicants seek pursuant to section 38 of the *BIA*.

4. The Applicants Are Entitled to Receive the Receiver's Books and Records Relating to the Proposed Civil Claim

62. This Court is vested with the power to order that the Receiver turn over copies of all books and records relevant to the proposed civil claim. Rule 5.13 of the Alberta *Rules of Court* provides:

> **Obtaining records from others**
>
> 5.13(1) On application, and after notice of the application is served on the person affected by it, the Court may order a person who is not a party to produce a record at a specified date, time and place if
>
> (a) the record is under the control of that person,
>
> (b) there is reason to believe that the record is relevant and material, and
>
> (c) the person who has control of the record might be required to produce it at trial.

[80] Houlden and Morawetz, §2:148. [**TAB 3**]

63. The test for whether a record is relevant and material is governed by Rule 5.2.[81] Rule 5.2 provides:

> **When something is relevant and material**
>
> 5.2(1) For the purposes of this Part, a question, record or information is relevant and material only if the answer to the question, or the record or information, could reasonably be expected
>
> > (a) to significantly help determine one or more of the issues raised in the pleadings, or
> >
> > (b) to ascertain evidence that could reasonably be expected to significantly help determine one or more of the issues raised in the pleadings.

64. Relevance is determined primarily by the pleadings, while materiality relates to whether the information can help, directly or indirectly, to prove a fact in issue.[82] These are not fixed standards and an element of judgment is required.[83] The production or records is discretionary.[84]

65. The Trustee has indicated that the Bankrupt's records are now, primarily, in the possession of the Receiver. Additionally, the Receiver would undoubtedly be required to produce said records were this matter to proceed to a trial. Therefore, the only portion of the test outlined in Rule 5.13 that is in question is whether or not the records are relevant and material.

66. As noted above, the production of records from a third party is a discretionary decision. The records requested in this instance are narrow in scope – the Applicants seek access only to those records, financial or otherwise, that are relevant for the purposes of the proposed civil claim. There should be no reason for the Receiver to object to the production of such documentation, particularly given that the Applicants seek by means of their proposed civil claim to advance similar objectives to those of the court-appointed officers involved in Home Solutions' bankruptcy and receivership.

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[81] *Terrigno v Butzner*, 2023 ABCA 124 [***Terrigno***] at para 7 [**TAB 13**], citing *Dow Chemical Canada ULC v Nova Chemicals Corporation*, 2014 ABCA 244 [***Dow***] at paras 16-17.
[82] *Terrigno* at para 9 [**TAB 13**], citing *Dow* at para 17.
[83] *Terrigno* at para 9 [**TAB 13**], citing *Dow* at para 19.
[84] *Terrigno* at para 10 [**TAB 13**].

67. On the issue of materiality, the Bankrupt's financials and other documentation relating to the relationship between PDP, Mr. Deacon, and the Applicants, would certainly assist in proving, either directly or indirectly, the facts alleged in the proposed civil claim, all of which are financial in nature.

68. The case for production is even more compelling in these circumstances than in most applications under Rule 5.13. Here, if the Applicants are authorized to advance the civil claim under section 38 of the *BIA*, it will be Home Solutions' claim that they are advancing. The only relief they seek as against the Receiver is copies of Home Solutions' very own records. The Receiver only has those records because the Trustee delivered them, and apparently did not retain copies. Allowing the Applicants to have access to all the relevant and material records of Home Solutions, to advance a claim of Home Solutions, is obvious and necessary ancillary relief.

69. As such, the Applicants submit that there is no reason that the books and records of Home Solutions that are relevant to the proposed civil claim and in possession of the Receiver should not be provided to the Applicants.

V. CONCLUSION

70. As described above, PDP and Mr. Deacon have caused substantial damages to the Bankrupt's estate. The Trustee has declined to pursue litigation in this regard and, despite being informed of the Applicants' willingness to do so in the Trustee's stead, has declined to issue a determination with respect to the Applicants' Proofs of Claim. In part, the Trustee cites a lack of documentation, noting the Applicants' evidence has been insufficient and the remainder of the documentation remains in the Receiver's possession.

71. The Applicants have demonstrated before this Court that they are properly creditors of the Bankrupt. The Applicants have also demonstrated the existence of the threshold merit required to permit them to proceed to litigate in the Trustee's stead. This Court's permission to proceed pursuant to section 38 of the *BIA*, as well as a declaration of the Applicants' status as creditors of the Bankrupt, is appropriate in the circumstances. To the extent it assists in informing their status as creditors, access to copies of records in the possession of the Receiver is similarly appropriate.

VI. RELIEF SOUGHT

72. The Applicants seek the following relief:

(a) A declaration that Andrew Davidson is an unsecured creditor of the Bankrupt in the amount of $402,454.00;

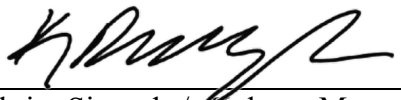
(b) A declaration that Jody Davidson is an unsecured creditor of the Bankrupt in the amount of $6,669.00;

(c) An Order requiring the Receiver to deliver to counsel for the Applicants true copies of all books and records of the Bankrupt that concern or relate to the proposed civil claim; and

(d) Pursuant to section 38 of the *BIA*, an Order authorizing the Applicants and any other Participating Creditors (as defined in the Applicants' Application) to proceed in the place of the Trustee and prosecute proceedings on behalf of the estate of the Bankrupt in their own names, for their own benefit and at their own expense as against PDP and Mr. Deacon (the "**Proceedings**"), as further described in the Applicants' Application and the form of Order appended thereto.

ALL OF WHICH IS RESPECTFULLY SUBMITTED at Calgary, Alberta this 31st day of May, 2023.

BENNETT JONES LLP

Per: 

Chris Simard / Kelsey Meyer / Adam J. Williams
Counsel for the Applicants,
Andrew Davidson and Jody Davidson

VII. TABLE OF AUTHORITIES

TAB

TAB 1

CANADA

CONSOLIDATION

CODIFICATION

Bankruptcy and Insolvency Act

Loi sur la faillite et l'insolvabilité

R.S.C., 1985, c. B-3

L.R.C. (1985), ch. B-3

Current to April 20, 2023

Last amended on September 1, 2022

À jour au 20 avril 2023

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OFFICIAL STATUS OF CONSOLIDATIONS

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

Published consolidation is evidence

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

Inconsistencies in Acts

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

CARACTÈRE OFFICIEL DES CODIFICATIONS

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

Codifications comme élément de preuve

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

Incompatibilité — lois

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

LAYOUT

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

MISE EN PAGE

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

NOTE

This consolidation is current to April 20, 2023. The last amendments came into force on September 1, 2022. Any amendments that were not in force as of April 20, 2023 are set out at the end of this document under the heading "Amendments Not in Force".

NOTE

Cette codification est à jour au 20 avril 2023. Les dernières modifications sont entrées en vigueur le 1 septembre 2022. Toutes modifications qui n'étaient pas en vigueur au 20 avril 2023 sont énoncées à la fin de ce document sous le titre « Modifications non en vigueur ».

(e) as soon as funds are available, pay to the former trustee his remuneration and disbursements as approved by the court.

R.S., 1985, c. B-3, s. 36; 1992, c. 27, s. 14; 1997, c. 12, s. 24; 2004, c. 25, s. 23; 2005, c. 47, ss. 28, 123(E); 2007, c. 36, s. 11(F).

e) dès que les fonds sont disponibles, paie à l'ancien syndic sa rémunération et ses débours, approuvés par le tribunal.

L.R. (1985), ch. B-3, art. 36; 1992, ch. 27, art. 14; 1997, ch. 12, art. 24; 2004, ch. 25, art. 23; 2005, ch. 47, art. 28 et 123(A); 2007, ch. 36, art. 11(F).

Appeal to court against trustee

37 Where the bankrupt or any of the creditors or any other person is aggrieved by any act or decision of the trustee, he may apply to the court and the court may confirm, reverse or modify the act or decision complained of and make such order in the premises as it thinks just.

R.S., c. B-3, s. 19.

Appel au tribunal contre le syndic

37 Lorsqu'un acte ou une décision du syndic lèse le failli ou l'un des créanciers ou toute autre personne, l'intéressé peut s'adresser au tribunal, et ce dernier peut confirmer, infirmer ou modifier l'acte ou la décision qui fait l'objet de la plainte et rendre à ce sujet l'ordonnance qu'il juge équitable.

S.R., ch. B-3, art. 19.

Proceeding by creditor when trustee refuses to act

38 (1) Where a creditor requests the trustee to take any proceeding that in his opinion would be for the benefit of the estate of a bankrupt and the trustee refuses or neglects to take the proceeding, the creditor may obtain from the court an order authorizing him to take the proceeding in his own name and at his own expense and risk, on notice being given the other creditors of the contemplated proceeding, and on such other terms and conditions as the court may direct.

Procédures par un créancier lorsque le syndic refuse d'agir

38 (1) Lorsqu'un créancier demande au syndic d'intenter des procédures qui, à son avis, seraient à l'avantage de l'actif du failli, et que le syndic refuse ou néglige d'intenter ces procédures, le créancier peut obtenir du tribunal une ordonnance l'autorisant à intenter des procédures en son propre nom et à ses propres frais et risques, en donnant aux autres créanciers avis des procédures projetées, et selon les autres modalités que peut ordonner le tribunal.

Transfer to creditor

(2) On an order under subsection (1) being made, the trustee shall assign and transfer to the creditor all his right, title and interest in the chose in action or subject-matter of the proceeding, including any document in support thereof.

Droits du créancier

(2) Lorsque cette ordonnance est rendue, le syndic cède et transfère au créancier tous ses droits, titres et intérêts sur les biens et droits qui font l'objet de ces procédures, y compris tout document à l'appui.

Benefits belong to creditor

(3) Any benefit derived from a proceeding taken pursuant to subsection (1), to the extent of his claim and the costs, belongs exclusively to the creditor instituting the proceeding, and the surplus, if any, belongs to the estate.

Les profits appartiennent au créancier

(3) Tout profit provenant de procédures exercées en vertu du paragraphe (1), jusqu'à concurrence de sa réclamation et des frais, appartient exclusivement au créancier intentant ces procédures, et l'excédent, s'il en est, appartient à l'actif.

Trustee may institute proceeding

(4) Where, before an order is made under subsection (1), the trustee, with the permission of the inspectors, signifies to the court his readiness to institute the proceeding for the benefit of the creditors, the order shall fix the time within which he shall do so, and in that case the benefit derived from the proceeding, if instituted within the time so fixed, belongs to the estate.

R.S., 1985, c. B-3, s. 38; 2004, c. 25, s. 24(F).

Le syndic peut intenter des procédures

(4) Lorsque, avant qu'une ordonnance soit rendue en vertu du paragraphe (1), le syndic, avec la permission des inspecteurs, déclare au tribunal qu'il est prêt à intenter les procédures au profit des créanciers, l'ordonnance doit prescrire le délai qui lui est imparti pour ce faire, et dans ce cas le profit résultant des procédures, si elles sont intentées dans le délai ainsi prescrit, appartient à l'actif.

L.R. (1985), ch. B-3, art. 38; 2004, ch. 25, art. 24(F).

Secured creditor may amend

132 (1) Where the trustee has not elected to acquire the security as provided in this Act, a creditor may at any time amend the valuation and proof on showing to the satisfaction of the trustee or the court that the valuation and proof were made in good faith on a mistaken estimate or that the security has diminished or increased in value since its previous valuation.

Amendment at cost of creditor

(2) An amendment pursuant to subsection (1) shall be made at the cost of the creditor and on such terms as the court orders, unless the trustee allows the amendment without application to the court.

Rights and liabilities of creditor where valuation amended

(3) Where a valuation has been amended pursuant to this section, the creditor

(a) shall forthwith repay any surplus dividend that he may have received in excess of that to which he would have been entitled on the amended valuation; or

(b) is entitled to be paid out of any money for the time being available for dividend any dividend or share of dividend that he may have failed to receive by reason of the amount of the original valuation before that money is made applicable to the payment of any future dividend, but he is not entitled to disturb the distribution of any dividend declared before the amendment is filed with the trustee.

R.S., c. B-3, s. 103.

Exclusion for non-compliance

133 Where a secured creditor does not comply with sections 127 to 132, he shall be excluded from any dividend.

R.S., c. B-3, s. 104.

No creditor to receive more than 100 cents in dollar

134 Subject to section 130, a creditor shall in no case receive more than one hundred cents on the dollar and interest as provided by this Act.

R.S., c. B-3, s. 105.

Admission and Disallowance of Proofs of Claim and Proofs of Security

Trustee shall examine proof

135 (1) The trustee shall examine every proof of claim or proof of security and the grounds therefor and may require further evidence in support of the claim or security.

Le créancier garanti peut modifier l'évaluation

132 (1) Lorsque le syndic n'a pas choisi d'acquérir la garantie dans les conditions prévues à la présente loi, un créancier peut modifier l'évaluation et la preuve en démontrant, à la satisfaction du syndic ou du tribunal, que l'évaluation et la preuve ont été faites de bonne foi sur une estimation erronée, ou que la garantie a diminué ou augmenté en valeur depuis son évaluation précédente.

Modification aux frais du créancier

(2) Une modification conforme au paragraphe (1) est faite aux frais du créancier et selon les modalités que le tribunal prescrit, à moins que le syndic ne permette la modification sans requête au tribunal.

Droits et obligations du créancier lorsque l'évaluation est modifiée

(3) Lorsqu'une évaluation a été modifiée conformément au présent article, le créancier, selon le cas :

a) doit rembourser sans retard tout surplus de dividende qu'il peut avoir reçu en sus du montant auquel il aurait eu droit sur l'évaluation modifiée;

b) a droit de recevoir, sur les deniers alors applicables à des dividendes, tout dividende ou part de dividende qu'il peut ne pas avoir reçu à cause du montant de l'évaluation primitive, avant que ces montants soient attribués au paiement d'un dividende futur; il n'a toutefois pas le droit de déranger la distribution d'un dividende déclaré avant que la modification soit déposée chez le syndic.

S.R., ch. B-3, art. 103.

Exclusion pour défaut de se conformer

133 Lorsqu'un créancier garanti ne se conforme pas aux articles 127 à 132, il est exclu de tout dividende.

S.R., ch. B-3, art. 104.

Aucun créancier ne peut recevoir plus de cent cents par dollar

134 Sous réserve de l'article 130, un créancier ne peut dans aucun cas recevoir plus de cent cents par dollar avec l'intérêt prévu par la présente loi.

S.R., ch. B-3, art. 105.

Admission et rejet des preuves de réclamation et de garantie

Examen de la preuve

135 (1) Le syndic examine chaque preuve de réclamation ou de garantie produite, ainsi que leurs motifs, et il peut exiger de nouveaux témoignages à l'appui.

Determination of provable claims

(1.1) The trustee shall determine whether any contingent claim or unliquidated claim is a provable claim, and, if a provable claim, the trustee shall value it, and the claim is thereafter, subject to this section, deemed a proved claim to the amount of its valuation.

Disallowance by trustee

(2) The trustee may disallow, in whole or in part,

(a) any claim;

(b) any right to a priority under the applicable order of priority set out in this Act; or

(c) any security.

Notice of determination or disallowance

(3) Where the trustee makes a determination under subsection (1.1) or, pursuant to subsection (2), disallows, in whole or in part, any claim, any right to a priority or any security, the trustee shall forthwith provide, in the prescribed manner, to the person whose claim was subject to a determination under subsection (1.1) or whose claim, right to a priority or security was disallowed under subsection (2), a notice in the prescribed form setting out the reasons for the determination or disallowance.

Determination or disallowance final and conclusive

(4) A determination under subsection (1.1) or a disallowance referred to in subsection (2) is final and conclusive unless, within a thirty day period after the service of the notice referred to in subsection (3) or such further time as the court may on application made within that period allow, the person to whom the notice was provided appeals from the trustee's decision to the court in accordance with the General Rules.

Expunge or reduce a proof

(5) The court may expunge or reduce a proof of claim or a proof of security on the application of a creditor or of the debtor if the trustee declines to interfere in the matter.

R.S., 1985, c. B-3, s. 135; 1992, c. 1, s. 20, c. 27, s. 53; 1997, c. 12, s. 89.

Scheme of Distribution

Priority of claims

136 (1) Subject to the rights of secured creditors, the proceeds realized from the property of a bankrupt shall be applied in priority of payment as follows:

(a) in the case of a deceased bankrupt, the reasonable funeral and testamentary expenses incurred by the

Réclamations éventuelles et non liquidées

(1.1) Le syndic décide si une réclamation éventuelle ou non liquidée est une réclamation prouvable et, le cas échéant, il l'évalue; sous réserve des autres dispositions du présent article, la réclamation est dès lors réputée prouvée pour le montant de l'évaluation.

Rejet par le syndic

(2) Le syndic peut rejeter, en tout ou en partie, toute réclamation, tout droit à un rang prioritaire dans l'ordre de collocation applicable prévu par la présente loi ou toute garantie.

Avis de la décision

(3) S'il décide qu'une réclamation est prouvable ou s'il rejette, en tout ou en partie, une réclamation, un droit à un rang prioritaire ou une garantie, le syndic en donne sans délai, de la manière prescrite, un avis motivé, en la forme prescrite, à l'intéressé.

Effet de la décision

(4) La décision et le rejet sont définitifs et péremptoires, à moins que, dans les trente jours suivant la signification de l'avis, ou dans tel autre délai que le tribunal peut accorder, sur demande présentée dans les mêmes trente jours, le destinataire de l'avis n'interjette appel devant le tribunal, conformément aux Règles générales, de la décision du syndic.

Rejet total ou partiel d'une preuve

(5) Le tribunal peut rayer ou réduire une preuve de réclamation ou de garantie à la demande d'un créancier ou du débiteur, si le syndic refuse d'intervenir dans l'affaire.

L.R. (1985), ch. B-3, art. 135; 1992, ch. 1, art. 20, ch. 27, art. 53; 1997, ch. 12, art. 89.

Plan de répartition

Priorité des créances

136 (1) Sous réserve des droits des créanciers garantis, les montants réalisés provenant des biens d'un failli sont distribués d'après l'ordre de priorité de paiement suivant :

shall vest in any person that the court may appoint, or, in default of any appointment, revert to the bankrupt for all the estate, or interest or right of the trustee in the estate, on any terms and subject to any conditions, if any, that the court may order.

Final statement of receipts and disbursements

(3) If an order is made under subsection (1), the trustee shall, without delay, prepare the final statements of receipts and disbursements referred to in section 151.

R.S., 1985, c. B-3, s. 181; 2004, c. 25, s. 86; 2005, c. 47, s. 109.

Stay on issue of order

182 (1) An order of discharge or annulment shall be dated on the day on which it is made, but it shall not be issued or delivered until the expiration of the time allowed for an appeal, and, if an appeal is entered, not until the appeal has been finally disposed of.

(2) [Repealed, 1992, c. 27, s. 65]

R.S., 1985, c. B-3, s. 182; 1992, c. 27, s. 65.

mais les biens du failli sont dévolus à la personne que le tribunal peut nommer, ou, à défaut de cette nomination, retournent au failli pour tout droit, domaine ou intérêt du syndic, aux conditions, s'il en est, que le tribunal peut ordonner.

État définitif des recettes et des débours

(3) Malgré l'annulation de la faillite, le syndic prépare sans délai l'état définitif des recettes et des débours visé à l'article 151.

L.R. (1985), ch. B-3, art. 181; 2004, ch. 25, art. 86; 2005, ch. 47, art. 109.

Suspension de l'émission de l'ordonnance

182 (1) L'ordonnance de libération ou d'annulation porte la date à laquelle elle est rendue, mais ne peut être émise ou délivrée avant l'expiration du délai accordé pour un appel ni, si appel est interjeté, avant que l'appel ait été finalement jugé.

(2) [Abrogé, 1992, ch. 27, art. 65]

L.R. (1985), ch. B-3, art. 182; 1992, ch. 27, art. 65.

PART VII

Courts and Procedure

Jurisdiction of Courts

Courts vested with jurisdiction

183 (1) The following courts are invested with such jurisdiction at law and in equity as will enable them to exercise original, auxiliary 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:

(a) in the Province of Ontario, the Superior Court of Justice;

(b) [Repealed, 2001, c. 4, s. 33]

(c) in the Provinces of Nova Scotia and British Columbia, the Supreme Court;

(d) in the Provinces of New Brunswick and Alberta, the Court of Queen's Bench;

(e) in the Province of Prince Edward Island, the Supreme Court of the Province;

(f) in the Provinces of Manitoba and Saskatchewan, the Court of Queen's Bench;

PARTIE VII

Tribunaux et procédure

Compétence des tribunaux

Tribunaux compétents

183 (1) Les tribunaux suivants possèdent la compétence en droit et en equity qui doit leur permettre d'exercer la juridiction de première instance, auxiliaire et subordonnée en matière de faillite et en d'autres procédures autorisées par la présente loi durant leurs termes respectifs, tels que ces termes sont maintenant ou peuvent par la suite être tenus, pendant une vacance judiciaire et en chambre :

a) dans la province d'Ontario, la Cour supérieure de justice;

b) [Abrogé, 2001, ch. 4, art. 33]

c) dans les provinces de la Nouvelle-Écosse et de la Colombie-Britannique, la Cour suprême;

d) dans les provinces du Nouveau-Brunswick et d'Alberta, la Cour du Banc de la Reine;

e) dans la province de l'Île-du-Prince-Édouard, la Cour suprême;

f) dans les provinces du Manitoba et de la Saskatchewan, la Cour du Banc de la Reine;

(g) in the Province of Newfoundland and Labrador, the Trial Division of the Supreme Court; and

(h) in Yukon, the Supreme Court of Yukon, in the Northwest Territories, the Supreme Court of the Northwest Territories, and in Nunavut, the Nunavut Court of Justice.

g) dans la province de Terre-Neuve-et-Labrador, la Division de première instance de la Cour suprême;

h) au Yukon, la Cour suprême du Yukon, dans les Territoires du Nord-Ouest, la Cour suprême des Territoires du Nord-Ouest et, au Nunavut, la Cour de justice du Nunavut.

Superior Court jurisdiction in the Province of Quebec

(1.1) In the Province of Quebec, the Superior Court is invested with the jurisdiction that will enable it to exercise original, auxiliary and ancillary jurisdiction in bankruptcy and in other proceedings authorized by this Act during its term, as it is now, or may be hereafter, held, and in vacation and in chambers.

Compétence de la Cour supérieure de la province de Québec

(1.1) Dans la province de Québec, la Cour supérieure possède la compétence pour exercer la juridiction de première instance, auxiliaire et subordonnée en matière de faillite et en d'autres procédures autorisées par la présente loi durant son terme, tel que celui-ci est maintenant ou peut par la suite être tenu, pendant une vacance judiciaire et en chambre.

Courts of appeal — common law provinces

(2) Subject to subsection (2.1), the courts of appeal throughout Canada, within their respective jurisdictions, are invested with power and jurisdiction at law and in equity, according to their ordinary procedures, except as varied by this Act or the General Rules, to hear and determine appeals from the courts vested with original jurisdiction under this Act.

Cours d'appel — provinces de common law

(2) Sous réserve du paragraphe (2.1), les cours d'appel du Canada, dans les limites de leur compétence respective, sont, en droit et en equity, conformément à leur procédure ordinaire, sauf divergences prévues par la présente loi ou par les Règles générales, investies de la compétence d'entendre et de juger les appels interjetés des tribunaux exerçant juridiction de première instance en vertu de la présente loi.

Court of Appeal of the Province of Quebec

(2.1) In the Province of Quebec, the Court of Appeal, within its jurisdiction, is invested with power and jurisdiction, according to its ordinary procedures, except as varied by this Act or the General Rules, to hear and determine appeals from the Superior Court.

Cour d'appel de la province de Québec

(2.1) Dans la province de Québec, la Cour d'appel, dans les limites de sa compétence, est, conformément à sa procédure ordinaire, sauf divergences prévues par la présente loi ou par les Règles générales, investie de la compétence d'entendre et de juger les appels interjetés de la Cour supérieure.

Supreme Court of Canada

(3) The Supreme Court of Canada has jurisdiction to hear and to decide according to its ordinary procedure any appeal so permitted and to award costs.

R.S., 1985, c. B-3, s. 183; R.S., 1985, c. 27 (2nd Supp.), s. 10; 1990, c. 17, s. 3; 1998, c. 30, s. 14; 1999, c. 3, s. 15; 2001, c. 4, s. 33; 2002, c. 7, s. 83; 2015, c. 3, s. 9.

Cour suprême du Canada

(3) La Cour suprême du Canada a compétence pour entendre et décider, suivant sa procédure ordinaire, tout appel ainsi autorisé et pour adjuger les frais.

L.R. (1985), ch. B-3, art. 183; L.R. (1985), ch. 27 (2e suppl.), art. 10; 1990, ch. 17, art. 3; 1998, ch. 30, art. 14; 1999, ch. 3, art. 15; 2001, ch. 4, art. 33; 2002, ch. 7, art. 83; 2015, ch. 3, art. 9.

Appointment of officers

184 Each of the following persons, namely,

(a) the Chief Justice of the court,

(b) in Quebec, the Chief Justice or the Associate Chief Justice in the district to which the Chief Justice or Associate Chief Justice was appointed,

(c) in Yukon, the Commissioner of Yukon,

Nomination de registraires, etc.

184 Chacune des personnes énumérées ci-dessous procède aux nominations et affectations de registraires, commis et autres fonctionnaires en matière de faillite qu'elle juge utiles pour l'expédition des questions au sujet desquelles la présente loi accorde compétence ou pouvoir, et peut spécifier ou restreindre la compétence territoriale de ces registraires, commis ou autres fonctionnaires :

a) le juge en chef du tribunal;

TAB 2

ALBERTA

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Part 5:
Disclosure of Information

Purpose of this Part

5.1(1) Within the context of rule 1.2 *[Purpose and intention of these rules]*, the purpose of this Part is

(a) to obtain evidence that will be relied on in the action,

(b) to narrow and define the issues between parties,

(c) to encourage early disclosure of facts and records,

(d) to facilitate evaluation of the parties' positions and, if possible, resolution of issues in dispute, and

(e) to discourage conduct that unnecessarily or improperly delays proceedings or unnecessarily increases the cost of them.

(2) The Court may give directions or make any order necessary to achieve the purpose of this Part.

Information note

This Part does not apply to actions started by originating application unless the parties otherwise agree or the Court otherwise orders. See rule 3.10 *[Application of Part 4 and Part 5]*.

Division 1
How Information Is Disclosed

Subdivision 1
Introductory Matters

When something is relevant and material

5.2(1) For the purposes of this Part, a question, record or information is relevant and material only if the answer to the question, or the record or information, could reasonably be expected

(a) to significantly help determine one or more of the issues raised in the pleadings, or

(b) to ascertain evidence that could reasonably be expected to significantly help determine one or more of the issues raised in the pleadings.

(2) The disclosure or production of a record under this Division is not, by reason of that fact alone, to be considered as an agreement or acknowledgment that the record is admissible or relevant and material.

(a) does not serve an affidavit of records in accordance with rule 5.5 *[When an affidavit of records must be served]* or within any modified period agreed on by the parties or set by the Court,

(b) does not comply with rule 5.10 *[Subsequent disclosure of records]*, or

(c) does not comply with an order under rule 5.11 *[Order for a record to be produced]*.

(2) If there is more than one party adverse in interest to the party ordered to pay the penalty, the penalty must be paid to the parties in the proportions determined by the Court.

(3) A penalty imposed under this rule applies irrespective of the final outcome of the action.

Information note

One of the additional sanctions that may be imposed is the striking out of pleadings. See rule 3.68(3) *[Court options to deal with significant deficiencies]*.

Obtaining records from others

5.13(1) On application, and after notice of the application is served on the person affected by it, the Court may order a person who is not a party to produce a record at a specified date, time and place if

(a) the record is under the control of that person,

(b) there is reason to believe that the record is relevant and material, and

(c) the person who has control of the record might be required to produce it at trial.

(2) The person requesting the record must pay the person producing the record an amount determined by the Court.

Inspection and copying of records

5.14(1) Every party is entitled, with respect to a record that is relevant and material and that is under the control of another party, to all of the following:

(a) to inspect the record on one or more occasions on making a written request to do so;

(b) to receive a copy of the record on making a written request for the copy and paying reasonable copying expenses;

(c) to make copies of the record when it is produced.

(2) This rule does not apply to a record for which a claim of privilege is made unless the Court orders the record to be produced for inspection.

TAB 3

CARSWELL

THE 2022-2023 ANNOTATED BANKRUPTCY AND INSOLVENCY ACT

Including
General Rules under the Act
Orderly Payment of Debts Regulations
Companies' Creditors Arrangement Act
CCAA Regulations and Forms
Farm Debt Mediation Act
Wage Earner Protection Program Act
Directives and Circulars

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The Honourable Geoffrey B. Morawetz, B.A., LL.B.
of the Superior Court of Justice

The Honourable L. W. Houlden, B.A., LL.B.
1922-2012, formerly a Judge of the Court of Appeal for Ontario

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resolution of disputes. There is no operational conflict between provincial limitations statutes and the operation of the *BIA*. A trustee is not required to warn creditors that the limitation period will resume on its discharge. When federal bankruptcy legislation is involved, a creditor is not relieved from the obligation of commencing litigation within a limitation period just because a debtor has acknowledged his or her debt or made a part payment of the debt; in Alberta, the legislation only extends the limitation period when an acknowledgment or partial payment is made. "Acknowledgement" requires more than acknowledgement a creditor has asserted a claim, it requires admission or acknowledgement of liability. On the facts, the s. 178 claim survived, other claims were dismissed as time barred as the claims by CRA for income tax debt were not statute barred as the *Limitations Act* does not override s. 222 of the *Income Tax Act*: *Re Dyrland* (2008), 2008 CarswellAlta 1049, 47 C.B.R. (5th) 243 (Alta. Q.B.).

§ 2:146 Formalities—Creditor Taking Proceedings Without Obtaining an Order Under Section 38

If a creditor takes proceedings without first applying for an order under s. 38, the proceedings will be dismissed, but the dismissal is not *res judicata*: *Re Sandwich Foundry Co.*, 20 C.B.R. 206, [1939] 2 D.L.R. 798 (Ont. S.C.); *Bank of Montreal v. Elliot*, 9 C.B.R. (N.S.) 253, [1967] Que. Q.B. 11; *Royal Bank v. Scappatura* (1967), 10 C.B.R. (N.S.) 117 (Ont. Dist. Ct.). In *DeGroote v. Canadian Imperial Bank of Commerce* (1996), 45 C.B.R. (3d) 132, Lax J. of the Ontario Court of Justice, General Division, without referring to the foregoing authorities, held that commencing an action without the consent of the trustee and without a s. 38 order was merely an irregularity that could be remedied by a *nunc pro tunc* order. In affirming the order made by Lax J., the Ontario Court of Appeal held that it is not every case that will lend itself to the making of a *nunc pro tunc* order; here, the order was appropriate since the action had proceeded for four years without any objection being taken regarding the failure to obtain an order under s. 38: *DeGroote v. Canadian Imperial Bank of Commerce* (1998), 2 C.B.R. (4th) 45, 37 O.R. (3d) 651 (C.A.).

In *Re Amegorena* (1999), 22 C.B.R. (4th) 31 (Que. S.C.), a creditor with a substantial claim, without obtaining an order under s. 38, brought a paulian action because the trustee refused to take the action and the limitation period was expiring. The court made a *nunc pro tunc* order curing the irregularity. A *nunc pro tunc* order will be made in these circumstances unless it will cause serious injury or prejudice.

§ 2:147 Formalities—Material in Support of the Application and Service of the Material

An affidavit should be filed in support of the application showing that the statutory prerequisites have been compiled with. The affidavit should, among other things, set out the date of the bankruptcy, the creditor's request to the trustee to bring the action, and the trustee's refusal to proceed: *Re Dominion Trustco Corp.* (1997), 45 C.B.R. (3d) 25 (Ont. Gen. Div.); affirmed (1997), 50 C.B.R. (3d) 84 (Ont. C.A.). The applicant for a s. 38 order must satisfy the court that in his or her opinion the proceeding will be for the benefit of the bankrupt estate. For a discussion, see *post* § 2:160 "Scope of Proceedings".

Only the trustee need be served with notice of the application: *Re Swerdlow* (1985), 57 C.B.R. (N.S.) 180 (Ont. S.C.). There is no necessity to serve the proposed defendant with notice of the application under s. 38; the creditor need only show that the trustee has refused or neglected to take the proceeding: *Re Parallels Restaurant Ltd.* (1988), 68 C.B.R. (N.S.) 266, 26 B.C.L.R. (2d) 385 (S.C.); *Caisse populaire Vanier Ltée v. Bales* (1991), 3 C.B.R. (3d) 264, 2 O.R. (3d) 456 (Gen. Div.); *Re Jolub Construction Ltd.* (1993), 21 C.B.R. (3d) 313 (Ont. Gen. Div.); *Re Coroban Plastics Ltd.* (1994), 28 C.B.R. (3d) 260 (B.C. S.C.). The bankrupt does not have standing to oppose the granting of a s. 38 order: *Re Swerdlow* (1985), 57 C.B.R. (N.S.) 180 (Ont. S.C.); *Re Coroban Plastics Ltd.* (1994), 34 C.B.R. (3d) 50, 10 B.C.L.R. (3d) 52, 52 B.C.A.C. 214 (C.A.); *Re Dominion Trustco Corp.* (1997), 50 C.B.R. (3d) 84 (Ont. C.A.); *Re Fermuik* (1998), 7 C.B.R. (4th) 154. Even if the bankrupt has been discharged, there is no need to serve him or her with notice of the s. 38 application: *Re Salloum* (1990), 1 C.B.R. (3d) 204, 51 B.C.L.R. (2d) 336 (C.A.).

Where there is uncertainty as to whether a party is a creditor, the bankrupt may be given standing to appear on a preliminary application to determine the status of the creditor pursuant to the court's authority to control its own process: *Re Kostiuk* (2003), 47 C.B.R. (4th) 274, 2003 CarswellBC 2196 (B.C. S.C.).

§ 2:148 Formalities—Right of Proposed Defendant to Oppose the Making of the Order

Even if the proposed defendant has notice of the s. 38 application, the defendant has no standing to appear on the hearing of the application, nor can the defendant cross-examine on the material filed in support of the application: *Re Nesi Energy Marketing Canada Inc.* (1998), 8 C.B.R. (4th) 76, 68 Alta. L.R. (3d) 150, [1999] 7 W.W.R. 217, 233 A.R. 347 (Q.B.).

A proposed defendant may have standing to be heard on the motion where it is necessary to prevent the court's process from being use to perpetrate a fraud or to ensure that the administration of justice and the integrity of the bankruptcy process has not been undermined. If a proposed defendant seeks to challenge the validity of a s. 38 order, the appropriate practice is to bring an application for review under s. 187(5) of the *BIA*: *Re Coroban Plastics Ltd.* (1994), 1994 CarswellBC 1186, 34 C.B.R. (3d) 50 (B.C. C.A.); *Ernst & Young (Thunder Bay) Inc. v. Nicol Island Development Inc.* (2009), 2009 CarswellOnt 1748, 51 C.B.R. (5th) 12 (Ont. C.A.); *John Deere Ltd. v. Toner* (2008), 2008 CarswellNB 280, 44 C.B.R. (5th) 79 (N.B. Q.B.); *Re Tirecraft Group Inc.* (2009), 2009 CarswellAlta 687, 54 C.B.R. (5th) 140 (Alta. Q.B.).

If the order purports to impose on the intended defendant certain obligations in the conduct of the litigation, or to direct the defendant to take certain steps in that litigation, or to subject the defendant to costs, the appropriate court to hear the complaint would be the court that made the order: *Bank of B.C. v. McCracken* (1986), 61 C.B.R. (N.S.) 287, 4 B.C.L.R. (2d) 35 (B.C. C.A.); *Re Coroban Plastics Ltd.* (1994), 28 C.B.R. (3d) 260 (B.C. S.C.); affirmed (1995), 34 C.B.R. (3d) 50 (B.C. C.A.).

§ 2:149 Formalities—Right of Defendant to Counterclaim and to add the Trustee as a Party

Since a creditor obtaining a s. 38 order is advancing not its own cause of action, but rather, the trustee's, the defendant is entitled to advance any relevant defence and counterclaim in the s. 38 action, and subject to the lifting of the stay imposed by s. 69.3, is entitled to add the trustee as a party defendant to the counterclaim: *Manitoba Capital Fund Ltd. Partnership v. Royal Bank* (2001), 27 C.B.R. (4th) 265, 2001 CarswellMan 381 (Man. Q.B.).

§ 2:150 Formalities—Consent of Trustee to the Making of the Order

Where the trustee is requested by a creditor to consent to a s. 38 application and it is clear from the material provided by the creditor to the trustee that the application is not frivolous or vexatious but a proper one, the trustee should give its consent. In these circumstances, it is improper for the trustee to actively oppose the application and, if it does, the court may order the trustee to pay the costs of the application personally on a solicitor and client basis: *Mutual Trust Co. v. Scott, Pichelli & Graci Ltd.* (1999), 11 C.B.R. (4th) 54 (Ont. Bktcy.); additional reasons at (1999), 11 C.B.R. (4th) 62 (Ont. Bktcy.).

A debtor was involved in a series of suspect transactions and a creditor sought a declaration that the transactions were unenforceable against it. Another creditor brought a motion to disallow the first creditor's claim. The Québec Superior Court granted the first creditor's motion. The record showed that the creditor had already been authorized by the trustee to commence proceedings on behalf of the trustee, and the second creditor's motion amounted to an attack of a decision already made by the court. The Court further held that the issue regarding the claim was premature as the trustee had yet to make a decision on the claims: *Syndic de Harco Québec inc*, 2017 CarswellQue 8182, 53 C.B.R. (6th) 194, 2017 QCCS 4403 (C.S. Que.).

§ 2:151 Formalities—Identification of the Action to be Taken by the Creditor

An order under s. 38 should give an express authorization to take a particular action and an assignment in respect of a distinct, identifiable claim. However, where the material served on creditors in support of the s. 38 application clearly identified the transactions to be challenged in the s. 38 proceeding, the court held that it could, under s. 187(9), excuse the failure to comply with the requirements of s. 38 and make an order *nunc pro tunc* varying the s. 38 order: *Jaston & Co. v. McCarthy* (1998), 168 D.L.R. (4th) 415, 116 B.C.A.C. 64, 8 C.B.R. (4th) 25, 190 W.A.C. 64 (C.A.). To the same effect, see *Mega Cranes Ltd. v. Toutant* (1999), 11 C.B.R. (4th) 38 (B.C. S.C. [In Chambers]).

§ 2:152 Formalities—Notice to Creditors of the Making of the Order

An order under s. 38 must provide for notice to other creditors so that they are given an opportunity to join in, providing they agree to share the costs. It is usual to provide that the notice will be given by registered mail. If other creditors do not join in, the benefit belongs exclusively to the creditor bringing the proceeding: s. 38(3); *Re Carrieres Frontenac Ltée* (1934), 15 C.B.R. 415 (Que. S.C.); *Re Hord*, 27 C.B.R. 229, [1946] O.W.N. 580, [1946] 3 D.L.R. 575 (Ont. S.C.); *Dufour v. Milligan*, 37 C.B.R. 155, [1958] R.L. 335 (Que. S.C.).

It is not necessary under s. 38 to notify the creditors in advance of the application for an order. It is only important that all the creditors be given a reasonable opportunity to decide whether or not to participate: *Toyota Canada Inc. v. Imperial Richmond Holdings Ltd.*, 20 C.B.R. (3d) 102, 10 Alta.

that the debt is a valid debt. No judgment recovered against the bankrupt, no covenant given by, or account stated with the bankrupt deprives the trustee of this right. The trustee is entitled to go behind such forms to get the truth; the trustee need not show fraud or collusion to set aside such documents: *Re Van Laun; Ex parte Chatterton*, [1907] 2 K.B. 23, 76 L.J.K.B. 644, 97 L.T. 69 (C.A.).

In *Re Canadian Asian Centre Development Inc.* (2003), 39 C.B.R. (4th) 35, 2003 CarswellBC 270, Burnyeat J. of the British Columbia Supreme Court was of the view that, despite the comments in cases such as *Re Van Laun; Ex parte Chatterton*, [1907] 2 K.B. 23, 76 L.J.K.B. 644, 97 L.T. 69 (C. A.), a judgment of a court of competent jurisdiction should almost invariably satisfy a trustee regarding the legitimacy of a debt or security if, in awarding judgment, the court has considered the merits of the claim. If it were otherwise, the trustee would be substituting its opinion regarding the matter decided by the judgment and thus displacing the authority given to the court.

To obtain information concerning a claim, the trustee may, with the permission of the inspectors, conduct examinations and obtain production of documents under section 163(1): see *post* §§ 7:30 to 7:43 "Examination by Trustee Under Section 163(1)". If the trustee disallows the claim and the creditor appeals, both the trustee and the creditor can use the examinations as evidence on the appeal: *Re Christie Grant Ltd.*, 1 C.B.R. 489, [1921] 3 W.W.R. 264 (Man. K.B.); *Re Dumfermline Trading Co.*, 3 C.B.R. 178, [1922] 2 W.W.R. 1274, 66 D.L.R. 813, 16 Sask. L.R. 71 (Q.B.).

§ 6:263 Disallowance of Claims and Security in Proposals

This subject is discussed *ante* in §§ 4:106 to 4:110 "Time for Determining Claims of Creditors, Proofs of Claim and Disallowance of Claims—(5) Disallowance of Claims".

§ 6:264 Admission of Proofs of Claim and Proofs of Security

If, after examining a proof of claim or security, the trustee is satisfied that the proof is a valid one, the trustee will accept the proof of claim or security and not require further evidence in support of it. Where a proof of claim is admitted, the notice of dividend is sufficient notice to the creditor that the claim has been admitted. However, the payment of a dividend to other creditors does not constitute an admission of the claim nor deprive the trustee of the right to disallow it: *Re Waltson Properties Ltd. (No. 1)* (1975), 21 C.B.R. (N.S.) 211 (Ont. S.C.).

In deciding the validity of a claim, *certainty* is not the test. If the method used in calculating the amount of the claim is reasonable and the evidence in support of the claim is relevant and probative, the claim should be admitted: *Re HDYC Holdings Ltd.* (1995), 35 C.B.R. (3d) 294 (B.C. S.C.); appeal allowed (1997), 50 C.B.R. (3d) 85, 43 B.C.L.R. (3d) 64, 151 D.L.R. (4th) 633 (C.A.); additional reasons at (1998), 1998 CarswellBC 353 (C.A.), without reference to this point.

