Court of Appeal File No: C66871
Court File Nos. 35-2395487 and 35-2395481

COURT OF APPEAL FOR ONTARIO

IN THE MATTER OF NOTICES OF INTENTION TO MAKE A PROPOSAL OF 1732427 ONTARIO INC. AND 1787930 ONTARIO INC. BOTH OF THE CITY OF ST. THOMAS, IN THE PROVINCE OF ONTARIO

APPELLANT'S BOOK OF AUTHORITIES

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McLachlin C.J.C., L'Heureux-Dubé, Gonthier, Iacobucci, Major, Bastarache, Binnie, Arbour, LeBel JJ.

Heard: October 2, 2001
Judgment: March 28, 2002 *
Docket: 27826

Proceedings: reversing [2000] 4 W.W.R. 173, 50 M.V.R. (3d) 70, 189 Sask. R. 51, 216 W.A.C. 51, 9 M.P.L.R. (3d) 126 (Sask. C.A.); reversed in part (1997), 161 Sask. R. 241, [1998] 5 W.W.R. 523, 44 M.P.L.R. (2d) 203 (Sask. Q.B.)

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Subject: Public; Civil Practice and Procedure; Torts; Tax — Miscellaneous; Municipal

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***Iacobucci, Major JJ.*:**

I. Introduction

1 A proposition that should be unnecessary to state is that a court of appeal should not interfere with a trial judge's reasons unless there is a palpable and overriding error. The same proposition is sometimes stated as prohibiting an appellate court from reviewing a trial judge's decision if there was some evidence upon which he or she could have relied to reach that conclusion.

2 Authority for this abounds particularly in appellate courts in Canada and abroad (see *Gottardo Properties (Dome) Inc. v. Toronto (City)* (1998), 162 D.L.R. (4th) 574 (Ont. C.A.); *Schwartz v. R.*, [1996] 1 S.C.R. 254 (S.C.C.); *Toneguzzo-Norvell (Guardian ad litem of) v. Burnaby Hospital*, [1994] 1 S.C.R. 114 (S.C.C.); *Van de Perre v. Edwards*, [2001] 2 S.C.R. 1014, 2001 SCC 60 (S.C.C.)). In addition scholars, national and international, endorse it (see C. A. Wright in "The Doubtful Omniscience of Appellate Courts" (1957), 41 *Minn. L. Rev.* 751, at p. 780; and the Honourable R. P. Kerans in *Standards of Review Employed by Appellate Courts* (1994); and American Bar Association, Judicial Administration Division, *Standards Relating to Appellate Courts* (1995), at pp. 24-25).

3 The role of the appellate court was aptly defined in *Underwood v. Ocean City Realty Ltd.* (1987), 12 B.C.L.R. (2d) 199 (B.C. C.A.), at p. 204, where it was stated:

> The appellate court must not retry a case and must not substitute its views for the views of the trial judge according to what the appellate court thinks the evidence establishes on its view of the balance of probabilities.

4 While the theory has acceptance, consistency in its application is missing. The foundation of the principle is as sound today as 100 years ago. It is premised on the notion that finality is an important aim of litigation. There is no suggestion that appellate court judges are somehow smarter and thus capable of reaching a better result. Their role is not to write better judgments but to review the reasons in light of the arguments of the parties and the relevant evidence, and then to uphold the decision unless a palpable error leading to a wrong result has been made by the trial judge.

5 What is palpable error? The *New Oxford Dictionary of English* (1998) defines "palpable" as "clear to the mind or plain to see" (p. 1337). The *Cambridge International Dictionary of English* (1996) describes it as "so obvious that it can easily be seen or known" (p. 1020). *Random House Dictionary of the English Language* (2nd ed. 1987) defines it as "readily or plainly seen" (p. 1399).

6 The common element in each of these definitions is that palpable is plainly seen. Applying that to this appeal, in order for the Saskatchewan Court of Appeal to reverse the trial judge the "palpable and overriding" error of fact found by Cameron J.A. must be plainly seen. As we will discuss, we do not think that test has been met.

II. The Role of the Appellate Court in the Case at Bar

7 Given that an appeal is not a retrial of a case, consideration must be given to the applicable standard of review of an appellate court on the various issues which arise on this appeal. We therefore find it helpful to discuss briefly the standards of review relevant to the following types of questions: (1) questions of law; (2) questions of fact; (3) inferences of fact; and (4) questions of mixed fact and law.

A. Standard of Review for Questions of Law

8 On a pure question of law, the basic rule with respect to the review of a trial judge's findings is that an appellate court is free to replace the opinion of the trial judge with its own. Thus the standard of review on a question of law is that of correctness: *Kerans*, *supra*, at p. 90.

9 There are at least two underlying reasons for employing a correctness standard to matters of law. First, the principle of universality requires appellate courts to ensure that the same legal rules are applied in similar situations. The importance of this principle was recognized by this Court in *Woods Manufacturing Co. v. R.*, [1951] S.C.R. 504 (S.C.C.), at p. 515:

> It is fundamental to the due administration of justice that the authority of decisions be scrupulously respected by all courts upon which they are binding. Without this uniform and consistent adherence the administration of justice becomes disordered, the law becomes uncertain, and the confidence of the public in it undermined. Nothing is more important than that the law as pronounced ... should be accepted and applied as our tradition requires; and even at the risk of that fallibility to which all judges are liable, we must maintain the complete integrity of relationship between the courts.

A second and related reason for applying a correctness standard to matters of law is the recognized law-making role of appellate courts which is pointed out by *Kerans*, *supra*, at p. 5:

> The call for universality, and the law-settling role it imposes, makes a considerable demand on a reviewing court. It expects from that authority a measure of expertise about the art of just and practical rule-making, an expertise that is not so critical for the first court. Reviewing courts, in cases where the law requires settlement, make law for future cases as well as the case under review.

Thus, while the primary role of trial courts is to resolve individual disputes based on the facts before them and settled law, the primary role of appellate courts is to delineate and refine legal rules and ensure their universal application. In order to fulfill the above functions, appellate courts require a broad scope of review with respect to matters of law.

B. Standard of Review for Findings of Fact

10 The standard of review for findings of fact is that such findings are not to be reversed unless it can be established that the trial judge made a "palpable and overriding error": *Stein v. "Kathy K" (The)* (1975), [1976] 2 S.C.R. 802 (S.C.C.), at p. 808; *Ingles v. Tutkaluk Construction Ltd.*, [2000] 1 S.C.R. 298, 2000 SCC 12 (S.C.C.), at para. 42; *Ryan v. Victoria (City)*, [1999] 1 S.C.R. 201 (S.C.C.) , at para. 57. While this standard is often cited, the principles underlying this high degree of deference rarely receive mention. We find it useful, for the purposes of this appeal, to review briefly the various policy reasons for employing a high level of appellate deference to findings of fact.

11 A fundamental reason for *general* deference to the trial judge is the presumption of fitness — a presumption that trial judges are just as competent as appellate judges to ensure that disputes are resolved justly. Kerans, *supra*, at pp. 10-11, states that:

> If we have confidence in these systems for the resolution of disputes, we should assume that those decisions are just. The appeal process is part of the decisional process, then, only because we recognize that, despite all effort, errors occur. An appeal should be the exception rather than the rule, as indeed it is in Canada.

12 With respect to findings of fact in *particular*, in *Gottardo Properties*, *supra*, Laskin J.A. summarized the purposes underlying a deferential stance as follows (at para. 48):

> Deference is desirable for several reasons: to limit the number and length of appeals, to promote the autonomy and integrity of the trial or motion court proceedings on which substantial resources have been expended, to preserve the confidence of litigants in those proceedings, to recognize the competence of the trial judge or motion judge and to reduce needless duplication of judicial effort with no corresponding improvement in the quality of justice.

Similar concerns were expressed by La Forest J. in *Schwartz*, *supra*, at para. 32:

> It has long been settled that appellate courts must treat a trial judge's findings of fact with great deference. The rule is principally based on the assumption that the trier of fact is in a privileged position to assess the credibility of witnesses' testimony at trial. ... Others have also pointed out additional judicial policy concerns to justify the rule. Unlimited intervention by appellate courts would greatly increase the number and the length of appeals generally. Substantial resources are allocated to trial courts to go through the process of assessing facts. The autonomy and integrity of the trial process must be preserved by exercising deference towards the trial courts' findings of fact; see R. D. Gibbens, "Appellate Review of Findings of Fact" (1992), 13 *Adv. Q.* 445, at pp. 445-48; *Fletcher v. Manitoba Public Insurance Co.*, [1990] 3 S.C.R. 191, at p. 204.

See also in the context of patent litigation, *Consolboard Inc. v. MacMillan Bloedel (Sask.) Ltd.*, [1981] 1 S.C.R. 504 (S.C.C.), at p. 537.

13 In *Anderson v. Bessemer (City)*, 470 U.S. 564 (U.S. N.C. 1985), at pp. 574 -75, the United States Supreme Court also listed numerous reasons for deferring to the factual findings of the trial judge:

> The rationale for deference to the original finder of fact is not limited to the superiority of the trial judge's position to make determinations of credibility. The trial judge's major role is the determination of fact, and with experience in fulfilling that role comes expertise. Duplication of the trial judge's efforts in the court of appeals would very likely contribute only negligibly to the accuracy of fact determination at a huge cost in diversion of judicial resources. In addition, the parties to a case on appeal have already been forced to concentrate their energies and resources on persuading the trial judge that their account of the facts is the correct one; requiring them to persuade three

> more judges at the appellate level is requiring too much. As the Court has stated in a different context, the trial on the merits should be "the 'main event' ... rather than a 'tryout on the road.'" ... For these reasons, review of factual findings under the clearly-erroneous standard — with its deference to the trier of fact — is the rule, not the exception.

14 Further comments regarding the advantages possessed by the trial judge have been made by R. D. Gibbens in "Appellate Review of Findings of Fact" (1992), 13 *Adv. Q.* 445, at p. 446:

> The trial judge is said to have an expertise in assessing and weighing the facts developed at trial. Similarly, the trial judge has also been exposed to the entire case. The trial judge has sat through the entire case and his ultimate judgment reflects this total familiarity with the evidence. The insight gained by the trial judge who has lived with the case for several days, weeks or even months may be far deeper than that of the Court of Appeal whose view of the case is much more limited and narrow, often being shaped and distorted by the various orders or rulings being challenged.

The corollary to this recognized advantage of trial courts and judges is that appellate courts are *not* in a favourable position to assess and determine factual matters. Appellate court judges are restricted to reviewing written transcripts of testimony. As well, appeals are unsuited to reviewing voluminous amounts of evidence. Finally, appeals are telescopic in nature, focussing narrowly on particular issues as opposed to viewing the case as a whole.

15 In our view, the numerous bases for deferring to the findings of fact of the trial judge which are discussed in the above authorities can be grouped into the following three basic principles.

(1) Limiting the Number, Length and Cost of Appeals

16 Given the scarcity of judicial resources, setting limits on the scope of judicial review is to be encouraged. Deferring to a trial judge's findings of fact not only serves this end, but does so on a principled basis. Substantial resources are allocated to trial courts for the purpose of assessing facts. To allow for wide-ranging review of the trial judge's factual findings results in needless duplication of judicial proceedings with little, if any improvement in the result. In addition, lengthy appeals prejudice litigants with fewer resources, and frustrate the goal of providing an efficient and effective remedy for the parties.

(2) Promoting the Autonomy and Integrity of Trial Proceedings

17 The presumption underlying the structure of our court system is that a trial judge is competent to decide the case before him or her, and that a just and fair outcome will result from the trial process. Frequent and unlimited appeals would undermine this presumption and weaken public confidence in the trial process. An appeal is the exception rather than the rule.

(3) Recognizing the Expertise of the Trial Judge and His or Her Advantageous Position

18 The trial judge is better situated to make factual findings owing to his or her extensive exposure to the evidence, the advantage of hearing testimony *viva voce*, and the judge's familiarity with the case as a whole. Because the primary role of the trial judge is to weigh and assess voluminous quantities of evidence, the expertise and insight of the trial judge in this area should be respected.

C. Standard of Review for Inferences of Fact

19 We find it necessary to address the appropriate standard of review for factual inferences because the reasons of our colleague suggest that a lower standard of review may be applied to the inferences of fact drawn by a trial judge. With respect, it is our view, that to apply a lower standard of review to inferences of fact would be to depart from established jurisprudence of this Court, and would be contrary to the principles supporting a deferential stance to matters of fact.

20 Our colleague acknowledges that, in *Goodman Estate v. Geffen*, [1991] 2 S.C.R. 353 (S.C.C.), this Court determined that a trial judge's inferences of fact and findings of fact should be accorded a similar degree of deference. The relevant passage from *Geffen* is the following (*per* Wilson J., at pp. 388-89):

> It is by now well established that findings of fact made at trial based on the credibility of witnesses are not to be reversed on appeal unless it is established that the trial judge made some palpable and overriding error which affected his assessment of the facts. ... Even where a finding of fact is not contingent upon credibility, this Court has maintained a non-interventionist approach to the review of trial court findings. ...
>
> And even in those cases where a finding of fact is neither inextricably linked to the credibility of the testifying witness nor based on a misapprehension of the evidence, the rule remains that appellate review should be limited to those instances where a manifest error has been made. Hence, in *Schreiber Brothers Ltd. v. Currie Products Ltd.*, [1980] 2 S.C.R. 78, this Court refused to overturn a trial judge's finding that certain goods were defective, stating at pp. 84-85 that it is wrong for an appellate court to set aside a trial judgment where the only point at issue is the interpretation of the evidence as a whole (citing *Métivier v. Cadorette*, [1977] 1 S.C.R. 371).

This view has been reiterated by this Court on numerous occasions: see *Palsky v. Humphrey*, [1964] S.C.R. 580 (S.C.C.), at p. 583; *Schwartz*, *supra*, at para. 32; *Hodgkinson v. Simms*, [1994] 3 S.C.R. 377 (S.C.C.), at p. 426, *per* La Forest J.; *Toneguzzo-Norvell*, *supra*. The United States Supreme Court has taken a similar position: see *Anderson*, *supra*, at p. 577.

21 In discussing the standard of review of the trial judge's inferences of fact, our colleague states, at para. 103, that:

> In reviewing the making of an inference, the appeal court will verify whether it can reasonably be supported by the findings of fact that the trial judge reached and whether the judge proceeded on proper legal principles. ... While the standard of review is identical for both findings of fact and inferences of fact, it is nonetheless important to draw an analytical distinction between the two. If the reviewing court were to review only for errors of fact, then the decision of the trial judge would necessarily be upheld in every case where evidence existed to support his or her factual findings. In my view, this Court is entitled to conclude that inferences made by the trial judge were clearly wrong, just as it is entitled to reach this conclusion in respect to findings of fact. [Emphasis added.]

With respect, we find two problems with this passage. First, in our view, the standard of review is not to verify that the inference can be *reasonably supported* by the findings of fact of the trial judge, but whether the trial judge made a *palpable and overriding* error in coming to a factual conclusion based on accepted facts, which implies a stricter standard.

22 Second, with respect, we find that by drawing an analytical distinction between factual findings and factual inferences, the above passage may lead appellate courts to involve themselves in an unjustified reweighing of the evidence. Although we agree that it is open to an appellate court to find that an inference of fact made by the trial judge is clearly wrong, we would add the caution that where evidence exists to support this inference, an appellate court will be hard pressed to find a palpable and overriding error. As stated above, trial courts are in an advantageous position when it comes to assessing and weighing vast quantities of evidence. In making a factual inference, the trial judge must sift through the relevant facts, decide on their weight, and draw a factual conclusion. Thus, where evidence exists which supports this conclusion, interference with this conclusion entails interference with the weight assigned by the trial judge to the pieces of evidence.

23 We reiterate that it is not the role of appellate courts to second-guess the weight to be assigned to the various items of evidence. If there is no palpable and overriding error with respect to the underlying facts that the trial judge relies on to draw the inference, then it is only where the *inference-drawing process itself* is palpably in error that an appellate court can interfere with the factual conclusion. The appellate court is not free to interfere with a factual conclusion that it disagrees with where such disagreement stems from a difference of opinion over the weight to be assigned to the underlying facts. As we discuss below, it is our respectful view that our colleague's finding that the trial judge erred by

imputing knowledge of the hazard to the municipality in this case is an example of this type of impermissible interference with the factual inference drawn by the trial judge.

24 In addition, in distinguishing inferences of fact from findings of fact, our colleague states, at para. 102, that deference to findings of fact is "principally grounded in the recognition that only the trial judge enjoys the opportunity to observe witnesses and to hear testimony first-hand", a rationale which does not bear on factual inferences. With respect, we disagree with this view. As we state above, there are numerous reasons for showing deference to the factual findings of a trial judge, many of which are equally applicable to all factual conclusions of the trial judge. This was pointed out in *Schwartz*, *supra*. After listing numerous policy concerns justifying a deferential approach to findings of fact, at para. 32 La Forest J. goes on to state:

> This explains why the rule [that appellate courts must treat a trial judge's findings of fact with great deference] applies not only when the credibility of witnesses is at issue, although in such a case it may be more strictly applied, but also to all conclusions of fact made by the trial judge. [Emphasis added.]

Recent support for deferring to all factual conclusions of the trial judge is found in *Toneguzzo-Norvell*, *supra*. McLachlin J. (as she then was) for a unanimous Court stated, at pp. 121-22:

> A Court of Appeal is clearly not entitled to interfere merely because it takes a different view of the evidence. The finding of facts and the drawing of evidentiary conclusions from facts is the province of the trial judge, not the Court of Appeal.
>
> . . . . .
>
> I agree that the principle of non-intervention of a Court of Appeal in a trial judge's findings of facts does not apply with the same force to inferences drawn from conflicting testimony of expert witnesses where the credibility of these witnesses is not in issue. This does not however change the fact that the weight to be assigned to the various pieces of evidence is under our trial system essentially the province of the trier of fact, in this case the trial judge. [Emphasis added.]

We take the above comments of McLachlin J. to mean that, although the same high standard of deference applies to the entire range of factual determinations made by the trial judge, where a factual finding is grounded in an assessment of credibility of a witness, the overwhelming advantage of the trial judge in this area must be acknowledged. This does not, however, imply that there is a lower standard of review where witness credibility is not in issue, or that there are not numerous policy reasons supporting deference to all factual conclusions of the trial judge. In our view, this is made clear by the underlined portion of the above passage. The essential point is that making a factual conclusion, of any kind, is inextricably linked with assigning weight to evidence, and thus attracts a deferential standard of review.

25 Although the trial judge will always be in a distinctly privileged position when it comes to assessing the credibility of witnesses, this is not the *only* area where the trial judge has an advantage over appellate judges. Advantages enjoyed by the trial judge with respect to the drawing of factual inferences include the trial judge's relative expertise with respect to the weighing and assessing of evidence, and the trial judge's inimitable familiarity with the often vast quantities of evidence. This extensive exposure to the entire factual nexus of a case will be of invaluable assistance when it comes to drawing factual conclusions. In addition, concerns with respect to cost, number and length of appeals apply equally to inferences of fact and findings of fact, and support a deferential approach towards both. As such, we respectfully disagree with our colleague's view that the *principal* rationale for showing deference to findings of fact is the opportunity to observe witnesses first-hand. It is our view that the trial judge enjoys numerous advantages over appellate judges which bear on *all* conclusions of fact, and, even in the absence of these advantages, there are other compelling policy reasons supporting a deferential approach to inferences of fact. We conclude, therefore, by emphasizing that there is one, and only one, standard of review applicable to all factual conclusions made by the trial judge — that of palpable and overriding error.

D. Standard of Review for Questions of Mixed Fact and Law

26 At the outset, it is important to distinguish questions of mixed fact and law from factual findings (whether direct findings or inferences). Questions of mixed fact and law involve applying a legal standard to a set of facts: *Canada (Director of Investigation & Research) v. Southam Inc.*, [1997] 1 S.C.R. 748 (S.C.C.), at para. 35. On the other hand, factual findings or inferences require making a conclusion of fact based on a set of facts. Both mixed fact and law and fact findings often involve drawing inferences; the difference lies in whether the inference drawn is legal or factual. Because of this similarity, the two types of questions are sometimes confounded. This confusion was pointed out by A. L. Goodhart in "Appeals on Questions of Fact" (1955), 71 *L.Q.R.* 402, at p. 405:

> The distinction between [the perception of facts and the evaluation of facts] tends to be obfuscated because we use such a phrase as "the judge found as a fact that the defendant had been negligent," when what we mean to say is that "the judge found as a fact that the defendant had done acts A and B, and as a matter of opinion he reached the conclusion that it was not reasonable for the defendant to have acted in that way."

In the case at bar, there are examples of both types of questions. The issue of whether the municipality ought to have known of the hazard in the road involves weighing the underlying facts and making factual findings as to the knowledge of the municipality. It also involves applying a legal standard, which in this case is provided by s. 192(3), to these factual findings. Similarly, the finding of negligence involves weighing the underlying facts, making factual conclusions therefrom, and drawing an inference as to whether or not the municipality failed to exercise the legal standard of reasonable care and therefore was negligent.

27 Once it has been determined that a matter being reviewed involves the application of a legal standard to a set of facts, and is thus a question of mixed fact and law, then the appropriate standard of review must be determined and applied. Given the different standards of review applicable to questions of law and questions of fact, it is often difficult to determine what the applicable standard of review is. In *Southam*, *supra*, at para. 39, this Court illustrated how an error on a question of mixed fact and law can amount to a pure error of law subject to the correctness standard:

> ... if a decision-maker says that the correct test requires him or her to consider A, B, C, and D, but in fact the decision-maker considers only A, B, and C, then the outcome is as if he or she had applied a law that required consideration of only A, B, and C. If the correct test requires him or her to consider D as well, then the decision-maker has in effect applied the wrong law, and so has made an error of law.

Therefore, what appears to be a question of mixed fact and law, upon further reflection, can actually be an error of pure law.

28 However, where the error does not amount to an error of law, a higher standard is mandated. Where the trier of fact has considered all the evidence that the law requires him or her to consider and still comes to the wrong conclusion, then this amounts to an error of mixed law and fact and is subject to a more stringent standard of review: *Southam*, *supra*, at paras. 41 and 45. While easy to state, this distinction can be difficult in practice because matters of mixed law and fact fall along a spectrum of particularity. This difficulty was pointed out in *Southam*, *supra*, at para. 37:

> ... the matrices of facts at issue in some cases are so particular, indeed so unique, that decisions about whether they satisfy legal tests do not have any great precedential value. If a court were to decide that driving at a certain speed on a certain road under certain conditions was negligent, its decision would not have any great value as a precedent. In short, as the level of generality of the challenged proposition approaches utter particularity, the matter approaches pure application, and hence draws nigh to being an unqualified question of mixed law and fact. See R. P. Kerans, *Standards of Review Employed by Appellate Courts* (1994), at pp. 103-108. Of course, it is not easy to say precisely where the line should be drawn; though in most cases it should be sufficiently clear whether the dispute is over a general proposition that might qualify as a principle of law or over a very particular set of circumstances that is not apt to be of much interest to judges and lawyers in the future.

29 When the question of mixed fact and law at issue is a finding of negligence, this Court has held that a finding of negligence by the trial judge should be deferred to by appellate courts. In *Jaegli Enterprises Ltd. v. Ankenman*, [1981] 2 S.C.R. 2 (S.C.C.), at p. 4, Dickson J. (as he then was) set aside the holding of the British Columbia Court of Appeal that the trial judge had erred in his finding of negligence on the basis that "it is wrong for an appellate court to set aside a trial judgment where there is not palpable and overriding error, and the only point at issue is the interpretation of the evidence as a whole" (see also *Schreiber Brothers Ltd. v. Currie Products Ltd.*, [1980] 2 S.C.R. 78 (S.C.C.)).

30 This more stringent standard of review for findings of negligence is appropriate, given that findings of negligence at the trial level can also be made by juries. If the standard were instead correctness, this would result in the appellate court assessing even jury findings of negligence on a correctness standard. At present, absent misdirection on law by the trial judge, such review is not available. The general rule is that courts accord great deference to a jury's findings in civil negligence proceedings:

> The principle has been laid down in many judgments of this Court to this effect, that the verdict of a jury will not be set aside as against the weight of evidence unless it is so plainly unreasonable and unjust as to satisfy the Court that no jury reviewing the evidence as a whole and acting judicially could have reached it.

McLean v. McCannell, [1937] S.C.R. 341 (S.C.C.), at p. 343; see also *Dubé v. Labar*, [1986] 1 S.C.R. 649 (S.C.C.), at p. 662, and *Canadian National Railway v. Muller* (1933), [1934] 1 D.L.R. 768 (S.C.C.). To adopt a correctness standard would change the law and undermine the traditional function of the jury. Therefore, requiring a standard of "palpable and overriding error" for findings of negligence made by either a trial judge or a jury reinforces the proper relationship between the appellate and trial court levels and accords with the established standard of review applicable to a finding of negligence by a jury.

31 Where, however, the erroneous finding of negligence of the trial judge rests on an incorrect statement of the legal standard, this can amount to an error of law. This distinction was pointed out by Cory J. in *Galaske v. O'Donnell*, [1994] 1 S.C.R. 670 (S.C.C.), at pp. 690-91:

> The definition of the standard of care is a mixed question of law and fact. It will usually be for the trial judge to determine, in light of the circumstances of the case, what would constitute reasonable conduct on the part of the legendary reasonable man placed in the same circumstances. In some situations a simple reminder may suffice while in others, for example when a very young child is the passenger, the driver may have to put the seat belt on the child himself. In this case, however, the driver took no steps whatsoever to ensure that the child passenger wore a seat belt. It follows that the trial judge's decision on the issue amounted to a finding that there was no duty at all resting upon the driver. This was an error of law.

Galaske, supra, is an illustration of the point made in *Southam, supra*, of the potential to extricate a purely legal question from what appears to be a question of mixed fact and law. However, in the absence of a legal error or a palpable and overriding error, a finding of negligence by a trial judge should not be interfered with.

32 We are supported in our conclusion by the analogy which can be drawn between inferences of fact and questions of mixed fact and law. As stated above, both involve drawing inferences from underlying facts. The difference lies in whether the inference drawn relates to a legal standard or not. Because both processes are intertwined with the weight assigned to the evidence, the numerous policy reasons which support a deferential stance to the trial judge's inferences of fact, also, to a certain extent, support showing deference to the trial judge's inferences of mixed fact and law.

33 Where, however, an erroneous finding of the trial judge can be traced to an error in his or her characterization of the legal standard, then this encroaches on the law-making role of an appellate court, and less deference is required, consistent with a "correctness" standard of review. This nuance was recognized by this Court in *St-Jean c. Mercier*, 2002 SCC 15 (S.C.C.), at paras. 48-49:

> A question "about whether the facts satisfy the legal tests" is one of mixed law and fact. Stated differently, "whether the defendant satisfied the appropriate standard of care is a question of mixed law and fact" (*Southam*, at para. 35).
>
> Generally, such a question, once the facts have been established without overriding and palpable error, is to be reviewed on a standard of correctness since the standard of care is normative and is a question of law within the normal purview of both the trial and appellate courts. [Emphasis added.]

34 A good example of this subtle principle can be found in "*Rhone*" *(The) v.* "*Peter A.B. Widener*" *(The)*, [1993] 1 S.C.R. 497 (S.C.C.), at p. 515. In that case the issue was the identification of certain individuals within a corporate structure as directing minds. This is a mixed question of law and fact. However, the erroneous finding of the courts below was easily traceable to an error of law which could be extricated from the mixed question of law and fact. The extricable question of law was the issue of the functions which are required in order to be properly identified as a "directing mind" within a corporate structure (p. 516). In the opinion of Iacobucci J. for the majority of the Court (at p. 526):

> With respect, I think that the courts below overemphasized the significance of sub-delegation in this case. The key factor which distinguishes directing minds from normal employees is the capacity to exercise decision-making authority on matters of corporate policy, rather than merely to give effect to such policy on an operational basis, whether at head office or across the sea.

35 Stated differently, the lower courts committed an error in law by finding that sub-delegation was a factor identifying a person who is part of the "directing mind" of a company, when the correct legal factor characterizing a "directing mind" is in fact "the capacity to exercise decision-making authority on matters of corporate policy". This mischaracterization of the proper legal test (the legal requirements to be a "directing mind") infected or tainted the lower courts' factual conclusion that Captain Kelch was part of the directing mind. As this erroneous finding can be traced to an error in law, less deference was required and the applicable standard was one of correctness.

36 To summarize, a finding of negligence by a trial judge involves applying a legal standard to a set of facts, and thus is a question of mixed fact and law. Matters of mixed fact and law lie along a spectrum. Where, for instance, an error with respect to a finding of negligence can be attributed to the application of an incorrect standard, a failure to consider a required element of a legal test, or similar error in principle, such an error can be characterized as an error of law, subject to a standard of correctness. Appellate courts must be cautious, however, in finding that a trial judge erred in law in his or her determination of negligence, as it is often difficult to extricate the legal questions from the factual. It is for this reason that these matters are referred to as questions of "mixed law and fact". Where the legal principle is not readily extricable, then the matter is one of "mixed law and fact" and is subject to a more stringent standard. The general rule, as stated in *Jaegli Enterprises*, *supra*, is that, where the issue on appeal involves the trial judge's interpretation of the evidence as a whole, it should not be overturned absent palpable and overriding error.

37 In this regard, we respectfully disagree with our colleague when he states at para. 106 that "[o]nce the facts have been established, the determination of whether or not the standard of care was met by the defendant will in most cases be reviewable on a standard of correctness since the trial judge must appreciate the facts within the context of the appropriate standard of care. In many cases, viewing the facts through the legal lens of the standard of care gives rise to a policy-making or law-setting function that is the purview of both the trial and appellate courts". In our view, it is settled law that the determination of whether or not the standard of care was met by the defendant involves the application of a legal standard to a set of facts, a question of mixed fact and law. This question is subject to a standard of palpable and overriding error unless it is clear that the trial judge made some extricable error in principle with respect to the characterization of the standard or its application, in which case the error may amount to an error of law.

III. Application of the Foregoing Principles to this Case: Standard of Care of the Municipality

A. The Appropriate Standard of Review

38 We agree with our colleague that the correct statement of the municipality's standard of care is that found in *Partridge v. Langenburg (Rural Municipality)*, [1929] 3 W.W.R. 555 (Sask. C.A.), *per* Martin J.A., at pp. 558-59:

> The extent of the statutory obligation placed upon municipal corporations to keep in repair the highways under their jurisdiction, has been variously stated in numerous reported cases. There is, however, a general rule which may be gathered from the decisions, and that is, that the road must be kept in such a reasonable state of repair that those requiring to use it may, exercising ordinary care, travel upon it with safety. What is a reasonable state of repair is a question of fact, depending upon all the surrounding circumstances; "repair" is a relative term, and hence the facts in one case afford no fixed rule by which to determine another case where the facts are different ...

However, we differ from the views of our colleague in that we find that the trial judge applied the correct test in determining that the municipality did not meet its standard of care, and thus did not commit an error of law of the type mentioned in *Southam*, *supra*. The trial judge applied all the elements of the *Partridge* standard to the facts, and her conclusion that the respondent municipality failed to meet this standard should not be overturned absent palpable and overriding error.

B. The Trial Judge Did Not Commit an Error of Law

39 We note that our colleague bases his conclusion that the municipality met its standard of care on his finding that the trial judge neglected to consider the conduct of the ordinary motorist, and thus failed to apply the correct standard of care, an error of law, which justifies his reconsideration of the evidence (para. 114). As a starting point to the discussion of the ordinary or reasonable motorist, we emphasize that the failure to discuss a relevant factor in depth, or even at all, is not itself a sufficient basis for an appellate court to reconsider the evidence. This was made clear by the recent decision of *Van de Perre*, *supra*, where Bastarache J. says, at para. 15:

> ... omissions in the reasons will not necessarily mean that the appellate court has jurisdiction to review the evidence heard at trial. As stated in *Van Mol (Guardian ad litem of) v. Ashmore* (1999), 168 D.L.R. (4th) 637 (B.C.C.A.), leave to appeal ref'd [2000] 1 S.C.R. vi, an omission is only a material error if it gives rise to the reasoned belief that the trial judge must have forgotten, ignored or misconceived the evidence in a way that affected his conclusion. Without this reasoned belief, the appellate court cannot reconsider the evidence.

In our view, as we will now discuss, there can be no reasoned belief in this case that the trial judge forgot, ignored, or misconceived the question of the ordinary driver. It would thus be an error to engage in a re-assessment of the evidence on this issue.

40 The fact that the conduct of the ordinary motorist was in the mind of the trial judge from the outset is clear from the fact that she began her standard of care discussion by stating the correct test, quoting the above passage from *Partridge*, *supra*. Absent some clear sign that she subsequently varied her approach, this initial acknowledgment of the correct legal standard is a strong indication that this was the standard she applied. Not only is there no indication that she departed from the stated test, but there are further signs which support the conclusion that the trial judge applied the *Partridge* standard. The first such indication is that the trial judge did discuss, both explicitly and implicitly, the conduct of an ordinary or reasonable motorist approaching the curve. The second indication is that she referred to the evidence of the experts, Mr. Anderson and Mr. Werner, both of whom discussed the conduct of an ordinary motorist in this situation. Finally, the fact that the trial judge apportioned negligence to Mr. Nikolaisen indicates that she assessed his conduct against the standard of the ordinary driver, and thus considered the conduct of the latter.

41 The discussion of the ordinary motorist is found in the passage from the trial judgment immediately following the statement of the requisite standard of care:

> Snake Hill Road is a low traffic road. It is however maintained by the R.M. so that it is passable year round. There are permanent residences on the road. It is used by farmers for access to their fields and cattle. Young people

> frequent Snake Hill Road for parties and as such the road is used by those who may not have the same degree of familiarity with it as do residents.
>
> There is a portion of Snake Hill Road that is a hazard to the public. In this regard I accept the evidence of Mr. Anderson and Mr. Werner. Further, it is a hazard that is not readily apparent to users of the road. It is a hidden hazard. The location of the Nikolaisen rollover is the most dangerous segment of Snake Hill Road. Approaching the location of the Nikolaisen rollover, limited sight distance, created by uncleared bush, precludes a motorist from being forewarned of an impending sharp right turn immediately followed by a left turn. While there were differing opinions on the *maximum* speed at which this curve can be negotiated, I am satisfied that when limited sight distance is combined with the tight radius of the curve and lack of superelevation, this curve cannot be *safely* negotiated at speeds greater than 60 kilometres per hour when conditions are favourable, or 50 kilometres per hour when wet.
>
> ... where the existence of that bush obstructs the ability of a motorist to be forewarned of a hazard such as that on Snake Hill Road, it is reasonable to expect the R.M. to erect and maintain a warning or regulatory sign so that a motorist, using ordinary care, may be forewarned, adjust speed and take corrective action in advance of entering a dangerous situation. [Italics in original; underlining added.]
>
> ([1998] 5 W.W.R. 523, at paras. 84-86)

42 In our view, this passage indicates that the trial judge did consider how a motorist exercising ordinary care would approach the curve in question. The implication of labelling the curve a "hidden hazard" which is "not readily apparent to users of the road", is that the danger is of the type that cannot be anticipated. This in turn implies that, even if the motorist exercises ordinary care, he or she will not be able to react to the curve. As well, the trial judge referred explicitly to the conduct of a motorist exercising ordinary care: "it is reasonable to expect the R.M. to erect and maintain a warning or regulatory sign so that a *motorist, exercising ordinary care*, may be forewarned, adjust speed and take corrective action in advance of entering a dangerous situation" (para. 86 (emphasis added)).

43 With respect to the *speed* of a motorist approaching the curve, there is also an indication that the trial judge considered the conduct of an ordinary motorist. First, she stated that she accepted the evidence of Mr. Anderson and Mr. Werner with respect to the finding that the curve constituted a hazard to the public. The evidence given by these experts suggests that between 60 and 80 km/h is a reasonable speed to drive parts of this road, and at that speed, the curve presents a hazard. Their evidence also indicates their general opinion that the curve was a hazardous one. Mr. Anderson refers to the curve being difficult to negotiate at "normal speeds". Also, Mr. Anderson states that "if you're not aware that this curve is there, the sharp course of the curve, and you enter too far into it before you realize that the curve is there, then you have to do a tighter radius than 118 metres in order to get back on track to be able to negotiate the second curve". He also states that "you could be lulled into thinking you've got an 80 km/h road until you are too far into the tight curve to able to respond".

44 The Court of Appeal found that, given the nature and condition of Snake Hill Road, the contention that this rural road would be taken at 80 km/h by the ordinary motorist was untenable. However, it is clear from the trial judge's reasons that she did not take 80 km/h as the speed at which the ordinary motorist would approach the curve. Instead she found, based on expert evidence, that "this curve cannot be *safely* negotiated at speeds greater than 60 kilometres per hour when conditions are favourable, or 50 kilometres per hour when wet" (para. 85 (emphasis in original)). From this finding, coupled with the finding that the curve was hidden and unexpected, the logical conclusion is that the trial judge found that a motorist exercising ordinary care could easily be deceived into approaching the curve at speeds in excess of the safe speed for the curve, and subsequently be taken by surprise. Therefore, the trial judge found that the curve was hazardous to the *ordinary motorist* and it follows that she applied the correct standard of care.

45 In our respectful view, our colleague errs in agreeing with the Court of Appeal's finding that the trial judge should have addressed the conduct of the ordinary motorist more fully (para. 47). At para. 42, he writes:

> A proper application of the test demands that the trial judge ask the question: "How would a reasonable driver have driven on this road?" Whether or not a hazard is "hidden" or a curve is "inherently" dangerous does not dispose of the question.

And later, he states, "In my view, the question of how the reasonable driver would have negotiated Snake Hill Road necessitated a somewhat more in-depth analysis of the character of the road" (para. 48). With respect, requiring the trial judge to have made this specific inquiry in her reasons is inconsistent with *Van de Perre*, *supra*, which makes it clear that an omission or a failure to discuss a factor in depth is not, in and of itself, a basis for interfering with the findings of the trial judge and reweighing the evidence. As we note above, it is clear that although the trial judge may not have conducted an extensive review of this element of the *Partridge* test, she did indeed consider this factor by stating the correct test, then applying this test to the facts.

46 We note that in relying on the evidence of Mr. Anderson and Mr. Werner, the trial judge chose not to base her decision on the conflicting evidence of other witnesses. However, her reliance on the evidence of Mr. Anderson and Mr. Werner is insufficient proof that she "forgot, ignored, or misconceived" the evidence. The full record was before the trial judge and we can presume that she reviewed all of it, absent further proof that the trial judge forgot, ignored or misapprehended the evidence, leading to an error in law. It is open to a trial judge to prefer the evidence of some witnesses over others: *Toneguzzo-Norvell*, *supra*, at p. 123. Mere reliance by the trial judge on the evidence of some witnesses over others cannot on its own form the basis of a "reasoned belief that the trial judge must have forgotten, ignored or misconceived the evidence in a way that affected his conclusion" (*Van de Perre*, *supra*, at para. 15). This is in keeping with the narrow scope of review by an appellate court applicable in this case.

47 A further indication that the trial judge considered the conduct of an ordinary motorist on Snake Hill Road is her finding that both Mr. Nikolaisen and the municipality breached their duty of care to Mr. Housen, and that the defendant Nikolaisen was 50 percent contributorily negligent. Since a finding of negligence implies a failure to meet the ordinary standard of care, and since Mr. Nikolaisen's negligence related to his driving on the curve, to find that Mr. Nikolaisen's conduct on the curve failed to meet the standard of the ordinary driver implies a consideration of that ordinary driver on the curve. The fact that the trial judge distinguished the conduct of Mr. Nikolaisen in driving negligently on the road from the conduct of the municipality in negligently failing to erect a warning sign is evidence that the trial judge kept the municipality's legal standard clearly in mind in its application to the facts, and that she applied this standard to the *ordinary* driver, not the *negligent* driver.

48 To summarize, in the course of her reasons, the trial judge first stated the requisite standard of care from *Partridge*, *supra*, relating to the conduct of the ordinary driver. She then applied that standard to the facts referring again to the conduct of the ordinary driver. Finally, in light of her finding that the municipality breached this standard, she apportioned negligence between the driver and the municipality in a way which again entailed a consideration of the ordinary driver. As such, we are overwhelmingly drawn to the conclusion that the conduct of the ordinary driver was both considered and applied by the trial judge.

49 Thus, we conclude that the trial judge did not commit an error of law with respect to the municipality's standard of care. On this matter, we disagree with the basis for the re-assessment of the evidence undertaken by our colleague (paras. 122-142) and regard this re-assessment to be an unjustified intrusion into the finding of the trial judge that the municipality breached its standard of care. This finding is a question of mixed law and fact which should not be overturned absent a palpable and overriding error. As discussed below, it is our view that no such error exists, as the trial judge conducted a reasonable assessment based on her view of the evidence.

C. The Trial Judge Did Not Commit A Palpable or Overriding Error

50 Despite this high standard of review, the Court of Appeal found that a palpable and overriding error was made by the trial judge. With respect, this finding was based on the erroneous presumption that the trial judge accepted 80

km/h as the speed at which an ordinary motorist would approach the curve, a presumption which our colleague also adopts in his reasons (para. 133).

51 As discussed above, the trial judge's finding was that an ordinary motorist could approach the curve in excess of 60 km/h in dry conditions, and 50 km/h in wet conditions, and that at such speeds the curve was hazardous. The trial judge's finding was not based on a particular speed at which the curve would be approached by the ordinary motorist. Instead, she found that, because the curve was hidden and sharper than would be anticipated, a motorist exercising ordinary care could approach it at greater than the speed at which it would be safe to negotiate the curve.

52 As we explain in greater detail below, in our opinion, not only is this assessment far from reaching the level of a palpable and overriding error, in our view, it is a sensible and logical way to deal with large quantities of conflicting evidence. It would be unrealistic to focus on some exact speed at which the curve would likely be approached by the ordinary motorist. The findings of the trial judge in this regard were the result of a reasonable and practical assessment of the evidence as a whole.

53 In finding a palpable and overriding error, Cameron J.A. relied on the fact that the trial judge adopted the expert evidence of Mr. Anderson and Mr. Werner which was premised on a *de facto* speed limit of 80 km/h taken from *The Highway Traffic Act*, S.S. 1986, c. H-3.1. However, whether or not the experts based their testimony on this limit, the trial judge did not adopt that limit as the speed of the ordinary motorist approaching the curve. Again, the trial judge found that the curve could not be taken safely at greater than 60 km/h dry and 50 km/h wet, and there is evidence in the record to support this finding. For example, Mr. Anderson states:

> If you don't anticipate the curve and you get too far into it before you start to do your correction then you can get into trouble even at, probably at 60. Fifty you'd have to be a long ways into it, but certainly at 60 you could.

It is notable too that both Mr. Anderson and Mr. Werner would have recommended installing a sign, warning motorists of the curve, with a posted limit of 50 km/h.

54 Although clearly the curve could not be negotiated safely at 80 km/h, it could also not be negotiated safely at much slower speeds. It should also be noted that the trial judge did not adopt the expert testimony of Mr. Anderson and Mr. Werner *in its entirety*. She stated: "There is a portion of Snake Hill Road that is a hazard to the public. *In this regard* I accept the evidence of Mr. Anderson and Mr. Werner" (para. 85 (emphasis added)). It cannot be assumed from this that she accepted a *de facto* speed limit of 80 km/h especially when one bears in mind (1) the trial judge's statement of the safe speeds of 50 and 60 km/h, and (2) the fact that both these experts found the road to be unsafe at much lower speeds than 80 km/h.

55 Given that the trial judge did not base her standard of care analysis on a *de facto* speed limit of 80 km/h, it then follows that the Court of Appeal's finding of a palpable and overriding error cannot stand.

56 Furthermore, the narrowly defined scope of appellate review dictates that a trial judge should not be found to have misapprehended or ignored evidence, or come to the wrong conclusions merely because the appellate court diverges in the inferences it draws from the evidence and chooses to emphasize some portions of the evidence over others. As we are of the view that the trial judge committed no error of law in finding that the municipality breached its standard of care, we are also respectfully of the view that our colleague's re-assessment of the evidence on this issue (paras. 52-65) is an unjustified interference with the findings of the trial judge, based on a difference of opinion concerning the inferences to be drawn from the evidence and the proper weight to be placed on different portions of the evidence. For instance, in the opinion of our colleague, based on some portions of the expert evidence, a reasonable driver exercising ordinary care would approach a rural road at 50 km/h or less, because a reasonable driver would have difficulty seeing the sharp radius of the curve and oncoming traffic (para. 52). However, the trial judge, basing her assessment on *other* portions of the expert evidence, found that the nature of the road was such that a motorist could be deceived into believing that the road did not contain a sharp curve and thus would approach the road normally, unaware of the hidden danger.

57 We are faced in this case with conflicting expert evidence on the issue of the correct speed at which an ordinary motorist would approach the curve on Snake Hill Road. The differing inferences from the evidence drawn by the trial judge and the Court of Appeal amount to a divergence on what weight should be placed on various pieces of conflicting evidence. As noted by our colleague, Mr. Sparks was of the opinion that "[if] you can't see around the corner, then, you know, drivers would have a fairly strong signal ... that due care and caution would be required". Similar evidence of this nature was given by Mr. Nikolaisen, and indeed even by Mr. Anderson and Mr. Werner. This is contrasted with evidence such as that given by Mr. Anderson and Mr. Werner that a reasonable driver would be "lulled" into thinking that there is an 80 km/h road ahead of him or her.

58 As noted by McLachlin J. in *Toneguzzo-Norvell*, *supra*, at p. 122 and mentioned above, "the weight to be assigned to the various pieces of evidence is under our trial system essentially the province of the trier of fact". In that case, a unanimous Court found that the Court of Appeal erred in interfering with the trial judge's factual findings, on the basis that it was open to the trial judge to place less weight on certain evidence and accept other, conflicting evidence which the trial judge found to be more convincing (*Toneguzzo-Norvell*, *supra*, at pp. 122-23). Similarly, in this case, the trial judge's factual findings concerning the proper speed to be used on approaching the curve should not be interfered with. It was open to her to choose to place more weight on certain portions of the evidence of Mr. Anderson and Mr. Werner, where the evidence was conflicting. Her assessment of the proper speed was a reasonable inference based on the evidence and does not reach the level of a palpable and overriding error. As such, the trial judge's findings with respect to the standard of care should not be overturned.

IV. Knowledge of the Municipality

59 We agree with our colleague that s. 192(3) of *The Rural Municipality Act, 1989*, S.S. 1989-90, c. R-26.1, requires the plaintiff to show that the municipality knew or should have known of the disrepair of Snake Hill Road before the municipality can be found to have breached its duty of care under s. 192. We also agree that the evidence of the prior accidents, in and of itself, is insufficient to impute such knowledge to the municipality. However, we find that the trial judge did not err in her finding that the municipality knew or ought to have known of the disrepair.

60 As discussed, the question of whether the municipality knew or should have known of the disrepair of Snake Hill Road is a question of mixed fact and law. The issue is legal in the sense that the municipality is held to a legal standard of knowledge of the nature of the road, and factual in the sense of whether it had the requisite knowledge on the facts of this case. As we state above, absent an isolated error in law or principle, such a finding is subject to the "palpable and overriding" standard of review. In this case, our colleague concludes that the trial judge erred in law by failing to approach the question of knowledge from the perspective of a prudent municipal councillor, and holds that a prudent municipal councillor could not be expected to become aware of the risk posed to the ordinary driver by the hazard in question. He also finds that the trial judge erred in law by failing to recognize that the burden of proving knowledge rested with the plaintiff. With respect, we disagree with these conclusions.

61 The hazard in question is an unsigned and unexpected sharp curve. In our view, when a hazard is, like this one, a permanent feature of the road which has been found to present a risk to the ordinary driver, it is open to the trial judge to draw an inference, on this basis alone, that a prudent municipal councillor ought to be aware of the hazard. In support of his conclusion on the issue of knowledge, our colleague states that the municipality's knowledge is inextricably linked to the standard of care, and ties his finding on the question of knowledge to his finding that the curve did not present a hazard to the ordinary motorist (para. 72). We agree that the question of knowledge is closely linked to the standard of care, and since we find that the trial judge was correct in holding that the curve presented a hazard to the ordinary motorist, from there it was open to the trial judge to find that the municipality ought to have been aware of this hazard. We further note that as a question of mixed fact and law this finding is subject to the "palpable and overriding" standard of review. On this point, however, we restrict ourselves to situations such as the one at bar where the hazard in question is a permanent feature of the road, as opposed to a temporary hazard which reasonably may not come to the attention of the municipality in time to prevent an accident from occurring.

62 In addition, our colleague relies on the evidence of the lay witnesses, Craig and Toby Thiel, who lived on Snake Hill Road, and who testified that they had not experienced any difficulties with it (para. 72). With respect, we find three problems with this reliance. First, since the curve was found to be a hazard based on its hidden and unexpected nature, relying on the evidence of those who drive the road on a daily basis does not, in our view, assist in determining whether the curve presented a hazard to the ordinary motorist, or whether the municipality ought to have been aware of the hazard. In addition, in finding that the municipality ought to have known of the disrepair, the trial judge clearly chose not to rely on the above evidence. As we state above, it is open for a trial judge to prefer some parts of the evidence over others, and to re-assess the trial judge's weighing of the evidence, is, with respect, not within the province of an appellate court.

63 As well, since the question of knowledge is to be approached from the perspective of a prudent municipal councillor, we find the evidence of lay witnesses to be of little assistance. In *Ryan*, *supra*, at para. 28, Major J. stated that the applicable standard of care is that which "would be expected of an ordinary, reasonable and prudent person *in the same circumstances*" (emphasis added). Municipal councillors are elected for the purpose of managing the affairs of the municipality. This requires some degree of study and of information gathering, above that of the average citizen of the municipality. Indeed, it may in fact require consultation with experts to properly meet the obligation to be informed. Although municipal councillors are not experts, to equate the "prudent municipal councillor" with the opinion of lay witnesses who live on the road is incorrect in our opinion.

64 It is in this context that we view the following comments of the trial judge, at para. 90:

> If the R.M. did not have actual knowledge of the danger inherent in this portion of Snake Hill Road, it should have known. While four accidents in 12 years may not in itself be significant, it takes on more significance given the close proximity of three of these accidents, the relatively low volume of traffic, the fact that there are permanent residences on the road and the fact that the road is frequented by young and perhaps less experienced drivers. I am not satisfied that the R.M. has established that in these circumstances it took reasonable steps to prevent this state of disrepair on Snake Hill Road from continuing.

From this statement, we take the trial judge to have meant that, given the occurrence of prior accidents on this low-traffic road, the existence of permanent residents, and the type of drivers on the road, the municipality did not take the reasonable steps it should have taken in order to ensure that Snake Hill Road did not contain a hazard such as the one in question. Based on these factors, the trial judge drew the inference that the municipality should have been put on notice and investigated Snake Hill Road, in which case it would have become aware of the hazard in question. This factual inference, grounded as it was on the trial judge's assessment of the evidence, was in our view, far from reaching the requisite standard of palpable and overriding error, proper.