The fact that the allowance of a claim will reduce the amount of the dividends of other unsecured creditors is not a valid reason for disallowing a claim. Until the dividend is declared, no creditor has a specific interest in the funds in the hands of the trustee; the creditor's only right is to receive a dividend in due course of the administration of the bankrupt estate. Even though a claim is filed some considerable time after the date of bankruptcy is no reason in itself to disallow it: *Re Cohen* (1956), 36 C.B.R. 21, 19 W.W.R. 14, 3 D.L.R. (2d) 528 (Alta. C.A.).

If the trustee does not disallow a claim or declares the claim to be valid, it does not prevent a creditor from obtaining an order under s. 38 permitting it to disallow the claim. The 30-day limitation period in s. 135(4) has no application in these circumstances; the 30-day limitation period only applies with respect to a determination of whether a contingent or unliquidated claim is provable or with respect to a disallowance of a claim: *Re Berman Fine Cars Inc.* (1999), 14 C.B.R. (4th) 178 (Ont. S.C.J.).

§ 6:265 Contingent and Unliquidated Claims

Contingent and unliquidated claims are discussed *ante* in §§ 6:124 to 6:132 "Contingent and Unliquidated Claims". By s. 135(1.1), the trustee is to determine whether a contingent or unliquidated claim is a provable claim and, if a provable claim, the trustee shall value it. Where the trustee makes a determination under s. 135(1.1), the trustee must provide a notice of the determination to the creditor: s. 135(3). The notice of determination is given in para. B of Form 77. The notice must be personally served or sent by registered mail or courier to the claimant: Rule 113. For appeals from the determination, see *post* §§ 6:273 to 6:282 "Appeal from Disallowance or Determination".

The Ontario Superior Court of Justice dismissed an undischarged bankrupt's motion seeking an order lifting a freeze direction of the Ontario Securities Commission ("OSC") over his registered retirement savings plan ("RRSP") and locked in retirement accounts ("LIR"). The Court also granted the OSC's motion for an order that certain monetary penalties that the bankrupt was ordered to pay as a result of violations of a cease trade order ("CTO") due to insider trading were not claims provable in bankruptcy, such that the OSC may proceed with enforcement of these claims

ment of the bankruptcy and setting aside the conveyance of the property may have merit, the motion was dismissed on the basis that no notice was given to creditors. The dismissal was without prejudice to bring the motion back with notice: *Jurrius v. Garcia*, 2019 CarswellOnt 9419, 71 C.B.R. (6th) 147, 2019 ONSC 3634 (Ont. S.C.J.).

§ 8:9 Conflict Between Ordinary Civil Courts and Courts Sitting in Bankruptcy—Proceedings to Determine Whether or Not a Person is a Creditor or the Rights and Obligations of a Creditor

If proceedings are taken to determine whether a person is a creditor of the bankrupt estate or the rights and obligations of a creditor, the court sitting in bankruptcy has jurisdiction.

A dispute between the trustee and a secured creditor as to the disposition of the amount realized from the sale of assets is properly brought to the court sitting in bankruptcy: *Re P.E. Laperrière Inc.* (1970), 16 C.B.R. (N.S.) 43 (Que. S.C.). The court has jurisdiction to deal with a claim by a trustee that a security is void: *Re Arctic Gardens Inc.*, [1989] R.J.Q. 397 (Que. S.C.); affirmed (1989), 78 C.B.R. (N.S.) 1, 35 Q.A.C. 68, [1990] R.J.Q. 6 (Que. C.A.). It also has jurisdiction to decide a claim that the trustee, not a secured creditor, is entitled to certain assets: *M.P. Industrial Mills Ltd. v. Manitoba Development Corp.* (1972), 17 C.B.R. (N.S.) 226 (Man. Q.B.); *Re Maritime Mining Co.* (1940), 21 C.B.R. 319 (N.B. K.B.).

§ 8:10 Conflict Between Ordinary Civil Courts and Courts Sitting in Bankruptcy—Proceedings to Obtain a Remedy Granted by Federal or Provincial Legislation

If it is sought in proceedings before the court sitting in bankruptcy to obtain some remedy that is given by provincial or federal legislation to a trustee, the proceedings are properly taken in the court: *Re Levine* (1921), 1 C.B.R. 479, 50 O.L.R. 316, 61 D.L.R. 219 (S.C.); *Re Reynolds* (1928), 10 C.B.R. 127, 62 O.L.R. 271, [1928] 2 D.L.R. 520 (S.C.); affirmed (1928), 10 C.B.R. 127 at 131, 62 O.L.R. 360, [1928] 3 D.L.R. 562 (C.A.).

However, where a creditor claimed liens under the warehouser lien legislation, since the goods were exempt from seizure and the trustee claimed no interest in them, the court held that it had no jurisdiction to decide a dispute between the secured creditor and the debtor concerning the validity of the liens. Those were matters to be determined by the ordinary courts: *Re King* (2004), 2004 CarswellNS 152, 49 C.B.R. (4th) 268 (N.S. S.C.).

§ 8:11 Conflict Between Ordinary Civil Courts and Courts Sitting in Bankruptcy—Proceedings to Determine Title to Property

If property vests in the trustee or comes into the possession of the trustee, any claim to the property is properly dealt with in the court sitting in bankruptcy: *Sauve v. McFarland* (1975), 20 C.B.R. (N.S.) 122 (Ont. C.A.); *Re Lumberking Home & Garden Centre Ltd.* (1975), 20 C.B.R. (N.S.) 181, 8 O.R. (2d) 563, 58 D.L.R. (3d) 531 (S.C.); affirmed (1975), 58 D.L.R. (3d) 531n, 8 O.R. (2d) 563n (C.A.); *Binet v. Asselin & frère* (1934), 17 C.B.R. 131 (Que. C.A.); *Re Peachtree Network Inc.* (2002), 37 C.B.R. (4th) 117, 2002 CarswellQue 1528 (Que. C.S.). Even though the property was not the bankrupt's, if it is in the possession of the bankrupt at the date of bankruptcy, all questions relating to that property must be determined in that court: *Bank of Montreal v. XED Services Ltd.* (1992), 15 C.B.R. (3d) 112 (B.C. S.C.).

§ 8:12 Conflict Between Ordinary Civil Courts and Courts Sitting in Bankruptcy—Proceedings Against Strangers to the Bankruptcy

In determining jurisdiction where strangers to the bankruptcy are involved, the court has to assume that the trustee will be successful in its application. The question then is, will the unsuccessful claimant be a creditor of the bankrupt estate as a result of losing the application? If the answer is yes, then the court sitting in bankruptcy has jurisdiction. If the answer is no, then the court does not have jurisdiction.

In *Re Eagle River International Ltd.* (2001), 2001 CarswellQue 2725, 2001 CarswellQue 2726, 30 C.B.R. (4th) 105 (S.C.C.), the trustee was asserting that the bankrupt was the owner of certain shares and warrants in the possession of a British Columbia company. The B.C. company was the largest creditor of the bankrupt estate. When the trustee made its claim, the B.C. company stated that it intended to raise a substantial counterclaim. In these circumstances, the Supreme Court of Canada held that the B.C. company was not a stranger to the bankruptcy, and, accordingly, the court sitting in bankruptcy had jurisdiction over the proceedings.

The trustee cannot bring proceedings against a stranger to the bankruptcy for damages or claims akin to damages or for an accounting: *Mancini (Trustee of) v. Falconi* (1987), 65 C.B.R. (N.S.) 246,

TAB 4

DATE OF RELEASE: September 14, 1995

No. 2625/91
No. 2626/91
Vancouver Registry

IN THE SUPREME COURT OF BRITISH COLUMBIA

IN BANKRUPTCY

IN THE MATTER OF THE BANKRUPTCY OF
HDYC HOLDINGS LTD.

AND

IN THE MATTER OF THE BANKRUPTCY OF
FOUR C'S DEVELOPMENT LTD.

BOTH DOING BUSINESS IN PARTNERSHIP AS
WING WAH COMPANY

REASONS FOR JUDGMENT

OF THE HONOURABLE MR. JUSTICE SHAW

Counsel for the creditor companies:	Mr. Robert G. Ward Ms. Susan E. Fraser
Counsel for the Province of British Columbia:	Mr. Jeffrey G. Pottinger Mr. Hunter W. Gordon
Place and dates of hearing:	Vancouver, B.C. November 30, 1994 and June 27 and 28, 1995

1 This dispute is between the Province of British Columbia and three tobacco companies. At stake is who has the right to share in the assets of a bankrupt partnership, Wing Wah Company. The net amount in the bankrupt's estate available for distribution after

payment of the secured creditors will be between $3,100,000 and $4,700,000.

2 The claim of British Columbia is for unpaid tobacco taxes of $6,537,418.23 which the Province says are owing under the ***Tobacco Tax Act***, R.S.B.C. 1979, c.404.

3 The tobacco companies are unsecured creditors. Their claims are as follows:

R.J.R. MacDonald Inc.	$ 794,177.57
Imperial Tobacco Limited	1,169,307.46
Rothmans, Benson and Hedges	782,259.39
	$ 2,745,744.42

4 The tobacco companies challenge the validity of the Province's claim. It is common ground that if the Province's claim is valid, the Province will have priority over the tobacco companies for the amount remaining in the bankrupt's estate. It is also common ground that if the Province's claim is void, then the tobacco companies, whose claims are not challenged, will have their claims paid from the remaining assets in the estate.

5 The Trustee in Bankruptcy accepted the Crown's proof of claim and declined a request by the tobacco companies to take court proceedings to disallow the proof of claim. However, the companies obtained leave of the court under s.38 of the ***Bankruptcy and Insolvency Act***, R.S.C. 1985, c.B-3, to challenge the validity of

the Crown's claim and this judgment is the ruling on that challenge.

6 The remedies requested by the tobacco companies are:

1. A declaration that the Wing Wah Company, or its estate, is not indebted or liable to the Province of British Columbia pursuant to the ***Tobacco Tax Act***;
2. An order that the Province's Proofs of Claim (there are two) be expunged or disallowed;
3. An order that any benefit derived from this proceeding belongs exclusively to the tobacco companies, to the extent of their claims and costs, and that the surplus, if any, belongs to the estate of Wing Wah Company; and
4. Costs.

7 Wing Wah Company is a partnership of two companies, HDYC Holdings Ltd. and Four C's Development Ltd. For ease of reference I call them and the partnership collectively Wing Wah.

8 For many years Wing Wah was a wholesaler. Its business included tobacco products. Wing Wah bought cigarettes and cigars in bulk from the tobacco companies and sold them to retailers. In turn, the retailers sold the tobacco products to the general public.

9 Throughout the period that Wing Wah was in business, tobacco taxes were collected under a collection scheme involving three basic steps: (1) the retailers would collect tobacco taxes from their customers by including the taxes in the sale prices; (2) the wholesalers would collect equivalent amounts from the retailers by including estimated tobacco taxes in their invoices to the retailers; and (3) the wholesalers would remit to the Provincial Crown the tax-equivalent monies they collected from the retailers.

10 From about February 1989 onwards, Wing Wah began reporting to the Province lower sales to retailers than were actually being made. This ruse resulted in Wing Wah reducing the payments to the Province below what they would have been had accurate sales information been reported. The reduced payments continued for a period of approximately two and a half years from February 1989 to September 1991. The shortfall in payments is the basis of the Province's claim.

11 The tobacco companies contend that the Province has no valid claim against Wing Wah on the ground that the collection scheme is ultra vires the ***Tobacco Tax Act***. The companies also say that the manner of calculating the amount of the Province's claim is fallacious and therefore unacceptable. I will discuss these issues separately under the headings "AUTHORITY FOR COLLECTION SCHEME" and "CALCULATION OF DEBT".

THE COLLECTION SCHEME

12 The collection scheme is described in part in an affidavit of Mr. Edward J. Turner, the former Executive Director of the Consumer Taxation Branch of the Ministry of Finance and Corporate Relations. He said:

> "The *Tobacco Tax Act* imposes a tax on consumers of tobacco products who acquire those products for their own consumption or use, or for the consumption or use of others at their expense. The retail vendors of such products are required to collect the tax at the time of sale, and pay it over to designated "collectors". Those "collectors" are wholesalers of tobacco products. The collectors/wholesalers must remit the collected tax to the Province.
>
> For reasons of administrative convenience, wholesaler/ collectors sell tobacco products to retailers at a price that includes an amount equal to the tax that would be paid by the ultimate consumer at a taxable sale. This system is advocated by the Province, and indeed, applies in all the Provinces."

13 Further details of the collection scheme and its operation are set out in the following excerpts from the affidavit of Mr. Michael Attard, Manager, Fuel and Tobacco Tax, Consumer Taxation Branch:

> "Tobacco wholesalers are required to file returns and to make payments to the Province on a periodic or monthly basis. In the case of Four C's Development Ltd. and HDYC Holdings Ltd., doing business as Wing Wah Company ("Wing Wah"), the returns and the payments were due on the 20th of each month.
>
> The amount that a wholesaler is required to pay to the Province each month is based upon that wholesaler's purchases of tobacco products made in the period ending 20 days before the payment is due. For example, Wing Wah's payment on June 20, 1991 should have been based upon its purchases during the period May 1 to May 31, 1991. The amount that the wholesaler must pay is equal to the tax that would be collectable if the tobacco products purchased by the wholesalers during the reporting period were sold to consumers, less certain adjustments described below.
>
> Wholesalers are allowed to make adjustments to their monthly payments to account for tax exempt sales (e.g.- sales of product destined for consumption by Native Indians or sales to out of Province retailers). A

> wholesaler may also apply for a refund of tax remitted in respect of sales made by it on credit in cases where the wholesaler is unable to collect from its retailer, and to account for product that is lost or stolen. Provided that the wholesaler complies with this system, these adjustments and refunds are designed so that, over time, the amount paid by a wholesaler and retained by the Province will exactly equal the amount of tax that the wholesaler actually collects from retailers.
>
> It is my understanding that tobacco products typically turn over at a relatively fast rate (e.g.-approximately once every ten days). Given this high turnover, it is assumed that by the time a wholesaler is required to remit tax in respect of its purchases of tobacco products, all of those tobacco products will have been resold by the wholesaler to retailers, and the vast majority will have been resold by the retailers to the ultimate consumers.
>
> Tobacco products are generally sold by wholesalers to retailers at a price that includes the amount of tax that will be payable by consumers.
>
> If a wholesaler makes the payments less adjustments described in paragraphs 3 and 4 of this affidavit, then no further payments are required of the wholesaler. If the full amount is not paid, then the wholesaler is subject to assessment following an audit."

14 One further aspect of the collection scheme is that it is enforced by tobacco dealers' licenses being subject to suspension or cancellation for failing to report and remit to the Crown the monies collected.

15 Throughout its period of operation, Wing Wah purported to make payments and seek refunds in accordance with the collection scheme.

AUTHORITY FOR COLLECTION SCHEME

16 Is the collection scheme ultra vires the ***Tobacco Tax Act***? The tobacco companies say that it is. They contend that on a plain reading of the ***Act*** the very taxes that are collected by retailers

from consumers must be paid to the Province, not amounts that are the equivalent of those taxes. It follows, the companies say, that the collection scheme must be ultra vires because it requires retailers to pay to the wholesalers the equivalent of taxes, not the actual taxes paid by the consumers to the retailers.

17 To support their contention the companies rely upon s-s.2(5) of the ***Tobacco Tax Act***:

> 2.(5) The tax imposed by this Act shall be collected by the retail dealer at the time of the sale and shall be remitted to the minister at the time and in the manner prescribed by the regulations.

18 The companies submit that the words "the tax ... shall be collected ... at the time of the sale and shall be remitted to the minister ..." indicate the legislature's intention that it is the very tax that is paid by the consumers that must be paid over to the Crown. It follows, the companies contend, that a collection system that is built upon the premise that tax equivalent dollars are to be paid to the Crown is not authorized by the ***Act***.

19 As authority, the tobacco companies cite the dissenting reasons of Lambert J.A. in ***Tseshaht Band v. British Columbia*** (1992), 69 B.C.L.R. (2d) 1 (C.A.) at 27:

> "It will readily be seen that the tax is collected by the retail dealer at the time of the sale. After that it must be remitted to the minister, either directly, if the retail dealer is a collector, or through a collector, if the retail dealer is not itself a collector. It is the very tax that is collected that must be remitted. Section 2(5) cannot be construed in any other way; and any regulation requiring payment of the tax before it is collected would not be in accordance with s.2(5)."

and further at p.27:

> "The collection practices are not in accordance with the system set out in the Act. In his affidavit E.J. Turner, the executive director of the Consumer Taxation Branch, said this:
>
> 5. The *Tobacco Tax Act* imposes a tax on consumers of tobacco products who acquire those products for their own consumption or use, or for the consumption or use of others at their expense. The retail vendors of such products are required to collect the tax at the time of sale, and pay it over to designated "collectors". Those "collectors" are wholesalers of tobacco products. The collectors/wholesalers must remit the collected tax to the Province.
>
> 6. For reasons of administrative convenience, wholesalers/collectors sell tobacco products to retailers at a price that includes an amount equal to the tax that would be paid by the ultimate consumer at a taxable sale. This system is advocated by the Province, and indeed, applies in all the Provinces.
>
> The system may be advocated by the province. It may apply in all provinces. But it is contrary to s.2(5) of the Act, which requires the very tax that is collected to be remitted to the minister."

20 The companies further rely upon ***British Columbia v. National Bank of Canada***, [1993] 3 W.W.R. 371 (B.C.S.C.); upheld, [1995] 2 W.W.R. 305 (C.A.); in which Newbury J. said at p.375:

> "It is a striking fact that the manner in which taxes are collected under the *Tobacco Tax Act* is completely different from what one would expect from a reading of the Act."

and at p.378:

> "However, because the timing of the wholesaler's remittance of the tax substitute bore no necessary relationship to the timing of the retail sale (the "trigger" for the exigibility of the actual tax), it could not be said as a matter of certainty in the legal sense that any particular tobacco products sold at the retail level were products in respect of which the "tax substitute" had or had not been remitted."

21 The companies also cite ***Johnson v. Nova Scotia (Attorney General)*** (1990), 96 N.S.R. (2d) 140 (N.S.S.C. App. Div.); leave to appeal to S.C.C. refused [1991] 1 C.N.L.R. vi; in which Jones J.A. in a majority judgment said at pp.147-148:

> "Evidence was led by the Crown as to the reasons for adopting the collection procedure. Apparently large quantities of cigarettes were being purchased at the wholesale level prior to May of 1985 and being resold and the tax was not being collected. The same difficulty was being experienced in other provinces. That is set out in detail in the case of *Bomberry and Hill*, supra. I do not think it is necessary to deal with that evidence. The mere convenience of collection does not justify the practice. Indeed it has not been shown that the tax cannot be collected at the retail level in the same manner as it is on chocolate bars or soda pop. It is convenient, of course, if you do not wish to show the public the extent of the tax. One reason for avoiding any reference to wholesalers in the *Act* is to avoid a challenge to the levy as being an indirect tax. If this method of collection is permissible then there is no reason why it cannot be extended to cover all purchasers."

22 The Crown's position is that the collection scheme is intra vires the ***Tobacco Tax Act***. The reasoning in support of this contention is captured in the following excerpts from the Crown's Memorandum of Argument:

> "When interpreting a taxation statute, it is not appropriate to take a strict, literal or technical approach. Rather, the correct approach is a common sense approach, in which one attempts to determine the intention of the legislature, with a view to commercial realities.
>
> . . .
>
> It could not possibly have been the intention of the legislature that each retailer would have to remit to its wholesaler precisely the same dollar bills that it collected from consumers. Such a requirement would be completely impractical, and totally at odds with commercial realities. It is therefore obvious that the legislature must have intended that it would be

> sufficient for retailers to remit an amount equal to the tax that they collect."

23 The Crown relies upon obiter dicta in support of the collection scheme in two decisions of the British Columbia Court of Appeal: ***Tseshaht Band v. British Columbia***, supra, Cumming J.A. for the majority at p.13; ***Chehalis Indian Band v. British Columbia*** (1988), 31 B.C.L.R. (2d) 333. I will deal with these cases later.

24 In approaching the question of interpretation of the ***Tobacco Tax Act***, I find guidance in recent decisions of the Supreme Court of Canada which have liberalized the interpretation of taxation statutes by the courts. These decisions start with ***Stubart Investments Ltd. v. The Queen***, [1984] 1 S.C.R. 536, and continue to the most recent one which is ***Notre Dame du Bon-Secours v. Quebec***, [1994] 3 S.C.R. 3. In one of the cases, ***The Queen v. Golden***, [1986] 1 S.C.R. 209, Estey J. for the majority said at pp.214-15:

> "...the law is not confined to a literal and virtually meaningless interpretation of the Act where the words will support on a broader construction a conclusion which is workable and in harmony with the evident purposes of the Act in question. Strict construction in the historic sense no longer finds a place in the canons of interpretation applicable to taxation statutes in an era such as the present, where taxation serves many purposes in addition to the old and traditional object of raising the cost of government from a somewhat unenthusiastic public."

The foregoing passage was cited in ***The Queen v. McClurg***, [1990] 3 S.C.R. 1020, Dickson C.J.C. at 1049-50 and ***Notre Dame du Bon-Secours v. Quebec***, supra, Gonthier J. for the court at p.16.

25 In ***Notre Dame du Bon-Secours*** the court recognized that there are still some instances where the strict rule of interpretation in favour of the taxpayer will apply. Counsel for the tobacco companies submits that this is one of those cases. I do not agree. In my opinion, the ***Tobacco Tax Act*** is not a statute which should be interpreted strictly or literally. In ***Notre Dame du Bon-Secours*** (at p.17), Gonthier J. pointed out that one must look to the purpose of the legislation in determining the correct approach to interpretation. As noted in the passage quoted above from ***Stubart***, present day taxation statutes serve many purposes in addition to the traditional object of financing the cost of government. In the case of the ***Tobacco Tax Act***, I infer from the high level of taxation which the ***Act*** imposes that its purposes include discouraging smoking because of the medical problems smoking causes. This social purpose, in my opinion, brings the statute within the liberal interpretation requirement.

26 I will employ the liberal and practical approach to interpretation in my analysis of the regulatory powers in the ***Tobacco Tax Act***.

27 I start with the fundamental proposition that the tax is on the consumer. This is so stated in s-s.2(1) which sets the tax rates. The opening words are:

> 2.(1) Every consumer shall, at the time of making a purchase of tobacco, pay to Her Majesty in right of the Province a tax at the rate of ..."

28 I turn next to the tax collection process. The initial collection of the tax is to be by retailers who sell tobacco products to consumers. I repeat s-s.2(5):

> 2.(5) The tax imposed by this Act shall be collected by the retail dealer at the time of the sale and shall be remitted to the minister at the time and in the manner prescribed by the regulations.

29 It is significant that s-s.2(5) provides that the remission to the minister shall be "at the time and in the manner prescribed by the regulations". These words connote the creation of a collection system, the details of which as to timing and manner of collection are left to be determined by regulations.

30 The next step is that the ***Act*** includes wholesalers as part of the tax collection process. This is evident from s.1 which defines "dealer" as including a "wholesaler" and s-s.2(6) which deems a "dealer" to be an agent of the minister with the duty to collect the tax.

> 1. In this *Act*
> "dealer means a person who, in the Province, sells or offers to sell tobacco or keeps tobacco for sale, either at wholesale or at retail; ...
>
> 2.(6) Every dealer shall be deemed to be an agent for the minister and as such shall levy and collect the tax imposed by this Act on the purchaser.

31 I pause at this point in the analysis to note s.5.1 of the ***Act*** which reads:

> 5.1(1) A wholesale dealer shall, in respect of tobacco delivered to him in the Province, pay, as security to the director, within the time required by the director, an amount equal to the tax that would be collectable if that tobacco were sold to a consumer in the Province.

> (2) On application by a wholesale dealer, the director may, in writing and on conditions he considers appropriate, exempt the wholesale dealer from the requirements of subsection (1) where the wholesale dealer satisfies the director that the tobacco in respect of which the security is payable will not be sold at a taxable retail sale in the Province.
>
> (3) The director shall refund to the wholesale dealer security paid under subsection (1) on being satisfied that the tobacco in respect of which security was paid was not sold or will not be sold to a consumer.

32 Section 5.1 was enacted by the ***Tobacco Tax Amendment Act***, S.B.C. 1989, c.16, and was assented to on June 1, 1989, after the commencement of the period of the Crown's claim in February 1989. While there is evidence that the Crown uses s.5.1 to collect taxes, Crown counsel took the position that he does not rely upon s.5.1 to support the Crown's claim in this case. I will therefore not deal with s.5.1 in my analysis of the statutory authority for the collection scheme, except to observe that in my opinion, it does not reduce the scope of the enabling powers that are set out in the provisions I do deal with.

33 I turn next to s-s.31(1)(b) which authorizes regulations prescribing the method of collection and remittance of the tax:

> 31.(1) The Lieutenant Governor in Council may make regulations including, without limiting the generality of the foregoing, regulations
>
> . . .
>
> (b) prescribing the method of collection and remittance of the tax and any other conditions or requirements affecting the collection and remittance, ...

34 The scope of s-s.31(1)(b) is wide. There are no stated restrictions on the methods of collection and remittance that may be adopted by the regulations. Apart from the usual limits that regulations must be within the objectives of the enabling statute, must not contravene its provisions and must not be unreasonable, I read s-s.31(1)(b) as enabling broad and flexible collection and remittance regulations.

35 Applying the liberal approach to interpretation, in my opinion, the regulatory powers in s-s.31(1)(b) and s-s.2(5) are sufficiently extensive to include the adoption of the regulatory scheme that is now in place. In arriving at this conclusion, I take into account the following observations: That practical effect of the collection scheme is that the consumers supply tax monies that enable the retailers to make payments to the wholesalers, and the wholesalers to make payments to the Crown. Thus, the real payment source that underlies the collection system and makes it work is the consumers. The amounts paid by the retailers to the wholesalers and by the wholesalers to the Crown are essentially the same amounts as are paid by the customers to the retailers. Because of the fast turnover of tobacco products, the timing of the retail sales substantially coincides with the payments by the retailers to the wholesalers and by the wholesalers to the Crown. The system is practical and in harmony with the commercial reality of the business of distribution and sale of tobacco products.

36 What then of s-s.2(5)? Does it conflict with the system? Does it require that only the very funds collected from the tax-

paying public must be remitted to the Crown and exclude any concept of the payment of tax equivalent dollars? In my opinion, s-s.2(5) should not be given a strict or literal interpretation. If the words "the tax ... collected" were taken absolutely literally, retailers would have to keep separate cash registers to physically separate out the actual tax dollars paid by the customers; so would wholesalers who collect from retailers. That would be pressing literal interpretation to the point of absurdity. In any event, every retailer in British Columbia selling tobacco products would require a separate accounting system to keep track of all tobacco sales and the taxes collected thereon. The cost of such requirements, whether to the Province or to the retailers, would be enormous.

37 In my opinion, s-s.2(5) can and should be interpreted in a manner that reconciles it with commercial common sense. The interpretation I adopt is that the expression "the tax ... collected" includes not only the actual money collected by the retailers from the consumers, but also amounts that are paid by retailers to wholesalers and by wholesalers to the Crown that are essentially equivalent, in both timing of payment and in amount, to the tax monies paid by the consumers.

38 Given the foregoing interpretation, in my opinion, the collection scheme does not conflict with s-s.2(5).

39 I turn next to the Regulations. Are they authorized by the Statute?

40 The provisions that are particularly relevant to the collection scheme are s-s.4(8), s.5 and s-s.6(1) as follows:

> 4.(8) Every dealer to whom a wholesale dealer's permit is issued shall be deemed to have been appointed a collector by the minister.
>
> 5. Every dealer who is not a collector shall collect the tax imposed by the Act and shall pay over the tax to a collector on demand.
>
> 6.(1) Every collector shall
> (a) on or before the 20th day of each month in respect of the previous month, deliver to the director such return as he requires, and
> (b) remit with the return required by paragraph (a) the amount of the tax as computed in the return.

41 These provisions set out fundamental elements of the collection scheme. Licenced wholesalers are deemed to be collectors: s-s.4(8). Retailers are required to pay over the taxes they collect to wholesalers on demand: s.5. I interpret "on demand" as referring to wholesalers' invoices. Wholesalers must provide monthly returns and remittances to the Crown by the 20th day of each month based upon the previous month's sales: s-s.6(1).

42 In my opinion, these regulations are clearly within the regulatory powers granted by s-s.31(1)(b) and s-s.2(5) as I have interpreted them.

43 Not all the elements of the scheme are in the Regulations. A significant one, which is only to be found in the statute, is the power to cancel a license for failure to collect or remit the tax. This is explicitly provided for in s-s.4(5)(b) as follows:

> 4.(5) The director may, with the approval of the minister, cancel or suspend a permit granted to a person under this section or refuse to grant a permit to a person who
>
> . . .
>
> (b) has failed to collect or remit, when required, tax imposed under this Act ...

44 Another aspect that is not in the Regulations is the adjustments that are allowed for bad debts, lost or stolen product and tax exempt sales. However, in my opinion, these adjustments are matters of financial policy pertaining to the adminstration of the ***Tobacco Tax Act*** and are within the authority of the Minister of Finance and, under him, the Director charged with the ***Act***'s adminstration. The minister's powers are set out in the***Financial Administration Act***, S.B.C. 1981, c.15, s.6, which reads:

> 6.(1) The Minister of Finance is responsible for
> (a) the management and administration of the consolidated revenue fund,
> (b) supervision of the revenues and expenditures of the government, and
> (c) matters relating to the fiscal policy of the government.
>
> (2) The Minister of Finance has, in addition to his responsibilities under sub-section (1), the supervision, control and direction of all other matters relating to the financial affairs of the government that are not assigned by this or any other enactment to the Treasury Board or to any other person.
>
> (3) Each minister is responsible for the administration of the financial affairs of his ministry, under the general direction of the Minister of Finance and the Treasury Board.

45 The Director's power to administer the ***Tobacco Tax Act*** is derived from s.1 of the ***Act*** which reads:

> 1. In this Act "director" means the person authorized by the minister to administer this Act;

46 In ***Optical Recording Co. v. Minister of National Revenue*** (1990), 116 N.R. 200, the Federal Court of Appeal adjudicated upon a ministerial policy to settle a tax claim in a manner not specifically provided for in the ***Income Tax Act***. The court held that the Minister held such a power "by virtue of his office." Urie J.A. for the court said at pp.207-8:

> "With great respect, it is my view that the learned judge in so viewing the Minister's actions misconstrued the role of the Minister in the collection of monies due the Crown. Section 220(1) requires the Minister to administer and enforce [the] Act and control and supervise all persons employed to carry out or enforce [the] Act ... Section 220(4) states that:
>
> > "The Minister may, if he considers it advisable in a particular case, accept security for payment of any amount that is or may become payable under this Act."
>
> The power which he is so given is to ensure that payment of the indebtedness by the debtor is ultimately secure. Normally the security provided would be monetary in nature. But the Minister's power is not limited to the statutory power to take security of that nature. He is empowered by virtue of his office, to manage his department, not exclusively from an administrative point of view but also from the point of view of what has in England been described as "management of taxes" which I take it means that as a creditor he has the right to arrange payment for a tax indebtedness in such a manner that best ensures that the whole will ultimately be paid. For example, if insistence on payment in full when due might jeopardize the solvency of the taxpayer, with consequent loss of potential for payment in full, and if the taxpayer can continue in business by giving him time to pay, in his discretion the Minister might arrange for payment in instalments with such security, if any, as he deems necessary. Effectively, such a course protects the Revenue and, as well, the taxpayer's solvency and continued ability to pay taxes. It applies too to the taxpayer satisfying the Minister in Part VIII tax situations that the taxpayer will eliminate its liability

> by year end. Such a course of conduct ought to be encouraged, not discouraged."

See also ***Tseshaht Band v. British Columbia***, supra, at 23.

47 While there is no direct evidence in the materials before the court that the portion of the scheme allowing adjustments for bad debts, lost or stolen product and tax exempt sales, was in fact administrative policy adopted by the Minister of the Director, I infer from the fact that it has been in place for many years and is an essential part of the scheme, that the policy was adopted by the Minister and the Director pursuant to their powers to do so.

48 I turn now to the cases which Crown counsel cites to support the Province's position that the ***Act*** and the Regulations authorize the collection scheme.

49 In ***Chehalis Indian Band v. British Columbia*** (1988), 31 B.C.L.R. (2d) 333 (C.A.), the issue was whether an Indian Band could claim a refund for fuel tax which Band members had paid, but which was later found to have been imposed without legal authority. The Court of Appeal refused the claim, holding that the Band itself had no right to make the claim on behalf of its members. The court, in the course of its reasoning, described the scheme as follows at pp.337-38:

> "The collection scheme employed in this case was designed for ease of administration and accounting. A retailer's inventory of gasoline is turned over relatively fast and the amount of tax that will be collected on the gasoline when sold to a retail purchaser is known. Thus each

> seller in the chain, from manufacturer to wholesale dealer, collects an amount equal to the tax at the time it makes its sale. The commercial effect is that the selling price of the gasoline, at each stage of the chain, is a price which includes an amount equal to the tax, *although the legal liability for the tax does not arise under the statute until the retail sale is made.*"

50 The court considered a submission by the Band that the scheme was an indirect tax and was not authorized by the ***Act*** and Regulations. In the course of rejecting this argument, the court commented on the scheme as follows at p.340:

> "The scheme was a practical method of collecting a known amount, equal to the tax which must be paid by the ultimate purchaser, and remitted by the band, as a retail dealer, to the minister. There is no suggestion that the minister received more tax than what was paid by those who purchased gas from the Chehalis gas bar."

51 In ***Tseshaht Band v. British Columbia***, supra, the issue was the validity of arrangements for tax-exempt on-reserve sales of tobacco and fuel to native Indians. By a majority decision, the British Columbia Court of Appeal concluded that the arrangements were legally valid. Cumming J.A. (Goldie J.A. concurring) commented upon the schemes under the ***Tobacco Tax Act*** and the ***Motor Fuel Tax Act*** at p.13:

> "The *Tobacco Tax Act* (ss.2 and 15) and the regulations (s.5) require a retail dealer (such as the Tseshaht Band) to remit tax to "collectors" on demand. All wholesale dealers in tobacco products are designated as "collectors." For reasons of efficiency and administrative convenience for the wholesale dealer, the retail dealer and the province, each wholesale dealer requires each of its customers who is a retail dealer to pay, at the time the retail dealer pays the wholesale dealer for the tobacco, an amount equal to the tax that will be collected on the retail sale.

> The scheme of the *Motor Fuel Tax Act* is similar. That Act imposes a tax on the "purchaser" of motor fuel (ss.4-9). The definition of "purchaser," somewhat like the definition of "consumer" under the *Tobacco Tax Act*, refers to a person who purchases for his own use (s.1). As with the *Tobacco Tax Act*, retail dealers of motor fuel are required to remit to their wholesale dealer amounts equal to the tax payable by the ultimate purchasers of that fuel. As with the tobacco tax scheme, each retail dealer includes the amount equivalent to the tax in the price it pays to its wholesale dealer for the fuel it purchases.
>
> These prepayment schemes appear, although it is not necessary to decide the question as it was neither pleaded nor argued otherwise, to be authorized by the provisions of the *Motor Fuel Tax Act* and the *Tobacco Tax Act.*"

52 Counsel for the tobacco companies submits that the foregoing passages from the ***Chehalis*** and ***Tseshaht*** decisions are obiter dicta. Counsel for the Province agrees, but contends they should nonetheless be accorded considerable weight. I agree. In my view, they reflect the liberal and practical approach to interpretation of tax statutes required by the decisions of the Supreme Court of Canada cited earlier in this judgment.

53 I will now deal with the cases cited by the tobacco companies. The judgment upon which the companies placed the most reliance was that of Lambert J.A. in his dissenting reasons in ***Tseshaht Band v. British Columbia***, supra. For reasons I have given earlier, and with great respect, I do not agree that the collection scheme contravenes s-s.2(5). I prefer to follow the views expressed in the majority judgment, albeit they are obiter dicta.

54 Lambert J.A. appeared to premise his opinion upon the view that the scheme imposed an indirect tax and was therefore beyond the Province's legislative powers under the ***Constitution Act, 1867***. Lambert J.A. said at p.37, supra:

> "There is a reason, of course, why the administrative collection scheme is not set out in the legislation. In my opinion, if such a scheme were set out in the legislation, the legislative scheme would almost certainly become a scheme for the imposition of an unconstitutional, indirect tax. Under the administrative scheme, the first and principal payment to the Crown is a payment by the initial manufacturer or importer. That payment, if compelled by law, would bear all the indicia of being a tax. The manufacturer or importer reimburses itself from the wholesaler, which reimburses itself from the retailer, which reimburses itself from the customer. The initial payment at the top of the chain to the Crown, followed by a cascading process of reimbursement, is the very essence of an indirect tax."

55 The concern expressed by Lambert J.A. has, I believe, been laid to rest by a subsequent decision of the Supreme Court of Canada in ***Reference re Quebec Sales Tax***, [1994] 2 S.C.R. 715. This was a reference to the Supreme Court as to the validity of the Province of Quebec adopting a tax system substantially the same as the federal Goods and Services Tax. Gonthier J., for the court, put the issue in focus at p.729:

> "The unique feature of a value-added tax, its collection along the production and marketing chain, may be the chief attraction for governments. However, the collection mechanism, which provides for the tax as the good moves through the consumption chain, may at first sight appear to raise the spectre of an indirect tax."

Gonthier J. then addressed the issue in the following passage at pp.729-30:

> "... The fact that the tax is recouped through a series of indemnifications before the goods reaches the final consumer does not, however, make the value-added tax an indirect tax for constitutional purposes. Close examination of the proposed tax reveals that the person who ultimately pays the tax is the one intended to bear the burden, and therefore, the tax is direct.
>
> As noted above, the proposed tax will be paid and then reimbursed at each stage until final consumption. Imposing the tax at each level in the consumption chain is simply a method of tax collection by instalments. The persons who collect the tax along the chain and who are reimbursed are really tax collectors. The draft Act, it will be remembered, explicitly identifies these persons as agents of the Minister of Revenue in their capacity as tax collectors (draft Act, s.28). Rather than putting forward a new and different type of tax, the essence of the proposed amendments is simply to substitute a new mechanism of collection."

56 I deal next with ***Johnson v. Nova Scotia (Attorney General)***, supra, in which the Appeal Division of the Nova Scotia Supreme Court held that the ***Health Services Tax Act*** did not authorize the collection of sales tax at the wholesale level and that regulations which imposed this duty on wholesalers were ultra vires the statute. In my opinion, the case is distinguishable because in the Nova Scotia statute there was no provision authorizing a wholesaler to collect the tax, whereas the ***Tobacco Tax Act*** in British Columbia imposes a duty on wholesalers to collect the tax as agents of the Minister: see s-s.(6) and the s.1 definition of "dealer".

57 The remaining case relied upon by the tobacco companies is ***British Columbia v. National Bank of Canada***, supra, in which Newbury J. commented at p. 375 that the manner in which the tobacco taxes are collected is "completely different from what one would expect from a reading of the ***Act***". I observe that the issue before

the court was not the validity of the collection scheme; it was whether monies received by a wholesaler from a retailer were trust funds within s.15 of the ***Act***. Newbury J. held they were not trust funds. Her decision was upheld by the Court of Appeal, [1995] 2 W.W.R. 305. In the Court of Appeal, an argument based on the equitable doctrine of "tracing" was raised. In rejecting this submission, Hollinrake J.A. for the court said at p.325:

> "In the case before us, in my opinion, the tracing exercise must logically commence from the time the moneys could arguably be said to be the Crown's moneys. This must be at the time the tobacco tax is collected from consumers by SDM. The Crown argues that when Red Carpet is paid for its invoices by SDM the amount of those invoices which can be calculated to be attributable to tobacco tax is the starting point for the tracing exercise. This calculated amount is still "tax" as defined by the Act but can it be said to be identifiable as the actual tax paid over by the consumer at the time of purchase of the tobacco product from SDM? There is a difference between calculating what one is owed over a set period of time as opposed to tracing the funds that initially represented that debt in the form of money in the hands of the debtor.
>
> The calculation leads to an in personam remedy in debt. The tracing leads to an in rem remedy by way of a constructive trust or equitable lien."

There is no suggestion in the above passage that the wholesaler (Red Carpet) was not indebted to the Crown for the monies it collected from the retailer (SDM). Indeed, albeit by way of obiter dicta, the court appears to say that the wholesaler was indebted to the Crown. In my view, this decision implicitly supports the Province's position in the present case.

58 For the foregoing reasons, I reject the tobacco companies' attack on the collection scheme under the ***Tobacco Tax Act***.

59 It follows from this ruling that Wing Wah is liable to the Crown under ss.15 and 17 of the ***Act*** for any money it received from retailers for taxes which it failed to remit to the Crown.

CALCULATION OF DEBT

60 The tobacco companies submit that the evidence establishes that there is no debt owing by Wing Wah to the Province. This submission is based on the proposition that Wing Wah as a wholesaler was not under any legal obligation to the Crown to remit the "tax equivalent" funds it received from its retailers. I have rejected this argument in the "LEGAL ISSUE" section above.

61 The tobacco companies further contend that the amounts said to be owing for tobacco tax are based on purchases by the wholesaler from the tobacco companies rather than sales of tobacco by retailers to consumers. The companies say that there is no necessary relationship between the taxes paid by the public to the retailers and the payments by the retailers to Wing Wah, either as to amount or as to the timing of the payments. The companies also submit that the method of calculating taxes owing with respect to cigar sales is in error because it is based on the tobacco companies' suggested retail prices rather than the prices actually charged by the retailers. These submissions question the validity

of the method used to quantify Wing Wah's obligation. I will deal first with the facts.

62 Pursuant to a request from the Director, a calculation of the amount of the indebtedness of Wing Wah was carried out by Mr. David Longman, C.M.A., the Director, Regional Operations, Consumer Tax Branch of the Ministry of Finance and Corporate Relations. In doing the calculations, Mr. Longman was acting under s-s.9(2) of the ***Act***:

> 9.(2) Where it appears from the inspection, audit or examination, or from the information that is available to him, that the person is a dealer within the meaning of this Act, or that this Act or the regulations have not been complied with, the person making the inspection, audit or examination shall calculate the tax collected or due in a manner and by a procedure the director may consider adequate and expedient, and the director shall assess the dealer or the person for the amount of the tax calculated, but the person assessed may appeal the amount of the assessment under section 10 of this Act.