65 Although we agree with our colleague that the circumstances of the prior accidents in this case do not provide a direct basis for the municipality to have had *knowledge* of the particular hazard in question, in the view of the trial judge, they should have *caused the municipality to investigate* Snake Hill Road, which in turn would have resulted in actual knowledge. In this case, far from causing the municipality to investigate, the evidence of Mr. Danger, who had been the municipal administrator for 20 years, was that, until the time of the trial, he was not even aware of the three accidents which had occurred between 1978 and 1988 on Snake Hill Road. As such, we do not find that the trial judge based her conclusion on any perspective other than that of a prudent municipal councillor, and therefore that she did not commit an error of law in this respect. Moreover, we do not find that she imputed knowledge to the municipality on the basis of the occurrence of prior accidents on Snake Hill Road. The existence of the prior accidents was simply a factor which caused the trial judge to find that the municipality should have been put on notice with respect to the condition of Snake Hill Road (para. 90).

66 We emphasize that, in our view, the trial judge did not shift the burden of proof to the municipality on this issue. Once the trial judge found that there was a permanent feature of Snake Hill Road which presented a hazard to the ordinary motorist, it was open to her to draw an inference that the municipality ought to have been aware of the

danger. Once such an inference is drawn, then, unless the municipality can rebut the inference by showing that it took reasonable steps to prevent such a hazard from continuing, the inference will be left undisturbed. In our view, this is what the trial judge did in the above passage when she states: "I am not satisfied that the R.M. has established that *in these circumstances* it took reasonable steps to prevent this state of disrepair on Snake Hill Road from continuing" (para. 90 (emphasis added)). The fact that she drew such an inference is clear from the fact that this statement appears directly after her finding that the municipality ought to have known of the hazard based on the listed factors. Thus, it is our view that the trial judge did not improperly shift the burden of proof onto the municipality in this case.

67 As well, although the circumstances of the prior accidents in this case do not provide strong evidence that the municipality ought to have known of the hazard, proof of prior accidents is not a necessary condition to a finding of breach of the duty of care under s. 192 of *The Rural Municipality Act, 1989*. If this were so, the first victim of an accident on a negligently maintained road would not be able to recover, whereas subsequent victims in identical circumstances would. Although under s. 192(3) the municipality cannot be held responsible for disrepair of which it could not have known, it is not sufficient for the municipality to wait for an accident to occur before remedying the disrepair, and, in the absence of proof by the plaintiff of prior accidents, claim that it could not have known of the hazard. If this were the case, not only would the first victim of an accident suffer a disproportionate evidentiary burden, but municipalities would also be encouraged not to collect information pertaining to accidents on its roads, as this would make it more difficult for the plaintiff in a motor vehicle accident to prove that the municipality knew or ought to have known of the disrepair.

68 Although in this case the trial judge emphasized the prior accidents that the plaintiff did manage to prove, in our view, it is not necessary to rely on these accidents in order to satisfy s. 192(3). For the plaintiff to provide substantial and concrete proof of the municipality's knowledge of the state of disrepair of its roads, is to set an impossibly high burden on the plaintiff. Such information was within the particular sphere of knowledge of the municipality, and in our view, it was reasonable for the trial judge to draw an inference of knowledge from her finding that there was an ongoing state of disrepair.

69 To summarize our position on this issue, we do not find that the trial judge erred in law either by failing to approach the question from the perspective of a prudent municipal councillor, or by improperly shifting the burden of proof onto the defendant. As such, it would require a palpable and overriding error in order to overturn her finding that the municipality knew or ought to have known of the hazard, and, in our view, no such error was made.

V. Causation

70 We agree with our colleague's statement at para. 82 that the trial judge's conclusions on the cause of the accident was a finding of fact: *Cork v. Kirby MacLean Ltd.*, [1952] 2 All E.R. 402 (Eng. C.A.), at p. 407, quoted with approval in *Horsley v. MacLaren* (1969), 4 D.L.R. (3d) 557 (Ont. H.C.), at p. 566. Thus, this finding should not be interfered with absent palpable and overriding error.

71 The trial judge based her findings on causation on three points (at para. 101):

> (1) the accident occurred at a dangerous part of the road where a sign warning motorists of the hidden hazard should have been erected;
>
> (2) even if there had been a sign, Mr. Nikolaisen's degree of impairment did increase his risk of not reacting, or reacting inappropriately, to a sign;
>
> (3) even so, Mr. Nikolaisen was not driving recklessly such that one would have expected him to have missed or ignored a warning sign. Moments before, on departing the Thiel residence, he had successfully negotiated a sharp curve which he could see and which was apparent to him.

The trial judge concluded that, on a balance of probabilities, Mr. Nikolaisen would have reacted and possibly avoided an accident, if he had been given advance warning of the curve. However she also found that the accident was partially

caused by the conduct of Mr. Nikolaisen, and apportioned fault accordingly, with 50 percent to Mr. Nikolaisen and 35 percent to the Rural Municipality (para. 102).

72 As noted above, this Court has previously held that "an omission is only a material error if it gives rise to the reasoned belief that the trial judge must have forgotten, ignored or misconceived the evidence in a way that affected his conclusion" (*Van de Perre*, *supra*, at para.15). In the present case, it is not clear from the trial judge's reasons which portions of the evidence of Mr. Laughlin, Craig and Toby Thiel and Paul Housen she relied upon, or to what extent. However, as we have already stated, the full evidentiary record was before the trial judge and, absent further proof that the omission in her reasons was due to her misapprehension or neglect of the evidence, we can presume that she reviewed the evidence in its entirety and based her factual findings on this review. This presumption, absent sufficient evidence of misapprehension or neglect is consistent with the high level of error required by the test of "palpable and overriding" error. We reiterate that it is open to the trial judge to prefer the testimony of certain witnesses over others and to place more weight on some parts of the evidence than others, particularly where there is conflicting evidence: *Toneguzzo-Norvell*, *supra*, at pp. 122-23. The mere fact that the trial judge did not discuss a certain point or certain evidence in depth is not sufficient grounds for appellate interference: *Van de Perre*, *supra*, at para.15.

73 For these reasons, we do not feel it appropriate to review the evidence of Mr. Laughlin and the lay witnesses *de novo*. As we concluded earlier, the trial judge's finding of fact that a hidden hazard existed at the curve should not be interfered with. The finding of a hidden hazard that requires a sign formed part of the basis of her findings concerning causation. As her conclusions on the existence of a hidden hazard had a basis in the evidence, her conclusions on causation grounded in part on the hidden hazard finding also had a basis in the evidence.

74 As for the silence of the trial judge on the evidence of Mr. Laughlin, we observe only that the evidence of Mr. Laughlin appears to be general in nature and thus of limited utility. Mr. Laughlin admitted that he could only provide general comments on the effects of alcohol on motorists, but could not provide specific expertise on the actual effect of alcohol on an individual driver. This is significant, as the level of tolerance of an individual driver plays a key role in determining the actual effect of alcohol on the motorist; an experienced drinker, although dangerous, will probably perform better on the road than an inexperienced drinker. It is noteworthy that the trial judge believed the evidence of Mr. Anderson that Mr. Nikolaisen's vehicle was travelling at the relatively slow speed of between 53 to 65 km/h at the time of impact with the embankment. It was also permissible for the trial judge to rely on the evidence of lay witnesses that Mr. Nikolaisen had successfully negotiated an apparently sharp curve moments before the accident, rather than relying on the evidence of Mr. Laughlin, which was of a hypothetical and unspecific nature. Indeed, the hypothetical nature of Mr. Laughlin's evidence reflects the entire inquiry into whether Mr. Nikolaisen would have seen a sign and reacted, or the precise speed that would be taken by a reasonable driver upon approaching the curve. The abstract nature of such inquiries supports deference to the factual findings of the trial judge, and is consistent with the stringent standard imposed by the phrase "palpable and overriding error".

75 Therefore we conclude that the trial judge's factual findings on causation were reasonable and thus do not reach the level of a palpable and overriding error, and therefore should not have been interfered with by the Court of Appeal.

VI. Common Law Duty of Care

76 As we conclude that the municipality is liable under *The Rural Municipality Act, 1989*, we find it unnecessary to consider the existence of a common law duty in this case.

VII. Disposition

77 As we stated at the outset, there are important reasons and principles for appellate courts not to interfere improperly with trial decisions. Applying these reasons and principles to this case, we would allow the appeal, set aside the judgment of the Saskatchewan Court of Appeal, and restore the judgment of the trial judge, with costs throughout.

***Bastarache J.*:**

I — Introduction

78 This appeal arises out of a single-vehicle accident which occurred on July 18, 1992, on Snake Hill Road, a rural road located in the Municipality of Shellbrook. The appellant, Paul Housen, a passenger in the vehicle, was rendered a quadriplegic by the accident. At trial, the judge found that the driver of the vehicle, Douglas Nikolaisen, was negligent in travelling Snake Hill Road at an excessive rate of speed and in operating his vehicle while impaired. The trial judge also found the respondent, the Municipality of Shellbrook, to be at fault for breaching its duty to keep the road in a reasonable state of repair as required by s. 192 of *The Rural Municipality Act, 1989*, S.S. 1989-90, c. R-26.1. The Court of Appeal overturned the trial judge's finding that the respondent municipality was negligent. At issue in this appeal is whether the Court of Appeal had sufficient grounds to intervene in the decision of the lower court. The respondent has also asked this Court to overturn the trial judge's finding that the respondent knew or ought to have known of the alleged disrepair of Snake Hill Road and that the accident was caused in part by the negligence of the respondent. An incidental question is whether a common law duty of care exists alongside the statutory duty imposed on the respondent by s. 192.

79 I conclude that the Court of Appeal was correct to overturn the trial judge's finding that the respondent was negligent. Though I would not interfere with the trial judge's factual findings on this issue, I find that she erred in law by failing to apply the correct standard of care. I would also overturn the trial judge's conclusions with regard to knowledge and causation. In coming to the conclusion that the respondent knew or should have known of the alleged disrepair of Snake Hill Road, the trial judge erred in law by failing to consider the knowledge requirement from the perspective of a prudent municipal councillor and by failing to be attentive to the fact that the onus of proof was on the appellant. In addition, the trial judge drew an unreasonable inference by imputing knowledge to the respondent on the basis of accidents that occurred on other segments of the road while motorists were travelling in the opposite direction. The trial judge also erred with respect to causation. She misapprehended the evidence before her, drew erroneous conclusions from that evidence and ignored relevant evidence. Finally, I would not interfere with the decision of the courts below to reject the appellant's argument that a common law duty existed. It is unnecessary to impose a common law duty of care where a statutory duty exists. Moreover, the application of common law negligence principles would not affect the outcome in these proceedings.

II — Factual Background

80 The sequence of events which culminated in this tragic accident began to unfold some 19 hours before its occurrence on the afternoon of July 18, 1992. On July 17, Mr. Nikolaisen attended a barbeque at the residence of Craig and Toby Thiel, located on Snake Hill Road. He arrived in the late afternoon and had his first drink of the day at approximately 6:00 p.m. He consumed four or five drinks before leaving the Thiel residence at approximately 10:00 or 10:30 p.m. After returning home for a few hours, Mr. Nikolaisen proceeded to the Sturgeon Lake Jamboree, where he met up with the appellant. At the jamboree, Mr. Nikolaisen consumed eight or nine double rye drinks and several beers. The appellant was also drinking during this event. The appellant and Mr. Nikolaisen partied on the grounds of the jamboree for several hours. At approximately 4:30 a.m., the appellant left the jamboree with Mr. Nikolaisen. After travelling around the back roads for a period of time, they returned to the Thiel residence. It was approximately 8:00 a.m. The appellant and Mr. Nikolaisen had several more drinks over the course of the morning. Mr. Nikolaisen stopped drinking two or three hours before leaving the Thiel residence with the appellant at approximately 2:00 p.m.

81 A light rain was falling when the appellant and Mr. Nikolaisen left the Thiel residence, travelling eastbound with Mr. Nikolaisen behind the wheel of a Ford pickup truck. The truck swerved or "fish-tailed" as it turned the corner from the Thiel driveway onto Snake Hill Road. As Mr. Nikolaisen continued on his way over the course of a gentle bend some 300 metres in length, gaining speed to an estimated 65 km/h, the truck again fish-tailed several times. The truck went into a skid as Mr. Nikolaisen approached and entered a sharper right turn. Mr. Nikolaisen steered into the skid but was unable to negotiate the curve. The left rear wheel of the truck contacted an embankment on the left side of the road. The vehicle travelled on the road for approximately 30 metres when the left front wheel contacted and climbed an

18-inch embankment on the left side of the road. This second contact with the embankment caused the truck to enter a 360-degree roll with the passenger side of the roof contacting the ground first.

82 When the vehicle came to rest, the appellant was unable to feel any sensation. Mr. Nikolaisen climbed out the back window of the vehicle and ran to the Thiel residence for assistance. Police later accompanied Mr. Nikolaisen to the Shellbrook Hospital where a blood sample was taken. Expert testimony estimated Mr. Nikolaisen's blood alcohol level to be between 180 and 210 milligrams in 100 millilitres of blood at the time of the accident, well over the legal limits prescribed in *The Highway Traffic Act, 1989*, S.S. 1986, c. H-3.1, and the *Criminal Code*, R.S.C. 1985, c. C-46.

83 Mr. Nikolaisen had travelled on Snake Hill Road three times in the 24 hours preceding the accident, but had not driven it on any earlier occasions. The road was about a mile and three quarters in length and was flanked by highways to the north and to the east. Starting at the north end, it ran south for a short distance, dipped between open fields, then curved to the southeast and descended in a southerly loop down and around Snake Hill, past trees, bush and pasture, to the bottom of the valley. There it curved sharply to the southeast as it passed the Thiels' driveway. Once it passed the driveway, it curved gently to the south east for about 300 metres, then curved more distinctly to the south. It was on this stretch that the accident occurred. From that point on, the road crossed a creek, took another curve, then ascended a steep hill to the east, straightened out, and continued east for just over half a mile, past tree-lined fields and another farm site, to an approach to the highway.

84 Snake Hill Road was established in 1923 and was maintained by the respondent municipality for the primary purpose of providing local farmers access to their fields and pastures. It also served as an access road for the two permanent residences and one veterinary clinic located on it. The road at its northernmost end, coming off the highway, is characterized as a "Type C" local access road under the provincial government's scheme of road classification. This means that it is graded, gravelled and elevated above the surrounding land. The portion of the road east of the Thiel residence, on which the accident occurred, is characterized as "Type B" bladed trail, essentially a prairie trail that has been bladed to remove the ruts and to allow it to be driven on. Bladed trails follow the path of least resistance through the surrounding land and are not elevated or gravelled. The province of Saskatchewan has some 45,000 kilometres of bladed trails.

85 According to the provincial scheme of road classification, both bladed trails and local access roads are "non designated", meaning that they are not subject to the Saskatchewan Rural Development Sign Policy and Standards. On such roads, the council of the rural municipality makes a decision to post signs if it becomes aware of a hazard or if there are several accidents at one specific spot. Three accidents had occurred on Snake Hill Road between 1978 and 1987. All three accidents occurred to the east of the site of the Nikolaisen rollover, with drivers travelling westbound. A fourth accident occurred on Snake Hill Road in 1990 but there was no evidence as to where it occurred. There was no evidence that topography was a factor in any of these accidents. The respondent municipality had not posted signs on any portion of Snake Hill Road.

III — Relevant Statutory Provisions

86 *The Rural Municipality Act, 1989*, S.S. 1989-90, c. R-261

> **192.**(1) Every Council shall keep in a reasonable state of repair all municipal roads, dams and reservoirs and the approaches to them that have been constructed or provided by the municipality or by any person with the permission of the council or that have been constructed or provided by the province, having regard to the character of the municipal road, dam or reservoir and the locality in which it is situated or through which it passes.
>
> . . . . .
>
> 2. Where the council fails to carry out its duty imposed by subsections (1) and (1.1), the municipality is, subject to *The Contributory Negligence Act*, civilly liable for all damages sustained by any person by reason of the failure.

3. Default under subsections (1) and (1.1) shall not be imputed to a municipality in any action without proof by the plaintiff that the municipality knew or should have known of the disrepair of the municipal road or other thing mentioned in subsections (1) and (1.1).

The Highway Traffic Act, 1986, S.S., c. H-3.1

33.(1) Subject to the other provisions of this Act, no person shall drive a vehicle on a highway:

(a) at a speed greater than 80 kilometres per hour; or

(b) at a speed greater than the maximum speed indicated by any signs that are erected on a highway.

(2) No person shall drive a vehicle on a highway at a speed greater than is reasonable and safe in the circumstances.

44.(1) No person shall drive a vehicle on a highway without due care and attention.

IV — Judicial History

***A. Saskatchewan Court of Queen's Bench*, [1998] 5 W.W.R. 523**

87 Wright J. found the respondent negligent in failing to erect a sign to warn motorists of the sharp right curve on Snake Hill Road, which she characterized as a "hidden hazard". She also found Mr. Nikolaisen negligent in travelling Snake Hill Road at an excessive speed and in operating his vehicle while impaired. The appellant was held to be contributorily negligent in accepting a ride with Mr. Nikolaisen. Fifteen percent of the fault was apportioned to the appellant, and the remainder was apportioned jointly and severally 50 percent to Mr. Nikolaisen and 35 percent to the respondent.

88 Wright J. found that s. 192 of *The Rural Municipality Act, 1989* imposed a statutory duty of care on the respondent toward persons travelling on Snake Hill Road. She then considered whether the respondent met the standard of care as delineated in s. 192 and the jurisprudence interpreting that section. She referred specifically to *Partridge v. Langenburg (Rural Municipality)*, [1929] 3 W.W.R. 555 (Sask. C.A.), in which it was stated at p. 558 that "the road must be kept in such a reasonable state of repair that those requiring to use it may, exercising ordinary care, travel upon it with safety". She also cited *Shupe v. Pleasantdale (Rural Municipality)*, [1932] 1 W.W.R. 627 (Sask. C.A.), at p. 630: "[R]egard must be had to the locality... the situation of the road therein, whether required to be used by many or by few; ... to the number of roads to be kept in repair; to the means at the disposal of the council for that purpose, and the requirements of the public who use the road." Relying on *Galbiati v. Regina (City)* (1971), [1972] 2 W.W.R. 40 (Sask. Q.B.), Wright J. observed that although the Act does not mention an obligation to erect warning signs, the general duty of repair nevertheless includes the duty to warn motorists of a hidden hazard.

89 Having laid out the relevant case law, Wright J. went on to discuss the character of the road. Relying primarily on the evidence of two experts at trial, Mr. Anderson and Mr. Werner, she found that the sharp right turning curve was a hazard that was not readily apparent to the users of the road. From their testimony she concluded (at para. 85):

> It is a hidden hazard. The location of the Nikolaisen rollover is the most dangerous segment of Snake Hill Road. Approaching the location of the Nikolaisen rollover, limited sight distance, created by uncleared bush, precludes a motorist from being forewarned of an impending sharp right turn immediately followed by a left turn. While there were differing opinions on the *maximum* speed at which this curve can be negotiated, I am satisfied that when limited sight distance is combined with the tight radius of the curve and lack of superelevation, this curve cannot be *safely* negotiated at speeds greater than 60 kilometres per hour when conditions are favourable, or 50 kilometres per hour when wet. [Emphasis in original.]

Wright J. then noted that, while it would not be reasonable to expect the respondent to construct the road to a higher standard or to clear all of the bush away, it was reasonable to expect the respondent to erect and maintain a warning

or regulatory sign "so that a motorist, using ordinary care, may be forewarned, adjust speed and take corrective action in advance of entering a dangerous situation" (para. 86).

90 Wright J. then considered s. 192(3) of the Act, which provides that there is no breach of the statutory standard of care unless the municipality knew or should have known of the danger. Wright J. observed that between 1978 and 1990, there were four accidents on Snake Hill Road, three of which occurred "in the same vicinity" as the Nikolaisen rollover, and two of which were reported to the authorities. On the basis of this information, she held that "[i]f the R.M. [Rural Municipality] did not have actual knowledge of the danger inherent in this portion of Snake Hill Road, it should have known" (para.90). Wright J. also found significant the relatively low volume of traffic on the road, the fact that there were permanent residences on the road, and the fact that the road was frequented by young and perhaps less experienced drivers.

91 In respect to causation, Wright J. found that it was probable that a warning sign would have enabled Mr. Nikolaisen to take corrective action to maintain control of his vehicle despite the fact of his impairment. She concluded (at para. 101):

> Mr. Nikolaisen's degree of impairment only served to increase the risk of him not reacting, or reacting inappropriately to a sign. Mr. Nikolaisen was not driving recklessly such that he would have intentionally disregarded a warning or regulatory sign. He had moments earlier, when departing the Thiel residence, successfully negotiated a sharp curve which he could see and which was apparent to him.

92 Wright J. also addressed the appellant's argument that the municipality was in breach of a common law duty of care which was not qualified or limited by any of the restrictions set out under s. 192. She held that *Just v. British Columbia*, [1989] 2 S.C.R. 1228 (S.C.C.), and the line of authority both preceding and following that decision did not apply to the case before her given the existence of the statutory duty of care. She also found that any qualifying words in s. 192 of the Act pertained to the standard of care and did not impose limitations on the statutory duty of care.

***B. Saskatchewan Court of Appeal*, [2000] 4 W.W.R. 173, 2000 SKCA 12**

93 On appeal, Cameron J.A., writing for a unanimous court, dealt primarily with the trial judge's finding that the respondent's failure to place a warning sign or regulatory sign at the site of the accident constituted a breach of its statutory duty of road repair. He did not find it necessary to rule on the issue of causation given his conclusion that the trial judge erred in finding the respondent negligent.

94 Cameron J.A. characterized the trial judge's conclusion that the respondent had breached the statutory duty of care as a matter of mixed fact and law. He noted that an appellate court is not to interfere with a trial judge's findings of fact unless the judge made a "palpable and overriding error" which affected his or her assessment of the facts. With respect to errors of law, however, Cameron J.A. remarked that the ability of an appellate court to overturn the finding of the trial judge is "largely unbounded". Regarding errors of mixed fact and law, Cameron J.A. noted that these are typically subject to the same standard of review as findings of fact. One exception to this, according to Cameron J.A., occurs where the trial judge identifies the correct legal test, yet fails to apply one branch of that test to the facts at hand. As support for this proposition, Cameron J.A. cited (at para. 41) Iacobucci J. in *Canada (Director of Investigation & Research) v. Southam Inc.*, [1997] 1 S.C.R. 748 (S.C.C.), at para. 39:

> [I]f a decision-maker says that the correct test requires him or her to consider A, B, C, and D, but in fact the decision-maker considers only A, B, and C, then the outcome is as if he or she had applied a law that required consideration of only A, B, and C. If the correct test requires him or her to consider D as well, then the decision-maker has in effect applied the wrong law, and so has made and error of law.

95 Turning to the applicable law in this case, Cameron J.A. acknowledged that the standard of care set out in the Act and the jurisprudence interpreting it requires municipalities to post warning signs to warn of hazards that prudent drivers, using ordinary care, would be unlikely to appreciate. Based on the jurisprudence, Cameron J.A. set out (at para.

50) an analytical framework to be used in order to assess if a municipality has breached its duty in this regard. This framework requires the judge:

> 1. To determine the character and state of the road at the time of the accident. This, of course, is a matter of fact that entails an assessment of the material features of the road where the accident occurred, as well as those factors going to the maintenance standard, namely the location, class of road, patterns of use, and so on.
>
> 2. To assess the issue of whether persons requiring to use the road, exercising ordinary car [sic], could ordinarily travel upon it safely. This is essentially a reasonable person test, one concerned with how a reasonable driver on that particular road would have conducted himself or herself. It is necessary in taking this step to take account of the various elements noted in the authorities referred to earlier, namely the locality of the road, the character and class of the road, the standard to which the municipality could reasonably have been expected to maintain the road, and so forth. These criteria fall to be balanced in the context of the question: how would a reasonable driver have driven upon this particular road? Since this entails the application of a legal standard to a given set of facts, it constitutes a question of mixed fact and law.
>
> 3. To determine either tha[t] the road was in a reasonable state of repair or that it was not, depending upon the assessment made while using the second step. If it is determined that the road was not in a reasonable state of repair, then it becomes necessary to go on to determine whether the municipality knew or should have known of the state of disrepair before imputing liability.

96 According to Cameron J.A., the trial judge did not err in law by failing to set out the proper legal test. She did, however, make an error in law of the type identified by Iacobucci J. in *Southam, supra*. In his view, when applying the law to the facts of the case, the trial judge failed to assess the manner in which a reasonable driver, exercising ordinary care, would ordinarily have driven on the road, and the risk, if any, that the unmarked curve might have posed for the ordinary driver. As noted by Cameron J.A., the trial judge "twice alluded to the matter, but failed to come to grips with it".

97 Cameron J.A. also found that the trial judge had made a "palpable and overriding" error of fact in determining that the respondent had breached the standard of care. According to Cameron J.A., the trial judge's factual error stemmed from her reliance on the expert testimony of Mr. Werner and Mr. Anderson. Cameron J.A. found that the evidence of both experts was based on the fundamental premise that the ordinary driver could be expected to travel the road at a speed of 80 km/h. In his view, this premise was misconceived and unsupported by the evidence.

98 Cameron J.A. concluded that although the trial judge was free to accept the evidence of some witnesses over others, she was not free to accept expert testimony that was based on an erroneous factual premise. According to Cameron J.A., had that trial judge found that a prudent driver, exercising ordinary care for his or her safety, would not ordinarily have driven this section of Snake Hill Road at a speed greater than 60 km/h, then she would have had to conclude that no hidden hazard existed since the curve could be negotiated safely at this speed.

99 Cameron J.A. agreed with the trial judge that a common law duty of care was not applicable in this case. His remarks in this respect are found at para. 44 of his reasons:

> Concerning the duty of care, it might be noted that unlike statutory provisions empowering municipalities to maintain roads, but imposing no duty upon them to do so, the duty in this instance owes its existence to a statute, rather than the neighbourhood principle of the common law: *Just v. British Columbia*, [1989] 2 S.C.R. 1228 (S.C.C.). The duty is readily seen to extend to all who travel upon the roads.

V — Issues

100

A. Did the Court of Appeal properly interfere with the trial judge's finding that the respondent was in breach of its statutory duty of care?

B. Did the trial judge err in finding the respondent knew or should have known of the alleged danger?

C. Did the trial judge err in finding that the accident was caused in part by the respondent's negligence?

D. Does a common law duty of care coexist alongside the statutory duty of care?

VI — Analysis

A. Did the Court of Appeal Properly Interfere with the Decision at Trial?

(1) The Standard of Review

101 Although the distinctions are not always clear, the issues that confront a trial court fall generally into three categories: questions of law, questions of fact, and questions of mixed law and fact. Put briefly, questions of law are questions about what the correct legal test is; questions of fact are questions about what actually took place between the parties; and questions of mixed law and fact are questions about whether the facts satisfy the legal tests (*Southam*, *supra*, at para. 35).

102 Of the three categories above, the highest degree of deference is accorded to the trial judge's findings of fact. The Court will not overturn a factual finding unless it is palpably and overridingly, or clearly wrong (*Southam*, *supra*, at para. 60; *Stein v. "Kathy K" (The)* (1975), [1976] 2 S.C.R. 802 (S.C.C.) , at p. 808; *Toneguzzo-Norvell (Guardian ad litem of) v. Burnaby Hospital*, [1994] 1 S.C.R. 114 (S.C.C.), at p. 121). This deference is principally grounded in the recognition that only the trial judge enjoys the opportunity to observe witnesses and to hear testimony first-hand, and is therefore better able to choose between competing versions of events (*Schwartz v. R.*, [1996] 1 S.C.R. 254 (S.C.C.), at para. 26). It is however important to recognize that the making of a factual finding often involves more than merely determining the who, what, where and when of the case. The trial judge is very often called upon to draw inferences from the facts that are put before the court. For example, in this case, the trial judge inferred from the fact of accidents having occurred on Snake Hill Road that the respondent knew or should have known of the hidden danger.

103 This Court has determined that a trial judge's inferences of fact should be accorded a similar degree of deference as findings of fact (*Goodman Estate v. Geffen*, [1991] 2 S.C.R. 353 (S.C.C.)). In reviewing the making of an inference, the appeal court will verify whether it can reasonably be supported by the findings of fact that the trial judge reached and whether the judge proceeded on proper legal principles. I respectfully disagree with the majority's view that inferences can be rejected only where the inference-drawing process itself is deficient: see *Toronto (City) Board of Education v. O.S.S.T.F., District 15*, [1997] 1 S.C.R. 487 (S.C.C.), at para. 45:

> When a court is reviewing a tribunal's findings of fact or the inferences made on the basis of the evidence, it can only intervene "where the evidence, viewed reasonably, is incapable of supporting a tribunal's findings of fact": *Lester (W. W.)(1978) Ltd. v. United Association of Journeymen and Apprentices of the Plumbing and Pipefitting Industry, Local 740*, [1990] 3 S.C.R. 644, at p. 669 *per* McLachlin J.

An inference can be clearly wrong where the factual basis upon which it relies is deficient or where the legal standard to which the facts are applied is misconstrued. My colleagues recognize themselves that a judge is often called upon to make inferences of mixed law and fact (para. 26). While the standard of review is identical for both findings of fact and inferences of fact, it is nonetheless important to draw an analytical distinction between the two. If the reviewing court were to review only for errors of fact, then the decision of the trial judge would necessarily be upheld in every case where evidence existed to support his or her factual findings. In my view, this Court is entitled to conclude that inferences made by the trial judge were clearly wrong, just as it is entitled to reach this conclusion in respect to findings of fact.

104 My colleagues take issue with the above statement that an appellate court will verify whether the making of an inference can reasonably be supported by the trial judge's findings of fact, a standard which they believe to be less strict than the "palpable and overriding" standard. I do not agree that a less strict standard is implied. In my view there is no difference between concluding that it was "unreasonable" or "palpably wrong" for a trial judge to draw an inference from the facts as found by him or her and concluding that the inference was not reasonably supported by those facts. The distinction is merely semantic.

105 By contrast, an appellate court reviews a trial judge's findings on questions of law not merely to determine if they are reasonable, but rather to determine if they are correct; *Moge v. Moge*, [1992] 3 S.C.R. 813 (S.C.C.), at p. 833; *Canada v. Pharmaceutical Society (Nova Scotia)*, [1992] 2 S.C.R. 606 (S.C.C.), at p. 647; R. P. Kerans, *Standards of Review Employed by Appellate Courts* (1994), at p. 90). The role of correcting errors of law is a primary function of the appellate court; therefore, that court can and should review the legal determinations of the lower courts for correctness.

106 In the law of negligence, the question of whether the conduct of the defendant has met the appropriate standard of care is necessarily a question of mixed fact and law. Once the facts have been established, the determination of whether or not the standard of care was met by the defendant will in most cases be reviewable on a standard of correctness since the trial judge must appreciate the facts within the context of the appropriate standard of care. In many cases, viewing the facts through the legal lens of the standard of care gives rise to a policy-making or law-setting function that is the purview of both the trial and appellate courts. As stated by Kerans, *supra*, at p. 103, "[t]he evaluation of facts as meeting or not meeting a legal test is a process that involves law-making. Moreover, it is probably correct to say that *every* new attempt to apply a legal rule to a set of facts involves some measure of interpretation of that rule, and thus more law-making"(emphasis in original).

107 In a negligence case, the trial judge is called on to decide whether the conduct of the defendant was reasonable under all the circumstances. While this determination involves questions of fact, it also requires the trial judge to assess what is reasonable. As stated above, in many cases, this will involve a policy-making or "law-setting" role which an appellate court is better situated to undertake (Kerans, *supra*, at pp. 5-10). For example, in this case, the degree of knowledge that the trial judge should have imputed to the reasonably prudent municipal councillor raised the policy consideration of the type of accident-reporting system that a small rural municipality with limited resources should be expected to maintain. This law-setting role was recognized by the United States Supreme Court in *Bose Corp. v. Consumers Union of U.S. Inc.*, 466 U.S. 485 (U.S. Mass. 1984) , at note 17, within the context of an action for defamation:

> A finding of fact in some cases is inseparable from the principles through which it was deduced. At some point, the reasoning by which a fact is "found" crosses the line between application of those ordinary principles of logic and common experience which are ordinarily entrusted to the finder of fact into the realm of a legal rule upon which the reviewing court must exercise its own independent judgment. Where the line is drawn varies according to the nature of the substantive law at issue. Regarding certain largely factual questions in some areas of the law, the stakes — in terms of impact on future cases and future conduct — are too great to entrust them finally to the judgment of the trier of fact.

108 My colleagues assert that the question of whether or not the standard of care was met by the defendant in a negligence case is subject to a standard of palpable and overriding error unless it is clear that the trial judge made some extricable error in principle with respect to the characterization of the standard or its application, in which case the error may amount to an error of law (para. 36). I disagree. In many cases, it will not be possible to "extricate" a purely legal question from the standard of care analysis applicable to negligence, which is a question of mixed fact and law. In addition, while some questions of mixed fact and law may not have "any great precedential value" (*Southam*, *supra*, at para. 37), such questions often necessitate a normative analysis that should be reviewable by an appellate court.

109 Consider again the issue of whether the municipality knew or should have known of the alleged danger. As a matter of law, the trial judge must approach the question of whether knowledge should be imputed to the municipality

having regard to the duties of the ordinary, reasonable and prudent municipal councillor. If the trial judge applies a different legal standard, such as the reasonable person standard, it is an error of law. Yet even if the trial judge correctly identifies the applicable legal standard, he or she may still err in the process of assessing the facts through the lens of that legal standard. For example, there may exist evidence that an accident had previously occurred on the portion of the road on which the relevant accident occurred. In the course of considering whether or not that fact satisfies the legal test for knowledge the trial judge must make a number of normative assumptions. The trial judge must consider whether the fact that one accident had previously occurred in the same location would alert the ordinary, reasonable and prudent municipal councillor to the existence of a hazard. The trial judge must also consider whether the ordinary, reasonable and prudent councillor would have been alerted to the previous accident by an accident-reporting system. In my view, the question of whether the fact of a previous accident having occurred fulfills the applicable knowledge requirement is a question of mixed fact and law and it is artificial to characterize it as anything else. As is apparent from the example given, the question may also raise normative issues which should be reviewable by an appellate court on the correctness standard.

110 I agree with my colleagues that it is not possible to state as a general proposition that all matters of mixed fact and law are reviewable according to the standard of correctness: citing *Southam*, *supra*, at para. 37 (para. 28). I disagree, however, that the dicta in *Southam* establishes that a trial judge's conclusions on questions of mixed fact and law in a negligence action should be accorded deference in every case. This Court in *St-Jean c. Mercier*, 2002 SCC 15 (S.C.C.), a medical negligence case, distinguished *Southam* on the issue of the standard applicable to questions of mixed fact and law where the tribunal has no particular expertise. Gonthier J., writing for a unanimous Court, stated at paras. 48-49:

> A question "about whether the facts satisfy the legal tests" is one of mixed law and fact. Stated differently, "whether the defendant satisfied the appropriate standard of care is a question of mixed law and fact" (*Southam*, at para. 35).
>
> Generally, such a question, once the facts have been established without overriding and palpable error, is to be reviewed on a standard of correctness since the standard of care is normative and is a question of law within the normal purview of both the trial and appellate courts. Such is the standard for medical negligence. There is no issue of expertise of a specialized tribunal in a particular field which may go to the determination of facts and be pertinent to defining an appropriate standard and thereby call for some measure of deference by a court of general appeal (*Southam*, *supra*, at para. 45; and *Nova Scotia Pharmaceutical Society*, *supra*, at p. 647).

111 I also disagree with my colleagues that *Jaegli Enterprises Ltd. v. Ankenman*, [1981] 2 S.C.R. 2 (S.C.C.), is authority for the proposition that when the question of mixed fact and law at issue is a finding of negligence, that finding should be deferred to by appellate courts. In that case the trial judge found that the conduct of the defendant ski instructor met the standard of care expected of him. Moreover, the trial judge found that the accident would have occurred regardless of what the ski instructor had done (*Jaegli Enterprises Ltd. v. Ankenman* (1978), 95 D.L.R. (3d) 82 (B.C. S.C.)). Seaton J.A. of the British Columbia Court of Appeal disagreed with the trial judge that the ski instructor had met the applicable standard of care (*Jaegli Enterprises Ltd. v. Ankenman* (1980), 112 D.L.R. (3d) 297 (B.C. C.A.)). Seaton J.A. recognized nevertheless that the "final question" was whether "the instructor's failure to remain was a cause of the accident". On the issue of causation, a question of fact, Sexton J.A. clearly substituted his opinion for that of the trial judge's without regard to the appropriate standard of review. His concluding remarks on the issue of causation at p. 308 highlight his lack of deference to the trial judge's conclusion on causation:

> On balance, I think that the evidence supports the plaintiff's claim against the instructor, that his conduct in leaving the plaintiff below the crest was one of the causes of the accident.

112 This Court, which restored the finding of the trial judge, did not clearly state whether it did so on the basis that the appellate court was wrong to interfere with the trial judge's finding of negligence or whether it did so because the appellate court wrongly interfered with the trial judge's conclusions on causation. The reasons suggest the latter. The only portion of the trial judgment that this Court referred to was the finding on causation. Dickson J. (as he then was) remarks at p. 4:

> At the end of a nine-day trial Mr. Justice Meredith, the presiding judge, delivered a judgment in which he very carefully considered all of the evidence and concluded that the accident had been caused solely by Larry LaCasse and that the plaintiffs should recover damages, in an amount to be assessed, against LaCasse. The claims against Paul Ankenman, Jaegli Enterprises Limited and the other defendants were dismissed with costs.

113 The Court went on to cite a number of cases, some of which did not involve negligence (see *Schreiber Brothers Ltd. v. Currie Products Ltd.*, [1980] 2 S.C.R. 78 (S.C.C.)), for the general proposition that "it [is] wrong for an appellate court to set aside a trial judgment where [there is not palpable and overriding error, and] the only point at issue [was] the interpretation of the evidence as a whole" (p. 84). Given that the Court focussed on the issue of causation, a question of fact alone, I do not think that *Jaegli* establishes that a finding of negligence by the trial judge should be deferred to by appellate courts. In my view, the Court in *Jaegli* merely affirmed the longstanding principle that an appellate court should not interfere with a trial judge's finding of fact absent a palpable and overriding error.

(2) Error of Law in the Reasons of the Court of Queen's Bench

114 The standard of care set out in s. 192 of *The Rural Municipality Act, 1989*, as interpreted within the jurisprudence, required the trial judge to examine whether the portion of Snake Hill Road on which the accident occurred posed a hazard to the reasonable driver exercising ordinary care. Having identified the correct legal test, the trial judge nonetheless failed to ask herself whether a reasonable driver exercising ordinary care would have been able to safely drive the portion of the road on which the accident occurred. To neglect entirely one branch of a legal test when applying the facts to the test is to misconstrue the law (*Southam*, *supra*, at para. 39). The Saskatchewan Court of Appeal was therefore right to characterize this failure as an error of law and to consider the factual findings made by the trial judge in light of the appropriate legal test.

115 The long line of jurisprudence interpreting s. 192 of *The Rural Municipality Act* and its predecessor provisions clearly establishes that the duty of the municipality is to keep the road "in such a reasonable state of repair that those requiring to use it may, exercising ordinary care, travel upon it with safety" (*Partridge*, *supra*, at p. 558; *Levey v. Rodgers (Rural Municipality)*, [1921] 3 W.W.R. 764 (Sask. C.A.), at p. 766; *Diebel Estate v. Pinto Creek (Rural Municipality) No. 75* (1996), 149 Sask. R. 68 (Sask. Q.B.), at pp. 71-72). Legislation in several other provinces establishes a similar duty of care and courts in these provinces have interpreted it in a similar fashion (*Jennings v. Cronsberry*, [1966] S.C.R. 532 (S.C.C.), at p. 537; *Parkland No. 31 (County) v. Stetar* (1974), [1975] 2 S.C.R. 884 (S.C.C.), at p. 892; *Fafard v. Quebec (City)* (1917), 39 D.L.R. 717 (S.C.C.), at p. 718). This Court, in *Jennings*, *supra*, interpreting a similar provision under the Ontario *Highway Improvement Act*, R.S.O. 1960, c. 171, remarked at p. 537 that: "[i]t has been repeatedly held in Ontario that where a duty to keep a highway in repair is imposed by statute the body upon which it is imposed must keep the highway in such a condition that travellers using it with ordinary care may do so with safety."

116 There is good reason for limiting the municipality's duty to repair to a standard which permits drivers exercising ordinary care to proceed with safety. As stated by this Court in *Fafard*, *supra*, at p. 718: "[a] municipal corporation is not an insurer of travellers using its streets; its duty is to use reasonable care to keep its streets in a reasonably safe condition for ordinary travel by persons exercising ordinary care for their own safety." Correspondingly, appellate courts have long held that it is an error for the trial judge to find a municipality in breach of its duty merely because a danger exists, regardless of whether or not that danger poses a risk to the ordinary user of the road. The type of error to be guarded against was described by Wetmore C.J. in *Williams v. North Battleford (Town)* (1911), 4 Sask. L.R. 75 (Sask. C.A.) (Court en banc), at p. 81:

> The question in an action of this sort, whether or not the road is kept in such repair that those requiring to use it may, using ordinary care, pass to and fro upon it in safety, is, it seems to me, largely one of fact ... I would hesitate about setting aside a finding of fact of the trial Judge if he had found the facts necessary for the determination of the case, but he did not so find. He found that the crossing was a "dangerous spot without a light, and that if the utmost care were used no accident might occur, but it was not in such proper or safe state as to render such accident

> unlikely to occur." He did not consider the question from the standpoint of whether or not those requiring to use the road might, using ordinary care, pass to and fro upon it in safety. The mere fact of the crossing being dangerous is not sufficient ... [Emphasis added.]

117 From the jurisprudence cited above, it is clear that the mere existence of a hazard or danger does not in and of itself give rise to a duty on the part of the municipality to erect a sign. Even if a trial judge concludes on the facts that the conditions of the road do, in fact, present a hazard, he or she must still go on to assess whether that hazard would present a risk to the reasonable driver exercising ordinary care. The ordinary driver is often faced with inherently dangerous driving conditions. Motorists drive in icy or wet conditions. They drive at night on country roads that are not well lit. They are faced with obstacles such as snow ridges and potholes. These obstacles are often not in plain view, but are obscured or "hidden". Common sense dictates that motorists will, however, exercise a degree of caution when faced with dangerous driving conditions. A municipality is expected to provide extra cautionary measures only where the conditions of the road and the surrounding circumstances do not signal to the driver the possibility that a hazard is present. For example, the ordinary driver expects a dirt road to become slippery when wet. By contrast, paved bridge decks on highways are often slick, though they appear completely dry. Consequently, signs will be posted to alert drivers to this unapparent possibility.

118 The appellant in this case argued, at paras. 26-27 of his factum, that the trial judge did, in fact, assess whether a reasonable driver using ordinary care would find the portion of Snake Hill Road on which the accident occurred to pose a risk. He points in particular to the trial judge's comments at paras. 85-86 that:

> There is a portion of Snake Hill Road that is a hazard to the public. In this regard I accept the evidence of Mr. Anderson and Mr. Werner. Further, it is a hazard that is not readily apparent to users of the road. It is a hidden hazard ...
>
> ... where the existence of ... bush obstructs the ability of a motorist to be forewarned of a hazard such as that on Snake Hill Road, it is reasonable to expect the R.M. to erect and maintain a warning or regulatory sign so that a motorist, using ordinary care, may be forewarned, adjust speed and take corrective action in advance of entering a dangerous situation. [Emphasis added.]

119 The appellant's argument suggests that the trial judge discharged her duty to apply the facts to the law merely by restating the facts of the case in the language of the legal test. This was not, however, sufficient. Although it is clear from the citation above that the trial judge made a factual finding that the portion of Snake Hill Road on which the accident occurred presented drivers with a hidden hazard, there is nothing in this portion of her reasons to suggest that she considered whether or not that portion of the road would pose a risk to the reasonable driver exercising ordinary care. The finding that a hazard, or even that a hidden hazard, exists does not automatically give rise to the conclusion that the reasonable driver exercising ordinary care could not travel through it safely. A proper application of the test demands that the trial judge ask the question: "How would a reasonable driver have driven on this road?" Whether or not a hazard is "hidden" or a curve is "inherently" dangerous does not dispose of the question. My colleagues state that it was open to the trial judge to draw an inference of knowledge of the hazard simply because the sharp curve was a permanent feature of the road (para. 61). Here again, there is nothing in the reasons of the trial judge to suggest that she drew such an inference or to explain how such an inference accorded with the legal requirements concerning the duty of care.

120 Nor did the trial judge consider the question in any other part of her reasons. Her failure to do so becomes all the more apparent when her analysis (or lack thereof) is compared to that in cases in which the courts applied the appropriate method. The Court of Appeal referred to two such cases by way of example. In *Nelson v. Waverley (Rural Municipality No. 44)* (1988), 65 Sask. R. 260 (Sask. Q.B.), the plaintiff argued that the defendant municipality should have posted signs warning of a ridge in the middle of the road that resulted from the grading of the road by the municipality. The trial judge concluded that if the driver had exercised ordinary care, he could have travelled along the roadway with safety. Instead, he drove too fast and failed to keep an adequate look-out considering the maintenance that was being performed on the road. In *Diebel Estate*, *supra*, the issue was whether the municipality had a duty under s. 192 to post

a sign warning motorists that a rural road ended abruptly in a T-intersection. The question of how a reasonable driver exercising ordinary care would have driven on that road was asked and answered by the trial judge in the following passage at p. 74:

> His [the expert's] conclusions as to stopping are, however, mathematically arrived at and never having been on the road, from what was described in the course of the trial, I would think the intersection could be a danger at night to a complete stranger to the area, depending on one's reaction time and the possibility of being confused by what one saw rather than recognizing the T intersection to be just that. On the other hand I would think a complete stranger in the area would be absolutely reckless to drive down a dirt road of the nature of this particular road at night at 80 kilometres per hour. [Emphasis added.]

121 The conclusion that Wright J. erred in failing to apply a required aspect of the legal test does not automatically lead to a rejection of her factual findings. This Court's jurisdiction to review questions of law entitles it, where an error of law has been found, to take the factual findings of the trial judge as they are, and to assess these findings anew in the context of the appropriate legal test.

122 In my view, neither Wright J.'s factual findings nor any other evidence in the record that she might have considered had she asked the appropriate question, support the conclusion that the respondent was in breach of its duty. The portion of Snake Hill Road on which the accident occurred did not pose a risk to a reasonable driver exercising ordinary care because the conditions of Snake Hill Road in general and the conditions with which motorists were confronted at the exact location of the accident signalled to the reasonable motorist that caution was needed. Motorists who appropriately acknowledged the presence of the several factors which called for caution would have been able to navigate safely the so-called "hidden hazard" without the benefit of a road sign.

123 The question of how a reasonable driver exercising ordinary care would have driven on Snake Hill Road necessitates a consideration of the nature and locality of the road. A reasonable motorist will not approach a narrow gravel road in the country in the same way that he or she will approach a paved highway. It is reasonable to expect a motorist to drive more slowly and to pay greater attention to the potential presence of hazards when driving on a road that is of a lower standard, particularly when he or she is unfamiliar with it.

124 While the trial judge in this case made some comments regarding the nature of the road, I agree with the Court of Appeal's findings that "[s]he might have addressed the matter more fully, taking into account more broadly the terrain through which the road passed, the class and designation of the road in the scheme of classification, and so on ... " (para. 55). Instead, the extent of her analysis of the road was limited to the following comments, found at para. 84 of her reasons:

> Snake Hill Road is a low traffic road. It is however maintained by the R.M. so that it is passable year round. There are permanent residences on the road. It is used by farmers for access to their fields and cattle. Young people frequent Snake Hill Road for parties and as such the road is used by those who may not have the same degree of familiarity with it as do residents.

125 In my view, the question of how the reasonable driver would have negotiated Snake Hill Road necessitated a somewhat more in-depth analysis of the character of the road. The trial judge's analysis focussed almost entirely on the use of the road, without considering the sort of conditions it presented to drivers. It is perhaps not surprising that the trial judge did not engage in this fuller analysis, given that she did not turn her mind to the question of how a reasonable driver would have approached the road. Had she considered this question, she likely would have engaged in the type of assessment that was made by the Court of Appeal at para. 13 of its judgment:

> The road, about 20 feet in width, was classed as "a bladed trail," sometimes referred to as "a land access road," a classification just above that of "prairie trail". As such, it was not built up, nor gravelled, except lightly at one end of it, but simply bladed across the terrain following the path of least resistance. Nor was it in any way signed.

Given the fact that Snake Hill Road is a low standard road, in a category only one or two levels above a prairie trail, one can assume that a reasonable driver exercising ordinary care would approach the road with a certain degree of caution.

126 Having considered the character of the road in general, and having concluded that by its very nature it warranted a certain degree of caution, it is nonetheless necessary to consider the material features of the road at the point at which the accident occurred. Even on roads which are of a lower standard, a reasonable driver exercising due caution may be caught unaware by a particularly dangerous segment of the road. That was, in fact, the central argument that the appellant put forward in this case. According to the appellant's "dual nature" theory, at para. 8 of his factum, the fact that the curvy portion of Snake Hill Road where the accident occurred was flanked by straight segments of road created a risk that a motorist would be lulled into thinking that the curves could be taken at speeds greater than that at which they could actually be taken.

127 While it is not clear from her reasons that the trial judge accepted the appellant's "dual nature" theory, it appears that her conclusion that the municipality did not meet the standard of care required by it was based largely on her observation of the material features of the road at the location of the Nikolaisen rollover. Relying on the evidence of two experts, Mr. Anderson and Mr. Werner, she found the portion of the road on which the accident occurred to be a "hazard to the public". In her view, the limited sight distance created by the presence of uncleared bush precluded a motorist from being forewarned of the impending sharp right turn immediately followed by a left turn. Based on expert testimony, she concluded that the curve could not be negotiated at speeds greater than 60 km/h under favourable conditions, or 50 km/h under wet conditions.

128 Again, I would not reject the trial judge's factual finding that the curve presented motorists with an inherent hazard. The evidence does not, however, support a finding that a reasonable driver exercising ordinary care would have been unable to negotiate the curve with safety. As I explained earlier, the municipality's duty to repair is implicated only when an objectively hazardous condition exists, *and* where it is determined that a reasonable driver arriving at the hazard would be unable to provide for his or her own security due to the features of the hazard.

129 I agree with the trial judge that part of the danger posed by the presence of bushes on the side of the road was that a driver would not be able to predict the radius of the sharp right-turning curve obscured by them. In my view, however, the actual danger inherent in this portion of the road was that the bushes, together with the sharp radius of the curve, prevented an eastbound motorist from being able to see if a vehicle was approaching from the opposite direction. Given this latter situation, it is highly unlikely that any reasonable driver exercising ordinary care would approach the curve at speeds in excess of 50 km/h, a speed which was found by the trial judge to be a safe speed at which to negotiate the curve. Since a reasonable driver would not approach this curve at speeds in excess of which it could safely be taken, I conclude that the curve did not pose a risk to the reasonable driver.

130 One need only refer to the series of photographs of the portion of Snake Hill Road on which the accident occurred to appreciate the extent to which visual clues existed which would alert a driver to approach the curve with caution [Respondent's Record, Vol. II, at pp. 373-76]. The photographs, which indicate what the driver would have seen on entering the curve, show the presence of bush extending well into the road. From the photographs, it is clear that a motorist approaching the curve would not fail to appreciate the risk presented by the curve, which is simply that it is impossible to see around it and to gauge what may be coming in the opposite direction. In addition, the danger posed by the inability to see what is approaching in the opposite direction is somewhat heightened by the fact that this road is used by farm operators. At trial, the risk was described in the following terms by Mr. Sparks, an engineer giving expert testimony:

> ... if you can't, if you can't see far enough down the road to, you know, if there's somebody that's coming around the corner with a tractor and a cultivator and you can't see around the corner, then, you know, drivers would have a fairly strong signal, in my view, that due care and caution would be required.

131 The expert testimony relied on by the trial judge does not support a finding that the portion of Snake Hill Road on which the accident occurred would pose a risk to a reasonable driver exercising ordinary care. When asked at trial whether motorists, exercising reasonable care, would enter the curve at a slow speed because they could not see what was coming around the corner, Mr. Werner agreed that he, himself, drove the corner "at a slower speed" and that it would be prudent for a driver to slow down given the limited sight distance. Similarly, Mr. Anderson admitted to having taken the curve at 40-45 km/h the first time he drove it because he "didn't want to get into trouble with it". When asked if the reason he approached the curve at that speed was because he could not see around it, he replied in the affirmative: "[t]hat's why I approached it the way I did."

132 Perhaps most tellingly, Mr. Nikolaisen himself testified that he could not see if a vehicle was coming in the opposite direction as he approached the curve. The following exchange which occurred during counsel's cross-examination of Mr. Nikolaisen at trial is instructive:

> Q. ... You told my learned friend, Mr. Logue, that your view of the road was quite limited, that is correct? The view ahead on the road is quite limited, is that right?
>
> A. As in regards to travelling through the curves, yes, that's right, yeah.
>
> Q. Yes. And you did not know what was coming as you approached the curve, that is correct?
>
> A. That's correct, yes.
>
> Q. There might be a vehicle around that curve coming towards you or someone riding a horse on the road, that is correct?
>
> A. Or a tractor or a cultivator or something, that's right.
>
> Q. Or a tractor or a cultivator. You know as a person raised in rural Saskatchewan that all of those things are possibilities, that is right?
>
> A. That's right, yeah, that is correct.

133 Nor do I accept the appellant's submission that the "dual nature" of the road had the effect of lulling drivers into taking the curve at an inappropriate speed. This theory rests on the assumption that the motorists would drive the straight portions of the road at speeds of up to 80 km/h, leaving them unprepared to negotiate suddenly appearing curves. Yet, while the default speed limit on the road was 80 km/h, there was no evidence to suggest that a reasonable driver would have driven any portion of the road at that speed. While Mr. Werner testified that a driver "would be permitted" to drive at a maximum of 80 km/h, since this was the default (not the posted) speed limit, he later acknowledged that bladed trails in the province are not designed to meet 80 km/h design criteria. I agree with the Court of Appeal that the evidence is that "Snake Hill Road was self-evidently a dirt road or bladed trail" and that it "was obviously not designed to accommodate travel at a general speed of 80 kilometres per hour". As I earlier remarked, the locality of the road and its character and class must be considered when determining whether the reasonable driver would be able to navigate it safely.

134 Furthermore, the evidence at trial did not suggest that drivers were somehow fooled by the so-called "dual nature" of the road. The following exchange between counsel for the respondent and Mr. Werner at trial is illustrative of how motorists would view the road:

> Q. Now, Mr. Werner, would you not agree that the change in the character of this road as you proceeded from east to west was quite obvious?
>
> A. It was straight, and then you came to a hill, and you really didn't know what might lie beyond the hill.

Q. That's right. But I mean, the fact that the road went from being straight and level to suddenly there was a hill and you couldn't see — you could see from the point of the top of the hill that the road didn't continue in a straight line, couldn't you?

A. Yes, you could, from the top of the hill, it's a very abrupt hill, yes.

Q. And as you proceeded down though the hill it became quite obvious, did it not, that the character of the road changed?

A. Yes, it changed, yes.

Q. Now you were faced with something other than a straight road?

A. M'hm. Yes.

Q. Now you were on — and at some point along there the surface of the road changed, did it not?

A. Yes.

Q. And, of course, the road was no longer, I use the term built-up to refer to a road that has grade and it has some drainage. As you proceeded from west to east, you realized, you could see, it was obvious that this was not longer a built-up road?

A. It was a road essentially that was cut out of the topography and had no ditches, and there was an abutment or shoulder right to the driving surface. It was different than the first part.

Q. Yes. And all those differences were obvious, were they not?

A. Well, I — they were clear, satisfactorily clear to me, yes. [Emphasis added.]

135 Although they may be compelling factors in other cases, in this case the "dual nature" of the road, the radius of the curve, the surface of the road, and the lack of superelevation do not support the conclusion of the trial judge. The question of how a reasonable driver exercising ordinary care would approach this road demands common sense. There was no necessity to post a sign in this case for the simple reason that any reasonable driver would have reacted to the presence of natural cues to slow down. The law does not require a municipality to post signs warning motorists of hazards that pose no real risk to a prudent driver. To impose a duty on the municipality to erect a sign in a case such as this is to alter the character of the duty owed by a municipality to drivers. Municipalities are not required to post warnings directed at drunk drivers and thereby deal with their inability to react to the cues that alert the ordinary driver to the presence of a hazard.

136 My colleagues assert that the trial judge properly considered all aspects of the applicable legal test, including whether the curve would pose a risk to the reasonable driver exercising ordinary care. They say that the trial judge did discuss, both explicitly and implicitly, the conduct of an ordinary or reasonable motorist approaching the curve. Secondly, they note that she referred to the evidence of the experts, Mr. Anderson and Mr. Werner, both of whom discussed the conduct of an ordinary motorist in this situation. Thirdly, the fact that the trial judge apportioned negligence to Nikolaisen indicates, in their view, that she assessed his conduct against the standard of the ordinary driver, and thus considered the conduct of the latter (para. 40).

137 I respectfully disagree that it is explicit in the trial judge's reasons that she considered whether the portion of the road on which the accident occurred posed a risk to the ordinary driver exercising reasonable care. As I explained above, the fact that the trial judge restated the legal test in the form of a conclusion in no way suggests that she turned her mind to the issue of whether the ordinary driver would have found the curve to be hazardous.

138 Nor do I agree that a discussion of the conduct of an ordinary motorist in the situation was somehow "implicit" in the trial judge's reasons. In my view, it is highly problematic to presume that a trial judge made factual findings on a particular issue in the absence of any indication in the reasons as to what those findings were. While a trial judge is presumed to know the law, he or she cannot be presumed to have reached a factual conclusion without some indication in the reasons that he or she did in fact come to that conclusion. If the reviewing court is willing to presume that a trial judge made certain findings based on evidence in the record absent any indication in the reasons that the trial judge actually made those findings, then the reviewing court is precluded from finding that the trial judge misapprehended or neglected evidence.

139 In my view, my colleagues have throughout their reasons improperly presumed that the trial judge reached certain factual findings based on the evidence despite the fact that those findings were not expressed in her reasons. On the issue of whether the curve presented a risk to the ordinary driver, my colleagues note that "in relying on the evidence of Mr. Anderson and Mr. Werner, the trial judge chose not to base her decision on the conflicting evidence of other witnesses" (para. 46). The problem with this statement is that although the trial judge relied on the evidence of Mr. Anderson and Mr. Werner to conclude that the portion of Snake Hill Road on which the accident occurred was a hazard, it is impossible from her reasons to discern what, if any, evidence she relied on to reach the conclusion that the curve presented a risk to the ordinary driver exercising reasonable care. In the absence of any indication that she considered this issue, I am not willing to presume that she did.

140 My colleagues similarly presume findings of fact when discussing the knowledge of the municipality. On this issue, they reiterate that "it is open for a trial judge to prefer some parts of the evidence over others, and to reassess the trial judge's weighing of the evidence, is, with respect, not within the province of an appellate court." (para. 62). At para. 64 of their reasons, my colleagues review the findings of the trial judge on the issue of knowledge and conclude that the trial judge "drew the inference that the municipality should have been put on notice and investigated Snake Hill Road, in which case it would have become aware of the hazard in question". I think that it is improper to conclude that the trial judge made a finding that the municipality's system of road inspection was inadequate in the absence of any indication in her reasons that she reached this conclusion. My colleagues further suggest that the trial judge did not impute knowledge to the municipality on the basis of the occurrence of prior accidents on Snake Hill Road (para. 65) They even state that it was not necessary for the trial judge to rely on the accidents in order to satisfy s. 192(3) (para. 67). This, in my view, is a reinterpretation of the trial judge's findings that stands in direct contradiction to the reasons that were provided by her. The trial judge discusses other factors pertaining to knowledge *only* to heighten the significance that she attributes to the fact that accidents had previously occurred on other portions of the road (at para. 90):

> If the R.M did not have actual knowledge of the danger inherent in this portion of Snake Hill Road, it should have known. While four accidents in 12 years may not in itself be significant, it takes on more significance given the close proximity of three of these accidents, the relatively low volume of traffic, the fact that there are permanent residences on the road and the fact that the road is frequented by young and perhaps less experienced drivers.

141 My colleagues refer to the decision of *Van de Perre v. Edwards*, 2001 SCC 60 (S.C.C.), in which I stated that "an omission [in the trial judge's reasons] is only a material error if it gives rise to the reasoned belief that the trial judge must have forgotten, ignored or misconceived the evidence in a way that affected his conclusion" (para. 15). This case is however distinguishable from *Van de Perre*, *supra*. In *Van de Perre*, the appellate court improperly substituted its own findings of fact for the trial judge's clear factual conclusions on the basis that the trial judge had not considered all of the evidence. By contrast, in this case my colleagues assert that this Court should not interfere with the "findings of the trial judge" even where no findings were made and where such findings must be presumed from the evidence. The trial judge's failure in this case to reach any conclusion on whether the ordinary driver would have found the portion of the road on which the accident occurred hazardous, in my view, gives rise to the reasoned belief that she ignored the evidence on the issue in a way that affected her conclusion.

142 Finally, I do not agree that the trial judge's conclusion that Mr. Nikolaisen was negligent equates to an assessment of whether a motorist exercising ordinary care would have found the curve on which the accident occurred to be hazardous. It is clear from the trial judge's reasons that she made a factual finding that the curve could be driven safely at 60 km/h in dry conditions and 50 km/h in wet conditions and that Mr. Nikolaisen approached the curve at an excessive speed. As earlier stated, what she failed to consider was whether the ordinary driver exercising reasonable care would have approached the curve at a speed at which it could be safely negotiated, or, stated differently, whether the curve posed a real danger to the ordinary driver.

B. Did the Trial Judge Err in Finding that the Respondent Municipality Knew or Should Have Known of the Danger Posed by the Municipal Road?

143 Pursuant to s. 192(3) of the *The Rural Municipality Act, 1989*, fault is not to be imputed to the municipality in the absence of proof by the plaintiff that the municipality "knew or should have known of the disrepair".

144 The trial judge made no finding that the respondent municipality had actual knowledge of the alleged state of disrepair, but rather imputed knowledge to the respondent on the basis that it should have known of the danger. This is apparent in her findings on knowledge at paras. 89-91 of her reasons:

> Breach of the statutory duty of care imposed by section 192 of *The Rural Municipality Act, 1989*, *supra*, cannot be imputed to the R.M. unless it knew of or ought to have known of the state of disrepair on Snake Hill Road. Between 1978 and 1990 there were four accidents on Snake Hill Road. Three of these accidents occurred in the same vicinity as the Nikolaisen rollover. The precise location of the fourth accident is unknown. While at least three of these accidents occurred when motorists where travelling in the opposite direction of the Nikolaisen vehicle, they occurred on that portion of Snake Hill Road which is the most dangerous — where the road begins to curve, rather than where it is generally straight and flat. At least two of these accidents were reported to authorities.
>
> If the R.M. did not have actual knowledge of the danger inherent in this portion of Snake Hill Road, it should have known. While four accidents in 12 years may not in itself be significant, it takes on more significance given the close proximity of three of these accidents, the relatively low volume of traffic, the fact that there are permanent residences on the road and the fact that the road is frequented by young and perhaps less experienced drivers. I am not satisfied that the R.M. has established that in these circumstances it took reasonable steps to prevent this state of disrepair on Snake Hill Road from continuing. [Emphasis added.]
>
> I find that by failing to erect and maintain a warning and regulatory sign on this portion of Snake Hill Road the R.M. has not met the standard of care which is reasonable in the circumstances. Accordingly, it is in breach of its duty of care to motorists generally, and to Mr. Housen in particular.

145 Whether the municipality should have known of the disrepair (here, the risk posed in the absence of a sign) involves both questions of law and questions of fact. As a matter of law, the trial judge must approach the question of whether knowledge should be imputed to the municipality with regard to the duties of the ordinary, reasonable and prudent municipal councillor (*Ryan v. Victoria (City)*, [1999] 1 S.C.R. 201 (S.C.C.), at para. 28). The question is then answered through the trial judge's assessment of the facts of the case.

146 I find that the trial judge made both errors of law and palpable and overriding errors of fact in determining that the respondent municipality should have known of the alleged state of disrepair. She erred in law by approaching the question of knowledge from the perspective of an expert rather than from the perspective of a prudent municipal councillor. She also erred in law by failing to appreciate that the onus of proving that the municipality knew or should have known of the alleged disrepair remained on the plaintiff throughout. The trial judge clearly erred in fact by drawing the unreasonable inference that the respondent municipality should have known that the portion of the road on which the accident occurred was dangerous from evidence that accidents had occurred on other parts of Snake Hill Road.

147 The trial judge's failure to determine whether knowledge should be imputed to the municipality from the perspective of what a prudent municipal councillor should have known is implicit in her reasons. The respondent could not be held, for the purposes of establishing knowledge under the statutory test, to the standard of an expert analysing the curve after the accident. Yet this is precisely what the trial judge did. She relied on the expert evidence of Mr. Anderson and Mr. Werner to reach the conclusion that the curve presented a hidden hazard. She also implicitly accepted that the risk posed by the curve was not one that would be readily apparent to a lay person. This is evident in the portion of her judgment where she accepts as a valid excuse for not filing a timely claim against the respondent the appellant counsel's explanation that he did not believe the respondent to be at fault until expert opinions were obtained. The trial judge stated in this regard: "[i]t was only later when expert opinions were obtained that serious consideration was given to the prospect that the nature of Snake Hill Road might be a factor contributing to the accident" (para. 64). Her failure to consider the risk to the prudent driver is also apparent when one considers that she ignored the evidence concerning the way in which the two experts themselves had approached the dangerous curve (see para. 54 above).

148 Had the trial judge considered the question of whether the municipality should have known of the alleged disrepair from the perspective of the prudent municipal councillor, she would necessarily have reached a different conclusion. There was no evidence that the road conditions which existed posed a risk that the respondent should have been aware of. The respondent had no particular reason to inspect that segment of the road for the presence of hazards. It had not received any complaints from motorists respecting the absence of signs on the road, the lack of superelevation on the curves, or the presence of trees and vegetation which grew up along the sides of the road.

149 In addition, the question of the respondent's knowledge is linked inextricably to the standard of care. A municipality can only be expected to have knowledge of those hazards which pose a risk to the reasonable driver exercising ordinary care, since these are the only hazards for which there is a duty to repair. The trial judge should not have expected the respondent in this case to have knowledge of the road conditions that existed at the site of the Nikolaisen rollover since that road condition simply did not pose a risk to the reasonable driver. In addition to the evidence that was discussed above in the context of the standard of care, this conclusion is supported by the testimony of the several lay witnesses that testified at trial. Craig Thiel, a resident on the road, testified that he was not aware that Snake Hill Road had a reputation of being a dangerous road, and that he himself had never experienced difficulty with the portion of the road on which the accident occurred. His wife, Toby, also testified that she had experienced no problems with the road.

150 The trial judge also clearly erred in fact by imputing knowledge to the municipality on the basis of the four accidents that had previously occurred on Snake Hill Road. While her factual findings regarding the accidents themselves have a sound basis in the evidence, these findings simply do not support her conclusion that a prudent municipal councillor ought to have known that a risk existed for the normal prudent driver. As such, the trial judge erred in drawing an unreasonable inference from the evidence that was before her. As stated above, the standard of review for inferences of fact is, above all, one of reasonableness. This is reflected in the following passage from *Kolesar v. Jeffries* (1977), [1978] 1 S.C.R. 491 (S.C.C.), at pp. 503-4:

> ... "it is a well-known principle that appellate tribunals should not disturb findings of fact made by a trial judge if there were credible evidence before him upon which he could reasonably base his conclusion". [Emphasis added.]

151 As I stated above, there was no evidence to suggest that the respondent had actual knowledge that accidents had previously occurred on Snake Hill Road. To the contrary, Mr. Danger, the administrator of the municipality, testified that the first he heard of the accidents was at the trial.

152 Implicit in the trial judge's reasons, then, was the expectation that the municipality should have known about the accidents through an accident-reporting system. The appellant put forward that argument explicitly before this Court, placing significant emphasis on the fact that respondent "has no regularized approach to gathering this information, whether from councillors or otherwise". The argument suggests that, had the municipality established a formal system

to find out whether accidents had occurred on a given road, it would have known that accidents had occurred on Snake Hill Road and would have taken the appropriate corrective action to ensure that the road was safe for travellers.

153 I find the above argument to be flawed in two important respects. First, the argument that the other accidents on Snake Hill Road were relevant in this case is based on the assumption that there was an obligation on the respondent municipality to have a "regularized" accident-reporting system, and that the informal system that was in place was somehow deficient. In my view, the appellant did not meet its onus to show that the system relied on by the municipality to discharge its obligations under s. 192 of the Act was deficient. The evidence shows that, prior to 1988, there was no formal system of accident reporting in place. There was, nonetheless, an informal system whereby the municipal councillors were responsible for finding out if there were road hazards. Information that hazards existed came to the attention of the councillors via complaints, and from their own familiarity with the roads within the township under their jurisdiction. The trial judge made a palpable error in finding that this informal system was deficient in the absence of any evidence of the practice of other municipalities at the time that the accidents occurred and what might have been a reasonable system, particularly given the fact that the rural municipality in question had only six councillors. There is no evidence that a rural municipality of this type requires the sort of sophisticated information-gathering process that may be required in a city, where accidents occur with greater frequency and where it is less likely that word of mouth will suffice to bring hazards to the attention of the councillors.

154 The respondent municipality now has a more formalized system of accident reporting. Since 1988, Saskatchewan Highways and Transportation annually provides the municipalities with a listing of all motor vehicle accidents which occur within the municipality and which are reported to the police. While I agree that this system may provide the municipality with a better chance of locating hazards in some circumstances, I do not accept that the adoption of this system is relevant on the facts of this case. Only one accident, which occurred in 1990, was reported to the respondent under this system. The appellant adduced no evidence to suggest that this accident occurred at the same location as the Nikolaisen rollover, or that this accident occurred as a result of the conditions of the road rather than the negligence of the driver.

155 Secondly, and perhaps more importantly, it was simply illogical for the trial judge to infer from the fact of the earlier accidents that the respondent should have known that the site of the Nikolaisen rollover posed a risk to prudent drivers. The three accidents, which took place in 1978, 1985, and 1987, occurred on different curves, while the vehicles involved were proceeding in the opposite direction. The accidents of 1978 and 1987 occurred on the first right-turning curve in the road with the drivers travelling westbound, at the bottom of the hill. The accident in 1985 took place on the next curve in the road with the driver also travelling westbound, again on a different curve from the one where the Nikolaisen rollover took place. If anything, these accidents signal that the municipality should have been concerned with the curves that were, when travelling westbound, to the east of the site of the Nikolaisen rollover. The evidence disclosed no accidents that had occurred at the precise location of the accident that is the subject of this case.

156 Furthermore, the mere occurrence of an accident does not in and of itself indicate a duty to post a sign. In many cases, accidents happen not because of the conditions of the road, but rather because of the negligence of the driver. Illustrative in this regard is Mr. Agrey's accident on Snake Hill Road in 1978. Mr. Agrey testified that, just prior to the accident, he had turned his attention away from the road to talk to one of the passengers in the vehicle. Another passenger shouted to him to "look out", but by the time he was alerted it was too late to properly navigate the turn. Mr. Agrey was charged and fined for his carelessness. As was discussed in the context of the standard of care, a municipality is not obligated to make safe the roads for all drivers, regardless of the care and attention that they are exercising when driving. It need only keep roads in such a state of repair as will allow a reasonable driver exercising ordinary care to drive with safety.

157 In addition to the substantial errors discussed above, I would also note that, in my view, the trial judge was inattentive to the onus of proof on this issue. When reviewing the evidence pertaining to other accidents on Snake Hill Road, the trial judge remarked: "Cst. Forbes does not recall any other accident on Snake Hill Road during her time at the Shellbrook RCMP Detachment, from 1987 until 1996. Cpl. Healey had heard of one other accident. *Forbes and*

Healy are only two of nine members of the RCMP Detachment at Shellbrook" (emphasis added). By this comment, the trial judge seems to imply that there may have been more accidents on Snake Hill Road that had been reported and that the respondent should have known about this. With all due respect to the trial judge, if there had been accidents other than the ones that were raised at trial, it was up to the appellant to bring evidence of these accidents forward, either by calling the R.C.M.P. members to whom they had been reported, or by calling those who were involved in the accidents, or by any other available means. Furthermore, the significance that the trial judge attributed to the other accidents that occurred on Snake Hill Road was dependent on her assumption that the respondent should have had a formal accident-reporting system in place. The respondent did not bear the onus of demonstrating that it was not obliged to have such a system; there was, rather, a positive onus on the appellant to demonstrate that such a system was required and that the informal reporting system was inadequate.

C. Did the Trial Judge Err in Finding that the Accident was Caused in Part by the Failure of the Respondent Municipality to Erect a Sign Near the Curve?

158 The trial judge's findings on causation are found at para. 101 of her judgment, where she states:

> I find that this accident occurred as a result of Mr. Nikolaisen entering the curve on Snake Hill Road at a speed slightly in excess of that which would allow successful negotiation. The accident occurred at the most dangerous segment of Snake Hill Road where a warning or regulatory sign should have been erected and maintained to warn motorists of an impending and hidden hazard. Mr. Nikolaisen's degree of impairment only served to increase the risk of him not reacting, or reacting inappropriately to a sign. Mr. Nikolaisen was not driving recklessly such that he would have intentionally disregarded a warning or regulatory sign. He had moments earlier, when departing the Thiel residence, successfully negotiated a sharp curve which he could see and which was apparent to him. I am satisfied on a balance of probabilities that had Mr. Nikolaisen been forewarned of the curve, he would have reacted and taken appropriate corrective action such that he would not have lost control of his vehicle when entering the curve.

159 The trial judge's above findings in respect to causation represent conclusions on matters of fact. Consequently, this Court will only interfere if it finds that in coming to these conclusions she made a manifest error, ignored conclusive or relevant evidence, misunderstood the evidence, or drew erroneous conclusions from it (*Toneguzzo-Norvell*, *supra*, at p. 121).

160 In coming to her conclusion on causation, the trial judge made several of the types of errors that this Court referred to in *Toneguzzo-Norvell*. To the extent that the trial judge relied on the evidence of Mr. Laughlin, the only expert to have testified on the issue of causation, I find that she either misunderstood his evidence or drew erroneous conclusions from it. The only other testimony in respect to causation was anecdotal evidence pertaining to Mr. Nikolaisen's level of impairment provided by Craig Thiel, Toby Thiel and Paul Housen. Although their testimonies provided some evidence in respect to causation, for reasons I will discuss, it was not evidence on which the trial judge could reasonably rely. Nor do I find that the trial judge was entitled to rely on evidence that Mr. Nikolaisen successfully negotiated the curve from the Thiel driveway onto Snake Hill Road. The inference that the trial judge drew from this fact was unreasonable and ignored evidence that Mr. Nikolaisen swerved even on this curve. In addition, the trial judge clearly erred by ignoring other relevant evidence in respect to causation, in particular the fact that Mr. Nikolaisen had driven on the road three times in the 18 to 20 hours preceding the accident.

161 I cannot agree with the trial judge that the testimony of Mr. Laughlin, a forensic alcohol specialist employed by the R.C.M.P, supports the finding that Mr. Nikolaisen would have reacted to a sign forewarning of the impending right-turning curve on which the accident occurred. The preponderance of Mr. Laughlin's testimony establishes that persons at the level of impairment which Mr. Nikolaisen was found to be at when the accident occurred would be unlikely to react to a warning sign. In addition, Mr. Laughlin's testimony points overwhelmingly to the conclusion that alcohol was the causal factor which led to this accident. The trial judge erred by misapprehending one comment in Mr. Laughlin's testimony and ignoring the significance of his testimony when taken as a whole.

162 Based on blood samples obtained by Constable Forbes approximately three hours after the accident occurred, Mr. Laughlin predicted that Mr. Nikolaisen's blood alcohol level at the time of the accident ranged from 180 to 210 milligrams percent. Mr. Laughlin commented at length on the effect that this level of blood alcohol could be expected to have on a person's ability to drive, testifying:

> Well, My Lady, this alcohol level that I've calculated here is a very high alcohol level. The critical mental faculties that are important in operating a motor vehicle will be impaired by the alcohol. And any skill that depends on these mental faculties will be affected. These include anticipation, judgment, attention, concentration, the ability to divide attention among two or more areas of interest. Because these are affected to such a degree, it would be unsafe for anybody to operate a motor vehicle with this level of alcohol in their body.

When asked about his knowledge of research pertaining to the effects of alcohol on the risk of being involved in an automobile accident, Mr. Laughlin had this to say:

> ... At this level the moderate user of alcohol risk of causing crash is tremendously high, probably 100 times that of a sober driver, or even higher. And in some cases at this level, I've seen scientific literature indicating that the risk of causing a fatal crash is 2 to 300 times that of a sober driver. ... if an impaired person is an experienced drinker there — it won't be that high. However, there will be an increased risk compared to a sober state. ... But above 100 milligrams percent, regardless of tolerance, a person will be impaired with respect to driving ability.

Following these comments, Mr. Laughlin discussed the ability of a severely impaired person to react to the presence of a hazard when driving:

> My Lady, I would like to add that the driving task is a demanding one and involves many multi-various tasks occurring at the same time. The hazard for a person under the influence of alcohol is it takes longer to notice a hazard or danger if one should occur; it takes longer to decide what corrective action is appropriate, and it takes longer to execute that decision and the person may tend to make incorrect decisions. So there is increased risk in that process. As well, if the impairment has progressed to the point where the motor skills are affected, the execution of that decision is impaired. So it's not a very graceful attempt at a corrective action. As well, some people tend to make more risks under the influence of alcohol. They do not apply sound reasoning and judgment. They are not able to properly assess the impairment of their driving skills, they are not able to properly assess the risk, not able to properly assess the changing road and weather conditions and adjust for that. But even if they do recognize those as hazards, they may tend to take more risks than a sober driver would.

163 The above comments support the conclusion that the accident occurred as a result of Mr. Nikolaisen's impairment and not as a result of any failure on the part of the respondent. Indeed, when the portions of Mr. Laughlin's testimony that the trial judge relied on are considered in their context, they do not support her conclusion that Mr. Nikolaisen would have been able to react to a sign had one been posted. When asked by counsel whether it was possible for an individual with Mr. Nikolaisen's blood alcohol level to perceive and react to a road sign, Mr. Laughlin responded:

> Yes, it's possible that a person will see and react to it and maybe react properly. It's possible that they will react improperly or may miss it altogether. I think what's key here is that at this level of alcohol, it's more likely that the person under this level of alcohol will either miss the sign or not react properly compared to the sober driver. That the driver with this level of alcohol will make more mistakes than will the sober driver. [Emphasis added.]

In the passage above, it is clear that Mr. Laughlin is merely admitting that anything is possible, while solidly expressing the view that drivers at this level of intoxication are more likely to not react to a sign or other warning. This view is also apparent in the following passage, in which Mr. Laughlin expands on the ability of an intoxicated driver to react to signs and other road conditions:

> What happens with respect to perception under the influence of alcohol is a driver tends to concentrate on the central field of vision, and miss certain indicators on the periphery, that's called tunnel vision. As well, drivers tend to concentrate on the lower part of that central field of view and therefore they don't have a very long preview distance in the course of operating a motor vehicle and looking down the road. And so studies indicate that under the influence of alcohol drivers tend to miss more signs, warnings, indicators, especially those in the peripheral field of view or farther down the road. [Emphasis added.]

164 In argument before this Court, the appellant emphasized that although Mr. Laughlin was the only expert to testify with respect to causation, lay witnesses testified that Mr. Nikolaisen was not visibly impaired prior to leaving the Thiel residence. It is not clear from the trial judge's reasons that she relied on testimony to this effect given by Craig Thiel, Toby Thiel and Paul Housen. To the extent that she did rely on such evidence to establish that the accident was caused in part by the respondent's negligence, I find this reliance to be unreasonable. Whereas the lay witnesses in this case were qualified to give their opinion on whether they, as ordinary drivers, could safely negotiate the segment of Snake Hill Road on which the accident occurred, they were not qualified to assess the degree of Mr. Nikolaisen's impairment. The reason for their lack of qualification in this regard was explained by Mr. Laughlin in the following response to counsel's question on whether it is possible to draw a conclusion from the fact that an individual does not exhibit any impairment of their motor skills and speech:

> ... No, Your Honour, because, My Lady, when you're looking at motor skill impairment or for signs of motor skill impairment, you're looking for signs of intoxication, not impairment. Remember I mentioned that the first components affected by alcohol are cognitive and mental faculties. These are all important in driving. However, it is very difficult when you look at an individual who has been consuming alcohol to tell that they have impaired in attention or divided attention, or concentration, or concentration, or judgment. So as an indicator of impairment, motor skills are not reliable. And if you think about the Criminal Code process, they've been abandoned 30 years ago as a useful indicator of impairment. No longer do we rely on police officers subjective assessment of person's motor skills to determine impairment. [Emphasis added.]

165 It is also clear from the trial judge's reasons that she relied to some extent on evidence that Mr. Nikolaisen successfully negotiated the curve at the point where the driveway to the Thiel residence intersected the road. I agree with the respondent that this fact is simply not relevant. The ability of Mr. Nikolaisen to negotiate this curve does not establish that his driving ability was not impaired. As noted by the respondent, at para. 101 of its factum, he may have been driving more slowly at this point, or he may simply have been lucky. More importantly, this evidence contributes nothing to the issue of whether or not Mr. Nikolaisen would have reacted to a sign on the curve where the accident occurred, had one been present. There was no sign on the curve one faces upon leaving the driveway, just as there was no sign on the curve where the accident took place.

166 At any rate, the trial judge's reliance on Mr. Nikolaisen's successful negotiation of the curve at the location of the Thiel driveway ignores relevant evidence that he had swerved or "fish-tailed" when leaving the Thiel residence. A reasonable inference to be drawn from this evidence is that while Mr. Nikolaisen was able to negotiate this curve, he did not do so free from difficulty. While this evidence may not be significant in and of itself, it should have been enough to alert the trial judge to the problems inherent in the inference she drew from his ability to navigate this earlier curve.

167 In addition to ignoring the relevant evidence of the fish-tail marks, the trial judge failed to consider the relevance of the fact that Mr. Nikolaisen had travelled Snake Hill Road three times in the 18 to 20 hours preceding the accident. In her review of the evidence, she noted at para. 8 of her reasons that: "Mr. Nikolaisen was unfamiliar with Snake Hill Road. While he had in the preceding 24 hours travelled the road three times, only once was in the same direction that he was travelling upon leaving the Thiel residence."

168 I simply cannot see how the trial judge found accidents which occurred when motorists were travelling in the opposite direction relevant to the issue of the respondent's knowledge of a risk to motorists while at the same time

suggesting that the fact that Mr. Nikolaisen had driven the road in the opposite direction twice was irrelevant to the issue of whether or not he would have recognized that the curve posed a risk or that he would have reacted to a warning sign. This discrepancy aside, I find the fact that Mr. Nikolaisen had travelled Snake Hill Road in the same direction when he left the Thiel residence to go to the Jamboree the evening before the accident highly relevant to the causation issue. The finding that the outcome would have been different had Mr. Nikolaisen been forewarned of the curve ignores the fact that he already knew that the curve was there. I agree with the respondent that the obvious reason Mr. Nikolaisen was unable to safely negotiate the curve on the afternoon of the 18 th, despite having negotiated this curve and others without difficulty in the preceding 18 to 20 hours was the combined effect of his drinking, lack of sleep and lack of food.

169 In conclusion on the issue of causation, I wish to clarify that the fact that the trial judge referred to some evidence to support her findings on this issue does not insulate those findings from review by this Court. The standard of review for findings of fact is reasonableness, not absolute deference. Such a standard entitles the appellate court to assess whether or not it was clearly wrong for the trial judge to rely on some evidence when other evidence points overwhelmingly to the opposite conclusion. The logic of this approach was aptly explained by Kerans, *supra*, in the following passage at p. 44:

> The key to the problem is whether the reviewer is to look merely for "evidence to support" the finding. Some evidence might indeed support the finding, but other evidence may point overwhelmingly the other way. A court might be able to say that reliance on the "some" in the face of the "other" was not what the reasonable trier of fact would do; indeed, it might say that, in all the circumstances it was convinced that to rely on the one in the face of the other was quite unreasonable. To say that "some evidence" is enough, then, without regard to that "other evidence" is to turn one's back on review for reasonableness.

D. Did the Courts Below Err in Finding that no Common Law Duty of Care Exists Alongside the Statutory Duty Imposed Under Section 192 of the Act?

170 The appellant urges this Court to find that a common law duty of care exists alongside the statutory duty of care imposed on the respondent by s. 192 of *The Rural Municipality Act, 1989*. According to the appellant, the application of the common law duty of care would free the Court from the need to focus on how a reasonable driver exercising ordinary care would have navigated the road in question. The appellant submits that the Court would instead apply the "classic reasonableness formulation" which, in its view, would require the Court to take into account the likelihood of a known or foreseeable harm, the gravity of that harm, and the burden or cost of preventing that harm. The appellant argues that the respondent would be held liable under this test.

171 The courts below rejected the above argument when it was put to them by the appellant. I would not interfere with their ruling on this issue for the reason that it is unnecessary for this Court to impose a common law duty of care where a statutory one clearly exists. In any event, the application of the common law test would not affect the outcome in these proceedings.

172 I agree with the respondent's submissions that in this case, where the legislature has clearly imposed a statutory duty of care on the respondents, it would be redundant and unnecessary to find that a common law duty of care exists. The two-part test to establish a common law duty of care set out in *Nielsen v. Kamloops (City)*, [1984] 2 S.C.R. 2 (S.C.C.), simply has no application where the legislature has defined a statutory duty. As was stated by this Court in *Brown v. British Columbia (Minister of Transportation & Highways)*, [1994] 1 S.C.R. 420 (S.C.C.), at p. 424:

> ... if a statutory duty to maintain existed as it does in some provinces, it would be unnecessary to find a private law duty on the basis of the neighbourhood principle in *Anns v. Merton London Borough Council*, [1978] A.C. 728. Moreover, it is only necessary to consider the policy/operational dichotomy in connection with the search for a private law duty of care.

All of the authorities cited by the appellant as support for the imposition of an independent common law duty of care can be distinguished from the case at hand on the basis that no statutory duty of care existed (*Just*, *supra*; *Brown*, *supra*; *Swinamer v. Nova Scotia (Attorney General)*, [1994] 1 S.C.R. 445 (S.C.C.); *Ryan*, *supra*).

173 In addition, I find that the outcome in this case would not be different if the case were determined according to ordinary negligence principles. First, were the Court to engage in a common law analysis, it would still look to the statutory standard of care as laid out in *The Rural Municipality Act, 1989*, as interpreted by the case law in order to assess the scope of liability owed by the respondent to the appellant. As this Court stated in *Ryan*, *supra*, at para. 29:

> Statutory standards can, however, be highly relevant to the assessment of reasonable conduct in a particular case, and in fact may render reasonable an act or omission which would otherwise appear to be negligent. This allows courts to consider the legislative framework in which people and companies must operate, while at the same time recognizing that one cannot avoid the underlying obligation of reasonable care simply by discharging statutory duties.

174 Moreover, even under the common law analysis, this Court would be called upon to question the type of hazards that the respondent, in this case, ought to have foreseen. Whatever the approach, it is only reasonable to expect a municipality to foresee accidents which occur as a result of the conditions of the road, and not, as in this case, as a result of the condition of the driver.

175 The Courts have long restricted the standard of care under the statutory duty to require municipalities to repair only those hazards which would pose a risk to the reasonable driver exercising ordinary care. Compelling reasons exist to maintain this interpretation. The municipalities within the province of Saskatchewan have some 175,000 kilometres of roads under their care and control, 45,000 kilometres of which fall within the "bladed trail" category. These municipalities, for the most part, do not boast large, permanent staffs with extensive time and budgetary resources. To expand the repair obligation of municipalities to require them to take into account the actions of unreasonable or careless drivers when discharging this duty would signify a drastic and unworkable change to the current standard. Accordingly, it is a change that I would not be prepared to make.

VII — Disposition

176 In the result, the judgment of the Saskatchewan Court of Appeal is affirmed and the appeal is dismissed with costs.

Appeal allowed.

Pourvoi accueilli.

Footnotes

* A corrigendum issued by the court on May 29, 2002 has been incorporated herein.

TAB
“2”

1999 CarswellBC 149
British Columbia Supreme Court

Gene Moses Construction Ltd., Re

1999 CarswellBC 149, [1999] B.C.J. No. 141, 4 B.C.T.C. 76, 85 A.C.W.S. (3d) 747, 9 C.B.R. (4th) 275

In the Matter of the Notice of Intention to File a Proposal of Gene Moses Construction Ltd.

Master Powers

Heard: January 11, 1999
Judgment: January 13, 1999
Docket: Vernon 22283, Bankruptcy 188154

Counsel: *F.J. Quinn*, for Gene Moses Construction Ltd.
R.C. Hunter, Q.C., for GE Capital Corporation.

Subject: Insolvency; Property

MOTION by company making proposal in bankruptcy for order that funds released by bank to creditor be returned.

***Master Powers*:**

The Application

1 Gene Moses Construction Ltd. (the company) seeks the declaration that GE Capital Leasing Services Inc. (GE Capital) unlawfully removed $29, 149.13 from the bank account of the company and for an order that those funds be returned to the company account.

Background

2 The company leased a piece of logging equipment with the assistance of GE Capital Leasing Services Inc. The cost of this equipment called a forwarder was $454,351. The monthly lease payments were $12,198.06 payable on the 1st day of each and every month excluding April and May. The payments were made by way of pre-authorization to debit an account. The lease was originally entered into on July 30, 1997. Problems arose in March of 1998 when payments were not made. GE Capital agreed to restructure the lease to allow for some skipped payments for 1998 and the payments were to be $12, 342.54 per month commencing July 1, 1998.

3 The company says that the method of payment was changed after the lease was restructured and this has not been denied by GE Capital. The company says that payments were not always processed on the 1st of the month but only after specific authorization by Mr. and Ms. Moses. GE Capital says that their position was that they had worked with the company but they advised the company it was imperative that the payments be made. $10,000 was paid towards the October payment on November 3, 1998 but no payments were made on the November or December accounts up to December 17, 1998.

4 The company executed a Notice of Intention to File a Proposal under the *Bankruptcy and Insolvency Act*. The notice was filed with the official receiver on December 17, 1998. Ms. Louise Moses states that she spoke to Mr. Sutherland, a representative of GE Capital, some time after December 17, 1998 and before December 22, 1998 and advised him that the notice had been filed. Mr. Sutherland does acknowledge speaking with Ms. Moses on December 15, 1998 and

December 17, 1998, but says he did not have any knowledge of the proposal until he was advised by telephone by the trustee on December 23, 1998.

5 On December 22, 1998 GE Capital presented three debit memos to the company's bank in the amount of $4,464.05, $12,342.54 and $12,342.54, for a total of $29,149.13. The bank honoured those debit memos and paid $29,149.13 to GE Capital.

6 The company says that the withdrawal of this money prevents the company from meeting its payroll and its payments to the Bank of Montreal. They also say the insurance on the forwarder has been cancelled for non payment of premiums. They also say that it may be detrimental to their efforts at reorganizing their affairs pursuant to the *Bankruptcy Act*.

7 GE Capital takes the position that they were unaware of the proposal and after attempting to deal with the company, simply processed the debit memos as they were entitled to do in order to collect the arrears of lease payments.

Bankruptcy and Insolvency Act

8 The company relies on Part III, Division I of the *Bankruptcy and Insolvency Act* and Section 69 which they say operates as a stay of proceedings upon the filing of the proposal or a notice of intention to file a proposal whether or not a creditor has knowledge of the notice or the proposal. The section relied on is as follows:

> 69 (1) Subject to subsections (2) and (3) and section 69.4 and 69.5 on the filing of a notice of intention under section 50.4 by an insolvent person,
>
> > (a) no creditor has any remedy against the insolvent person or the insolvent person's property, or shall commence or continue any action, execution or other proceedings, for the recovery of a claim provable in bankruptcy,

9 The issue is whether the presentation of the debit memos to collect the arrears of lease payments was the exercise of a "remedy" and prohibited pursuant to section 69(1) of the Act.

10 The company refers to a number of decisions in support of its position including:

Vachon v. Canada (Employment & Immigration Commission) (1985), 57 C.B.R. (N.S.) 113 (S.C.C.). This deal with a stay under s. 49(1) of the *Bankruptcy Act* at the time. Revenue Canada had made an overpayment to an individual who subsequently became bankrupt. The individual subsequently became entitled to Unemployment Insurance benefits but Revenue Canada exercised its statutory authority to set off the overpayment against the new benefits. Subsequent to a discharge from bankruptcy the bankrupt applied to the court for a declaration that such set off was contrary to section 49(1) of the *Bankruptcy Act*. Section 49(1) of the *Bankruptcy Act* provided:

> Upon the filing of a proposal made by an insolvent person or upon the bankruptcy of any debtor, no creditor with a claim provable in bankruptcy shall have any remedy against the debtor or his property or shall commence or continue any action, execution or other proceeding for the recovery of a claim provable in bankruptcy until the trustee has been discharged or until a proposal has been refused, unless with the leave of the court and on such terms as the court may impose.

11 The court decided that the *Bankruptcy Act* should be broadly interpreted and that the remedy included the statutory retention of subsequent benefits. The court said at page 121:

> This broad meaning is confirmed by the fact that the legislature took the trouble to exclude actions against either the creditor or his property.

12 This broad meaning was consistent with the general scheme of the *Bankruptcy and Insolvency Act* (page 125). Remedies were not restricted to proceedings of a judicial nature.

13 It was also referred to *National Bank of Canada v. Dutch Industries Ltd.* (1996), 45 C.B.R. (3d) 103 (Sask. Q.B.). In this case the court dealt with a bank's right to impose margining requirements which allowed the bank to take the debtor's cash deposits made to its account. The bank applied to lift the stay but the court found if the stay were lifted it would prevent the debtor from making a viable proposal. The stay was not lifted but terms were imposed on the monies deposited into the accounts. The court treated the contractual margining rights as a remedy covered by section 69(1) of the Act.

14 I conclude that "remedy" in section 69 must be given a broad meaning. I also conclude that in presenting the debit memos for payment of the arrears of lease payments GE Capital was exercising a remedy to try and collect its debt. The exercise of this remedy is stayed pursuant to section 69(1) of the *Bankruptcy and Insolvency Act* and therefore GE Capital was not entitled to the use of those debits memos.

15 It is not necessary for me to decide whether Ms. Moses actually told Mr. Sutherland about the notice of intention to file a proposal because knowledge of the filing of the notice is not necessary for the stay to be effective.

16 I grant the declaration that the sum of $29,149.13 was removed from the account of the company at the Bank of Montreal contrary to the provisions of section 69(1) of the *Bankruptcy and Insolvency Act* and direct that those funds be repaid to the company's account at the Bank of Montreal.

17 The fact that the insurance on the forwarder has been cancelled does raise a concern. GE Capital is at liberty to apply to lift the stay under section 69 of the *Bankruptcy and Insolvency Act* and may wish to do so if satisfactory arrangements cannot be made for the placement of insurance on the forwarder. Neither party had an opportunity to address that issue at the hearing before me.

18 The point argued by the parties was a novel one with limited case authority to support either position and I find it is appropriate that each party bear their own costs.

Motion granted.

TAB
“3”

2000 BCSC 1316
British Columbia Supreme Court [In Chambers]

Startek Computer Inc. (Trustee of) v. Samtack Computer Inc.

2000 CarswellBC 1802, 2000 BCSC 1316, [2000] B.C.W.L.D. 1297, 20 C.B.R. (4th) 166, 99 A.C.W.S. (3d) 209

Campbell, Saunders Ltd., Trustee in Bankruptcy of the Estate of Startek Computer Inc., Plaintiff and Samtack Computer Inc., Defendant

Harvey J.

Heard: August 30, 2000
Judgment: September 1, 2000
Docket: Vancouver S001120

Counsel: *C.L. Shaley*, for Plaintiff.
C. Tong, for Defendant.

Subject: Insolvency

APPLICATION by trustee in bankruptcy for summary judgment against vendor.

***Harvey J.* (In Chambers):**

1 The plaintiff applies for judgment pursuant to Rule 18A against the defendant Samtack Computer Inc. ("Samtack") in the amount of $20,098.88 plus interest and costs.

2 Startek Computer Inc. ("Startek") paid the defendant for certain goods, computer equipment, sold by it to Startek with a cheque. That cheque was returned to the defendant for non-sufficient funds.

3 Startek provided the defendant with a replacement cheque for the goods. The defendant negotiated the replacement cheque.

4 On June 17 two events occurred. Startek filed a Notice of Intention to Make a Proposal pursuant to the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 and pursuant to s. 69(2) of the said statute a stay of proceedings was in effect as of June 17, 1999.

5 On or about June 21, 1999 without the knowledge or consent of Startek or the trustee, the defendant renegotiated the original cheque which was cleared by Startek's bank.

6 The matter has a history.

7 On July 6, 2000 the matter came on for hearing before Pitfield J. At that time Samtack claimed that the first cheque and the replacement cheque were not issued to pay for the same three invoices. Samtack claimed it had evidence that supported its position but that evidence was not before the court. As a result, Pitfield J. ordered Samtack to produce this evidence and the application was adjourned accordingly.

8 In due course Samtack forwarded copies of the invoices it claims were paid by the first cheque and the replacement cheque.

9 The issue is framed in counsel for the plaintiff's outline of argument as follows:

Is Samtack liable to the trustee in the amount of $20,098.88 for cashing both the first cheque and the replacement cheque on the basis that renegotiating the first cheque was a remedy prohibited as a result of the stay of proceedings imposed by section 69(1) of the BIA.

10 The answer to this question is yes.

11 The short answer to this application is that Samtack by renegotiating what has been referred to as the First Cheque on or about June 21, 1999, without the knowledge or consent of Startek or the trustee, exercised a remedy and violated the existing stay of proceedings. Further, upon a comparison of the invoices and particularly the further material ordered to be produced by Pitfield J. it is apparent the cheques were issued to pay for the same three invoices and not as alleged by Samtack invoices in relation to additional goods sold to Startek. In this perspective Samtack was paid twice for the same goods and the same invoices.

12 I do not accept Samtack's assertion that it has some form of defence based upon the fact it was not aware of the filing and the stay of proceedings referred to supra. In this regard in *Re Gene Moses Construction Ltd.* (1999), 9 C.B.R. (4th) 275 (B.C. Master) the Court of Appeal confirms that knowledge of the filing of the Notice of Intention to make a proposal is not necessary for the stay to be effective. It follows that in this case pursuant to the relevant provision of the BIA a stay of proceedings was in effect as of June 17, 1999 and no creditor, including Samtack, had any remedy against it for a claim provable in bankruptcy.

13 I grant the application for summary judgment in the amount as claimed together with interest and costs on Scale 3.

Application granted.

End of Document

TAB
“4”

37 CBR-ART 161
Canadian Bankruptcy Reports (Articles)
2008

Dealing with Suppliers in A Reorganization

E. Patrick Shea *

I. — Introduction

Reorganization is the preferred option for a company facing financial difficulty where the going concern value of the enterprise is greater than its liquidation value. By finding a going concern solution that will enable the debtor's business to continue, stakeholders should realize greater returns than they would in a liquidation. If, however, a reorganization is to be successful, it is essential that the debtor continue to operate in order to preserve the going concern value of its business. To do this, the debtor must be able to secure the goods and services it needs to operate. It is not enough to obtain a stay of proceedings that prevents creditors from taking steps to enforce claims against the debtor's assets; steps have to be taken to ensure that the debtor is able to continue carrying on business.

Generally, suppliers will continue to supply goods and services after the commencement of a reorganization, provided the debtor is able to provide reasonable assurances that prompt payment will be received by the supplier. In most situations, the supplier is as anxious to do business with the debtor and preserve the debtor's business as the debtor is to do business with the supplier. From time to time, however, a supplier will threaten to stop supplying unless amounts owing by the debtor as at the commencement of the reorganization are paid. The effect of such a payment if made, will be to elevate the priority of suppliers unsecured claim — the supplier receives a preference over other unsecured creditors — in contravention of the basic principles underlying insolvency laws.

This paper will look at the position of suppliers in the context of reorganization proceedings under the *Bankruptcy and Insolvency Act* [1] and the *Companies' Creditors Arrangement Act* [2] and various options available to provide suppliers with comfort that they will be paid for going-forward supply. Special attention will be paid to the issues encountered in paying pre-filing claims in order to secure on-going supply.

II. — Treatment of Suppliers in a Reorganization

There are various strategies available to debtors and suppliers in both BIA and CCAA reorganizations that can provide reasonable comfort that payment will be made for going-forward supply.

A. — Bankruptcy and Insolvency Act

In the case of proposal proceedings under the BIA, the BIA prohibits parties (including public utilities) from terminating their contracts or discontinuing service on the basis only that the debtor is insolvent, has commenced a reorganization or, in the case of leases, licenses and utilities, has failed to make a payment due prior to the commencement of the reorganization [3].