63 Mr. Longman determined that the shortfall of tax monies due to be paid by Wing Wah to the Crown was $6,196,897.66. Pursuant to s-s.9(2), the Director then assessed Wing Wah for the amount of $6,196,897.66. The Director also filed a proof of claim in this amount with the Trustee in Bankruptcy, Deloitte & Touche Inc.

64 Mr. Longman's calculations were carried out by a method he described in paragraphs 6 to 17 of his affidavit as follows:

> "6. Tobacco taxes are payable by the ultimate consumers of tobacco products. Except for cigars, the amount of tax payable is based entirely upon the quantity of product purchased by the ultimate consumer. For example, at the present time a tax of 11.0 cents is payable on each cigarette purchased.

7. In the case of cigars, the rate of tax is dependant upon the retail price. For example, a tax of 4 cents per cigar is payable on a 9 cent cigar, and a tax of 5 cents per cigar is payable on a 10 cent to 13 cent cigar.

8. Because the tax on items other than cigars is based on the quantity of product sold, it is possible to determine, at the moment those items are purchased by a wholesaler, precisely how much tax will be payable on those items by the ultimate consumer (assuming that the consumer is taxable).

9. In the case of cigars, a calculation similar to that referred to in paragraph 8 of this my affidavit is possible, provided that one assumes that the cigars will be sold at the manufacturer's suggested retail price. With respect to cigars, I relied on tax calculations provided to me by the cigar manufacturers, and I presumed that those calculations were based upon the manufacturer's suggested retail price. I do not believe that cigars formed a material percentage of Wing Wah's total sales.

10. I have reviewed copies of invoices and listing of invoices supplied to the Province by Wing Wah's suppliers, relating to Wing Wah's purchases of tobacco products during the period March 1, 1989 to November 30, 1991. Based upon that information, I have determined that during the April 1, 1989 to September 16, 1991 reporting period, Wing Wah acquired tobacco products on which taxable consumers would be required to pay $50,076,372.70 in tobacco taxes.

11. I have adjusted the amounts referred to in paragraph 10 of this my affidavit to reflect:
a) amounts of tax payable on product left unsold at the date of Wing Wah's bankruptcy;
b) amounts of tax that would have been payable on products that Wing Wah reported as being lost or stolen;
c) amounts of tax that Wing Wah or the Trustee in Bankruptcy for Wing Wah reported as being uncollectible from retailers (ie-amounts relating to Wing Wah's bad debts);
d) changes in the rate of tax between the time Wing Wah purchased tobacco products and the time those products were likely sold to the ultimate consumers; and
e) amounts of tax that would not have been paid because the products in question were sold to a retailer for the purpose of re-selling that product to Native Indians.

12. The adjustments referred to in paragraph 11(d) of this my affidavit were based upon inventory information supplied by Wing Wah. The total amount of those adjustments was $236,262.59.

> 13. Based on the foregoing, I have determined that Wing Wah collected, or should have collected, $49,244,674.36 in tobacco taxes from retail dealers, relating to tobacco products purchased by Wing Wah in respect of the April 1, 1989 to November 30, 1991 reporting periods.
>
> 14. Based upon the returns filed by Wing Wah in relation to the period April 1, 1989 to November 30, 1991, I have determined that Wing Wah remitted $43,050,652.43 in tobacco taxes in relation to the purchases referred to in paragraph 13 of this my affidavit.
>
> 15. After allowing for a commission of $10,000.00 claimable by Wing Wah in respect of its collections, the difference between the amounts referred to in paragraphs 13 and 14 of this my affidavit is $6,184,021.93.
>
> 16. My conclusions were based upon actual figures obtained from documents that were supplied by Wing Wah, the trustee in bankruptcy for Wing Wah, or Wing Wah's suppliers, or that were found at Wing Wah's premises by the Province's auditors. In some cases, I relied upon summaries of these documents prepared by members of my staff. In no case did I rely on prorations.
>
> 17. As indicated in paragraph 9 of this my affidavit, I estimated the selling price of cigars based upon the manufacturer's suggested retail price. As indicated in paragraph 12 of this my affidavit, I estimated the additional tax payable as a result of tax increases based upon inventory information supplied by Wing Wah. In no other case did I rely on estimates."

65 Subsequently, Mr. Longman carried out further calculations which included matters that he had not taken into account in his initial work. His revised determination was in the amount of $6,537,418.23. The Director filed a new proof of claim with the Trustee in this amount.

66 The Trustee, Deloitte & Touche Inc., carried out its own separate analysis of the Province's claim using information supplied by the tobacco companies. According to the Trustee's calculations, the amount owing was $6,505,490.10. Thus, there was

a difference of $31,928.13 between the amounts determined by the Trustee and by the Crown. The Trustee concluded that while there were some variations between the two sets of analyses, they in fact complemented each other. The Trustee accepted the new proof of claim for $6,537,418.23.

67 The tobacco companies have not produced any countering calculations. Rather, they challenge the Province's claim with arguments as to why it should not be accepted. Their main argument is that there is no legal basis for finding that Wing Wah was indebted to the Crown. As noted earlier, I disposed of this submission in the "AUTHORITY FOR COLLECTION SCHEME" section above. I therefore turn to the arguments relating to the quantification of the Crown's claim.

68 The tobacco companies submit that there is no necessary correlation between the taxes paid by the consumers and the calculation of taxes based upon sales by Wing Wah to its retailers. The tobacco companies cite the following observations of Newbury J. in the ***National Bank*** case, supra, at p.378:

> "However, because the timing of the wholesaler's remittance of the tax substitute bore no necessary relationship to the timing of the retail sale (the "trigger" for the exigibility of the actual tax), it could not be said as a matter of certainty in the legal sense that any particular tobacco products sold at the retail level were products in respect of which the "tax substitute" had or had not been remitted."

and, at p.380:

> "...on these facts it cannot be said with certainty how much of every dollar paid by retailers such as SDM to Red Carpet (the wholesale dealer) represented tobacco products in respect of which Red Carpet had already remitted its "tax substitute" and how much represented tobacco products in respect of which the Crown had yet to be paid."

69 I observe that Newbury J. was addressing a submission that monies paid by a retailer to a wholesaler for taxes were trust monies in the hands of the wholesaler. She was not addressing the validity of the method of calculation of the indebtedness of the wholesaler to the Crown.

70 In my opinion, "certainty" is not the test for calculating the amount of the indebtedness of Wing Wah to the Crown. Rather, provided the method is reasonable and the evidence is relevant and probative, that is sufficient, in my view, to quantify the Crown's claim. I find on the evidence that the sales by the tobacco companies to Wing Wah provide a reasonably accurate basis upon which to calculate the taxes paid by the consumers to the retailers and by the retailers to Wing Wah. The timing of the turnover of tobacco products substantially coincides with the required remittances by the wholesalers to the Crown. Reasonable adjustments are taken into account. The method of calculation is practical and in keeping with the commercial realities of the business of wholesale and retail tobacco product sales. Furthermore, in this particular case, the Trustee's own calculations confirm the amount of the claim.

71 The tobacco companies argue that the calculations for taxes on cigars are not valid because the manufacturers' suggested retail prices were used rather than the actual selling prices by the retailers. While there is an element of logic in this argument, I am of the opinion that the submission overlooks the practical difficulty of surveying the numerous retailers who sell cigars in order to determine their selling prices. In my view, a fair inference may be drawn that the cigar prices will generally be at or near the manufacturers' suggested retail prices and that any differences will be so insignificant that the overall calculations will be little affected by the use of suggested retail prices.

72 In summary, I find that the type of calculations used to determine the shortfall of taxes paid by Wing Wah to be reasonable and supported by relevant and probative evidence.

73 For the foregoing reasons, I conclude that the quantification of the Crown's proof of loss in the amount of $6,537,418.23 should be upheld.

CONCLUSION

74 The remedies requested by the tobacco companies are denied. Their motion is dismissed with costs against the tobacco companies.

"D.W. Shaw, J."

Vancouver, B.C.
September 14, 1995

TAB 5

IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation: *Asian Concepts Franchising Corporation (Re),* 2018 BCSC 1022

Date: 20180621
Docket: B131424
Registry: Vancouver

Between:

In Bankruptcy and Insolvency

In the Matter of the Proposal of Asian Concepts Franchising Corporation

Before: The Honourable Madam Justice Fitzpatrick

Reasons for Judgment

Counsel for Grant Thornton Limited, Trustee in the Proposal of Asian Concepts Franchising Corporation:	Kimberley A. Robertson Blair McRadu
Counsel for Adrenaline Drive Inc.:	Jeremy H. H. Hockin, Q.C. Heather A. Frydenlund
Counsel for Asian Concepts Franchising Corporation:	Gordon G. Plottel
Place and Date of Hearing:	Vancouver, B.C. March 27, 2018
Place and Date of Judgment:	Vancouver, B.C. June 21, 2018

INTRODUCTION

[1] These proceedings concern the proposal of Asian Concepts Franchising Corporation ("ACFC"), which was filed pursuant to the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the "*BIA*").

[2] One of ACFC's creditors, Adrenaline Drive Inc. ("Adrenaline"), is vigorously opposed to this proposal. Adrenaline has advanced its opposition in a number of ways. It has voted against the proposal and it has magnified its opposition by successfully appealing the Trustee's determination as to the amount of its claim, although the newly determined amount of its claim was not sufficient to carry the vote. Adrenaline also intends to oppose any court approval of the proposal, if approved by the creditors, pursuant to s. 59 of the *BIA*.

[3] This application by Adrenaline is another means by which it can oppose the proposal process. It amounts to a challenge to the amount of the claim of another creditor, WB Heartland Restaurant Inc. ("Heartland"), in terms of its right to vote in favour of the Amended Proposal (as later defined in these reasons) and any later distribution.

BACKGROUND

a) The Adrenaline Litigation

[4] On September 9, 2008, Adrenaline and ACFC, the franchisor of the Wok Box Fresh Asian Kitchen franchise, entered into a Master Developer Agreement (the "MDA") governing the operation and development of "Wok Box" franchise locations located within a territory. The territory initially included all of northern Alberta, Saskatchewan and Manitoba.

[5] The initial term of the MDA was for a period of 10 years. Upon expiry, the MDA provided that Adrenaline had the option of renewing the MDA for an unlimited number of additional 10-year terms upon, among other things, payment of a $25,000 renewal fee. Adrenaline earned substantial royalty fees under the MDA, with average monthly payments of approximately $35,000.

[6] By February 2012, Adrenaline had expanded the number of Wok Box restaurants in its territory to include at least 26 locations.

[7] ACFC ceased making royalty payments to Adrenaline in January or February 2012. On February 27, 2012, ACFC purported to terminate the MDA. Two days later, ACFC notified all franchisees in Adrenaline's former territory that the franchises had been assigned to WB Franchising Ltd. (“WB Franchising”).

[8] On June 11, 2012, Adrenaline filed a statement of claim in the Alberta Court of Queen's Bench. One of its claims was that ACFC had breached the MDA and wrongfully terminated it without cause. Adrenaline claimed liquidated damages of $166,774.82 and unliquidated damages of $8 million. Adrenaline filed its claim against both ACFC and WB Franchising and also, Scott Bender, the principal of both companies.

[9] In its Alberta action, Adrenaline alleged that the defendants conspired to deprive it of the benefit of the MDA. Adrenaline was aware that, in 2011, ACFC was also facing court actions or claims by other creditors, including that of 1448244 Alberta Inc., in excess of $1.7 million. Adrenaline alleged in its action that, to avoid all these potential claims, Mr. Bender, as the directing mind of ACFC, WB Franchising and 0839297 B.C. Ltd. (“839”) developed a scheme. 839 is an entity also controlled by Mr. Bender. It holds the Wok Box trademark license, which is an important asset within the Wok Box franchising system.

[10] Adrenaline alleges that Mr. Bender’s scheme involved: firstly, terminating the master development agreements, including Adrenaline’s MDA, so that the income or royalty streams would revert to ACFC; and, secondly, arranging to transfer the trademarks, franchise agreements and the other assets required to operate the Wok Box franchise from ACFC to WB Franchising. Adrenaline alleges that WB Franchising paid a small amount for the tangible assets and that it paid nothing for the transfer of the franchise agreements and intellectual property that WB Franchising received from ACFC.

[11] The MDA contained a term that required arbitration of any dispute to take place in British Columbia. In accordance with this provision, Adrenaline commenced arbitration proceedings against ACFC in British Columbia.

b) The *BIA* Proposal Proceedings

[12] On November 20, 2013, shortly after the arbitration proceedings were scheduled, ACFC filed a notice of intention to make a proposal to its creditors pursuant to Division I of Part III of the *BIA* (s. 50.4). In the usual course, this filing resulted in a stay of proceedings in relation to Adrenaline's arbitration proceedings. Grant Thornton Limited was to act as the Trustee under the proposal.

[13] On December 20, 2013, ACFC filed its proposal pursuant to s. 62 of the *BIA*. On that date, Mr. Bender, described by the Trustee as ACFC's "sole" director, executed ACFC's statement of affairs. The statement disclosed total unsecured claims of $361,312.74 and the balance of secured claims of $610,000, for total unsecured claims of $971,312.74.

[14] The Trustee's report to the creditors in respect of the proposal indicated that ACFC was no longer carrying on business, having sold its assets in 2012/2013. The only remaining asset indicated was a minimal bank balance of $2,700. Nevertheless, the proposal was that "related third parties" would fund monies into the proceedings in order to create a pool of not less than $300,000 for payment to the unsecured creditors.

[15] On February 14, 2014, ACFC amended its initial proposal (the "Amended Proposal") and it is the Amended Proposal upon which the creditors' would ultimately vote. In substance, the proposal again provided that a sum of money would be funded (then $325,000) in which all the unsecured creditors would share *pro rata* based on their proven claims. On February 27, 2014, the first meeting of creditors was held, although it was adjourned to allow distribution of the Amended Proposal to all creditors for their consideration.

[16] There were some unusual aspects of the Amended Proposal, particularly in light of Adrenaline's allegations in its Alberta action and perhaps allegations by other creditors. The Amended Proposal provided in part:

> 1. In this Proposal:
>
> (e) "Contributors" means WB Franchising Limited and 0839297 B.C. Ltd., who have Claims or potential Claims for indemnity against the Debtor.
>
> …
>
> 15. Unsecured Creditors will accept the payments provided for in this Proposal in complete satisfaction of all their Claims, as against the Debtor or any of the Contributors .... all of which shall be released upon payment of the amounts provided for in this Proposal….
>
> 16. Upon performance by the Debtor of its obligations under this Proposal, each and every Director of the Debtor shall be released from any and all demands, claims, debts, judgments and other recoveries on account of any potential, contingent or actual statutory liability of whatever nature ....

[17] Accordingly, if the creditors accept the Amended Proposal and it is approved by this Court in accordance with the *BIA*, Adrenaline's ability to pursue its claim in its Alberta action or the arbitration proceedings will be adversely affected, if not eliminated, as against certain persons. This will include Adrenaline's ability to pursue WB Franchising and 839 (since they are "Contributors" under the Amended Proposal). It will also affect Adrenaline's ability to pursue ACFC's directors, being Mr. Bender and Lawrence Eade.

[18] As stated above, the focus of this application is the validity of Heartland's claim against ACFC. A brief history of Heartland's claim both prior to and in the proposal proceedings is as follows:

a) prior to the filing of the notice of intention, Heartland filed a claim in the Ontario Superior Court of Justice against ACFC and three of ACFC's directors, including Mr. Bender, Mr. Eade and another principal of ACFC, Chris Bullock;

b) in its statement of affairs sworn December 20, 2013 by Mr. Bender, ACFC attached no value to Heartland's claim;

c) just one day after the filing of ACFC's initial proposal on December 20, 2013, Heartland was dissolved by way of a certificate of dissolution issued on December 21, 2013;

d) notwithstanding its dissolution, Heartland filed a proof of claim of approximately $2.38 million against ACFC. In addition, on January 7, 2014, Heartland sent in a voting letter indicating that it was voting against ACFC's proposal. On January 8, 2014, Heartland's counsel in particular objected to the releases sought in the proposal in relation to Messrs. Bender, Eade and Bullock;

e) on February 27, 2014, Heartland submitted a replacement proof of claim and voting letter. Heartland's claim was now presented and allowed at $1.6 million and Heartland indicated that it was voting in favour of the Amended Proposal; and

f) the acceptance of Heartland's claim by the Trustee at even this reduced amount was such that it's claim constituted approximately 51% of the overall value of the total claims allowed by the Trustee. As such, Heartland's support contributed greatly to ACFC meeting the 2/3 in value of creditor claims threshold needed to approve the Amended Proposal later on March 10, 2014.

[19] Adrenaline was not particularly aware as to why ACFC and Heartland agreed to reduce Heartland's claim and why Heartland changed its vote at some point after January 7, 2014, and before February 27, 2014. It was on the latter date when the Trustee indicated that Heartland's claim had been "settled." However, there are statements and court filings which give some context and suggest that negotiations between ACFC and Heartland led to this result:

a) the Trustee's minutes of a meeting of creditors on February 27, 2014 states:

> Two other claims from WB Heartland and from 1448244 Alberta Inc. have been admitted pursuant to negotiations and a settlement of amounts between the debtor and respective creditors.

b) according to documents filed in Heartland's Ontario action, a settlement was reached with Mr. Bender and Mr. Eade, which resulted in that action being dismissed as against them on February 21, 2014. The action continued against the remaining parties, including Mr. Bullock, who apparently agreed to settle Heartland's claim for $50,000. In February 2016, when Mr. Bullock did not perform his part of the settlement, Heartland obtained judgment against him for the settlement amounts and costs.

[20] On March 10, 2014, a further meeting was held at which ACFC presented the Amended Proposal to its unsecured creditors for consideration and voting purposes. In accordance with s. 54(2) of the *BIA*, the requisite majority of creditors approved the proposal, both in dollar amount (98%) and number (13/14). Adrenaline's claim had been filed in the amount of $8 million, consistent with its claim in the Alberta action; however, the Trustee disallowed most of that amount and Adrenaline's claim was valued at only $65,720. Adrenaline was the only creditor to vote against the Amended Proposal. All other creditors, including Heartland, with approximately $3 million in value collectively, voted in favour.

c) Post-Voting Events

[21] Adrenaline was unhappy with its claim being valued at $65,720, particularly since it meant that its negative vote was not sufficient to defeat the Amended Proposal.

[22] It filed an appeal of the Trustee's determination of its claim pursuant to s. 135(4) of the *BIA*. That appeal resulted in this Court directing that the Trustee further evaluate Adrenaline's claim based on a more expansive definition of what constituted, or should have constituted, the record before the Trustee. Eventually, on

January 15, 2015, the Trustee valued Adrenaline's claim for voting purposes at $754,720.25.

[23] Adrenaline appealed again. On August 17, 2017, Registrar Muir agreed that Adrenaline's claim should be increased to $1,122,720.25 for voting purposes: *Asian Concepts Franchising Corporation (Re)*, 2017 BCSC 1452 at para. 123 [*Asian Concepts*]. This further increase was still not sufficient to cause a defeat of the Amended Proposal, since Adrenaline's claim constituted only 26.7% in value of the voting creditors.

[24] In the meantime, after the voting, Adrenaline was also taking aim at other creditors' claims or the value of those claims, which had resulted in a vote approving the Amended Proposal. This included Heartland's claim.

[25] Unfortunately, as with the determination of Adrenaline's claim, the challenges to these other claims has equally been a drawn-out and litigious process that has significantly delayed the resolution of this proposal proceeding. This process has been marked by considerable disagreements and a fractious relationship that arose between Adrenaline and the Trustee as to both the substance of Adrenaline's objections, and also the procedures necessary to move the issues forward.

[26] The Trustee refused Adrenaline's request for copies of the proofs of claim filed by various creditors, including that of Heartland. The Trustee only provided them after Registrar Muir ordered that production on February 12, 2015.

[27] Once it had reviewed the materials provided by the Trustee with respect to Heartland's claim, Adrenaline wrote to the Trustee pointing out what it considered were discrepancies in that claim. On May 24, 2016, the Trustee disagreed with Adrenaline's assessment of Heartland's claim and provided a detailed justification for allowing Heartland's claim at $1.6 million. I will address the Trustee's response in more detail below.

[28] On July 14, 2017, Registrar Muir directed that Adrenaline write to the holders of the third party claimants, including Heartland, for the purposes of notifying them of

Adrenaline's intention to challenge their claims in court. On July 18, 2017, Adrenaline's counsel did just that. On July 31, 2017, Heartland's principal, Rick Menendez replied, stating that Heartland would not be attending any court hearing.

[29] As directed by Registrar Muir, Adrenaline was to file and serve separate applications relating to its challenge to each third party claim. This application is intended to address the Trustee's acceptance of Heartland's claim at $1.6 million.

[30] As previously indicated by Mr. Menendez, no one appeared for Heartland on this application, despite being served. However, Heartland did file a response to this application, essentially adopting the position of the Trustee.

HEARTLAND'S CLAIM

[31] In March 2010, Heartland and ACFC executed a franchise agreement by which Heartland was to operate a Wok Box franchise in Mississauga, Ontario. In November 2009, in anticipation of this document being executed, ACFC provided a disclosure statement to Heartland.

[32] The tenant of the restaurant premises was 1185662 Alberta Ltd. ("118"). As I will discuss in more detail below, Heartland executed an indemnity agreement in favour of the landlord, Orlando Corporation ("Orlando"), in respect of 118's obligations under the lease.

[33] Heartland operated the restaurant for about one year, from 2010–2011. The operation was formally abandoned in August 2011. Shortly thereafter, Orlando officially terminated 118's lease in October 2011 and retook the premises.

[34] It is common ground that the procedures leading up to these franchise arrangements, the franchise agreements and the fallout from the franchise's failure, were governed by the *Arthur Wishart Act (Franchise Disclosure), 2000*, S.O. 2000, c. 3 (the "*Wishart Act*"). Although s. 13.6 of Heartland's franchise agreement specified that it was to be governed by and construed in accordance with the laws of British

Columbia, s. 10 of the *Wishart Act* provided that such a choice of law clause was void.

[35] Section 5 of the *Wishart Act* requires a "disclosure document", such as ACFC purported to give Heartland in this case. Disclosure requirements are governed by ss. 5(4) and (6).

[36] Sections 6 and 7 of the *Wishart Act* are highly relevant to Heartland's claim:

> **6** (1) A franchisee may rescind the franchise agreement, without penalty or obligation, no later than 60 days after receiving the disclosure document, if the franchisor failed to provide the disclosure document or a statement of material change within the time required by section 5 or if the contents of the disclosure document did not meet the requirements of section 5.
>
> (2) A franchisee may rescind the franchise agreement, without penalty or obligation, no later than two years after entering into the franchise agreement if the franchisor never provided the disclosure document.
>
> (3) Notice of rescission shall be in writing and shall be delivered to the franchisor, personally, by registered mail, by fax or by any other prescribed method, at the franchisor's address for service or to any other person designated for that purpose in the franchise agreement.
>
> (4) The notice of rescission is effective …
>
> …
>
> (6) The franchisor, or franchisor's associate, as the case may be, shall, within 60 days of the effective date of the rescission,
>
> > (a) refund to the franchisee any money received from or on behalf of the franchisee, other than money for inventory, supplies or equipment;
> >
> > (b) purchase from the franchisee any inventory that the franchisee had purchased pursuant to the franchise agreement and remaining at the effective date of rescission, at a price equal to the purchase price paid by the franchisee;
> >
> > (c) purchase from the franchisee any supplies and equipment that the franchisee had purchased pursuant to the franchise agreement, at a price equal to the purchase price paid by the franchisee; and
> >
> > (d) compensate the franchisee for any losses that the franchisee incurred in acquiring, setting up and operating the franchise, less the amounts set out in clauses (a) to (c).
>
> **7** (1) If a franchisee suffers a loss because of a misrepresentation contained in the disclosure document or in a statement of a material change or as a result of the franchisor's failure to comply in any way with section 5, the franchisee has a right of action for damages against,
>
> > (a) the franchisor;

> (b) the franchisor's agent;
>
> (c) the franchisor's broker, being a person other than the franchisor, franchisor's associate, franchisor's agent or franchisee, who grants, markets or otherwise offers to grant a franchise, or who arranges for the grant of a franchise;
>
> (d) the franchisor's associate; and
>
> (e) every person who signed the disclosure document or statement of material change.
>
> (2) If a disclosure document or statement of material change contains a misrepresentation, a franchisee who acquired a franchise to which the disclosure document or statement of material change relates shall be deemed to have relied on the misrepresentation.
>
> (3) If a franchisor failed to comply with section 5 with respect to a statement of material change, a franchisee who acquired a franchise to which the material change relates shall be deemed to have relied on the information set out in the disclosure document.
>
> (4) A person is not liable in an action under this section for misrepresentation if the person proves that the franchisee acquired the franchise with knowledge of the misrepresentation or of the material change, as the case may be.
>
> …

[37] In August 2011, Heartland delivered a notice of rescission to ACFC in relation to the franchise agreement.

[38] In March 2012, Heartland commenced an action against ACFC and Messrs. Bender, Eade and Bullock in the Ontario Superior Court of Justice. Heartland asserted that it had not received the required disclosure from ACFC in that the disclosure it had received was "materially deficient." Heartland therefore claimed the right to rescind the franchise agreement under ss. 6(2) and (3) of the *Wishart Act*. In its amended statement of claim filed in April 2013, Heartland claimed damages, being approximately $1,383,186.77 (under s. 6(6)) and damages for misrepresentation (under s. 7(1)).

[39] On January 7, 2014, after the filing of ACFC's initial proposal, Heartland filed its first proof of claim in these proceedings in the amount of $2,383,187. The particulars of the two separate claims under the *Wishart Ac*t were set out in Schedule "A", "Calculation of Claim", as follows:

a) Part A (s. 6(6)): $1,383,186.77 - these included: (a) out of pocket monies paid to ACFC for the setting up of the franchise; (b); inventory; (c) equipment and supplies; and (d) other “losses” incurred in acquiring, setting up and operating the franchise, which were said to include “operational losses” of $347,500.54 and “lease indemnity costs” of $523,318.04; and

b) Part B (s. 7(1)): damages of $1 million.

[40] On February 27, 2014, Heartland filed a second proof of claim in the amount of $1.6 million. As with its first proof of claim, the same Schedule “A” was attached (indicating total claims of $2.38 million) with no particular clarity about which claims had been deleted or reduced to account for the overall reduction in the amount claimed.

[41] On March 24, 2015, after Adrenaline had reviewed the second proof of claim filed by Heartland, Adrenaline wrote to the Trustee requesting that it expunge Heartland’s claim pursuant to s. 135(5) of the *BIA*. At this point, Adrenaline had not received the package of supporting documents provided by Heartland to the Trustee in January 2014, including Heartland’s Compensation Brief.

[42] In its letter, Adrenaline’s counsel pointed out various apparent discrepancies. These included:

a) the lack of substantiation for the $1 million claim in damages for misrepresentation under the *Wishart Act*, which was said to be a duplication of the s. 6(6)(d) lost profit or operational loss claim;

b) that no credit had been received for the disposition proceeds of the assets which ACFC was required to repurchase from Heartland;

c) the inclusion of “non-cash” items in the s. 6(6) operational loss claim, being depreciation of $35,236.68; and

d) the validity of the claim for lease indemnity costs.

[43] Adrenaline's counsel asserted that there was "no discernable basis to support" the $1.6 million claim. Although Adrenaline referred to "expunging" the claim, it is more than apparent that what was also being sought was a *reduction* of Heartland's claim in relation to the questionable aspects of the claim.

[44] On May 24, 2016, the Trustee's counsel replied to Adrenaline's concerns regarding Heartland's claim. It was only at this point that the Trustee provided Adrenaline with the Compensation Brief previously provided by Heartland back in January 2014. I will deal with the Trustee's analysis and conclusions below in more detail under "Discussion." It will suffice at this time to state that the Trustee was satisfied with the quantification of the claim based on certain "Revised Calculations." The Trustee's counsel advised Adrenaline that it would not be taking any further position on, or expunging, Heartland's second proof of claim.

STANDARD OF REVIEW

[45] The process by which a trustee examines proofs of claim and either allows or disallows them is set out in s. 135 of the *BIA*:

> 135 (1) The trustee shall examine every proof of claim or proof of security and the grounds therefor and may require further evidence in support of the claim or security.
>
> (1.1) The trustee shall determine whether any contingent claim or unliquidated claim is a provable claim, and, if a provable claim, the trustee shall value it, and the claim is thereafter, subject to this section, deemed a proved claim to the amount of its valuation.
>
> (2) The trustee may disallow, in whole or in part,
>
> (a) any claim; …
>
> (3) Where the trustee makes a determination under subsection (1.1) or, pursuant to subsection (2), disallows, in whole or in part, any claim, any right to a priority or any security, the trustee shall forthwith provide, in the prescribed manner, to the person whose claim was subject to a determination under subsection (1.1) or whose claim, right to a priority or security was disallowed under subsection (2), a notice in the prescribed form setting out the reasons for the determination or disallowance.
>
> (4) A determination under subsection (1.1) or a disallowance referred to in subsection (2) is final and conclusive unless, within a thirty day period after the service of the notice referred to in subsection (3) or such further time as the court may on application made within that period allow, the person to

> whom the notice was provided appeals from the trustee's decision to the court in accordance with the General Rules.
>
> (5) The court may expunge or reduce a proof of claim or a proof of security on the application of a creditor or of the debtor if the trustee declines to interfere in the matter.

[46] Section 113 of the *Bankruptcy and Insolvency General Rules*, C.R.C., c. 368, provides that a trustee is required to serve or deliver a notice of disallowance or valuation under s. 135(3) of the *BIA* on the affected person. There is no evidence on this application that the Trustee performed this task although I have no doubt that Heartland understood in some fashion that its claim had been valued and accepted at the "settled" amount.

[47] Adrenaline's application is brought under s. 135(5), which permits the Court to "…expunge or reduce a proof of claim or a proof of security on the application of a creditor ... if the trustee declines to interfere in the matter." The Trustee must have allowed the claim and there must be a request from the creditor to deal with the claim resulting in the trustee declining to "interfere": *Re Light's Travel Service Ltd* (1985), 56 C.B.R. (N.S.) 175 (B.C.S.C.) at 181; *Roberts v. E. Sands & Associates Inc.,* 2013 BCSC 902 at para. 29, rev'd on other grounds 2014 BCCA 122.

[48] The Trustee takes issue with Adrenaline having made any "request" to it to reduce Heartland's claim, as a pre-condition to this application. She submits that there was no issue with the Trustee's conclusion that ACFC was liable to Heartland arising from the disclosure issues under the franchise agreement. In that event, she says that there was simply no basis upon which to "expunge" Heartland's claim, as she interpreted Adrenaline's March 24, 2015 letter as asking her to do.

[49] In my view, this is an overly technical reading of Adrenaline's March 24, 2015 letter requesting that the Trustee address certain issues relating to the Heartland claims. I agree that the word "expunge" was generally used in the letter; however, the letter also refers to various "reductions" of Heartland's liquidated damage claims. Reading the letter in its entirety, Adrenaline was clearly conveying its objections to

certain parts of the claims that would have, if accepted, resulted in reductions or a complete disallowance of certain aspects of the damage claims.

[50] I conclude that Adrenaline has met the necessary requirement to engage s. 135(5). The Trustee allowed Heartland's claim at $1.6 million. Adrenaline then requested that the Trustee disallow certain portions of Heartland's damage claims and the Trustee failed to do so or "interfere."

[51] Adrenaline bears the onus to show, on a balance of probabilities, that Heartland's claims should be reduced: *Purdy (Re)* 1997, 44 B.C.L.R. (3d) 369 at para. 31 (B.C.S.C.); *Roberts* at paras. 31–32.

[52] The Trustee and Adrenaline do not agree on the standard of review to be applied by the Court on this s. 135(5) application and what deference, if any, is to be accorded to the Trustee's decision to allow Heartland's claim.

[53] Firstly, I agree with the Trustee that normally a court should accord a trustee's decision to value a claim with deference. To do otherwise is to ignore a trustee's expertise in what is intended to be an efficient and summary process to resolve such commercial matters. This deference would also normally be afforded to a trustee acting under s. 135(1.1) of the *BIA* in valuing contingent and unliquidated claims.

[54] This approach was confirmed in *Galaxy Sports Inc. (Re)*, 2004 BCCA 284:

> [39] On a consideration of all the "contextual" factors mandated by the "pragmatic and functional" approach, I see no reason to disagree with the long-standing principle enunciated in *Re McCoubrey*, *supra*, which requires the application of a "correctness" standard where compliance with a "mandatory" provision (which I would equate to a question of law or statutory compliance) is involved, and the application of a "reasonableness" standard where the determination of a factual matter or an exercise of true discretion is called for. In the former category, I would place the chair's decision under s. 108 rejecting a proof of claim for voting purposes and the trustee's decision disallowing a proof of claim under ss. 124 and 135(2). In the latter category, I would place the trustee's role in valuing contingent and unliquidated claims under s. 135(1.1). This general approach conforms with the objective, which I see as implicit in the *BIA*, of enabling debtors to have their proposals voted upon expeditiously and permitting creditors to have their rights and claims

> determined in a business-like manner, while at the same time providing a meaningful appeal to a court of law on questions that clearly affect legal rights, engage the relative expertise of judges, and set precedents for other cases.
>
> [Emphasis added.]

[55] Accordingly, assuming that a trustee has properly exercised her discretion in coming to a decision under s. 135(1.1), that decision will ordinarily be approached on a "reasonableness" standard: *Galaxy Sports* at paras. 43–44. For that proposition, the Trustee also refers to *Erdman, Re,* 2006 SKQB 280. In that case, the court similarly confirmed:

> [32] … The trustee, when valuing a contingent or unliquidated claim, must consider all the relevant circumstances and arrive at what the trustee believes is a fair and reasonable valuation: See *Re Wiebe* (1995), 1995 CanLII 7367 (ON SC), 30 C.B.R. 109 (Ont. Gen. Div.). …

[56] Applying administrative law principles to this standard, the question will be whether the process employed by the trustee in coming to a valuation of a contingent or unliquidated claim was justified, transparent and intelligible and whether the decision, based on discretion, falls within possible acceptable outcomes: *Transglobal Communications Group Inc., Re*, 2009 ABQB 195 at para. 73.

[57] However, it will not be sufficient for the Trustee to simply show that she conducted a reasonable process and came to a reasonable decision based on that process. Adrenaline may show that the claim lacked merit or was not properly supported such it should not have been allowed. It is common sense that allowing a claim that lacked merit or had insufficient support could not have been reasonably done by the Trustee using its discretionary powers under the *BIA*: *Marsuba Holdings Ltd, Re*1998*,* 8 C.B.R. (4th) 268 at paras. 14–17 (B.C.S.C.).

[58] Indeed, the Registrar made this same comment in relation to Adrenaline's own appeal as to the value of its claim in *Asian Concepts* where the Trustee had made errors:

> [70] If I am to give deference to the Trustee's decision in that regard, it seems contradictory to then say, that because of the errors in calculation, I should conclude that the valuation would still be reasonable because it is

> greater than the value if one corrects for the admitted errors but assumes that there are no renewals of the MDA.
>
> [71] I accept that deference should be given to the Trustee's decision on the methodology for the valuation, provided it is reasonable. There is, however, nothing in the rationale for deference to the decision of the Trustee that requires me to turn a blind-eye to admitted calculation errors.
>
> [72] In addition, in my view a valuation that is based on incorrect calculations cannot be said to be defensible in respect of the facts, as referred to above from *Transglobal Communications*.

[59] The Trustee and Adrenaline also disagree as to the nature of this application. The Trustee asserts that this is a true appeal and not a *de novo* hearing. As Adrenaline points out, the weight of authority is against the Trustee's position such that the strictures of a true appeal are not applicable.

[60] In *Ted LeRoy Trucking Ltd. (Re)*, 2012 BCCA 511, Justice Lowry, although in *obiter*, specifically considered the proper approach where the application is brought under s. 135(5), such as the case here. He stated:

> [16] This is sufficient to dispose of the appeal but, while nothing appears to turn on it, I do consider s. 135(5) of the *BIA,* which provides that a court may expunge or reduce a proof of claim, effectively provides for applications such as made by the government here to be heard *de novo.* A s. 135(5) application is brought where, as here, a trustee declines to interfere in the matter at issue as opposed to instances where a trustee determines a claim is proven or disallows a claim, which determination or disallowance is, by virtue of s. 134(4), final subject to an appeal. An application under s. 135(5) to expunge or reduce a proof of claim is not an appeal.

[61] In *Roberts* at paras. 33–37, Justice Burnyeat discussed this issue and drew a distinction between appeals from decisions of a trustee under s. 135(4) (such as in *Galaxy Sports*) and those under s. 135(5).

[62] In an application under s. 135(5), a creditor is challenging the decision of the trustee after having had no knowledge of the process and basis upon which the earlier decision was made. In that event, such as here, a creditor is completely in the dark about the process undertaken by the Trustee until disclosure and after the Trustee's decision was made. To restrict the process to only what was before the Trustee would unduly hamper the ability of that challenging creditor to put evidence

before the Court relevant to the claim and its validity. In that event, restricting such a challenge as under a true appeal would be unfair in the extreme.

THE TRUSTEE'S ASSESSMENT/VALUATION

[63] The *BIA* anticipates a robust process by which claims will be submitted and then reviewed by the trustee for allowance or disallowance in whole or in part.

[64] Firstly, every creditor must "prove" his or her claim: s. 124(1) of the *BIA*. The creditor bears the onus of establishing its claim. Certainty is not the test; however, the creditor must provide relevant and probative evidence to substantiate the claim: s. 124(4) of the *BIA*; *Mamczasz Electrical Ltd. v. South Beach Homes Ltd.,* 2010 SKQB 182 at paras. 46–47; Lloyd W. Houlden, Geoffrey B. Morawetz & Janis P. Sarra, *The 2017–2018 Annotated Bankruptcy and Insolvency Act* (Toronto: Thomson Reuters, 2017–2018) at G§104, citing *HDYC Holdings Ltd., Re* (1995), 35 C.B.R. (3d) 294 at para. 70 (B.C.S.C.), rev'd on other grounds (1997), 43 B.C.L.R. (3d) 64 (C.A.).

[65] Secondly, the trustee has a duty to examine every proof of claim and the grounds and documentation supporting the proof to determine its validity and, if provable, its value. If a trustee is unsatisfied with the material or evidence provided in support of a claim or the value of a claim, the trustee has both the ability and the right to require further evidence from the creditor. This duty extends to proposals: *In re Toronto Permanent Furniture Showrooms Co.* (1960), 1 C.B.R. (N.S.) 16 (Ont. S.C.) [*Toronto Permanent Furniture*]; *Mamczasz Electrical* at para. 1.

[66] So what did the Trustee do in this case to evaluate Heartland's claim before the voting on March 10, 2014?

[67] The Trustee began communications with Heartland's counsel in November 2013 after Heartland's receipt of the notice of intention to make a proposal. Heartland's counsel advised that they did have a claim of $1,383,186, despite ACFC/Mr. Bender's position in the statement of affairs. On December 31, 2013, the

Trustee advised that Heartland would be required to prove its claim by filing a proof of claim.

[68] On January 7, 2014, Heartland delivered its first proof of claim and voting letter to the Trustee. The Trustee noted that there were no supporting documents. She requested copies.

[69] On January 8, 2014, Heartland's counsel provided Schedule "A" to its proof of claim and a "Compensation Brief" from 2012 that included back-up documentation with respect to the Part A amounts claimed under s. 6(6) of the *Wishart Act*. Later in January 2014, Heartland provided further documentation to the Trustee, as requested, such as the franchise agreement and notice of rescission.

[70] Michelle Madrigga, the Trustee's representative, indicates that she reviewed and investigated Heartland's first proof of claim to determine whether there were documents to support it and whether the heads of damages claimed were appropriate under the *Wishart Act*. After that review, she specifically identified that the unliquidated claims for future profit loss and lease indemnity costs were not supported by documentation.

[71] Based on her later discussions with ACFC's counsel, she understood the ACFC did not dispute liability but that it disagreed with the damages claimed.

[72] It is important to note that no one seriously suggested that ACFC was not liable to Heartland under the *Wishart Act*. ACFC was aware of a previous judgment granted against it by the Alberta Court of Queen's Bench by which the Alberta court determined that ACFC's disclosure was deficient in that case. Accordingly, the issue for the Trustee was, at the beginning, and remains now, a matter of the valuation of Heartland's claim.

[73] Nevertheless, in February 2014, in advance of the vote, Ms. Madrigga understood that negotiations were underway between ACFC and Heartland. On February 26, 2014, she enquired of ACFC's counsel, Mr. Bender and Mr. Eade as to whether the negotiations had been "finalized." On that same date, she was advised by Mr. Eade that information was to be sent to the Trustee that day by which the

Trustee would receive Heartland's revised proof of claim and voting letter, indeed implying that negotiations had been completed.

[74] On February 27, 2014, Heartland's counsel indicated to the Trustee that its claim had been "valued" at $1.6 million. When she received the revised proof of claim in that amount, Ms. Madrigga noted that Schedule "A" was unchanged such that she had no idea which heads of damage had been "amended and agreed to."

[75] This lack of knowledge does not appear to have prompted the Trustee to question any aspect of Heartland's revised claim, particularly as it related to determining the value of that claim for the purpose of the upcoming vote on the Amended Proposal. The evidence indicates that, even after receipt of the revised proof of claim, the Trustee had still not received the documentation to support the profit loss and lease indemnity claims and she made no effort to obtain that documentation.

[76] It was only *after* the voting on March 10, 2014, that, for some inexplicable reason, the Trustee sought further clarification and confirmation of Heartland's claim. On April 4, 2014, Ms. Madrigga requested that ACFC's counsel provide "written confirmation" as to the agreement reached regarding the quantification of Heartland's damage claims.

[77] On April 14, 2014, ACFC's counsel provided his written response. He stated that he was confirming his previous verbal advice as to the settlement. He indicated that ACFC disputed Heartland's claim for damages with respect to the alleged landlord liability (which he estimated at $600,000). However, ACFC's counsel briefly concluded:

> In other respects, ACFC accepted the quantification of the damages established by WB Heartland as recoverable as a statutory claim in [Heartland's Ontario] action.