> 65.1(1) If a notice of intention or a proposal has been filed in respect of an insolvent person, no person may terminate or amend any agreement with the insolvent person, or claim an accelerated payment, or a forfeiture of the term, under any agreement with the insolvent person, by reason only that
>
> (a) the insolvent person is insolvent; or

(b) a notice of intention or a proposal has been filed in respect of the insolvent person.

(2) Where the agreement referred to in subsection (1) is a lease or a licensing agreement, subsection (1) shall be read as including the following paragraph:

(c) the insolvent person has not paid rent or royalties, as the case may be, or other payments of a similar nature, in respect of a period preceding the filing of

(i) the notice of intention, if one was filed, or

(ii) the proposal, if no notice of intention was filed.

(3) Where a notice of intention or a proposal has been filed in respect of an insolvent person, no public utility may discontinue service to that insolvent person by reason only that

(a) the insolvent person is insolvent;

(b) a notice of intention or a proposal has been filed in respect of the insolvent person; or

(c) the insolvent person has not paid for services rendered, or material provided, before the filing of

(i) the notice of intention, if one was filed, or

(ii) the proposal, if no notice of intention was filed.

There is no clear guidance in the BIA or the existing cases as to what is required in order for there to be an "agreement". The BIA does not require that there be a written agreement so section 65.1 of the BIA probably restricts the termination of verbal contracts (to the extent that the debtor can establish such a contract exists). It is not, however, clear whether section 65.1 is broad enough to include arrangements for supply where the there is no contract that requires the supplier to provide goods or services, but there is a long term course of conduct between the parties whereby the supplier has delivered goods and services to the debtor as requested by the debtor.

It is clear, however, that section 65.1 of the BIA only prevents termination of agreements on the basis of the grounds specified in subsections 65(1), (2) and (3). If there are other defaults under the agreement that would otherwise permit the other party to the agreement to terminate, then section 65.1 does not prevent the termination of the contract based on those defaults. However, the issue in such circumstances will be the actual basis for the termination. Where, for example, the debtor relies on a pre-existing technical default to terminate an agreement after the commencement of proposal proceedings, the Court may inquire as to whether the actual basis for termination is insolvency or the commencement of the proposal proceedings.

It is impossible to contract out of section 65.1 of the BIA, but the Court may declare that the provisions do not apply if the other party to the contract satisfies the court that the operation of the provisions would likely cause "significant financial hardship" [4].

65.1(5) Any provision in an agreement that has the effect of providing for, or permitting, anything that, in substance, is contrary to subsections (1) to (3) is of no force or effect.

(6) The court may, on application by a party to an agreement or by a public utility, declare that subsections (1) to (3) do not apply, or apply only to the extent declared by the court, where the applicant satisfies the court that the operation of those subsections would likely cause it significant financial hardship.

There is not a great deal of case law dealing with what will qualify as significant financial hardship. In *Toronto-Dominion Bank v. Ty (Canada) Inc.* [5] the Court agreed that to succeed under subsection 65.1(6), the contract party must be able to show quantitatively the prejudice that it will suffer if the restriction on termination is not removed. This would probably have to involve establishing something more than the fact that the supplier made a bad bargain with the debtor.

In proposal proceedings under the BIA, risk of non-payment for on-going supply is on the supplier. Suppliers who chose to do business with the reorganizing debtor are not provided with any assurance that they will be paid. The BIA does not, for example, provide any special priority for amounts owing in respect of goods or services supplied to the reorganizing debtor. In the event that the reorganization is not successful, any amounts owing to suppliers in respect of goods and services supplied after the commencement of the proposal proceedings will be unsecured claims in the resulting bankruptcy [6]. It is, as a result, necessary for suppliers to take steps to ensure that they protect themselves in the event the debtor's reorganization fails.

From the perspective of suppliers, the key to going forward supply is the fact that the BIA provides that suppliers may require immediate payment for goods and services provided to the reorganizing debtor after proposal proceedings are commenced and they cannot be required to extend further credit to the reorganizing debtor [7]. The supplier can request immediate payment notwithstanding what the agreement provides with respect to payment terms [8]. The Court has no jurisdiction to require that a supplier continue to provide goods or services to the reorganizing debtor on credit, even where the debtor provides security [9].

> 65.1(4) Nothing in subsections (1) to (3) shall be construed
>
> (a) as prohibiting a person from requiring immediate payment for goods, services, use of leased or licensed property or other valuable consideration provided after the filing of
>
> (i) the notice of intention, if one was filed, or
>
> (ii) the proposal, if no notice of intention was filed; or
>
> (b) as requiring the further advance of money or credit.

The effect of subsections 65.1(1), (2) and (5) is that a party providing such goods and services to the reorganizing debtor before the commencement of the proposal proceedings is prevented from exercising certain contractual rights that it may have to terminate or amend the contract or lease or to accelerate payment. In an attempt to balance the interests of the debtor and the party who is required to continue to supply, the supplier may require immediate payment for goods, services or the use of leased property.

In summary, where a supplier is subject to a supply agreement, the supplier's right to terminate the agreement is restricted, but it can demand immediate payment from the reorganizing debtor for any goods or services it supplies. If the goods and services the supplier provides cannot be easily (or economically) replaced — the supplier is critical — and the debtor is not able to make immediate payment or requires that the supplier supply on credit, then the supplier and the debtor will have to negotiate the terms of supply going forward. Suppliers who do not have supply agreements with the debtor are free to refuse to supply goods and services after the commencement of proposal proceedings if they are not comfortable that they will be paid. If the supplier is critical, then the debtor will have to negotiate arrangements with the supplier to secure going-forward supply.

With respect to assurances of payment for goods and services supplied after the commencement of the proposal proceedings, some (limited) comfort that suppliers will be paid arises from the fact that the debtor is required to prepare and file a cash flow projection detailing its anticipated cash flow in the reorganization proceeding. The cash flow should provide for the payment of all the expenses necessary for the debtor to carry on business. The proposal trustee is required

to review and opine on the debtor's cash flow projection. The cash flow is, however, just a projection and there is a risk that the debtor will go "off-side" the cash flows or that the proposal proceedings will terminate before the debtor has had the opportunity to make payment for goods or services.

What measures are ultimately put in place as between the debtor and its suppliers will depend on a number of factors, including: (a) the relative bargaining power of the supplier and the debtor; and (b) the financial ability of the debtor (which may restrict the options available). There are a wide variety of ways that the debtor can provide these assurances. These include:

(a) letters of credit in favour of the supplier;

(b) cash (or certified cheque) on delivery;

(c) cash in advance of delivery;

(d) personal guarantees from the principals of the reorganizing debtor or some other solvent third party;

(e) cash deposits provided to the supplier or a third party [10]; and

(f) security to secure obligations owing to the supplier for goods or services delivered after the commencement of the proceeding [11].

Aside from negotiated arrangements between the debtor and each of its suppliers, it may be possible to have an interim receiver appointed in the proposal proceedings in order to provide enhanced assurances that suppliers will be paid for goods and services [12]. In the reorganization of Atlantic HVAC Systems Ltd., for example, the proposal trustee was appointed as interim receiver over the reorganizing debtor's cash flow [13]. The interim receivership order provided that the interim receiver was to collect all of the debtor's receivables and distribute those receivables to suppliers in accordance with an agreed cash flow projection. In this scenario, there is some exposure that the debtor will not operate within the cash flow projections. This risk was mitigated somewhat by the role that the BIA assigns to the proposal trustee to monitor the debtor's cash flow. Under the BIA, the proposal trustee is required to monitor the debtor's cash flow and report any material adverse change to creditors [14].

B. — Companies' Creditors Arrangement Act

i. — Current Law

The current position of suppliers in reorganizations under the CCAA is somewhat different than under BIA proposals. This is due to the fact that the CCAA, unlike the BIA, is not intended to be a complete "code" detailing the procedural and substantive aspects of the reorganization procedure. The CCAA establishes a basic framework and then leaves it up to stakeholders to develop the structure that the reorganization will take through Court orders. As a result, the treatment afforded to suppliers can vary from case to case and will depend on the orders made in the CCAA proceedings.

The CCAA does not contain provisions parallel to subsections 65.1(1) and (2) of the BIA. It is, however, common for the initial order under the CCAA to include provisions that restrict the termination of agreements with the reorganizing debtor. Typically the language used in these provisions in CCAA orders is broader than section 65.1 of the BIA insofar as the provisions prevent the other party from terminating the agreements for any reason whatsoever [15].

One critical issue that remains unresolved in a CCAA reorganization is whether suppliers who are not party to supply agreements with the debtor and who supply goods or services on a "purchase order by purchase order" basis can be forced to continue to supply after the commencement of a CCAA reorganization — does the Court have the jurisdiction to force supplier to continue to supply in accordance with pre-filing arrangements? It is not uncommon for debtors reorganizing

under the CCAA to take the position that the terms of the initial CCAA order made by the Court require that suppliers continue to provide goods and services to the reorganizing debtor in accordance with the pre-filing "arrangements" in order to enhance their bargaining position with suppliers.

The closest that the Courts appear to have come is in *Quintette Coal Ltd. v. Nippon Steel Corp.* [16] where the British Columbia Court of Appeal found:

> "To the extent that a general principle can be extracted from the few cases directly on point, and the others in which there is persuasive obiter, it would appear to be that the courts have concluded that under s. 11 there is a discretionary power to restrain judicial or extra judicial conduct against the debtor company the effect of which is, or would be, seriously to impair the ability of the debtor company to continue in business during the compromise or arrangement negotiating period. The power is discretionary and therefore to be exercised judicially. It would be a reasonable expectation that it would be *extremely unlikely* that the power would be exercised where the result would be to enforce the continued supply of goods and services to the debtor company without payment for current deliveries, whereas it would not be unlikely when the result would be to enforce payment for goods thereafter taken from, or services thereafter received from, the debtor company, . . . " (emphasis added)

The Court in *Quintette* left it open for a court to force a person to supply the debtor provided measures were put in place to ensure payment.

In terms of payment for supply going forward, it is not uncommon for reorganizing debtors to assert that the initial order made under section 11 of the CCAA require that suppliers continue to supply in accordance with the same payment terms as were in place pre-filing. However, the CCAA specifically prohibits the Court from making an order under section 11 of the CCAA that has this effect. The CCAA contains language that parallels subsection 65.1(4) of the BIA. Section 11.3 of the CCAA provides:

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

While section 11.3 of the CCAA provides suppliers with the ability to protect their exposure on post-filing supply, the Courts have found that the section should be construed narrowly [17]. In a CCAA reorganization, a supplier is entitled, relying on section 11.3, to require payment of the contract price for any goods or services provided after the commencement of the reorganization [18]. Section 11.3 of the CCAA does not, however, create any special interest for suppliers who chose to supply goods or services to the reorganizing debtor [19]. The Court has, however, exercised its jurisdiction when terminating a reorganization to provide security or a segregated fund to pay unpaid suppliers who had supplied goods or services to a reorganizing debtor in reliance on provisions in the CCAA that implied that creditors would be paid in the ordinary course for any goods or services supplied [20]. Initial CCAA orders often require that suppliers continue to supply goods and services to the reorganizing debtor so long as they are paid for goods and services supplied after the date of the order, but do not oblige the debtor to pay for such goods and services. The debtor is typically authorized, but not obliged, to make such payments.

In CCAA reorganization the debtor is required to prepare and file a cash flow projection. These cash flow projections must be filed with the Court at the time the application to commence the CCAA proceedings is brought. The Court is, therefore, able to evaluate whether the debtor is in a position to pay for the goods and services it requires to continue operating. There is, however, always the possibility that the debtor will go "off side" the cash flow projections. In a CCAA proceeding the monitor is required to monitor the cash flow and report any material adverse changes [21].

Notwithstanding that a CCAA reorganization takes place under Court supervision, it is typically up to the debtor and its suppliers to negotiate the terms upon which goods and services will be supplied after the commencement of the proceedings. The negotiated options available to provide assurances to suppliers that they will be paid for goods and services supplied after the commencement of a CCAA reorganization are, essentially, the same as those available in BIA proposals.

Negotiations between the debtor and its suppliers take place in the shadow of the initial order made in the CCAA reorganization and may be influenced by the terms of the initial order. For example, provisions in an initial order that can be interpreted to require suppliers to continue to supply in accordance with the existing "arrangements" may be interpreted as requiring that suppliers without supply contracts continue to supply the debtor on a purchase order by purchase order basis.

Aside from negotiated arrangements, the judicially-driven nature of CCAA reorganizations provides the debtor with the ability to assure that suppliers will be paid. The debtor can ask the Court to make orders in the CCAA proceeding that have the effect of providing suppliers with assurances of payment so that they will be more willing to supply on credit.

The Court can implement payment systems which ensure that suppliers will be paid for goods or services delivered after the commencement of the reorganization or grant security to suppliers to secure the payment of amounts owing by the debtor for goods or services supplied after the commencement of the reorganization. In the first reorganization of the T. Eaton Company the Court authorized the debtor to put in place a supplier payment program supervised by the monitor that virtually guaranteed that suppliers would be paid for any inventory ordered by the debtor.

The Court can also provide suppliers with priority security over the debtor's assets for any amounts owing in respect of goods or services delivered after the commencement of the reorganization. In the 1992 CCAA reorganization of Westar Mining Ltd., the British Columbia Superior Court made an order clarifying that the Court had no jurisdiction to require suppliers to extend further credit to the reorganizing debtor and granted a charge over certain of the debtor's assets to secure the payment of amounts owing to suppliers for goods and services delivered after the commencement of the reorganization. The Court found that its jurisdiction to grant a charge over the reorganizing debtor's assets could properly be exercised to protect suppliers prepared to extend credit to keep the debtor operating [22].

The Court will not grant a charge in every CCAA reorganization. The granting of a priority charge for post-filing suppliers has the potential to adversely impact the debtor's other secured creditors by eroding their security. The willingness of the Court to grant a charge for post-filing supply and the extent to which any charge granted will provide adequate protection to suppliers will vary depending on the circumstances of each case. For example, if a charge is granted that is subordinate to the debtor's existing secured creditors, the adequacy of the protection afforded by the charge will depend on the value of the debtor's assets.

ii. — Proposed Amendments

An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts [23] was introduced in the House of Commons on June 3, 2005 and received Royal Assent on November 25, 2005, but has not yet been proclaimed in force.

Insolvency Reform Act 2005 will amend the CCAA to restrict the ability of a party to an agreement (including a security agreement) with a reorganizing debtor from terminating or amending the agreement on the basis of the CCAA filing or, in the case of leases or utilities, on the basis that amounts were owing as at the date of the debtor's initial application under the CCAA. [24] It will not be possible to contract out of these restrictions, [25] but the Court will have the jurisdiction to declare that the new provisions do not apply where the other party to the agreement can establish that the inability to terminate will likely cause "significant financial hardship". [26]

The proposed CCAA provisions are intended to have the same effect as the existing provisions of the BIA discussed above. [27]

III. — Paying Pre-Filing Claims

In reorganizations under both the BIA and the CCAA, amounts owing by the reorganizing debtor to its suppliers as at the date the reorganization is commenced — pre-filing claims — are subject to compromise in the debtor's reorganization [28]. In some circumstances, suppliers who believe that they are essential to the debtor's business will attempt to leverage their position to force the debtor to pay their pre-filing claims in full as a condition of continuing to supply. Depending on the circumstances, the debtor may have no choice but to make the payment to remain in business.

In these circumstances, the objective is to ensure that the debtor's ability to carry on business will not be disrupted while, at the same time, ensuring that the process is transparent and the general body of creditors is protected from the being held hostage by a supplier. To the extent that the debtor believes that the goods or services supplied by a supplier are: (a) essential to the ability of the debtor to continue to carry on business; and (b) a replacement supplier cannot be found or the cost of finding a replacement supplier is prohibitive, the supplier will be in a position to secure better terms for supply, terms that provide better assurances of payment.

This portion of the paper will look at how preferential payments to suppliers are dealt with in reorganizations under the BIA and the CCAA.

A. — Bankruptcy and Insolvency Act

The BIA provides a substantive and procedural code for the debtor's reorganization and it is, comparatively, rare for the Court to become involved in a BIA proposal. (There are no reported cases dealing with the circumstances in which a reorganizing debtor can make preferential payments to suppliers.) The debtor doesn't typically ask permission from the Court to make the payment. The debtor typically makes the decision as to what he has to do — and what he has to pay — to get suppliers to continue to supply. The BIA does, however, provide a certain degree of protection to the debtor's stakeholders to ensure that they are not prejudiced should such payments be made.

The automatic statutory stay of proceedings that arises in proposal proceedings under the BIA prevents creditors from taking or continuing any proceedings to recover a claim provable against the reorganizing debtor [29] — debts existing as at the date of the filing of the notice of intention or the proposal.

> 69(1) Subject to subsections (2) and (3) and sections 69.4 and 69.5, on the filing of a notice of intention under section 50.4 by an insolvent person,
>
> (a) no creditor has any remedy against the insolvent person or the insolvent person's property, or shall commence or continue any action, execution or other proceedings, for the recovery of a claim provable in bankruptcy,
>
> (b) no provision of a security agreement between the insolvent person and a secured creditor that provides, in substance, that on
>
> (i) the insolvent person's insolvency, (ii) the default by the insolvent person of an obligation under the security agreement, or (iii) the filing by the insolvent person of a notice of intention under section 50.4,
>
> the insolvent person ceases to have such rights to use or deal with assets secured under the agreement as he would otherwise have, has any force or effect,

> 69.1 (1) Subject to subsections (2) to (6) and sections 69.4 and 69.5, on the filing of a proposal under subsection 62(1) in respect of an insolvent person,
>
> (a) no creditor has any remedy against the insolvent person or the insolvent person's property, or shall commence or continue any action, execution or other proceedings, for the recovery of a claim provable in bankruptcy, until the trustee has been discharged or the insolvent person becomes bankrupt;
>
> (b) no provision of a security agreement between the insolvent person and a secured creditor that provides, in substance, that on
>
> (i) the insolvent person's insolvency,
>
> (ii) the default by the insolvent person of an obligation under the security agreement, or
>
> (iii) the filing of a notice of intention under section 50.4 or of a proposal under subsection 62(1) in respect of the insolvent person, the insolvent person ceases to have such rights to use or deal with assets secured under the agreement as the insolvent person would otherwise have, has any force or effect until the trustee has been discharged or the insolvent person becomes bankrupt;

There is, however, no specific prohibition in the BIA on the debtor effecting payment of claims provable in the proposal proceedings. Instead, the BIA provides the trustee in the proposal (or the bankruptcy trustee in the event the proposal fails) with remedies against any creditor who receives such a payment on the basis that the payment is a preference. Payments to critical suppliers in the context of proposal proceedings are best analyzed on the basis that they are a preference.

Section 95 of the BIA deals with preferential payments to creditors.

> 95(1) Every transfer of property, every charge made on property, 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, when it is made, given, 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, or in the Province of Quebec, may not be set up against, the trustee in the bankruptcy.
>
> (2) If any 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. [30]

Section 95 has the practical effect of placing the risk of any payments to critical suppliers on the supplier rather than the debtor.

In the event that the debtor's reorganization is not successful, a bankruptcy results [31]. In the context of the bankruptcy that results from a failed proposal, section 95 is intended to be structured to capture all payments made by the debtor between the date that the notice of intention or proposal was filed up to the date of the bankruptcy as well as payment made prior to the commencement of the reorganization. The bankruptcy trustee should, therefore, have the ability to challenge any payments made by the debtor to critical suppliers after the commencement of the reorganization on the basis that they were preferences. Where the bankruptcy trustee refuses or neglects to take steps to challenge these transactions, other creditors can ask to have the bankruptcy trustee's right to challenge these payments assigned to them pursuant to section 38 of the BIA [32].

> 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.

If the debtor's reorganization is successful, payments to critical suppliers to secure going-forward supply may still be subject to attack. As a general rule, sections 91 through to 101 of the BIA apply in proposal proceedings unless the proposal provides otherwise [33].

> 101.1(1) Where a proposal is made under Division I of Part III, sections 91 to 101 apply to the proposal, with such modifications as the circumstances require, except where the proposal otherwise provides.
>
> (2) For the purposes of subsection (1), any reference in sections 91 to 101 to "becomes bankrupt" shall be construed as a reference to "files a notice of intention" or "files a proposal", whichever filing was done first, and any reference in those sections to a bankrupt shall be construed as a reference to the debtor in respect of whom the proposal is filed.

In the context of a payment to a critical supplier, the practical effect of section 101.1 is to allow the unsecured creditors and the Court to determine if they believe the payment was justified in the circumstances.

The fact that payments have been made to critical suppliers is something that will be brought to the attention of the unsecured creditors by the trustee supervising the debtor's proposal. The unsecured creditors will then be able to either instruct the proposal trustee or take steps to attack the payments as preferences or seek an order under section 38 of the BIA. It is, however, open to the debtor to provide in its proposal that the sections do not apply by providing specific language to that effect in its proposal [34].

Any exclusion of the ability to attack preferences is only effective if the debtor's proposal is accepted by the required majority of the debtor's unsecured creditors and approved by the Court. If the proposal does exclude the application of section 95, then the creditors can decide to vote against the acceptance of the proposal and trigger a bankruptcy in the context of which the payments should be attackable.

Where the proposal provides that sections 91 through to 101 do not apply, the proposal trustee should report to the creditors on any transaction of which it is aware that might be attackable so that creditors may properly evaluate what, if any, potential recoveries they are foregoing by accepting the debtor's proposal. Provided that the required majority of the unsecured creditors vote in favour of the proposal with full knowledge of the fact that potentially attackable payments were made by the debtor and the Court approves of the proposal, again with full knowledge of the payments, then there ought, from a policy basis, not to be any reason to question the payments.

The key to analysis of protection afforded to stakeholders by the preference provisions is, arguably, the report prepared by the proposal trustee. In *Mutual Trust* the Court addressed the reporting obligations of the trustee under a proposal [35]. The Court found that a trustee under a proposal is required to make an appraisal and investigation of the affairs and property of the debtor so as to enable the trustee to estimate with reasonable accuracy the financial situation of the debtor and report the results to the meeting of the creditors. In supplemental reasons on the issue of costs [36], the Court was critical of the trustee for not dealing with the potentially attackable transactions in its report to creditors on the

proposal. The Court found: "It is not an answer to speculate that the creditors with full disclosure might have accepted the amended proposal on the basis of the creditors agreeing that s. 91(2) of the *Act* did not apply in the case at hand. That would be a decision for informed creditors to make."

When considering payments to pre-filing claims, it is also important to consider section 97 of the BIA.

> 97(1) No payment, contract, dealing or transaction to, by or with a bankrupt made between the date of the initial bankruptcy event and the date of the bankruptcy is valid, except the following, which are valid if made in good faith, subject to the foregoing provisions of this Act with respect to the effect of bankruptcy on an execution, attachment or other process against property, and subject to the provisions of this Act respecting settlements, preferences and reviewable transactions:
>
> (a) a payment by the bankrupt to any of the bankrupt's creditors;
>
> (b) a payment or delivery to the bankrupt;
>
> (c) a transfer by the bankrupt for adequate valuable consideration; and
>
> (d) a contract, dealing or transaction, including any giving of security, by or with the bankrupt for adequate valuable consideration.

Originally, section 97 was intended to deal with the fact that the BIA provided for bankruptcies to be retroactive to the date the proceeding was commenced. In the case, for example, of a bankruptcy that arose as a result of a petition, the BIA made the bankruptcy retroactive to the date the petition was issued. The intention of section 97 was to "temper the severity" of the retroactivity of a bankruptcy. Absent this section, all transactions that took place after the presentation of a petition on which a receiving order was made were, arguably, void [37]. The section had the effect of saving certain good faith transactions entered into by the debtor.

When the BIA was amended in 1997 to make bankruptcies effective as of the date that the bankruptcy actually occurs [38], section 97 of the BIA was left in place and amended to validate certain good faith transactions entered into by the debtor between the initial bankruptcy event — the date an insolvency proceeding is commenced — and any bankruptcy. By virtue of section 101.1 of the BIA, section 97 also applies to proposal proceedings that do not result in bankruptcies unless the proposal provides otherwise.

In the context of proposals, section 97 arguably clarifies that payments to suppliers made in good faith after the date the proposal proceedings are commenced (even payments of pre-filing claims) are intended to be valid.

In the event a payment is challenged as a preference, the supplier will have to defend the payment. If the supplier is not successful, it will have to return the payment.

In order to successfully attack a payment, it is necessary to establish that the debtor was insolvent at the time the payment was made and that it was made "with a view" to giving a preference. Where the payment has the effect of giving the creditor a preference over other creditors, it is presumed to be given with a view to giving a preference unless the contrary is established [39].

To commence proposal proceedings, the debtor must be insolvent [40] and the effect of paying a supplier's pre-filing claim is to give that supplier a preference. As a result, in most cases, a supplier who receives payment of a pre-filing claim in the context of a proposal proceeding will be in the position of having to rebut the presumption that the payment was made with a view to giving the supplier a preference. There are, however, a number of established grounds that a supplier could rely upon to rebut the presumption that a payment by the debtor was intended to prefer. For example:

(a) The payment was made in the ordinary course of business;

(b) The payments was made with the bona fide expectation that making the payment would enable the debtor to continue to carry on business to make a proposal [41] ; and

(c) The payment was made to secure more favourable terms for supply of goods or services post-filing [42] .

By approaching the issue of payments of the pre-filing claims of critical suppliers in the context of a BIA proposal proceedings as preferences, the proper balance is achieved between allowing the debtor to make payments necessary to allow it to continue to carry on business, on the one hand, and transparency and equitable treatment of creditors on the other. Any payments will be disclosed and other stakeholders impacted by the payment will have the opportunity to determine if they wish to challenge the payment and the Court will have an opportunity to review the payment to ensure it is proper. Any review will take place after the fact, but this does not appear, in the overall context of the proposal process, to be prejudicial to stakeholders being able to recover any preferential payments.

Unfortunately, there is a slight, likely unintentional, problem with the analysis that arose when the BIA was amended in 1997. Subsection 101.1(2) provides that, in proposal proceedings, any reference to "becomes bankrupt" in sections 91 through 101 will be construed as the earlier of the date the debtor files a notice of intention or files a proposal. In 1997, sections 91 through 101 were amended to apply to the period between the date of the initial bankruptcy event and the date of the bankruptcy. In the context of a proposal, the date of the initial bankruptcy event is defined by section 2(1) of the BIA to mean the date that the proposal proceedings are commenced. Absent the effect of subsection 101.1(2), in proposal proceedings, this would mean that all transactions after the commencement of the proceeding would be caught by sections 91 through 101. The effect of subsection 101.1(2), however, is to make the date of the initial bankruptcy event and the date of bankruptcy the same date in the vast majority of proposal proceedings. Unfortunately, subsection 101.1(2) of the BIA was not amended in 1997 to reflect the changes made to sections 91 through 101 [43] .

As a result, the section of the BIA that was meant to be subject to transactions made after the commencement of a reorganization to attack — section 101.1 — may now have the opposite effect. Prior to the 1997 amendments, subsection 101.1(2) was required in order to make sections 91 through 101 effective in proposal proceedings. Prior to the 1997 amendments, sections 91 through 101 referred only to the date of bankruptcy as the reference date for attacking transactions. In order to make the provisions work in proposal proceedings, it was necessary to make provisions for what the reference date would be in a proposal proceeding. Subsection 101.1(2) had the effect of making the reference date in the case of proposal proceedings the date that the proposal proceedings were commenced.

Arguably, subsection 101.1(2) and section 101.2 should have been amended when sections 91 to 101 of the BIA were. Unfortunately, they appear to have been overlooked.

B. — Companies' Creditors Arrangement Act

The payment of pre-filing claims in the context of reorganizations under the CCAA cannot be dealt with in the same manner as under the BIA. To begin with, the CCAA does not contain any provisions that permit the monitor to attack preferential payments [44] . More importantly, while the CCAA does not itself prohibit the debtor from paying creditors' pre- filing claims, it is common for initial orders made under the CCAA to specifically prohibit the reorganizing debtor from making payments to creditors in respect of pre-filing claims in order to preserve the *status quo* [45] .

In the reorganization of Stelco Inc., the Court considered the effect of an inadvertent payment by Stelco of a pre-filing claim in the face of an initial order that prohibited Stelco from paying any pre-filing claims. The Court found that it would be inappropriate and inequitable for the supplier to receive payment in the face of an order prohibiting the debtor from making the payment, and ordered the funds returned to Stelco [46] .

In CCAA reorganizations, initial orders sometimes include authorization for the debtor to pay the pre-filing claim of certain creditors. For example, employees and essential suppliers may be authorized to be paid inasmuch as their services and goods are viewed as essential for the restructuring efforts of the debtor company[47]. The initial order made in the CCAA reorganization of Air Canada[48], for example, provided:

> 20. THIS COURT ORDERS that, after the date hereof and except as otherwise provided to the contrary herein, the Applicants shall be entitled but not required to pay the following expenses incurred by the Applicants in carrying on the Business or discontinuing part of the Business:
>
> a) With the consent of the Monitor, up to $25 million for goods or services actually supplied to an Applicant prior to the date of this order, by a North American supplier, including payments in respect of outstanding documentary credits or deposits, if, in the opinion of the Applicants, the supplier is critical to the Business and ongoing operations of the Applicants;
>
> b) Goods or services actually supplied to an Applicant prior to the date of this order, including payments in respect of outstanding documentary credits or deposits, by trade vendors and suppliers outside North America;
>
> c) All outstanding and future insurance premiums (including directors and officers liability insurance, property and casualty, group insurance or other necessary insurance policy);
>
> d) Expenses and capital expenditures reasonably necessary for the preservation of the Applicants' Property or the Business (including, without limitation, payments on account of insurance, maintenance and security); and
>
> e) All outstanding and future wages, salaries (except group RRSP contributions), disbursements, directors' fees and expenses, employee benefits, severance, termination and other like amounts, vacation pay, and retention payments accruing due to employees or as approved by this Court, and all employee benefits and pension benefits payable to former employees.

Few would argue that the debtor's employees ought, for many reasons, to be paid wages owing to them for work performed for the debtor prior to the commencement of the reorganization. However, provisions in CCAA orders that provide the debtor and the monitor with broad discretion to pay the pre-filing claims of suppliers that are considered "critical" can cause difficulty in dealing with suppliers post-filing. The key problem with these provisions is that they lack transparency in that they: (a) contain no criteria to be applied by the debtor and the monitor to determine whether a particular supplier is a critical supplier; and (b) do not require that the debtor or the monitor obtain a further order of the Court prior to effecting payment to a vendor that they consider "critical" or even to notify other creditors that a payment has been made.

There has, to date, been no judicial determination with respect to critical vendor provisions in initial orders under the CCAA or how the Court should approach the issue when asked to make orders authorizing the debtor to pay the pre-filing claims of certain suppliers.

However, in the CCAA reorganization of Air Canada, the Court considered a motion by the debtor seeking authority to pay a pre-filing claim owing to Deutsche Lufthansa Aktiengesellschaft ("Lufthansa") as part of a settlement that would have seen the relationship between Air Canada and Lufthansa continue[49]. The Court approved the settlement, but did so on the basis that such payment should be avoided in future absent justifiable and unusual circumstances.

The Court appears to have been influenced by "truly extraordinary and indeed . . . unique" relationship between Air Canada and Lufthansa and the impact on Air Canada's stakeholders of the relationship falling apart. The Court found that:

(a) The arrangement between Air Canada and Lufthansa was unique and it would not likely be possible to duplicate it with any other airline;

(b) The future net benefit to Air Canada of the relationship with Lufthansa was expected to be substantial and considerably in excess of the pre-filing claim to be paid by Air Canada;

(c) The cost to Air Canada to attempt to obtain even part of the benefit of the agreement with Lufthansa through alliances through other airlines, if possible, would be extremely expensive.

The Court also indicated that the extent of the support of interested parties was a relevant consideration — "In any event, it would appear to me that in exercising its discretion, the Court ought to take into account the extent and nature of support of interested parties as to the payment to a critical vendor." [50] This implies that notice to other stakeholders ought to be a serious issue when the Court is considering whether to permit the debtor to pay pre-filing claims.

When considering the payment of the pre-filing claims of critical vendors in reorganizations under the CCAA, it is of some assistance to consider how the issue is dealt with in proceeding under Chapter 11 of the *United States Bankruptcy Code*. There are a number of similarities between the approach to the payment of critical suppliers that has been taken in a number of judicial districts in the United States and the approach to the payment of pre-filing claims taken in *Air Canada*.

In some judicial districts, the United States Bankruptcy Court will grant orders that permit the reorganizing debtor to pay the pre-filing claims of certain suppliers on the basis that: (a) these vendors will refuse to supply to the debtor going forward if such payments are not made; and (b) this refusal to supply will cause harm to the debtor's estate.

The legitimacy of these payments was, however, called into question in the Chapter 11 bankruptcy of Kmart Corporation [51]. In *Kmart*, the Seventh Circuit affirmed the decision of the district court denying the validity of the bankruptcy court's "critical vendor" order [52]. The Seventh Circuit's opinion did not close the door on the ability of a Bankruptcy Court to authorize the payment of certain pre-filing claims, but it placed the onus of establishing that the payment was warranted on the debtor. In order to establish that a payment ought to be made "out of the ordinary course", the debtor must, according to Kmart, prove:

(a) The supplier will actually refuse to deliver goods or services if the pre-filing claims are not paid; and

(b) The refusal of these suppliers to supply will be prejudicial to all stakeholders. This in turn may require that the debtor establish: (i) the supplier is the only supplier reasonable to supply the goods or services; (ii) the inability to procure the goods or services will cause quantifiable loss to the estate; and (iii) the resulting loss will be greater than the amount that must be paid to the supplier to secure the on-going supply.

Following on Kmart, the Bankruptcy Court in the State of Texas recently established a three part test to determine whether a vendor is critical. The Bankruptcy Court *In re Co-Serv, L.L.C.* [53] set forth the following three conditions for evaluating critical supplier treatment:

(a) The debtor must have a critical need to deal with the specific supplier;

(b) There is no other practical or legal solution to secure supply from the supplier; and

(c) Unless the debtor deals with that supplier, it risks (i) the probability of harm, or, alternatively, (ii) loss of some economic benefit to the estate's going concern value, that is disproportionate to the payment;

On the basis of the foregoing, in the CCAA reorganizations the Courts ought to require that, to justify paying a pre-filing debt, the debtor establish:

(a) there is a critical need to deal with the specific supplier for the specific goods or services supplied by that supplier — there is no other source of supply that is practical;

(b) the benefit it will derive from the continued supply (or the cost that will be avoided by dealing with the specific supplier) is greater than the amount of the pre-filing claim to be paid; and

(c) there is no other practical or legal solution other than payment of the pre- filing claim.

In addition, provisions permitting the debtor to pay essential suppliers ought not to be made on *ex parte* or limited notice applications save and except in truly exceptional circumstances and the payment of the pre-filing debt should be conditional on the supplier continuing to supply product to the debtor.

A final thought is warranted should the Court determine that it has the jurisdiction to order that suppliers continue to supply to the reorganizing debtor and exercises that jurisdiction to make such an order. In these circumstances, it is hard to imagine the Court permitting the debtor to pay a pre-filing claim in order to secure an agreement to supply. In doing so the Court would be, essentially, permitting the supplier to benefit from its willingness to breach the order to supply. Where suppliers are ordered to continue to supply the debtor, critical supplier orders should only be made where the supplier is, for some reason, not subject to the order or other exceptional circumstances exist [54].

IV. — Proposed "Critical" Supplier Amendments to the CCAA

Insolvency Reform Act 2005, if and when it comes into force, will amend the CCAA to provide the Court with the jurisdiction to declare that a supplier is "critical" [55]. Where a supplier is declared to be critical, the Court will have the jurisdiction to order that the supplier supply goods or services to the reorganizing debtor on terms that are consistent with the existing supply relationship — which could require the extension of credit to the debtor — or other terms that the Court considers appropriate. [56] If the Court orders a critical supplier to supply goods or services to the debtor, it will be required to provide the supplier with security over the debtor's assets to secure payment for the goods or services to be supplied [57].

The proposed CCAA provisions will not provide for the payment of pre-filing claims of suppliers that are found to be critical.

Footnotes

* Partner, Gowling Lafleur Henderson LLP. Patrick Shea's practice is focused on commercial and insolvency law. The input of Robin D. Walker, Q.C. is greatly appreciated.

1 R.S.C. 1985, c. B-3, as amended (the "BIA").

2 R.S.C. 1985, c. C-36, as amended (the "CCAA").

3 BIA, s. 65.1.

4 BIA, 65.1(5) and (6).

5 2003 CarswellOnt 1371, 42 C.B.R. (4th) 142 (Ont. S.C.J.). Note that the Court was accepting the argument made in a factum filed by one of the parties to the dispute.

6 BIA, s. 121(1). See, *Pike v. Bel-Tronics Co.* (2000), 2000 CarswellOnt 3540, 19 C.B.R. (4th) 262 (Ont. S.C.J.).

7 BIA, s. 65.1(4).

8 *Cosgrove-Moore Bindery Services Ltd., Re* (2000), 2000 CarswellOnt 1561, 48 O.R. (3d) 540, 17 C.B.R. (4th) 205 (Ont. S.C.J. [Commercial List]).

9 *728835 Ontario Ltd., Re*, 1998 CarswellOnt 2025, 3 C.B.R. (4th) 211 (Ont. Gen. Div. [Commercial List]); affirmed 1998 CarswellOnt 2576, 3 C.B.R. (4th) 214 (Ont. C.A.).

10 This is a common way of dealing with utility suppliers. Where a deposit is provided, the debtor should ensure that the supplier agrees to waive its right to exercise set-off should the entire deposit not be required to pay for post-filing goods or services.

11 Where security is to be provided, regard must be had to section 97 of the BIA, which may have the effect of invalidating the security. Section 97 of the BIA contemplates that security may be provided to a creditor provided that the security is provided in good faith and in return for adequate valuable consideration. The terms "adequate valuable consideration" is defined to mean "consideration of fair and reasonable money value with relation to the known or reasonably anticipated benefits of the [giving of security]". In the context of a supply arrangement, the granting of security to the supplier equal to the value of the goods or services to be supplied would fit within the definition of adequate valuable consideration. It is important to note that where security is given to a supplier in the context of a BIA proposal, the proposal should not exclude the application of section 97. Section 97 is discussed further below.

12 BIA, s. 47.1.

13 Order dated September 24, 2004 (Court File No.: 31-437770). It may have been possible for the interim receiver to have been granted security over the debtor's assets to secure payments required to be made pursuant to the cash flow or to have been given the authority to grant security to secure obligations owing for supply in accordance with the cash flow. The BIA contemplates that the interim receiver may be granted (or may grant) security over the debtor's assets. See BIA, subsection 31(1) and section 47.2.

14 BIA, s. 50.4(7).

15 See, for example, paragraph 11 of the Short Form Model Initial CCAA Order and paragraph 18 of the Long Form Model Initial CCAA Order developed by the Commercial List Users' Committee in Ontario, and paragraph 22 of the Model Initial CCAA Order developed for use in the British Columbia Supreme Court.

16 1990 CarswellBC 384, 51 B.C.L.R. (2d) 105 (B.C. C.A.), leave to appeal refused 7 C.B.R. (3d) 164 (note) (S.C.C.). In *Quintette*, the issue was whether Nippon Steel Corp. was stayed from exercising set-off rights. The discussion with respect to supply is contained in a discussion of the general principles that should be applied with respect to the scope of the stay under s. 11. *Quintette* was decided prior to the CCAA being amended to include s. 11.3.

17 *Smith Brothers Contracting Ltd., Re*, 1998 CarswellBC 678, 53 B.C.L.R. (3d) 264, 13 P.P.S.A.C. (2d) 316 (B.C. S.C.)

18 *Air Canada, Re* (2004), 2004 CarswellOnt 643, 47 C.B.R. (4th) 182 (Ont. S.C.J. [Commercial List])

19 *Mosaic Group Inc., Re*, 2004 CarswellOnt 2254, 3 C.B.R. (5th) 40 (Ont. S.C.J.)

20 See, *Molson Canada v. O-I Canada Corp.*, 2003 CarswellOnt 2226, 43 C.B.R. (4th) 172 (Ont. C.A.) where the Ontario Court of Appeal discusses the factual background of the case and the making of an order that provides for a segregated pool of funds provide protection - on a fairness basis - as to any supplier who would have supplied on credit and a bankruptcy having occurred before the credit had been fully discharged by payment. A similar structure was used in the insolvency proceedings involving Slater Steel Inc.

21 CCAA, s. 11.7(3).

22 *Westar Mining Ltd., Re*, 1992 CarswellBC 508, 14 C.B.R. (3d) 88 (B.C. S.C.)

23 S.C. 2005, c. 47 (the "*Insolvency Reform Act 2005*"). See, E. Patrick Shea, "The Insolvency Reform Act 2007 — A Review of the Proposed Commercial Insolvency-Related Amendments to the Bankruptcy and Insolvency Act and the Companies'

Creditors Arrangement Act", 27 C.B.R. (5th) 163 and Susan Grundy, "Proposed Insolvency Law Amendments — Take Two", OBA Insolvency News (February 2007) 5.

24 CCAA, s. 34 (not yet in force). The *CCAA* already restricts the ability of the court to require that a person advance money or credit to the reorganizing debtor or restrict a person from requiring immediate payment for goods and services supplied to the reorganizing debtor; CCAA, s. 11.3. *Insolvency Reform Act 2005* will move these provisions to s. 34(4) (not yet in force).

25 CCAA, s. 34(5) (not yet in force).

26 CCAA, s. 34(6) (not yet in force).

27 See E. Patrick Shea, *Bankruptcy and Insolvency Act, Companies' Creditors Arrangement Act, Bill C-55 & Commentary* (LexisNexis 2006) at 26.

28 BIA, subsection 62(1.1) and CCAA, section 12. The CCAA is not as clear on this point as the BIA. Rather than specify what debts are subject to a CCAA reorganization, section 12 refers to the BIA with respect to what obligations will constitute claims for the purposes of the CCAA. There have been some cases where CCAA debtors have attempted to effect a compromise of claims arising after the date the CCAA proceedings were commenced.

29 BIA, s. 69 and 69.1. See also *Vachon v. Canada (Employment & Immigration Commission*, 1985 CarswellNat 12 (S.C.C.) and *Re Jones*, 2003 CarswellOnt 3184, 45 C.B.R. (4th) 263 (C.A.).

30 BIA, section 95. Section 96 of the BIA extended the review period under section 95 to one year in the case of transactions with related parties.

31 See for example BIA, s. 57 — where the required majority of unsecured creditors do not accept the debtor's proposal, the debtor is deemed to have made a bankruptcy assignment — and subsection 61 — where the Court refuses to approve the debtor's proposal, the debtor is deemed to have made a bankruptcy assignment.

32 BIA, s. 38.

33 BIA, s. 101.1.

34 BIA, s. 101.1.

35 1999 CarswellOnt 2190, 11 C.B.R. (4th) 54 (Ont. Bktcy.)

36 1999 CarswellOnt 3025, 11 C.B.R. (4th) 62 (Ont. Bktcy.)

37 L Duncan and J.D. Honsberger, *Bankruptcy in Canada* (Canada Law Book, 1961), at para 499.

38 For example, section 2.1 of the BIA now provides that a bankruptcy occurs at the date of the granting of receiving order, the making of an assignment or the event that causes a deemed assignment. The settlement, preference, reviewable transactions, etc. provisions of the BIA were amended with the intention to provide that they would apply to transactions that occur between the time the proceeding that results in the bankruptcy was commenced — the date of the initial bankruptcy event — and the date of the bankruptcy thereby receiving the same practical result as having the bankruptcy retroactive without the various issues that were created by retroactivity. Unfortunately, there appears to be a drafting error in section 101.1 that may have the effect of making transactions entered into during a proposal effectively not subject to attack in a subsequent bankruptcy.

39 BIA, s. 95(2).

40 BIA, s. 50.

41 See for example, *Burns v. Royal Bank*, 2 C.B.R. 241 (Ont. S.C.); affirmed 4 C.B.R. 190 (Ont. C.A.), *D. Elkind Clothing Inc., Re*, 26 C.B.R. (N.S.) 240 (Ont. H.C.) and *Hodden Gray Graphics Ltd., Re*, 19 C.B.R. (N.S.) 204 (Ont. S.C.).

42 *D & G Burner Service Inc. (Trustee of) v. Flex-Temp Ltd.* (1987), 1987 CarswellOnt 158 (Ont. S.C.).

43 The same analysis applies to section 101.2 which probably should also have been amended in 1997.

44 It is not uncommon for creditors to seek leave from the Court at the commencement of a CCAA reorganization to issue a bankruptcy application against the reorganizing debtor in order to establish a reference date for attacking transactions in a subsequent bankruptcy. In those circumstances, the preference analysis may exist.

45 See, for example, paragraph 6 of the Short Form Model Initial CCAA Order and paragraph 10 of the Long Form Model Initial CCAA Order developed by the Commercial List Users' Committee in Ontario, and paragraph 10 of the Model Initial CCAA Order developed for use in the British Columbia Supreme Court. *New Skeena Forest Products Inc. v. Kitwanga Lumber Co.*, 2007 CarswellBC 1323 (B.C. S.C.), at para 50.

46 *Stelco Inc., Re*, 2004 CarswellOnt 1882, 49 C.B.R. (4th) 283 (Ont. S.C.J. [Commercial List]); leave to appeal granted 2004 CarswellOnt 3864, 4 C.B.R. (5th) 115 (Ont. C.A.). *New Skeena Forest Products Inc. v. Kitwanga Lumber Co.*, 2007 CarswellBC 1323 (B.C. S.C.) at para 50.

47 *New Skeena Forest Products Inc. v. Kitwanga Lumber Co.*, 2007 CarswellBC 1323 (B.C. S.C.), at para 50.

48 Order dated April 1. 2003 (Court File No. 03-CL-4932).

49 *Air Canada, Re*, 2003 CarswellOnt 5296, 47 C.B.R. (4th) 163 (Ont. S.C.J. [Commercial List]) . See also *Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re*, 1999 CarswellOnt 3123 (Ont. S.C.J. [Commercial List]) where the Court refused to approve the payment of a pre-filing claim.

50 *Air Canada, Re*, 2003 CarswellOnt 5296, 47 C.B.R. (4th) 163 (Ont. S.C.J. [Commercial List]) at para 2.

51 *In re Kmart Corp.*, 359 F.3d 866 (7th Cir. 2004).

52 See, K. H. Kurthe "First among Equals?" (2004) 14 *Business Law Today*.

53 273 B.R. 487, 497 (Bankr. N.D. Tex. 2003). See also In *re Mirant Corp.*, 296 B.R. 427 (Bankr. N.D. Tex. 2003).

54 A supplier in a foreign jurisdiction may not, for example, be subject to an order made under the CCAA. It may, for example, be the case that the supplier requires that some portion of its pre-filing claim be paid in order to allow it to continue to carry on business.

55 CCAA, s. 11.4 (not yet in force).

56 CCAA, s. 1 1.4(2) (not yet in force). Insolvency Reform Act 2005 does not provide criteria for determining when a supplier is critical or when it is appropriate to make an order requiring that a supplier continue to supply goods or services to the reorganization debtor.

57 CCAA, s. 11.4(3) (not yet in force).

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TAB
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2018-2019

The 2018-2019 Annotated Bankruptcy and Insolvency Act

Lloyd W. Houlden, Geoffrey B. Morawetz & Janis P. Sarra

CARSWELL

THE 2018-2019 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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96. (1) **Transfer at undervalue** — On application by the trustee, a court may declare that a transfer at undervalue is void as against, or, in Quebec, may not be set up against, the trustee — or order that a party to the transfer or any other person who is privy to the transfer, or all of those persons, pay to the estate the difference between the value of the consideration received by the debtor and the value of the consideration given by the debtor — if

(a) the party was dealing at arm's length with the debtor and

(i) the transfer occurred during the period that begins on the day that is one year before the date of the initial bankruptcy event and that ends on the date of the bankruptcy,

(ii) the debtor was insolvent at the time of the transfer or was rendered insolvent by it, and

(iii) the debtor intended to defraud, defeat or delay a creditor; or

(b) the party was not dealing at arm's length with the debtor and

(i) the transfer occurred during the period that begins on the day that is one year before the date of the initial bankruptcy event and ends on the date of the bankruptcy, or

(ii) the transfer occurred during the period that begins on the day that is five years before the date of the initial bankruptcy event and ends on the day before the day on which the period referred to in subparagraph (i) begins and

(A) the debtor was insolvent at the time of the transfer or was rendered insolvent by it, or

(B) the debtor intended to defraud, defeat or delay a creditor.

(2) **Establishing values** — In making the application referred to in this section, the trustee shall state what, in the trustee's opinion, was the fair market value of the property or services and what, in the trustee's opinion, was the value of the actual consideration given or received by the debtor, and the values on which the court makes any finding under this section are, in the absence of evidence to the contrary, the values stated by the trustee.

(3) **Meaning of "person who is privy"** — In this section, a "person who is privy" means a person who is not dealing at arm's length with a party to a transfer and, by reason of the transfer, directly or indirectly, receives a benefit or causes a benefit to be received by another person.

2007, c. 36, s. 43

F§201 — Preferences and Transfers at Undervalue

Sections 95 and 96 create a complete framework for challenging transactions that may diminish the value of the insolvent debtor's estate, reducing the amount of money available for distribution to the creditors. These types of transactions are called preferences and transfers at undervalue. A preference occurs when an insolvent debtor pays one or more creditors at the expense of other creditors. A transfer at undervalue is disposition of property or provision of services for which no consideration is received by the debtor or for which the consideration received is conspicuously less than the fair market value of the consideration given by the debtor. The framework is aimed at ensuring fairness and predictability when dealing with these types of transactions in the insolvency system.

The Saskatchewan Court of Appeal reviewed the law relating to an "all obligations" clause contained in an assigned general security agreement (GSA), in particular, whether it could secure the previously unsecured debts owing by the debtor to the assignee from a time before the assignment took place. In the circumstances, the only amounts secured were those amounts owing by the debtor to the assignor at the time of the assignment. Justice Jackson held that courts must give sufficient respect to the principles of secured transactions law that allows security agreements to secure past and present indebtedness as well as future indebtedness, and thereby, give effect to what are known in the trade as "all obligations" clauses. A court must be concerned about fairness and the effect on bankruptcy and other priorities, but if the contract will have no effect on priorities, there may be nothing preventing an assignee from converting unsecured debt into secured debt, if that is the intention of the contracting parties. Jackson J.A. held that the court must first interpret the GSA and the letter of offer to determine whether the original contracting parties intended the assignment clause to secure the unsecured debts of a future assignee. If the parties did so intend, the court then determines whether a commercially defensible reason would exist to prevent the GSA from operating in that manner. In this appeal, the court did not have to consider the second question. Justice Jackson found that ascertaining the intention of contracting parties is an objective exercise informed by the factual matrix surrounding the formation of the contract, with the words in the contract being given their natural and ordinary meaning unless absurdity would result. The court concluded that it did not appear objectively that the bank and the debtor intended that the GSA would cover the unsecured debts of the debtor that may be owed to a third party upon assignment. While the GSA permitted an assignment without notice, it did not state that on assignment, the GSA would act to secure any and all unsecured debts previously owed to the assignee. No provision in the loan documents or the GSA clearly expressed an intention by the bank with respect to the unsecured debts of a third party. The appeal was dismissed: *CPC Networks Corp. v. Eagle Eye Investments Inc.*, 2012 CarswellSask 838, 95 C.B.R. (5th) 76, 2012 SKCA 118, [2013] 2 W.W.R. 260 (Sask. C.A.).

Section 96 is directed at transfers by insolvent persons for a consideration that is materially or significantly less than the fair market value of the property. In this context, the concept of a non-arm's length relationship is one in which there is no incentive for the transferor to maximize the consideration for the property being transferred in negotiations with the transferee. It addresses situations in which the economic self-interest of the transferor is, or is likely to be, displaced by other non-economic considerations that result in the consideration for the transfer failing to reflect the fair market value of the transferred property: *Juhasz (Trustee of) v. Cordeiro*, 2015 CarswellOnt 4744, 24 C.B.R. (6th) 69, 2015 ONSC 1781, [2015] O.J. No. 1654 (Ont. S.C.J.).

(1) — Transfers at Undervalue, Generally

In 2009, settlements and reviewable transactions were replaced with a single cause of action, "transfer at undervalue". The court determines as a question of fact whether the transfer was at undervalue, and whether the parties were at arm's length or at non-arm's length. Persons who are related to each other are deemed not to deal at arm's length unless there is evidence to the contrary. If the court finds that the transaction was a transfer at undervalue and that the other party was at arm's length, the court may grant judgment for the difference between the actual consideration and the fair market value if the transfer took place within one year before the date of the initial bankruptcy event and the debtor was insolvent at the time of the transfer and the debtor intended to defeat the interests of creditors.

If the court finds that the transaction was a transfer at undervalue and that the other party was not at arm's length, the court may grant judgment for the difference between the actual

Grant was satisfied that the transfer was not fraudulent or designed to defeat the creditors of the bankrupt; however, the consideration received by the bankrupt was conspicuously less than the fair market value of the consideration given. It was therefore a transfer at undervalue. Because the transfer was not fraudulent or intended to defeat creditors, Grant J. ordered that the brothers pay to the trustee $11,000 plus costs, rather than declare the transaction void. If they failed to pay, the trustee was authorized to file with the court an order declaring the transfer to be void: *Re Kelson Apartments Ltd.*, 2017 CarswellNB 374, 51 C.B.R. (6th) 145, 2017 NBQB 135 (N.B. Q.B.).

The Ontario Superior Court of Justice granted the motion of a trustee for a declaration pursuant to s. 96 of the *BIA* that certain transactions were transfers at undervalue. Justice Pattillo concluded that there was no evidence that the counterparties to the transactions or their principals were related to each other. The two companies were not "related persons" within the definitions of related persons in s. 4 of the *BIA*. Justice Pattillo held that the finding of fact mandated by s. 4(4) of the *BIA* requires a determination, based on the totality of the evidence, of whether the transaction involved generally accepted commercial incentives such as bargaining and negotiation in an adversarial format and the maximizing of a party's economic self-interest. In the absence of any such indicia, the inference that arises is that the parties were not dealing at arm's length. In this case, Pattillo J. found no evidence that the three transactions in issue displayed any of the characteristics of ordinary commercial incentives, regardless of whether the transactions were loans or an investment in a joint venture. In light of the finding that they were not acting at arm's length, s. 96(1)(b) of the *BIA* was engaged. Pattillo J. found that the evidence established all of the elements required to bring the impugned transactions within s. 96(1)(b)(ii). All of the transactions in issue took place within five years prior to the initial bankruptcy event, and Pattillo J. held that, by entering into the transactions, the debtor intended to defraud or delay its major creditor, by falsifying its receivables and payables: *National Telecommunications v. Stalt*, 2018 CarswellOnt 5360, 59 C.B.R. (6th) 263, 2018 ONSC 1101 (Ont. S.C.J.).

The Québec Superior Court held that the transfer of ownership of an airplane hangar by a debtor corporation to the principal's mother without consideration was a transfer at undervalue under the *BIA*. The parcel of land on which the hanger was built was owned by the mother. The evidence showed that the mother was not dealing at arm's length and the transaction took place in the year preceding the debtor's bankruptcy. The debtor's sole director and his mother were ordered to pay the value of unpaid claims for construction of the hangar: *Syndic de Services Wil-Be inc.*, 2017 CarswellQue 9202, 53 C.B.R. (6th) 222, 2017 QCCS 4682 (C.S. Que.)

See Roderick Wood, "Transfers at Undervalue: New Wine in Old Wineskins?" in Janis P. Sarra and Barbara Romaine, eds., *Annual Review of Insolvency Law 2017* (Toronto: Carswell, 2018) 1–38.

(2) — Preferences, Generally

The provisions of ss. 95 and 96 are a means of carrying into effect the principle of the *Act* contained in s. 141 that all ordinary creditors should rank equally: *Hudson v. Benallack* (1975), 21 C.B.R. (N.S.) 111 at 117, [1976] 2. S.C.R. 168. Sections 95 and 96 create a complete framework for challenging transactions that may diminish the value of the insolvent debtor's estate, reducing the amount of money available for distribution to the creditors.

Section 95 specifies that a transfer of property made, provision of services made, a charge on property made, a payment made, an obligation incurred or a judicial proceeding taken or suffered by an insolvent person in favour of a creditor who is dealing at arm's length with the insolvent person, or a person in trust for that creditor, with a view to giving that creditor

a preference over another creditor is void as against the trustee, or, in Québec, may not be set up against the trustee, if it is made during the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date of the bankruptcy. For creditors not dealing at arm's length with the insolvent person, or a person in trust for that creditor, that period is twelve months.

Section 95(2) specifies that if the transfer, charge, payment, obligation or judicial proceeding referred to has the effect of giving the creditor a preference, it is, in the absence of evidence to the contrary, presumed to have been made with a view to giving the creditor the preference, even if it was made, incurred, taken or suffered under pressure. Evidence of pressure is not admissible to support the transaction. Section 95(2.1) specifies that in the case of a margin deposit made by a clearing member with a clearing house, or in the case of a transfer, charge, or payment made in connection with an eligible financial contract, parties are deemed to be dealing with each other at arm's length and subsection (2) does not apply.

If a payment or other disposition of property is made in circumstances that amount to a preference, the transaction is valid unless and until it is set aside as a preference: *Re Bernard Motors Ltd.* (1960), 38 C.B.R. 162 (S.C.C.).

The trustee of a bankrupt company brought a motion to declare certain transactions entered into between the bankrupt and an airline company declared void pursuant to s. 95 of the *BIA*. The threshold issue was whether or not a trustee could pursue a preference action solely on behalf of, and for the benefit of, a secured creditor and whether the proceeds of a preference action under s. 95 *BIA* are subject to the rights of secured creditors. Justice Morawetz held that the focus must be on whether or not the secured creditor had rights in the collateral at the time of the suspect transaction; and for floating charges, the issue is whether the floating charge had crystallized. In Ontario, since the enactment of the *Personal Property Security Act* (*PPSA*), security agreements do not generally refer to fixed and floating security, but the concepts of fixed and floating charges are still recognized. Morawetz J. held that a trustee or a s. 38 *BIA* assignee is the only party that can bring a preference action in bankruptcy proceeding pursuant to s. 95. The proceeds recovered by the trustee are brought into the estate; distribution under the *BIA* is subject to the rights of recovery of secured creditors; and the bringing of a preference action and the recovery of proceeds does not preclude secured creditors from pursuing whatever remedies they may have under the provisions of the security agreement and relevant statutes. Further, there is nothing that would preclude a secured creditor from pursuing appropriate remedies in conjunction with the trustee pursuing its remedies, likely requiring a cooperative effort and some sort of formal agreement to recognize how matters are to be prosecuted and how proceeds of litigation are to be allocated. Overall, the objective of the preference action is to avoid preferential transactions for the benefit of creditors, while recognizing legitimate security interests: *Tucker v. Aero Inventory (UK) Ltd.* (2011), 2011 CarswellOnt 8476, 80 C.B.R. (5th) 1 (Ont. S.C.J. [Commercial List]). See Jean-Daniel Breton, "Case Comment: *Tucker v. Aero Inventory (UK) Ltd.*", in *Annual Review of Insolvency Law, 2011* (Toronto: Carswell, 2012) 543-566.

Where a bankrupt settled his credit card account with the respondent bank out of proceeds of a new mortgage on his house and subsequently made an assignment in bankruptcy, the trustee was correct in demanding repayment from the bank as a preference under s. 95 of the *BIA*. The debtor was unable to pay credit card indebtedness as it become due and lacked sufficient assets to pay those debts, and thus was insolvent. The payment to the bank had the effect of preferring the bank over the other creditors and was a preference in fact. In such circumstances, s. 95(2) comes into play and the intention of the bankrupt to prefer is presumed unless the creditor has shown that the bankrupt did not have that intention. The court allowed the trustee's appeal and ordered the bank to repay the trustee: *Keith G. Collins Ltd.*

v. Canadian Imperial Bank of Commerce (2011), 2011 CarswellMan 196, 77 C.B.R. (5th) 180 (Man. C.A.).

The Alberta Court of Queen's Bench dismissed a fraudulent preference claim relating to the granting of a legal mortgage, on the basis that an equitable mortgage had been granted long before the preference review period. Justice Burrows held that an unregistered equitable interest has priority over an unsecured debt, even when the unsecured debt is reduced to a writ of enforcement. Further, the unregistered equitable mortgage has priority even if the writ is registered prior to anyone giving notice of the equitable interest. Here, there was no evidence that when the equitable mortgage was granted, the bankrupt was in insolvent circumstances, or unable to pay debts in full, or knew that she was on the eve of insolvency, or that she intended to give a preference over other creditors. The provincial fraudulent preferences legislation, which applied to the extent the *BIA* provision did not, would not render the equitable mortgage void as against any other creditor. In these circumstances, Burrows J. concluded that the equitable interest in the property and the trust fund that stood in its place had priority to the bank's claim represented by the writ of enforcement: *Rahemtulla v. Kushwaha*, 2013 CarswellAlta 312, 30 R.P.R. (5th) 226, 2013 ABQB 136 (Alta. Q.B.).

F§202 — Preferential Transactions Immune From Attack

There are certain transactions that, although they confer a preference on a creditor, cannot be ordinarily attacked by a licensed insolvency trustee.

Section 136 of the *Act* gives a preference to certain classes of creditors over ordinary creditors. If a claim of a creditor falls into one of these classes, a payment to the creditor for the amount provided in s. 136 cannot ordinarily be attacked by a trustee.

The word "property" in s. 95(1) only includes property that vests in the trustee for distribution to creditors and does not include property exempt from execution and seizure: *Can. Credit Men's Trust Assn. v. Umbel* (1931), 13 C.B.R. 40 (Alta. S.C.); *Alberta Drywall Supply Ltd. v. Hauk* (1984), 53 C.B.R. (N.S.) 62, 55 A.R. 226 (Master).

In *Kisluk v. B.L. Armstrong Co.* (1982), 44 C.B.R. (N.S.) 251 (Ont. S.C.), it was held that payment of rent to a landlord for the three months preceding the date of bankruptcy could not be attacked as a preference, since the landlord is a preferred creditor under s. 136(1)(f) for that amount. But amounts paid for arrears of rent for the period prior to the three-month period can be attacked as a fraudulent preference: *Re K.S. & D. Engineering Ltd.* (1992), 9 C.B.R. (3d) 130 (B.C. S.C.).

If a creditor has received a transfer of property or a payment from a third party in satisfaction of its claim, that cannot be attacked by a trustee as a preference, because the property is not the property of the bankrupt: *Re Regal Phonograph Co.* (1924), 4 C.B.R. 418 (Ont. S.C.); *Re Bagnell* (1985), 58 C.B.R. (N.S.) 66 (N.S. T.D.); *Re Samuels Car Market*, [1961] Que. Q.B. 271, 2 C.B.R. (N.S.) 136.

F§203 — Transactions Covered by Section 95

Section 95 specifies that a transfer of property made, provision of services made, a charge on property made, a payment made, an obligation incurred or a judicial proceeding taken or suffered by an insolvent person in favour of a creditor who is dealing at arm's length with the insolvent person, or a person in trust for that creditor, with a view to giving that creditor a preference over another creditor is void as against the trustee, or, in Québec, may not be set up against the trustee, if it is made during the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date of the bankruptcy. For creditors not dealing at arm's length with the insolvent person, or a person in

C.B.R. 147 (B.C. S.C.). Evidence that is speculative and based on hearsay will not be sufficient: *Re Debentis Invts. Ltd.* (1981), 39 C.B.R. (N.S.) 39 (Ont. S.C.); *Re Bagnell* (1985), 58 C.B.R. (N.S.) 66 (N.S. T.D.). The trustee is not, however, required to prove insolvency beyond a reasonable doubt; proof is the usual proof in civil cases: *Re Blenkarn Planer Ltd., supra*; *Thorne Riddell v. Fleishman* (1983), 47 C.B.R. (N.S.) 233 (Ont. S.C.); *C.I.B.C. v. Kennedy Homes Ltd.* (1989), 77 C.B.R. (N.S.) 159 (B.C. S.C.). The proof must, however, be clear and convincing: *Fischer v. Moffatt & Powell, Perth Ltd.* (1984), 53 C.B.R. (N.S.) 28 (Ont. S.C.).

(6) — Insolvency of a Member of a Partnership

If a debtor is a member of a partnership that is clearly insolvent at the date of an alleged preference but is solvent as regards his or her separate estate, he or she is still insolvent. A person cannot be partly solvent and partly insolvent: *Re Rosedale Produce Co.*, 4 C.B.R. 277, 25 O.W.N. 274, [1924] 1 D.L.R. 321 (Ont. S.C.).

(7) — Payment, Conveyance, etc. by an Agent of an Insolvent Person

The payment, conveyance, *etc.*, must be made by an insolvent person. A payment, conveyance, *etc.*, by an agent with intent to prefer a creditor is, however, sufficient, even though the principal had no intent to prefer: *Re Drabble Bros.*, [1930] 2 Ch. 211, 99 L.J. Ch. 451, [1930] B.&C.R. 158, 143 L.T. 337. Similarly, a payment by a privately appointed receiver which, by the terms of the debenture under which the receiver was appointed, was acting as agent for the debtor will, if the requirements of s. 95 are met, constitute a preference: *Cargill Ltd. v. Compton Agro Inc.* (1997), 47 C.B.R. (3d) 176 (Man. Q.B.).

F§207 — Preference in Fact

Section 95(2) specifies that if the transfer, charge, payment, obligation or judicial proceeding referred to has the effect of giving the creditor a preference, it is, in the absence of evidence to the contrary, presumed to have been made with a view to giving the creditor the preference, even if it was made, incurred, taken or suffered under pressure, and evidence of pressure is not admissible to support the transaction. Section 95(2.1) provides that in the case of a margin deposit made by a clearing member with a clearing house, or in the case of a transfer, charge, or payment made in connection with an eligible financial contract, parties are deemed to be dealing with each other at arm's length and subsection (2) does not apply. The cases cited below pre-September 2009 must be read with caution, but many will have reasoning relevant to the new provisions.

The trustee must prove that the transfer, payment, *etc.*, had the effect of giving the creditor a preference in fact over another creditor or other creditors: s. 95(2): *Burns v. Royal Bank* (1922), 2 C.B.R. 241; affirmed 4 C.B.R. 190 (Ont. C.A.); *Re Van der Liek* (1970), 14 C.B.R. (N.S.) 229 (Ont. S.C.); *Re Piette*, 1 C.B.R. (N.S.) 1, [1960] R.L. 156 (Que. S.C.); *Re W. Slaunwhite & Sons Dev. Ltd.* (1982), 45 C.B.R. (N.S.) 37, 112 A.P.R. 309, (sub nom. *Price Waterhouse Ltd. v. Sumner Holdings Ltd. (Halliday Craftsmen))* 54 N.S.R. (2d) 309 (T.D.).

The preferential effect of the transaction is ordinarily proved by the evidence of other creditors, who give evidence that their accounts that were unpaid at the relevant date, were still unpaid at the date of bankruptcy and that the creditors who received the transfer, payment, *etc.*, received different treatment from the treatment that they received. The creditors who give this evidence will ordinarily be the same creditors who give evidence of insolvency: *Re Van der Liek, supra.*

To prove a preference in fact, it is only necessary to prove that there was a preference in fact over one or more creditors; it is not necessary to prove that there was a preference in fact over all other creditors of the bankrupt: *Medler-McKay Holdings Ltd. (Trustee of) v. Teac Canada Ltd.* (1994), 26 C.B.R. (3d) 147, 1994 CarswellOnt 284; affirmed (1997), 50 C.B.R. (3d) 55, 1997 CarswellOnt 2192 (Ont. C.A.); *Re Slaumwhite & Sons Dev. Ltd., supra*; *Deloitte & Touche Inc. v. White Veal Meat Packers Ltd.* (2000), 16 C.B.R. (4th) 74, 2000 CarswellMan 72 (Q.B.); affirmed (2000), 21 C.B.R. (4th) 234, 2000 CarswellMan 602 (C.A.).

F§208 — With a View to Giving a Preference

Section 95(2) specifies that if the transfer, charge, payment, obligation or judicial proceeding referred to has the effect of giving the creditor a preference, it is, in the absence of evidence to the contrary, presumed to have been made with a view to giving the creditor the preference, even if it was made, incurred, taken or suffered under pressure, and evidence of pressure is not admissible to support the transaction. Under the previous statutory language, intent had to be established: *Hudson v. Benallack* (1975), 59 D.L.R. (3d) 1 (S.C.C.); however, there is now a rebuttable presumption of intent once the effect of giving the creditor a preference is established.

F§209 — The Presumption

Section 95(2) creates a presumption of a preference if the transfer, charge, payment, obligation or judicial proceeding referred to has the effect of giving the creditor a preference. It is, in the absence of evidence to the contrary, presumed to have been made with a view to giving the creditor the preference, even if it was made, incurred, taken or suffered under pressure, and evidence of pressure is not admissible to support the transaction.

F§210 — Rebutting The Presumption

(1) — Generally

The presumption created by s. 95(2) is not an absolute or conclusive presumption; it is capable of being rebutted: *Salter & Arnold Ltd. v. Dominion Bank* (1926), 7 C.B.R. 639 (S.C.C.). It is a question of fact whether the presumption has been displaced: *ibid.*

There was considerable discussion in the cases prior to the 2009 amendment about "dominant view" or "dominant intent" of the debtor. This concept is useful in distinguishing motive from intent, "motive" being the underlying reason or emotion prompting the debtor's actions, such as friendship, fear, *etc.*, "intent", on the other hand, being the object aimed at by the debtor when he or she made the conveyance, transfer, payment, *etc.* Thus, if a debtor makes a payment to a creditor within three months of bankruptcy because the creditor is a friend and the debtor wishes to prefer him or her over other creditors, the motive for the payment is friendship, but the intent is to prefer: *Coderre (Trustee of) v. MBNA Canada Bank* (2006), 2006 CarswellMan 369, 26 C.B.R. (5th) 175 (Man. Q.B.); *Dubois-Vandale (Trustee of) v. MBNA Canada Bank* (2006), 2006 CarswellMan 377, 26 C.B.R. (5th) 261 (Man. Q.B.).

A debtor had made two payments of income tax to the Minister of National Revenue (MNR) within three months of bankruptcy. The trustee successfully challenged those payments as fraudulent preferences under s. 95 and MNR appealed. The Manitoba Court of Appeal held that the applicant has the initial onus of establishing a *prima facie* case that the debtor made a payment to a creditor within three months prior to the date of bankruptcy, the debtor was insolvent person at the time of the payment, and the payment was made with a view to

giving that creditor a preference over the other creditors. If the application judge is satisfied that the onus has been met, the onus shifts to the deemed preferred creditor to rebut the presumption. To be successful, the deemed preferred creditor must establish, on a balance of probabilities, that at least one of the three factors did not exist when the debtor made the payment. The dominant intent is based on an objective assessment of the circumstances. MNR had not appealed the application judge's ruling that the applicant had established a *prima facie* case that the debtor was insolvent and intended to prefer the MNR at the time of the payments. As a result, the payments gave the MNR a preference in fact, and it was open for the judge to find that there was no satisfactory explanation given for the increased expenditure rate and that her repayment plan to avoid bankruptcy was not objectively reasonable: *Andrews (Trustee of) v. Minister of National Revenue* (2011), 2011 CarswellMan 613, 85 C.B.R. (5th) 286 (Man. C.A.).

The starting point is that the transferee is not obliged to rebut the presumption on a balance of probabilities; rather, once some contrary evidence is adduced, the presumption has "no more than its own weight": *Re Indarsingh*, 2015 CarswellAlta 378, 25 C.B.R. (6th) 289, 2015 ABQB 158, [2015] A.J. No. 259 (Alta. Q.B.). For a discussion of this judgment, see F§201 "Preferences and Transfers at Undervalue".

The Registrar of the Alberta Court of Queen's Bench held that if a payment constitutes preference in fact, it is presumed to have been an illegal preference unless the presumption in s. 95(2) is rebutted by showing on a balance of probabilities that the dominant intent at the time of payment was not to prefer. The demonstrated intent must be objectively reasonable. In this case, there was no affidavit from the bankrupt. What was before the court was the trustee's report in the Division I proposal, which, if it is was evidence, consisted partly of hearsay. In the circumstances, Registrar Schlosser treated the trustee's report as evidence, and found that the motive fell short of demonstrating a dominant intent not to prefer some creditors over others: *Re Gustafson*, 2018 CarswellAlta 142, 56 C.B.R. (6th) 258, 2018 ABQB 77 (Alta. Q.B.).

(2) — Ordinary Course of Business

If the court, after examining all relevant evidence, concludes that a payment was made in the ordinary course of business, the presumption will have been rebutted and the payment will stand: *Touche Ross Ltd. v. Weldwood of Canada Sales Ltd.* (1983), 48 C.B.R. (N.S.) 83; additional reasons at (1984), 49 C.B.R. (N.S.) 284 (Ont. S.C.).

Payments in the ordinary course of business will ordinarily be made for one of two reasons: so that the bankrupt might take advantage of favourable payment terms, or to secure a continued supply of goods or services from the trade creditor so that the bankrupt could continue in business: *Re Norris* (1994), 28 C.B.R. (3d) 167 (Alta. Q.B.).

(3) — Diligent Creditors

The courts have previously held that where creditors acted diligently, the "intent to prefer" presumption was rebutted. The 2009 amendments now specify that evidence of pressure is not admissible to support the transaction: s. 95(2). Section 95(2) specifies that if the transfer, charge, payment, obligation or judicial proceeding has the effect of giving the creditor a preference, it is, in the absence of evidence to the contrary, presumed to have been made with a view to giving the creditor the preference, even if it was made, incurred, taken or suffered under pressure.

F§211 — Transactions Entered Into to Permit the Debtor to Remain in Business

If the creditor, who received the alleged preference, can show that the payment was made by the debtor in the *bona fide* expectation that it would enable the debtor to continue in business and to extricate itself from its financial difficulties, it may rebut the statutory presumption: *Re A.R. Colquhoun & Son Ltd.* (1936), 18 C.B.R. 124 (Sask. K.B.); *Re Trafalgar Motors* (1952), 33 C.B.R. 87 (Ont. S.C.); *Eastern Trust Co. v. Bank of Nova Scotia* (1956), 36 C.B.R. 77 (N.S. T.D.).

If the creditor alleges that the impugned transaction was carried out in order that the bankrupt could continue in business, the belief by the bankrupt that it could carry on its operations must be a reasonable belief. It is the court which determines the issue of "reasonableness", having regard to the evidence: *Re Yorkville Homes Ltd.*, 62 C.B.R. (N.S.) 70, 46 Alta. L.R. (2d) 281, [1986] 6 W.W.R. 54, 73 A.R. 223 (Q.B.); *Re Spectrum Interiors (Guelph) Ltd.* (1979), 29 C.B.R. (N.S.) 218 (Ont. H.C.); *Houle v. St-Laurent* (1985), 56 C.B.R. (N.S.) 211 (Que. S.C.). The fact that the debtor may have been overly optimistic in its belief that it could carry on business does not make the belief unreasonable: *Re D. Elkind Clothing Inc.* (1979), 26 C.B.R. (N.S.) 240 (Ont. H.C.). The payment must be tied to the continuation of the business or a reasonably held hope or expectation of continuance: *Principal Group Ltd. (Trustee of) v. Anderson* (1994), 29 C.B.R. (3d) 216 (Alta. Q.B.).

Where goods of the kind supplied by the creditor were available from other dealers and the creditor supplied only very few goods after receiving the alleged preference, it was held that the transaction had not been entered into in order to permit the debtor to remain in business: *Sinco Trucking Ltd. (Trustee of) v. Western Tire Service Ltd.* (1992), 11 C.B.R. (3d) 291, (sub nom. *Re Sinco Trucking Ltd. (Trustee of)*) 99 Sask. R. 246 (Q.B.).

F§212 — Payment, etc., Made to Remedy a Wrongful Act

Under the previous wording of s. 95, if a payment was made by the debtor with the intent to remedy a wrongful act committed by him or her, it was found not to be a fraudulent preference: *Sharp v. Jackson*, [1899] A.C. 419, 68 L.J.Q.B. 866, 6 Mans. 264.

F§213 — *Bona Fide* Belief That Debtor Under a Legal Obligation

Where a debtor had a *bona fide* belief based on reasonable grounds that he or she was under a legal obligation to make a payment or return goods to a creditor, this belief rebutted the presumption under the previous wording of the statute, even though the debtor was not, in fact, under such a obligation: *Re Fletcher; Ex parte Suffolk* (1891), 9 Morr. 8; *Re Taylor* (1922), 3 C.B.R. 454, 1922 CarswellOnt 94, 23 O.W.N. 293 (Ont. S.C.). However, if the payment or return of goods was made from a sense of moral obligation or duty, that would not be sufficient to rebut the presumption: *Re Blackburn*, [1899] 2 Ch. 725.

F§214 — Security for Present Advance

If a security is given for a present advance, the transaction cannot be attacked as a preference. The debtor's intention is to obtain ready cash, not to give a preference: *Re Gauvin* (1962), 5 C.B.R. (N.S.) 180; *Re Aboud* (1940), 22 C.B.R. 121 (Ont.); *Re Goldstein*, 3 C.B.R. 404, 53 O.L.R. 60, [1923] 1 D.L.R. 864; aff'd 53 O.L.R. 65 (C.A.).

TAB
“6”

1994 CarswellAlta 353
Alberta Court of Queen's Bench, In Bankruptcy

Norris, Re

1994 CarswellAlta 353, [1994] A.W.L.D. 831, [1994] A.J. No. 699, [1995] 1 W.W.R. 292, 161 A.R. 77, 23 Alta. L.R. (3d) 397, 28 C.B.R. (3d) 167, 50 A.C.W.S. (3d) 175

Re Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, as amended; Re bankruptcy of DAVID CARL NORRIS

Agrios J.

Judgment: September 21, 1994
Docket: Doc. Edmonton BKCY 39553

Counsel: *K.A. Rowan*, for Browning, Smith Inc., trustee in bankruptcy of David Carl Norris.
S.J. Bocock, for Minister of National Revenue.

Subject: Corporate and Commercial; Insolvency

Application by trustee in bankruptcy for declaration that payment to Revenue Canada was fraudulent preference.

***Agrios J.*:**

1 In this bankruptcy I held that a payment of $8,548.40 made to Revenue Canada was a fraudulent preference within the meaning of s. 95 of the *Bankruptcy and Insolvency Act*.

2 At the time the decision was rendered, I indicated to counsel that should they require written reasons I would be happy to provide such and I now do so at the request of counsel for Revenue Canada.

Facts

3 The facts are not in issue. On November 25, 1992 Revenue Canada received a payment on taxes of $8,548.40 from David Carl Norris. On January 26, 1993 Mr. Norris made a voluntary assignment into bankruptcy.

4 Revenue Canada had made a series of demands on the bankrupt. There was a letter on September 12, 1992, a notice of October 9, 1992 amending the balance owing and again demanding payment, and a final letter on October 24, 1992 making still a further demand and stating that if arrangements were not made for payment, legal action such as garnishee of income or instructions to the Sheriff to seize and sell assets might be made. On October 29, 1992 the bankrupt called Revenue Canada in response to the last letter, and requested a one-month grace period, which was granted and the aforementioned payment was received on November 25, 1992.

Issues

5 There is no serious dispute that the prima facie presumption under s. 95 as raised by the Trustee had established the three required criteria, namely:

1. that the transfer took place within three months of bankruptcy;

2. that at the date the transfer was made, it gave the creditor a preference in fact;

3. that the debtor was an insolvent person at the date of the payment.

6 Section 95(2) of the Act provides that the presumption may be rebutted on a balance of probabilities that the dominant intention of the debtor was not to prefer the creditor. There were only two issues that Revenue Canada could use to rebut the presumption:

1. they were a diligent creditor;

2. alternatively, the payment was made in the ordinary course of business.

Ordinary Course of Business

7 I have accepted the submission of counsel for the Trustee. As stated in its brief of law, all of the cases cited by Revenue Canada can fairly be characterized as payments made by the debtor in the ordinary course of its business to trade creditors for two reasons Firstly, so that the bankrupt might take advantage of favourable payment terms or, secondly, to secure a continued supply of goods and services from those trade creditors in order that it might continue in its business. There is no doubt that evidence that after payment on account, goods were supplied to the bankrupt by a trade creditor which, under normal circumstances, rebut the presumption. I accept Mr. Rowan's submission that Revenue Canada was not a trade creditor and there was no evidence that would assist Revenue Canada to be considered a trade creditor in having received a payment in the ordinary course of business.

Diligent Creditor

8 The case of *Houston v. Thornton* (1973), 18 C.B.R. (N.S.) 102 (Ont. S.C.), followed by *Coopers & Lybrand Ltd. v. O'Brien Electric Co.* (1983), 47 C.B.R. (N.S.) 243 (N.B. Q.B.), is cited for the following proposition [p. 103]:

> Both creditors had substantially overdue accounts and both were exerting every effort to obtain payment of their accounts. As has been so often said, our law does not penalize a diligent creditor. In order for me to set aside these transactions, I must find that there was a fraudulent scheme on the part of the debtor to prefer these creditors over other creditors.
>
> On the evidence, I cannot find any such scheme. Rather, I think it is a situation where diligent creditors have managed to obtain substantial payments on their accounts at a time when other creditors, who were not as diligent, did not obtain payment.
>
> ... The only reason for making the payments to the respondents was because the respondents were pressing more vigorously than other creditors for payment of their accounts.

9 I have again accepted the submissions of counsel for the Trustee that these authorities are characterized by a theme of an extremely aggressive creditor whose actions would cause an imminent business crisis unless they were dealt with. As Mr. Rowan stated: "The payments were motivated by a desire to 'get the creditor off the debtor's back', and because the continued actions of the creditor would cause an immediate business crisis."

10 Frankly, in my view, the forwarding of three letters, one of which threatened legal action and the subsequent granting of one month's grace period, could best be described as steps that any ordinary creditor would take, making demands and threatening legal proceedings. I accept the proposition that the actions of Revenue Canada, when compared with those in the cited authorities, did not amount to such aggressive action such as to create an imminent business or personal crisis for the bankrupt. Had Revenue Canada in fact taken garnishee proceedings or instructed seizure, I should have held otherwise.

11 Accordingly, as the presumed intention was not, in my view, rebutted on the balance of probabilities, I ordered that Revenue Canada pay the Trustee the sum of $8,546.40.

Application allowed.

End of Document

TAB

“7”

1996 ABCA 357
Alberta Court of Appeal

Norris, Re

1996 CarswellAlta 884, 1996 ABCA 357, [1976] A.J. No. 975, [1996] A.W.L.D. 1103, [1997] 2 W.W.R. 281, 135 W.A.C. 15, 193 A.R. 15, 44 C.B.R. (3d) 218, 45 Alta. L.R. (3d) 1, 66 A.C.W.S. (3d) 1021

The Attorney General of Canada (Appellant) and Browing Smith, Trustee of the Estate of David Carl Norris, a Bankrupt (Respondent)

Belzil, Bracco and O'Leary JJ.A.

Heard: April 12, 1996
Judgment: November 13, 1996
Docket: Edmonton Appeal 9403-0459-AC

Proceedings: reversing (1994), 23 Alta. L.R. (3d) 397 (Q.B.)

Counsel: *J.L. Medhurst*, for appellant.
K.A. Rowan, for respondent.

Subject: Insolvency

Appeal of setting aside of transaction under Bankruptcy and Insolvency Act (1994), 23 Alta. L.R. (3d) 397, 28 C.B.R. (3d) 167, [1995] 1 W.W.R. 292, (sub nom. *Re Norris (Bankrupt)*) 161 A.R. 77.

***Belzil J.A.* (*Bracco J.A.* concurring):**

1 By amendment to the *Bankruptcy and Insolvency Act* effective November 30, 1992, the traditional priority of the Crown theretofore enjoyed at common law for its claims for income tax owed by a bankrupt are removed. In bankruptcies occurring after that date, proven Crown claims are to rank equally and be paid rateably with all other unsecured creditors.

2 The issue in this appeal is whether a payment of income tax to the Minister of National Revenue made within the three months preceding the taxpayer's bankruptcy was a fraudulent preference within the meaning of s. 95 of the *Bankruptcy and Insolvency Act* and void as against the Trustee. On application by the Trustee, the Court of Queen's Bench sitting in chambers in bankruptcy declared it to be so and ordered its repayment by the Minister to the Trustee. The order was granted orally in open chambers at the conclusion of the application on May 24, 1994.

3 At the request of the appellant Attorney General of Canada, the learned justice subsequently provided written reasons which were issued September 21, 1994, now reported in 23 Alta. L.R. (3d) 397. These are the only reasons before us in this appeal. We do not know what may have been said by the learned justice during the application when making his order in chambers.

4 The Attorney General of Canada, acting for Her Majesty in right of Canada represented by the Minister of National Revenue (herein called "Revenue Canada"), then obtained an order from a judge of this court granting leave for this appeal. The material supporting the application for leave alleges that of 24,902 active files in Edmonton alone involving Alberta individual and corporate taxpayers, 13,319 involve taxpayers in bankruptcy, with a number of potential cases in which Revenue Canada has received funds in circumstances similar to the present case. Counsel have found no other reported decision dealing with the position of Revenue Canada as ordinary creditor in these circumstances. The appeal is advanced as a test case which, it is said, will significantly impact other similar cases.

5 The basic facts giving rise to the issue are concisely set out in the reasons of the learned chambers judge as follows:

> The facts are not in issue. On November 25, 1992 Revenue Canada received a payment of taxes of $8,548.40 from David Carl Norris. On January 26, 1993 Mr. Norris made a voluntary assignment into bankruptcy.
>
> Revenue Canada had made a series of demands on the bankrupt. There was a letter on September 12, 1992, a notice of October 9, 1992 amending the balance owing and again demanding payment, and a final letter on October 24, 1992 making still a further demand stating that if arrangements were not made for payment, legal action such as garnishee of income or instructions to the Sheriff to seize and sell assets might be made. On October 29, 1992 the bankrupt called Revenue Canada in response to the last letter, and requested a one-month grace period, which was granted and the aforementioned payment was received on November 25, 1992.

6 The impeached payment to Revenue Canada was made pursuant to a notice of reassessment for 1991 and prior taxation years.

7 The vehicle for the Trustee's application was s. 95 of the *Bankruptcy and Insolvency Act* the pertinent sub-sections of which provide:

> (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 with a view to giving that creditor a preference over the other creditors shall, if the person making, incurring, taking, paying or suffering it becomes bankrupt within three months after the date of making, incurring, taking, paying or suffering it, be deemed fraudulent and void as against the Trustee in 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 to support the transaction.
>
> (3) .....

8 The grounds of appeal are that the learned trial judge erred in finding that:

> (a) Norris was insolvent on November 25, 1992:
>
> (b) Revenue Canada was not acting as a diligent creditor when it solicited and received the Payment; and
>
> (c) The Payment was not made in the ordinary course of business between Revenue Canada and Norris.

9 Having reached this conclusion that the issues raised in this application should be returned to the Court of Queen's Bench for resolution by trial, I do not decide any of the grounds of appeal.

10 In his written reasons, the learned justice said:

> **Issues:**
>
> There is no serious dispute that the *prima facie* presumption under s. 95 as raised by the Trustee had established the three required criteria, namely:
>
> 1. that the transfer took place within three months of bankruptcy;
>
> 2. that at the date the transfer was made, it gave the creditor a preference in fact.

3. that the debtor was an insolvent person at the date of the payment.

11 This is manifest error: the presumption under s. 95 does not establish the three required criteria but rather it is the proof of the three criteria which raises the presumption.

12 No suggestion is made that the learned judge misunderstood the test in s. 95. The error obviously results from an inadvertent clerical transposition of thoughts or words, or from an accidental omission of part of his text, missed in proofreading before issue. This editorial error was not commented on by counsel at the hearing, and I would not have raised it but for the fact that the reasons are now reported and that this test case may go higher.

13 There is no disagreement between the parties as to the substance and effect of s. 95 of the *Act*. It creates and defines the concept of fraudulent preference as it applies in bankruptcy. It sets out the three elements which had to be proven by the Trustee in its application to set aside the payment as a fraudulent preference, namely, (1) that the payment in question was made to an ordinary creditor within three months of the bankruptcy; (2) that the bankrupt was at the date the payment was made an insolvent person within one of the definitions in s. 2 and; (3) that the payment was made by the debtor "with a view to giving that creditor a preference over the other creditors", in the words of the statute.

14 If elements (1) and (2) are established and the Trustee proves that the creditor received a preference in fact over other creditors, s. 95(2) then raises a presumption in the absence of evidence to the contrary that the preference in fact was made with a view to giving that creditor a preference over the other creditors, and was thus a fraudulent preference within s. 95(1).

15 The presumption is rebuttable and will be rebutted if the totality of the evidence to the contrary at the end of the case is sufficient to show on the balance of probabilities that the debtor did not have the dominant intent to prefer the creditor over others when he made the impeached payment.

16 In considering this section, it is well to keep in mind the distinction between preference in fact and fraudulent preference as that latter is defined in the *Act*. There can be no doubt in this case that Revenue Canada received a preference in fact from the payment of tax made by this debtor on November 25, 1992. Its debt was paid where the debts owing to other ordinary creditors were not. What would render that preference in fact a fraudulent one under s. 95 is the accompanying intent of the insolvent debtor who in the face of imminent bankruptcy is moved to prefer or favor, before losing control over his assets, a particular creditor over others who will have to wait for and accept as full payment their rateable share on distribution by the Trustee in the ensuing bankruptcy. It is called fraudulent because it prejudices other creditors who will receive proportionately less, or nothing at all, and upsets the fundamental scheme of the *Act* for equal sharing among creditors. That accompanying intent to favour one creditor over another is what makes a preference in fact a fraudulent preference and is referred to in the cases as the "dominant intent". The state of mind of the debtor at the time of making the payment is ultimately the paramount consideration to be addressed by the court. The intent or state of mind of the preferred creditor is irrelevant, *Hudson v. Benallack* (1975), 21 C.B.R. (N.S.) 111 (S.C.C.).

17 This concept of "dominant intent" of the debtor comes to us from English law. It is irrelevant under American law where preference in fact is sufficient for setting aside a preferential payment if other preconditions set out in that bankruptcy code are met.

18 Why a department of government charged to administer legislation and compelled by the rules of natural justice to act fairly and impartially, and unable to return a *quid pro quo* favor would ever be intentionally so favoured by an insolvent debtor over other creditors is difficult to understand. It is possible, but seems highly improbable at first blush. The allegation of it and its *prima facie* occurrence invites a close scrutiny of all surrounding circumstances for another and more likely purpose behind the preference in fact, particularly where the bankruptcy is not sought by creditors but is voluntary and its timing orchestrated by the debtor himself.

19 If after consideration of all of the evidence before it the court is satisfied on a balance of probability that the debtor was pursuing a purpose other than that of favouring the particular creditor over others, the presumption is displaced and the application fails. The finding of the court on that particular issue is one of fact which will not be disturbed on appeal, unless relevant evidence has not been taken into account by the trier of fact. This unfortunately is the situation in this appeal; two items of cogent evidence on the specific issue of dominant intent found in the material filed by the Trustee in support of its application were not brought to our attention at the hearing before us, and presumably not brought to the attention of the learned chambers judge at his hearing.

20 The first item of cogent evidence, not disclosed, was that of a family relationship existing between the creditor Carl Ortan Norris and the bankrupt. This issue was first raised by the court in a question to counsel for the Trustee because of the similarity in names, and counsel for the Trustee advised the court that there was no evidence of such relationship. He asserted to the court that as far as he knew the similarity in names was a mere coincidence. This was accepted by the court and the issue not then pursued further. Judgment was then reserved and the court recessed. When reviewing the material thereafter, in preparation for judgment, the court itself discovered that, contrary to what counsel for the Trustee had stated to it, there was indeed in the Trustee's own material a statement by the creditor Carol Ortan Norris that he was related to the debtor. That evidence was in his Proof of Claim for $15,000.00 filed with the Trustee's material. This positive assertion had been achieved by crossing out the word "not" appearing before the word "related" in the printed form. This alteration of the form seems to have escaped the attention of counsel for the Trustee as well as counsel for the appellant.

21 This was relevant to the issue of dominant intent. Just as preference given to a close relative can support an inference of a dominant intent to prefer that relative over others, so a preference given to an unrelated creditor which would materially adversely affect the claim of a close relative could support an inference against a dominant intent to prefer the unrelated creditor to the related one.

22 The other relevant evidence not drawn to the attention of the learned chambers judge, nor to us, is found in the Statement of Affairs signed by the bankrupt in support of his assignment into bankruptcy. To Question 9, appendix B: "within the last 12 months have you disposed of or transferred any of your assets", the answer is "No". To question 10A: "within the last 5 years have you sold, disposed of or transferred any real estate", the answer is "Yes". The explanatory note to question 10A reads that in August, 1992, he sold real estate property in Calgary for $179,000.00, and adds "net proceeds used as a down payment on another residence". No further details are given. Then in the statement of assets, under item 6 "real property" in form 74A is stated: "House ..... NE 24-69-12-W6 (JOINT) (Enc) (EXEMPT) ..... 75,000.00". The Statement of Affairs further discloses that the bankrupt was self-employed as a 50 per cent shareholder in a construction business which ceased to operate on September 1, 1992, and that he was unemployed at the date of the statement. The timing of the voluntary assignment and the orchestration of the events leading to the claimed expenditure remained throughout with the bankrupt. These were factual circumstances surrounding the alleged preferential payment to Revenue Canada which were relevant to the issue of dominant intent and to the issue of "evidence to the contrary" under s. 95. The respondent Trustee in bankruptcy was duty bound but failed to draw to the attention of the Court these factual circumstances.

23 The duty of a Trustee in bankruptcy, as well as those of counsel, is referred to in *Harper v. Harper* (1979), [1980] 1 S.C.R. 2, in the context of an application to admit fresh evidence. Laskin C.J. speaking for the unanimous nine member Court on this point, said at p. 13:

> It is clear that Justice Ritchie did not lay down an exhaustive test for the admissibility of fresh evidence in the Supreme Court, saying only what the special grounds under the proviso to. s. 67 include. In my opinion, they also include a situation where there has been a failure of an officer of the Court, *e.g.* a trustee in bankruptcy, to bring all the relevant matters to the Court's attention, although the matters were not newly discovered but existed before trial: see *Brown v. Gentleman*. Equally, in my opinion, they will yield to a situation where a solicitor as an officer of the Court has not brought to the Court's attention pre-existing matters of which he had knowledge or where a

> party to the proceedings has misled the Court as to facts in issue or has misled his own solicitor or counsel, with the result that the action has proceeded on an erroneous factual basis.

and at p. 16

> ... No Court can condone attempts to mislead it; and if the respondent put his counsel, be he Mr. Scoffield or Mr. Horn, in an unenviable position, the Court is entitled to have their co-operation in clarifying the record once they have become aware of the true state of the title.
>
> At the conclusion of the hearing of the motion for leave to adduce new evidence, the Court was unanimously of the opinion that the motion should be granted, with costs of the motion to the successful appellant and with reasons to be delivered later. The reasons have been set out in what has gone before, and I turn now to the merits in the light of the newly admitted evidence.

24 The duties of a Trustee in bankruptcy are also outlined in brief form in Houlden & Morawetz and I quote from the 1995 annotated *Bankruptcy & Insolvency* page 32:

> **C§10 Duties and Powers of Trustees - Generally**
>
> The Trustee is an officer of the court and should impartially represent the interest of creditors: *Re Roy* (1963), 4 C.B.R. (N.S.) 275 (Que. S.C.). He should act equitably and, as far as possible, hold an even hand between competing interests of various classes of creditors: *Re Reed* (1980), 34 C.B.R. (N.S.) 83 (Ont. C.A.). In bringing proceedings, such as an application to set aside a fraudulent preference, he should not adopt an adversarial or hostile role: *Touche Ross Ltd. v. Weldwood of Canada Sales Ltd.* (1983), 48 C.B.R. (N.S.) 83, additional reasons at 49 C.B.R. (N.S.) 284 Ont. S.C.). Rather, he should present the relevant facts to the court in a dispassionate, non-adversarial manner, and leave the matter to the court for decision.
>
> The trustee is under a continuing duty, until his discharge, to effect recovery of the assets of the bankrupt, and the fact that the bankrupt has received his discharge in no way affects that duty: *Re Salloum* (1988), 69 C.B.R. (N.S.) 255, 22 B.C.L.R. (2d) 77 (S.C.).

The Trustee in this case adopted an adversarial and hostile role in this application. Instead of presenting to the court, as it was his duty to do as an officer of the court, all the relevant facts which were within his knowledge as Trustee, he presented a bare bones skeletal case just sufficient to invoke the presumption in s. 95(2) without disclosing to the court those facts in his material to which I have already alluded which might, in the mind of the chambers judge, weigh against the presumption. This is conduct by a Trustee as an officer of the court which must not be tolerated or condoned. A judge is entitled to expect that all relevant and pertinent information on any application placed before him by officers of the court will be specifically drawn to his attention even if it is also in the written material. This was not followed here. Accordingly, the decision of the chambers judge cannot stand.

25 This is a proper case for adopting what was suggested by Huband J.A. of the Manitoba Court of Appeal in the case of *Craig (Trustee of) v. Devlin Estate* (1989), (sub nom. *Craig (Trustee of) v. Craig)* 76 C.B.R. (N.S.) 256 at 261, 63 Man. R. (2d) 122, where he said:

> When a motion for an order under s. 95 is contested and affidavit evidence is filed by a respondent, the normal practice will be to direct a trial of the issues so that the decision can be based upon *viva voce* evidence rather than affidavits and attached exhibits.

26 The two issues raised in this application whether the bankrupt was insolvent within s. 2 of the *Act*, and whether the presumption in s. 95, if it arose, was rebutted by evidence to the contrary, are referred back to the Court of Queen's Bench for trial.

***O'Leary J.A.* (dissenting):**

27 I do not agree that this matter should be remitted to Queen's Bench for further inquiry into the facts. Revenue Canada and the Trustee have each been represented throughout by experienced and capable counsel. They were content to have this matter determined here and below on the basis of the evidence before the Trial Judge. Neither has complained that any relevant evidence is missing. In my view, we are not justified in initiating a further investigation of the facts on the strength of speculation that some material information has not been forthcoming. We have had the benefit of written and oral argument on the issues raised on appeal. I believe we should decide the appeal on the basis of the facts accepted by the Trial Judge and the parties.

28 Counsel for Revenue Canada has not indicated that any material evidence is missing, and has not asked for or even hinted that a re-hearing is necessary to bring forward further information. This Court undoubtedly has jurisdiction to remit a matter like this for further inquiry into the facts. In *Craig (Trustee of) v. Devlin Estate* (1989), (sub nom. *Craig (Trustee of) v. Craig)* 76 C.B.R. (N.S.) 256, the Manitoba Court of Appeal confirmed that such a direction is available in an appeal from a declaration that a payment was a fraudulent preference (although the matter was not sent back in that case). That is a direction which I believe should be made only where the decision of the trier of fact could reasonably have been affected by an intentional or inadvertent failure to bring forward material evidence or by reliance on false or misleading evidence or representations, or where for any other reason the interests of justice demand that missing relevant and material evidence be brought forward. This is not such a case.

29 A further inquiry into the facts cannot be justified on the basis that this is a test case. It was not presented here or below as a test case. Its resolution turns on the application of the fraudulent preference provisions of the *Bankruptcy and Insolvency Act* to a hitherto protected transaction. To that extent the case is novel, however no new principles of law are raised by the facts or advanced by the parties.

30 The circumstances of the payment do not in themselves create any suspicion as to the bankrupt's intention. I do not agree with the suggestion that the borrowing of money by an insolvent person from a relative, out of which income tax arrears are paid, does, without more, create suspicion that the payment was made for some purpose other than to give a preference.

31 In my opinion, there is no basis for suggesting that the Trial Judge and this Court have been deprived of material evidence. No such thing was suggested by Counsel for Revenue Canada. It does not appear the issue was raised below. The material before us is the same as was before the Trial Judge. It does not, in my view, raise any suspicion that evidence relevant to the issues has been kept from the Court.

32 Lastly, I do not believe there is any foundation in the filed material or in the conduct of Counsel for the Trustee for questioning the diligence or good faith of the Trustee or its Counsel.

33 Following is an elaboration of the above comments.

Test Case

34 The proceedings are not described as a test case in Revenue Canada's Factum. As far as I can determine from the Reasons for Judgment and the material filed at trial, it was not treated as such at that level. Revenue Canada filed an affidavit in support of its application for leave to appeal to this Court which stated that there were approximately 13,000 income tax collection files in its Edmonton office involving taxpayers in bankruptcy. It is not revealed in how many of these cases payments to Revenue Canada were made within three months of the date of bankruptcy. The deponent went on to say that "the point at issue in the appeal could have a significant impact on bankruptcy and insolvency practice in Alberta and potentially throughout Canada". In my view, that is an overstatement. No new principles of law are involved. None were advocated by Counsel for Revenue Canada. Its position on appeal was based on the application of well-known principles to the facts of this case. The only thing novel about this case is the identity of the creditor.