[78] With ACFC's counsel's April 14, 2014 letter in hand, Ms. Madrigga now states in her affidavit:

> 17. Because of the admission of liability by [ACFC], and with the removal of the disputed lease indemnity costs, the Proposal Trustee was satisfied with

> the quantification of this claim at $1,600,000 and, accordingly, allowed their vote in that amount.
>
> **Conclusion and Summary**
>
> 18. In summary, the valuation of the [Heartland] claim evolved as it was investigated by the Proposal Trustee, with input from Asian Concepts who, as noted, admitted liability, and ultimately settled or compromised for the amount allowed.
>
> 19. In that respect, at no time has any party disputed that Asian Concepts is liable for damages under the *Wishart Act*. The only issue was, therefore, with respect to its valuation, with the specific issues being as to the ability to claim lease costs and quantifying future loss, those being unliquidated claims of a nature that Asian Concepts was best able to provide insight into insofar as to what a reasonable damage valuation would be given their knowledge of the franchise operations and general profitability for them.
>
> …
>
> 22. In summary, based upon the above, when the claim was re-submitted at $1,600,000 (that being approximately 67% of its originally claimed value), with an indication by counsel for [ACFC] that Lease Indemnity Costs of "approximately $600,000" (as noted by [ACFC's] counsel) were largely negotiated away as being in dispute, the Trustee was satisfied that the claim was quantified at an amount that was reasonable having regard to the fact that the disputed items were unliquidated, and that the amount had been fully negotiated and ultimately approved by the debtor, [ACFC], and the costs in any court applications that would have been likely on a disputed claim.

[79] It is unclear whether ACFC's counsel's specific rationale set out in his April 14, 2014 letter factored into the Trustee's decision to accept Heartland's revised claim for voting purposes, since that letter was received *after* the vote. I accept that Ms. Madrigga appears to have received verbal advice from someone before the vote on March 10, 2014, giving some rationale for the $1.6 million valuation by ACFC, although what that advice may have been is unknown.

[80] New evidence as to the rationale for the settlement of Heartland's claim was introduced on this application by ACFC, not Heartland. This evidence comes from Mr. Menendez of Heartland and Mr. Eade of ACFC.

[81] Mr. Menendez now states that in reaching the settled amount, Heartland took into account the "general circumstances," the relative and specific circumstances of the parties and the strength and weaknesses of Heartland's claim, "as [he] understood them." He describes this as a "global assessment." Even Mr. Menendez

recognized that Orlando had not advanced any claim against Heartland under the indemnity agreement and it was unlikely that Heartland would ever be called upon to pay Orlando, given the passage of time. Mr. Menendez says that this assessment was a major factor in justifying a reduction of its claim by approximately $783,000.

[82] Similarly, Mr. Eade's evidence is that, in February 2014, ACFC and Heartland fully negotiated the claim. ACFC hoped that the claim amount would be reduced since at that time, Heartland was voting against the proposal. He states that various elements of the claim were considered, being the lease indemnity costs (which he considered a weak point), the liquidation costs of equipment, the lost profits claim and litigation costs. Mr. Eade states that ACFC agreed to reduce the claim "on a global basis" to $1.6 million.

[83] Finally, Mr. Eade suggests in his recent evidence that, when the vote was taken, and Heartland voted in favour of the Amended Proposal, there was "no agreement between [ACFC] and Heartland as to how Heartland would vote…"

[84] In my view, Mr. Eade's suggestion is a completely false portrayal of what happened. The evidence shows that the "settlement" of the claim was directly linked to Heartland voting in favour of the Amended Proposal. On February 26, 2014, Mr. Eade advised the Trustee that Heartland would be filing a revised proof of claim and voting letter prior to the February 27 meeting. Both the second proof of claim and the new voting letter are dated February 27, 2014. Heartland's counsel forwarded both to the Trustee on that date, and copied ACFC's counsel. Heartland's counsel expressly advised both that, if Heartland's claim was not valued at $1.6 million, Heartland would reconsider its vote and it reserved the right to change its positive vote. By any stretch of the imagination, ACFC had secured the support of Heartland for the Amended Proposal through the negotiations on the claim.

[85] What emerges from this chronology is that the Trustee largely abandoned its role within the proposal process, in relation to the review and assessment of Heartland's damage claims, in favour of ACFC. In particular:

a) while the Trustee states that she "investigated" this claim, that investigation can only be described as superficial, as including a review of the *Wishart Act* and a document review via the Compensation Brief (which was acknowledged by the Trustee as insufficient in supporting certain claims); and

b) the Trustee refers to ACFC being the one who "…ultimately settled or compromised for the amount allowed." Ms. Madrigga states that ACFC was "best able to provide insight … insofar as to what a reasonable damage valuation would be given their knowledge of the franchise operations and general profitability for them." This is largely confirmed by her later evidence that she relied upon ACFC's advice that it had "…fully negotiated and ultimately approved…" the settled amount.

[86] Ms. Madrigga asserts at para. 20 of her affidavit that the Trustee admitted the claim pursuant to its discretion to compromise and/or settle claims against the estate, pursuant to s. 30(1)(i) of the *BIA*. Nothing could be further from the truth. This claim was compromised by *ACFC*, not the Trustee. Accordingly, I do not consider that this application is an appeal from the Trustee's decision to accept the claim under that provision.

[87] In her affidavit, the Trustee also now asserts that, in addition to considering the Compensation Brief documents, and communications from Heartland and ACFC's counsel as to the settlement, she considered the legal costs to pursue litigation on the issues, including any appeal as to a partial disallowance. However, if is difficult to conceive that the Trustee could have made any such assessment prior to the vote or even after, given that she did not even really know why the claim was settled at $1.6 million beyond very general assertions. She simply had no idea as to the specifics of the issues, beyond the fact that ACFC disputed the Orlando liability claim. Even after receiving ACFC's counsel's letter of April 14, 2014, she had no details as to *why* ACFC disputed Orlando's liability claim.

[88] In these circumstances, the Trustee could have not have had any idea as to what legal process was involved in resolving the issues and any attendant legal costs. There is no indication that, prior to accepting the "settled" claim, the Trustee consulted legal counsel on this matter. For that matter, there is no indication that prior to that time, the Trustee sought any legal advice in her consideration of Heartland's claims, particularly the profit loss and Orlando's potential claim under the indemnity agreement.

[89] I have no doubt that, in some circumstances, input from a proposal debtor as to claims advanced against the estate could and should reasonably be considered by a trustee and factored into the valuation of those claims. In most cases, a debtor will have in-depth knowledge of the background of the claims, including circumstances which may support defences to the claim, all of which will be unknown to the Trustee.

[90] However, the duty of the trustee to properly evaluate claims is not abrogated in a proposal process. In *Toronto Permanent Furniture*, the court stated at 21–22:

> It is true that the debtor remains in possession of his property and looks after its administration and his only obligation is to remit to the trustee whatever amount he has arranged to pay his creditors but the scheme of a proposal is and it is so provided by the Form in which proposals are required to be, as well as s. 34(4), that payment in priority to all other claims of all claims directed by the Act to be so paid in the distribution of the property of a bankrupt or a debtor (as the case may be) shall be provided for, so that the trustee in distributing the money received by him from the debtor must have regard to this requirement. The proposal also must provide that payment shall be made on all *provable* claims. In a proposal under The Bankruptcy Act, the debtor making the proposal is, of course, always an insolvent person or a bankrupt and it must be of concern to the creditors that payments to them be made in accordance with the provisions of The Bankruptcy Act with respect to priorities and equal distribution to ordinary creditors who have provable claims. This is so, even if the proposal provides for payment in full of all claims because it cannot be denied that not infrequently a debtor fails to carry out the proposal. Unless, therefore, only those creditors who are entitled to priority and only those creditors who have provable claims are so paid, some of the creditors, at least, will suffer. It would seem therefore necessary that in order to carry out the scheme of the Act with respect to proposals, that the appropriate provisions of s. 94 must be applicable thereto and with great respect I think it is applicable, by virtue of s. 38. This would include the responsibility to see that only provable claims were paid and in accordance with their priorities. This appears to be in accordance with the practice which

> has been followed and is in accordance with comments made in a number of cases.
>
> In the case of *Re McKay* (1922), 2 C.B.R. 462, 52 O.L.R. 466, 3 Can. Abr. 637, the headnote reads in part:
>
> > In composition proceedings taken under s. 13 of the Bankruptcy Act without an assignment or receiving order, the rights and obligations of the debtor and his creditors are to be worked out in substantially the same manner as in cases of assignments and receiving orders.
>
> An appeal was taken from the disallowance by a trustee of certain items in the claim of a creditor. While Orde J. allowed the appeal, the right of a trustee to disallow a claim on a proposal or a composition, as it was then called, was not questioned. In the case of *Re Jacobs* (1922), 3 C.B.R. 419, 23 O.W.N. 118, 3 Can. Abr. 636, the trustee disallowed a proof of a preferred creditor for $300 and the right of the trustee was not only not questioned but the disallowance was upheld. Also in the case of *In re McIntyre* (1922), 2 C.B.R. 396, 3 Can. Abr. 625, McKeown C.J.K.B.D. said at p. 408:
>
> > The approval [by the Court] of this compromise does not involve any pronouncement on the *bona fides* of any claim filed. It is open to the trustee to require the fullest proof to allow or disallow the claim and an appeal can be taken from his decision.
>
> I do not see how it can make any difference whether the trustee has taken possession of the property. It is not a case of administering the property or having management of it, but rather of distributing the moneys of the debtor available to creditors according to the proper priorities and proportions. It may well be that in a proposal the trustee will collaborate more closely with the debtor, but I do not see why he should be less interested in seeing that only provable claims are paid and in accordance with their priorities as provided in the proposal and by the Act. I might add, however, that whereas in *Re Marcotte Inc., supra*, the trustee acted independently of the debtor, there is no evidence that such was so in the case at bar, rather it would appear that the contrary is the fact, namely, that the disallowance was in accordance with the instructions of the debtor.
>
> [Emphasis added.]

[91] In this case, ACFC was out of business, having transferred the vast majority of its assets well before the *BIA* proposal filing. Therefore, it was or should have been questionable just what ACFC was obtaining from this process.

[92] On the face of it, the Amended Proposal appears to be about the “related third parties” funding a pot of money to statutorily “satisfy” the claims of ACFC’s creditors, so as to nullify actions by ACFC’s creditors against those “related third parties.” In doing so, these “related third parties” avoided risk to ACFC’s substantial assets that had been transferred to other companies controlled by Mr. Bender, such

as WB Franchising. The Amended Proposal is also, of course, intended to insulate Mr. Bender from claims he was already facing from ACFC's creditors, including Adrenaline. Whether Adrenaline will succeed in opposing the proposal as not being fair and reasonable on this basis remains to be seen: ss. 58-59 of the *BIA*.

[93] When questioned by the Court during submissions, it also became apparent that the ultimate goal may be to "cleanse" ACFC of its creditors' claims so that ACFC's tax losses can be used in some fashion by other entities (for example, WB Franchising, also controlled by Mr. Bender).

[94] I acknowledge that, on the face of things, ACFC and Heartland appeared to be acting at arms length from each other in the negotiations. However, a broader consideration of the entire circumstances raises the prospect that ACFC's and Mr. Bender's motivation toward the Heartland "settlement" was more about securing the cooperation of the single largest creditor against the estate in return for a favourable vote in respect of the Amended Proposal which will benefit him and his companies greatly. That vote in turn was instrumental in winning the vote, particularly since Mr. Bender was voting another of his companies' claim in favour of the Amended Proposal.

[95] Out of fairness, I would also highlight that Heartland's support of the Amended Proposal was likely influenced by the significant reduction of Adrenaline's claim by that point, which would have meant that Heartland would receive the majority of the pooled money funded by the related third parties.

[96] The Trustee's approach (or lack of approach really) is surprising indeed. For a point of contrast, one need only look at the Trustee's rigour applied to its valuation of Adrenaline's unliquidated claim, which was ultimately largely rejected by Registrar Muir in 2017: *Asian Concepts* at paras. 27-32.

[97] All of these circumstances cried out for an *independent* assessment by the Trustee in terms of admitting all or some of Heartland's claims for both voting and distribution purposes. To simply rely on ACFC's assessment without that review

leaves the possibility that ACFC settled Heartland's claims for purposes beyond ensuring that only valid claims are admitted within these proceedings.

[98] It is clear enough that the valuation exercise of Heartland's claim within these proceedings would affect not only ACFC, the debtor (although that is not particularly evident here for the reasons already expressed), but other stakeholders as well. The valuation exercise is intended to be done in a fair and reasonable manner since it affects the claims of all other creditors, not only in terms of the vote, but also distribution. It is the Trustee's role to ensure that all interests are respected within the process, not just those of the debtor or one creditor.

[99] If a trustee simply abdicates or improperly delegates its mandatory statutory duty to review claims and value unliquidated or contingent claims in favour of another entity with perhaps other motivations, the statutory objectives and purposes of the *BIA* proposal process have not been served. I have unfortunately come to the conclusion that this is what happened in this case. Whether the claim was valued at $2.38 million or $1.6 million, the Trustee's mandatory duty was to independently review the claims and if necessary, require support for those claims. This was not done here.

[100] Accordingly, I do not consider that the Trustee has properly exercised her discretion, or exercised it at all, such that any deference is to be afforded to her decision (see similar comment in *Galaxy Sports* at para. 44). The question remains whether certain aspects of Heartland's claim should have been accepted as it was.

DISCUSSION – HEARTLAND CLAIMS

[101] The Trustee's counsel's letter to Adrenaline's counsel, dated May 24, 2016, notionally provided a rationale for accepting the $1.6 million "settlement" amount, taking the following position:

a) She "questioned" the quantification of Heartland's revised claim and made enquiries of both Heartland and ACFC since they were "…most knowledgeable as to the strengths and weaknesses of their respective

positions and claim valuation." They all agreed that the proper quantification was $1.6 million; and

b) that separate claims advanced under ss. 6(6) and 7 of the *Wishart Act* for lost profits were not duplicative.

[102] The Trustee's letter attached "Revised Calculations" which indicate the following breakdown for the s. 6(6) liquidated claims of $1,289,979.08;

a) s. 6(6)(a) claims: $28,000;

b) s. 6(6)(b) claims: $7,925;

c) s. 6(6)(c) claims: $153,588.37;

d) s. 6(6)(d) claims: $1,100,465.71; these principally included, in addition to other minor adjustments:

i. operational losses accepted at $348,645.42 (slight increase from $347,500). This was supported by Heartland's profit and loss report from January 2010 to January 2012 and general ledger entries for those amounts; and

ii. lease indemnity claim accepted at $480,598.20 based on the Orlando indemnity agreement and a simple calculation of 45 monthly rental payments from September 2011 (after the premises were abandoned) to the end of the five-year indemnity term to May 2015.

[103] In addition, the Trustee indicated that she accepted Heartland's unliquidated damage claim under s. 7 of the *Wishart Act* at $310,020.92, for a total accepted claim of $1.6 million.

[104] On May 24, 2016, the Trustee's counsel stated in her letter to Adrenaline:

> 5. **Overall valuation of the Claim** – Based upon the representations of counsel of [Heartland] and [ACFC], along with the revised Proof of Claim filed

> by [Heartland], the Proposal Trustee is satisfied with this quantification of the claim.
>
> Not only did the Compensation Brief provide supporting documents and a rationale to support liquidated damages under s. 6(6) of the Act in the amount of $1,289,979.08, but a claim for approximately $300,000 for unliquidated damages for future loss of the franchise appeared to be a reasonable amount on its face, particularly given that, as a result of bona fide negotiations involving WB and the Debtor Company, there was an overall reduction of the claim by $783,186.77 that being a 1/3rd reduction in its overall claim (2/3rds reduction in the unliquidated claim).
>
> We also note that, pursuant to ss. 30(1)(i) and 66 of the *Bankruptcy and Insolvency Act,* the Proposal Trustee is entitled to compromise any claim made against the Estate.

[105] Even so, Ms. Madrigga's affidavit sworn on March 22, 2018, filed in opposition to this application, does not refer to her counsel's earlier letter of May 24, 2016, or to the specifics found in that letter, as supporting her acceptance of the "settlement." She simply refers to ACFC's counsel's letter of April 14, 2014, as discussed above, which also does not support the "settlement" with the specific figures found in the May 24, 2016 letter. She does not refer to the "Revised Calculations" which are also referred to in the May 24, 2016 letter. In fact, both ACFC's counsel's April 14, 2014 letter and Ms. Madrigga's affidavit purport to justify the settlement on a completely different basis, namely that there was a "removal of the lease indemnity costs" of approximately $600,000.

[106] In addition, neither Mr. Menendez nor Mr. Eade refer to or justify the "settlement" amount on the basis of any "Revised Calculations"; rather, they now support the settlement only on a "global" basis. Both Mr. Menendez and Mr. Eade also refer to the particular dispute over the lease indemnity costs as justifying the reduction in the claimed amount.

[107] These conflicting and shifting rationales for the ACFC/Heartland settlement raise issues and concerns in and of themselves and do not reflect well upon the Trustee.

[108] I find as a fact that the specific Revised Calculations referred to in the Trustee's letter of May 24, 2016 are the basis upon which ACFC and Heartland

settled Heartland's claim and also, the basis upon which the Trustee accepted those calculations. If one looks at the liquidated damage claim of $1,289,979 (the s. 6(6) claims) in the Revised Calculations, one needs only to add the further very specific number of $310,020 (for the s. 7 damages) to come to the nice round global settlement figure of $1.6 million. I conclude and find as a fact that this was the basis upon which the Trustee valued and accepted Heartland's claims.

[109] Adrenaline's current objections to Heartland's claim are limited to only the lease indemnity costs under s. 6(6)(d) and the lost profit claims under s. 7, as claimable by Heartland against ACFC under the *Wishart Act*. It remains to be determined whether those aspects of Heartland's claims should have been accepted by the Trustee.

1) Lease Indemnity Costs

[110] I have already generally referred to Heartland's agreement with ACFC under its franchise agreement. 118 was the tenant at the location where Heartland's franchise business was conducted. Orlando was the landlord.

[111] On April 3, 2010, 118, as tenant, and Orlando, as landlord, entered into a 10-year lease of certain premises in Mississauga, Ontario. In addition, on June 1, 2010, Heartland entered into an indemnity agreement with Orlando, by which Heartland agreed to indemnify Orlando with respect to amounts owing by the tenant (118) under that lease during the first five years of the term. The indemnity agreement provided that it was to be governed and construed in accordance with the law of Ontario.

[112] 118 abandoned the leased premises in August 2011. At that time, rent was in arrears in the amount of $48,204.82. Orlando issued a notice of termination of the lease on October 25, 2011. Thereafter, the leased premises remained vacant until March 1, 2013, when Orlando's new tenant began operations there. This new tenant remained in occupation of the premises until at least June 2017 and possibly beyond.

[113] It is undisputed on this application that Heartland had a claim against ACFC under the *Wishart Act* for any losses arising from the rescission of the franchise agreement, including recovery for claims advanced against Heartland under Orlando's indemnity agreement.

[114] Adrenaline objects to this aspect of Heartland's s. 6(6)(d) claim being accepted in the amount of $480,598. The basis for Adrenaline's objection is that any claim by Orlando under the indemnity agreement signed by ACFC is statute-barred.

[115] To be a provable claim, a claim must be recoverable by legal process. Therefore, a claim may not be advanced if it is statute-barred at the date of bankruptcy or, in the case of a proposal, the date of the initial bankruptcy event. The initial bankruptcy event here was on November 20, 2013, when ACFC filed the notice of intention to make a proposal: *Farm Credit Corporation v. Dunwoody Limited*, 1988 ABCA 216 at para. 7.

[116] Section 4 of the Ontario *Limitations Act*, *2002*, S.O. 2002, c. 24, Sched. B, states that the basic limitation period for Orlando to have advanced a claim against Heartland was two years after the "claim was discovered." Section 5 of that *Act* provides that a claim is discovered on the earlier of:

> **5** (1) A claim is discovered on the earlier of,
>
> (a) the day on which the person with the claim first knew,
>
> (i) that the injury, loss or damage had occurred,
>
> (ii) that the injury, loss or damage was caused by or contributed to by an act or omission,
>
> (iii) that the act or omission was that of the person against whom the claim is made, and
>
> (iv) that, having regard to the nature of the injury, loss or damage, a proceeding would be an appropriate means to seek to remedy it; and
>
> (b) the day on which a reasonable person with the abilities and in the circumstances of the person with the claim first ought to have known of the matters referred to in clause (a).
>
> (2) A person with a claim shall be presumed to have known of the matters referred to in clause (1) (a) on the day the act or omission on which the claim is based took place, unless the contrary is proved.

[117] As previously stated, 118 abandoned the premises in August 2011 and Orlando issued a notice of termination in respect of the lease in October 2011. As such, Orlando would have known of 118's default no later than October 2011 and therefore, would have known then of its right to file legal action against both 118 and Heartland for both past and prospective losses. The premises were leased again in March 2013.

[118] However, Joy Okpara, who is employed in Orlando's legal department, states in her affidavit sworn June 9, 2017:

> 8. Orlando has not commenced any recovery proceedings against the Tenant for damages arising from its breach of the Lease and abandonment of the Leased Premises, nor has it commenced any recovery proceedings against [Heartland] pursuant to the Indemnity Agreement or received any payments thereunder, as at [June 9, 2017].

[119] In the above circumstances, I agree that, since Orlando did not commence any action against Heartland, any claim became statute-barred no later than October 2013, being two years after 118's default and the notice of termination was sent.

[120] In its response to Adrenaline's request that this portion of Heartland's claim be expunged, the Trustee advised that the amounts claimed "relate to [Heartland's] obligation to" the Landlord. Heartland's two proofs of claim included "lease indemnity costs" of $523,318.04. Even so, the Compensation Brief simply referred to 118's monthly estimated lease amount of $10,679.96, which was multiplied by 45 months (September 2011 to the end of term in May 2015), being presumably the remainder of the indemnity period left on the lease. This resulted in a total claim for lease indemnity costs of $480,598.20. Heartland offered no other support for this claim.

[121] However, it is clear that Heartland suffered no loss by reason of 118's default under Orlando's lease. It never paid Orlando under its indemnity obligations and never will by reason of the expiry of the limitation period. This means that Heartland in turn had no valid claim that it could have advanced against ACFC under the *Wishart Act*.

[122] I agree with Adrenaline that the Trustee was in error in admitting this aspect of Heartland's claim in the amount of $480,598 or at all. As a matter of law, it was not a valid claim that could be advanced against ACFC. That aspect of the claim should be entirely expunged.

2) Lost Profits

[123] Heartland's claim, as advanced in its Ontario action and in its proofs of claim, relied solely on its rights under the *Wishart Act*. Heartland made no claim for damages at common law generally.

[124] In relation to the lost profits claim, Heartland's amended statement of claim set out:

a) Para. 1(a): it claimed a declaration that it had validly rescinded the franchise agreement pursuant to the *Wishart Act*;

b) Para. 1(c): it claimed damages of $1 million pursuant to s. 7 of the *Wishart Act* (in addition to the s. 6(6) damages claimed);

c) Para. 17: that ACFC's omissions in its disclosure statement constituted a "misrepresentation" within the meaning of s. 7 of the *Wishart Act*;

d) Para. 18: that as a result, Heartland has "suffered losses including but not limited to the amounts expended on or in connection with the franchise fee, construction costs, and the operational losses incurred by [Heartland] during [its] operation of the Franchise."

[125] Again, there is no dispute that ACFC was liable to Heartland for inadequate disclosure under the *Wishart Act*. ACFC conceded that its disclosure statement given to Heartland was in the same form of disclosure documents given to another franchisee in Alberta which had been found to be incomplete and not in compliance with the *Wishart Act*: *1448244 Alberta Inc. v. Asian Concepts Franchising Corporation,* 2013 ABQB 221.

[126] Turning to the matter of damages, Heartland's principal, Mr. Menendez, describes the s. 7 claim as unliquidated damages and including:

> 11. … future loss of profit and opportunity under the franchise agreement. Such damages were caused by certain misrepresentations made to [Heartland], that were contained in an alleged "franchise disclosure document," that [ACFC] provided to [Heartland] in order to entice [Heartland] to purchase a franchise from [ACFC].

[127] As the Trustee notes, it is not clear whether the s. 7 claim was duplicative of what had already been claimed under s. 6(6)(d). Both of Heartland's proofs of claim simply refer, in Schedule "A", to a damage claim under s. 7 in the amount of $1 million.

[128] Possible duplication was particularly evident from the operational loss claim. The Compensation Brief attached various documents in support of an "operational loss" claim under s. 6(6)(d). This amount was originally claimed in the amount of $347,500 but was later increased to $348,645.42 in the Revised Calculations. As previously noted, this figure was taken from Heartland's profit and loss detail report from January 2010 to January 2012, supported by general ledger entries. Heartland's principal, Mr. Menendez, describes this as a liquidated claim and including "…losses that [Heartland] had incurred in acquiring, setting up and operating its franchised business."

[129] As noted above, in the Trustee's May 24, 2016 response to Adrenaline's request that it review Heartland's claim, the Trustee took the view that s. 7(1) of the *Wishart Act* permits a claim for lost future profit, the value of which was accepted by the Trustee at $310,020.92. In part, the Trustee's counsel stated in her letter:

> Ultimately, it was agreed by all parties that a proper quantification of the claim was $1,600,000, that being $1,289,979.08 under s. 6(6) , and the remaining amount of $310,020.92 under s. 7(1) for future loss of profit and opportunity under the franchise agreement, had it not been rescinded.
>
> ….
>
> Not only did the Compensation Brief provide supporting documents and a rationale to support liquidated damages under s. 6(6) of the Act in the amount of $1,289,979.08, but a claim for approximately $300,000 for unliquidated damages for future loss of the franchise appeared to be a reasonable amount

> on its face, particularly given that, as a result of bona fide negotiations involving WB and the Debtor Company, there was an overall reduction of the claim by $783,186.77 that being a 1/3rd reduction in its overall claim (2/3rds reduction in the unliquidated claim).
>
> [Emphasis added.]

[130] Adrenaline initially argued that, since the franchise agreement was rescinded under s. 6 of the *Wishart Act*, Heartland could not have claimed for future losses under s. 7 as a matter of law. Adrenaline drew a distinction between s. 6(6) damages which seek to put the injured party in a position they would have been in had the misrepresentation had not been made, and to future claims under the agreement.

[131] The Trustee (and impliedly Heartland) argued that the respective remedies of a franchisee under s. 6(6) and 7 of the *Wishart Act* are cumulative and not duplicative. She argues that while s. 6(6) provides for damage claims that are normally seen in rescission cases, s. 7 provides a mechanism to recover statutory damages that are not based on common law principles. This would include the principle that, upon a party electing to rescind a contract, the contract is no longer afoot and it is no longer open to that party to claim the benefit of the rescinded contract in respect of benefits arising under the contract, such as lost future profits: John McCamus, *The Law of Contracts* (Toronto: Irwin Law, 2005) at 337–38; Dominic O'Sullivan, Steven Elliott & Rafal Zakrzewski, *The Law of Rescission* (Oxford, UK: Oxford University Press, 2008 at 297–98).

[132] It is apparent based on the research presented on this application that there are very few Ontario cases interpreting ss. 6(6) and 7 of the *Wishart Act*.

[133] In *1490664 Ontario Limited v. Dig This Garden Retailers Ltd.* 2005, 256 D.L.R. (4th) 451 (Ont. C.A.), the trial court concluded that inadequate disclosure was made in the disclosure statement (para. 19). At para. 28, the court described the remedy under s. 6 as "statutory rescission" which is different than equitable rescission. Further, the court drew a clear distinction in remedies as between s. 6(6) and s. 7:

> [38] As I indicated earlier, the principles of equitable rescission do not apply in a case of statutory rescission. Further, the Act specifically provides for certain payments to be made to the franchisee within sixty days of the effective date of rescission as set out in s. 6(6). In addition, s. 7 clearly provides that if a franchisee suffers a loss as a result of a franchisor's failure to comply *in any way* with s. 5, the franchisee has a right of action for damages. Failure to comply in any way with s. 5 includes a failure to provide the disclosure document that the section requires. In circumstances where a franchisor fails to make the payments required of it under s. 6(6), those damages could include such amounts. As well, if a franchisee suffered any other loss as a result of the franchisor's failure to comply with s. 5, the franchisee may sue for such damages under s. 7.
>
> [Emphasis added.]

[134] In *Salah v. Timothy's Coffees of the World Inc.*, 2010 ONCA 673, the court upheld the trial court's decision (*Salah v. Timothy's Coffees of the World Inc.* 2009, 65 B.L.R. (4th) 235 (Ont. S.C.J.)) to award damages for both breach of contract and breach of the duty of good faith and mental distress. Those damages included past and future losses in respect of the franchise agreement under the *Wishart Act* (paras. 23–24). At trial, the income loss was for a period of 10 years, being the usual and actual term of that franchise: para. 129. Unlike this case, Mr. Salah had not rescinded the franchise agreement.

[135] In *Salah* (Ont. C.A.), at paras. 26–27, the court rejected the contention that an interpretation of the *Wishart Act* restricted damages to compensatory damages only, commenting that the *Wishart Act* is remedial legislation deserving of a broad and generous interpretation. It is important to note, however, that the evidence in *Salah* filed in support of the future damage claim very much supported that claim.

[136] In *1706228 Ontario Ltd. v. Grill It Up Holdings Inc.*, 2011 ONSC 2735, the court awarded only restitutionary damages (not future loss of profits), although that appears to have been based on what was sought at trial: para. 40. The court stated:

> [58] … Upon rescission, the plaintiffs were entitled to be put in the position that they would have been in had they not entered into the agreements. Thus they are entitled to return of the deposits they paid to the defendants and their out-of-pocket expenses associated with the transaction, including their equipment purchases related to the business.... I do not award anything for lost profit: the plaintiffs are seeking a restitutionary remedy, based on rescission, rather than their loss of the profits they expected to earn had the

> transaction closed. In the end, then, the damages for failing to close equal the damages for breach of the *Arthur Wishart Act.*
>
> [Emphasis added.]

[137] *Dig This Garden* and *Salah* were followed in *Burnett Management Inc. v. Cuts Fitness for Men*, 2012 ONSC 3358. There, the franchisees had elected to rescind the agreement. At para. 49, the court agreed that s. 7 damages were available *in addition* to s. 6(6) damages. However, only liquidated damages were awarded.

[138] The final case is *8150184 Canada Corporation v. Rotissieries*, 2014 ONSC 815; aff'd *8150184 Canada Corporation v. Rotisseries Mom's Express (Les Rotisseries Mom's Express Limitée)*, 2016 ONCA 115. The plaintiff franchisees had moved for judgment based on allegations of a breach of s. 3 of the *Wishart Act*, being a duty of fair dealing in relation to a franchise agreement. The s. 6(6) damages claimed were accepted by the court based on a failure to respond to a notice to admit. However, the franchisee also claimed s. 7 damages for misrepresentation and for loss of profit from the time the franchise was intended to be operational from June to October 2012: para. 13. The court directed that this issue proceed to trial.

[139] The later trial with respect to damages was addressed in *8150184 Canada Corporation v. Rotissieries Mom's Express Ltd.*, 2014 ONSC 3256. The court stated:

> [21] Loss of profits is recoverable if an evidentiary basis has been provided sufficient for the court to make an informed determination of the potential loss. (See *Mincom Corona Realty Inc. v. Mincom Realty Systems Inc.*, [2004] O.J. No. 4729 (Ont. C.A.) at paras. 5-6).

In that case, the court accepted as reasonable proof certain *pro forma* calculations as the loss of potential profits but only to October 2012, being the date of rescission by the franchisee (paras. 22, 31(4), Appendix "A").

[140] Accordingly, I agree with the Trustee that s. 7 damages are statutory damages intended to compensate a franchisee for "other loss" or damages that would not be recoverable under s. 6(6). Nevertheless, the Ontario case law is far from clear as to what is included in "other loss" under s. 7—and as to whether this refers to quantifiable further losses arising from the rescission not specifically

identified in s. 6(6), or whether some other head of damages, such as a contingent claim for loss of future profits, may be claimed, and if so, for what period of time.

[141] Even so, accepting *arguendo* for the purposes of this application that claims for loss of future profit may be recoverable under s. 7, it remains the case that a creditor must prove such damages. As stated in *Mincom Corona Realty Inc. v. Mincom Realty Systems Inc.*, [2004] O.J. No. 4729 at para. 6 (Ont. C.A.), the franchisee must provide a "…basis upon which an informed determination of … potential lost profits could be made." Without any such evidence, no claim will have been proven.

[142] As noted above, Heartland itself made no claim for "lost profit", either in its Ontario Action pleadings filed against ACFC or in its two proofs of claim. In accordance with the Trustee's acceptance of the s. 6(6)(d) claim, operational losses (not loss of profits) to January 2012 were taken as proven.

[143] Even accepting that this claim was put forward to ACFC and the Trustee (although that is far from clear), Heartland has *never* provided any evidentiary basis for its $1 million claim for s. 7 "lost profit" damages. ACFC, Heartland and the Trustee do not suggest otherwise.

[144] There was no substantiation for this claim in Heartland's Compensation Brief. As far as I'm aware, there was no substantiation given by Heartland to ACFC as part of the negotiations leading to the "settlement." Most importantly, there is no evidence that the Trustee either requested and/or received any such substantiation in support of this claim. This would have been in relation to the Trustee's consideration as to the proper valuation of this contingent claim. Certainly, even accepting the Trustee's submission that this claim was settled by it pursuant to s. 30 of the *BIA* (which I do not accept), I am not aware that the Trustee even evaluated this aspect of the claim in terms of agreeing to the "settlement" amount negotiated by ACFC.

[145] The Trustee's explanations for her acceptance of this claim are surprising even in the face of a complete absence of any evidentiary basis for this claim. In the

Trustee's counsel's letter of May 24, 2016, she states that the claim for approximately $300,000 for unliquidated damages for future loss of the franchise appeared to be a "reasonable amount on its face." The rationale appears to be that the "reasonableness" arose because of ACFC and Heartland's negotiations that resulted in a significant reduction of the overall claim. This statement was repeated in Ms. Madrigga's affidavit, which only generally referred to the overall claim amount as being "reasonable."

[146] One wonders how indeed the Trustee could have asserted the reasonableness of even the overall settlement without a consideration and understanding of the $1 million loss of profits claim and without having received any materials in support of such a claim. I will repeat that the Trustee seems to have simply relied on the negotiations between ACFC and Heartland in that respect, although what evidence, if any, was provided by Heartland to ACFC in that regard is not known.

[147] In conclusion, the Trustee was not in a position to have accepted Heartland's claim for loss profits, whether at $1 million or even the accepted amount of $310,020.92, without a proper evidentiary basis for doing so. Having done so, the Trustee improperly admitted Heartland's proof of claim as including this type of claim.

DISSOLUTION OF HEARTLAND

[148] On December 21, 2013, Heartland was dissolved as a corporate entity pursuant to the issuance of a certificate of dissolution under s. 212 of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 ("*CBCA*"). Section 212(4) of the *CBCA* provides that the "corporation ceases to exist on the date shown in the certificate of dissolution."

[149] As such, Heartland ceased to exist as a corporate entity just one day after ACFC filed its proposal, but before ACFC filed its Amended Proposal on February 14, 2014, and before Heartland filed both proofs of claim and the voting took place on March 10, 2014.

[150] As a result of the dissolution, it is undisputed that Heartland was then not a "person" who could have a provable claim under the *BIA* when it purported to deliver its proofs of claim to the Trustee on January 7, 2014 and February 27, 2014, respectively: ss. 2 "creditor" and "person", 124 of the *BIA*.

[151] At the time of the vote on March 10, 2014, Heartland was not a "person" who had proved its claim and therefore, it was not entitled to vote its claim at that time: s. 109(1) of the *BIA*. In addition, by operation of s. 228(1) of the *CBCA*, any property interest of Heartland would have vested in the Crown upon dissolution.

[152] On March 14, 2018, Adrenaline's counsel wrote to the Trustee, ACFC and Heartland to alert them as to this issue.

[153] On March 23, 2018, in advance of this hearing, Mr. Menendez filed an affidavit indicating that, just days before, he had been alerted to the dissolution. He indicates that this resulted for inadvertence, rather than a deliberate decision on the part of Heartland. He indicated that he had instructed Heartland's counsel to take steps to revive Heartland under the *CBCA*. As of that date of the hearing, Heartland's status was still unclear.

[154] After the hearing, the Trustee provided evidence that, in fact, Heartland was revived on March 22, 2018, just days before the hearing.

[155] In light of the revival, Heartland is now able to proceed as if it had never been dissolved, by reason of s. 209(4) and (5) of the *CBCA*:

> **(4)** Subject to any reasonable terms that may be imposed by the Director, to the rights acquired by any person after its dissolution and to any changes to the internal affairs of the corporation or other body corporate after its dissolution, the revived corporation is, in the same manner and to the same extent as if it had not been dissolved,
>
> > **(a)** restored to its previous position in law, including the restoration of any rights and privileges whether arising before its dissolution or after its dissolution and before its revival; and
> >
> > **(b)** liable for the obligations that it would have had if it had not been dissolved whether they arise before its dissolution or after its dissolution and before its revival.

> **(5)** Any legal action respecting the affairs of a revived corporation taken between the time of its dissolution and its revival is valid and effective.

[156] The combined effect of these provisions is to restore Heartland's assets and "erase" the dissolution and vesting of that property in the Crown: *Saini v. Grand Forks (City)*, 2011 BCSC 320 at para. 23.

[157] As a result of the foregoing, I am satisfied that Heartland's revival has reinstated its status as a "person" for the purpose of participating as a creditor in these proposal proceedings and defending its claim for the purposes of voting and distribution.

CONCLUSION

[158] I conclude that certain aspects of Heartland's claims were not properly accepted by the Trustee for both voting and distribution purposes.

[159] Adrenaline submits that these admitted amounts should be deducted from the admitted second proof of claim of $1.6 million. I agree. The Trustee's rationale for the accepted claim is set out in its May 24, 2016 and the Revised Calculations indicate that minor adjustments were made to other claims made under s. 6(6)(c) and (d). Accordingly, the only deductions from the admitted amount relate to the lease indemnity claim and the s. 7 damage claim.

[160] Heartland failed to prove any losses under s. 7 of the *Wishart Act* in the amount of $1 million, or even that accepted by the Trustee ($310,020). No claims were properly admitted in that category. My other conclusion results in a reduction of the amounts under the s. 6(6) *Wishart Act* claims totalling $1,289,979, which was accepted by the Trustee, in relation to the lease indemnity claim set out in the Revised Calculations ($480,598).

[161] Accordingly, the total of Heartland's provable claim in this proceeding is $809,382 ($1.6 million less $310,020 and less $480,598).

"Fitzpatrick J."

TAB 6

Province of Alberta

EMPLOYMENT STANDARDS CODE

Revised Statutes of Alberta 2000
Chapter E-9

Current as of February 16, 2023

Office Consolidation

Alberta King's Printer
Suite 700, Park Plaza
10611 - 98 Avenue
Edmonton, AB T5K 2P7
Phone: 780-427-4952

E-mail: kings-printer@gov.ab.ca
Shop on-line at kings-printer.alberta.ca

Note

All persons making use of this consolidation are reminded that it has no legislative sanction, that amendments have been embodied for convenience of reference only. The official Statutes and Regulations should be consulted for all purposes of interpreting and applying the law.

Amendments Not in Force

This consolidation incorporates only those amendments in force on the consolidation date shown on the cover. It does not include the following amendments:

2017 c9 s44 repeals and substitutes s65, adds ss65.1 to 65.3, repeals s66.

Vacation pay for employee paid monthly

34.1 For each week of vacation, the employer must pay an employee paid by the month vacation pay of an amount at least equal to the employee's wages for the employee's normal hours of work in a work month divided by 4 1/3.

2017 c9 s24

Vacation pay for employee paid other than monthly

34.2 The employer must pay an employee who is not paid by the month vacation pay of an amount at least equal to,

(a) for an employee entitled to 2 weeks' vacation or any lesser amount, 4% of the employee's wages for the year of employment for which vacation is given, or

(b) for an employee entitled to 3 weeks' vacation, 6% of the employee's wages for the year of employment for which vacation is given.

2017 c9 s24

Vacation entitlements with a common anniversary date

35(1) For the purpose of calculating vacation and vacation pay, an employer may establish a common anniversary date for all employees or a group of them.

(2) If an employer establishes a common anniversary date, then, despite any other provision in this Division,

(a) the amount of vacation pay, and

(b) the length of an employee's vacation,

must not be reduced to less than the employee would have received if the common anniversary date had not been established.

(3) If an employee has a common anniversary date, the employee becomes entitled to an annual vacation as follows:

(a) on the first common anniversary date after employment starts with the employer, at least 2 weeks' vacation or a proportionately lesser period of vacation if the employee has been employed for less than one year;

(b) on the 2nd, 3rd, 4th and 5th common anniversary date after employment starts with the employer, at least 2 weeks' vacation;

(c) on the 6th common anniversary date after employment starts with the employer, at least

(c) a combination of termination notice and termination pay under section 57(2).

(2) Termination notice is not required

(a) if the employment of the employee is terminated for just cause,

(b) when an employee has been employed by the employer for 90 days or less,

(c) when the employee is employed for a definite term or task for a period not exceeding 12 months on completion of which the employment terminates,

(d) when the employee is laid off after refusing an offer by the employer of reasonable alternative work,

(e) if the employee refuses work made available through a seniority system,

(f) if the employee is not provided with work by the employer by reason of a strike or lockout occurring at the employee's place of employment,

(g) when the employee is employed under an agreement by which the employee may elect either to work or not to work for a temporary period when requested to work by the employer,

(h) if the contract of employment is or has become impossible for the employer to perform by reason of unforeseeable or unpreventable causes beyond the control of the employer,

(i) if the employee is employed on a seasonal basis and on the completion of the season the employee's employment is terminated, or

(j) when employment ends in the circumstances described in sections 62 to 64.

RSA 2000 cE-9 s55;2017 c9 s37;2020 c28 s1(14)

Employer's termination notice

56 To terminate employment an employer must give an employee written termination notice of at least

(a) one week, if the employee has been employed by the employer for more than 90 days but less than 2 years,

(b) 2 weeks, if the employee has been employed by the employer for 2 years or more but less than 4 years,

(c) 4 weeks, if the employee has been employed by the employer for 4 years or more but less than 6 years,

(d) 5 weeks, if the employee has been employed by the employer for 6 years or more but less than 8 years,

(e) 6 weeks, if the employee has been employed by the employer for 8 years or more but less than 10 years, or

(f) 8 weeks, if the employee has been employed by the employer for 10 years or more.

RSA 2000 cE-9 s56;2017 c9 s38

Termination pay

57(1) Instead of giving a termination notice, an employer may pay an employee termination pay of an amount at least equal to the wages the employee would have earned if the employee had worked the regular hours of work for the applicable termination notice period.