35 Shortly before this case arose Revenue Canada assumed the same position as any other creditor with respect to fraudulent preference claims under the *Bankruptcy and Insolvency Act*. In all s. 95 cases, the facts are critical. I am unable to appreciate how any new facts generated by a re-hearing could have any effect on the principles governing the resolution of s. 95 fraudulent preference claims against Revenue Canada. Where Revenue Canada is the target, the inquiry will be the same as it is in respect of other creditors - determining the dominant intention of the debtor in making the payment, having regard to the presumption contained in s. 95.

36 This case is not important to Revenue Canada or to bankruptcy law in general. It involves a modest amount of money and is no more than the application of existing principles to the facts of this particular case.

Circumstances of Payment

37 It is suggested that the fact the bankrupt borrowed from a relative and used a portion of the proceeds to make a preferential payment of income tax arrears creates suspicion about the bankrupt's intention. Why would an insolvent person pay an outstanding income tax assessment in preference to paying other creditors, and borrow money from a relative in order to do so? I do not agree that these circumstances create any suspicion that would not exist were the creditor not Revenue Canada and were the funds from the bankrupt's own resources. Revenue Canada was applying pressure. It had threatened to take formal steps to collect and had set a deadline for payment. There is no evidence that other creditors were pressuring the bankrupt for payment. It cannot be assumed the bankrupt, though insolvent, had the intention when he paid Revenue Canada to make an assignment in bankruptcy shortly thereafter. Preferential payments are, I suspect, often made in an effort to stave off bankruptcy rather than with a conscious intent to preferring the creditor in anticipation of imminent bankruptcy.

Missing Evidence

38 There is nothing in the material filed here or below or in the submissions of Counsel which indicates that any relevant or material evidence is missing. Revenue Canada does not say anything like that in its Factum and did not allege it in oral argument. The Trial Judge proceeded on the basis of affidavit evidence as he was entitled to do. He asked for and received written submissions from the parties. Revenue Canada did not dispute any of the allegations of fact in the affidavits filed on behalf of the Trustee. Nor did it question the accuracy or sufficiency of the information contained in the Statement of Affairs filed by the bankrupt. Similarly, the facts deposed to on behalf of Revenue Canada were unchallenged. Revenue Canada had ample opportunity to pursue any suspicions raised by the Trustee's affidavits or the Statement of Affairs and to alert the Trial Judge or this Court to its concerns.

39 The majority judgment points to two circumstances which it sees as suspicious. It assumes that further inquiry may reveal evidence relevant to the bankrupt's intention in making the impugned payment. In my view, there is no basis for suspicion that any relevant material evidence is not before the Court.

40 The first area of concern stems from the source of the funds used by the bankrupt to make the payment. He borrowed $15,000 from a relative the day before he paid Revenue Canada. It is fair to assume that he used $8,457 of the borrowed money to pay his tax arrears. The relative has filed a Proof of Claim as an ordinary creditor for the amount of the loan. We are not, of course, concerned with the validity of the Proof of Claim.

41 It is said that the source of the funds is relevant to the issue of the dominant intent behind the payment to Revenue Canada. I do not understand the logic of that suggestion in these circumstances. The question seems to be: why, in the absence of some indirect intention, would an insolvent debtor make an unsecured loan from a relative in order to pay a creditor like Revenue Canada and then make a voluntary assignment in bankruptcy two months later, leaving the relative with an unsecured claim in bankruptcy? In my view, the mere fact that the funds were borrowed from a relative, as opposed to a bank or other independent source, has no bearing on the dominant intention of the bankrupt in making the payment. There is absolutely no evidence the loan and subsequent payment were part of a scheme to benefit the bankrupt at the expense of his creditors. Nothing like that was alleged or even mentioned by Counsel for Revenue Canada.

42 Second, it is suggested that the property transactions revealed in the Statement of Affairs arouse suspicion and the Trustee should have explained them. Counsel for Revenue Canada apparently saw nothing suspicious in these transactions. Neither did the Trial Judge and neither do I.

43 In his Statement of Affairs the bankrupt gave the following answer to the question whether he had disposed of real property during the previous five years:

> Sold 251 Hawk Stone Close Northwest, Calgary, Alberta in August of 1992 for $179,000. *Net proceeds* used as *down payment* on another residence. [emphasis added]

44 The list of assets shows the bankrupt's current residence as a quarter section near Beaverlodge, Alberta, described as the NE 1/4 of 24 - 69 - 12, W6M ("the acreage"), owned in joint tenancy, and valued at $75,000. The bankrupt claimed his interest in the acreage as exempt pursuant to the *Exemptions Act*, R.S.A. 1980, c. E-15.

45 Had the bankrupt retained the house in Calgary his real property exemption would have been $40,000. If the house was owned in joint tenancy, the co-owner would have been entitled to a like exemption. The exemption for a rural residence is a quarter section. There can be no suspicion that the bankrupt sold his house and purchased the acreage with the proceeds and thereby increased his real property exemption at the expense of his creditors. Assuming clear titles, the bankrupt's exemption in the acreage would be $37,500 compared to $40,000 in the Calgary house.

46 Nor can it be speculated that the bankrupt is attempting to deprive his creditors of the difference between the sale proceeds of the residence and the purchase price of the acreage. There is no evidence of the equity in the residence when it was sold. The sale price of $179,000 says little about the equity or the net proceeds. The bankrupt says he used the "net proceeds" as the "down payment" on another residence, presumably the acreage valued at $75,000. That is an unequivocal statement that the full amount realized by the bankrupt from the sale of his residence was used to buy the acreage and is reflected in its stated value.

47 I see nothing suspicious in these circumstances. In any event, they have no obvious relationship to the issue in these proceedings - the bankrupt's intention in making the payment to Revenue Canada.

The Trustee

48 There is no basis for criticizing the conduct of the Trustee or its Counsel. Nothing in the evidence indicates that any material information has been withheld from the Court or from Revenue Canada. Indeed, Revenue Canada does not complain about lack of disclosure or any other default or misconduct by the Trustee.

49 I assume the bankrupt was required to attend a meeting of his creditors and was subjected to the usual questioning by the Registrar. Apparently no creditor, including Revenue Canada, has alleged any impropriety on the part of the bankrupt. The Trustee is a licensed and accountable officer of the Court. It has a duty to enquire into suspicious circumstances surrounding the conduct or property of the bankrupt, and to make full disclosure of such matters to the Court. The Trustee is also under a duty to get in all of the property of the bankrupt and this includes investigating suspicious transactions. There is no basis for suspecting, much less finding, that the Trustee has defaulted in the execution of its duties in these circumstances. I decline to make such an assumption and I dissociate myself from any suggestion that either the Trustee or its counsel has been less than candid with the Court or has been guilty of any other misconduct or impropriety.

50 The Act provides adequate remedies to any creditor who is dissatisfied with the efforts of a Trustee to identify and get in the property of the bankrupt or who has any other complaint about the administration of the bankrupt estate.

Appeal allowed; new trial ordered.

End of Document

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1999 BCCA 217
British Columbia Court of Appeal

Coast Wire Rope & Supply Ltd. (Trustee of) v. Trans Pacific Hardware Inc.

1999 CarswellBC 638, 1999 BCCA 217, [1999] B.C.J. No. 748, 122 B.C.A.C. 257, 200 W.A.C. 257, 9 C.B.R. (4th) 255

Hayes Debeck & Partners Ltd., a Trustee of the Bankrupt Estate of Coast Wire Rope & Supply Ltd., Applicant (Appellant) and Trans Pacific Hardware Inc., Respondent (Respondent)

Finch, Ryan, Hall JJ.A.

Heard: February 15, 1999
Judgment: April 1, 1999
Docket: Victoria V03202

Counsel: *Michael B. Paine*, for Appellant.
Lee Buckler and *Robert Ward*, for Respondent.

Subject: Insolvency

APPEAL by trustee from decision holding that bankrupt's transfer of equipment to wholesaler did not constitute fraudulent preference.

***Finch J.A.* (*Ryan J.A.* concurring):**

1 The Trustee in bankruptcy of the estate of Coast Wire Rope & Supply Ltd. appeals from the judgment of the Supreme Court of British Columbia pronounced 29 January, 1998, holding that the transfer of certain equipment to the respondent Trans Pacific Hardware Inc. did not constitute a fraudulent preference, contrary to s.95 of the *Bankruptcy and Insolvency Act* R.S.C. 1985, c. B-3. Section 95 provides

> 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. When view to prefer presumed -- s.95(2)
>
> (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.

2 Trans Pacific wholesales various hardware, and between 1985 and November of 1995 had sold hardware to Coast Wire. By August 1996, Coast Wire's total unpaid account with Trans Pacific was $17,016.53. After reaching a settlement agreement on 5 September, 1996 Coast Wire agreed to pay some $15,596.89 by 31 October, 1996; only $5,000 of this amount was paid by that date. In January, 1997 Coast Wire decided to downsize its business and to sell one of its presses to pay creditors in order to continue in business. Trans Pacific agreed to find a purchaser for the press so long as the proceeds of the sale were used to pay off Coast Wire's outstanding debt. Trans Pacific then bought the press, resold it, and

applied the sum of $10,596.89 to pay off its outstanding debt. The balance of the sale proceeds were paid to Coast Wire. Two weeks later Coast Wire filed an assignment in bankruptcy, and Hayes Debeck were named trustees in bankruptcy.

3 Trans Pacific conceded in the court below that the transfer occurred within three months of Coast Wire's assignment into bankruptcy, and that the transfer in fact resulted in a preference to Trans Pacific. On this appeal, Trans Pacific further conceded that Coast Wire was insolvent at the time of the transfer. The concession of these three factors gives rise to the presumption that the transfer was made with "a view" to giving Trans Pacific a preference over other creditors, and hence, prima facie, of a fraudulent preference.

4 According to s.95(1) of the *Bankruptcy and Insolvency Act* every transfer of property, inter alia, made by an insolvent within the three months prior to the initial bankruptcy event is deemed a fraudulent preference when such a transfer is done in order to prefer that creditor over other creditors rather than in the ordinary course of business. Section 95(2) creates the presumption to intend to defraud rightful creditors by preference in the absence of evidence to the contrary.

5 Trans Pacific argued in the court below that it had rebutted the presumption of a fraudulent preference in two ways. First it lead evidence to show that Coast Wire had transferred the equipment with the dominant intention of permitting it to stay in business; and second, it lead evidence to show that Coast Wire transferred the equipment in order to persuade Trans Pacific to sell the transferred equipment, retain funds sufficient to satisfy Coast Wire's indebtedness to Trans Pacific, and to return the balance of some $15,000 to Coast Wire.

6 The learned chambers judge accepted the first of these two positions and found that Coast Wire's dominant intention in making the transfer was in fact to try to stay in business. As this submission effectively rebutted the presumption, the chambers judge did not consider it necessary to deal with the second argument.

7 On this appeal, the Trustee says the learned chambers judge erred in his finding as to Coast Wire's dominant intention. The Trustee says the error was made because the chambers judge applied a subjective test in determining Coast Wire's dominant intention, or alternatively, that if he applied an objective test, he did so in error by failing to consider facts relevant to the test. Trans Pacific disputes both of these contentions, and says, in the alternative, that the presumption could equally as well have been found to have been rebutted on the second ground advanced below.

8 In *Hudson v. Benallack* (1975), [1976] 2 S.C.R. 168, [1975] 6 W.W.R. 109, 21 C.B.R. (N.S.) 111, 59 D.L.R. (3d) 1, 7 N.R. 119 (S.C.C.), the Supreme Court of Canada held that the words "with a view" in s.73 (now s. 95) of the Act refer only to the intention of the bankrupt. The intention of the payee or transferee is not relevant. And this Court has held in *Ferrostaal Metals Canada. Ltd. v. Olympic Steel Ltd. (Trustee of)* (March 15, 1985), Doc. CA83000261 (B.C. C.A.) at p.6, that the intention of the debtor is to be determined objectively and not subjectively. Mr. Justice Carrothers for the Court said at para.17:

> The relevant intention governing determination of whether the prima facie presumption of a preference has been rebutted is that intention which the conduct of the parties bears when reasonably construed. It is an objective rather than a subjective test.

In other words, the conduct of the parties may be a better measure of the debtor's intention than his expressed words.

9 The objective test was applied by Mr. Justice Spencer in *Consolidated Seed Exports Ltd., Re* (1985), 69 B.C.L.R. 273 (B.C. S.C.). He held that a debtor's bona fide intention to stay in business could be found, even if that intention proved to be hopeless in the result. I do not read this judgment to say that the debtor's principal knew that the business could not be salvaged, because that would negate the judge's conclusion that the intent to stay in business was bona fide.

10 In *Principal Group Ltd. (Trustee of) v. Anderson* (1994), 164 A.R. 81, 29 C.B.R. (3d) 216 (Alta. Q.B.) at 234-238, the Alberta Queen's Bench held that to rebut the presumed intention to prefer, the intention must be tested objectively. In other words, the reasonableness of the asserted intention to stay in business must be shown on a balance of probabilities.

11 I think it is clear that the issue of dominant intention, tested objectively, and therefore dependent upon a showing of circumstances which rendered the intention reasonable, is a question of fact for the chambers judge. Where such a finding of fact is challenged in this Court, the usual standard of review for factual questions decided upon affidavit evidence should be applied. Where affidavit evidence provides a basis for the chambers judge's findings of fact, an appellate court will not intervene unless those findings are shown to be clearly wrong, or not supported by the evidence: see *Orangeville Raceway Ltd. v. Wood Gundy Inc.* (1995), 6 B.C.L.R. (3d) 391 (B.C. C.A.), at 400; *Westcoast Energy Inc. v. Peace River (Regional District)* (1998), 167 D.L.R. (4th) 98 (B.C. C.A.) at para.68; and *Rootman Estate v. British Columbia (Public Trustee)* (1998), 115 B.C.A.C. 281 (B.C. C.A.) at para.26. Thus, while it is open to this Court to draw all reasonable inferences from the affidavit evidence, this Court will not interfere with the findings of a chambers judge unless they are shown to be clearly wrong, or could not reasonably be supported by the evidence.

12 I am satisfied on a careful reading of the chambers judge's reasons that he did apply the objective test required by law. Specifically, on an objective consideration of the circumstances, the chambers judge found a bona fide intention on behalf of Coast Wire to stay in business. Coast Wire's dominant intention in entering the transaction with Trans Pacific was to continue Coast Wire's business by generating sufficient funds for that purpose.

13 As to the argument that the chambers judge misapplied the objective test, the Trustee refers to the evidence showing that Coast Wire was insolvent, that its liabilities exceeded its assets by some $50,000, that it had terminated its employees at the time of the transfer, that monies received by Coast Wire from the sale of the equipment by Trans Pacific were used by Coast Wire's principal to pay company debts for which he might have been held personally liable, that Coast Wire had no plan to resolve rental arrears with its landlord, and that Coast Wire had no continuing market, suppliers, credit or employees. The Trustee says that all of these factors would lead a reasonable observer to conclude that Coast Wire had no intention of continuing in business, and that the learned chambers judge therefore erred in finding that to be Coast Wire's dominant intention.

14 As against the circumstances relied upon by the Trustee, Trans Pacific points to evidence which supports the chambers judge's conclusion. First, there is the affidavit evidence of Mr. Cavallin, the principal of the bankrupt company, stating that his intention in arranging the sale of the equipment was to downsize Coast Wire's operation, and to obtain cash with which to pay off creditors so as to enable Coast Wire to continue in business. He said his employees were laid off because of an extreme work shortage caused at the time by a severe snow storm. He said that at the time of those lay offs in January 1997 it remained his intention to continue the business of Coast Wire, focussing on the recycling of wire.

15 It is in my view a circumstance to be considered that Mr. Cavallin was not cross-examined on his affidavit evidence. In *K. & C. Thermoglass Ltd., Re* (1979), 16 B.C.L.R. 33 (B.C. S.C.), at 34, the circumstances of an impeached transaction were described in an affidavit of the president of the bankrupt company. Even though "...there is no need for proof of dishonest intention in order for a transaction to be successfully impeached," Mr. Justice Taylor accepted the president's recitation of the facts because he was not cross-examined on his affidavit. As his affidavit evidence was unchallenged, the evidence of the president stood as an effective rebuttal of the presumption of an intention to give preference by satisfying what is now section 95(2) of the Bankruptcy and Insolvency Act as evidence of an intention contrary to the presumption to fraudulently prefer. While Mr. Cavallin's affidavit evidence is not conclusive, it is a factor which may be considered along with all the other evidence.

16 The circumstantial evidence also includes the fact that Mr. Cavallin approached his landlord with a view to reducing the space he rented. Although his request was unsuccessful, his approach is confirmed by the landlord's agent. Further, that the "termination" of employees as noted above may properly be regarded as a "lay off" is supported by the affidavit evidence of Coast Wire's book-keeper, Ms. Doyle.

17 Mr. Cavallin used some $3,000 of the proceeds of sale to pay his employees' back wages that were owing. Although he might otherwise have been personally liable for this debt, the payment is also consistent with an intention to stay

in business, and inconsistent with an intention to prefer the respondent. Similarly, other proceeds of sale were used to pay secured creditors.

18 Given the excess of Coast Wire's liabilities over its assets, it would appear that on all the evidence Mr. Cavallin's chances of saving the business in January, 1997 were very slim indeed. I am not however, able to say that there was no evidence to support a finding by the chambers judge that his intention to do so was other than reasonable; that is to say that viewed objectively there were circumstances on which the judge could reasonably find the bona fide dominant intention to be that asserted by Mr. Cavallin.

19 I do not think therefore that this Court can interfere with the result. It was open to the learned chambers judge to find that the presumption of preference had been rebutted. Like him I do not think it necessary to consider the second ground relied upon by the respondent.

20 I would dismiss this appeal.

Hall J.A.:

21 I agree generally with the Reasons of Finch J.A. The only respect in which I would differ from Finch J.A. is that I would not be disposed to put any weight on the consideration that Mr. Cavallin, an officer of the bankrupt corporation, was not cross-examined on his affidavit. In these cases, which turn on an objective assessment of the state of affairs extant at an earlier time concerning the now bankrupt entity, there may often be conflicting affidavit material that will require consideration. These may, as in the instant case, contain subjective opinions but ultimately it will be for the court to make an objective assessment, based on all the evidence, of the true state of affairs.

22 In my opinion, this case was very near the line but I cannot say the chambers judge was clearly wrong in his conclusions. One factor that weighs with me is that it appears the press that was sold was at the time of sale essentially surplus to the operations of the bankrupt corporation. I, too, would dismiss the appeal.

Appeal dismissed.

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2013 ABCA 330
Alberta Court of Appeal

Orion Industries Ltd. (Trustee of) v. Neil's General Contracting Ltd.

2013 CarswellAlta 1795, 2013 ABCA 330, 235 A.C.W.S. (3d) 880, 556 A.R. 389, 584 W.A.C. 389, 7 C.B.R. (6th) 329, 89 Alta. L.R. (5th) 14

Grant Thornton Alger Inc. in its capacity as Trustee of Orion Industries Ltd. Appellant (Applicant) and Neil's General Contracting Ltd. Respondent (Respondent)

Patricia Rowbotham, Brian O'Ferrall, Barbara Lea Veldhuis JJ.A.

Heard: March 7, 2013
Judgment: September 30, 2013
Docket: Calgary Appeal 1201-0233-AC

Counsel: R.N. Billington, Q.C., J.M. Blitt for Appellant
M.L. Engelking for Respondent

Subject: Insolvency; Corporate and Commercial

APPEAL by trustee from refusal to set aside payment by company to one of its creditors on eve of company's bankruptcy.

***Per curiam*:**

1 This is an appeal of a bankruptcy judge's refusal to set aside a payment made by a company to one of its creditors on the eve of company's bankruptcy.

2 The appellant is the trustee in bankruptcy of the bankrupt company which sought to set aside the payment made by the insolvent company. The respondent is the creditor of the bankrupt company which received the payment.

3 The trustee in bankruptcy had applied for a declaration that the payment to the respondent creditor was void by virtue of section 95(1)(a) of the *Bankruptcy and Insolvency Act*, RSC 1985 c B-3. Section 95(1)(a) provides that a payment made by an insolvent person to a creditor with a view to giving that creditor a preference is void as against the trustee in bankruptcy.

4 Section 95(2) of the *Bankruptcy and Insolvency Act* provides that if a payment to a creditor has the effect of giving that creditor a preference, it will be presumed to have been made with a view to giving a voidable preference unless there is evidence establishing that the payment was not made with the view to giving that creditor a preference over other creditors.

5 The term "fraudulent preference" has sometimes been used in this context. Obviously, if the preference is fraudulent, it is voidable. However, in *Piikani Nation v. Piikani Energy Corp.*, 2012 ABQB 187, 537 A.R. 211 (Alta. Q.B.), rev'd on other grounds 2013 ABCA 293 (Alta. C.A.), Justice Graesser suggested that the use of the term "fraudulent" is sometimes inappropriate. We agree. Using the term "fraudulent preference" may wrongly impugn the integrity of the creditor receiving the payment because it may not know that it is being paid in preference to others. It may also wrongly impugn the integrity of the debtor making the payment because it may not know that its destiny, within the next three months, is bankruptcy. As Justice Graesser pointed out, neither may be aware that bankruptcy is imminent when the payment is made. Also, when the payment is made, it may not be apparent to either party that the payment in fact gives a preference to the recipient creditor over other creditors. That is, the fact that such payment has had the effect

of conferring a preference may only be apparent with the benefit of hindsight. Sometimes, of course, onlythe insolvent debtor knows that a preference is being given. The creditor receiving the payment does not.

6 A preferable phrase to describe these potentially voidable payments is "preferential payment". Preferential payments are those which in fact confer a preference on one creditor over another. Preferential payments are not voidable *per se.* Only those preferential payments made with a view to giving the preference are voidable at the instance of the trustee. But if the payment confers a preference in fact, the presumption will be that the payment was intended to confer the preference. And if the presumption is not rebutted, the payment will be void as against the trustee.

7 Here it is acknowledged that the impugned payment gave the respondent creditor a preference over other creditors. It is also acknowledged that this occurred within three months of the insolvent company's bankruptcy. So, there was no doubt the payment was a preferential payment capable of being set aside at the instance of the trustee in the absence of evidence that it was not made with a view to giving the preference.

8 The issue before the bankruptcy judge and on appeal was whether the creditor which received the preferential payment had rebutted the presumption in section 95(2) of the *Bankruptcy and Insolvency Act*, namely the presumption that a payment which has the effect of giving a preference is presumed to be a payment made with a view to giving a preference. The issue then was whether there was "evidence to the contrary", i.e., evidence that the payment was not made with a view to giving a preference or, put another way, evidence that the payment was not intended to be preferential.

9 The bankruptcy judge found that the presumption had been rebutted by evidence about why the payment had been made. The evidence was that it was made by the insolvent company to secure access to an asset which might be sold to generate revenue. As such, the bankruptcy judge found that the payment was valid, not made with a view to giving a preference, and therefore not voidable at the instance of the trustee.

10 It is settled law that the onus or burden of rebutting the presumption in section 95(2) is on the creditor receiving the preferential payment. Discharging that burden is difficult because the creditor receiving the payment may not know what motivated the payment. And though the onus is on the creditor receiving the payment to rebut the presumption of preference, it is the intention of the insolvent debtor which governs: *Salter & Arnold Ltd. v. Dominion Bank*, [1926] S.C.R. 621, [1926] 3 D.L.R. 684 (S.C.C.), at 686.

11 It is also settled law that a payment made in the ordinary course of business, such as those made to discharge debts incurred in the conduct of the bankrupt's business, will not be found to have been made with a view to giving a preference. If it can be established that the preferential payment was made in the ordinary course of the bankrupt's business, the presumption that the payment was made with a view to giving a preference will be rebutted, see *Canadian Credit Men's Assn. v. Jenkins*, [1928] 3 D.L.R. 139 (Ont. C.A.), at 144, (1928), 10 C.B.R. 77 (Ont. C.A.).

12 What constitutes a payment made in the ordinary course of business is fact dependent. But, payments made to purchase goods or services required for the on-going conduct of the bankrupt's business have been found to be payments made in the ordinary course of business. Payments made to honor contractual obligations allowing the insolvent to carry on business have been found to be payments made in the ordinary course of business. And even a preferential payment made by an insolvent company at a time when its financial collapse is inevitable may be found to be legitimate if the payment was made with a view to generating income or liquidating assets to satisfy the insolvent's creditors: *St. Anne-Nackawic Pulp Co. (Trustee of) v. Logistec Stevedoring (Atlantic) Inc.*, 2005 NBCA 55, 255 D.L.R. (4th) 137 (N.B. C.A.), *[St Anne-Nackawic]*.

13 In this case, the evidence with respect to why the preferential payment was made came from the chief financial officer of the insolvent company which handled the insolvent company's accounting and financial affairs and which was also its majority shareholder and largest creditor. Evidence with respect to the payment also came from the principal of the creditor which received the payment.

14 The insolvent company's chief financial officer testified that the preferential payment was made because he believed that the creditor which received the payment could and would deny the insolvent company access to, and thereby prevent the sale of, a piece of equipment which it was trying to sell in order to avoid bankruptcy. Additionally, he testified that the payment was made in the belief that the creditor who received the preferential payment could and would cause a major client of the insolvent company to quit doing business with it, thereby putting the insolvent company out of business.

15 The creditor's evidence was that it had dismantled the insolvent company's asset and then, at the insolvent company's request, transported the components to a storage site which the creditor owned. The insolvent company's plan was to sell the asset to generate revenue. A similar asset had previously been sold for just that purpose. It was the creditor's evidence that more than half the money it was owed by the insolvent company was for dismantling and transporting the asset which the insolvent company hoped to sell to generate income. The creditor's evidence was that it would not release the asset unless it was paid for the services it had provided.

16 Having considered the foregoing evidence and the parties' arguments, the bankruptcy judge found that the section 95(2) statutory presumption that the preferential payment was made with a view to giving the creditor which received the payment a preference had been rebutted. That is, the bankruptcy judge found that the evidence to the contrary rebutted the presumption that the preferential payment was intended to give a preference. We see no palpable or overriding error in that finding.

17 The bankruptcy judge found that the "dominant intent" of the insolvent company in making the payment was "to ensure that a certain valuable asset... could be protected because they (the insolvent company) wanted to liquidate it and hopefully get their money back." The bankruptcy judge found that to be a legitimate and sensible business decision.

18 The New Brunswick Court of Appeal's decision in *St. Anne-Nackawic* is instructive. There the Court held that when the insolvent debtor paid one creditor at the expense of others for the purposes of generating income to pay a secured creditor of the insolvent debtor, the payment was not a voidable preference.

19 The facts of that case were similar to those in this appeal. The bankrupt operated a pulp mill. It typically shipped pulp to the creditor's warehouse. One day prior to declaring bankruptcy, the bankrupt paid this creditor about $500,000 to ensure that pulp being stored there would be shipped, thereby generating income. When it made this payment, the bankrupt knew it would be declaring bankruptcy the following day.

20 The trustee in bankruptcy sought and obtained a declaration that the payment was void under section 95 of the *Bankruptcy and Insolvency Act*. The Court of Appeal set aside the bankruptcy judge's declaration, holding that the evidence disclosed that the payment was not made with a view to giving the creditor a preference over other creditors, but rather was intended to generate income, which income would be available to satisfy the claims of the secured creditor.

21 While the Court of Appeal did not articulate a test for determining whether a payment is made with a view to giving a preference, it did consider what the trustee might have done had the impugned payment not been made by the insolvent prior to bankruptcy. The Court of Appeal was of the view that the trustee might well have made the payment it was now attacking because it would have generated much needed income for the bankrupt.

22 That analysis is instructive. What would the trustee have done with the funds used to pay the preferred creditor in this appeal? Assuming the trustee had no better information than the financial officer of the insolvent company had at the time of the impugned payment, it might well have paid the creditor with a view to generating income by freeing up a stored asset for a possible sale.

23 Counsel for the trustee argues that the payment, unlike the payment in *St. Anne-Nackawic*, did not generate income for the insolvent company. Furthermore, he argues, it was not objectively reasonable for the insolvent company to pay the creditor because there was no actual or pending sale of the asset. Indeed, there was not even a prospective purchaser

on the horizon. Given that fact, counsel for the trustee argued that it was not commercially necessary, reasonable or sensible to protect the asset by paying the creditor for dismantling, transporting and storing it.

24 However, the bankruptcy judge concluded that the payment was commercially necessary in order to secure access to an asset which could be sold to generate revenue and it was therefore not made with a view to giving a preference. That conclusion must be accorded deference.

25 But, to address the appellant's argument, the absence of an actual or pending sale did not make the purpose of the payment, or the intention of the insolvent debtor in making it, objectively unreasonable. The payment might well have paved the way for the generation of income and certainly removed an obstacle to generating income. Had the payment not been made, the very least that could be said is that the prospects of selling the asset would have been diminished.

26 This raises the issue of "pressure". As previously set out, section 95(2) of the *Bankruptcy and Insolvency Act* provides that, in the absence of evidence to the contrary, a payment which has the effect of giving a creditor a preference is presumed to have been made with a view to giving the preference, even if made under pressure. The section also provides that evidence of pressure is not admissible to validate a preferential payment. So, evidence of pressure cannot be used to rebut the presumption that a preferential payment was made with a view to giving the preference and therefore voidable.

27 The pressure argued by the trustee was evidence of a threat or perceived threat by the creditor to inform the insolvent company's largest customer that the insolvent company was delinquent in paying its debts. The insolvent company's largest customer apparently had a policy which required those providing services to it to pay their suppliers in a timely manner, or else lose its business.

28 This pressure argument was not advanced before the bankruptcy judge. The argument below revolved around the presumption that the preferential payment made with a view to conferring a preference and therefore voidable at the instance of the trustee in the absence of evidence to the contrary. And the evidence to the contrary argument revolved around the reasonableness of paying the creditor in order to protect an asset which might not be capable of generating revenue for the insolvent company.

29 It may not, strictly speaking, be necessary for us to deal with the pressure argument because if there is evidence rebutting the presumption that a preferential payment was made with a view to giving the preference, then the fact that there might also have been evidence of pressure is irrelevant. Evidence of pressure, of course, cannot be adduced to rebut the presumption of preference; but in this case there was evidence independent of the pressure evidence which was found to rebut the presumption. There is nothing in the bankruptcy judge's reasons or in his exchanges with counsel to suggest that he relied on the evidence of pressure which was argued on appeal to support his finding that the presumption had been rebutted.

30 However, in addition to the evidence of the pressure of the threat or perceived threat that the insolvent company's delinquencies would be reported to its largest customer, there was also the evidence of the creditor's insistence that it be paid before access to the asset would be given. That evidence might also be construed as evidence of pressure and the bankruptcy judge did rely on that evidence as rebutting the presumption that a preference was intended. However, the bankruptcy judge characterized that evidence not as evidence of pressure but rather as evidence of a normal business imperative.

31 Prior to the enactment of Canada's bankruptcy legislation, a payment by an insolvent debtor which had the effect of giving one or more of the debtor's creditors a preference over other creditors was not voidable if it were made under pressure. The rationale for this judicial exception to the rule that preferential payments by insolvent debtors were voidable (in those days at the instance of the insolvent debtor's creditors) was that the conferring of a preference necessarily involved a voluntary act. The making of a payment under pressure was not considered to be a voluntary act. Indeed, a creditor's mere demand for payment was sufficient to show that the payment was involuntary and therefore not voidable: *Molsons Bank v. Halter* (1890), 18 S.C.R. 88 (S.C.C.) (available on QL).

32 Then, Canada's first bankruptcy legislation, in 1919, prohibited pressure as a factor capable of validating an otherwise voidable preferential payment. Likewise, under today's *Bankruptcy and Insolvency Act*, pressure cannot be invoked to rebut the presumption that a preferential payment to a creditor was made with a view to giving a preference. Indeed, evidence of pressure is inadmissible.

33 The question then is, was the evidence that the respondent creditor would not release the asset unless it was paid, evidence of pressure and therefore inadmissible and not capable of validating an otherwise preferential payment? Or, was it simply evidence of a commercial imperative which required the payment to be made in order to generate income?

34 The answer, of course, depends upon how the evidence is characterized. And characterizing such evidence is something upon which reasonable people can disagree: *Norris, Re* (1996), 193 A.R. 15, 45 Alta. L.R. (3d) 1 (Alta. C.A.).

35 The bankruptcy judge characterized the evidence of the insolvent company's desire to realize upon its asset as a reasonable response to a financial imperative. The amount of income hoped to be generated by liquidating the asset was considerably greater than the cost of paying the creditor. Also, if the asset had been sold for the price the insolvent debtor thought it could fetch, the income generated might have gone a long way toward saving the insolvent company from bankruptcy. For those reasons, we find that the bankruptcy judge's characterization of the evidence was reasonable and entitled to deference.

36 In the result, the trustee's appeal is dismissed.

Appeal dismissed.

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“10”

2005 NBCA 55
New Brunswick Court of Appeal

St. Anne-Nackawic Pulp Co. (Trustee of) v. Logistec Stevedoring (Atlantic) Inc.

2005 CarswellNB 285, 2005 CarswellNB 286, 2005 NBCA 55, [2005] A.N.B. No. 204, [2005] N.B.J. No. 204, 139 A.C.W.S. (3d) 803, 13 C.B.R. (5th) 125, 255 D.L.R. (4th) 137, 286 N.B.R. (2d) 95, 748 A.P.R. 95, 9 B.L.R. (4th) 1

In the Matter of the Bankruptcy of St. Anne Nackawic Pulp Company Ltd.

Logistec Stevedoring (Atlantic) Inc. (Respondent / Appellant) and A.C. Poirier & Associates Inc., Trustee in Bankruptcy of St. Anne Nackawic Pulp Company Ltd. (Applicant / Respondent)

Turnbull, Deschênes, Robertson JJ.A.

Heard: March 22, 2005
Judgment: June 2, 2005
Docket: 186/04/CA

Proceedings: reversing *A. C. Poirier & Associates Inc. (Trustee of) v. Logistec Stevedoring (Atlantic) Inc.* (2004), 2004 CarswellNB 633, (sub nom. *St. Anne-Nackawic Pulp Co. (Bankrupt), Re)* 276 N.B.R. (2d) 147, (sub nom. *St. Anne-Nackawic Pulp Co. (Bankrupt), Re)* 724 A.P.R. 147, 7 C.B.R. (5th) 1, 2004 NBQB 457 (N.B. Q.B.)

Counsel: D. Leslie Smith, Q.C. for Appellant
G. Patrick Gorman, Q.C. for Respondent

Subject: Contracts; Corporate and Commercial; Torts; Insolvency

APPEAL by creditor from judgment reported at *St. Anne-Nackawic Pulp Co. (Trustee of) v. Logistec Stevedoring (Atlantic) Inc.* (2004), 2004 CarswellNB 633, (sub nom. *St. Anne-Nackawic Pulp Co. (Bankrupt), Re)* 276 N.B.R. (2d) 147, (sub nom. *St. Anne-Nackawic Pulp Co. (Bankrupt), Re)* 724 A.P.R. 147, 7 C.B.R. (5th) 1, 2004 NBQB 457 (N.B. Q.B.), declaring that payment made by bankrupt was fraudulent preference within meaning of s. 95 of *Bankruptcy and Insolvency Act*.

Robertson J.A.:

1 We are asked to decide whether the application judge erred in holding that a $500,000 payment made by an insolvent debtor to one of its creditors qualifies as a fraudulent preference within the meaning of s. 95 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (BIA). In my respectful view, the application judge erred. Specifically, he failed to ask whether the impugned payment was made with the "dominant intent" of preferring one creditor over the others. When that test is applied to the facts of the present case, it is evident that the debtor harboured no such intent. Admittedly, the creditor in receipt of the payment received a "preference in fact", but that is not a sufficient basis for declaring the payment a fraudulent preference. As will be explained, s. 95 has no application in circumstances where the insolvent debtor is effecting a payment with a view to generating income to be applied against the debts of both secured and unsecured creditors. This remains true even if it were unrealistic to expect that the unsecured creditors would share in the income generated.

2 The essential facts are as follows. Until September 15, 2004, St. Anne Nackawic Pulp Company Ltd. had been operating a pulp mill in Nackawic, New Brunswick. That corporation is a wholly owned subsidiary of St. Anne Industries Ltd. St. Anne Industries is also the primary secured creditor of St. Anne Pulp under a registered general security agreement, the validity of which is being challenged in other proceedings. Finally, St. Anne Industries is a wholly owned

subsidiary of Parsons & Whittemore Inc. of New York. On September 15, 2004, St. Anne Pulp made a voluntary assignment in bankruptcy. A trustee was appointed on that date, but later replaced by the respondent, A.C. Poirier & Associates Inc. Prior to the bankruptcy, it was customary for St. Anne Pulp to transport its pulp to Saint John where it was stored in a dockside warehouse belonging to the appellant, Logistec Stevedoring (Atlantic) Inc. Logistec was also responsible for loading of pulp onto ships and trucks. On September 14, 2004, one day prior to the filing for bankruptcy, Logistec was informed by St. Anne Pulp that it would be ceasing operations but that it wanted to ensure that the 10,800 tonnes of pulp, being presently stored in Logistec's warehouse, would be released and loaded onto two ships that were to arrive in Saint John on or about September 18, 2004. As well, one shipment was to be effected by truck. In response, Logistec asserted that it possessed a warehouseman's lien on the goods and refused to release and load any pulp unless it received prior payment, in full, with respect to past due accounts. Logistec informed St. Anne Pulp that it was owed $562,574.72 plus amounts not yet posted to the account. Initially, Logistec demanded payment from anyone other than St. Anne Pulp in order to avoid the possibility of someone alleging the payment was a fraudulent preference. Eventually, Parsons & Whittemore agreed to indemnify Logistec in the event the payment from St. Anne Pulp to Logistec was successfully challenged. The impugned payment was made on September 14, 2004. The next day St. Anne Pulp made a voluntary assignment in bankruptcy. On the same date, St. Anne Industries appointed a receiver under the terms of its security agreement. On September 16, 2004, Logistec determined that a further $232,945.91 would be needed to settle the account. The receiver paid this amount with funds drawn on St. Anne Pulp's bank account, over which St. Anne Industries had taken security. As of September 27, 2004, all the pulp in the warehouse had been shipped.

3 On December 10, 2004, the respondent trustee filed an application for a declaration that the $562,574.72 payment was fraudulent and void under s. 95 of the BIA. Correlatively, the trustee sought judgment for that amount. On December 21, 2004, the application was heard. On the same date the application judge granted the relief requested. His decision is now reported at [2004] N.B.J. No. 477 (N.B. Q.B.). The reasons for judgment address two issues. The first was whether the application proceedings should be converted into an action. On this issue, the application judge ruled in favour of the trustee. Although Logistec pursued this issue on appeal, there is no need to convert this matter into an action. The only factual matter which the parties failed to resolve concerns the extent to which the $500,000 payment related to work already performed, as opposed to work to be performed. However, that factual determination is only relevant if the payment in question were declared a fraudulent preference, in which case part of the payment may have been valid. As I find that the payment in question does not constitute a fraudulent preference, there is no need to dwell on the first issue. As to the second issue, I turn to s. 95. At the relevant time, ss. 95(1) and (2) read as follows:

> **95.** (1) Every conveyance or transfer of property or charge thereon made, every payment made, every obligation incurred and every judicial proceeding taken or suffered by any insolvent person in favour of any creditor or of any person in trust for any creditor with a view to giving that creditor a preference over the other creditors is, where it is made, incurred, taken or suffered within the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date the insolvent person became bankrupt, both dates included, deemed fraudulent and void as against the trustee in the bankruptcy.
>
> (2) Where any conveyance, transfer, charge, payment, obligation or judicial proceeding mentioned in subsection (1) has the effect of giving any creditor a preference over other creditors, or over any one or more of them, it shall be presumed, in the absence of evidence to the contrary, to have been made, incurred, taken, paid or suffered with a view to giving the creditor a preference over other creditors, whether or not it was made voluntarily or under pressure and evidence of pressure shall not be admissible to support the transaction.
>
> **95.** (1) Sont tenus pour frauduleux et inopposables au syndic dans la faillite tout transport ou transfert de biens ou charge les grevant, tout paiement fait, toute obligation contractée et toute instance judiciaire intentée ou subie par une personne insolvable en faveur d'un créancier ou d'une personne en fiducie pour un créancier, en vue de procurer à celui-ci une préférence sur les autres créanciers, s'ils surviennent au cours de la période allant du premier jour du troisième mois précédant l'ouverture de la faillite jusqu'à la date de la faillite inclusivement.

> (2) Lorsqu'un tel transport, transfert, charge, paiement, obligation ou instance judiciaire a pour effet de procurer à un créancier une préférence sur d'autres créanciers, ou sur un ou plusieurs d'entre eux, il est réputé, sauf preuve contraire, avoir été fait, contracté, intenté, payé ou subi en vue de procurer à ce créancier une préférence sur d'autres créanciers, qu'il ait été fait ou non volontairement ou par contrainte, et la preuve de la contrainte ne sera pas recevable pour justifier pareille transaction.

[Note that the wording of ss. 95(1) and 95(2) was amended, effective December 15, 2004, but those changes have no effect on the disposition of this case.]

4 The law is settled with respect to the interpretation and application of s. 95 of the BIA. In order for a payment to a creditor to qualify as a fraudulent preference three conditions precedent must be met: (1) the payment must have been made within three months of bankruptcy; (2) the debtor must have been insolvent at the date of the payment; and (3) as a result of the payment the creditor must have in fact received a preference over other creditors (see *Van der Liek, Re* (1970), 14 C.B.R. (N.S.) 229 (Ont. S.C.).

5 Once the three conditions precedent have been met, a presumption arises that the payment was made "with a view to giving that creditor a preference over the other creditors." However, it is a rebuttable presumption. In that regard, the courts have interpreted the above-quoted phrase as placing an onus on the creditor to establish that the debtor's dominant intent was not to prefer that creditor. The genesis of the dominant intent test is invariably traced to the following passage in *Van der Liek, Re*, at pages 231-32:

> When the trustee has proved these three essentials, he need proceed no further and the onus is then on the creditor to satisfy the court, if he can, that there was no intent on the part of the debtor to give a preference. If the creditor can show on the balance of probabilities that the dominant intent of the debtor was not to prefer the creditor but was some other purpose, then the application will be dismissed, but if the creditor fails to meet the onus, then the trustee succeeds.

6 Certain factors may or not be relevant to the task of ascertaining the debtor's dominant intent. Based on the Supreme Court's decision in *Hudson v. Benallack* (1975), [1976] 2 S.C.R. 168 (S.C.C.), it is settled law that the creditor's knowledge of the debtor's insolvency at the time of the payment is an irrelevant consideration. On the other hand, it is relevant that the corporate debtor knew of its insolvency at the date of the payment. If the debtor is related to the creditor the payment will be scrutinized with greater care and suspicion. However, it is no defence to an allegation of fraudulent preference that the creditor exerted pressure on the insolvent debtor to secure the payment. According to s. 95(2), pressure is no longer a ground for upholding a transaction which is otherwise preferential within the meaning of s. 95(1). Finally, as the dominant intent test is an objective one, we need not be concerned with the subjective intent of the insolvent debtor at the time of the payment. The requisite intent will be drawn from all of the relevant circumstances, as opposed to the debtor's personal ruminations. See generally Lloyd W. Houlden & Geoffrey B. Morawetz, *Bankruptcy & Insolvency Law of Canada*, looseleaf (Toronto: Carswell, 1992) at 4-66 to 4-67, 4-79.

7 Returning to the facts of the present case, the parties agree that conditions precedent (1) and (2) have been met. However, Logistec argues that it was not the beneficiary of a preference in fact and, therefore, s. 95 has no application. A concise and accurate statement of the law as to the relationship between the concept of preference in fact and dominant intent is found in *Norris, Re* (1996), 193 A.R. 15 (Alta. C.A.) at para. 16:

> In considering this section, it is well to keep in mind the distinction between preference in fact and fraudulent preference as that latter is defined in the **Act**. There can be no doubt in this case that Revenue Canada received a preference in fact from the payment of tax made by this debtor on November 25, 1992. Its debt was paid where the debt owing to other ordinary creditors were not. What would render that preference in fact a fraudulent one under s. 95 is the accompanying intent of the insolvent debtor who in the face of imminent bankruptcy is moved to prefer or favour, before losing control over his assets, a particular creditor over others who will have to wait

> for and accept as full payment their rateable share on distribution by the Trustee in the ensuing bankruptcy. It is called fraudulent because it prejudices other creditors who will receive proportionately less, or nothing at all, and upsets the fundamental scheme of the **Act** for equal sharing among creditors. That accompanying intent to favour one creditor over another is what makes a preference in fact a fraudulent preference and is referred to in the cases as the "dominant intent". ...

8 In my view, Logistec's argument would have been persuasive had the impugned payment related solely to work or services to be performed in regard to the pulp that was being stored in Logistec's warehouse at the time of the payment. In other words, had the entire $500,000 payment related to the storage and shipping of the 10,800 tonnes of pulp in Logistec's warehouse, Logistec's argument would have been well founded. The situation would be no different had Logistec sold St. Anne Pulp a piece of machinery within the three months preceding the bankruptcy and St. Anne Pulp paid in cash. Such a payment would not qualify as a preference, but rather as a purchase and sale made in the ordinary course of business. However, counsel for Logistec conceded that part of the $500,000 was to be applied against amounts already owing for work undertaken in the past. In these circumstances, Logistec did receive a preference in fact when contrasted with St. Anne Pulp's other creditors who were also awaiting payment of their outstanding accounts. That said, the mere establishment of a preference in fact does not lead to the conclusion that the payment qualifies as a fraudulent preference within the meaning of s. 95 of the BIA. What we are left with is a rebuttable presumption that the payment in question so qualifies.

9 Logistec bore the onus of establishing that St. Anne Pulp's dominant intent was not to prefer Logistec over the other creditors. Alternatively stated, the onus was on Logistec to establish that St. Anne Pulp's dominant intent was to achieve a purpose other than to prefer Logistec. Regrettably, the application judge did not address that issue. For this reason, this court must draw the necessary inference from the primary findings of fact, as found by the application judge. Those facts are not in dispute.

10 St. Anne Pulp's dominant intent may be formulated in at least one of four ways. First, it can be argued that it intended to bestow a preference on Logistec over the other creditors. This is the position of the trustee in bankruptcy. Second, it can be argued that St. Anne Pulp made the payment in order to honour its contractual obligations to its customers who had purchased the pulp and, hence, to ensure that the goods were duly shipped. This is the position of Logistec. The third and fourth characterizations flow from the second. Third, it can be argued that St. Anne Pulp's dominant intent was to generate income in the form of accounts receivable. Moneys collected would be applied against amounts owing to creditors and in the order of priority established at law. Fourth, it can be argued that St. Anne Pulp's dominant intent was to maximize St. Anne Industries' recovery on its secured debt. This characterization is a logical extension of the reality that, as the primary secured creditor, St. Anne Industries is entitled to the proceeds arising from the sale of inventory in priority to the unsecured creditors. If it can be fairly said that St. Anne Pulp's dominant intent falls within either the second, third or fourth formulations, it is my view that the payment in question does not qualify as a fraudulent preference under s. 95 of the BIA. I so find. My formal reasoning is as follows.

11 At common law and even after passage of the *Statute of Elizabeth* in 1570 (fraudulent conveyances) there was no impediment against an insolvent debtor preferring one creditor over another. The question of why a debtor would prefer one creditor over another goes to the question of the debtor's underlying motive, which text writers point out is irrelevant to the issue of dominant intent. Admittedly, it is easy to blur the legal distinctions often drawn between motive, intent, purpose or object. Be that as it may, one cannot help but ask why a debtor would prefer one creditor over another. In some cases the answer is self-evident. The common law allowed an insolvent debtor to engage in selective generosity by paying first those he liked most. Thus, payment to a creditor who is a family member or friend is more apt than not to qualify as a fraudulent preference within the meaning of s. 95 of the BIA: see *Craig (Trustee of) v. Devlin Estate* (1989), 63 Man. R. (2d) 122 (Man. C.A.). Ironically, there is also a reported case in which the debtor allegedly made the payment to a non-related creditor (Revenue Canada) in order to prefer a creditor who was a close but distant relative: see *Norris, Re*. But even if there is no close relationship between the debtor and the preferred creditor, the payment may be caught by s. 95. For example, where the payment is made to a creditor with respect to an indebtedness that had been guaranteed

by the debtor's spouse, the payment has been held to be a fraudulent preference: see *Speedy Roofing Ltd., Re* (1990), 74 O.R. (2d) 633 (Ont. C.A.) and also *Royal City Chrysler Plymouth Ltd., Re* (1998), 38 O.R. (3d) 380 (Ont. C.A.).

12 As a general observation, it is evident that the cases in which the creditor has been unable to rebut the presumption arising under s. 95 of the BIA generally involve two factual patterns. First, the insolvent debtor and the creditor in receipt of the payment are somehow related (e.g., family members). Second, the payment to an arm's length creditor has the subsidiary effect of conferring an unjustified benefit or advantage on the insolvent debtor or a family member. While these factual patterns are not exhaustive, it is clear that the facts of the present case do not support a finding that St. Anne Pulp's dominant intent was to prefer Logistec over the other creditors. But that is not the end of the matter. It is still necessary to isolate, by inference, St. Anne Pulp's dominant intent. In my view, its ultimate goal was to generate income from its accounts receivable, the proceeds of which would be applied first against the debt owing to St. Anne Industries, the primary secured creditor. In brief, St. Anne Pulp's dominant intent was to maximize the amount that the receiver would recover on behalf of St. Anne Industries from the sale of the existing inventory. Does this inference support the allegation of fraudulent preference under s. 95 of the BIA? In my view, it does not for two reasons. First, s. 95 speaks of fraudulent preference in terms of the creditor who received the payment. In this case, it was Logistec who received the payment, not St. Anne Industries. Second, and more importantly, St. Anne Industries cannot be accused of obtaining a fraudulent preference when as a matter of law it is entitled to a preference as a secured creditor of St. Anne Pulp. It is St. Anne Industries that has priority over the unsecured creditors by virtue of its security agreement. St. Anne Industries is to be paid first. If the income generated resulted in a surplus that surplus would be shared pro-rata amongst the unsecured creditors. The fact that St. Anne Pulp made the impugned payment to Logistec with a view to generating income which would be applied first against the debt owing to the secured creditor, St. Anne Industries, and then against amounts owing to the unsecured creditors, cannot be regarded as a valid basis on which to declare the payment to Logistec a fraudulent preference.

13 My understanding of the law is that in circumstances where an insolvent debtor pays one creditor at the expense of another for purposes of carrying on business, the payment will more likely than not be deemed not to constitute a fraudulent preference within the meaning of s. 95 of the BIA. I need only refer to two cases in support of this proposition. In *Davis v. Ducan Industries Ltd.* (1983), 45 C.B.R. (N.S.) 290 (Alta. Q.B.) the bankrupt was a manufacturer of recreational vehicles. The creditor who received the questionable payment was a supplier of parts that the debtor used in its business. The supplier refused to continue to do business with the debtor unless payments were made towards its large outstanding account. Less than three months before the bankruptcy, the debtor made payments to the supplier. Once the debtor became bankrupt, another creditor challenged this transaction as a fraudulent preference. The court found that the dominant intent of the bankrupt in making the payments to the supplier was to secure supplies to continue to run its business and not to give the creditor a preference. Similarly, in *Econ Consulting Ltd. (Trustee of) v. Deloitte Haskins & Sells* (1985), 31 Man. R. (2d) 313 (Man. C.A.) the bankrupt made a payment of $10,000 to accountants in respect of an outstanding account sixteen days prior to making an assignment in bankruptcy. The debtor's income tax returns were due and the accountants required the payment before they would prepare income tax returns for the debtor. The Court of Appeal cited this finding of the application judge with approval:

> I am satisfied that Econ made this payment not to give a preference to Deloitte but to get what it needed and required, i.e. its income tax returns prepared. I think that Deloitte would not have received payment if it had not been necessary for Econ to do so in order to persuade Deloitte to do the work that had to be done.

14 Under Canadian law, if a creditor refuses to perform an act for an insolvent debtor, such as delivering goods or preparing income tax returns, unless its existing account is paid in full or in part, and the account is so paid in order to have the act performed, the transaction will not be deemed a fraudulent preference. This is because the debtor made the payment, not for purposes of preferring the creditor, but rather to obtain the performance of an act which is consistent with what is expected of someone who is acting in the ordinary course of business: see Houlden & Morawetz at 4-79 to 4-80.

15 I admit that in the present case St. Anne Pulp did not make the payment for purposes of carrying on its pulp business in the long term. The impugned payment was made one day prior to St. Anne Pulp's voluntary assignment in bankruptcy. In the interim, however, it was entitled to carry on business albeit for a day. The truth of the matter is that St. Anne Pulp was acting in the best interests of all concerned when it made the payment to Logistec. Let me explain.

16 It would have been irresponsible for either St. Anne Pulp, the trustee or the privately appointed receiver to allow the inventory of pulp to sit in Logistec's warehouse. St. Anne Pulp had entered into binding contracts for the sale of this product. The goods had to be shipped, otherwise St. Anne Pulp would have been in breach of its contractual obligations and liable for any consequential damages. When completed, those contracts generated income for St. Anne Pulp. The net amount invoiced on the three contracts in question was $1.3 million (U.S.), $2.3 million (U.S.) and $300,000 (Cdn.). Together, the shipment of the pulp generated more than $4.6 million (Cdn.) in accounts receivable. That amount is net of the $800,000 paid to Logistec to ensure the shipment of the pulp ($562,574.72 + $232,945.91 = $795,520.63). In effect, for every $1 paid to Logistec, St. Anne Pulp generated at least $5 in accounts receivable. In addition, by fulfilling the pulp contracts, future pulp sales might not otherwise be jeopardized if the trustee or the receiver decided to operate St. Anne Pulp pending a disposition of the mill.

17 What the trustee fails to appreciate is that although a debtor is insolvent, it is entitled to carry on in the ordinary course of business even if only for a day, so long as it is acting in a commercially reasonable manner and, therefore, in the best interests of all concerned. As well, the trustee appears to be proceeding on the mistaken assumption that prior to the voluntary assignment in bankruptcy any moneys held in St. Anne Pulp's bank account could be used only for purposes of effecting a settlement of all debts on a pro-rata basis. The reality is that if anyone possessed a priority with respect to moneys in St. Anne Pulp's bank account, it was St. Anne Industries under its general security agreement. That security extended not only to St. Anne Pulp's accounts receivable and inventory, but also to all moneys held on St. Anne Pulp's account. It is out of that bank account that the receiver paid Logistec $232,000 in order to secure shipment of the pulp. Had St. Anne Pulp not made the payment to Logistec on September 14, 2004, here is what would have happened. On the following day, the newly appointed receiver would have seized the moneys held in St Anne Pulp's bank account. From that account the receiver would have paid the full amount owing to Logistec, for both past and present work. As it happens, the fact that a substantial payment was made one day prior to the bankruptcy is of no moment. Finally, I should point out that the payment to Logistec will work to the benefit of the unsecured creditors in the event St. Anne Industries' security agreement is successfully challenged and declared invalid. The income generated by that payment ($5 for every $1 paid to Logistec) would become available to all unsecured creditors.

18 At first blush the "optics" of this case cast a long shadow over the actions of St. Anne Pulp, St. Anne Industries and, ultimately, Parsons & Whittemore. It is understandable that Logistec was adamant that it receive an indemnity from Parsons & Whittemore with respect to the possibility the payment in question would be successfully challenged as a fraudulent preference under s. 95 of the BIA. The fact that the payment was made one day prior to the voluntary assignment in bankruptcy, and that both Logistec and St. Anne Pulp were aware of the latter's insolvency, threw suspicion over the transaction. However, when properly viewed, the transaction made good commercial sense. There is no doubt that St. Anne Industries was the true beneficiary of St Anne Pulp's payment to Logistec. But no one can complain of the preferential treatment being accorded that secured creditor. The preference arises as a matter of the security contract and is sanctioned by both the common law and the BIA.

19 For these reasons, I would allow the appeal, set aside the order dated January 7, 2005 and dismiss the application for declaratory and ancillary relief. The appellant is entitled to costs of $3,000 throughout.

Appeal allowed.

TAB
“11”

2012 ONSC 3767
Ontario Superior Court of Justice [Commercial List]

Cinram International Inc., Re

2012 CarswellOnt 8413, 2012 ONSC 3767, 217 A.C.W.S. (3d) 11, 91 C.B.R. (5th) 46

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

And In the Matter of a Plan of Compromise or Arrangement of Cinram International Inc., Cinram International Income Fund, CII Trust and The Companies Listed in Schedule "A" (Applicants)

Morawetz J.

Heard: June 25, 2012
Judgment: June 26, 2012
Docket: CV-12-9767-00CL

Counsel: Robert J. Chadwick, Melaney Wagner, Caroline Descours for Applicants
Steven Golick for Warner Electra-Atlantic Corp.
Steven Weisz for Pre-Petition First Lien Agent, Pre-Petition Second Lien Agent and DIP Agent
Tracy Sandler for Twentieth Century Fox Film Corporation
David Byers for Proposed Monitor, FTI Consulting Inc.

Subject: Insolvency

APPLICATION by group of debtor companies for initial order and other relief under *Companies' Creditors Arrangement Act*.

Morawetz J.:

1 Cinram International Inc. ("CII"), Cinram International Income Fund ("Cinram Fund"), CII Trust and the Companies listed in Schedule "A" (collectively, the "Applicants") brought this application seeking an initial order (the "Initial Order") pursuant to the *Companies' Creditors Arrangement Act* ("CCAA"). The Applicants also request that the court exercise its jurisdiction to extend a stay of proceedings and other benefits under the Initial Order to Cinram International Limited Partnership ("Cinram LP", collectively with the Applicants, the "CCAA Parties").

2 Cinram Fund, together with its direct and indirect subsidiaries (collectively, "Cinram" or the "Cinram Group") is a replicator and distributor of CDs and DVDs. Cinram has a diversified operational footprint across North America and Europe that enables it to meet the replication and logistics demands of its customers.

3 The evidentiary record establishes that Cinram has experienced significant declines in revenue and EBITDA, which, according to Cinram, are a result of the economic downturn in Cinram's primary markets of North America and Europe, which impacted consumers' discretionary spending and adversely affected the entire industry.

4 Cinram advises that over the past several years it has continued to evaluate its strategic alternatives and rationalize its operating footprint in order to attempt to balance its ongoing operations and financial challenges with its existing debt levels. However, despite cost reductions and recapitalized initiatives and the implementation of a variety of restructuring alternatives, the Cinram Group has experienced a number of challenges that has led to it seeking protection under the CCAA.

5 Counsel to Cinram outlined the principal objectives of these CCAA proceedings as:

(i) to ensure the ongoing operations of the Cinram Group;

(ii) to ensure the CCAA Parties have the necessary availability of working capital funds to maximize the ongoing business of the Cinram Group for the benefit of its stakeholders; and

(iii) to complete the sale and transfer of substantially all of the Cinram Group's business as a going concern (the "Proposed Transaction").

6 Cinram contemplates that these CCAA proceedings will be the primary court supervised restructuring of the CCAA Parties. Cinram has operations in the United States and certain of the Applicants are incorporated under the laws of the United States. Cinram, however, takes the position that Canada is the nerve centre of the Cinram Group.

7 The Applicants also seek authorization for Cinram International ULC ("Cinram ULC") to act as "foreign representative" in the within proceedings to seek a recognition order under Chapter 15 of the United States Bankruptcy Code ("Chapter 15"). Cinram advises that the proceedings under Chapter 15 are intended to ensure that the CCAA Parties are protected from creditor actions in the United States and to assist with the global implementation of the Proposed Transaction to be undertaken pursuant to these CCAA proceedings.

8 Counsel to the Applicants submits that the CCAA Parties are part of a consolidated business in Canada, the United States and Europe that is headquartered in Canada and operationally and functionally integrated in many significant respects. Cinram is one of the world's largest providers of pre-recorded multi-media products and related logistics services. It has facilities in North America and Europe, and it:

(i) manufactures DVDs, blue ray disks and CDs, and provides distribution services for motion picture studios, music labels, video game publishers, computer software companies, telecommunication companies and retailers around the world;

(ii) provides various digital media services through One K Studios, LLC; and

(iii) provides retail inventory control and forecasting services through Cinram Retail Services LLC (collectively, the "Cinram Business").

9 Cinram contemplates that the Proposed Transaction could allow it to restore itself as a market leader in the industry. Cinram takes the position that it requires CCAA protection to provide stability to its operations and to complete the Proposed Transaction.

10 The Proposed Transaction has the support of the lenders forming the steering committee with respect to Cinram's First Lien Credit Facilities (the "Steering Committee"), the members of which have been subject to confidentiality agreements and represent 40% of the loans under Cinram's First Lien Credit Facilities (the "Initial Consenting Lenders"). Cinram also anticipates further support of the Proposed Transaction from additional lenders under its credit facilities following the public announcement of the Proposed Transaction.

11 Cinram Fund is the direct or indirect parent and sole shareholder of all of the subsidiaries in Cinram's corporate structure. A simplified corporate structure of the Cinram Group showing all of the CCAA Parties, including the designation of the CCAA Parties' business segments and certain non-filing entities, is set out in the Pre-Filing Report of FTI Consulting Inc. (the "Monitor") at paragraph 13. A copy is attached as Schedule "B".

12 Cinram Fund, CII, Cinram International General Partner Inc. ("Cinram GP"), CII Trust, Cinram ULC and 1362806 Ontario Limited are the Canadian entities in the Cinram Group that are Applicants in these proceedings (collectively, the "Canadian Applicants"). Cinram Fund and CII Trust are both open-ended limited purpose trusts, established under

the laws of Ontario, and each of the remaining Canadian Applicants is incorporated pursuant to Federal or Provincial legislation.

13 Cinram (US) Holdings Inc. ("CUSH"), Cinram Inc., IHC Corporation ("IHC"), Cinram Manufacturing, LLC ("Cinram Manufacturing"), Cinram Distribution, LLC ("Cinram Distribution"), Cinram Wireless, LLC ("Cinram Wireless"), Cinram Retail Services, LLC ("Cinram Retail") and One K Studios, LLC ("One K") are the U.S. entities in the Cinram Group that are Applicants in these proceedings (collectively, the "U.S. Applicants"). Each of the U.S. Applicants is incorporated under the laws of Delaware, with the exception of One K, which is incorporated under the laws of California. On May 25, 2012, each of the U.S. Applicants opened a new Canadian-based bank account with J.P. Morgan.

14 Cinram LP is not an Applicant in these proceedings. However, the Applicants seek to have a stay of proceedings and other relief under the CCAA extended to Cinram LP as it forms part of Cinram's income trust structure with Cinram Fund, the ultimate parent of the Cinram Group.

15 Cinram's European entities are not part of these proceedings and it is not intended that any insolvency proceedings will be commenced with respect to Cinram's European entities, except for Cinram Optical Discs SAC, which has commenced insolvency proceedings in France.

16 The Cinram Group's principal source of long-term debt is the senior secured credit facilities provided under credit agreements known as the "First-Lien Credit Agreement" and the "Second-Lien Credit Agreement" (together with the First-Lien Credit Agreement, the "Credit Agreements").

17 All of the CCAA Parties, with the exception of Cinram Fund, Cinram GP, CII Trust and Cinram LP (collectively, the "Fund Entities"), are borrowers and/or guarantors under the Credit Agreements. The obligations under the Credit Agreements are secured by substantially all of the assets of the Applicants and certain of their European subsidiaries.

18 As at March 31, 2012, there was approximately $233 million outstanding under the First-Lien Term Loan Facility; $19 million outstanding under the First-Lien Revolving Credit Facilities; approximately $12 million of letter of credit exposure under the First-Lien Credit Agreement; and approximately $12 million outstanding under the Second-Lien Credit Agreement.

19 Cinram advises that in light of the financial circumstances of the Cinram Group, it is not possible to obtain additional financing that could be used to repay the amounts owing under the Credit Agreements.

20 Mr. John Bell, Chief Financial Officer of CII, stated in his affidavit that in connection with certain defaults under the Credit Agreements, a series of waivers was extended from December 2011 to June 30, 2012 and that upon expiry of the waivers, the lenders have the ability to demand immediate repayment of the outstanding amounts under the Credit Agreements and the borrowers and the other Applicants that are guarantors under the Credit Agreements would be unable to meet their debt obligations. Mr. Bell further stated that there is no reasonable expectation that Cinram would be able to service its debt load in the short to medium term given forecasted net revenues and EBITDA for the remainder of fiscal 2012, fiscal 2013, and fiscal 2014. The cash flow forecast attached to his affidavit indicates that, without additional funding, the Applicants will exhaust their available cash resources and will thus be unable to meet their obligations as they become due.

21 The Applicants request a stay of proceedings. They take the position that in light of their financial circumstances, there could be a vast and significant erosion of value to the detriment of all stakeholders. In particular, the Applicants are concerned about the following risks, which, because of the integration of the Cinram business, also apply to the Applicants' subsidiaries, including Cinram LP:

(a) the lenders demanding payment in full for money owing under the Credit Agreements;

(b) potential termination of contracts by key suppliers; and

(c) potential termination of contracts by customers.

22 As indicated in the cash flow forecast, the Applicants do not have sufficient funds available to meet their immediate cash requirements as a result of their current liquidity challenges. Mr. Bell states in his affidavit that the Applicants require access to Debtor-In-Possession ("DIP") Financing in the amount of $15 millions to continue operations while they implement their restructuring, including the Proposed Transaction. Cinram has negotiated a DIP Credit Agreement with the lenders forming the Steering Committee (the "DIP Lenders") through J.P. Morgan Chase Bank, NA as Administrative Agent (the "DIP Agent") whereby the DIP Lenders agree to provide the DIP Financing in the form of a term loan in the amount of $15 million.

23 The Applicants also indicate that during the course of the CCAA proceedings, the CCAA Parties intend to generally make payments to ensure their ongoing business operations for the benefit of their stakeholders, including obligations incurred prior to, on, or after the commencement of these proceedings relating to:

(a) the active employment of employees in the ordinary course;

(b) suppliers and service providers the CCAA Parties and the Monitor have determined to be critical to the continued operation of the Cinram business;

(c) certain customer programs in place pursuant to existing contracts or arrangements with customers; and

(d) inter-company payments among the CCAA Parties in respect of, among other things, shared services.

24 Mr. Bell states that the ability to make these payments relating to critical suppliers and customer programs is subject to a consultation and approval process agreed to among the Monitor, the DIP Agent and the CCAA Parties.

25 The Applicants also request an Administration Charge for the benefit of the Monitor and Moelis and Company, LLC ("Moelis"), an investment bank engaged to assist Cinram in a comprehensive and thorough review of its strategic alternatives.

26 In addition, the directors (and in the case of Cinram Fund and CII Trust, the Trustees, referred to collectively with the directors as the "Directors/Trustees") requested a Director's Charge to provide certainty with respect to potential personal liability if they continue in their current capacities. Mr. Bell states that in order to complete a successful restructuring, including the Proposed Transaction, the Applicants require the active and committed involvement of their Directors/Trustees and officers. Further, Cinram's insurers have advised that if Cinram was to file for CCAA protection, and the insurers agreed to renew the existing D&O policies, there would be a significant increase in the premium for that insurance.

27 Cinram has also developed a key employee retention program (the "KERP") with the principal purpose of providing an incentive for eligible employees, including eligible officers, to remain with the Cinram Group despite its financial difficulties. The KERP has been reviewed and approved by the Board of Trustees of the Cinram Fund. The KERP includes retention payments (the "KERP Retention Payments") to certain existing employees, including certain officers employed at Canadian and U.S. Entities, who are critical to the preservation of Cinram's enterprise value.

28 Cinram also advises that on June 22, 2012, Cinram Fund, the borrowers under the Credit Agreements, and the Initial Consenting Lenders entered into a support agreement pursuant to which the Initial Consenting Lenders agreed to support the Proposed Transaction to be pursued through these CCAA proceedings (the "Support Agreement").

29 Pursuant to the Support Agreement, lenders under the First-Lien Credit Agreement who execute the Support Agreement or Consent Agreement prior to July 10, 2012 (the "Consent Date") are entitled to receive consent

consideration (the "Early Consent Consideration") equal to 4% of the principal amount of loans under the First-Lien Credit Agreement held by such consenting lenders as of the Consent Date, payable in cash from the net sale proceeds of the Proposed Transaction upon distribution of such proceeds in the CCAA proceedings.

30 Mr. Bell states that it is contemplated that the CCAA proceedings will be the primary court-supervised restructuring of the CCAA Parties. He states that the CCAA Parties are part of a consolidated business in Canada, the United States and Europe that is headquartered in Canada and operationally and functionally integrated in many significant respects. Mr. Bell further states that although Cinram has operations in the United States, and certain of the Applicants are incorporated under the laws of the United States, it is Ontario that is Cinram's home jurisdiction and the nerve centre of the CCAA Parties' management, business and operations.

31 The CCAA Parties have advised that they will be seeking a recognition order under Chapter 15 to ensure that they are protected from creditor actions in the United States and to assist with the global implementation of the Proposed Transaction. Thus, the Applicants seek authorization in the Proposed Initial Order for:

> Cinram ULC to seek recognition of these proceedings as "foreign main proceedings" and to seek such additional relief required in connection with the prosecution of any sale transaction, including the Proposed Transaction, as well as authorization for the Monitor, as a court-appointed officer, to assist the CCAA Parties with any matters relating to any of the CCAA Parties' subsidiaries and any foreign proceedings commenced in relation thereto.

32 Mr. Bell further states that the Monitor will be actively involved in assisting Cinram ULC as the foreign representative of the Applicants in the Chapter 15 proceedings and will assist in keeping this court informed of developments in the Chapter 15 proceedings.

33 The facts relating to the CCAA Parties, the Cinram business, and the requested relief are fully set out in Mr. Bell's affidavit.

34 Counsel to the Applicants filed a comprehensive factum in support of the requested relief in the Initial Order. Part III of the factum sets out the issues and the law.

35 The relief requested in the form of the Initial Order is extensive. It goes beyond what this court usually considers on an initial hearing. However, in the circumstances of this case, I have been persuaded that the requested relief is appropriate.

36 In making this determination, I have taken into account that the Applicants have spent a considerable period of time reviewing their alternatives and have done so in a consultative manner with their senior secured lenders. The senior secured lenders support this application, notwithstanding that it is clear that they will suffer a significant shortfall on their positions. It is also noted that the Early Consent Consideration will be available to lenders under the First-Lien Credit Agreement who execute the Support Agreement prior to July 10, 2012. Thus, all of these lenders will have the opportunity to participate in this arrangement.

37 As previously indicated, the Applicants' factum is comprehensive. The submissions on the law are extensive and cover all of the outstanding issues. It provides a fulsome review of the jurisprudence in the area, which for purposes of this application, I accept. For this reason, paragraphs 41-96 of the factum are attached as Schedule "C" for reference purposes.

38 The Applicants have also requested that the confidential supplement — which contains the KERP summary listing the individual KERP Payments and certain DIP Schedules — be sealed. I am satisfied that the KERP summary contains individually identifiable information and compensation information, including sensitive salary information, about the individuals who are covered by the KERP and that the DIP schedules contain sensitive competitive information of the CCAA Parties which should also be treated as being confidential. Having considered the principals of *Sierra Club of*

Canada v. Canada (Minister of Finance), [2002] 2 S.C.R. 522 (S.C.C.), I accept the Applicants' submission on this issue and grant the requested sealing order in respect of the confidential supplement.

39 Finally, the Applicants have advised that they intend to proceed with a Chapter 15 application on June 26, 2012 before the United States Bankruptcy Court in the District of Delaware. I am given to understand that Cinram ULC, as proposed foreign representative, will be seeking recognition of the CCAA proceedings as "foreign main proceedings" on the basis that Ontario, Canada is the Centre of Main Interest or "COMI" of the CCAA Applicants.

40 In his affidavit at paragraph 195, Mr. Bell states that the CCAA Parties are part of a consolidated business that is headquartered in Canada and operationally and functionally integrated in many significant respects and that, as a result of the following factors, the Applicants submit the COMI of the CCAA Parties is Ontario, Canada:

> (a) the Cinram Group is managed on a consolidated basis out of the corporate headquarters in Toronto, Ontario, where corporate-level decision-making and corporate administrative functions are centralized;
>
> (b) key contracts, including, among others, major customer service agreements, are negotiated at the corporate level and created in Canada;
>
> (c) the Chief Executive Officer and Chief Financial Officer of CII, who are also directors, trustees and/or officers of other entities in the Cinram Group, are based in Canada;
>
> (d) meetings of the board of trustees and board of directors typically take place in Canada;
>
> (e) pricing decisions for entities in the Cinram Group are ultimately made by the Chief Executive Officer and Chief Financial Officer in Toronto, Ontario;
>
> (f) cash management functions for Cinram's North American entities, including the administration of Cinram's accounts receivable and accounts payable, are managed from Cinram's head office in Toronto, Ontario;
>
> (g) although certain bookkeeping, invoicing and accounting functions are performed locally, corporate accounting, treasury, financial reporting, financial planning, tax planning and compliance, insurance procurement services and internal audits are managed at a consolidated level in Toronto, Ontario;
>
> (h) information technology, marketing, and real estate services are provided by CII at the head office in Toronto, Ontario;
>
> (i) with the exception of routine maintenance expenditures, all capital expenditure decisions affecting the Cinram Group are managed in Toronto, Ontario;
>
> (j) new business development initiatives are centralized and managed from Toronto, Ontario; and
>
> (k) research and development functions for the Cinram Group are corporate-level activities centralized at Toronto, Ontario, including the Cinram Group's corporate-level research and development budget and strategy.

41 Counsel submits that the CCAA Parties are highly dependent upon the critical business functions performed on their behalf from Cinram's head office in Toronto and would not be able to function independently without significant disruptions to their operations.

42 The above comments with respect to the COMI are provided for informational purposes only. This court clearly recognizes that it is the function of the receiving court — in this case, the United States Bankruptcy Court for the District of Delaware — to make the determination on the location of the COMI and to determine whether this CCAA proceeding is a "foreign main proceeding" for the purposes of Chapter 15.

43 In the result, I am satisfied that the Applicants meet all of the qualifications established for relief under the CCAA and I have signed the Initial Order in the form submitted, which includes approvals of the Charges referenced in the Initial Order.

Schedule "A"

Additional Applicants

Cinram International General Partner Inc.

Cinram International ULC

1362806 Ontario Limited

Cinram (U.S.) Holdings Inc.

Cinram, Inc.

IHC Corporation

Cinram Manufacturing LLC

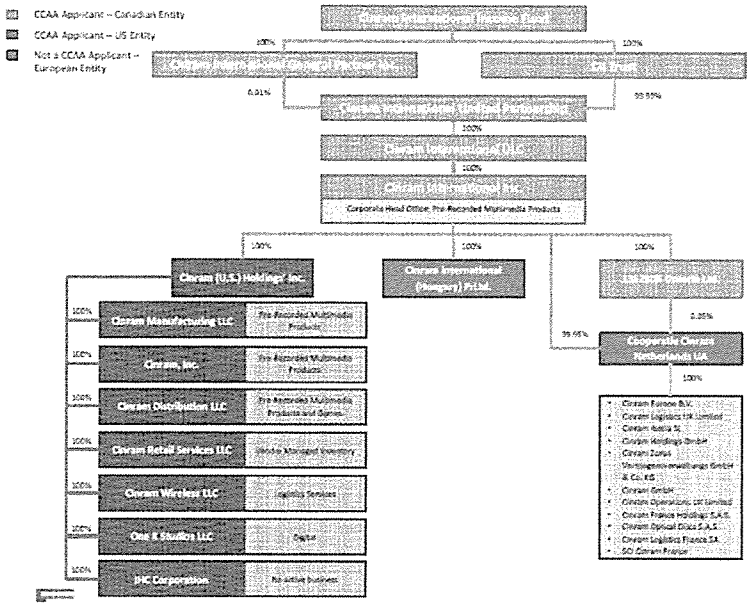
Cinram Distribution LLC

Cinram Wireless LLC

Cinram Retail Services, LLC

One K Studios, LLC

Schedule "B"



Graphic 1

Schedule "C"

A. The Applicants Are "Debtor Companies" to Which the CCAA Applies

41. The CCAA applies in respect of a "debtor company" (including a foreign company having assets or doing business in Canada) or "affiliated debtor companies" where the total of claims against such company or companies exceeds $5 million.

CCAA, Section 3(1).

42. The Applicants are eligible for protection under the CCAA because each is a "debtor company" and the total of the claims against the Applicants exceeds $5 million.

(1) The Applicants are Debtor Companies

43. The terms "company" and "debtor company" are defined in Section 2 of the CCAA as follows:

> "company" means any company, corporation or legal person incorporated by or under an Act of Parliament or of the legislature of a province and any incorporated company having assets or doing business in Canada, wherever incorporated, and any income trust, but does not include banks, authorized foreign banks within the meaning of section 2 of the *Bank Act*, railway or telegraph companies, insurance companies and companies to which the *Trust and Loan Companies Act* applies.
>
> "debtor company" means any company that:
>
> (a) is bankrupt or insolvent;
>
> (b) has committed an act of bankruptcy within the meaning of the *Bankruptcy and Insolvency Act* or is deemed insolvent within the meaning of the *Winding-Up and Restructuring Act*, whether or not proceedings in respect of the company have been taken under either of those Acts;
>
> (c) has made an authorized assignment or against which a receiving order has been made under the *Bankruptcy and Insolvency Act*; or
>
> (d) is in the course of being wound up under the *Winding-Up and Restructuring Act* because the company is insolvent.

CCAA, Section 2 ("company" and "debtor company").

44. The Applicants are debtor companies within the meaning of these definitions.

(2) The Applicants are "companies"

45. The Applicants are "companies" because:

a. with respect to the Canadian Applicants, each is incorporated pursuant to federal or provincial legislation or, in the case of Cinram Fund and CII Trust, is an income trust; and

b. with respect to the U.S. Applicants, each is an incorporated company with certain funds in bank accounts in Canada opened in May 2012 and therefore each is a company having assets or doing business in Canada.

Bell Affidavit at paras. 4, 80, 84, 86, 91, 94, 98, 102, 105, 108, 111, 114, 117, 120, 123, 212; Application Record, Tab 2.

46. The test for "having assets or doing business in Canada" is disjunctive, such that either "having assets" in Canada or "doing business in Canada" is sufficient to qualify an incorporated company as a "company" within the meaning of the CCAA.

47. Having only nominal assets in Canada, such as funds on deposit in a Canadian bank account, brings a foreign corporation within the definition of "company". In order to meet the threshold statutory requirements of the CCAA, an applicant need only be in technical compliance with the plain words of the CCAA.

Canwest Global Communications Corp., Re (2009), 59 C.B.R. (5th) 72 (Ont. S.C.J. [Commercial List]) at para. 30 [*Canwest Global*]; Book of Authorities of the Applicants ("*Book of Authorities*"), Tab 1.

Global Light Telecommunications Inc., Re (2004), 2 C.B.R. (5th) 210 (B.C. S.C.) at para. 17 [*Global Light*]; Book of Authorities, Tab 2.

48. The Courts do not engage in a quantitative or qualitative analysis of the assets or the circumstances in which the assets were created. Accordingly, the use of "instant" transactions immediately preceding a CCAA application, such as the creation of "instant debts" or "instant assets" for the purposes of bringing an entity within the scope of the CCAA, has received judicial approval as a legitimate device to bring a debtor within technical requirements of the CCAA.

Global Light Telecommunications Inc., Re, *supra* at para. 17; Book of Authorities, Tab 2.

Cadillac Fairview Inc., Re (1995), 30 C.B.R. (3d) 29 (Ont. Gen. Div. [Commercial List]) at paras. 5-6; Book of Authorities, Tab 3.

Nova Metal Products Inc. v. Comiskey (Trustee of) (1990), 1 O.R. (3d) 289 (Ont. C.A.) at paras. 74, 83; Book of Authorities, Tab 4.

(3) The Applicants are insolvent

49. The Applicants are "debtor companies" as defined in the CCAA because they are companies (as set out above) and they are insolvent.

50. The insolvency of the debtor is assessed as of the time of filing the CCAA application. The CCAA does not define insolvency. Accordingly, in interpreting the meaning of "insolvent", courts have taken guidance from the definition of "insolvent person" in Section 2(1) of the *Bankruptcy and Insolvency Act* (the "BIA"), which defines an "insolvent person" as a person (i) who is not bankrupt; and (ii) who resides, carries on business or has property in Canada; (iii) whose liabilities to creditors provable as claims under the BIA amount to one thousand dollars; and (iv) who is "insolvent" under one of the following tests:

a. is for any reason unable to meet his obligations as they generally become due;

b. has ceased paying his current obligations in the ordinary course of business as they generally become due; or

c. the aggregate of his property is not, at a fair valuation, sufficient, or if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due.

BIA, Section 2 ("insolvent person").

Stelco Inc., Re (2004), 48 C.B.R. (4th) 299 (Ont. S.C.J. [Commercial List]); leave to appeal to C.A. refused [2004] O.J. No. 1903 (Ont. C.A.); leave to appeal to S.C.C. refused [2004] S.C.C.A. No. 336 (S.C.C.), at para.4 [*Stelco*]; Book of Authorities, Tab 5.

51. These tests for insolvency are disjunctive. A company satisfying any one of these tests is considered insolvent for the purposes of the CCAA.

Stelco Inc., Re, *supra* at paras. 26 and 28; Book of Authorities, Tab 5.

52. A company is also insolvent for the purposes of the CCAA if, at the time of filing, there is a reasonably foreseeable expectation that there is a looming liquidity condition or crisis that would result in the company being unable to pay its debts as they generally become due if a stay of proceedings and ancillary protection are not granted by the court.

Stelco Inc., Re, *supra* at para. 40; Book of Authorities, Tab 5.

53. The Applicants meet both the traditional test for insolvency under the BIA and the expanded test for insolvency based on a looming liquidity condition as a result of the following:

a. The Applicants are unable to comply with certain financial covenants under the Credit Agreements and have entered into a series of waivers with their lenders from December 2011 to June 30, 2012.

b. Were the Lenders to accelerate the amounts owing under the Credit Agreements, the Borrowers and the other Applicants that are Guarantors under the Credit Agreements would be unable to meet their debt obligations. Cinram Fund would be the ultimate parent of an insolvent business.

d. The Applicants have been unable to repay or refinance the amounts owing under the Credit Agreements or find an out-of-court transaction for the sale of the Cinram Business with proceeds that equal or exceed the amounts owing under the Credit Agreements.

e. Reduced revenues and EBITDA and increased borrowing costs have significantly impaired Cinram's ability to service its debt obligations. There is no reasonable expectation that Cinram will be able to service its debt load in the short to medium term given forecasted net revenues and EBITDA for the remainder of fiscal 2012 and for fiscal 2013 and 2014.

f. The decline in revenues and EBITDA generated by the Cinram Business has caused the value of the Cinram Business to decline. As a result, the aggregate value of the Property, taken at fair value, is not sufficient to allow for payment of all of the Applicants' obligations due and accruing due.

g. The Cash Flow Forecast indicates that without additional funding the Applicants will exhaust their available cash resources and will thus be unable to meet their obligations as they become due.

Bell Affidavit, paras. 23, 179-181, 183, 197-199; Application Record, Tab 2.

(4) The Applicants are affiliated companies with claims outstanding in excess of $5 million

54. The Applicants are affiliated debtor companies with total claims exceeding 5 million dollars. Therefore, the CCAA applies to the Applicants in accordance with Section 3(1).

55. Affiliated companies are defined in Section 3(2) of the CCAA as follows:

a. companies are affiliated companies if one of them is the subsidiary of the other or both are subsidiaries of the same company or each is controlled by the same person; and

b. two companies are affiliated with the same company at the same time are deemed to be affiliated with each other.

CCAA, Section 3(2).

56. CII, CII Trust and all of the entities listed in Schedule "A" hereto are indirect, wholly owned subsidiaries of Cinram Fund; thus, the Applicants are "affiliated companies" for the purpose of the CCAA.

Bell Affidavit, paras. 3, 71; Application Record, Tab 2.

57. All of the CCAA Parties (except for the Fund Entities) are each a Borrower and/or Guarantor under the Credit Agreements. As at March 31, 2012 there was approximately $252 million of aggregate principal amount outstanding under the First Lien Credit Agreement (plus approximately $12 million in letter of credit exposure) and approximately $12 million of aggregate principal amount outstanding under the Second Lien Credit Agreement. The total claims against the Applicants far exceed $5 million.

Bell Affidavit, paras. 75; Application Record, Tab 2.

B. The Relief is Available under The CCAA and Consistent with the Purpose and Policy of the CCAA

(1) The CCAA is Flexible, Remedial Legislation

58. The CCAA is remedial legislation, intended to facilitate compromises and arrangements between companies and their creditors as an alternative to bankruptcy. In particular during periods of financial hardship, debtors turn to the Court so that the Court may apply the CCAA in a flexible manner in order to accomplish the statute's goals. The Court should give the CCAA a broad and liberal interpretation so as to encourage and facilitate successful restructurings whenever possible.

Nova Metal Products Inc. v. Comiskey (Trustee of), *supra* at paras. 22 and 56-60; Book of Authorities, Tab 4. *Lehndorff General Partner Ltd., Re* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]) at para. 5; Book of Authorities, Tab 6.

Hongkong Bank of Canada v. Chef Ready Foods Ltd. (1990), 4 C.B.R. (3d) 311 (B.C. C.A.), at pp. 4 and 7; Book of Authorities, Tab 7.

59. On numerous occasions, courts have held that Section 11 of the CCAA provides the courts with a broad and liberal power, which is at their disposal in order to achieve the overall objective of the CCAA. Accordingly, an interpretation of the CCAA that facilitates restructurings accords with its purpose.

Sulphur Corp. of Canada Ltd., Re (2002), 35 C.B.R. (4th) 304 (Alta. Q.B.) ("*Sulphur*") at para. 26; Book of Authorities, Tab 8.

60. Given the nature and purpose of the CCAA, this Honourable Court has the authority and jurisdiction to depart from the Model Order as is reasonable and necessary in order to achieve a successful restructuring.

(2) The Stay of Proceedings Against Non-Applicants is Appropriate

61. The relief sought in this application includes a stay of proceedings in favour of Cinram LP and the Applicants' direct and indirect subsidiaries that are also party to an agreement with an Applicant (whether as surety, guarantor or otherwise) (each, a "Subsidiary Counterparty"), including any contract or credit agreement. It is just and reasonable to grant the requested stay of proceedings because:

a. the Cinram Business is integrated among the Applicants, Cinram LP and the Subsidiary Counterparties;

b. if any proceedings were commenced against Cinram LP, or if any of the third parties to such agreements were to commence proceedings or exercise rights and remedies against the Subsidiary Counterparties, this would have a detrimental effect on the Applicants' ability to restructure and implement the Proposed Transaction and would lead to an erosion of value of the Cinram Business; and

c. a stay of proceedings that extends to Cinram LP and the Subsidiary Counterparties is necessary in order to maintain stability with respect to the Cinram Business and maintain value for the benefit of the Applicants' stakeholders.

Bell Affidavit, paras. 185-186; Application Record, Tab 2.

62. The purpose of the CCAA is to preserve the *status quo* to enable a plan of compromise to be prepared, filed and considered by the creditors:

> In the interim, a judge has great discretion under the CCAA to make order so as to effectively maintain the status quo in respect of an insolvent company while it attempts to gain the approval of its creditors for the proposed compromise or arrangement which will be to the benefit of both the company and its creditors.

Lehndorff General Partner Ltd., Re, *supra* at para. 5; Book of Authorities, Tab 6. *Canwest Global Communications Corp., Re*, *supra* at para. 27; Book of Authorities, Tab 1.

CCAA, Section 11.

63. The Court has broad inherent jurisdiction to impose stays of proceedings that supplement the statutory provisions of Section 11 of the CCAA, providing the Court with the power to grant a stay of proceedings where it is just and reasonable to do so, including with respect to non-applicant parties.

Lehndorff General Partner Ltd., Re, *supra* at paras. 5 and 16; Book of Authorities, Tab 6.

T. Eaton Co., Re (1997), 46 C.B.R. (3d) 293 (Ont. Gen. Div.) at para. 6; Book of Authorities, Tab 9.

64. The Courts have found it just and reasonable to grant a stay of proceedings against third party non-applicants in a number of circumstances, including:

a. where it is important to the reorganization process;

b. where the business operations of the Applicants and the third party non-applicants are intertwined and the third parties are not subject to the jurisdiction of the CCAA, such as partnerships that do not qualify as "companies" within the meaning of the CCAA;

c. against non-applicant subsidiaries of a debtor company where such subsidiaries were guarantors under the note indentures issued by the debtor company; and

d. against non-applicant subsidiaries relating to any guarantee, contribution or indemnity obligation, liability or claim in respect of obligations and claims against the debtor companies.

Woodward's Ltd., Re (1993), 17 C.B.R. (3d) 236 (B.C. S.C.) at para. 31; Book of Authorities, Tab 10. *Lehndorff General Partner Ltd., Re*, *supra* at para. 21; Book of Authorities, Tab 6.

Canwest Global Communications Corp., Re, *supra* at paras. 28 and 29; Book of Authorities, Tab 1.

Sino-Forest Corp., Re, 2012 ONSC 2063 (Ont. S.C.J. [Commercial List]) at paras. 5, 18, and 31; Book of Authorities, Tab 11.

Re MAAX Corp, Initial Order granted June 12, 2008, Montreal 500-11-033561-081, (Que. Sup. Ct. [Commercial Division]) at para. 7; Book of Authorities, Tab 12.

65. The Applicants submit the balance of convenience favours extending the relief in the proposed Initial Order to Cinram LP and the Subsidiary Counterparties. The business operations of the Applicants, Cinram LP and the Subsidiary Counterparties are intertwined and the stay of proceedings is necessary to maintain stability and value for the benefit of the Applicants' stakeholders, as well as allow an orderly, going-concern sale of the Cinram Business as an important component of its reorganization process.

(3) Entitlement to Make Pre-Filing Payments

66. To ensure the continued operation of the CCAA Parties' business and maximization of value in the interests of Cinram's stakeholders, the Applicants seek authorization (but not a requirement) for the CCAA Parties to make certain pre-filing payments, including: (a) payments to employees in respect of wages, benefits, and related amounts; (b) payments to suppliers and service providers critical to the ongoing operation of the business; (c) payments and the application of credits in connection with certain existing customer programs; and (d) intercompany payments among the Applicants related to intercompany loans and shared services. Payments will be made with the consent of the Monitor and, in certain circumstances, with the consent of the Agent.

67. There is ample authority supporting the Court's general jurisdiction to permit payment of pre-filing obligations to persons whose services are critical to the ongoing operations of the debtor companies. This jurisdiction of the Court is not ousted by Section 11.4 of the CCAA, which became effective as part of the 2009 amendments to the CCAA and codified the Court's practice of declaring a person to be a critical supplier and granting a charge on the debtor's property in favour of such critical supplier. As noted by Pepall J. in *Canwest Global Communications Corp., Re*, the recent amendments, including Section 11.4, do not detract from the inherently flexible nature of the CCAA or the Court's broad and inherent jurisdiction to make such orders that will facilitate the debtor's restructuring of its business as a going concern.

Canwest Global Communications Corp., Re supra, at paras. 41 and 43; Book of Authorities, Tab 1.

68. There are many cases since the 2009 amendments where the Courts have authorized the applicants to pay certain pre-filing amounts where the applicants were not seeking a charge in respect of critical suppliers. In granting this authority, the Courts considered a number of factors, including:

a. whether the goods and services were integral to the business of the applicants;

b. the applicants' dependency on the uninterrupted supply of the goods or services;

c. the fact that no payments would be made without the consent of the Monitor;

d. the Monitor's support and willingness to work with the applicants to ensure that payments to suppliers in respect of pre-filing liabilities are minimized;

e. whether the applicants had sufficient inventory of the goods on hand to meet their needs; and

f. the effect on the debtors' ongoing operations and ability to restructure if they were unable to make pre-filing payments to their critical suppliers.

Canwest Global Communications Corp., Re supra, at para. 43; Book of Authorities, Tab 1.

Brainhunter Inc., Re, [2009] O.J. No. 5207 (Ont. S.C.J. [Commercial List]) at para. 21 [*Brainhunter*]; Book of Authorities, Tab 13.

Priszm Income Fund, Re (2011), 75 C.B.R. (5th) 213 (Ont. S.C.J.) at paras. 29-34; Book of Authorities, Tab 14.

69. The CCAA Parties rely on the efficient and expedited supply of products and services from their suppliers and service providers in order to ensure that their operations continue in an efficient manner so that they can satisfy customer requirements. The CCAA Parties operate in a highly competitive environment where the timely provision of their products and services is essential in order for the company to remain a successful player in the industry and to ensure the continuance of the Cinram Business. The CCAA Parties require flexibility to ensure adequate and timely supply of required products and to attempt to obtain and negotiate credit terms with its suppliers and service providers. In order to accomplish this, the CCAA Parties require the ability to pay certain pre-filing amounts and post-filing payables to

those suppliers they consider essential to the Cinram Business, as approved by the Monitor. The Monitor, in determining whether to approve pre-filing payments as critical to the ongoing business operations, will consider various factors, including the above factors derived from the caselaw.

Bell Affidavit, paras. 226, 228, 230; Application Record, Tab 2.

70. In addition, the CCAA Parties' continued compliance with their existing customer programs, as described in the Bell Affidavit, including the payment of certain pre-filing amounts owing under certain customer programs and the application of certain credits granted to customers pre-filing to post-filing receivables, is essential in order for the CCAA Parties to maintain their customer relationships as part of the CCAA Parties' going concern business.

Bell Affidavit, paras. 234; Application Record, Tab 2.

71. Further, due to the operational integration of the businesses of the CCAA Parties, as described above, there is a significant volume of financial transactions between and among the Applicants, including, among others, charges by an Applicant providing shared services to another Applicant of intercompany accounts due from the recipients of those services, and charges by a Applicant that manufactures and furnishes products to another Applicant of inter-company accounts due from the receiving entity.

Bell Affidavit, paras. 225; Application Record, Tab 2.

72. Accordingly, the Applicants submit that it is appropriate in the present circumstances for this Honourable Court to exercise its jurisdiction and grant the CCAA Parties the authority to make the pre-filing payments described in the proposed Initial Order subject to the terms therein.

(4) The Charges Are Appropriate

73. The Applicants seek approval of certain Court-ordered charges over their assets relating to their DIP Financing (defined below), administrative costs, indemnification of their trustees, directors and officers, KERP and Support Agreement. The Lenders and the Administrative Agent under the Credit Agreements, the senior secured facilities that will be primed by the charges, have been provided with notice of the within Application. The proposed Initial Order does not purport to give the Court-ordered charges priority over any other validly perfected security interests.

(A) DIP Lenders' Charge

74. In the proposed Initial Order, the Applicants seek approval of the DIP Credit Agreement providing a debtor-in-possession term facility in the principal amount of $15 million (the "DIP Financing"), to be secured by a charge over all of the assets and property of the Applicants that are Borrowers and/or Guarantors under the Credit Agreements (the "Charged Property") ranking ahead of all other charges except the Administration Charge.

75. Section 11.2 of the CCAA expressly provides the Court the statutory jurisdiction to grant a debtor-in-possession ("DIP") financing charge:

> 11.2(1) *Interim financing* - On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, a court may make an order declaring that all or part of the company's property is subject to a security or charge — in an amount that the court considers appropriate — in favour of a person specified in the order who agrees to lend to the company an amount approved by the court as being required by the company, having regard to its cash-flow statement. The security or charge may not secure an obligation that exists before the order is made.
>
> 11.2(2) *Priority* — secured creditors — The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

Timminco Ltd., Re, 211 A.C.W.S. (3d) 881 (Ont. S.C.J. [Commercial List]) [2012 CarswellOnt 1466] at para. 31; Book of Authorities, Tab 15. CCAA, Section 11.2(1) and (2).

76. Section 11.2 of the CCAA sets out the following factors to be considered by the Court in deciding whether to grant a DIP financing charge:

> 11.2(4) Factors to be considered — In deciding whether to make an order, the court is to consider, among other things,
>
> (a) the period during which the company is expected to be subject to proceedings under this Act;
>
> (b) how the company's business and financial affairs are to be managed during the proceedings;
>
> (c) whether the company's management has the confidence of its major creditors;
>
> (d) whether the loan would enhance the prospects of a viable compromise or arrangement being made in respect of the company;
>
> (e) the nature and value of the company's property;
>
> (f) whether any creditor would be materially prejudiced as a result of the security or charge; and
>
> (g) the monitor's report referred to in paragraph 23(1)(*b*), if any.

CCAA, Section 11.2(4).

77. The above list of factors is not exhaustive, and it may be appropriate for the Court to consider additional factors in determining whether to grant a DIP financing charge. For example, in circumstances where funds to be borrowed pursuant to a DIP facility were not expected to be immediately necessary, but applicants' cash flow statements projected the need for additional liquidity, the Court in granting the requested DIP charge considered the fact that the applicants' ability to borrows funds that would be secured by a charge would help retain the confidence of their trade creditors, employees and suppliers.

Canwest Publishing Inc./Publications Canwest Inc., Re (2010), 63 C.B.R. (5th) 115 (Ont. S.C.J. [Commercial List]) at paras. 42-43 [*Canwest Publishing*]; Book of Authorities, Tab 16.

78. Courts in recent cross-border cases have exercised their broad power to grant charges to DIP lenders over the assets of foreign applicants. In many of these cases, the debtors have commenced recognition proceedings under Chapter 15.

Re Catalyst Paper Corporation, Initial Order granted on January 31, 2012, Court File No. S-120712 (B.C.S.C.) [*Catalyst Paper*]; Book of Authorities, Tab 17.

Angiotech, *supra*, Initial Order granted on January 28, 2011, Court File No. S-110587; Book of Authorities, Tab 18

Fraser Papers Inc., Re [2009 CarswellOnt 3658 (Ont. S.C.J. [Commercial List])], Initial Order granted on June 18, 2009, Court File No. CV-09-8241-00CL; Book of Authorities, Tab 19.

79. As noted above, pursuant to Section 11.2(1) of the CCAA, a DIP financing charge may not secure an obligation that existed before the order was made. The requested DIP Lenders' Charge will not secure any pre-filing obligations.

80. The following factors support the granting of the DIP Lenders' Charge, many of which incorporate the considerations enumerated in Section 11.2(4) listed above:

a. the Cash Flow Forecast indicates the Applicants will need additional liquidity afforded by the DIP Financing in order to continue operations through the duration of these proposed CCAA Proceedings;

b. the Cinram Business is intended to continue to operate on a going concern basis during these CCAA Proceedings under the direction of the current management with the assistance of the Applicants' advisors and the Monitor;

c. the DIP Financing is expected to provide the Applicants with sufficient liquidity to implement the Proposed Transaction through these CCAA Proceedingsand implement certain operational restructuring initiatives, which will materially enhance the likelihood of a going concern outcome for the Cinram Business;

d. the nature and the value of the Applicants' assets as set out in their consolidated financial statements can support the requested DIP Lenders' Charge;

e. members of the Steering Committee under the First Lien Credit Agreement, who are senior secured creditors of the Applicants, have agreed to provide the DIP Financing;

f. the proposed DIP Lenders have indicated that they will not provide the DIP Financing if the DIP Lenders' Charge is not approved;

g. the DIP Lenders' Charge will not secure any pre-filing obligations;

h. the senior secured lenders under the Credit Agreements affected by the charge have been provided with notice of these CCAA Proceedings;and

i. the proposed Monitor is supportive of the DIP Facility, including the DIP Lenders' Charge.

Bell Affidavit, paras. 199-202, 205-208; Application Record, Tab 2.

(B) Administration Charge

81. The Applicants seek a charge over the Charged Property in the amount of CAD$3.5 million to secure the fees of the Monitor and its counsel, the Applicants' Canadian and U.S. counsel, the Applicants' Investment Banker, the Canadian and U.S. Counsel to the DIP Agent, the DIP Lenders, the Administrative Agent and the Lenders under the Credit Agreements, and the financial advisor to the DIP Lenders and the Lenders under the Credit Agreements (the "Administration Charge"). This charge is to rank in priority to all of the other charges set out in the proposed Initial Order.

82. Prior to the 2009 amendments, administration charges were granted pursuant to the inherent jurisdiction of the Court. Section 11.52 of the CCAA now expressly provides the court with the jurisdiction to grant an administration charge:

11.52(1) *Court may order security or charge to cover certain costs*

On notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of a debtor company is subject to a security or charge — in an amount that the court considers appropriate — in respect of the fees and expenses of

(a) the monitor, including the fees and expenses of any financial, legal or other experts engaged by the monitor in the performance of the monitor's duties;

(b) any financial, legal or other experts engaged by the company for the purpose of proceedings under this Act; and

(c) any financial, legal or other experts engaged by any other interested person if the court is satisfied that the security or charge is necessary for their effective participation in proceedings under this Act.

11.52(2) *Priority*

The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

CCAA, Section 11.52(1) and (2).

82. Administration charges were granted pursuant to Section 11.52 in, among other cases, *Timminco Ltd., Re*, *Canwest Global Communications Corp., Re* and *Canwest Publishing Inc./Publications Canwest Inc., Re.*

Canwest Global Communications Corp., Re, *supra*; Book of Authorities, Tab 1.

Canwest Publishing, *supra*; Book of Authorities, Tab 16.