(2) An employer may give an employee a combination of termination pay and termination notice, in which case the termination pay must be at least equal to the wages the employee would have earned for the applicable termination notice period that is not covered by the notice.

(3) If the wages of an employee vary from one pay period to another, the employee's termination pay must be determined by calculating the average of the employee's wages during the previous 13 weeks in which the employee worked preceding the date of termination of employment.

RSA 2000 cE-9 s57;2017 c9 s39

Termination of employment by an employee

58(1) Except as otherwise provided in subsection (2), to terminate employment an employee must give the employer a written termination notice of at least

(a) one week, if the employee has been employed by the employer for more than 90 days but less than 2 years, or

(b) 2 weeks, if the employee has been employed by the employer for 2 years or more.

(2) Subsection (1) does not apply when

TAB 7

IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation: *Sellathamby (Re),*
2020 BCSC 1567

Date: 20201023
Docket: Victoria
Registry: 180017

IN THE MATTER OF THE CONSUMER PROPOSAL OF VEREINDRA CHRISTOPHER SELLATHAMBY

Before: The Honourable Mr. Justice Steeves

Reasons for Judgment

Counsel for the applicant David Lofthaug:	S. Dvorak
Counsel for Vireindra Christopher Sellathamby:	C. Reedman
Place and Date of Hearing:	Victoria, B.C. July 23, 2020
Place and Date of Judgment:	Victoria, B.C. October 23, 2020

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INTRODUCTION

[1] This is an application by a creditor, David Lofthaug, under the *Bankruptcy and Insolvency Act,* R.S.C. 1985, c. B-3 ("*BIA*") and the *Bankruptcy and Insolvency General Rules,* C.R.C., c. 368 ("*General Rules*"), for orders related to a consumer proposal. A Notice of Intention to Make a Proposal was filed by the debtor, Vireindra Christopher Sellathamby, in December 2015.

[2] For clarification, unlike the style of cause, the spelling used in this decision reflects the correct spelling of Mr. Sellathamby's first name, as was done by Master Bouck in 2019 BCSC 2061.

[3] The specific orders sought by the creditor in this application (by means of a Notice of Motion filed August 14, 2018) are as follows:

> 1. That the consumer proposal (the "Consumer Proposal") of Vereindra Christopher Sellathamby (the "Debtor"), be annulled.
> 2. That G. Moroso & Associates Inc., Licensed Insolvency Trustee (the "Substituted Trustee"), be appointed as Trustee in connection with the Consumer Proposal.
> 3. A declaration that the Notice of Disallowance of the Applicant's Proof of Claim, issued by Abakhan on December 5, 2017 (the "Notice of Disallowance"), is a nullity and of no force or effect, and that the Notice of Disallowance be vacated.
> 4. That the Applicant have its costs of and incidental to this application, assessed as special costs, or alternatively at such scale as this Honourable Court may deem just and appropriate, payable forthwith and in any event of the cause, pursuant to *Supreme Court Civil Rule* 14-1 and the *Bankruptcy and Insolvency General Rules*.

[4] The applicant creditor relies on s. 135 of the *BIA* to support his position that the proposal trustee did not value his claim or decide it in a timely manner and this prevented him from exercising his rights under the consumer proposal. The principal argument of the applicant is that the Notice of Disallowance issued in 2017 is a nullity because the trustee was discharged from his duties as a trustee at the time and did not have the authority to issue the notice. It is submitted that if I find the 2017 Notice of Disallowance is a nullity, then a new trustee should be appointed to examine and evaluate the applicant's claim.

[5] The respondent is the debtor under the consumer proposal and he opposes the subject application. His principal argument is that the applicant should not be permitted to challenge the Notice of Disallowance in this forum. Rather, the applicant had an opportunity to appeal the Notice of Disallowance but he missed the deadline of which he was clearly aware. It is submitted that it would be an abuse of process to allow the applicant to circumvent the deadline by seeking relief in this manner. The respondent also argues that the trustee was permitted to issue the Notice of Disallowance after being discharged. This was "incidental" and thus permitted by s. 41(10) of the *BIA.*

[6] In the event I find the December 2017 Notice of Disallowance is a nullity, the respondent opposes the substitution of a new trustee and, in the alternative, says if a new trustee is appointed that trustee should be located in Victoria, where the respondent debtor resides.

[7] The trustee is not participating in this application other than providing an affidavit.

[8] Submissions by counsel focused entirely on the relief sought in orders 2 and 3 in the Notice of Motion. It appears from reading the Notice of Motion that, according to the applicant, in the event I grant the relief sought in orders 2 and 3, this matter will be returned to the "Substituted Trustee." And depending on that trustee's findings, counsel for the applicant will apply again to this Court and seek the relief sought in order 1. This was the same approach counsel took when arguing this application before a Registrar in Bankruptcy of this Court in November 2019 in which the Registrar declined jurisdiction.

A. BACKGROUND

[9] In 2008 a consent judgment involving the parties was issued by the Alberta Court of Queen's Bench. It decided the respondent debtor had liability for the debts owed but quantum was not determined. There is an order from 2014 stating that a trial will be held to determine damages but that trial has never occurred.

[10] On December 9, 2015 the respondent debtor filed a Notice of Intention to Make a Proposal under s. 66 (Division II) of the *BIA*. The proposal was administered by Abakhan and Associates as the Proposal Trustee.

[11] On January 22, 2016 the applicant creditor filed a Proof of Claim with the trustee relating to outstanding damages from Alberta. The Proof of Claim included an expert report setting out a valuation of the applicant's losses from investments and commissions. The value of those losses was described as $1,144,000-$1,239,000. There were two heads of damages: loss of investment value and loss of potential commissions. The respondent debtor also filed an expert report on the same subject. It concluded that the losses were substantially less than the valuation in the applicant's expert report.

[12] Sometime between February 2016 and September 2016 there was a meeting of the creditors and they voted in favour of the consumer proposal. The applicant creditor was not at the meeting. He says he never received notice of the meeting and he did not receive any communication from the trustee until a Notice of Disallowance was sent to him in December 2017. In his affidavit, the trustee deposes that a Notice of Disallowance was prepared in February 2016 and he believed it had been sent by registered mail to the applicant at that time (or, perhaps, a previous trustee had sent it).

[13] In September 2016, the trustee certified that the consumer proposal had been fully performed and approved by the eligible creditors, and the money had been paid out in accordance with the proposal. In December 2016, the trustee obtained a discharge under s. 41 of the *BIA.*

[14] In December 2017, approximately one year after his discharge, the trustee learned there was no record of mailing the Notice of Disallowance in February 2016 to the applicant, and he executed another copy of the Notice of Disallowance, dated December 5, 2017.

[15] In an affidavit sworn by the trustee, these events are explained as follows:

> …
>
> 5. Attached as Exhibit "A" to this Affidavit is a true copy of the statement of affairs of Mr. Sellathamby provided by to me by Four Pillars [a debt consultant].
> 6. I discussed Mr. Sellathamby's statement of affairs with him. After my discussion with Mr. Sellathamby, I had no reason to believe that the statement of affairs was anything but accurate.
> 7. On behalf of Abakhan [name of trustee's company], I received and considered the proof of claim of Mr. Lofthaug [applicant creditor]. Shortly after he submitted it to Abakhan, I noted that the claim was with regard to a court action in Alberta which had been under way since no later than 2008. I also noted that the court in Alberta, in the intervening period, had not made a determination as to the quantum owing to the plaintiffs in that action.
> 8. The trustee was not in any better position than the Court to make a determination as to the value, if any, of the claim. In the circumstances where the trustee is unable to place a value on a claim, it is the practice of the Trustee to disallow the claim.
> 9. Accordingly, I prepared a Notice of Disallowance in February, 2016 that was signed by [name omitted] at our Vancouver office. I believed at that time that the disallowance had been sent from our Vancouver office by registered mail to Mr. Lofthaug's mailing address.
> 10. When I learned, in 2017, that Abakhan had no record of mailing the Notice of Disallowance, I executed a second copy and delivered the executed second copy of the Notice of Disallowance to Mr. Lofthaug by registered mail.
> 11. Abakhan did not receive notice of an appeal from Mr. Lofthaug within 30 days of serving the Notice of Disallowance in 2017.

[16] There is no documentary evidence before me of any registered mail as described above and there is no Notice of Disallowance dated February 2016 before me. The applicant deposes that he never received a Notice of Disallowance in 2016.

[17] The applicant did receive a Notice of Disallowance dated December 5, 2017 and this is in evidence. Among other things it stated:

> … I [the trustee] have disallowed your claim in whole, pursuant to subsection 135(2) of the Act, for the following reasons:
>
> > You have not provided the documentation quantifying the amount of your claim as per the Consent Judgement dated September 2, 2008.

[18] The applicant sought an extension of time for appealing the December 2017 Notice of Disallowance. An order of this court dated January 4, 2018 granted an extension to February 5, 2018. A Notice of Motion was then filed on February 7, 2018. The respondent raises this appeal as a problem with the subject application.

B. ANALYSIS

[19] As above, among other things, the applicant creditor seeks to have the December 2017 Notice of Disallowance declared a nullity. The applicant also says that the trustee was required to value his claim but did not do so. In these circumstances, according to the applicant, a new trustee should be appointed. The respondent says that, if the applicant had a remedy, it was through the appeal system but the applicant has now missed the time period for any appeal.

[20] The applicable parts of the *BIA* are:

> **Trustee shall examine proof**
>
> 135 (1) The trustee shall examine every proof of claim or proof of security and the grounds therefor and may require further evidence in support of the claim or security.
>
> **Determination of provable claims**
>
> (1.1) The trustee shall determine whether any contingent claim or unliquidated claim is a provable claim, and, if a provable claim, the trustee shall value it, and the claim is thereafter, subject to this section, deemed a proved claim to the amount of its valuation.
>
> **Disallowance by trustee**
>
> (2) The trustee may disallow, in whole or in part,
>
> (a) any claim;
>
> (b) any right to a priority under the applicable order of priority set out in this Act; or
>
> (c) any security.
>
> …

> **Determination or disallowance final and conclusive**
>
> (4) A determination under subsection (1.1) or a disallowance referred to in subsection (2) is final and conclusive unless, within a thirty day period after the service of the notice referred to in subsection (3) or such further time as the court may on application made within that period allow, the person to whom the notice was provided appeals from the trustee's decision to the court in accordance with the General Rules.
>
> [Emphasis added.]

[21] Subsections 135(3) and (5) relate to, respectively, notice of determination or disallowance and "expunge" or reduce a proof.

[22] I will address the following issues:

(a) Is the December 2017 Notice of Disallowance a nullity?

(b) Should a new trustee be appointed?

(a) Is the December 2017 Notice of Disallowance a nullity?

[23] The chronology of events for this issue is that the applicant filed his Proof of Claim in January 2016 (the respondent had filed a Notice of Intention to Make a proposal in December 2015). Some time after that there was a meeting of the creditors (but without the applicant) and they voted in favour of the consumer proposal. In September 2016 the trustee certified that the consumer proposal was fully performed and he obtained a discharge from his duties in December 2016. Then, in December 2017, a Notice of Disallowance was sent to the applicant.

[24] I will discuss these events as sub-issues.

(i) Notice of Disallowance

[25] The trustee deposes that a previous Notice of Disallowance was prepared and signed in February 2016 and it had been sent to the applicant. But he also deposes that he learned in 2017 that his office had no record of mailing the notice and a "second copy" was executed and delivered. There is no evidence of the 2016 document or any evidence it was sent such as, for example, records of registered

mail. On the evidence before me I can only conclude that, if this notice was prepared in 2016, it was not sent to the applicant creditor.

[26] The result was that the applicant had no knowledge of what occurred with his claim. Specifically, the evidence supports the applicant's contention that he received no notice of the creditors' meeting or had any opportunity to participate in the meeting. I make that finding.

[27] It follows that the only Notice of Disallowance that can be considered is the one prepared and issued in December 2017, after the meeting of the creditors and after the trustee was discharged from his duties. It is that Notice that the applicant seeks to have declared as a nullity.

[28] The December 2017 Notice of Disallowance stated that the reason for the disallowance was that the applicant had not provided documentation quantifying the amount of his claim (pursuant to the Alberta consent judgement). However, the applicant has provided sworn evidence that he did provide that documentation in the form of the July 2012 expert report. In addition, the respondent creditor provided a counter expert report. The result was that the trustee had something of a full record before him concerning the applicant's claim.

[29] I conclude that the lack of documentation could not be a reason to disallow the subject claim, as relied on in the December 2017 Notice. Instead the trustee erred when he stated there was no documentation of the claim and he made a decision to disallow the applicant's claim without any evidence to support that decision.

(ii) Valuation

[30] The trustee was required to value the applicant's claim. This is set out in the following provisions of the *BIA* which I set out again:

> **Trustee shall examine proof**
>
> 135 (1) The trustee shall examine every proof of claim or proof of security and the grounds therefor and may require further evidence in support of the claim or security.

> **Determination of provable claims**
>
> (1.1) The trustee shall determine whether any contingent claim or unliquidated claim is a provable claim, and, if a provable claim, the trustee shall value it, and the claim is thereafter, subject to this section, deemed a proved claim to the amount of its valuation.
>
> [Emphasis added.]

[31] In the subject application, the applicant's claim related to the 2008 Alberta Court of Queen's Bench consent judgment, where liability was admitted by the respondent, but quantum had not yet been determined. The claim was clearly unliquidated as a specific value of the claim had not yet been determined.

[32] In his affidavit the trustee explained that he "received and considered" the applicant's claim. I accept that this complies with the requirement in s. 135(1) to "examine" every Proof of Claim.

[33] However, the trustee also noted that the Alberta court made no determination on the quantum owing. This was apparently significant because in the next paragraph of his affidavit he relies on it as the reason for disallowing the applicant's claim and then preparing a Notice of Disallowance:

> 8. The trustee was not in any better position than the Court to make a determination as to the value, if any, of the claim. In the circumstances where the trustee is unable to place a value on a claim, it is the practice of the Trustee to disallow the claim.

[34] This paragraph is enigmatic and problematic. The thrust of it appears to be that, because the Alberta court did not make any determination of quantum, the trustee was not in any better position to do so. Further, when a claim cannot be valued the "practice" is to disallow the claim as was done here. This is apparently a reference to the 2016 Notice of Disallowance that was not provided to the applicant. The effect was to deny him important rights of participation in the proceedings before the trustee.

[35] In any event, a trustee under s. 135(1.1) of the *BIA*, has a responsibility to value a claim (after examining it). If the reasoning of the trustee includes some deference to the court in Alberta on the valuation issue then that is not exercising the

duties of a trustee under the *BIA*. Similarly, the trustee appears to have concluded that he was unable to place a value on the claim because the Alberta court had not made any determination on it. There is no evidence that the court declined to make a determination on quantum or otherwise rejected or dismissed anyone's interests on quantum. I do not agree that the fact that the court in Alberta made no determination of quantum means that the trustee was somehow unable to place a value on the claim submitted to him.

[36] The trustee was required by s. 135(1.1) of the *BIA* to value a claim before disallowing (or allowing) it and there is no basis for concluding the Alberta proceeding somehow decided, pre-empted or superseded the proceeding before the trustee. Any reliance on the Alberta court for a decision for the trustee under the *BIA* would have been a fettering of the statutory responsibility of the trustee.

(iii) Provable claim

[37] The trustee was also required to determine if the claim was a "provable claim" as set out in s. 135(1.1) above. Section 2 of the *BIA* is also applicable:

> **Definitions**
>
> 2. In this Act,
>
> …
>
> **claim provable in bankruptcy**, **provable claim** or **claim provable** includes any claim or liability provable in proceedings under this Act by a creditor;
>
> …

[38] Again, the applicant creditor is a holder of a consent judgment from the Alberta Court of Queen's Bench for liability in connection with a commercial contract. The parties agree that a holder of a judgment for liability in connection with a commercial contract has a provable claim for the purposes of s. 2 of the *BIA*. I agree with that interpretation: that it is clearly a liability provable by the applicant creditor under the *BIA* and meets the definition in s. 2. I also note that it meets the requirement for a provable claim as emphasized in *Re Wiebe* (1995), 30 C.B.R. (3d) 109 (Ont. Gen. Div.) that such a claim must be recoverable by legal process. And,

while it was not fully argued, this result appears to be consistent with s. 121(1) and (2) of the *BIA*.

[39] As the two prerequisites were clearly met on the facts before him, the trustee was required by s. 135(1.1) to value the unliquidated, provable claim. I note the use of the word "shall" demonstrates that the trustee was required to value the claim where the prerequisites were met and he had no discretion not to value it. He may value a claim at zero.

[40] The trustee here disallowed the applicant's claim because the trustee did not have the documentation required. As above, the evidence is that there was a full record before the trustee.

(iv) Discharge of trustee

[41] There is then the fact that the December 2017 Notice of Disallowance was issued by the trustee after he applied for and was discharged in December 2016.

[42] The provisions of the *BIA* set out what is to be done by a trustee with a Notice of Disallowance. Section 135(3) of the *BIA* states:

> (3) Where the trustee makes a determination under subsection (1.1) or, pursuant to subsection (2), disallows, in whole or in part, any claim, any right to a priority or any security, the trustee shall forthwith provide, in the prescribed manner, to the person whose claim was subject to a determination under subsection (1.1) or whose claim, right to a priority or security was disallowed under subsection (2), a notice in the prescribed form setting out the reasons for the determination or disallowance.
>
> [Emphasis added.]

[43] In my view, the delivery of a Notice of Disallowance one year after the decision to disallow is not providing it "forthwith." There was apparently a belief within the trustee's office that it had been sent in February 2016 but, as above, the evidence is that it was not provided until December 2017.

[44] Similarly, the *General Rules* state as follows:

> **Code of Ethics for Trustees**
>
> …

> 36 Trustees shall perform their duties in a timely manner and carry out their functions with competence, honesty, integrity and due care.
>
> [Emphasis added.]

[45] I conclude that provision of the Notice of Disallowance one year after the trustee was discharged and almost two years from the applicant's Proof of Claim is not a timely discharge of the trustee's duties. Certainly, providing the Notice after the meeting of the creditors and after the vote to approve the proposal cannot be considered timely.

[46] It is true, as emphasized by the respondent, that the trustee has some residual authority following his discharge. This is set out in s. 41(10) of the *BIA*:

> **Application to court**
>
> 41 …
>
> …
>
> **Trustee remains**
>
> (10) Notwithstanding his discharge, the trustee remains the trustee of the estate for the performance of such duties as may be incidental to the full administration of the estate.
>
> [Emphasis added.]

[47] In a previous judgement Master Patterson discussed what duties are "incidental" (*Re Sindaco*, 2003 BCSC 1396):

> [17] In considering the effect of s.41(10), the court must consider what is meant by the words "such duties as may be incidental" to the administration of the estate. The **Shorter Oxford Dictionary** defines incidental as "occurring or liable to occur in fortuitous or subordinate conjunction with something else."
>
> [18] It is my view that the legislation contemplates the trustee being able to complete minor matters and tie up loose ends pursuant to s.41(10) …
>
> [Bold in original, underlining added.]

[48] In my view, issuing a Notice of Disallowance to a creditor after the consumer proposal is fully performed does not constitute "tying up loose ends" or "completing minor matters." By that time the creditors' meeting was completed and the proposal had been voted on without the applicant being able to exercise important rights of

participating. For example, he could not speak on the proposal because he did not know about it and he could not vote at the meeting of the creditors because he did not know about the meeting and, therefore, exercise his rights as a creditor.

(v) Conclusion: Is the 2017 Notice of Disallowance a nullity?

[49] In the circumstances here the trustee did not value the applicant's claim as he was required to do under the *BIA*. Instead he wrongly concluded that the claim was not supported by any documentation. He also appears to have deferred to the Alberta court regarding the valuation of the applicant's claim; a matter he was required to decide. And he was required to prove the claim but did not do so.

[50] In the usual course these matters would be legitimate issues for an appeal under s. 135(4) of the *BIA.* I agree with the respondent's submission to that extent and disagree with the applicant that, taken by themselves, they do not amount to a nullity.

[51] The problem here is that there is no dispute that the trustee issued the December 2017 Notice of Disallowance after he requested and was granted discharge from his duties in December 2016. Section 41(1) of the *BIA* states that an application to court for a discharge is made when a trustee "has completed the duties required of him." A trustee may perform duties incidental to the full administration of the estate after his discharge but issuing a Notice of Disallowance is not an incidental duty or otherwise tying up loose ends.

[52] In my view the December 2016 discharge of the trustee is significant because at that point he did not have the authority or jurisdiction to make determinations under s. 135 of the *BIA*. That is, assuming the trustee properly valued the applicant's claim (without, for example, deferring to the Alberta court) and he assessed the full record before him, he could not have made a decision to disallow (or allow) the claim because his authority to make those decisions ended with his discharge as trustee. His option at that point was to request a re-appointment as trustee (*Re Sindaco,* at para. 18). The respondent submits that, as a practical matter, a trustee cannot always be re-appointed and he or she should have the discretion to determine and

value proofs of claim after discharge. However, s. 41(10) of the *BIA* is very clear that a trustee can only decide "incidental" matters after discharge.

[53] It follows that the trustee's Notice of Disallowance in December 2017 was made without any legal force or effect. That is, I agree with the applicant creditor that it is a nullity.

[54] Returning to the issue of an appeal under the *BIA*, s. 135(4) states that an appeal is available for a "determination under subsection (1.1) or a disallowance referred to in subsection (2)." The respondent says that the applicant should have appealed the trustee's decision but he has missed the time period for any appeal and that is the end of the matter. The respondent also submits that what the applicant is seeking here amounts to a collateral attack on the trustee's decision and in the wrong forum (*Garland v. Consumers' Gas Co.,* 2004 SCC 25, at para. 71). The subject application should be dismissed on that basis as well, according to the respondent. I disagree.

[55] Section 135(4) states that a right to appeal is available for a "determination under subsection (1.1) or a disallowance referred to in subsection (2)." But there was no determination of a provable claim or disallowance of a claim because the authority of the trustee to make those decisions had ended some time after his discharge (and they were not incidental issues). I have some difficulty accepting that there can be an appeal of a null decision. I also am unable to find that there was a binding order that could be the subject of a collateral attack.

[56] As for the reference in s. 135(4) to "a disallowance referred to in subsection (2)" that is a statement of the remedial authority available to a court. In my view it is to be read with, for example, s. 135(1.1) and it would be anomalous to describe a decision made solely under subsection (2); some substantive basis for a decision under subsection (2) is required.

[57] In summary, as the trustee's decision in December 2017 was a nullity the applicant was not limited to his right of appeal under the *BIA* to challenge that

decision. Nor can the subject application be dismissed as a collateral attack on the December 2017 decision.

(b) Should a new trustee be appointed?

[58] Having decided above that the December 2017 decision of the trustee was a nullity the next issue is what remedy follows from that decision.

[59] As a starting point, the fact that the original proposal has been approved and implemented raises obvious difficulties. And yet the fact remains that the applicant's claim was not considered by a trustee with the authority to value it. In the circumstances here I conclude that a new trustee should be appointed and I turn to how that can be done. I note that the applicant has not plead s. 37 of the *BIA* which authorizes a court to "confirm, reverse or modify the act complained of and make such order in the premises as it thinks just."

[60] Section 14.04 of the *BIA* provides for the removal and appointment of a trustee:

> **Removal and appointment**
>
> 14.04 The court, on the application of any interested person, may for cause remove a trustee and appoint another licensed trustee in the trustee's place.
>
> [Emphasis added.]

[61] This provision was discussed in a previous judgement relied on by the respondent (*Re Herman*, 1930 2 D.L.R. 471 (Ont. S.C. (A.D.)) at 477, leave to appeal ref'd 11 C.B.R. 318 (S.C.C.)):

> Counsel for the trustee contends that under s. 37(2) [a predecessor to s. 14.04] there is power to appoint a new trustee and in any event the Act contemplates a trustee continuing to be a trustee notwithstanding his discharge and that he had authority as such to apply for directions.
>
> In my opinion Rose, J., was right in holding that s. 37 (2) had no application to the present case. That section means that creditors may by resolution at any time, and for reasons that may appear to them proper, remove a trustee, and if the removal is not made at the instance of creditors by resolution, then it may be effected on an application to the Court *for cause*, such as, I take it,

> that a trustee has been guilty of misconduct or fraud or dishonesty or has become bankrupt or otherwise incapable of acting as a trustee.
>
> [Emphasis added.]

[62] Counsel for the applicant did not put any authority before me on this point and did not dispute this interpretation of s. 14.04.

[63] On the evidence before me, while there are certainly problems in the December 2017 decision of the trustee, I cannot conclude that he is guilty of misconduct, fraud or dishonesty, has become bankrupt or is otherwise incapable of acting as a trustee. The trustee exceeded his authority by incorrectly interpreting s. 135 of the *BIA* and by not acting in a timely manner but that does not rise to the level of "cause" for the purpose of s. 14.04. Nor has the applicant proven his specific allegation of fraud against the respondent.

[64] There is then s. 41(11) of the *BIA* which permits the appointment of a trustee when assets have not been realized or distributed:

> 41
>
> …
>
> (11) The court, on being satisfied that there are assets that have not been realized or distributed, may, on the application of any interested person, appoint a trustee to complete the administration of the estate of the bankrupt, and the trustee shall be governed by the provisions of this Act, in so far as they are applicable.
>
> [Emphasis added.]

[65] In *Re Sindaco,* Master Patterson discussed this provision in the following terms:

> [18] It is my view that the legislation contemplates the trustee being able to complete minor matters and tie up loose ends pursuant to s.41(10) but that does not extend to taking possession of after-acquired assets. The correct procedure is for an application to be made to re-appoint the trustee or to appoint a new trustee to take possession of the after-acquired assets pursuant to s.41(11) BIA …
>
> [Emphasis added.]

[66] A prerequisite of appointing a trustee to complete the administration of the estate under s. 41(11) is a finding that there are assets that were not realized or distributed. I am not making findings with respect to fraud, as this was not argued before me and presumably will be addressed in a subsequent application for annulment of the consumer proposal, the relief sought under order 1.

[67] The following are assets that were not realized or distributed, according to the applicant's materials:

(a) various patents;

(b) "hidden assets," including overseas funds and land; and

(c) an outstanding claim in damages against the debtor's former legal counsel in Alberta, of which former counsel has admitted negligence. The Alberta Lawyers' Insurance Association has indicated it is prepared to indemnify the debtor for any amount owing from that negligence.

[68] On the evidence before me, I am not satisfied that the patents are an asset of the debtor. The only evidence I have on this point is the applicant's assertion that patents were invented by the debtor on his own and under his former company and I have a copy of a print-out from the website "Justia Patent Searches." This states "Christopher Sellathamby has filed for patents to protect the following inventions" and then provides details with relation to each patent application and grant. Counsel did not take me through this document to establish that, for instance, the debtor is in fact the holder of the patents.

[69] There is also affidavit evidence of the debtor that the patents were irrevocably assigned to the company he previously worked for. He attached one assignment of invention form to his affidavit as an example. In looking at the Justia Patent Searches print-out, it is clear that each patent except one has the name of a company as an assignee of the patent. With respect to the one exception, without further evidence and explanation I am not satisfied that the debtor is in fact the

current holder of the patents. I again note that the debtor has deposed he irrevocably assigned the patents to the company he worked for, and this would presumably include this one patent.

[70] I cannot conclude that the patents are in fact assets of the debtor rather than of his former company. Thus the patents are not "assets that have not been realized or distributed" under s. 41(11).

[71] The debtor categorically denies the existence of the "hidden assets" comprised of the land and overseas funds. I am asked to find otherwise solely on the basis of the applicant's assertions that there are hidden assets. However, without more evidence, I am not satisfied that the alleged "hidden assets" are "assets that have not been realized or distributed" under s. 41(11).

[72] With respect to the outstanding Alberta Lawyers' Insurance Association claim, I am also not satisfied that an outstanding insurance claim against former legal counsel is, at this point in time, an asset. The details of this claim are few and, for example, there is no evidence before me about the amount of damages that will be paid out on the insurance claim. I do not agree that what appears to be the prospect of insurance proceeds amounts to an after acquired asset and, therefore, it is not a basis for appointing a new trustee under s. 41(11).

[73] Finally, I note that I have jurisdiction under s. 183 of the *BIA* to do "what is right and equitable in the circumstances of a case" (*Sellathamby (Re),* 2019 BCSC 2061, at para. 5; citing *Bennet on Bankruptcy,* 15th Edition, at 594 and s. 183 of the *BIA*). In my view it is necessary here to have a timely resolution of the applicant's claim to the trustee. It has been outstanding since 2016 and the intervening events have made it more complicated, to perhaps understate the situation. It was submitted by the applicant that, if the December 2017 Notice of Disallowance is a nullity, the remedy should be the appointment of a different trustee (the respondent emphasized that their first position is that the December 2017 Notice of Disallowance is not a nullity).

[74] In these exchanges during argument the applicant proposed an order that reinstates Grant Thornton (formerly Abakhan) to adjudicate on the claim, subject to Grant Thornton providing a consent to act within 14 days (in its Notice of Motion the applicant sought the appointment of a new firm of trustees). I adopt that change in the applicant's position and add that the reinstated trustee be located in Victoria, British Columbia.

[75] I exercise my authority under s. 183 of the *BIA* to do "what is right and equitable in the circumstances" and make that order.

D. SUMMARY

[76] The applicant seeks orders that, among other things, would nullify the trustee's December 2017 Notice of Disallowance.

[77] At the time of the 2017 Notice the trustee had applied for and had been granted discharge from his duties. As well, the consumer proposal had been presented at a meeting of creditors in 2016 and voted on. The applicant was not part of these proceedings because he was not told about them, although he had submitted a claim to the trustee with an expert report (and the debtor had submitted a counter expert report). There is no evidence of a Notice of Disallowance sent to the applicant in 2016.

[78] Since the trustee was discharged of his duties at the time, the trustee was without authority to issue the 2017 Notice of Disallowance under s. 135 of the *BIA*. Section 41(10) permits a trustee to perform incidental duties after discharge but issuing a Notice of Disallowance is not an incidental matter. It is, therefore, a nullity. There was no determination of the applicant's claim and, therefore, no appeal could have been made under s. 135(4) and the subject Notice of Motion is not a collateral attack on the 2017 notice. The notice also failed to value the applicant's claim and it was not done in a forthwith or timely manner as required by s. 135(1.1) and (3) of the *BIA*.

[79] The firm of Grant Thornton (through offices in Victoria, British Columbia) is reinstated pursuant to the broad, equitable authority under s. 183 of the *BIA* to value the applicant's claim and make the orders necessary to complete the respondent's consumer proposal. I make no comment on the validity or value of the applicant's claim.

[80] I appreciate that the issues discussed above were for the most part out of the control of the respondent. However, the problem of the applicant's unrecognized claim was clear and the respondent has opposed resolving that problem except through litigation. The applicant has been substantially successful and is entitled to his costs from the respondent under Scale B. The applicant's application for special costs is based on an assertion of fraud by the respondent, but that has not been proven and is denied.

"The Honourable Mr. Justice Steeves"

TAB 8

In the Court of Appeal of Alberta

Citation: Kingsway General Insurance Company v. Residential Warranty Company of Canada Inc. (Trustee of), 2006 ABCA 293

Date: 20061010
Docket: 0603-0093-AC
Registry: Edmonton

Between:

Kingsway General Insurance Company

Appellant
(Applicant)

- and -

Deloitte & Touche Inc., Trustee In Bankruptcy of Residential Warranty Company of Canada Inc. and Residential Warranty Insurance Services Ltd.

Respondent

Corrected judgment: A corrigendum was issued on October 18, 2006; the corrections have been made to the text and the corrigendum is appended to this judgment.

The Court:

The Honourable Mr. Justice Jean Côté
The Honourable Madam Justice Marina Paperny
The Honourable Madam Justice Doreen Sulyma

Reasons for Judgment Reserved of The Honourable Madam Justice Paperny
Concurred in by The Honourable Mr. Justice Côté
Concurred in by The Honourable Madam Justice Sulyma

Appeal from the Decision of
The Honourable Madam Justice J. E. Topolniski
Dated the 24th day of March, 2006
(24 112232; 24 112233)

Reasons for Judgment of
The Honourable Madam Justice Paperny

Introduction

[1] This is an appeal from a case management judge, sitting in bankruptcy, granting a charge for trustee's fees against property subject to conflicting, undetermined trust claims.

Background

[2] The bankruptcy judge reviewed the facts in her reasons: (2006), 21 C.B.R. (5th) 57, 2006 ABQB 236. The following is a summary.

[3] Residential Warranty Company of Canada ("RWC") and Residential Warranty Insurance Services ("RWI") operated a home warranty business in Alberta and British Columbia. The appellant Kingsway General Insurance ("Kingsway") underwrote warranty policies sold by RWI and RWC.

[4] RWI collected insurance premiums on behalf of Kingsway pursuant to a broker agreement. RWC and RWI also received funds from home builders by way of fees for membership in the warranty programs and by way of cash deposits or letters of credit as security for repairs covered by the warranty policies.

[5] RWC and RWI became bankrupt on May 31, 2005. The respondent, Deloitte & Touche, is the trustee in bankruptcy of their estates.

[6] Kingsway filed proofs of claim pursuant to s. 81 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*") asserting that all property in the bankrupt estates is subject to a trust in Kingsway's favour. Unsecured creditors, Canada Revenue Agency and other competing trust claimants (home builders) also claim interests in the property.

[7] Kingsway claims that the entirety of the bankrupts' estates is comprised of premiums which the bankrupts collected on its behalf and therefore is impressed with a trust under the *Insurance Act*, R.S.A. 2000, c. I-3 and corresponding legislation in British Columbia. Section 504 (formerly 124) of the Alberta statute provides that an insurance agent who acts for an insurer in negotiating, renewing or continuing a contract of insurance and who receives insurance premiums from an insured, is deemed to hold the premiums in trust for the insurer. Kingsway submits that these premiums cannot be subject to the charge granted because as trust funds they do not form part of the bankrupts' estates. Kingsway also asserts an express trust by virtue of the broker agreement and a constructive or resulting trust. The broker agreement between Kingsway and RWI provides that "[a]ll money received by the Broker [RWI] on behalf of the Company [Kingsway] less the Broker commission shall be the property of the Company and shall be held...as Trust Funds...".

[8] The trustee disallowed Kingsway's trust claim and notified Kingsway pursuant to s. 81(2) of the *BIA*. The trustee's review of the records indicated to it that all premiums owing had been paid

to Kingsway and that the funds in the estate represent other income from the operation of the business.

[9] Kingsway appealed the trustee's decision to the Court of Queen's Bench, a summary proceeding under s. 81(2) of the *BIA*. That appeal is pending.

[10] Kingsway applied to the bankruptcy judge seeking that Deloitte & Touche be prohibited from accessing any property in the estates for any purpose, including paying its past and future fees and expenses for appearing on the appeal and otherwise, pending the determination of Kingsway's trust claim.

[11] The trustee opposed Kingsway's application and sought a retrospective and prospective charge against all assets under its administration.

[12] The trustee has been administering the estates of RWC and RWI in accordance with the *BIA*, including: conducting financial analysis; securing and retaining possession of property of RWC and RWI; communicating with Kingsway and builders who are also advancing trust claims; establishing and executing a process to deal with builder claims to cash security deposits held by RWC and RWI; communicating with home owners claiming insurance coverage pursuant to policies issued by Kingsway; and administering insurance claims on a limited basis.

[13] The trustee anticipates future costs arising from dealing with the validity and priority of the trust claims of Kingsway and various builders.

[14] The trustee asserts that because Kingsway's trust claims encompass the entirety of the property under the trustee's administration, the ultimate determination of Kingsway's claim is critical to the administration of these bankruptcies. The trustee is concerned about prejudice to other creditors and competing trust claimants if it is unable to respond to Kingsway's appeal of the disallowance due to lack of funding.

Decision Below

[15] The case management judge denied Kingsway's application and granted the trustee's application for a retrospective charge. She also granted the trustee's application for a prospective charge, subject to the trustee filing an interim report with the court confirming the inspectors approved the actions proposed by the trustee, including its involvement in the proceedings to determine Kingsway's trust claim. She stipulated that both the retrospective and prospective charges were subject to challenge by builders with trust claims who had not been given notice of the applications before her. She further ordered the trustee to minimize general estate administration, not to pursue further asset realization without Kingsway's consent or the court's approval, and that Kingsway's appeal from the trustee's disallowance proceed on an expedited basis.

Issues on Appeal

[16] This appeal raises the following issues:

1. Does a bankruptcy judge have jurisdiction to order that a trustee's fees be paid from property that is subject to undetermined trust

> claims?
>
> 2. If so, does that jurisdiction include the trustee's fees associated with determination of a trust claim?
>
> 3. If jurisdiction exists, what factors should a court consider in exercising its discretion to make such orders?
>
> 4. If jurisdiction exists, did the case management judge properly exercise the discretion?

Standard of Review

[17] The first three issues raise a question of law, subject to the standard of correctness: ***Murphy Oil Co. v. Predator Corp.*** (2005), 384 A.R. 251, 2006 ABCA 69. The fourth issue involves the exercise of discretion of a case management justice and cannot be interfered with in the absence of a palpable or overriding error: ***Northstone Power Corp. v. R.J.K. Power Systems Ltd.*** (2002), 36 C.B.R. (4th) 272, 2002 ABCA 201.

Discussion

1. Jurisdiction to order trustee's fees be paid from property subject to undetermined trust claims

[18] The *BIA* does not address the ability of a trustee to obtain a charge for its fees on property that is subject to undetermined trust claims. The trustee submits that the jurisdiction to do so is found in the inherent jurisdiction of the bankruptcy court.

[19] Section 183(1) of the *BIA* preserves the inherent jurisdiction of the Court of Queen's Bench of Alberta sitting in bankruptcy, stating in part:

> 183. (1) The following courts are invested with such jurisdiction at law and in equity as will enable them to exercise original, auxiliary and ancilliary 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:
> ...
>
> (d) in the Provinces of New Brunswick and Alberta, the Court of Queen's Bench;...

[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: ***Baxter Student Housing Ltd. v. College Housing Cooperative Ltd.***, [1976] 2 S.C.R. 475 at 480; ***Wasserman Arsenault Ltd. v. Sone*** (2002), 33 C.B.R. (4th)145 (Ont. C.A.). In ***Wasserman***, the trustee applied for an increase in fees in a summary administration bankruptcy. Rule 128 of the *BIA* Rules caps the trustee's fees in summary administration bankruptcies with no permissive or discretionary language. The Ontario

Court of Appeal concluded that inherent jurisdiction could not be used to conflict with that legislative expression.

[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. In this context, there should not be frequent resort to the power. However, inherent jurisdiction has been used where it is necessary to promote the objects of the *BIA*: ***Re Tlustie*** (1923), 3 C.B.R. 654; ***Canada (Minister of Indian Affairs and Northern Development) v. Curragh Inc.*** (1994), 27 C.B.R. (3d) 148 (Ont. S.C.). It has also been used where there is no other alternative available: ***Re Olympia & York Developments Ltd.*** (1997), 18 C.B.R. (4th) 243 (Ont. Gen.Div.); ***Re City Construction Company Ltd.*** (1961), 2 C.B.R. (N.S.) 245 (B.C.C.A.) and to accomplish what justice and practicality require: ***Canada v. Curragh***.

[22] Kingsway asserts that s. 67(1) of the *BIA* prohibits such a charge. That section states:

> 67. (1) The property of a bankrupt divisible among his creditors shall not comprise
> (a) property held by the bankrupt in trust for any other person...

[23] Kingsway relies on s. 67 to assert that property held by a bankrupt in trust for others does not form part of the estate and therefore use of inherent jurisdiction to grant a charge on that property would be contrary to the Act. Section 67 does not mean, however, that trust property does not fall within a trustee's administration. It only addresses the division of the bankrupt's property among the creditors; it does not address what property forms the estate that must be administered by the trustee.

[24] The Supreme Court of Canada addressed this issue in ***Ramgotra (Trustee of) v. North American Life Assurance Co.***, [1996] 1 S.C.R. 325 at para. 61:

> Unlike provisions of the [BIA] such as ss. 71(2), 91 or 68, s. 67(1) tells us nothing about the property-passing stage of bankruptcy. Instead, it relates to the estate-administration stage by defining which property in the estate is available to satisfy the claims of creditors. It effectively constitutes a direction to the trustee regarding the disposition of property...the trustee is barred from dividing two categories of property among creditors: property held by the bankrupt in trust for another person (s. 67(1)(a)), and property rendered exempt from execution or seizure under provincial legislation (s. 67(1)(b)). *While such property becomes part of the bankrupt's estate in the possession of the trustee, the trustee may not exercise his or her estate distribution powers over it by reason of s. 67.*
> (Emphasis added)

[25] In any event, Kingsway's argument in regard to s. 67 rests on the premise that the property is in fact trust property, a proposition that remains undetermined.

[26] Kingsway also asserts that there is no jurisdiction to order that a trustee's fees be paid from property subject to a statutory trust, citing ***P.A.T. Local 1590 v. Broome*** (1986), 61 C.B.R. (N.S.) 233 (Ont. Master) and ***Re C.J. Wilkinson Ford Mercury Sales Ltd.*** (1986), 60 C.B.R. (N.S.) 289 (Ont. S.C.).

[27] In both of those cases, however, the validity of the trusts in question was clear and accepted by the trustee. Further, the question of fees for sorting out their validity was not squarely in issue in either decision. Here, a statutory trust as well as several other trust claims have been asserted but not accepted by the trustee and all remain to be determined by the Court of Queen's Bench.

[28] Kingsway also relies on ***Re Gill*** (2002), 37 C.B.R. (4th) 257, 2002 BCSC 1401 at paras. 29-32 in support of its statutory trust argument. In that case, however, Sigurdson J. recognized the jurisdiction to grant a charge for trustee fees over assets subject to trust claims. He determined on the distinct facts before him not to grant the charge requested.

[29] I therefore accept that inherent jurisdiction exists to grant a charge on property subject to undetermined trust claims.

2. Permitting trustee costs involved in determining the validity of the trust to be paid out of trust property

[30] Kingsway objects to the trustee being paid to "defeat" its claim out of what it alleges to be its property. Kingsway's opinion on the merits of its trust claim differs from the trustee's. However, Kingsway does not suggest that the trustee has acted improperly or unfairly in its disallowance of its claim.

[31] I do not characterize the actions of the trustee as an attempt to "defeat" Kingsway's claims. Upon receiving a proof of claim claiming property in possession of the bankrupt, the trustee must respond in one of two ways according to s. 81(2) of the *BIA*. The trustee can either admit the claim and deliver possession of the property to the claimant, or give notice in writing to the claimant that the claim is disputed, indicating the reasons for the dispute. The section provides for an appeal to the Court of Queen's Bench if the trustee disputes the claim. The trustee is not to function as an adversary. Rather, it functions to advise the court of the relevant facts as its officer in a dispassionate manner, in furtherance of its role to administer the estates to completion, leaving the court to decide the matter: see ***Re Beetown Honey Products Inc.*** (2003), 46 C.B.R. (4th) 195 (Ont. S.C.J.), aff'd (2004), 3 C.B.R. (5th) 204 (Ont. C.A.) and *BIA*, s. 41(4). The trustee's conduct to date has been in accordance with requirements of the Act and its participation in the appeal is necessary in this case. Kingsway's claims purport to cover the entire estates of both bankrupts, against which there are competing property claims and unsecured claims.

[32] There is precedent for allowing a trustee to be remunerated from trust property for efforts in sorting out trust claims and distributing the trust *res* to beneficiaries: see for example, ***Re***

Nakashidze (1948), 29 C.B.R. 35 (Ont. S.C.); ***Re Rideout Real Estate Ltd.*** (1957), 36 C.B.R. 111 (Ont. S.C.); ***Re Kern Agencies, Ltd.*** (No. 3) (1932), 13 C.B.R. 333 (Sask. K.B.); ***Re NRS Rosewood Real Estate Ltd.*** (1992), 9 C.B.R. (3d) 163 (Ont. S.C.). In ***NRS Rosewood***, for example, Austin J.

faced the same argument made by Kingsway in this case that the trustee had no entitlement to share in assets which were not the property of the bankrupt. Austin J. concluded that "[a]s the question had to be settled one way or another, and as the Trustee took the initiative, it is only reasonable that some part of the Trustee's fees be paid out of the property in issue".

[33] I do not suggest that a trustee will in every case be entitled to be paid from trust property. On the contrary, such an order, based on inherent jurisdiction, must be granted sparingly. The situation before us is unique in many respects:

1. Kingsway asserts a trust on various grounds, none of which are obvious. Kingsway has delayed determination of its claim, resulting in additional work by the trustee;

2. Kingsway's claim encompasses the entirety of the estate;

3. There are other trust claimants making claims to the same funds;

4. There are significant sums in dispute;

5. This bankruptcy occurred as a result of a failed proposal. Deloitte & Touche went from interim receiver to trustee and the typical guarantee of the trustee's fees is not in place;

6. There is no other reasonable and more expeditious alternative but to have the trustee participate in the appeal process as part of its administration of these bankruptcies. Most of the other creditors are owed small amounts, aside from a government claim;

7. There is no suggestion that the trustee is acting improperly in disputing the claims; and

8. Kingsway seeks to link the appeal from the trustee's disallowance with the trial of other unrelated issues.

These circumstances and the centrality of the trust claims to the bankruptcies underscore the necessity of the trustee's involvement and the payment of its fees from the property subject to the disputed trusts.

[34] Even if Kingsway is ultimately successful in its appeal of the trustee's disallowance, the trustee has been administering the property and a significant part of its work will likely have benefited Kingsway. The trustee has expended and will continue to expend considerable effort in

sorting out other claims on the property, including the formulation of a plan that Kingsway has joined in for resolving builder claims. It has offered assistance to Kingsway in related proceedings

concerning proposals made by directors and officers of the bankrupts. It has also formulated, coordinated and attended case management meetings throughout the course of its administration.

[35] Kingsway suggests its claim will not go unchallenged if the trustee is not funded to defend the litigation on behalf of the estates; it asserts that one or more of the creditors can pursue the litigation at their own cost pursuant to s. 38 of the *BIA*. However, the litigation is central to these bankruptcies and not merely an action that interests select creditors. The validity and priority of Kingsway's trust claims must be determined and follows from the claims review process mandated by the *BIA*. That process is designed to ensure that only proper claimants share in the bankrupt's property and in these circumstances, the trustee plays an integral part.

[36] Kingsway also submits that the appeal to the Queen's Bench from the trustee's disallowance will be complex, as it intends to bring other solvent parties into the action. Accordingly, Kingsway argues, the *res* of the estates could be frittered away with fees. However, the appeal to the Queen's Bench is intended to be a summary and efficient process to determine the issue relevant to the bankruptcy. To the extent that Kingsway chooses to increase the scope and complexity of the appeal, it must similarly accept the increased costs of the trustee in dealing with that action.

3. Factors in exercise of discretion

[37] Generally, inherent jurisdiction should only be exercised where it is necessary to further fairness and efficiency in legal process and to prevent abuse. The following non-exhaustive factors should be considered before invoking inherent jurisdiction here:

> 1. The strength of the trust claim being asserted. The mere assertion of a trust claim is not determinative of the validity of the trust and cannot preclude the trustee from investigating concerns. In some cases, the trust claim may be obvious, as was the case in ***C.J. Wilkinson***, where the claim was based on statutory trusts in favour of employees or tax authorities and the interim receiver conceded their validity. In other circumstances, a trustee will have no choice but to have the issue of the trust determined in order to further the administration of the bankruptcy. In that event, the ultimate beneficiary of the trust may have to shoulder the costs of the determination;
>
> 2. 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;
>
> 3. The need to maintain the integrity of the bankruptcy process. The equitable distribution of the bankrupt estate must remain at the forefront. The court should recognize the expertise of the trustee in this regard and in effective management of bankruptcy: see ***GMAC*** at para. 50. Also, the court should assess the extent to which the determination is necessary to administer the bankruptcy and discourage academic

or potentially unrewarding litigation;

4. The realistic alternatives in the circumstances. This could include a s. 38 order, deferring a decision or empowering a court to review the decision in the future, for example, after final determination of the claims and the extent of the property available for distribution. The court should consider whether there is an existing guarantee of the trustee's fees, whether the party ultimately determined to be the beneficiary might bear some responsibility for the costs, and whether counsel might be hired on contingency;

5. The impact on the trust claimants and on the trust property as well as on other creditors. The court should examine the breadth of the trust claims, the existence of competing proprietary claims, and whether the trust claims leave any assets in the estate for unsecured creditors in assessing which stakeholder is going to suffer most from the trustee's disputing of the trust claim. In that exercise, the court should assess what part of the estate would ideally bear the burden of costs. It is important to consider whether the determination would proceed by default if the trustee were not fully funded;

6. The anticipated time and costs involved. The court should contemplate whether the proposed determination represents an efficient and effective means of resolving the issue to the benefit of all stakeholders. Consideration should be given to expediting the process;

7. The limits that can be placed on the fees or charge; and

8. The role that the trustee will take in the determination process.

4. Exercise of discretion by the case management judge

[38] The case management judge considered the relevant factors and the applicable law. She carefully constructed a limited charge that she viewed as suitable in the circumstances. The order for a prospective charge is subject to the trustee filing a report confirming the bankruptcy inspectors had approved the steps the trustee proposed to take. She delayed the operation of her order to give builder claimants an opportunity to challenge it. She held that if all the property was not ultimately found to be impressed with a trust in Kingsway's favour, that a further hearing be held in order to prorate the trustee's fees between estate and trust assets. Further, she directed that the trustee only address urgent matters of general administration, and that Kingsway's claim be addressed as quickly and efficiently as possible. I see no basis to disturb her exercise of discretion.

[39] One of the fundamental purposes of the *BIA* is to ensure equitable distribution of a bankrupt debtor's assets among the estate's creditors: ***Ramgotra*** at para. 15, citing ***Husky Oil Operations Ltd. v. Minister of National Revenue***, [1995] 3 S.C.R. 453. Determination of the validity of Kingsway's trust claims is central to these bankruptcies. This trustee's participation in that process furthers

appropriate distribution of the assets, whether that be to unsecured creditors in the event all or part of Kingsway's trust claim is rejected by the Court of Queen's Bench, or whether the estate stays out of reach of other creditors as trust property.

[40] The ultimate purpose of the administrative powers granted a trustee under the *BIA* is to manage the estate in order to provide equitable satisfaction of the creditors' claims: ***Ramgotra*** at para. 45. The trustee will be assisting the court and all of the claimants in the bankruptcies in coordinating Kingsway's claims, as well as dealing with the validity and priority of the other trust claims and in providing the necessary information to the Court of Queen's Bench to resolve these issues. For these reasons, it is also just and practical that inherent jurisdiction be used to grant the charge for the trustee's fees.

Conclusion

[41] There is inherent jurisdiction to permit trustee's fees to be paid from property that is subject to undetermined trust claims in appropriate circumstances. The case management judge recognized the power must be used sparingly and did not err in exercising jurisdiction in this case. The appeal is therefore dismissed.

Application heard on September 05, 2006

Reasons filed at Edmonton, Alberta
this 10th day of October, 2006

"Paperny J.A."

Paperny J.A.

I concur: "Côté J.A."

Côté J.A.

I concur: "Paperny J.A."

Authorized to sign for: Sulyma J.

Appearances:

E.A. Dolden
B.D. Rhodes
for the Appellant

K.A. Rowan
for the Respondent

Corrigendum of the Reasons for Judgment of
The Honourable Madam Justice Marina Paperny

On page 6, [33] & [34] have been joined and now read:”....contrary, such an order, ...”

TAB 9

INDUSTRIAL ACCEPTANCE CORPORATION LTD.

AND

THE T. EATON CO. LIMITED OF MONTREAL ..... APPELLANTS;

1951
*Oct. 25

1952
**Mar. 12, 13, 14, 17.
*Jun. 4

AND

ACHILLE LALONDE ..... RESPONDENT,

AND

ALBERT LAMARRE ..... TRUSTEE.

ON APPEAL FROM THE COURT OF KING'S BENCH, APPEAL SIDE, PROVINCE OF QUEBEC.

Bankruptcy—Assets not equalling 50 per cent of unsecured claims—Discretion to refuse discharge—Terms—After-acquired salary—Whether non-exempt portion vests in trustee—Whether distinction between salary earned in bankrupt business and elsewhere—Bankruptcy Act, R.S.C. 1927, c. 11, ss. 23(ii), 142, 143—Article 599 C.P.

The trial judge refused the respondent his discharge in bankruptcy on the grounds that the assets did not equal 50 per cent of the claims of the unsecured creditors; that the debtor had failed to pay to the trustee the seizable portion of his after-acquired salary; and the insufficiency of his answers as he gave his evidence. The Court of Appeal for Quebec reversed that judgment and granted him his absolute discharge on the main grounds that his debt position had developed from circumstances for which he could not be held responsible and that he did not have to account for salary earned elsewhere than in carrying on the business in which he went bankrupt.

Held, that the conduct of the bankrupt, while not sufficient to justify the absolute refusal, did justify his discharge only subject to the imposition of terms.

Parliament, in adopting the language of s. 23(ii) of the *Bankruptcy Act,* intended that only such portion of the salary of the debtor as was subject to seizure by legal process under the law of the respective provinces should vest in the trustee. The section discloses a clear intention that the bankrupt should retain those exemptions which the Legislature of the Province in which he resided provided for him. Apart from such exemptions, the section applies to all property subject to execution or seizure including wages or salary which could only be reached by garnishee or attachment procedure.

There is nothing in the Bankruptcy Act to support the making of any distinction between a salary earned by the debtor in carrying on the business which was the subject-matter of the bankruptcy and a salary earned elsewhere.

*PRESENT: Rinfret C.J. and Taschereau, Rand, Estey and Fauteux JJ.
**REPORTER'S NOTE:—The appeal was first argued on October 25, 1951. By order of the Court, it was re-argued on March, 1952.

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The purpose and object of the *Bankruptcy Act* is to equitably distribute the assets of the debtor and to permit of his rehabilitation as a citizen, unfettered by past debts. The discharge, however, is not a matter of right and the provisions of ss. 142 and 143 of the *Act* plainly indicate that in certain cases the debtor should suffer a period of probation. The penalty involved in the absolute refusal of discharge ought to be imposed only in cases where the conduct of the debtor has been particularly reprehensible, or in what have been described as extreme cases.

APPEAL from the judgment of the Court of King's Bench, appeal side, province of Quebec (1), reversing the judgment of the Superior Court which had refused the respondent his discharge from bankruptcy.

John L. O'Brien Q.C. and *E. E. Saunders* for the appellant, Industrial Acceptance Corporation. This is a clear case of a judgment based on the facts and on the credibility of the witnesses and should not therefore have been reversed by the Court of Appeal. The trial judge could by virtue of s. 142(2) of the *Bankruptcy Act,* in his discretion, give various orders, including the refusal of the discharge, its suspension, or the attachment of conditions to the discharge. *In re Geller* (2).

The trial judge had no discretion but to refuse the discharge in view of the failure to deposit part of the salary earned subsequently to the bankruptcy. The Court of Appeal erred in finding that the respondent was not obliged to give to the trustee any of his after-acquired earnings if earned in a different occupation. (Ss. 23, 142, 191 of the *Act.*).

Under s. 142, it is mandatory for the Court to refuse the discharge in all cases where the bankrupt has committed a bankruptcy offence or any offence connected with his bankruptcy. As to the obligation to turn the seizable portion of the debtor's salary over to the trustee: *Clarkson* v. *Tod* (3), *In re Scherzer* (4) and *In re Baillargeon* (5).

Failure to deposit was a bankruptcy offence and contempt of Court, which made it mandatory on the Court to refuse the discharge. The trent of the authorities is that the deposit must be made even before an order of the Court is made.

(1) Q.R. [1951] K.B. 226.
(2) 20 C.B.R. 359.
(3) [1934] S.C.R. 230.
(4) 15 C.B.R. 194.
(5) 15 C.B.R. 77.

On the question as to whether, on the Court refusing the discharge on the ground that an offence against the *Act* has been committed, there should not have been a conviction of that offence by a competent Court, the words in s. 142(2) of the *Act* appear to be clear. They do not provide that the discharge is to be refused where the bankrupt has been convicted of an offence, but where he has committed an offence. *Electric Motor & Machinery* v. *Bank of Montreal* (1).

R. Gerard Sampson and *Cicely M. Sampson* for the appellant, The T. Eaton Company. This appellant adopted the argument of John L. O'Brien Q.C., but added that it was entitled to oppose the discharge of the respondent notwithstanding that its claim was of an alimentary nature for necessaries of life, and with respect to this appellant's claim, the application for discharge should have been refused and in any event costs should not have been awarded against this appellant. *In re Reynolds* (2) and *Vincent* v. *Daigneault* (3).

Redmond Quain Q.C. for the respondent. Strictly speaking, the case of *Jackson* v. *Tod* (*supra*) is only authority for the proposition that some part of the ordinary salary of the bankrupt earned before his discharge, in the same occupation as he was engaged in at the time of his bankruptcy, is divisible amongst his creditors.

The consequences of the bankrupt being guilty of an offence under the old *Act* are, of course, that he can never get a discharge—or so, at any rate, would seem to be the case. Even if the consequences do not go that far and the cases would seem to indicate that they do, it would be at variance with a practice prevailing in this country and elsewhere to find a person guilty of an offence without a full and thorough trial before a judge and a competent Court.

The power of the judge in dealing with an application for discharge is not a discretionary one for, amongst other reasons, the reason that he is obliged to consider the report of the trustee and the resolution of the inspectors and must

(1) Q.R. 52 K.B. 162. (2) 5 C.B.R. 69.
(3) Q.R. 70 S.C. 551.

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give them their due weight. If he was in the present case exercising a discretion, he did not exercise it in such a way as to preclude review.

The judgment was not one that should be upheld. The Court does not appear under s. 142(1) of the *Act* to be given the authority to refuse to give a conditional discharge. What it is empowered to do is to refuse to give an absolute discharge. It should be noted that under the new *Act*, the provision whereby the Court was bound to refuse the discharge has been omitted.

The judgment of the Court was delivered by

ESTEY, J.:—This is an appeal pursuant to leave granted under s. 174(2) of the *Bankruptcy Act* (R.S.C. 1927, c. 11) from a judgment of the Court of King's Bench, Appeal Side, of the Province of Quebec (1), reversing the judgment of the Superior Court and granting to the respondent, Achille Lalonde, his absolute discharge in bankruptcy.

Achille Lalonde, against whom the receiving order was made, entered into the business of selling automobiles and agricultural implements and operating a garage in the spring of 1947. Approximately two months later he formed Lalonde Motor Sales Limited, which took over the business and assumed the assets and liabilities thereof. Lalonde personally guaranteed the indebtedness of, as well as subsequent obligations incurred by, the company. This business, as operated first under his own name and then under that of Lalonde Motor Sales Limited, continued for about eleven months, when a receiving order was made against the company. A few days later T. A. Lalonde presented a petition in bankruptcy dated July 28, 1948, against his son, the respondent in this appeal. The respondent was judged a bankrupt on the third day of August, 1948, and on July 25, 1949, he requested an appointment for the hearing of his application for a discharge in bankruptcy.

The liabilities of Achille Lalonde, as guarantor, approximated $90,000, and his other obligations over $1,900, a total indebtedness of about $92,000. His assets realized $22,600, which permitted a payment to the creditors of about 12 cents on the dollar.

(1) Q.R. [1951] K.B. 226.

Mr. Justice Marquis, presiding in the Superior Court, had before him the trustee's report, the minutes of the inspectors' meeting at which that report was considered and the evidence of the respondent-debtor Achille Lalonde. The trustee's report, which under s. 148(8) is prima facie evidence of the statements therein contained, set out that the debtor's guarantee of the debts of Lalonde Motor Sales Limited was the cause of his bankruptcy; a dividend of about 12 per cent would be paid to the unsecured creditors; the conduct of the debtor, both before and after bankruptcy, had not been reprehensible; and that he had not committed an act of bankruptcy. The trustee, however, recommended that the discharge should be refused because

Que l'actif du débiteur n'était pas égal à cinquante pour cent de son passif non garanti.

Mr. Justice Marquis refused the discharge and based his decision largely upon grounds that may be grouped under three headings: that the assets did not equal 50 per cent of the claims of the unsecured creditors; that the debtor had failed to pay to the trustee the seizable, or non-exempt, portion of his salary; and the insufficiency of his answers as he gave his evidence.

The learned judges in appeal reversed his judgment, mainly upon a consideration of the first two of these bases. The relevant portions of s. 142 provide that the judge shall refuse or suspend the discharge, or impose a condition, if, as set out in s. 143(*a*), the "assets of the bankrupt . . . . are not of a value equal to fifty cents in the dollar on the amount of his unsecured liabilities unless he satisfies the court" that this low valuation "has arisen from circumstances for which he cannot justly be held responsible."

Lalonde's personal bankruptcy was due to the failure of Lalonde Motor Sales Limited, a company which he had formed to take over his personal business, which he completely controlled and managed. Such a company has a separate legal existence, but when, as here, the bankruptcy of that company, which he alone had managed, was the cause of his own bankruptcy, it was quite proper that the learned judge should examine Lalonde's conduct of that business in order to determine whether, within the meaning of s. 143(*a*), his debt position had developed "from circumstances for which he cannot justly be held responsible."

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Lalonde estimated the company had done a million dollars' worth of business in eleven months and entertained the opinion that the future was bright. In fact, he says that after he was aware of the indebtedness of the company he tried to continue in the hope that the sales would realize a sufficient profit to permit it to carry on. He deposed that, while the company kept books, there was no record made of his personal drawings, as to the amount of which the only evidence was his own statement that he drew money as he needed it and

J'ai essayé de vivre comme les gens avec qui je transigeais.

He did not produce a balance sheet or any records of the company, but was content to state to the court that these were all in the hands of the trustee in bankruptcy of the company and to give evidence of figures based upon his estimates and recollections. Upon these figures the learned trial judge found a sum of $45,000 unaccounted for. The Appellate Court examined the figures and concluded that they had accounted for at least a part thereof. These figures, incomplete and, at most, but approximately accurate, with great respect, did not provide sufficient proof upon which to found a conclusion that the debtor had made a satisfactory explanation as to why his assets were less than 50 cents on the dollar.

The learned judges of the Court of King's Bench, after referring to the fact that the assets did not equal 50 per cent of the unsecured liabilities and to the provisions of s. 143(*a*), stated:

ATTENDU que par son témoignage nullement contredit, le failli établit que si la valeur de son actif n'égale pas cinquante cents par dollar de ses obligations non garanties, cela provient de circonstances dont il ne saurait raisonnablement être tenu responsable;

The debtor, in his pleadings, took the position that if the assets did not equal 50 cents on the dollar that was because que ladite liquidation n'a pas été faite avec les soins voulus.

At the hearing before the learned judge he withdrew that allegation.

At the hearing he did complain that the Kayser-Fraser Company Limited shipped to him too many automobiles. Here again he merely stated that the company shipped these automobiles without his ordering them, but did not indicate on what basis automobiles were properly shipped

to him. His evidence as to this allegation, as well as upon other items, was based upon recollection expressed in most general terms and entirely unsupported by any documents which, if they existed, were available, because, as he deposed, the records of the company were in the possession of the company's trustee. The evidence, however, of the number of automobiles on hand, having regard to the nature and volume of the business, did not support this contention. Moreover, he did not show to what extent that contributed to his bankruptcy which, in view of the company's financing methods, would appear to be important. The same remarks apply to his complaints with respect to the finance company, both in relation to his own and the company's business, and of the Turcotte Company.

The learned judges in the Appellate Court commented upon the fact that the sale of the Val d'Or property was, upon the evidence, in the best interests of the estate. It would rather appear that the learned judge of the first instance was not making a finding as to the merits of the sale. He did comment upon the fact that the purchase price of $20,200 was less than the municipal valuation of $27,500, but it was Lalonde's attitude, as he gave his evidence, his professed ignorance as to details thereof, and particularly that he did not know his brother-in-law had purchased it, that impressed the learned trial judge and undoubtedly influenced him, along with the other facts, in his estimation of Lalonde.

Throughout his evidence Lalonde's statements are so vague and general in character that a reading thereof justifies agreement with the learned judge, who had the added advantage of observing him as he gave his evidence, when he stated:

> CONSIDERANT que les déclarations du failli devant la Cour, lors de l'enquête sur la présente demande, n'ont pas été à notre point de vue suffisantes pour justifier sa demande;

The learned judge was evidently of the opinion that Lalonde, upon his own evidence, had not satisfied the onus placed upon him by s. 143(*a*) to establish that though the assets were less than 50 cents upon the dollar it was due to circumstances for which he could not justly be held responsible.

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The learned judge also commented upon Lalonde's failure to pay, as requested, the seizable portion of his salary to the trustee.

The learned judges in the Court of Appeal commented upon the debtor's failure to pay the salary as follows:

> ATTENDU qu'il est vrai que le failli n'a déposé aucun produit de son salaire chez le syndic avant qu'une demande ne lui en ait été faite; que l'article 143 qui énumère les faits qui peuvent être un motif de refus de libération, ne fait nullement une obligation au failli de rendre compte du salaire qu'il gagne, hors les opérations du commerce qui sont la cause de sa faillite;

Lalonde, after becoming bankrupt, was employed by The Sherwin-Williams Co. of Canada Limited at a salary of $390 per month. On April 25, 1949, the trustee verbally and in writing requested Lalonde to deposit the seizable portion of his salary with him. The trustee based his request upon the view that all of the salary vested in him except that which was exempt under s. 23(ii), where the provincial laws with respect to exemptions are adopted. The exemptions provided to those in the Province of Quebec earning salaries or wages are provided for in Article 599(11) of the *Civil Code of Procedure*. There it is provided that one who is earning a salary in excess of $6.00 per day is entitled to two-thirds thereof by way of an exemption. Upon a date that the evidence does not fix accurately, but in the summer months, Lalonde left the employment of The Sherwin-Williams Co. of Canada Limited and accepted employment with his father at a salary of $50 per week. He was, therefore, earning more than $6.00 per day with both employers and, within the meaning of Article 599 of the *Civil Code of Procedure,* in the trustee's view, one-third of the salary, as earned, vested in him. Lalonde paid to the trustee $175, whereas he should have paid $1,800.

The attention of the learned judges was not directed to the decision *in Re Tod* (1), where this Court held that the salary of a debtor in bankruptcy, earned subsequently to his being adjudged bankrupt, vested in the trustee, subject to the court fixing an alimentary allowance.

S. 23 of the Canadian act is based upon s. 15 of the English Bankruptcy Act of 1869 (32 & 33 Vict., c. 71) and now contained in s. 38 of An Act to Consolidate the Law

(1) [1934] S.C.R. 230.

Relating to Bankruptcy (1914, 4 & 5 Geo. V, c. 59). There are, however, important differences. In particular, s. 38(2) of the English act reads:

> 38. The property of the bankrupt divisible amongst his creditors, ... shall not comprise the following particulars:—
>
> (2) The tools (if any) of his trade and the necessary wearing apparel and bedding of himself, his wife and children, to a value, inclusive of tools and apparel and bedding, not exceeding twenty pounds in the whole:

The corresponding s. 23(ii) of the Canadian Act reads:

> 23. Les biens du débiteur, susceptibles d'être partagés entre ses créanciers . . . . ne doivent pas comprendre ce qui suit:
>
> (ii) Les biens qui, au préjudice du débiteur, sont exempts d'exécution ou de saisie selon la procédure judiciaire, conformément aux lois de la province dans laquelle sont situés les biens ou dans laquelle est domicilié le débiteur.

S. 2(*f*) defines "property" as follows:

> "biens" comprend les deniers, marchandises, choses en action, ...

Mr. Justice Smith, in writing the judgment of *In re Tod, supra*, stated at p. 241:

> The English decisions referred to above seem to establish beyond any question that, by the language of the English Act, "all such property as . . . . may be acquired by or devolve on him before his discharge," the instalments of salary such as are in question here vest in and belong to the trustee as they fall due, subject to the alimentary provisions referred to.
>
> This precise language is adopted in the Canadian Act and is not capable of any difference of meaning in Canada from its meaning in England.

It would appear that Parliament, in adopting the language of s. 23(ii) (particularly when compared with the language of s. 38(2) in the English act) intended that only such portion of the salary as was subject to seizure by legal process under the law of the respective provinces should vest in the trustee. Moreover, the omission of any such provision as that contained in s. 51(2) of the English act, under which, on the application of the trustee, an order might be made against a bankrupt in receipt of a salary to pay the whole or part thereof to the trustee, appears to support the foregoing view.

Neither the provisions of s. 23 nor of any other section of the act appear to support, with great respect, the distinction suggested by the learned judges in the Appellate

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Court between a salary earned in carrying on the business the subject matter of the bankruptcy and that earned elsewhere.

It follows the trustee was within his rights when he requested Lalonde to pay to him the seizable or non-exempt portion of his salary and it was the duty of the debtor to pay over such salary to him. The record discloses that in response to the trustee's request he did pay the sum of $175, but he made no explanation to the trustee of his failure to pay a further sum in excess of $1,600 and at the hearing he made no other suggestion than that it was due to illness, in respect of which neither its character nor duration was specified, nor, indeed, the time of its occurrence. The learned judge, however, did not consider whether his failure constituted an offence under s. 191(*b*) of the *Bankruptcy Act*. He was nevertheless justified, where, as here, no satisfactory explanation was made as to his failure, in taking into consideration his conduct in relation to his non-payment of the required portion of his salary in the exercise of his judicial discretion to refuse, suspend or direct the discharge, subject to a condition.

Mr. Quain, on behalf of Lalonde, contended that s. 23(ii) applied only to property subject to seizure under execution and that the phrase in s. 23(ii) "execution or seizure under legal process" did not apply to wages or salary which could only be reached by a garnishee or attachment procedure. His contention was that this is the effect of *Re Tod, supra.* The application in that case was made by the trustee asking the court to direct that a bankrupt, earning a salary of $10,000 a year, should pay all in excess of $100 per week to the trustee. The decision is based largely upon *Hamilton* v. *Caldwell* (1), with regard to which Mr. Justice Smith, writing the judgment of this Court *in Re Tod,* stated at p. 242:

> The decision is that it is competent to the court to make such an order and this decision is arrived at on the general principles of equity and not by virtue of any special provisions in the Scottish act.

Hamilton v. *Caldwell* was a decision of the House of Lords under the Scottish act in which, as in Canada, there is no section corresponding to s. 51(2) of the English act.

(1) (1919) 88 L.J. (N.S.) P.C. 173.

The Bankruptcy Court in *Re Tod, supra,* exercised its power to fix an alimentary allowance which, under the Canadian act, might be more than but not less than the exemption provided to the bankrupt by s. 23(ii). The relevant exemption law in Ontario was *The Wages Act* (R.S.O. 1927, c. 176). S. 7 thereof provided to the debtor an exemption of 70 per cent of his salary, with power in a court to reduce that percentage. The court in *Re Tod* acted within the scope of that enactment. The application considered (in *Re Tod, supra*) was quite different from that here under consideration and the language used must be read and construed in relation to the issues raised.

It would appear that when the Parliament of Canada saw fit to omit s. 51(2) of the English act and to entirely rewrite s. 23(ii), being the corresponding section in the Canadian act, it disclosed a clear intention that s. 23(ii) should retain to the bankrupt those exemptions which the Legislature of the province in which he resided provided for him. The language in s. 23(ii), as expressed in French:

et tous les biens qui peuvent être acquis par lui ou qui peuvent lui être dévolus avant sa libération;

and as in English:

and all property which may be acquired by or devolve on him before his discharge;

is sufficiently comprehensive to include a procedure by way of garnishment or attachment of salary or wages. In the Province of Quebec the exemptions where salary or wages are garnisheed or attached are fixed, as already stated, by Article 599(11) of the *Civil Code of Procedure.*

It is not submitted that the learned judge, in the exercise of his judicial discretion contemplated by s. 142, overlooked any fact. The learned judges in the Appellate Court did not agree with certain of his conclusions, as already discussed. Moreover, the learned judges appear, in addition to the items already considered, to have been influenced by the fact that the creditors had not adduced evidence in support of their respective allegations. No witnesses were called by the creditors, but they had a right to submit their contentions upon the evidence adduced before the learned judge. Upon the evidence before him the learned judge, in the exercise of his judicial discretion, concluded that Lalonde was not entitled to his discharge.

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INDUSTRIAL ACCEPTANCE CORP. v. LALONDE

Estey J.

A judgment rendered in the exercise of a judicial discretion under s. 142 ought not to be disturbed by an appellate court, unless the learned judge, in arriving at his conclusion, has omitted the consideration of or misconstrued some fact, or violated some principle of law. *In re Richards* (1); *In re Wood* (2); *In re Labrosse* (3); *In re Lobel* (4); *Re Smith* (5). A consideration of the whole of the evidence, with great respect, does not warrant a reversal of the judgment of the learned judge of the first instance.

Appellate courts, however, where they have concluded that the discretionary judgment of the judge of the first instance ought not to be disturbed, have repeatedly relieved against what has appeared to them to be an undue severity in the terms imposed. *Re Nicholas* (6); *Re Swabey* (7); *Re Thiessen* (8). The purpose and object of the *Bankruptcy Act* is to equitably distribute the assets of the debtor and to permit of his rehabilitation as a citizen, unfettered by past debts. The discharge, however, is not a matter of right and the provisions of ss. 142 and 143 plainly indicate that in certain cases the debtor should suffer a period of probation. The penalty involved in the absolute refusal of discharge ought to be imposed only in cases where the conduct of the debtor has been particularly reprehensible, or in what have been described as extreme cases. The conduct of the debtor in this case, while not sufficient, with great respect, to justify the absolute refusal, does justify his discharge only subject to the imposition of terms.

The usual practice would suggest a reference of this matter back to the judge of first instance. There are, however, here present reasons, including the fact that the assets are not large, which, in the interests of the debtor and the creditors, justify a present final disposition and the avoidance of the expense incident to further proceedings.

(1) (1893) 10 Mor. B.R. 136.
(2) (1915) Han. B.R. 53.
(3) 5 C.B.R. 600.
(4) [1929] 1 D.L.R. 986.
(5) [1947] 1 All E.R. 769.
(6) 7 Mor. B.R. 54.
(7) 76 T.L.R. 534.
(8) [1924] 1 D.L.R. 588.

The claim of the appellant, The T. Eaton Co. Limited, is for necessaries and, therefore, an alimentary debt as defined in s. 2(*b*). Section 147 provides:

> 147. An order of discharge shall not release the bankrupt or authorized assignor.
>
> * * *
>
> (*d*) from any debt or liability for necessaries of life, and the court may make such order for payment thereof as it deems just or expedient.

Under the terms of this provision we direct that the debtor make payment forthwith of the claim for the necessaries of life by The T. Eaton Co. Limited in the sum of $92.60.

We further direct that under the provisions of s. 142(2) (*d*) the debtor, as a condition of his discharge, shall consent to a judgment against him by the trustee for a part of the balance of the debts proved in these proceedings in the sum of $5,000 and that the said sum of $5,000 shall be paid: $1,500 on June 30, 1953; $1,500 on June 30, 1954; and $2,000 on June 30, 1955.

The Court appreciates the exhaustive presentation by counsel of their respective submissions and is particularly grateful to Mr. Quain, who undertook the presentation of the debtor's case at its request.

The appellants, Industrial Acceptance Corporation and T. Eaton Co. Ltd. of Montreal, will have their costs in this Court and in the Courts below, payable to them out of the estate. The respondent, Lalonde, will have costs in this Court only, payable out of the estate.

Solicitors for Industrial Acceptance Corporation: *O'Brien, Stewart, Hale & Nolan.*

Solicitor for The T. Eaton Co. Ltd. of Montreal: *R. Gerard Sampson.*

Solicitors for the respondent: *Quain, Bell & Gillies.*

TAB 10

In the Court of Appeal of Alberta

Citation: Toyota Canada Inc. v. Toronto-Dominion Bank, 1994 ABCA 261

Date: 19940704
Docket: 9303-0395-AC,
9303-0397-AC,
9303-0400-AC
and 9303-0404-AC
Registry: Edmonton

Between:

Toyota Canada Inc. and Hyundai Auto Canada Inc.

Respondents
(Plaintiffs)

- and -

The Toronto-Dominion Bank, HongKong Bank of Canada, 351224 Alberta ltd., now known as 488638 Alberta Ltd., Edwin E. Bean, Terry A. Bean, Alfred Milke, 288314 Alberta Ltd., 322680 Alberta Ltd., now known as Sharpewood Holdings Ltd., Ronald L. Funnell, Garry A. Levang, Ralph Meyers, and Robert Farquhar

Appellants (Defendants)

- and -

Imperial Richmond Holdings Ltd., 321149 Alberta Ltd., 288314 Alberta Ltd., 351224 Alberta Ltd., now known as 488638 Alberta Ltd., 322680 Alberta Ltd., now known as Sharpewood Holdings Ltd., 349189 Alberta Inc., Lloyds Bank Canada, now known as Hongkong Bank of Canada, HongKong Bank of Canada, The Toronto-Dominion Bank, Edwin E. Bean, Ronald L. Funnell, Alfred Milke, Terry A. Bean, James Wilkins, Richard Heyman, Dale Mather, Del Manary, Robert Nelson, Henry A. Smith, Garry A. Levang, Ralph Meyers, Robert Farquhar, Jim Patterson, Alan N. Parkinson, B.A.B. Newell, Ron F. King, Arthur Odamura, D. Cameron, Rodney L.J. Child, Gerry Peterson, and Robert Blades

Defendants

The Court:

The Honourable Mr. Justice Lieberman
The Honourable Mr. Justice Belzil
The Honourable Madam Justice Conrad

Reasons for Judgment of The Honourable Madam Justice Conrad
Concurred in by The Honourable Mr. Justice Lieberman
Concurred in by The Honourable Mr. Justice Belzil

APPEAL FROM THE WHOLE OF THE JUDGMENT OF THE HONOURABLE MR. JUSTICE T.H. MILLER, FILED THE 18TH DAY OF MAY, 1993

COUNSEL:

V.L. Lirette, for the respondents

M.M. Simpson, for the appellant, Toronto-Dominion Bank

M.J. McCabe, for the appellant, HongKong Bank of Canada

R. Sadownik, for the appellants, 351224 Alberta Ltd., now known as 488638 Alberta Ltd., Edwin E. Bean, Terry A. Bean, Alfred Milke

REASONS FOR JUDGMENT OF THE HONOURABLE MADAM JUSTICE CONRAD

[1] The question of law in this appeal is whether a statement of claim issued pursuant to s. 38 of the **Bankruptcy Act**, R.S.C. 1985, c. B-3 (now known as the **Bankruptcy and Insolvency Act,** S.C. 1992, c. 27, s. 2) ('the **Bankruptcy Act**"), without prior notice to other creditors, is a nullity. I am of the view it is not, and would dismiss the appeal.

The Facts

[2] The respondents, Toyota Canada Inc. ("Toyota") and Hyundai Auto Canada Limited ("Hyundai") are two of the main creditors of International Warranty Company Limited ("International") who went into receivership by court order, December 31, 1987. On November 9, 1992, an order was obtained under the **Bankruptcy Act** appointing a trustee in bankruptcy. Toyota and Hyundai forwarded a letter, on November 10, 1992, to the trustee requesting him to commence the proceeding which is the subject-matter of this appeal. The trustee, by letter dated November 18, 1992, communicated that he had made a decision not to pursue the litigation because the estate did not have the required funds. He proceeded without consultation with the inspectors, as it was not possible to prepare a proper list of creditors, or have a first meeting of creditors, in time to avoid the limitation risk that existed with respect to the action.

[3] November 23rd was the last day under the **Limitation of Actions Act**, R.S.A. 1980, c. L-15 for filing the statement of claim. On that date, Toyota and Hyundai, on notice to the trustee of International, made application for an order under s.38 of the **Bankruptcy Act**, authorizing them to take proceedings in this action. It is common ground that the cause of action in this suit is that of the bankrupt, and it is only by virtue of s. 38 that Toyota and Hyundai have the right to sue. While notice of that application was given to parties other than the trustee (including the appellant Lloyds Bank Canada), generally the creditors were not served.

[4] The Chambers Judge granted the application of Toyota and Hyundai, authorizing them to commence proceedings. That order included the following paragraph:

> Subject to paragraph 12, all benefits to be derived from the proceedings authorized by this Order together with the costs of same shall belong exclusively to the applicants and to such other creditors of the bankrupt who may within sixty (60) days of service upon them of the notice of the granting of this Order agree to contribute pro rata according to the amount of their respective claims to the expense and risk of such proceedings, and who within the like time in writing directed to the law firm of Reynolds, Mirth, Richards & Farmer, solicitors for the applicants, signify their agreement pursuant to the form of agreement attached as Schedule "B" to this Order. The applicants shall also within 60 days of this Order provide security in the amount of 5% of their claims, less all costs and fees incurred by them in accordance with paragraph 14 hereof.

On November 23rd, the trustee assigned to Toyota and Hyundai its interest in this cause of action. Pursuant to the order and the assignment, the statement of claim was issued that day, and thereafter notice to creditors was served on all known creditors. Of the creditors served, five elected to become involved in the action with the plaintiffs, and signed a written agreement.

[5] Several of the named defendants sought to set aside the order of the Chambers Judge and strike the statement of claim as being a nullity. At the time of that application, the limitation period for commencing this action had expired. The judge dismissed the application, and the appellants now appeal from that order. Although many issues were raised before the Chambers Judge, the hearing of this appeal revolved around the failure to give notice to creditors prior to issuance of the statement of claim.

Analysis

[6] Section 38 of the **Bankruptcy Act** provides the mechanism for creditors to proceed with an action of the bankrupt where the trustee refuses or fails to act, without which Hyundai

and Toyota would have no cause of action against the defendants. Since the right of a creditor to bring an action under s. 38 is purely statutory, a creditor must bring itself strictly within the provisions of the section in order to exercise the powers provided by it (see *In re Andrew Motherwell* (1924), 4 C.B.R. 484 (Ont.S.C.) at 486; *Re Points of Call Airlines Ltd.* (1990), 80 C.B.R. 157 (B.C.S.C.) at 164).

[7] Section 38 of the **Bankruptcy Act** reads as follows:

> (1) Where a creditor requests the trustee to take any proceedings that in his opinion would be for the benefit of the estate of the bankrupt and the trustee refuses or neglects to take the proceedings, the creditor may obtain from the court an order authorizing him to take the proceeding in his own name and at his own expense and risk, on notice being given the other creditors of the contemplated proceeding, and on such other terms and conditions as the court may direct.
>
> (2) On an order under subsection (1) being made, the trustee shall assign and transfer to the creditor all his right, title and interest in the chose in action or subject-matter of the proceeding, including any document in support thereof.
>
> (3) Any benefit derived from a proceeding taken pursuant to subsection (1), to the extent of his claim and the costs, belongs exclusively to the creditor instituting the proceeding, and the surplus, if any, belongs to the estate.

[8] The appellants rely on the decision in *B.N.R. Holdings Ltd. v. Royal Bank of Canada,* [1993] 2 W.W.R. 471 (B.C.C.A.) for the proposition that notice is a condition precedent to the validity of the action. In *B.N.R. Holdings Ltd., supra,* Seaton, J.A. comments on the distinction between s. 38 applications and those brought under s. 69 to allow continuation of a creditor's action, when he states at p. 479:

> In the cases that granted leave nunc pro tunc that have been brought to our attention, it could be said that there was a cause of action when the proceedings were commenced. In those cases, suing a trustee (ss. 37 and 215) or a bankrupt (s. 69), the plaintiff has a claim that it cannot present without leave. In cases under s. 38, on the other hand, the plaintiff has no claim to present. Until the trustee assigns the claim the plaintiff has no status to start the action. That is not a mere technical error. The plaintiff has no cause of action absent the assignment. It can only receive the assignment after complying with the statute.

He also sets out what he considers to be the five conditions to obtaining a s. 38 order:

> (1) The creditor must request the trustee to take proceedings,
>
> (2) The trustee must refuse or neglect to take proceedings,
>
> (3) The creditor must apply to the court for an order authorizing it to take proceedings in its own name,

(4) Notice of the contemplated proceedings must be given to the other creditors,

(5) The trustee must assign and transfer the claim to the creditor.

With respect to those five conditions, Seaton, J.A. commented at p. 479:

> These are not just procedural steps. The assignment is essential - it is the foundation for the action. Clearly each of the other steps must precede the assignment.

[9] This reasoning differs from that in *Imprimerie* Canadienne Gazette v. Turcotte (1991), 50 Q.A.C. 152 (Que.CA), where the Quebec Court of Appeal approves its earlier decisions requiring that the pursuing creditor must satisfy two conditions precedent: first, to ask the trustee to take proceedings, and second, if the trustee refuses, to obtain the Court's authorization. Fish, J.A. states at p. 156-7:

> Case law also favours the position that the permission of the inspectors is not required under s. 38(1). As mentioned earlier, this court has set out two conditions precedent for an action under s. 38: failure or refusal of the trustee to take an action when requested to do so, and permission of the court. There is no mention, as a further requirement, that the inspectors authorize the proceeding: see **Bank of Montreal v. Elliott** and **Manifattura Lane Gaetano Marzotto**, supra.

[10] I approach this issue in two stages: firstly, does the section require that the notice be given before the action is commenced; and, secondly, if it does, is it a condition precedent or merely a procedural irregularity which can be cured?

[11] The Chambers Judge did not deal squarely with the jurisdictional issue of notice, but certainly took a purposive approach to interpretation of the section. He found that the intention of s. 38 in requiring notice, was to preclude any opportunity for preference of one creditor over others, which he satisfied by the terms of his order. Following the application to vary his order, the Chambers Judge stated:

> Five creditors have agreed to participate and will join in sharing the costs and potential benefits. They are not precluded from joining even if the notice was given after the action was commenced and after the limitation period has expired. The cause of action is affected by the limitation period. The cause of action has not been altered, nor have any parties been added to the cause of action that would cause difficulties. They are not prejudiced by lack of notice before the statement of claim was issued. The policy objective of section 38, to preclude an opportunity for preference of one creditor over others, is not frustrated. It must be noted that if the Plaintiffs had failed to commence the action immediately then the other creditors would have been prejudiced. All creditors would have lost the opportunity to bring the action forever.
>
> (A.B. 91)

[12] The general rule of interpretation of the **Bankruptcy Act** has been commented on specifically by the Supreme Court of Canada in *Mercure v. Marquette & Fils Inc.,* [1977] 1 S.C.R. 547, at p. 556 where it is stated:

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

[13] Similarly, in *Re Andrew Motherwell of Canada Ltd.* (1924), 55 O.L.R. 294 (Ont.S.C.) the Court commented on the interpretation of the predecessor to the present s. 38, and stated at p. 298:

> Any interpretation to be given to the meaning and scope of sec. 35 should be a liberal one, and not a construction that would debar a creditor, if he is prepared to undertake the risk, of the right to proceed for his own benefit.

[14] What then is the purpose of section 38? In my view, its primary purpose is to ensure that the bankrupt's assets are preserved for the benefit of the creditors. It provides the mechanism for creditors to proceed with an action when the trustee refuses or fails to act; thereby ensuring that assets of the bankrupt (which may otherwise go unrecovered) are available to creditors willing to finance the litigation.

[15] The secondary purpose, relating to notice, is to make sure the section operates fairly. While it is fair that those parties willing to accept the risks and costs of litigation receive a preference in terms of recovering their losses, the right to that preference must be shared with all creditors. To ensure that no creditor receives an unfair advantage over another, the section requires that notice be given to all other creditors. The interpretation of the requirement of notice should be approached with this distinction, and purpose, in mind.

[16] It is necessary to address the meaning of the words "…the creditor may obtain an order…on notice being given the other creditors of the contemplated proceeding…" in s. 38(1). There appear to be three alternative interpretations:

(1) "contemplated proceeding" refers to the application for a s. 38 order, and therefore notice to the creditors of that application is required before the application for a s. 38 order is made;

(2) "contemplated proceeding" refers to the statement of claim, and "on notice" should be read to mean "after notice". This means that notice is required before the statement of claim has been issued;

(3) "contemplated proceeding" refers to that proceeding contemplated by the order (in this case the statement of claim), and while notice must be given, the timing of that notice is flexible. The reason for the phrase "contemplated proceeding" is because at the time the order is made the proceeding is only "contemplated". This interpretation would mean that the order may be obtained, but there will be a condition in the order to give notice and to do such other things as the court directs.

[17] At first blush, the first alternative appears to technically fit best with subsections 38(2) and (3). Section 38(2) provides that "…on the order being made…the trustee shall assign and transfer to the creditor…" all his interest in the action. Section 38(3) then provides that the creditor is entitled to the benefit of the proceeding to the extent of its claim and costs. Since the duty to assign occurs immediately on the making of the order, a strict reading would require that it is only the creditor that receives the assignment who would have an opportunity to participate. If that were true, notice would be required before the application so that those creditors who were interested in participating could be assignees.

[18] There is, however, authority to support the position that the application stage only requires notice to the trustee. Fish, J.A. in *Imprimerie Canadienne Gazette, supra,* dealt with this issue at p. 157, where he says:

> In **Re Parallels Restaurant Ltd.** (1988), 68 C.B.R. (N.S.) 266 (B.C.S.C), it was held that the issue under s. 20 (now s. 38), at least initially, is between the trustee and the pursuing creditor. Notice therefore does not have to be given to the defendant or to the other creditors until after the court order is made; nor is the trustee obliged to call a meeting of the creditors before deciding not to proceed with the action. See also: **Re Swerdlow** (1985), 57 C.B.R. (N.S.) 180 (Ont. S.C.); **Re Wagon Stop Inc.** (1979), 30 C.B.R. (N.S.) 63 (Ont. S.C.)

[19] In fact, the position taken by the appellants is the second alternative interpretation, namely, that notice is required before the statement of claim has been issued. As a matter of statutory interpretation, they argue the words "on notice being given" must be read "after notice being given", and cite *R. v. Arkwright,* 12 Adol. & E., N.S., 960, 966 as authority for the proposition.

[20] The respondents opt for the third interpretation, and say that the timing of the notice is not mandated by the section, and the requirements of the section are met by the judge providing for notice to the creditors, along with any other terms and conditions he sees fit, so that the objects of the Act can be met. In any event, they say the obligation is directory only, and not substantive, and can be cured.

[21] The Alberta Court of Appeal commented on the issue of notice in *Transamerica Commercial Financial Corp., Canada v. Computer Corp. Systems Inc.* (1993), 10 Alta.L.R. (3d) 337, where the Court said at p. 340:

> …no notice was given to the other creditors. To this day, it is not clear they know that the judge transferred away from them at least some of the fruit of the litigation. They were entitled to notice. It is no answer to say it was a better deal than any other offer. They should decide, or at least have a chance to be heard on the point. That is why s. 38 requires notice to the creditors. It is at least equally vital that they know of a proposed assignment to a shareholder.

While this quote is helpful on the importance of notice, I do not read it as demanding that notice occur prior to commencement of proceedings as long as creditors' rights are preserved.

[22] On a strict interpretation, I acknowledge that both alternatives (2) and (3) present difficulties because s. 38(2) and (3) appear to suggest that only the creditor who receives the assignment would obtain the benefit. In my view, that is far too narrow an approach. The judge can, as he did in this case, provide for one creditor to receive the assignment on terms and conditions that allow others to join in and participate. Requiring notice before the statement of claim can lead to unreasonable, if not absurd, results. The definition of creditor under the **Bankruptcy Act** is a broad one and a bankruptcy may occur near the end of a limitation period, when ascertainment of an exhaustive list of creditors would not be possible. It is also easy to imagine a lawsuit proceeding, past its prescription date, and suddenly a "new creditor" appears. Would the section intend the action to be a nullity? I think not. It goes against the primary object of the Act to suggest that a failure of notice to creditors should defeat the cause of action. Notice is unrelated to the main purpose.

[23] I accept that the proper approach to interpretation is a purposive one, and the third interpretation best meets the purpose. It meets the objectives of preserving the bankrupt's assets, while still providing fairness to creditors.

[24] The defendants to the action have no interest in what creditors participate and share in the proceeds of the action. If the bankrupt has an asset in the nature of a cause of action, the defendants cannot be heard to complain if the suit is pursued on behalf of the bankrupt's estate, if done within the limitation period. They are not prejudiced because the cause of action exists, albeit in another person. The words "on notice being given to the other creditors of the contemplated proceeding" simply means that the other creditors must be given notice of the proceedings contemplated by the order. It must be a condition contained within the order. A judge can address, having regard to all the circumstances of the application, the timing of the notice and the means of participation in both the lawsuit and the proceeds. I agree with the trial judge's comments, quoted earlier, with respect to the ability of creditors to apply to participate subsequent to the commencement of the action.

[25] In the event I am wrong on the interpretation of and the timing of notice under s. 38, I would find that notice is not a condition precedent and could be cured if necessary. I recognize this appears to be contrary to the decision in *B.N.R. Holdings Limited v. Royal Bank of Canada, supra.* However, in that case the Court was dealing with a fact situation where the action was commenced without an order under s. 38, and the Court ruled on whether the action could be saved by the issuance of an order under s. 38 *nunc pro tunc.* Any discussion on the issue of notice to the creditor is *obiter dicta.* The case was not dealing with the interpretation of the notice provision or the timing of notice, Thus a provision in the order for notice would suffice, if my interpretation is correct. In any event, I prefer the reasoning in *Imprimerie Canadienne Gazette* that there are only two conditions precedent to the commencement of proceedings. Firstly, failure or refusal of the trustee to act, and secondly, the court order under s. 38.

[26] Moreover, this is more consistent with the holding of the Supreme Court of Canada in *Traders Finance Corporation Ltd. v. Emilien Levesque,* [1961] S.C.R. 83, dealing with a similar provision. The Supreme Court, at page 87, said: "Cette obligation est une conséquence et non une condition du droit préférence et du droit de poursuivre pour l'exercer." The assignment of the action to the creditor is not a condition precedent to the action being brought, but a consequence of the order under s. 38. Thus, the creditor's right to carry on the action does not flow from the assignment by the trustee, but is a function of law upon the granting of the s. 38 order. Nor does it flow directly from notice. Notice is required to deal with the results of the order.

[27] In my view, if notice is required, it is merely procedural, and any irregularity can be cured. Section 187 of the **Bankruptcy Act** allows that procedural irregularities may be cured. Section 187(9) reads:

> (9) No proceeding in bankruptcy shall be invalidated by any formal defect or by any irregularity, unless the court before which an objection is made to the proceeding is of the opinion that substantial injustice has been caused by the defect or irregularity and that the injustice cannot be remedied by any order of that court.

[28] No substantial injustice has been caused by the failure to give notice before the statement of claim was issued. The defendants are not prejudiced. If the action against them has merit, they are liable, and not entitled to any benefit directed solely for the protection of the creditors. The action was brought against the defendants in time and they suffer no substantial injustice. In addition, no creditor can be said to have been harmed. The judge has jurisdiction to impose whatever conditions may be necessary to do justice. In this case all creditors were given notice of the proceedings after the statement of claim was issued. No creditor has been precluded from joining the action in terms of contributing to the costs and sharing in the proceeds. The creditors could have suffered harm if the statement of claim had not been issued when it was, as the limitation period was about to expire. Any substantial injustice that may have occurred would, in any event, be curable by order under s. 187(11) of the **Bankruptcy Act** which allows the court "…to extend the time either before or after the expiration date…" for doing any act or thing for which the time is limited. Therefore the court could permit service of notice on the creditors after the statement of claim has been issued. But as all the creditors have already been notified in the proceeding, this step is unnecessary.

[29] In summary, the notice required by s. 38(1) need not be served prior to the commencement of the proceeding, and is most properly dealt with by the court when granting the order, to ensure that all creditors are provided with ample opportunity to participate in the action in such manner as the court directs. There is ample jurisdiction in section 38 for a judge to deal with all the issues required to do justice between creditors. Even if notice was required prior to issuance, it is not a substantive condition nullifying the statement of claim.

[30] The appeal is dismissed.

JUDGMENT DATED at EDMONTON, Alberta,
this 4th day Of July
A.D. 1994

TAB 11

In the Court of Appeal of Alberta

Citation: Smith v Pricewaterhousecoopers Inc., 2013 ABCA 288

Date: 20130822
Docket: 1301-0046-AC
Registry: Calgary

Between:

William Franklin Smith

Applicant

- and -

Pricewaterhousecoopers Inc. and Servus Credit Union Ltd.

Respondents

Reasons for Decision of
The Honourable Madam Justice Patricia Rowbotham

Application for Leave to Appeal the Order by
The Honourable Madam Justice K.M. Horner
Dated the 20th day of February, 2013
(Docket: BK01-094263)

Reasons for Decision of
The Honourable Madam Justice Patricia Rowbotham

Introduction

[1] The applicant wishes to commence an action on behalf of the estate of a bankrupt company. The respondent trustee did not consent to the commencement of the action. The applicant applied pursuant to section 38(1) of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-6 *(BIA)* for leave to commence the action. A bankruptcy judge refused to give leave. The applicant applies to this court for a declaration that he does not require leave to appeal, or, in the alternative for leave to appeal. For the reasons that follow I find that leave is required and I deny leave to appeal.

Background

[2] The applicant is the founder of Caliber Systems Inc., a heavy construction company. It had entered into a credit facility with a credit union that has now merged to become Servus. Caliber found itself in financial distress during a downturn in the economy, and after nine months of violating the terms of its credit facility with Servus, became subject to a receivership order. Caliber was ultimately assigned into bankruptcy.

[3] It was ultimately determined that Servus was not the first secured creditor, but that the first priority went to GE Capital, who was fully paid out once Caliber was liquidated. There were insufficient funds to pay out the remaining creditors, including Servus, who are now attempting to make up the shortfall through recourse to a guarantee provided by the applicant. The applicant alleges that Servus was negligent in failing to provide notice to the first secured creditor, and to engage in discussions on potential restructuring of Caliber with a view to pay the indebtedness.

[4] The draft statement of claim pleads improvident realization, breach of fiduciary duty, negligence in relation to the appointment of the receiver, and a claim for economic loss. In response to a request for the trustee's consent to sue, the trustee's counsel replied in writing: "We are having trouble understanding the basis for such a claim in an instance where Caliber had consented to the receivership appointment and the realization was completed through a Court supervised and approved process."

[5] At the leave application a preliminary issue arose as to the standing of Servus to address the application. The bankruptcy judge found that this was a situation where there is an:

> [I]nterested party who has evidence that is germane and relevant to the Court's determination with respect to whether or not there is an action here, to use your words, or a cause of action that might be accepted. That evidence is essential and vital to the Court's deliberation. The exceptions are present. There appear to be

> material at least omissions from your client's affidavit if not downright misrepresentations, so I would grant Servus the standing to enter their evidence, that being the affidavit of Mr. Tuchee and make submissions on it and other matters that may arise during the application.

[6] Counsel agreed that the test for granting the application was whether the applicant could show that the claim is not obviously spurious.

Decision of the Bankruptcy Judge

[7] The bankruptcy judge found that the claim was spurious. She said:

> There cannot be a better documented situation, in my view, of a company which was in financial difficulty that reached out to its lender, Servus, and through a series of nine months attempts were made to save Caliber which were not successful. That is the sum total of what happened here.
>
> I cannot see on any of the evidence that has been presented by Mr. Smith any of the causes of action that we outlined -- that we went through that could possibly be framed or outlined in the statement of claim being anything more than spurious.
>
> This is very well documented, Mr. Hanley, through the forebearance agreements and through the e-mails, right up until the day of the taking of the consent order from Mr. Robinson. It did not work.
>
> ...
>
> I see from one of the cases you had referred me to that there was a similar allegation made by counsel in front of the judge at that time, and that judge also took the position that the motivation was not relevant, the question is whether or not there is anything on the face of the -- of the proposed action that would -- that has the merest chance of success or, put differently, that it's not obviously spurious. This is to my mind obviously spurious. There just is such -- it's so well documented what occurred, what happened here, that the possibility of a string of oral agreements in the face of the written agreements is just not -- just -- just to my mind is completely not possible.

Legislation

[8] The appeal of an order under section 38(1) is governed by section 193 of the *BIA*. The appellant relies on section 193(c), or alternatively section 193(e):

> 193. Unless otherwise expressly provided, an appeal lies to the Court of Appeal from any order or decision of a judge of the court in the following cases:
>
> (a) if the point at issue involves future rights;
>
> (b) if the order or decision is likely to affect other cases of a similar nature in the bankruptcy proceedings;
>
> (c) if the property involved in the appeal exceeds in value ten thousand dollars;
>
> (d) from the grant of or refusal to grant a discharge if the aggregate unpaid claims of creditors exceed five hundred dollars; and
>
> (e) in any other case by leave of a judge of the Court of Appeal.

Analysis

Automatic Right of Appeal (Section 193(c))

[9] This court has consistently held that appeals involving procedural rights that are not appreciable in monetary terms fall outside the scope section 193(c) of the *BIA*: *Elias v Hutchison* (1981), 27 AR 1, 14 Alta LR (2d) 268 (CA); *Simonelli v Mackin*, 2003 ABCA 47, 320 AR 330 at paras 13-27. *Elias* involved an appeal from the refusal to grant the appellant leave to sue the bankruptcy for allegedly wrongful acts in the course of his bankruptcy. *Simonelli* involved an appeal from an application to strike a statement of claim under former Rule 129 Alberta *Rules of Court*, Alta Reg 390/168. *Simonelli* and *Elias* were followed by the New Brunswick Court of Appeal in *Isabelle Estate (Trustee of) v Royal Bank of Canada*, 2008 NBCA 69, 299 DLR (4th) 727, in similar circumstances to this appeal. There, the appellant was a guarantor to a bankrupt company and sought to pursue a claim against a bank so that he might reduce any claim against him personally under the guarantee. As in the present appeal, the application for leave pursuant section 38(1) was unsuccessful. The court observed at para 21:

> [I]t is difficult to think of a case involving a corporate bankrupt in which the amount ultimately in issue would not exceed $10,000. Consequently, there would be little utility to the other four subsections under s. 193 if such cases were subject to an appeal as of right. Since the issue on appeal in this case does not directly involve an amount in excess of $10,000 there can be no appeal as of right under s. 193(c). The central issue in this case is whether or not the motion judge erred by failing to consider whether the appellant, as a guarantor, is a creditor of the bankrupt. Since the issue on appeal does not involve an amount in excess of $10,000, there can be no appeal as of right under s. 193(c).

[10] I conclude that the applicant does not have an appeal as of right and must apply for leave to appeal.

Leave to Appeal (Section 193(e))

[11] The test for leave to appeal involves consideration of the following five factors:

(1) whether the point of appeal is of significance to the bankruptcy practice;

(2) whether the point is of significance to the action itself;

(3) whether the appeal is *prima facie* meritorious;

(4) whether the appeal will unduly hinder the progress of the action; and

(5) whether the judgment appears to be contrary to law, amounts to an abuse of judicial power, or involves an obvious error causing prejudice, for which there is no remedy.

(See *Alternative Fuel Systems Inc v Edo (Canada) Ltd (Trustee of)* (1997), 206 AR 295 at para 12; *Dykun v Odishaw*, 1998 ABCA 220, 7 CBR (4th) 151 at para 5; and *Simonelli* at para 28.)

[12] It is acknowledged that as Caliber's estate has been fully liquidated and distributed to creditors, there is no further consequence to the bankruptcy proceedings. Accordingly, the fourth factor is met.

[13] The applicant advances four grounds of appeal. He says that the bankruptcy judge erred:

(1) in her application of the test for authorization to commence an action under section 38(1);

(2) in rendering a decision on the merits without sufficient evidentiary basis to make that decision;

(3) in granting standing to the defendant Servus; and

(4) in taking into consideration submissions made by the trustee contesting the application.

Grounds One and Two - Application of the Test and the Evidentiary Basis

[14] The applicant argues that the clarification of the test to be applied to applications under section 38(1) is of significance to bankruptcy practice. However, given that counsel agreed on the test to be applied, and that the bankruptcy judge adopted the test articulated in the authorities, I cannot find that test for a section 38(1) application requires clarification. Rather, the issue is one of the application of the test to a specific set of facts. While this is of potential significance to the bankruptcy itself, it is not an issue of significance to the bankruptcy practice.

[15] Turning to the requirement that the appeal be *prima facie* meritorious, the applicant submits that the bankruptcy judge erroneously held him to the more onerous standard of demonstrating that Caliber would succeed on the merits of the proposed action. He says that she

erred in considering the affidavit evidence tendered by the respondents and that she treated this as akin to an application for summary judgment.

[16] To obtain an order under section 38(1) an applicant must satisfy a court that four criteria are met:

(1) the applicant must be a creditor of the bankrupt estate;

(2) the applicant must have requested that the trustee undertake the proceeding which the applicant now seeks permission to undertake itself;

(3) the trustee must have refused or neglected to undertake the requested proceeding; and

(4) there is threshold merit to the proposed proceeding, i.e., it is not obviously spurious.

[17] The first three criteria arise from the statutory language of section 38(1), and it is acknowledged that the applicant met these criteria. The real issue was whether there was threshold merit to the proposed action.

[18] The threshold merit criterion emanates from the implicit gatekeeper function assigned to the court under section 38(1). Without the authority to make an inquiry into the merits of a proposed action, the court would become a rubber stamp and there would be no utility in requiring a creditor to seek the court's permission when the statutory criteria are met: *Re Jolub Construction Ltd*, 1993 CarswellOnt 235 at para 16, 21 CBR (3d) 313 (Ont Gen Div).

[19] An applicant seeking leave under section 38(1) must demonstrate a *prima facie* case, which must be supported by evidence and not mere allegations: Houlden and Morawetz, *Bankruptcy and Insolvency Law of Canada* (looseleaf) at 1-236.1; *Polar Products Inc v Hongkong Bank of Canada* (1992) 14 CBR (3d) 225 (BCSC); *Re Jolub* at para 20. The threshold is not particularly high, and requires the applicant to show that the claim is not "obviously spurious": *NESI Energy Marketing Canada Inc (Re)*, 1998 ABQB 912 at para 22, 233 AR 347 (QB); *Alberta Treasury Branches v Chocolaterie Bernard Callebaut Partnership*, 2012 ABQB 245 at para 15).

[20] The applicant swore an affidavit in which he deposed not only to the statutory requirements but also described the background to the proposed statement of claim. This included evidence about the trustee's actions and, in particular, that the trustee had failed to meet with the applicant or consider an offer by the applicant and others to purchase certain assets. The respondents swore brief affidavits attaching documents and correspondence relating to the meetings and the offer. The purpose of the affidavits was to give the court a complete picture and to address certain material omissions in the applicant's narrative.

[21] In his memorandum on the leave application the applicant submits that there is no requirement under section 38(1) for an applicant to provide evidence as to the merits of the proposed action. He relies on *Re Dominion Trustco Corp*, 1997 CanLII 12398, 45 CBR (3d) 25 at para 16 (Ont Gen Div), aff'd (1997), 50 CBR (3d) 84, 1997 CarswellOnt 4901 (ONCA) , where the

court stated, in respect of section 38(1) applications, "...I see no requirements that the [applicant's] affidavit must deal with the merits of the proposed action." However, the application in *Re Dominion* proceeded with the consent of the trustee, and there was no issue raised as to the merit of the proposed action during the section 38(1) hearing.

[22] There is ample authority requiring an applicant to provide some evidence in support of the merits of its claim. In *Re Nesi*, the court commented that in addition to meeting the procedural requirements of section 38(1) of the *BIA*, an applicant must demonstrate a *prima facie* case which amounts to a requirement that "some evidence needs to be presented which is sufficient to persuade the court that the claim is not 'obviously spurious'": at para 22. In *Re Jolub* the court stated that some screening of creditors' claims was clearly contemplated by section 38(1) and that an applicant must establish a "sufficient case on the merits...to warrant the Court's approval to proceed": at para 19. Recently, in *ATB v Callebaut* the court stated that "an applicant must establish a threshold case sufficient on its merits to warrant the Court's approval to proceed... [t]here must be evidence beyond mere allegations to support the claim": at para 15.

[23] Moreover, the applicant acknowledged at the hearing that he bore the onus to demonstrate that his proposed action was not obviously spurious. This onus necessarily required him to demonstrate, through evidence, at least the barest merit to his claim. This was particularly so in this case where the threshold merit of the proposed claim was contested.

[24] Before this court the applicant submitted that the bankruptcy judge was not entitled to receive evidence from the respondents, and that in so doing she delved into the merits of the claim and overstepped her gate-keeping function. The applicant was unable to point to any authority which would deny the respondents the opportunity to put in evidence. Indeed, given the bankruptcy judge's comments that there appeared to be material omissions if not downright misrepresentations in the applicant's affidavit, it was important to the court's function that it have that evidence.

[25] I am not satisfied that there is any *prima facie* merit to the applicant's contention that the bankruptcy judge erred in permitting the respondents to adduce evidence. I am not persuaded that her decision was contrary to the law or that her decision amounted to an abuse of power or involved an obvious error causing prejudice.

[26] The applicant also contends that the bankruptcy judge held him to a more onerous standard than was required. A bankruptcy judge's decision under section 38(1) is discretionary, and would attract deference on appeal: *Decock v Alberta*, 2000 ABCA 122 at para 13, 255 AR 234. The bankruptcy judge went through each of the causes of action and inquired of the applicant what evidence he had in support of those causes of action. She concluded that "I cannot see on any of the evidence that has been presented by Mr. Smith any of the causes of action that we outlined -- that we went through that could possibly be framed or outlined in the statement of claim being anything more than spurious."

[27] The transcript of the hearing reveals several bases upon which to conclude that the bankruptcy judge correctly applied the test for section 38(1). First, she adopted the correct test, and confirmed that test with the applicant's counsel. And, the applicant's counsel repeatedly reminded the bankruptcy judge that she was not to render a decision on the merits of the proposed claim. The bankruptcy judge specifically canvassed each potential cause of action disclosed by the proposed statement of claim and invited the applicant's counsel to highlight the factual foundation for those causes of action. This avenue of inquiry is consistent with a proper application of the correct legal test. A review of the transcript reveals that the bankruptcy judge was merely asking the applicant to show the location of the supporting facts, not that she was demanding that he show that his evidence was persuasive or that he would ultimately prevail.

[28] When discussing the cause of action plead as improvident realization, the bankruptcy judge inquired about the elements of the cause of action. Improvident realization has been recognized as a defence available to a guarantor, and may obviate the guarantor's obligations to the debtor if it is demonstrated that the debtor's manner of selling the collateral was improvident and the debtor's failure to act in a commercially reasonable manner resulted in the recovery of less money than would otherwise have been the case: *Bank of Montreal v Tolo-Pacific Consolidated Industries Corp*, 2012 BCSC 1785 at para 98, 97 CBR (5th) 56, citing *J & W Investments Ltd v Black* (1963), 38 DLR (2d) 251 at 264 (BCCA) and *HSBC Bank Canada v Kupritz*, 2011 BCSC 788 at para 35. See also *Alberta Treasury Branches v New Hatchwear Co*, 2012 ABQB 788; 97 CBR (5th) 227. The applicant conceded that it was the court appointed receiver who conducted all realizations of Caliber's assets, not Servus, the only named defendant in the proposed statement of claim. Further, there was evidence from the respondents that all sales were conducted with court supervision and approval and that the total realization of Caliber's assets yielded a higher return than their appraised value. Accordingly, it was reasonable for the bankruptcy judge to have concluded that there was no factual basis to allege an improvident realization claim against Servus.

[29] She also considered the fiduciary duty claim. The applicant alleged that Servus' actions to appoint a receiver was an improper breach of an oral agreement or oral promise that amounted to a breach of a fiduciary duty. In discussing this claim with counsel the bankruptcy judge stated:

> Okay. And – and again, I – I – I agree with you, Mr. Hanley, it's a many splendored thing, fiduciary duties. They seem to continuously be evolving. That still doesn't mean that you – that you just – it's not magic. You can't just say "fiduciary duty" in a statement of claim and hope that the Court finds one. You need to set up a foundation of facts giving rise to a fiduciary duty. Do – I don't see that here, but I may just be missing it

[30] The bankruptcy judge was not requesting proof of the breach of the alleged fiduciary duty. She merely asked that he identify the factual foundation for the claim, which she did not see on the face of the applicant's material.

[31] The draft statement of claim also alleged that Servus acted negligently or unreasonably and in bad faith in putting Caliber into receivership at the time that it did. The applicant failed to identify any evidence that could support his allegations. He acknowledged that Caliber was in "a cash flow crisis." It was never seriously disputed that Caliber had been in a constant state of default for the nine-month period leading up to the receivership. The terms of the final forebearance agreement executed between Caliber and Servus, which the applicant personally signed on behalf of Caliber, made it explicit in clauses 3.4 and 3.5 that Servus was at liberty to make immediate use of the Consent Receivership Order that had previously been signed by Caliber's legal counsel on the company's behalf. The applicant's counsel conceded that it would have been easy to undo the receivership order if any of Caliber's other creditors or another third party would have come forward to rescue the company. It was demonstrably false that the trustee and Servus refused to meet with the restructuring group as alleged in the proposed statement of claim. Accordingly, it was reasonable for the chambers judge to have concluded, as she did, that the negligence claim was spurious.

[32] The bankruptcy judge also attempted to identify the factual foundations of Smith's economic loss claim. These were not apparent.

[33] In conclusion on this ground, the bankruptcy judge articulated the proper test, and in analyzing the proposed action found that it was spurious. I am not persuaded that there is *prima facie* merit to the contention that she set the threshold any higher than that of a spurious case. Nor am I persuaded that the decision was contrary to law, an abuse of judicial power or involved any obvious errors. Accordingly, the applicant has failed to satisfy the test for granting leave to appeal on these grounds.

Standing of the Respondent Servus

[34] As a general rule prospective defendants, do not by virtue of that status alone, have standing to oppose a section 38(1) application: *Re Nesi* at paras 18-19. There are exceptions to this rule including for the purpose of preventing the court's process "being used so as to perpetuate a fraud": see *Formula Atlantic Financial Corp v Canada (AG)*, 52 BCAC 214 at para 13, 10 BCLR (3d) 52, (BCCA); *Re Tirecraft Group Inc*, 2009 ABQB 281, 470 AR 113 at para 34 citing *Shaw (Trustee of) v Nicol Island Development Inc*, 2009 ONCA 276 at para 45. There is also an exception where there is a procedural irregularity in the bankruptcy proceeding: *Tirecraft* at para 34.

[35] In my view, the discretionary decision of a chambers judge to grant standing to a proposed defendant within the ambit of the recognized exceptions to the general rule precluding standing is not of particular significance to the bankruptcy practice. No party is challenging the validity of the general rule, and Servus relied on recognized exceptions to the general rule to establish standing. There is no novel point of law or interpretation being advanced on this issue, simply an application of the existing law to the circumstances of this case.

[36] However, I do find that this issue is of significance to the action. If Servus was improperly granted standing, a significant portion of the evidence that was before the bankruptcy judge should not have been admitted. Without Servus' evidence a different outcome on the application may have resulted.

[37] I am not satisfied that there is *prima facie* merit to this ground. This was a discretionary decision which would be accorded significant appellate deference. The grant of standing to Servus was within the ambit of the existing exceptions to the general rule denying standing to proposed defendants to oppose section 38(1) applications. The bankruptcy judge was concerned about material omissions in the applicant's affidavit. There were also irregularities in the proceedings. The applicant conceded the existence of a procedural irregularity. The application had initially been made within Smith's personal bankruptcy action, rather than Caliber's bankruptcy action where it properly belonged.

[38] As the applicant has not satisfied the test for leave to appeal on this ground, leave is denied.

Submissions by the Trustee

[39] The applicant contends that the bankruptcy judge erred in hearing submissions and admitting evidence from the trustee. He says that it was improper for the trustee to actively oppose the application. While of significance to the action itself and even potentially to the practice, I am not persuaded that there is *prima facie* merit to this ground.

[40] The applicant did not object to the trustee's participation at the section 38(1) hearing. In any event there does not appear to be any authority for the proposition that considering a trustee's submissions on a section 38(1) application can amount to an error in law. What the authorities do say is that a trustee should not oppose a creditor's section 38(1) application where it is clear on the basis of materials provided to the trustee from the creditor that the proposed action is not frivolous and vexatious: Houlden and Morawetz, *Bankruptcy and Insolvency Law of Canada*, 4th ed (looseleaf) at 1-204; *Halsbury's Laws of Canada*, 1st ed (Canada: LexisNexis, 2009) - Bankruptcy & Insolvency, V.62(c), at para HBI-200; see also *Mutual Trust Co v Scott, Pichelli & Graci Ltd*, 11 CBR (4th) 54 at para 27, [1999] OJ No 2659. Further, these same authorities establish that where a trustee opposes a section 38(1) application in circumstances where it was clear the proposed action was not frivolous, the trustee is subject to having costs awarded against it.

[41] Moreover, it does not appear that the trustee acted improperly. From the outset the letter from the trustee's counsel made it plain that the trustee did not see the basis for the proposed action. At the very least it was arguable the claim was frivolous, and the bankruptcy judge's ultimate conclusion that Smith's proposed action was obviously spurious supports the reasonableness of the trustee's decision to oppose the application.

[42] In conclusion on this ground, the applicant has failed to satisfy the test for granting leave to appeal.

Conclusion

[43] Leave to appeal from an application under *BIA* section 38(1) is required in this case. Leave to appeal is denied.

Application heard on August 14, 2013
Reasons filed at Calgary, Alberta
this 22nd day of August, 2013

Rowbotham J.A.

Appearances:

J.G. Hanley
for the Applicant

H.A. Gorman
for the Respondent Pricewaterhousecoopers Inc.

R. Gurofsky
for the Respondent Servus Credit Union Ltd.

TAB 12

Date: 19981215
Docket: CA022340, CA022840
Registry: Vancouver

COURT OF APPEAL FOR BRITISH COLUMBIA

CA022840

IN THE MATTER OF THE BANKRUPTCY OF JOHN HOWARD McCARTHY

BETWEEN: CA022340

JASTON & COMPANY LIMITED and MULHOLLAND WEBSTER

PLAINTIFFS
(APPELLANTS)

AND:

JOHN HOWARD McCARTHY, CAROL ANNE McCARTHY and MARJORY IRENE McCARTHY

DEFENDANTS
(RESPONDENTS)

Before: The Honourable Madam Justice Prowse
The Honourable Mr. Justice Donald
The Honourable Madam Justice Huddart
The Honourable Mr. Justice Braidwood
The Honourable Madam Justice Proudfoot

J.C. Fairburn	Counsel for the Appellants
J.M. Lepp and J.P. Sullivan	Counsel for the Respondents
Place and Dates of Hearing	Vancouver, British Columbia November 9 and 10, 1998
Place and Date of Judgment	Vancouver, British Columbia December 15, 1998

Written Reasons by:
The Honourable Madam Justice Prowse

Concurred in by:
The Honourable Mr. Justice Donald
The Honourable Madam Justice Huddart
The Honourable Mr. Justice Braidwood
The Honourable Madam Justice Proudfoot

Reasons for Judgment of the Honourable Madam Justice Prowse:

NATURE OF APPEAL

[1] This is an appeal from the decision of a trial judge, pronounced August 28, 1996, dismissing the action of Jaston & Company Limited and Mulholland Webster (the "appellants") against John Howard McCarthy, Carol Anne McCarthy and Marjory Irene McCarthy (the "McCarthys"). The action was to set aside two transactions pursuant to the provisions of the ***Bankruptcy Act***, now the ***Bankruptcy and Insolvency Act***, R.S.C. 1985, c. B-3, and the ***Fraudulent Conveyance Act***, R.S.B.C. 1979, c. 142. The trial judge held that the appellants lacked standing to bring the action as a result of their failure to comply with s. 38 of the ***Bankruptcy Act***, as interpreted by this Court in ***B.N.R. Holdings Ltd. v. Royal Bank*** (1992), 74 B.C.L.R. (2d) 332. The trial judge also held that, if the appellants had had standing to bring the action, he would have set aside one of the impugned transactions involving the transfer of Mr. McCarthy's shares in McCarthy Realty (72) Ltd. and Dev-Gro Developments Ltd. to Ms. Carol McCarthy, but he would have declined to set aside a mortgage made by Mr. and Ms. McCarthy in favour of Mrs. Marjory McCarthy ("Mrs. McCarthy Sr.").

[2] In supplemental reasons for judgment pronounced January 17, 1997, the trial judge dismissed an application by the

appellants for reconsideration of his previous decision. He also dismissed as an abuse of process the appellants' application for summary judgment pursuant to a second order obtained by them on September 23, 1996 pursuant to s. 38 of the ***Bankruptcy Act***.

[3] This appeal was heard by a five-member panel for the purpose of reconsidering its earlier decision in ***B.N.R. Holdings***.

[4] As a matter of convenience, I will refer to the ***Bankruptcy Act*** as the "***BIA***".

ISSUES ON APPEAL

[5] The principal issue on this appeal is whether this Court should follow its earlier decision in ***B.N.R. Holdings*** concerning the correct interpretation and application of s. 38 of the ***BIA***, or whether it should adopt a more flexible approach to the interpretation of that section applied in such cases as ***Imprimerie Canadienne Gazette v. Turcotte*** (1991), 50 Q.A.C. 152 (C.A.); ***Toyota Canada v. Imperial Richmond*** (1993), 10 Alta. L.R. (3d) 127 (Q.B.), affirmed (1994), 27 C.B.R. (3d) 1 (Alta. C.A.); leave refused (1995), 29 C.B.R. (3d) 153 (S.C.C.); and ***DeGroote v. Canadian Imperial Bank of Commerce*** (1996), 45 C.B.R. (3d) 132 (Ont. C.J.), affirmed under ***Re Montego Forest***

Products Ltd. (1998), 37 O.R. (3d) 651 (C.A.); leave refused (8 October 1998), S.C.C. Bulletin, 1998, p. 1477.

[6] In the event this Court decides to overrule its previous decision in ***B.N.R. Holdings***, two further issues arise. The first is whether the trial judge erred in refusing to exercise his discretion under s. 187(5) or 187(9) of the ***BIA*** to amend the original order obtained pursuant to s. 38 of the ***BIA***, *nunc pro tunc*, to specify the action before him as that which the appellants were permitted to take pursuant to that order. The second is whether the trial judge erred in finding that the mortgage made in favour of Mrs. McCarthy Sr. was executed on August 24, 1989 and, thus, was outside the time limits for transactions which could be successfully attacked under s. 95 of the ***BIA***.

BACKGROUND

[7] A detailed recitation of the background giving rise to these proceedings is set forth in the reasons for judgment of the trial judge, reported at (1996) 41 C.B.R. (3d) 212. For the purposes of this appeal, I will refer only to those aspects of that background which are germane to the issues raised on appeal. I begin with the facts relevant to the s. 38 order and the issue of standing.

[8] On September 5, 1990, Mr. McCarthy, a businessman, made a voluntary assignment into bankruptcy pursuant to s. 49(1) of the ***BIA***. His creditors, and the approximate amount owed to them, were as follows:

Preferred Creditors		
1.	Revenue Canada Taxation	$ 33,668.71
Secured Creditors		
1.	Bank of Montreal	25,000.00
2.	Hamilton Delong Ltd.	66,476.25
3.	Jaston & Co.	983,173.75
4.	Mulholland Webster	50,223.55
5.	Toronto Dominion Bank	9,361.47

[9] On December 2, 1991, Mulholland Webster applied pursuant to s. 38 of the ***BIA*** for the following relief:

> a) an order authorizing Mulholland Webster to take this proceeding in its own name and at its own expense and risk pursuant to section 38(1) of the Bankruptcy Act, R.S.C. 1979 [sic], c. B-3;
>
> b) an order that any benefit derived from this proceeding to the extent of the claim of Mulholland Webster and the costs of the proceedings, belong exclusively to Mulholland Webster and the surplus, if any, belongs to the Estate, pursuant to section 38(3) of the Bankruptcy Act as aforesaid; and
>
> c) an order confirming that service of this Notice of Motion and accompanying documentation by regular mail, postage prepaid to the other creditors of John Howard McCarthy pursuant to the mailing list attached as Minutes to this Notice of Motion at least ten clear days prior to the hearing of this application

> constitutes satisfactory service of same pursuant to Rule 13 of the General Rules under the Bankruptcy Act as aforesaid.

[10] An affidavit deposed to by a legal assistant at Mulholland Webster was filed in support of the motion. She deposed that Mr. McCarthy had made a voluntary assignment in bankruptcy on September 5, 1990 and that Wolrige Mahon Limited had been appointed as the trustee of the estate. She further deposed that the amount owing to Mulholland Webster pursuant to a certificate under the ***Legal Profession Act***, S.B.C. 1987, c. 25, s. 73, was $50,223.55. She stated that Mr. Fairburn had attended a meeting of creditors at the offices of the trustee on November 19, 1991 at which the trustee advised that he held only $13,000 on account of the bankruptcy. She stated that Mr. Fairburn had concluded that the trustee would be unable to commence legal proceedings against the bankrupt and that Mulholland Webster had decided to "proceed independently" by applying under s. 38 of the ***BIA***.

[11] Two letters from Mulholland Webster to the trustee were attached to the affidavit in support of the s. 38 order. The first letter, dated June 10, 1991, provided as follows:

> As you are aware, we are a judgment creditor of John Howard McCarthy, being owed the sum of $50,222.55 as of March 16, 1990. We have reviewed the documents enclosed with your letter of January 18, 1991, to our office, including the Joint Statement of Assets and Liabilities of Mr. McCarthy and his wife, Carol Anne McCarthy dated October 31, 1987. This discloses

> substantial assets on the part of Mr. McCarthy at that time.
>
> We also note that the bankruptcy of Mr. McCarthy was precipitated by a guarantee he granted in favour of Jaston & Company Limited dated June 14, 1988. Our preliminary inquiries have revealed that approximately one month prior to that date Mr. McCarthy disposed of his interest in McCarthy Realty (72) Ltd. to his wife for the stated consideration of $4.00. In addition, we have learned that Mr. and Mrs. McCarthy disposed of a property in Delta for the sum of $250,000.00 in April, 1990, after mortgaging this property in favour of Marjory Irene McCarthy the previous month for the sum of $180,000.00. The timing of these transactions is strongly suggestive of their being planned to avoid the creditors of Mr. McCarthy.
>
> We hereby request pursuant to s. 38 of the Bankruptcy Act that you take proceedings under both the Bankruptcy Act and the Fraudulent Conveyance Act for the benefit of the Estate to challenge these transactions without delay. We require your confirmation within ten days of the date of this letter that you will be initiating such proceedings, failing which we will take steps to assume conduct of this bankruptcy at our own expense and risk.

In its second letter to the trustee dated November 4, 1991, Mulholland Webster again requested the trustee to take action.

[12] It is common ground that the trustee either failed or refused to take action to set aside the transactions referred to by Mulholland Webster in its June 10th letter.

[13] The application for a s. 38 order, together with the materials in support of the order, were served on all creditors of Mr. McCarthy. The only creditor who expressed interest in

joining with Mulholland Webster to pursue an action against the McCarthys was Jaston.

[14] The application for a s. 38 order was heard by Mr. Justice B.D. Macdonald on February 4, 1992. No one appeared at the hearing on behalf of the trustee, the Superintendent of Bankruptcy or any of the other creditors. Jaston did not appear, but consented to the order, which is in the following terms:

> THIS COURT ORDERS AND AUTHORIZES Mulholland Webster and Jaston & Co. to take this proceeding in their own names and at their own expense and risk pursuant to section 38(1) of the Bankruptcy Act, R.S.C. 1979, c. B-3.
>
> THIS COURT FURTHER ORDERS that any benefit derived from this proceeding to the extent of the claims of Mulholland Webster and Jaston & Co. and the costs of the proceedings, belong exclusively to Mulholland Webster and Jaston & Co., and the surplus, if any, belongs to the Estate, pursuant to section 38(3) of the Bankruptcy Act as aforesaid.
>
> THIS COURT FURTHER ORDERS AND CONFIRMS that service of this Notice of Motion and accompanying documentation by regular mail, postage prepaid, to the other Creditors of John Howard McCarthy pursuant to the mailing list attached as Minutes to the Notice of Motion filed the 2nd day of December, 1991 at least ten (10) clear days prior to the original hearing of this application on the 19th day of December, 1991, constitutes satisfactory service of same.

[15] Thereafter, on March 9, 1992, the appellants commenced action against the McCarthys to set aside the two transactions involving the transfer of shares and the mortgage. The action was discontinued on February 5, 1993, because the appellants

had failed to obtain an assignment from the trustee before commencing the action.

[16] The assignment was obtained on February 4, 1993. It provided that the trustee assigned to Mulholland Webster and Jaston & Co.:

> . . . our right, title and interest in the choses in action or proceedings which have accrued or will hereafter accrue to the Estate of John Howard McCarthy, as directed in the Order of Mr. Justice B.D. MacDonald, dated February 4th 1992. . . .

[17] On February 5, 1993, the appellants recommenced their action against the McCarthys seeking the following relief:

> a) a declaration and order that the transfers and transactions complained of aforesaid, are fraudulent and void as against the Plaintiffs, including the transfer of shares of the Defendant John Howard McCarthy in McCarthy Realty (72) Ltd. and Dev-Gro Holdings Ltd., and the granting of the mortgage in favour of the Defendant Marjory Irene McCarthy;
>
> b) an order transferring the shares of the Defendant John Howard McCarthy in McCarthy Realty (72) Ltd. and Dev-Gro Holdings Ltd. to the Plaintiffs and for such other directions as appropriate;
>
> c) an order that the Defendants forthwith pay to the Plaintiffs the sum of $180,000.00;

The transactions described in the statement of claim accord with those described in the June 10th letter from Mulholland Webster to the trustee quoted at para. 11 of these reasons and appended to the affidavit in support of the s. 38 application.

[18] On April 13, 1993, the McCarthys filed a statement of defence to the action. The critical paragraph of the statement of defence in relation to the issue of standing is para. 3:

> 3. In answer to the whole of the Statement of Claim the Defendants say that the Plaintiffs are without standing to bring these proceedings as the Order obtained by the Plaintiffs pursuant to section 38(1) of the Bankruptcy Act, R.S.C. 1979, chapter B-3, did not authorize or empower the Plaintiffs to assert the specific causes of action that are hereby asserted nor did it authorize and direct Wolrige Mahon Limited, the Trustee of the Estate of John Howard McCarthy, a bankrupt to assign such causes of action to the Plaintiffs.

[19] Although counsel for each of the parties indicated at various times during the course of the proceedings which followed that they were going to take steps to resolve the issue of standing, neither took the initiative to do so. Rather, the issue was left to be determined at trial. Following a nine-day trial, the issue was resolved against the appellants.

DECISION AT TRIAL

[20] In dealing with the issue of standing, the trial judge relied on the decision of this Court in ***B.N.R. Holdings*** and concluded that the appellants had not brought themselves strictly within s. 38 of the ***BIA***. In particular, the trial judge concluded that the s. 38 order obtained by the appellants did not authorize them to bring the action for the relief they

sought in their statement of claim. He noted that the wording of the order authorized the appellants to take "this proceeding" in their own names and at their own expense, and he concluded that "this proceeding" must mean the bankruptcy proceeding in which the s. 38 order was obtained. At para. 10 of his reasons, the trial judge stated:

> The order does not expressly authorize the plaintiffs to take the present action; rather, it authorizes them to take the proceeding in which it was granted — the bankruptcy proceeding. Counsel for the plaintiffs submits that the authorization to take the bankruptcy proceeding, supplemented by the consequent assignment from the trustee, clothes the plaintiffs with authority to take any proceedings the trustee might have taken that the plaintiffs may consider to be for the benefit of the estate, including this action. The assignment, which was of "the choses in action or proceedings which have accrued or will hereafter accrue to the estate" of Mr. McCarthy, is of no effect unless it has been first authorized by an order made pursuant to s. 38(1): B.N.R. Investments [sic] Ltd., *supra*, at p. 340. I cannot agree that the plaintiffs are authorized to receive an assignment of the present causes of action and to bring this action by virtue of an order authorizing them to take the bankruptcy proceeding. What is required is an express authorization to commence action on the particular claims presented here. That conclusion is supported by a consideration of the words used in the section, by judicial interpretations of the section, and by bankruptcy practice.

The trial judge went on to emphasize that Parliament's intent in enacting s. 38 was to ensure that creditors of a bankrupt obtain an authorization and an assignment "in respect of distinct, identified claims."

[21] The trial judge next dealt with the appellants' alternative submission that, if the s. 38 order was not

effective to give them standing, the court should exercise its remedial powers under ss. 187(5) and (9) of the ***BIA*** to grant them standing, or to vary the order *nunc pro tunc* to permit them to bring the action. The trial judge rejected this submission on the basis that lack of standing was not a "formal defect" or an "irregularity" within the meaning of s. 187(9), but was a matter of substance. Further, he refused to amend the order since to do so would be to grant the appellants standing *nunc pro tunc* which, in his view, would be inconsistent with ***B.N.R. Holdings***.

[22] The trial judge went on to state that, even if he had the power to amend the order *nunc pro tunc* and thereby effectively grant the appellants standing retroactively, he would decline to exercise it in their favour. He based this decision on the appellants' delay in resolving the issue of standing after it was brought to their attention, and on his view that there was some prospect that the other creditors might have chosen to participate in the proceedings if the s. 38 order had specified the action which the appellants intended to pursue.

[23] Although the trial judge resolved the issue of standing against the appellants, he, nonetheless, went on to deal with the action on its merits. I will discuss his findings with respect to the merits later in my reasons.

DISCUSSION OF THE ISSUES

(1) The Appellants' Standing

(a) Relevant Provisions of the *BIA*

[24] The relevant provisions of the ***BIA*** for the purpose of this discussion are s. 38 and ss. 187(5) and (9).

[25] Section 38 provides:

> 38. (1) Where a creditor requests the trustee to take any proceeding that in his opinion would be for the benefit of the estate of a bankrupt and the trustee refuses or neglects to take the proceeding, the creditor may obtain from the court an order authorizing him to take the proceeding in his own name and at his own expense and risk, on notice being given the other creditors of the contemplated proceeding, and on such other terms and conditions as the court may direct.
>
> (2) On an order under subsection (1) being made the trustee shall assign and transfer to the creditor all his right, title and interest in the chose in action or subject-matter of the proceeding, including any document in support thereof.
>
> (3) Any benefit derived from a proceeding taken pursuant to subsection (1), to the extent of his claim and the costs, belongs exclusively to the creditor instituting the proceeding, and the surplus, if any, belongs to the estate.
>
> (4) Where, before an order is made under subsection (1), the trustee, with the permission of the inspectors, signifies to the court his readiness to institute the proceeding for the benefit of the creditors, the order shall fix the time within which he shall do so, and in that case the benefit derived from the proceeding, if instituted within the time so fixed, belongs to the estate.

[26] Sections 187(5) and (9) provide:

> [187](5) Every court may review, rescind or vary any order made by it under its bankruptcy jurisdiction.
>
> . . .
>
> (9) No proceeding in bankruptcy shall be invalidated by any formal defect or by any irregularity, unless the court before which an objection is made to the proceeding is of opinion that substantial injustice has been caused by the defect or irregularity and that the injustice cannot be remedied by any order of that court.

(b) <u>The s. 38 Order</u>

[27] The order obtained by the appellants pursuant to s. 38 of the ***BIA*** is set out at para. 14 of these reasons. In my view, the trial judge was correct in finding that this order does not comply with s. 38 of the ***BIA***. In particular, it does not correctly set out the proceeding or proceedings which the appellants intended to pursue at their own expense and for their own benefit. Rather, according to its terms, it purports to permit the appellants to take over the bankruptcy proceeding. While the material filed in support of the order makes it clear that the two transactions which the appellants were seeking to set aside were those attacked in the action which they subsequently commenced, this is not evident on the face of the order. The matter is further confused by the wording of the assignment obtained pursuant to the order, which purports to grant the appellants the right to pursue

unspecified actions in existence at the time of the assignment, or discovered thereafter.

[28] In summary, I agree with the trial judge that the appellants failed to comply with s. 38 of the ***BIA*** by failing to specify adequately in their order the precise proceeding or proceedings which they were seeking to pursue on their own behalf. I also agree with the trial judge that, in the absence of an amendment to the order, it did not grant the appellants standing to commence this action against the McCarthys. Nor could the assignment obtained pursuant to the order grant standing to commence an action which was not specified in the order.

[29] The troubling issue which then arises is whether the trial judge erred in concluding that he had no power to amend the order, *nunc pro tunc*, to permit the appellants to specify this action as that which they intended to pursue. As earlier noted, the trial judge relied on the decision of this Court in ***B.N.R. Holdings*** as authority for the proposition that a failure to comply strictly with the requirements of s. 38 rendered the proceedings taken pursuant to the order a nullity.

(c) The Decision in *B.N.R. Holdings*

[30] The facts in ***B.N.R. Holdings*** were somewhat unusual. B.N.R. Ltd. ("B.N.R.") owned and operated a restaurant. The principals of B.N.R., Mr. and Mrs. Bishop, personally guaranteed a loan by the Royal Bank to B.N.R. Within a short period of time, B.N.R. went into bankruptcy and a trustee was appointed. The trustee was discharged in March 1982 leaving B.N.R. an undischarged bankrupt. In April, 1985, B.N.R. was struck from the register of companies for failure to file annual reports.

[31] In November 1985, B.N.R. and Mr. and Mrs. Bishop commenced an action in contract and in tort against the bank, the trustee and the former lessor of the restaurant premises. No order had been obtained under s. 38. The defendants applied to strike their statement of claim, and Mr. and Mrs. Bishop applied for an order under s. 38 of the ***BIA***, *nunc pro tunc*, to allow them to proceed with the action. The trial judge concluded that it was appropriate to make the latter order on the basis that there was no prejudice to the defendants.

[32] This Court allowed the defendants' appeal. Mr. Justice Seaton, speaking for the Court, succinctly summarized the issue before the Court as follows, at p. 333:

> The narrow question of law raised by this appeal [from 14 C.B.R. (3d) 233, [1992] B.C.W.L.D. 556] is

> whether the leave contemplated by s. 38 of the *Bankruptcy Act*, R.S.C. 1985, c. B-3, can be given after the trustee has been discharged, the company has been struck from the register and the action that was started years ago without regard for the section is plodding towards trial.

In concluding that the court had no jurisdiction to make an order *nunc pro tunc*, it is apparent that Mr. Justice Seaton considered himself bound by an earlier decision of this Court. At p. 339 of the decision, he stated:

> In *Sigurdson v. Reid* (1980), 26 B.C.L.R. 336, 37 C.B.R. (N.S.) 146, 118 D.L.R. (3d) 555, this court decided that an action commenced without leave under s. 215 (then s. 186) of the *Bankruptcy Act* was a nullity and leave could not be granted nunc pro tunc. The court adopted with approval the language of Henry J. in *Re Pelee Motor Inn Ltd*. (1979), 30 C.B.R. (N.S.) 216, at p. 217 (Ont. H.C.):
>
> > The situation therefore is embraced by s. 186, and according to the plain words of the section leave is required. Not only that, but it is also clear that no action lies unless leave is acquired, and hence it is a condition precedent to the right to issue the writ that leave be given before that time.

[33] Seaton J.A. noted that, while the ***Pelee*** decision had not been followed in later decisions in Ontario, that did not make the ***Sigurdson*** decision any less authoritative in British Columbia. He went on, at p. 340, to discuss the necessary steps to be taken under s. 38 of the ***BIA***:

> Section 38 offers an avenue by which a creditor can present a claim of the bankrupt and thereby recover its own claim against the bankrupt. The steps to be taken are clear:

> (1) The creditor must request the trustee to take proceedings,
>
> (2) The trustee must refuse or neglect to take the proceedings,
>
> (3) The creditor must apply to the court for an order authorizing it to take proceedings in its own name,
>
> (4) Notice of the contemplated proceedings must be given to the other creditors,
>
> (5) The trustee must assign and transfer the claim to the creditor.
>
> These are not just procedural steps. The assignment is essential — it is the foundation for the action. Clearly each of the other steps must precede the assignment.
>
> [Emphasis added]

[34] Mr. Justice Seaton also cited with approval a passage from L.W. Houlden & C.H. Morawetz, ***Bankruptcy Law of Canada***, 3rd ed., vol. 1 (Toronto: Carswell, 1989) stating that, since the right of a creditor to take proceedings in the name of the trustee is purely statutory, a creditor must bring himself strictly within s. 38 in order to do so.

(d) Other Appellate Authorities Considering s. 38

[35] Since ***B.N.R. Holdings*** was decided, the Alberta Court of Appeal and the Ontario Court of Appeal have considered the interpretation and application of s. 38 of the ***BIA*** in ***Toyota Canada*** and ***Re Montego Forest Products***, *supra*, respectively. In each of those decisions, the courts rejected the strict

interpretation adopted in ***B.N.R. Holdings*** in favour of a more flexible approach. An earlier decision of the Quebec Court of Appeal, ***Imprimerie***, *supra*, which was not referred to in ***B.N.R. Holdings***, also adopted a more flexible approach to the application of s. 38.

[36] In ***Imprimerie***, the trustee elected not to continue a paulian action (to attack a fraudulent transfer) commenced prior to the bankruptcy against a party who subsequently went bankrupt. The creditor who had originally commenced the action, sought an order under s. 38 permitting it to continue with the action. The trial judge dismissed the application. Several issues were raised on appeal, one of which was whether leave of the court was required under s. 38 to permit the creditor to continue with the action. Mr. Justice Fish, speaking for the court, concluded that leave was required. In so doing, he followed an earlier decision of that court which held that s. 38 of the ***BIA*** required the pursuing creditor to satisfy two conditions precedent: the first was to ask the trustee to take proceedings; the second, if the trustee refused or failed to act, was to obtain the court's authorization. In other words, the court identified only two of the five steps set out in ***B.N.R. Holdings*** and referred to in para. 32 of these reasons as conditions precedent to a valid action.

[37] Subsequent to the ***Imprimerie*** decision, on facts more closely resembling those in this appeal, the Quebec Court of

Appeal indicated that there was room for even greater flexibility in the interpretation and application of s. 38.

[38] In ***Banque Royale du Canada v. Dupont (syndic)***, [1993] A.Q. No. 3 (Q.C.A.), the bank commenced an action to have a transfer of property by a husband to his wife shortly before the husband went into bankruptcy declared invalid. The bank failed to obtain leave under s. 38 prior to commencing its action. The bankrupt applied to dismiss the action on the basis that the failure to obtain leave under s. 38 of the ***BIA*** precluded the bank from pursuing its claim. The trial judge stayed the application for dismissal so that it could be tried at the same time as the bank's application for leave under s. 38.

[39] The Court of Appeal dismissed the bankrupt's appeal. In so doing, the court stated that the ***Imprimerie*** decision did not decide the question of whether the court could remedy the default where a creditor failed to obtain authorization from the court under s. 38 prior to commencing proceedings. In other words, the court left open the possibility that failure to comply with this aspect of s. 38 did not automatically render the proceeding taken in the absence of such authorization a nullity.

[40] In ***Toyota Canada***, *supra*, the Alberta Court of Appeal considered the interpretation and application of s. 38. There, a creditor of the bankrupt obtained an order under s. 38 of the

BIA without notice to the other creditors. It was a term of the order that the other creditors be given 60 days after service of the order upon them to participate in the action. The order and subsequent assignment from the trustee were obtained the last day before the limitation period for the action expired.

[41] The defendants sought to set aside the order and strike the statement of claim on the basis that there had not been strict compliance with s. 38 of the ***BIA***. The principal breach of s. 38 relied on by the appellants was the failure of the pursuing creditor to give notice of the application to the other creditors before commencing the action. The appellants relied on the decision of this Court in ***B.N.R. Holdings*** for the proposition that this failure to comply strictly with s. 38 was fatal to the action.

[42] Madam Justice Conrad, speaking for the court, identified two issues: (1) whether s. 38 required notice to other creditors to be given before the action is commenced, and (2) if so, whether failure to do so was fatal to the action, or simply a procedural irregularity which could be cured. In addressing these issues, she referred to the general approach to the interpretation of the ***Bankruptcy Act*** adopted by the Supreme Court of Canada in ***Mercure v. A. Marquette & Fils***, [1977] 1 S.C.R. 547, at 556:

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

[43] In the result, Madam Justice Conrad concluded that s. 38 did not require that notice be given to the other creditors before commencement of the action and that, while notice must be given, its timing was flexible. In so doing she expressed her preference for the approach taken by the Quebec Court of Appeal in ***Imprimerie*** to that taken by this Court in ***B.N.R. Holdings***.

[44] In the event she was wrong in her interpretation of the notice provision, Madam Justice Conrad concluded that failure to give notice prior to the commencement of the action was merely a procedural irregularity which could be cured under s. 187(9) of the ***BIA***. She would have applied the curative provision on the basis that none of the creditors had suffered prejudice.

[45] In ***Re Montego Forest Products***, the Ontario Court of Appeal also declined to follow the approach to the interpretation and application of s. 38 adopted by this Court in ***B.N.R. Holdings***.

In that case, Montego Forest Products was petitioned into bankruptcy in 1990 by one of its secured creditors, C.I.B.C. In 1992, Montego and its principal shareholder, Roger DeGroote, together with others, commenced an action, against the C.I.B.C. and the trustee in bankruptcy claiming damages for breach of contract, trespass, conversion, and improvident realization of the assets of Montego. The trustee had neither refused nor failed to take action and no order had been obtained under s. 38 of the ***BIA***. The action was defended on the merits and the defendants did not take exception to the failure of the plaintiffs to obtain a s. 38 order until May, 1996. At that time, the defendants applied to have the action dismissed on the basis that it was a nullity. Madam Justice Lax held that the failure to obtain an order under s. 38 was an irregularity which could be cured by making an order under s. 38, *nunc pro tunc*, granting Montego leave to continue the action on its own behalf and on behalf of other creditors. The defendants appealed.

[46] The Court of Appeal dismissed the appeal. In so doing, the court set forth the issue and its resolution at 653-4 of the decision:

> Reduced to its essentials, the argument before this court was whether - as the appellants urged - the failure to obtain a s. 38 order before the commencement of the action was a foundational defect that rendered the action a nullity or whether - as the respondents urged - such failure constituted only an irregularity that could be cured by the making of a s. 38 order *nunc pro tunc*. This question has been

addressed, with differing results, by appellate courts in Alberta and British Columbia. The Alberta Court of Appeal has held that non-compliance with s. 38 is a procedural irregularity which can be cured after the event: *Toyota Canada Inc. v. Imperial Richmond Holdings Ltd.* [citation given]. The British Columbia Court of Appeal has held that a s. 38 order is the foundation for the action and that failure to obtain such an order cannot be cured after the event: *B.N.R. Holdings Ltd. v. Royal Bank* [citation given]. We respectfully prefer the view of the Alberta Court of Appeal, and adopt the conclusion of Lax J. that the commencement of an action without the consent or refusal of the trustee and without a s. 38 order is an irregularity only, which may be cured through the mechanism of an order *nunc pro tunc*.

Counsel for the appellants submitted that this result would open the door to a plethora of actions instituted without a s. 38 order in the confident expectation that the court would bestow its approval retroactively. We do not consider that concern to be realistic. It is not every case that will lend itself to the granting of a s. 38 order *nunc pro tunc*. Circumstances alter cases: the facts presented in many cases may not engage the discretion of the court to make such an order, whereas the facts presented in others may invite the exercise of that discretion. The present case falls into the latter category. This action (to which, it should be recalled, the trustee was a party from its inception [as a defendant]) proceeded for more than four years without objection by the appellants. Such objection was first raised the day before the scheduled pretrial conference, on the eve of the expiry, of the limitation period. In the words of Lax J., it was first put forward "only after much time and money had been expended by all parties to the litigation . . . [despite the fact that] the defendant Peat, as trustee of the bankrupt's estate, must have known of the absence of a s. 38 order". In these circumstances, it was open to Lax J. to exercise her discretion as she did, and we are not persuaded that she made any error in so doing.

[Emphasis added]

(e) Conclusion - Nullity or Irregularity

[47] It is apparent from the authorities to which I have referred that the courts are moving away from a strict approach to the interpretation and application of s. 38 toward a more flexible approach more in keeping with that espoused by the Supreme Court of Canada in ***Marquette & Fils***, *supra*. This trend has resulted in the courts treating some or all of the steps set forth in s. 38 as being of a procedural, rather than a substantive nature. As a consequence, failure to comply, or incomplete compliance, with those steps has been treated as an irregularity which the court has the power to cure in appropriate circumstances. In my view, this is a salutary development since it permits the court to decide actions on their merits in circumstances in which the court is satisfied that non-compliance with s. 38 has not resulted in prejudice to any party or to other creditors of the bankrupt.

[48] The purpose of s. 38 of the ***BIA*** is to permit a creditor, or creditors, of the bankrupt to pursue actions in their own name and at their own expense and risk where the trustee has refused or failed to do so. A narrow interpretation of s. 38, which treats each of the steps set forth in it as a condition precedent to a valid action, is contrary to this purpose since it renders actions which have not been taken in strict compliance with s. 38 a nullity, without regard to whether anyone has been prejudiced by the non-compliance.

[49] In my view, the approach to the interpretation of s. 38 expressed by Mr. Justice Whalen in the following passages from ***Penfold v. Provenzano*** (1996), 42 C.B.R. (3d) 148, at paras. 16 and 18 (Ont. Gen. Div.), quoted with approval by Madam Justice Lax at para. 17 of ***DeGroote***, *supra*, is apposite:

> To begin with, I agree the interpretation of Section 38 should be large and liberal, in favour of its intended purposes and beneficiaries. Section 12 of the *Interpretation Act, 1985*, R.S.C. I-21 provides:
>
> > 12. Every enactment is deemed remedial and shall be given such fair, large and liberal construction and interpretation as best ensures the attainment of its objects.
>
> * * *
>
> If the creditors seeking the benefit of Section 38 fail, then they do so at their own risk, without consequence to the trustee or bankrupt. Therefore, a liberal interpretation of Section 38 accommodates the purposes intended and without prejudice to the bankrupt (in this case, the defendants). The contrasting, narrow approach proposed in the *B.N.R. Holdings Ltd.* case is interpretively inconsistent with these purposes.

[50] I also agree with the view expressed by the trial judge in ***Toyota Canada*** that the purpose of s. 38 is to protect the rights of creditors of the bankrupt to sue in the event of a refusal or failure of the trustee to act. In addition, s. 38 endeavours to treat all creditors equally by providing that they be given notice so that they may decide whether they wish to participate in the action.

[51] Nor am I persuaded that treating a failure to comply with s. 38 as an irregularity capable of being cured will operate as an open invitation to creditors to ignore s. 38. Non-compliance will invariably jeopardize the right of the creditor to continue with the action in the event that the failure has resulted in significant prejudice to a party to the action or to another creditor.

[52] In this case, all of the concerns raised by counsel for the McCarthys as to the dire consequences which will flow from taking a more liberal approach to the interpretation and application of s. 38 turn on potential prejudice to others. These concerns are matters well suited to resolution by the exercise of the trial judge's discretion in deciding whether the curative provisions of the ***BIA*** should be applied.

[53] In the result, I am persuaded that the preferred approach to the interpretation and application of s. 38 is the more liberal and flexible approach adopted by the Courts of Appeal in Quebec, Alberta and Ontario. Of those decisions, the facts in ***Re Montego Forest Products*** most closely resemble those here.

[54] In this case, the trial judge adopted the approach to the interpretation of s. 38 established by this Court in ***B.N.R. Holdings***, as he was bound to do. Because I am of the view that this approach should no longer be applied, I would set aside the finding of the trial judge that the failure of the

appellants to comply strictly with s. 38 deprived them of standing to bring the action. Rather, I conclude that the non-compliance in this case amounted to an irregularity within the meaning of s. 187(9) which was capable of being cured by a variation of the order under s. 187(5).

[55] The next question which then arises is whether the trial judge erred in his alternative finding that, assuming he had a discretion to cure the irregularity, he would not have exercised it in favour of the appellants.

(f) Application of s. 187(5) and (9)

[56] The appellants relied on a combination of s. 187(5) and (9) of the ***BIA*** in asking the trial judge to cure the defect by amending the s. 38 order obtained before Mr. Justice Macdonald *nunc pro tunc*. The application of these curative provisions in any particular case is discretionary.

[57] In deciding whether the trial judge erred in the exercise of his discretion, the standard of review which this Court must apply is that set forth in such cases as ***Elsom v. Elsom***, [1989] 1 S.C.R. 1367, where Mr. Justice Gonthier, speaking for the court, stated that an appellate court should not interfere with the exercise of a trial judge's discretion unless the trial judge has misdirected himself or unless his decision is so clearly wrong as to amount to an injustice.

[58] In this case, the trial judge gave two reasons for refusing to exercise his discretion in favour of the appellants. First, he relied on the appellants' delay in seeking to resolve the issue of standing despite early notice that this was an issue. Second, he found that other creditors of Mr. McCarthy may have been prejudiced by the fact that the appellants had not specified in the order the precise action they were seeking to pursue.

[59] In my view, the second reason given by the trial judge for refusing to exercise his discretion in favour of the appellants is flawed. The materials before the trial judge were such that it could not reasonably be said that any of the creditors were prejudiced by the failure of the appellants to specify the precise action they intended to commence pursuant to the s. 38 order. As noted earlier, the two transactions that the appellants were seeking to pursue were identified in the materials filed in support of the order. Those materials were served on the creditors, together with an invitation to contact the solicitor for the appellants if they had any questions. Of the creditors served, only Jaston expressed any interest in participating in an action against the McCarthys. The action commenced by the appellants claimed relief limited to setting aside the transactions referred to in the materials served on the creditors. I am unable to see how any of them could have been misled in these circumstances. Even if the order requested and granted could be viewed as enabling the

appellants to commence actions beyond setting aside the two transactions referred to in the materials filed in support of it, application of the curative provision would have narrowed the scope of the order to restrict the action to those transactions. This could only have operated to the benefit of the creditors.

[60] The fact that the creditors did not express any interest in participating in the action when served with notice of the second order under s. 38 (which correctly identified the action the appellants were seeking to pursue) also lends support to the conclusion that they were not prejudiced by the defect in the original order.

[61] Since I have concluded that the trial judge erred in one of the two bases upon which he declined to exercise his discretion in favour of the appellants, it is open to this Court to make the order that the trial judge should have made. While I agree with the chambers judge that it would have been preferable for the appellants to have taken steps to clarify the issue of standing prior to trial, it was also open to the McCarthys to do so. Delay in moving to resolve that issue is not, in itself, a sufficient basis for refusing to amend the order. Prejudice to one of the parties or to the creditors would be a proper basis for refusing to do so. In this case, however, I am unable to find that there would be any prejudice to a party or to any of the creditors in varying the original

order *nunc pro tunc* to specify the cause of action which was in fact pursued. On the other hand, there would be serious prejudice to the appellants in refusing to do so, given the findings of the trial judge in their favour on the merits of the action, at least in relation to the impugned share transaction.

[62] In the result, I would make an order that the order of Macdonald J. be amended, *nunc pro tunc*, to provide, in part, as follows:

> THIS COURT ORDERS that Mulholland Webster and Jaston & Company Limited be and are hereby authorized to take proceedings in their own names and at their own expense and risk, for the purpose of setting aside the transfer by John Howard McCarthy to Carol Anne McCarthy of his shares in McCarthy Realty (72) Ltd. and Dev-Gro Holdings Ltd., as a fraudulent conveyance pursuant to the *Fraudulent Conveyance Act*, R.S.B.C. 1979, c. 142, as amended, and ancillary relief in relation thereto.
>
> THIS COURT FURTHER ORDERS that Mulholland Webster and Jaston & Company Limited be and are hereby authorized to take proceedings in their own names and at their own expense and risk, for the purpose of setting aside a mortgage granted by John Howard McCarthy and Carol Anne McCarthy to Marjory Irene McCarthy, which mortgage is dated August 24, 1989 and was registered in the Vancouver Land Registry office on March 9, 1990, pursuant to s. 95 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3.
>
> THIS COURT FURTHER ORDERS that any benefit derived from the proceedings taken pursuant to the preceding two paragraphs, to the extent of their claims and the costs, belong exclusively to Mulholland Webster and Jaston & Company Limited, and the surplus, if any, belongs to the estate of John Howard McCarthy, in bankruptcy.

Once the amended order is entered, the appellants should seek an assignment from the trustee consistent with the wording of the order.

(2) <u>The Merits of the Action</u>

[63] The trial judge found that the transaction whereby Mr. McCarthy transferred all of his shares in McCarthy Realty (72) Ltd. and Dev-Gro Holdings Ltd. to Ms. McCarthy was a fraudulent conveyance contrary to the ***Fraudulent Conveyance Act***. This finding is not challenged on appeal.

[64] The appellants, however, submitted that the trial judge erred in finding that a mortgage granted by Mr. and Ms. McCarthy to Mrs. McCarthy Sr. in the amount of $180,000 did not amount to a fraudulent preference contrary to s. 95 of the ***BIA***. In particular, the appellants submitted that the trial judge erred in finding that the mortgage was executed on August 24, 1989 rather than on March 9, 1990. If the mortgage had been executed on the latter date, it would have fallen within the one-year period during which transactions between related parties could successfully be attacked by virtue of a combination of ss. 95 and 96 of the ***BIA***. Those sections provide, in part, as follows:

> 95. (1) Every conveyance or transfer of property or charge thereon made, every payment made,

> every obligation incurred and every judicial proceeding taken or suffered by any insolvent person in favour of any creditor or of any person in trust for any creditor with a view to giving that creditor a preference over the other creditors is, where it is made, incurred, taken or suffered within the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date the insolvent person became bankrupt, both dates included, deemed fraudulent and void as against the trustee in the bankruptcy.
>
> (2) Where any conveyance, transfer, charge, payment, obligation or judicial proceeding mentioned in subsection (1) has the effect of giving any creditor a preference over other creditors, or over any one or more of them, it shall be presumed, in the absence of evidence to the contrary, to have been made, incurred, taken, paid or suffered with a view to giving the creditor a preference over other creditors, whether or not it was made voluntarily or under pressure and evidence of pressure shall not be admissible to support the transaction.
>
> . . .
>
> 96. Where the conveyance, transfer, charge, payment, obligation or judicial proceeding mentioned in section 95 is in favour of a person related to the insolvent person, the period referred to in subsection 95(1) shall be one year instead of three months.

[65] Counsel for the appellants referred to evidence from which the trial judge could have inferred that the mortgage was executed on March 9, 1990, including the fact that the mortgage was registered on that date. Counsel also submitted that the trial judge's negative findings regarding the credibility of Mr. and Ms. McCarthy with respect to other aspects of their testimony should have raised grave suspicions in his mind concerning their credibility with respect to the impugned

mortgage transaction, so as to give rise to a *prima facie* case of fraud.

[66] The trial judge dealt with each of the arguments raised by the appellants in support of their position that the mortgage had been executed on March 9, 1990. After a thorough review of the evidence in that regard, including documents supporting Mr. and Mrs. McCarthy's evidence about the date the mortgage was executed, he concluded that it was executed on the date on its face, namely, August 24, 1989. Evidence of the solicitor before whom Mr. and Mrs. McCarthy executed the mortgage regarding his usual practice in attending to the execution of mortgages supported this conclusion.

[67] Counsel for the appellants drew our attention to a second date stamp on the mortgage bearing the date March 9, 1990. This date stamp was not put to any witness at trial, nor was it drawn to the attention of the trial judge. Its significance, therefore, is unknown. It is not improbable that it was placed on the document at the time the document was accepted for registration. In any event, it does not provide a reliable basis for overturning the decision of the trial judge on this issue.

[68] As has been stated on many occasions, it is not the function of this Court to substitute findings of fact or credibility for those of a trial judge in the absence of

palpable and overriding error. In my view, the finding of the trial judge with respect to the date the mortgage was executed was supported by the evidence and cannot be said to be the product of palpable and overriding error.

[69] In the result, I would dismiss this ground of appeal.

CONCLUSION

[70] I would allow the appeal to the extent of setting aside the order dismissing the action, amending the order of Mr. Justice Macdonald dated February 4, 1992, *nunc pro tunc*, as set forth in para. 62 of these reasons, and making a further order including the following provisions:

(a) a declaration and order that the transfer of the shares of John Howard McCarthy in McCarthy Realty (72) Ltd. and in Dev-Gro Holdings Ltd. to Carol Anne Mccarthy are fraudulent transfers pursuant to the Fraudulent Conveyance Act and void and of no effect as against Jaston & Company Limited and Mulholland Webster;

(b) an accounting of the assets of McCarthy Realty (72) Ltd. and Dev-Gro Holdings Ltd. subsequent to May 1, 1988, and their disposition thereafter;

(c) such further and other orders as are necessary to give effect to the orders set forth in paras. (a) and (b).

[71] Subsequent to the hearing of this appeal, counsel provided submissions with respect to what further directions, if any, should be provided to the Supreme Court for the purpose of

giving effect to the judgment of this Court. In my view, it would be preferable to leave the specific form of order arising from the setting aside of these transactions to the Supreme Court to be dealt with on the basis of further submissions before that court.

[72] With respect to the issue of costs, there was divided success. Further, it was the failure of the appellants to obtain the proper form of order in the first instance which gave rise to the issue of standing at trial and led to the necessity of this appeal. For that reason, I would order each party to bear its own costs, both of the trial and of the appeal.

"The Honourable Madam Justice Prowse"

I AGREE: "The Honourable Mr. Justice Donald"

I AGREE: "The Honourable Madam Justice Huddart"

I AGREE: "The Honourable Mr. Justice Braidwood"

I AGREE: "The Honourable Madam Justice Proudfoot"

TAB 13

In the Court of Appeal of Alberta

Citation: Terrigno v Butzner, 2023 ABCA 124

Date: 20230411
Docket: 2201-0101AC
Registry: Calgary

Between:

Mike Terrigno

Appellant

- and -

Decker Butzner

Respondent

- and -

Terrigno Investments Inc.

Not a Party to the Appeal

The Court:

The Honourable Justice Peter Martin
The Honourable Justice Bernette Ho
The Honourable Justice Anne Kirker

Memorandum of Judgment

Appeal from the Order by
The Honourable Justice R. Hall
Dated the 4th day of April, 2022
(Docket: 1701 02748)

Memorandum of Judgment

The Court:

Introduction

[1] The appellant, Mr. Terrigno, has brought a claim in defamation against the respondent, Dr. Butzner, arising out of an alleged incident between the appellant and the respondent; the respondent maintains the appellant threatened him outside of a City of Calgary Planning Commission meeting. The incident was reported to the Law Society of Alberta because the appellant was a student-at-law at the time. The Law Society conducted an investigation and prepared a report.

[2] The appellant appeals an order of a case management judge that requires the entirety of pages 1 to 30 (an executive summary) and documents contained behind tabs 19 to 23 of the investigation report be produced in the defamation action. The appellant maintains that the case management judge erred in two primary ways: (i) he applied the wrong legal test when considering whether the records should be produced, and (ii) he denied the appellant procedural fairness by ordering the production of records beyond what the respondent asked for at first instance.

The Production of Records

[3] The respondent sought to have the Law Society's investigation file produced in the defamation action. The Law Society did not object to production but sought a court order to maintain the confidentiality of its records for other purposes. The case management judge conducted a hearing and put in place a process which saw the Law Society provide portions of the investigation file to him for review for relevance and privilege.

[4] In a January 5, 2022 Order (the January Order), the case management judge ordered the Law Society to produce its "entire, unredacted investigative file ... to the parties, except for records over which solicitor-client privilege is claimed or may be claimed and any compelled statements provided by Terrigno". Before such records were provided to the respondent, they were to be provided to the case management judge for review and a determination on whether the records were subject to privilege and whether they were "relevant, material, and producible" in the action. The January Order further provided that any party could apply to have other records reviewed for a final determination by the case management judge with respect to "relevance, materiality, and privilege".

[5] The case management judge considered the appellant's specific objections and, in an April 4, 2022 Endorsement (the Endorsement) he determined that parts of the investigative file need not be produced because the records were irrelevant. He ordered that other parts be produced as they are potentially relevant to the issues in dispute in the defamation action.

[6] The appellant maintains that the case management judge applied the wrong test by considering whether the records are "potentially relevant" rather than whether they are relevant and material, and that he failed to weigh the prejudice associated with releasing the records, relying on *R v Handy*, 2002 SCC 56. He argues that the case management judge failed to consider privacy interests and inefficiencies that will be introduced in the litigation. Finally, he maintains that the case management judge failed to give adequate reasons in addressing the production of records, as he addressed only the "bottom line".

[7] The respondent's application before the case management judge was made pursuant to Rule 5.13 of the *Alberta Rules of Court*, Alta Reg 124/2010 which addresses third-party production. A court may order the third party to produce a record if the record is under control of that person, there is a reason to believe that the record is relevant and material, and the person who has control of the record might be required to produce it at trial. The test for whether a record is relevant and material is governed by Rule 5.2: *Dow Chemical Canada ULC v Nova Chemicals Corporation*, 2014 ABCA 244 at paras 16 and 17.

[8] Rule 5.2 provides that:

> …a question, record or information is relevant and material only if the answer to the question, or the record or information, could reasonably be expected
>
> (a) to significantly help determine one or more of the issues raised in the pleadings, or
>
> (b) to ascertain evidence that could reasonably be expected to significantly help determine one or more of the issues raised in the pleadings.

[9] Relevance is determined primarily by the pleadings and materiality relates to whether the information can help, directly or indirectly, to prove a fact in issue: *Dow Chemical* at para 17. There is no fixed standard as to what is material and an element of judgment is required: *Dow Chemical* at para 19.

[10] The production of records is a discretionary decision that is afforded deference on appeal. Absent an error of law or a palpable and overriding error, an appeal court should not interfere with the decision of a case management judge: *Kennedy v Swientach*, 2022 ABCA 161 at paras 12-13; *Geophysical Service Incorporated v Husky Oil Limited*, 2013 ABCA 99 at para 17; *The Blood Tribe v Canada (Attorney General)*, 2010 ABCA 112 at para 13.

[11] It is clear from both the January Order and the Endorsement that the case management judge was alive to the requirements of the *Alberta Rules of Court* regarding relevance, materiality and privilege in the production of records. On this record, we are not satisfied that his use of the words "potentially relevant" reveals an error of law. The case management judge did not apply the wrong legal test when reviewing the records sought by the respondent.

[12] The appellant's action is based on defamation. Paragraph 46 of the Amended Amended Amended Statement of Claim asserts that the appellant has and continues to suffer injury, loss and damage as a result of the respondent's actions, including substantial and persisting injury to reputation, as well as injury to the appellant's professional and personal relationships. Given the scope of the pleadings, we see no reviewable error in the case management judge's assessment that the investigative report of the Law Society is relevant and material to the issues raised in the action. Likewise, we see no reviewable error in his assessment that the documents under Tabs 19 to 23 are relevant and material, given the nature of the issues raised by the pleadings in the action.

[13] We decline to interfere with the case management judge's exercise of discretion and consider his reasons to be sufficient having regard for the entire context and the full record before him: *Davidson v 1773907 Alberta Ltd*, 2017 ABCA 267 at paras 20-25.

Procedural Fairness

[14] The appellant also argues that the case management judge erred in ordering the production of information that relates to a different disciplinary matter unrelated to the incident in dispute in the current action, which was broader than what the respondent sought in his initial application. In this way, the appellant submits he was denied procedural fairness because he was unable to respond fully and properly.

[15] The respondent's application for the production of records from third parties sought the following at paragraph 1(a):

> With respect to the Law Society, it shall produce its unredacted investigative file with respect to the Plaintiff, Mike Terrigno, following the incident on February 26, 2015 including, but not limited to, investigative notes and reports, the complete transcript from the Application, Dr. Buztner's interview on March 9, 2015, Dr. Butzner's police statement provided to the Law Society, additional witness statements, and the date in which these records were released to Terrigno; …

[16] The application also provided at paragraph 22:

> The Law Society's file pertaining to Terrigno in its complete and unredacted form as well as the date in which it was provided to Terrigno is:
>
> (a) Under the care and control of the Law Society;
>
> (b) Relevant and material to the issues of this Action, and can reasonably be expected to help determine one or more of the issues raised in the pleadings and identify additional witnesses who were also interviewed by the Law Society about Terrigno's behaviour;

(c) Likely to contain important information related to liability and damages; and

(d) Relevant and material and will assist in the fair determination of the Action.

[17] Given the above language, we do not accept the appellant's submission regarding the limited scope of the respondent's application at first instance.

[18] Moreover, it is clear from the transcript that the appellant was aware of what was being sought and discussed before the case management judge. The appellant was fully engaged in making submissions, and he did not seek an adjournment or allege in the court below that he needed additional time to file further submissions.

[19] There is no merit to the appellant's allegation that he was denied procedural fairness in the court below. This ground of appeal is dismissed.

Conclusion

[20] The appeal is dismissed. The records that are contained within the appellant's confidential Extracts of Key Evidence shall be released to the respondent's counsel.

[21] As the successful party on this application, the respondent is granted costs in accordance with Schedule C, Column 2, less $1,685 representing costs awarded to the appellant in relation to his prior successful application for a sealing order.

Appeal heard on March 30, 2023

Memorandum filed at Calgary, Alberta
this 11th day of April, 2023

Authorized to sign for: Martin J.A.

Ho J.A.

Kirker J.A.

Appearances:

Appellant, M. Terrigno

D.W. Dear, K.C.
for the Respondent