Timminco Ltd., Re, 2012 ONSC 106 (Ont. S.C.J. [Commercial List]) [*Timminco*]; Book of Authorities, Tab 20.

84. In *Canwest Publishing*, the Court noted Section 11.52 does not contain any specific criteria for a court to consider in granting an administration charge and provided a list of non-exhaustive factors to consider in making such an assessment. These factors were also considered by the Court in *Timminco*. The list of factors to consider in approving an administration charge include:

a. the size and complexity of the business being restructured;

b. the proposed role of the beneficiaries of the charge;

c. whether there is unwarranted duplication of roles;

d. whether the quantum of the proposed charge appears to be fair and reasonable;

e. the position of the secured creditors likely to be affected by the charge; and

f. the position of the Monitor.

Canwest Publishing supra, at para. 54; Book of Authorities, Tab 16.

Timminco, *supra*, at paras. 26-29; Book of Authorities, Tab 20.

85. The Applicants submit that the Administration Charge is warranted and necessary, and that it is appropriate in the present circumstances for this Honourable Court to exercise its jurisdiction and grant the Administration Charge, given:

a. the proposed restructuring of the Cinram Business is large and complex, spanning several jurisdictions across North America and Europe, and will require the extensive involvement of professional advisors;

b. the professionals that are to be beneficiaries of the Administration Charge have each played a critical role in the CCAA Parties' restructuring efforts to date and will continue to be pivotal to the CCAA Parties' ability to pursue a successful restructuring going forward, including the Investment Banker's involvement in the completion of the Proposed Transaction;

c. there is no unwarranted duplication of roles;

d. the senior secured creditors affected by the charge have been provided with notice of these CCAA Proceedings; and

e. the Monitor is in support of the proposed Administration Charge.

Bell Affidavit, paras. 188, 190; Application Record, Tab 2.

(C) Directors' Charge

86. The Applicants seek a Directors' Charge in an amount of CAD$13 over the Charged Property to secure their respective indemnification obligations for liabilities imposed on the Applicants' trustees, directors and officers (the "Directors and Officers"). The Directors' Charge is to be subordinate to the Administration Charge and the DIP Lenders' Charge but in priority to the KERP Charge and the Consent Consideration Charge.

87. Section 11.51 of the CCAA affords the Court the jurisdiction to grant a charge relating to directors' and officers' indemnification on a priority basis:

11.51(1) *Security or charge relating to director's indemnification*

On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge — in an amount that the court considers appropriate — in favour of any director or officer of the company to indemnify the director or officer against obligations and liabilities that they may incur as a director or officer of the company after the commencement of proceedings under this Act.

11.51(2) *Priority*

The court may order that the security or charge rank in priority over the claim of any secured creditors of the company

11.51(3) *Restriction* — indemnification insurance

The court may not make the order if in its opinion the company could obtain adequate indemnification insurance for the director or officer at a reasonable cost.

11.51(4) *Negligence, misconduct or fault*

The court shall make an order declaring that the security or charge does not apply in respect of a specific obligation or liability incurred by a director or officer if in its opinion the obligation or liability was incurred as a result of the director's or officer's gross negligence or wilful misconduct or, in Quebec, the director's or officer's gross or intentional fault.

CCAA, Section 11.51.

88. The Court has granted director and officer charges pursuant to Section 11.51 in a number of cases. In *Canwest Global Communications Corp., Re*, the Court outlined the test for granting such a charge:

I have already addressed the issue of notice to affected secured creditors. I must also be satisfied with the amount and that the charge is for obligations and liabilities the directors and officers may incur after the commencement of proceedings. It is not to extend to coverage of wilful misconduct or gross negligence and no order should be granted if adequate insurance at a reasonable cost could be obtained.

Canwest Global Communications Corp., Re, *supra* at paras 46-48; Book of Authorities, Tab 1.

Canwest Publishing, *supra* at paras. 56-57; Book of Authorities, Tab 16.

Timminco, *supra* at paras. 30-36; Book of Authorities, Tab 20.

89. The Applicants submit that the D&O Charge is warranted and necessary, and that it is appropriate in the present circumstances for this Honourable Court to exercise its jurisdiction and grant the D&O Charge in the amount of CAD $13 million, given:

a. the Directors and Officers of the Applicants may be subject to potential liabilities in connection with these CCAA proceedings with respect to which the Directors and Officers have expressed their desire for certainty with respect to potential personal liability if they continue in their current capacities;

b. renewal of coverage to protect the Directors and Officers is at a significantly increased cost due to the imminent commencement of these CCAA proceedings;

c. the Directors' Charge would cover obligations and liabilities that the Directors and Officers, as applicable, may incur after the commencement of these CCAA Proceedings and is not intended to cover wilful misconduct or gross negligence;

d. the Applicants require the continued support and involvement of their Directors and Officers who have been instrumental in the restructuring efforts of the CCAA Parties to date;

e. the senior secured creditors affected by the charge have been provided with notice of these CCAA proceedings; and

f. the Monitor is in support of the proposed Directors' Charge.

Bell Affidavit, paras. 249, 250, 254-257; Application Record, Tab 2.

(D) KERP Charge

90. The Applicants seek a KERP Charge in an amount of CAD$3 million over the Charged Property to secure the KERP Retention Payments, KERP Transaction Payments and Aurora KERP Payments payable to certain key employees of the CCAA Parties crucial for the CCAA Parties' successful restructuring.

91. The CCAA is silent with respect to the granting of KERP charges. Approval of a KERP and a KERP charge are matters within the discretion of the Court. The Court in *Grant Forest Products Inc., Re* [2009 CarswellOnt 4699 (Ont. S.C.J. [Commercial List])] considered a number of factors in determining whether to grant a KERP and a KERP charge, including:

a. whether the Monitor supports the KERP agreement and charge (to which great weight was attributed);

b. whether the employees to which the KERP applies would consider other employment options if the KERP agreement were not secured by the KERP charge;

c. whether the continued employment of the employees to which the KERP applies is important for the stability of the business and to enhance the effectiveness of the marketing process;

d. the employees' history with and knowledge of the debtor;

e. the difficulty in finding a replacement to fulfill the responsibilities of the employees to which the KERP applies;

f. whether the KERP agreement and charge were approved by the board of directors, including the independent directors, as the business judgment of the board should not be ignored;

g. whether the KERP agreement and charge are supported or consented to by secured creditors of the debtor; and

h. whether the payments under the KERP are payable upon the completion of the restructuring process.

Grant Forest Products Inc., Re, 57 C.B.R. (5th) 128 (Ont. S.C.J. [Commercial List]) at para. 8-24 [*Grant Forest*]; Book of Authorities, Tab 21.

Canwest Publishing Inc./Publications Canwest Inc., Re supra, at paras 59; Book of Authorities, Tab 16.

Canwest Global Communications Corp., Re supra, at para. 49; Book of Authorities, Tab 1.

Timminco Ltd., Re (2012), 95 C.C.P.B. 48 (Ont. S.C.J. [Commercial List]) at paras. 72-75; Book of Authorities, Tab 22.

92. The purpose of a KERP arrangement is to retain key personnel for the duration of the debtor's restructuring process and it is logical for compensation under a KERP arrangement to be deferred until after the restructuring process has been completed, with "staged bonuses" being acceptable. KERP arrangements that do not defer retention payments to completion of the restructuring may also be just and fair in the circumstances.

Grant Forest Products Inc., Re, supra at para. 22-23; Book of Authorities, Tab 21.

93. The Applicants submit that the KERP Charge is warranted and necessary, and that it is appropriate in the present circumstances for this Honourable Court to exercise its jurisdiction and grant the KERP Charge in the amount of CAD $3 million, given:

a. the KERP was developed by Cinram with the principal purpose of providing an incentive to the Eligible Employees, the Eligible Officers, and the Aurora Employees to remain with the Cinram Group while the company pursued its restructuring efforts;

b. the Eligible Employees and the Eligible Officers are essential for a restructuring of the Cinram Group and the preservation of Cinram's value during the restructuring process;

c. the Aurora Employees are essential for an orderly transition of Cinram Distribution's business operations from the Aurora facility to its Nashville facility;

d. it would be detrimental to the restructuring process if Cinram were required to find replacements for the Eligible Employees, the Eligible Officers and/or the Aurora Employees during this critical period;

e. the KERP, including the KERP Retention Payments, the KERP Transaction Payments and the Aurora KERP Payments payable thereunder, not only provides appropriate incentives for the Eligible Employees, the Eligible Officers and the Aurora Employees to remain in their current positions, but also ensures that they are properly compensated for their assistance in Cinram's restructuring process;

f. the senior secured creditors affected by the charge have been provided with notice of these CCAA proceedings; and

g. the KERP has been reviewed and approved by the board of trustees of Cinram Fund and is supported by the Monitor.

Bell Affidavit, paras. 236-239, 245-247; Application Record, Tab 2.

(E) Consent Consideration Charge

94. The Applicants request the Consent Consideration Charge over the Charged Property to secure the Early Consent Consideration. The Consent Consideration Charge is to be subordinate in priority to the Administration Charge, the DIP Lenders' Charge, the Directors' Charge and the KERP Charge.

95. The Courts have permitted the opportunity to receive consideration for early consent to a restructuring transaction in the context of CCAA proceedings payable upon implementation of such restructuring transaction. In *Sino-Forest Corp., Re*, the Court ordered that any noteholder wishing to become a consenting noteholder under the support agreement and entitled to early consent consideration was required to execute a joinder agreement to the support agreement prior to the applicable consent deadline. Similarly, in these proceedings, lenders under the First Lien Credit Agreement who execute the Support Agreement (or a joinder thereto) and thereby agree to support the Proposed Transaction on or before July 10, 2012, are entitled to Early Consent Consideration earned on consummation of the Proposed Transaction to be paid from the net sale proceeds.

> *Sino-Forest Corp., Re, supra*, Initial Order granted on March 30, 2012, Court File No. CV-12-9667-00CL at para. 15; Book of Authorities, Tab 23. Bell Affidavit, para. 176; Application Record, Tab 2.

96. The Applicants submit it is appropriate in the present circumstances for this Honourable Court to exercise its jurisdiction and grant the Consent Consideration Charge, given:

> a. the Proposed Transaction will enable the Cinram Business to continue as a going concern and return to a market leader in the industry;
>
> b. Consenting Lenders are only entitled to the Early Consent Consideration if the Proposed Transaction is consummated; and
>
> c. the Early Consent Consideration is to be paid from the net sale proceeds upon distribution of same in these proceedings.
>
> Bell Affidavit, para. 176; Application Record, Tab 2.

Application granted.

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TAB
“12”

2012 ANNREVINSOLV 9

Annual Review of Insolvency Law
Editor: Janis P. Sarra

9 — Section 11.4 CCAA and Beyond: A "Critical" Look at
Critical Supplier Orders and the Payment of Pre-Filing Claims

Section 11.4 CCAA and Beyond: A "Critical" Look at Critical Supplier Orders and the Payment of Pre-Filing Claims

Steven D. Dvorak and Helen M. E. Sevenoaks [*]

I. — Introduction

When an insolvent company seeks protection from its creditors under the *Companies' Creditors Arrangement Act* ("*CCAA*")[2] in an attempt to reorganize its affairs, the debtor often faces challenges in securing the ongoing supply of goods and services. Suppliers may be unwilling to deal with the debtor without the payment of pre-filing invoices, or without the arrangement of favourable payment terms. This has the potential to jeopardize the debtor's ability to continue its operations, the going concern value of the debtor's enterprise, and the restructuring as a whole.

In an attempt to remedy these difficulties, the courts, relying on their inherent jurisdiction, developed innovative tools to facilitate the continued supply of essential goods and services during the restructuring process. The primary approach was to grant orders directed at the third party suppliers, compelling them to continue to deal with the debtor, while providing for immediate payment (cash on delivery, or "COD") on any post-filing supply, payment of all or a portion of the pre-filing invoices, the creation of a charge against the debtor's assets, or some combination thereof. While this *ad hoc* approach was well-recognized and routinely invoked, it lacked uniformity in application, and generated uncertainty for debtors, creditors and suppliers.

The introduction of section 11.4 of the *CCAA* in the 2009 legislative amendments codified various parts of this past practice, providing for the designation of a supplier as a critical supplier, obliged to continue supplying on directed terms, with the protection of a court-ordered charge or security ("critical supplier charge").[3] Despite this enactment, the post-amendment decisions demonstrate that there remains some confusion and inconsistency surrounding the treatment of critical suppliers. In particular, there has been inconsistency in: (i) the determination of the scope of section 11.4 of the *CCAA*, including the test for the designation of critical supplier status, the nature and extent of the obligation to supply on credit, and the adequacy of the critical supplier charge; and (ii) the payment of pre-filing debt to suppliers. This paper considers these issues, focussing on recent case law to illustrate the uneven application of section 11.4 of the *CCAA*, and offering suggestions for the treatment of critical suppliers in conformity with the purpose and intent behind the 2009 amendments.

II. — The Importance of Suppliers

The continued supply of goods and services is essential to the restructuring of an insolvent company. It is not enough to obtain a stay of proceedings that prevents creditors from taking steps to enforce claims against the debtor's assets; steps must also be taken to ensure that the debtor is able to continue carrying on its business.[4]

In most situations, the debtor relies on the supply of goods and services from its suppliers in order to satisfy customer requirements and to preserve its going concern value. It is equally common that the supplier is willing to continue

supplying goods and services to the debtor in order to preserve the value of its own business, mitigating potential pre-filing losses through the profit margin earned on post-filing sales and the imposition of COD terms.

In certain instances, the goods and services provided by suppliers are so integral to the debtor's business that any interruption of supply could have an immediate material adverse impact upon the debtor's operations. This is particularly notable in cases where the debtor is unable to quickly re-source goods from another supplier, [5] holds very little inventory, [6] or operates in an industry where the timely provision of products and services is essential to remaining a competitive enterprise. [7] Access to necessary goods and services may be further strained by suppliers who threaten to discontinue supplying goods and services under the existing supply agreement unless the outstanding amounts owed at the commencement of the insolvency proceeding are paid in full. Therefore, it is fundamental that the debtor has access to mechanisms that safeguard the continued supply of goods and services in order to preserve the going concern value of the business and to facilitate an effective restructuring for the benefit of all stakeholders.

III. — Critical Suppliers under the CCAA

A. — Approach Prior to the 2009 CCAA Amendments

Prior to the introduction of section 11.4 of the *CCAA* in the 2009 legislative amendments, *CCAA* initial orders commonly reflected the necessity for the continued supply of goods and services to the debtor, by providing that counter parties with existing service or supply agreements were restrained from terminating, suspending or modifying such agreements during the stay period. While the initial orders addressed the continuing supply challenge of the debtor, they often failed to address the liquidity crisis that would permit the debtor, absent a debtor in possession ("DIP") credit facility, to pay for such goods and services on accelerated payment terms. In fact, sections 11.01 and 34(4)(a) prohibited the court from granting an order: (i) preventing the supplier from requiring immediate payment for goods and services; or (ii) requiring the supplier to further advance credit to the debtor company. This limitation was invoked in the case of *Air Canada*, [8] wherein the court held that section 11.01 entitled a critical supplier to require advance payment of the contract price for post-filing supply of goods and services.

Given the foregoing provisions of the *CCAA*, it was incumbent upon the debtor and supplier to achieve negotiated payment terms for the ongoing supply of goods and services. Such payment terms might provide for COD, cash in advance ("CIA") or the posting of cash deposits equivalent to potential exposure arising from post-filing supply.

Prior to the 2009 legislative amendments, the *CCAA* failed to provide suppliers with any additional protection for their exposure in the restructuring process beyond that provided in section 11.01 of the *CCAA*. Nevertheless, on some occasions, the courts had been willing to provide suppliers with court ordered charges over certain property of the debtor. In the case of *Molson Canada v. O-I Canada*, [9] the court, relying on its inherent jurisdiction, provided unpaid suppliers a charge over the debtor's assets for goods and services supplied throughout the restructuring period. The court concluded that such a charge was consistent with the provisions of the *CCAA* stipulating that post-filing suppliers should be paid in the ordinary course for goods and services supplied. In the case of *Westar Mining*, [10] the court granted a charge over the debtor's property to protect suppliers who were prepared to extend post-filing credit, enabling the debtor to continue operating without interruption. Forward thinking decisions such as these laid the foundation and served to incubate the legislative amendments that included the critical supplier provisions outlined in section 11.4 of the *CCAA*.

B. — Introduction of Section 11.4 of the CCAA: Legislative Intent

The extensive amendments to the *CCAA* in 2009 codified various practical measures, described in the case of *Kerr Interior Systems* [11] as the "creative use of authority" and "judicial innovation", routinely undertaken by the courts to fulfill their mandate in restructuring scenarios. The introduction of section 11.4 of the *CCAA*, [12] which provides for the designation of a "critical supplier", with an obligation to supply, is recognition of the courts' historical practice. The relevant provisions are as follows:

> 11.4 (1) Critical supplier — On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring a person to be a critical supplier to the company if the court is satisfied that the person is a supplier of goods or services to the company and that the goods or services that are supplied are critical to the company's continued operation.
>
> (2) Obligation to supply — If the court declares a person to be a critical supplier, the court may make an order requiring the person to supply any goods or services specified by the court to the company on any terms and conditions that are consistent with the supply relationship or that the court considers appropriate.
>
> (3) Security or charge in favour of critical supplier — If the court makes an order under subsection (2), the court shall, in the order, declare that all or part of the property of the company is subject to a security or charge in favour of the person declared to be a critical supplier, in an amount equal to the value of the goods or services supplied under the terms of the order.
>
> (4) Priority — The court may order that the security or charge rank in priority over the claim of any secured creditor of the company. [13]

The rationale for the introduction of section 11.4 of the *CCAA* was outlined in the Industry Canada *Clause by Clause Briefing Book* [14] as follows:

> Companies undergoing a restructuring must be able to continue to operate during the period. On the other hand, suppliers will attempt to restrict their exposure to credit risk by denying credit or refusing services to those debtor companies. To balance the conflicting interests, the court will be given the authority to designate certain key suppliers as "critical suppliers". The designation will mean that the supplier will be required to continue its business relationship with the debtor company but, in return, the critical supplier will be given security for payment.
>
> Subsection (1) provides that a court may designate a supplier to the debtor company to be a critical supplier. The designation should not be lightly granted but should only be made where the supplier is of such a nature that the debtor company would not be able to continue to operate without a continuing business relationship.
>
> Subsection (2) provides that a court may require a critical supplier to continue to supply goods and services to the debtor company. The court will have the authority to determine the appropriate terms and conditions of the business relationship; however, the court should look to the existing terms or, if necessary, the prevailing market terms.
>
> Subsection (3) stipulates that the court must provide the critical supplier with a security charge for the value of the goods or services supplied as a critical supplier. The provision is to ensure that the critical supplier is paid for its goods or services.
>
> Subsection (4) provides the court with the ability to determine the priority of the security charge. It is expected that the court will recognize the uniqueness of this situation and grant the critical supplier a high priority.

The Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals, in their 2002 Report on Bill C-55 ("BILR Task Force Report") which led to the legislative amendments of 2009, made the following recommendations regarding critical suppliers:

> 17. Provide that during the reorganization if there is no readily available alternative source of reasonably equivalent supply, then in order to prevent hostage payments the court has jurisdiction, on notice to the

> affected persons, to order any existing critical suppliers of goods and services (even though not under pre-filing contractual obligations to provide goods or services) to supply the debtor during the reorganization proceedings on normal pricing terms so long as effective arrangements are made to assure payment for post-filing supplies. [15]

Aside from these two documents, it is difficult to find any substantive government reports, studies or debates regarding the legislative intent behind the introduction of section 11.4. This has led Jacob Ziegel, among other academics, to argue that the amendments were "seriously flawed because neither of the amendments received the serious scrutiny needed ... and, for the most part, received no scrutiny at all but were simply rubber stamped." [16] The Canadian Bar Association also raised its concerns regarding the scrutiny of amendments, noting that the amendments had "been passed without the relevant Parliamentary Committees having the opportunity to conduct extensive review of the Bills". [17]

Despite this, recent case law has attempted to cast light on the objectives of section 11.4. In the case of *Canwest Publishing*, [18] Pepall J noted that section 11.4 has a twofold purpose: (i) to codify the authority to permit suppliers who are critical to the continued operation of the company to be paid; and (ii) to require the granting of a charge in circumstances where the court is compelling a person to supply. In the case of *Northstar Aerospace*, Brown J also noted that section 11.4 of the *CCAA* codified the practice of declaring a person to be a critical supplier and granting a charge on the debtor's property in favour of such critical supplier. [19]

In most cases, the courts are granting critical supplier orders conforming to the twofold legislative purpose of section 11.4 of the *CCAA*. In the case of *Priszm Income Fund*, the court designated five categories of targeted supplies to be "critical" within the meaning of section 11.4 of the *CCAA*, and granted a critical suppliers' charge ranking behind the administrative charge. [20] In the case of *Catalyst*, [21] the court designated 16 suppliers to be critical suppliers, protected by a charge ranking behind both the administrative charge and DIP lender charge.

However, in other instances the courts have broadened the application of the legislative provisions and applied section 11.4 as a tool to authorize the payment of pre-filing debt to critical suppliers. In the case of *Brainhunter*, [22] the court held that section 11.4 authorized the payment of pre-filing amounts to critical suppliers. The debtor was in the business of providing human resources and operated in large through umbrella agreements with respective clients. Each time a contracting staffing client retained the services of an individual contractor, the contractor issued invoices to the debtor for the work performed for the client. The debtor then paid the contractor and billed the client. Since the debtor received payment from their clients after they paid their contractors, the debtor argued that an order permitting the payment of pre-filing amounts was necessary to ensure the continued provision of services from the contractors to the debtor and prevent the potentially significant harm that could follow if payments were not made.

While it is permissive for the court to authorize the debtor to make payments in connection with pre-filing debt, it is our view that, under the current regime, section 11.4 is not the authoritative basis for such a practice. Rather, section 11.4 strictly deals with post-filing situations, compelling a "critical supplier" to continue supplying goods and services on directed terms. Belanger also adopts this view, noting that section 11.4 does not, expressly or implicitly, make reference to the authority to pay pre-filing amounts. [23] Furthermore, the critical supplier provisions should not be confused with the US concept of "critical vendor doctrine." In Chapter 11 proceedings, the US Bankruptcy Court may grant the debtor in possession authority to settle and pay pre-petition debt to vendors whom the debtor deems vital to its continued business operations. [24]

Nevertheless, as Pepall J conceded in the case of *Canwest Publishing*, the scope of section 11.4 is somewhat unclear. [25] As a result there is a demand to carefully consider: (i) the legislative intent; (ii) the relationship with section 34 and section 11.01; and (iii) the practical implications for suppliers, debtors and the restructuring process as a whole. The following sections will address the various components of section 11.4, relying upon recent case law for illustration.

C. — The Test for Designating a Supplier as a "Critical Supplier"

On an application by the debtor pursuant to section 11.4(1), the court may declare a person to be a critical supplier. [26] In determining the critical supplier designation, the court must be satisfied that the debtor has adduced satisfactory evidence that the nature of the goods and services supplied are critical to its continued operation through the restructuring process. The recent cases of *Priszm Income Fund* [27] and *Catalyst* [28] suggest that the courts will adopt a pragmatic, contextual approach, looking at whether the nature of supply is critical in fact to the debtor's operations. The categories of potential critical suppliers are not limited, and the threshold for designation appears to be relatively low. With the exception of the unusual decision in *Cow Harbour* [29] in which only creditors having a builder's lien claim under Alberta legislation were deemed critical suppliers, and eligible for payment of pre-filing debts, the authors are not aware of any reported decisions in which a supplier has not been ruled to be "critical" to the applicant debtor's operations.

i. — Priszm Income Fund

In the case of *Priszm Income Fund*, the debtors, a group of restaurant companies across seven provinces, filed for and obtained relief under the *CCAA*. [30] The court granted an initial order that provided for, *inter alia*, the designation of five categories of critical suppliers within the meaning of section 11.4. The initial order required that the suppliers within the designated categories continue supplying on terms and conditions consistent with existing arrangements and past practice. The court also granted a critical suppliers' charge over the property of the debtor as security for the payment for goods and services supplied after the date of the initial order.

In determining whether the targeted suppliers were critical in fact, Morawetz J noted that the debtor companies were entirely reliant on their: (i) ability to prepare, cook and sell their products by an uninterrupted flow of product (chicken supplier category and other food supplier category); (ii) assess the quantity and nature of their inventory (information technology supplier category); (iii) ensure the timely provision of waste disposal (waste disposal category); and (iv) access various utilities (utilities supplier category). [31] As a result, the court held that any interruption by the critical suppliers could have an "immediate material adverse impact" on the debtors' business and cash flow. [32]

ii. — Catalyst

In the case of *Catalyst*, the debtor companies brought an application to amend the provisions of the initial order with respect to certain suppliers. [33] Pursuant to section 11.4, Catalyst sought an order declaring 16 of its suppliers to be critical suppliers, and therefore obligated to provide goods or services to Catalyst on credit terms. The targeted suppliers questioned whether, as a matter of law, a supplier with an ongoing supply obligation, which could not be terminated or amended under the initial order, could be declared a critical supplier under section 11.4. The suppliers argued that the policy behind the enactment of section 11.4 of the *CCAA* was the doctrine of necessity, and that its use should therefore be restricted to situations where the court had no alternative but to compel a person to deal with the debtor company against its will. This situation, they argued, did not meet that limited criteria as the targeted suppliers were already obligated to deal with the debtor pursuant to existing supply agreements. This situation, they asserted, should be dealt with under section 11.01 (which would have entitled them to immediate payment for any post-filing supply).

The court ruled that the goods and services provided by the 16 suppliers were essential to the continuing operation of the debtor company, and could not be replaced in any practical way by alternative suppliers. The court determined that unless the company was able to obtain supply from the critical suppliers, there was no realistic prospect of a successful reorganization. In the result, the court directed that the suppliers continue to furnish credit to Catalyst upon terms consistent with their respective pre-filing arrangements.

iii. — Analysis

In both the cases of *Priszm Income Fund and Catalyst*, the suppliers declared as "critical" had existing supply agreements with the debtor that could not be terminated or amended pursuant to section 34 and the continuation of services provisions in the initial orders. Despite this, the critical supplier orders were granted since the targeted suppliers were held to be critical in fact. Is this an appropriate use of section 11.4?

It is the authors' view that, based upon the plain language of section 11.4, and the existence and effect of section 11.01, critical supplier status should be restricted to circumstances of demonstrated necessity. We suggest that the application of section 11.4 should be limited to two broad circumstances. The first is: (i) where there is an existing supply relationship between the debtor and the supplier premised on a course of conduct or other informal supply arrangement (not contractually bound); (ii) the supplier's continued involvement is established to be critical in fact to the debtor's restructuring efforts; and (iii) the supplier is unwilling to supply goods and services to the insolvent company. In such instances, it may be deemed necessary to compel the unwilling supplier to supply the debtor with goods and services by designating it as a critical supplier upon such terms as the court sees fit. This view is endorsed by Belanger,[34] and is consistent with the stated objectives of section 11.4.

The second appropriate use of section 11.4, as demonstrated in the case of *Catalyst*, is: (i) where there is a contractual relationship between the debtor and the supplier; (ii) the supplier's continued involvement is established to be critical in fact to the debtor's restructuring efforts; (iii) the supplier requires (demands) payment on COD or CIA terms (as permitted under section 11.01); and (iv) the debtor is unable to satisfy such payment requirements as a result of insufficient liquidity or other reasonable grounds. Although this view may be seen as defeating the purpose of section 11.01, and conscripting the critical supplier as a *de facto* DIP lender, we conclude that the requirement to preserve the continued operation and the going concern value of the debtor's business for the larger stakeholder community may necessitate the application of section 11.4, and the subjugation of section 11.01.

In our view, the "rubber stamped" legislative amendments to the *CCAA* in 2009 did not consider the interplay between these two legislative provisions, creating the ambiguity identified by counsel in the case of *Catalyst*:[35] section 11.4 and section 11.01 are mutually exclusive on the simple logic that both cannot apply concurrently. However, there will frequently be circumstances where the existence of an ongoing supply contract will coexist with a debtor's inability to pay post-filing accounts from cash flow, and inadequate DIP credit funds. In such circumstances, the court must have recourse to a broad array of tools, including the ability to compel continued supply, accompanied by appropriate protection in the form of a court-ordered charge. As a result, we agree with the conclusion of the court in *Catalyst* that section 11.4 should prevail over section 11.01 in instances where the targeted supplier is determined to be critical in fact, the supplier has demanded accelerated payment terms, and the debtor can demonstrate an inability to fund immediate post-filing supply payments through cash flow or a DIP credit facility.

On a final note, even in instances where the debtor and supplier have negotiated favourable payment terms under the existing supply agreement for the continued supply of goods and services during the post-filing period, a supplier may pursue designation as a "critical supplier" to take advantage of a court-ordered charge or security to "boot strap" its position. We argue that the designation of critical supplier status must focus on the needs of the debtor and its stakeholders at large, not the supplier, and that accordingly such an approach should be discouraged. It is only the adequacy assessment of the critical suppliers' charge under sections 11.4(3) and 11.4(4) that takes into account the position of supplier. Accordingly, section 11.4(1) should be confined to applications brought by the debtor.

iv. — Notice and Comeback Hearings

Under section 11.4(1), the debtor company is required to give notice to secured creditors likely to be affected by the security or charge. This of course is sensible: a party holding a priority position must be aware of any proposed charges that would subordinate its position, and be granted an opportunity to voice its concerns. However, we suggest that section 11.4(1) should be interpreted broadly to include all parties who could be subjected to court-ordered charges, including the DIP lender, parties protected by an administrative charge and even the Attorney General of Canada or specified provinces where the critical suppliers charge may achieve priority over the claims for unpaid source deductions, GST

or PST, wages and pension amounts. [36] While most counsel follow this practice, ensuring that all potentially affected parties are notified of the application, it is not strictly required under the current legislation.

We further suggest that section 11.4(1) applications should not be heard without notice to the targeted supplier. As the critical supplier order may impose an obligation to supply goods and services on credit terms, increasing the supplier's financial exposure, it is reasonable for the targeted supplier to be given the opportunity to: (i) state its position with respect to the purported critical nature of its supply (and the existence of alternatives available to the debtor); (ii) lead evidence on its own ability to withstand the exposure to continued financial risk and delayed payment and (iii) ensure that the protection afforded by a charge or security is adequate to mitigate its exposure. This view was also endorsed in the BILR Task Force Report, noting that, after filing, the debtor should not obtain additional credit from any person, including a supplier or a lender, without first giving the person appropriate notice of the proceeding. [37]

In cases where short notice of the critical supplier application has been given, it is appropriate to require an early comeback hearing, preferably well in advance of the initial 30 day stay date, to permit fulsome arguments for and against the continuation of the order. In the case of *Catalyst*, since the monitor's reports indicated that the debtor's cash flow would likely improve within weeks of the initial order, the court granted leave to any critical supplier to apply to amend or rescind the terms of the critical supplier order. [38] The court ordered that the onus of establishing the necessity of continuing the critical supplier order would rest with Catalyst, and directed the monitor to disclose to the critical suppliers such financial information as the monitor deemed necessary to assist the critical suppliers in assessing their position. [39] This approach is reasonable as the critical supplier would not otherwise have access to post-filing information that is available to other parties, including the DIP lender (while unwillingly serving in a similar capacity to the DIP lender).

v. — Obligation to Supply Credit

The obligation to supply credit to an insolvent debtor raises obvious policy concerns regarding the role that critical suppliers should be expected to play in restructuring proceedings.

In the case of *Catalyst*, the suppliers' right not to be forced to grant further credit to the insolvent debtor and their ability to require COD or CIA terms was at stake. [40] Catalyst argued that its cash flow was not sufficient to permit it to make payments to its suppliers on a COD or CIA basis, as would be required under section 11.01, and that the court should grant the order on terms that required the extension of credit, but with the protection of a courtordered charge against specified assets. The suppliers argued that such an order would be contrary to the purpose of section 11.4, that section 11.01 governed, and that Catalyst should obtain any necessary funding to address its cash flow concerns through its DIP lender, which was a volunteer in that role, was being paid a significant fee (including payment of any professional fees), and had demanded a risk-based interest rate for lending to an insolvent business.

The court accepted Catalyst's argument that its cash flow and DIP credit facility were insufficient to pay its suppliers in advance, and that the extension of limited credit by its vendors, consistent with credit terms contained in their existing supply arrangements was necessary to ensure Catalyst's ongoing operations. The court placed significant emphasis upon the monitor's cash flow projections and recommendations in making this determination. The court recognized that the critical suppliers were not volunteers, and further that it would not be appropriate to expose them to any material risk of loss for post-filing accounts. For that reason, the court granted a charge equal to 130% of the total credit to be extended by the critical suppliers, set the interest rate on any outstanding balance at a rate equal to that charged by the DIP lender, plus 2% *per annum*, and awarded each critical supplier costs fixed at $15,000, payable forthwith, in recognition of the need to involve counsel in this process.

At the comeback hearing, five critical suppliers brought an application to set aside or terminate the rights of the debtor under the critical supplier order. Counsel for the critical suppliers argued the underlying conditions for the continuation of the order did not exist, and in particular that the debtor and its DIP lender could arrange adequate liquidity to pay out the critical suppliers' charge and begin paying the critical suppliers on a COD or CIA basis. The applicants argued

that they had been conscripted as "involuntary DIP lenders" to Catalyst, and that the requisite necessity to invoke this extraordinary relief did not exist. The critical suppliers argued that they should not be obligated to participate in the financial risk of Catalyst's restructuring process, beyond the amounts incurred pre-filing.

Having reviewed updated cash flow statements, and with the benefit of the monitor's recommendations for the continuation of the critical supplier order, the court held that the debtor could not absorb, within the existing DIP facility, the financial impact of a termination of the critical supplier order without a material risk of exceeding its available liquidity, with all of the deleterious consequences inherent in such circumstance. It is also likely that the timing of the critical suppliers' application, which essentially coincided with the plan approval process, was a factor in the court's decision to simply continue the established regime to avoid any unnecessary or unwarranted distractions at that crucial time.

As an aside, it is worth noting that, with the assistance of the monitor, Catalyst was able to achieve a negotiated settlement with a number of the critical suppliers through the targeted payment of limited pre-filing debt. This blunted the collective desire of the critical suppliers to fully challenge the critical supplier order, and was an effective, practical approach that demonstrated the art of managing multiple and diverse supplier interests during a difficult restructuring process.

The case of *Catalyst* illustrates the court's willingness to impose involuntary post-filing risk on third parties where it is deemed necessary and appropriate during the restructuring process. As already noted, the court's approach leads us to the conclusion that, under the current regime, section 11.4 will trump section 11.01 when it is demonstrated that the supply is critical in fact to the nature of the debtor's business, and there is no ability to pay in advance or on delivery. This is, we suggest, a sensible position. That said, in instances where the critical supplier is compelled to extend credit, incurring greater financial risk, it is imperative that the protection afforded to the critical supplier by the court, by way of a charge or security pursuant to section 11.4(3), is adequate to mitigate such financial risk. What should we consider to be "adequate" security in relation to a conscripted supplier's risk? The following section addresses this issue.

vi. — Critical Suppliers' Charge

The language of section 11.4(3) is mandatory, stipulating that the court shall provide the designated critical supplier a charge or security for the value of the goods or services being supplied during the post-filing period. However, the court has the discretion under section 11.4(4) to determine both the quantity and priority of the critical suppliers' charge.

In keeping with the policy behind the enactment of section 11.4, the court should be prepared to grant a charge that is of sufficient value to: (i) minimize the overall financial exposure faced by the critical supplier; (ii) provide comfort to the critical supplier that payment for its goods and services will be achieved; and (iii) reflect the extraordinary nature of the order granted.

When exercising its jurisdiction to grant a charge in favour of the critical supplier, it is fundamental that the court consider the adequacy of the charge, in terms of quantum, quality and priority. The qualitative issue was raised in the *Catalyst* case.[41] In exchange for supplying goods and credit to a maximum aggregate total of $14 million to the insolvent company, each critical supplier was granted a charge that ranked (*pari passu*) behind the administrative charge (of $1.5 million) and a DIP charge (of $170 million) against specified assets, and in second priority position against a second, specified set of assets.

In terms of the value of the assets supporting the charge, the court accepted the monitor's observation that the book value was in excess of $1 billion, and concluded that the critical suppliers were fully secured for any postfiling accounts. At the comeback hearing, the critical suppliers argued that the liquidation value of the assets securing their charge was questionable, and that the debtor had failed to establish that adequate security had been provided. They noted in particular that following the granting of the charge, Catalyst's board had taken a voluntary write down of approximately one third of the value of the charged assets. This, they reasoned, suggested that the book value of the charged assets was not a reliable indicator of value, and that additionally it did not take into account the risk of environmental and

other factors that could reduce the net realizable value of their security. Without requiring any independent or expert evidence of the liquidation value of these assets, the court continued to rely upon the estimates offered by the monitor in holding that the charge provided adequate protection for any exposure arising from the order after satisfaction of the administration charge and the forecast amount owing on the DIP facility at a specified future date. Further, the court noted that both the restructuring plan and a related back-up asset purchase agreement called for the payment of all *CCAA* court ordered charges in full.

The *Catalyst* case highlights the number and complexity of the variables that must be considered by the court in considering the adequacy and ranking of a court ordered critical suppliers' charge. As considered by the court in *Catalyst*, the liquidation value of the encumbered debtor property (underpinned by probable and hypothetical assumptions regarding value and timing of events) and the time frame for realisation under the *CCAA* plan (underpinned by future events that are far from certain) exponentially increase the complexity of the courts' consideration of the adequacy and ranking of the critical suppliers' charge. In addition to the foregoing, in instances where the critical suppliers' charge is subordinated to the DIP lender charge, the administrative charge, or other charges it has created to facilitate the restructuring, the court must consider both the projected amounts that will be secured by such charges and the net liquidation value of the charged assets before satisfying itself that the critical suppliers' charge will be adequate in the event of a failed *CCAA* process.While the critical suppliers argued that Catalyst should be obligated to produce recent evidence as to the net liquidation value of the security, it is our view that such a requirement would be both impractical and an improvident investment in the fast-moving setting of a restructuring proceeding. The courts are alive to the concern, and will make judgments on the best available evidence. Terms providing the critical suppliers with timely access to meaningful financial information, and liberty to apply for reconsideration where their risk is materially altered, should form part of every critical supplier order, as should an award of substantial indemnity for any anticipated costs associated with the administration of the order.

D. — Payment of Pre-Filing Claims to Suppliers Under the CCAA

In *CCAA* proceedings, the general rule is that any pre-filing amounts the debtor company owes to unsecured creditors are subject to compromise in the eventual plan of arrangement, and paid out on a *pari passu* basis.

However, in some cases suppliers may refuse to continue supplying goods or services in an attempt to leverage their position, seeking to force the debtor to pay all or part of its pre-filing obligations. Although the *CCAA* contains no express language to authorize such payments, the courts have occasionally permitted the payment of pre-filing amounts to a person whose goods and services are deemed critical, or to prevent the restructuring process from being thwarted by such suppliers.

In permitting or facilitating the payment of pre-filing claims, courts have historically relied upon their broad discretion and inherent jurisdiction under section 11 of the CCAA.[42] In the pre-amendment case of *Air Canada*[43] the court approved a settlement between Air Canada and Lufthansa that provided for the payment of Lufthansa's pre-filing claims, on the basis that the relationship between Air Canada and Lufthansa was so unique and beneficial to Air Canada that the court considered it to be essential to Air Canada's future success. The court reasoned that payment of the pre-filing amounts would so substantially enhance the position of Air Canada that the payment would be in the best interests of all stakeholders, even though it might reduce their present recovery from Air Canada's assets.

Since the introduction of section 11.4 in 2009, the courts have continued to allow the payment of pre-filing obligations to certain critical suppliers. In the case of *Cinram International*, Morawetz J observed that there is ample authority supporting the court's general jurisdiction to permit payment of pre-filing obligations to persons whose services are critical to the ongoing operations of the debtor company, and concluded that such jurisdiction was not ousted by section 11.4.[44]

In determining whether to grant approval for the payment of pre-filing obligations, *Cinram International* indicates that the court will consider a number of factors, including:

(i) whether the goods and services were integral to the business of the debtor;

(ii) the debtors' dependency on the uninterrupted supply of the goods or services;

(iii) the fact that no payment would be made without the consent of the monitor;

(iv) the monitor's support and willingness to work with the debtor to ensure that payments to suppliers in respect of pre-filing liabilities are minimized;

(v) whether the debtor had sufficient inventory of the goods on hand to meet their needs; and

(vi) the effect on the debtor's ongoing operations and ability to restructure if they were unable to make pre-filing payments to their critical suppliers. [45]

Relying on this framework, Morawetz J held that the debtor company required flexibility to ensure adequate and timely supply of required products and to attempt to obtain and negotiate credit terms with its suppliers and service providers. [46] In order to accomplish this, the debtor required the ability to pay certain pre-filing amounts and post-filing payables to those suppliers it considered essential to the debtor's business, as approved by the monitor. The court exercised its jurisdiction and granted the debtor the authority to make pre-filing payments described in the proposed *CCAA* initial order.

The case of *Northstar Aerospace* illustrates the unusual circumstance where the debtor has no choice but to pay the supplier its pre-filing claims. [47] The debtor, a commercial and military aerospace defence company, applied for an order authorizing it to make a payment to Changsha, a supplier located in China that threatened to discontinue supplying further material to the debtor unless two pre-filing invoices were paid, despite being subject to the critical supplier provisions of the *CCAA* initial order.

In granting an order permitting the payments to Changsha, Brown J applied the tests set out in *Cinram International*, while additionally recognizing that the supplier was located outside the jurisdiction of the court, making enforcement of the *CCAA* initial order far from a timely or convenient exercise. [48] Therefore, the business reality weighed in favour of granting the order sought in order to ensure the continued operation of the debtor. Brown J acknowledged that in granting the order, the court was rewarding the improper conduct by the critical supplier that has ignored an order of the court, having the effect of countenancing a form of hard-ball queue-jumping. Notwithstanding the benefit gained from the supplier, the overriding need for the continued supply of goods and services to effect a successful restructuring took precedence in this case.

The recent case law indicates the courts are sensitive to the practical necessities of a debtor seeking to pay pre-filing debt to critical suppliers in order to ensure the continued operation of its business. Although this practice enriches certain suppliers, in effect preferring their claims over similarly ranking claims, we submit that this discretion should only be available where it can be demonstrated that the consequences of failing to make such payments can be expected to result in far greater impairment to the interests of the stakeholders at large.

IV. — Conclusion

A. — Issues with the Current Approach

The post-amendment landscape indicates that the treatment of suppliers under the current regime is not wholly synchronized or apt to meet the demands of both debtors and suppliers in a *CCAA* restructuring. The existing framework for the designation of critical supplier status pursuant to section 14(1) gives no clear guidance on threshold requirements needed to be deemed critical in fact. The nature and extent of the obligation to supply on credit remains unclear since section 11.4 is not aligned with sections 11.01 and 34, creating ambiguity over the scope of and interrelationship among

the provisions. The critical supplier charge, although mandatory in prescription, is discretionary in adequacy, leading to potential *de facto* DIP exposure for critical suppliers, as seen in the case of *Catalyst*.[49] Finally, the current regime does not directly address the issue of payment of pre-filing claims to critical suppliers.

The next anticipated round of insolvency reforms presents an opportunity to reflect upon the current law and to resolve the existing difficulties in order to craft a balanced, principled and cohesive approach to the critical supplier regime. In the authors' view, the application of the critical supplier regime must focus on first principles and be consistent with the general objectives of the *CCAA* to ensure that critical supplier orders are measured, fair and limited in their scope and application. The following section contains suggestions as to how these objectives might be achieved.

B. — Recommendations for Reform of the Critical Supplier Rules

The existing provisions distinguish between and set differing rules for suppliers with ongoing supply obligations, and those without. This distinction is without merit. Suppliers that are obligated to provide goods or services to a restructuring debtor, whether as a result of an existing supply obligation or as a result of a critical supplier designation made by the court, should be treated equally. There is no policy basis that would support the current favoured treatment accorded to suppliers with contractual obligations (who under section 11.01 need not grant further credit) and those who do not have contractual supply obligations but are compelled to supply by the court (and under section 11.4 can be compelled to grant credit).

This split treatment should be eliminated in favour of a unified, principled approach, under which suppliers who are essential to the restructuring plan can be compelled to deal with the debtor. This is the result seen in *Catalyst*.[50] However, we suggest that suppliers should only be obligated to extend postfiling credit in the rarest of circumstances. To do otherwise would be to conscript such parties to fill a role that should be undertaken by specialized DIP lenders, whose business it is to analyze the financial risk, determine (with the debtor) an appropriate level for the DIP facility, and establish reporting and lending conditions. Such lenders will extract an appropriate, market-based return for their involvement. To expect involuntary suppliers to fulfill such a role is clearly inequitable: if the debtor cannot obtain sufficient credit from its DIP lender to fund its ongoing operations, including the current payment of post-filing supplier accounts, then why should a court visit this obvious financial risk upon suppliers? This is particularly so where critical suppliers are given inadequate returns for the risk imposed, questionable security for their charges, and no compensation for the costs they incur through this process.

The current approach is open to abuse, and encourages the debtor and DIP lender to treat the suppliers as another source of inexpensive financing, generally with security positions that are subordinate to the DIP charge. If the debtor and DIP lender are compelled to make adequate provisions in their arrangements to deal with post-filing supply costs, the risk of the restructuring effort will be placed where it belongs. The contribution of suppliers should, it is submitted, be limited to their pre-filing claims, which can fairly be said to have been incurred on a voluntary basis.

In an equitable critical supplier regime, only in very limited circumstances of demonstrated necessity would the court compel a supplier to extend post-filing credit. In such instances, the debtor should be required to explain why it was not able to secure adequate DIP funds at first instance (or why its DIP arrangements turned out to be inadequate as the restructuring progressed), and also what alternatives it has considered (including shareholder or existing lender involvement) and why they are not available to address the issue. The fundamental point is that engaging a non-lender to fund the operations of an insolvent entity should be avoided, and only invoked following a deliberate, rigorous process.

In circumstances where the critical supplier is forced to provide credit, the critical supplier charge must be adequate, in terms of quantum, quality and priority. In the authors' view, a critical supplier should be granted a second priority charge, ranking only behind any administrative charge. This high level of priority is warranted as the critical supplier is facing financial exposure that, unlike a DIP lender, it is not being paid to undertake. The charge should also provide for the anticipated costs associated with the administration of the order, including the operation of the credit account

and full indemnity for reasonable legal costs incurred in responding to the critical supplier application and any resulting steps in dealing with the order.

Lastly, just as critical suppliers should not be prejudiced on account of their involvement in the restructuring process, neither should they expect to be preferred. Thus, critical supplier status should not be considered an avenue to enable payment of pre-filing debt, unless actual financial necessity can be established. In this context, necessity means that the designated critical supplier cannot perform its obligations unless it is paid some or all of its pre-filing debt. The use of the critical supplier charge to pay pre-filing debt, as seen in *Cow Harbour*, *Catalyst*, and other cases, must be discouraged. Taking a relaxed approach to the payment of pre-filing debt not only subverts the priority scheme and grants preferred status, thereby diminishing the integrity of the process, it also tends to confuse the courts' analysis as to the proper treatment of a postfiling supply account. To the extent that this concept has been used to indirectly compensate suppliers forced to assume post-filing risk, it is a well-intentioned but misguided approach. It is much preferable that any compensation of critical suppliers be addressed in a transparent, principled manner, and that the court's discretion to permit the payment of pre-filing accounts be restricted to cases of demonstrable necessity.

In summary, the 2009 amendments have not resulted in a cohesive, integrated and predictable system for dealing with the needs of debtors and their critical suppliers. The present legislation has exposed suppliers to unfair and often unnecessary financial risk arising from compelled involvement in the granting of credit. It seems obvious that the parties best situated to consider this risk, and to create a market-based solution, are the debtors and the specialized lenders who voluntarily participate in the restructuring realm. Amendments to the legislation are necessary, both to address the inconsistencies noted among sections 11.01, 11.4 and 34, and to embody the forgoing principles of fairness. However, any amendment to the supplier framework must continue to provide the courts with the necessary degree of flexibility to ensure the various challenges debtors face in securing the ongoing supply of goods and services throughout the restructuring process can be successfully administered.

Footnotes

* Steven D. Dvorak and Helen M. E. Sevenoaks, Bull, Housser and Tupper LLP.

2 *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 [*CCAA*].

3 *Ibid*, s 11.4 *CCAA*.

4 E.P. Shea, "Dealing with Suppliers in a Reorganization", (2008) 37 CBR (5th) 161.

5 *Re Northstar Aerospace*, 2012 ONSC 4546, 2012 CarswellOnt 9721 [*Northstar Aerospace*].

6 See *Re Priszm Income Fund*, 2011 ONSC 2061, 75 CBR (5th) 213, 2011 CarswellOnt 2258 [*Priszm Income Fund*].

7 See *Re Cinram International*, 2012 ONSC 3767, 91 CBR (5th) 46, 2012 CarswellOnt 8413 [*Cinram International*].

8 *Re Air Canada*, 129 ACWS (3d) 21, 47 CBR (4th) 182, 2004 CarswellOnt 643 (Sup Ct J).

9 *Re Molson Canada v. O-I Canada*, [2003] OJ No 556, 2003 CarswellOnt 517 (Sup Ct J); aff'd [2003] OJ No 2328, 2003 CarswellOnt 2226 (CA).

10 *Re Westar Mining Ltd*, 70 BCLR (2d) 6, 14 CBR (3d) 88, [1992] 6 WWR 331 (SC).

11 *Re Kerr Interior Systems Ltd*, 2011 ABQB 214, 79 CBR (5th) 1.

12 The same critical supplier issues can exist in the context of a restructuring under the *Bankruptcy and Insolvency Act*, RSC 1985 c B-3 [*BIA*]. However, no such mirroring provisions exist under the current *BIA* legislative scheme.

13 *CCAA*, *supra* note 1, s 11.4.

14 Corporate and Insolvency Law Policy, *Clause by Clause Briefing Book*, online: Industry Canada <http://www.ic.gc.ca/eic/site/cilp-pdci.nsf/eng/cl00865.html?#p 10>.

15 See the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals ("CAIRP") Bankruptcy and Insolvency Law Reform Task Reports, online: CAIRP <http://www.cairp.ca/publications/submissions-to-government/law-reform/index.php> [BILR Taskforce Report].

16 J Ziegel, "Canada's Dysfunctional Insolvency Reform Process and the Search for Solutions" (2010) 26 BFLR 63.

17 Canadian Bar Association, "Study of the Senate Banking Committee on Bankruptcy and Insolvency Legislation" (2008), online: Canadian Bar Association <www.cba.org/cba/submissions/pdf/08-16-eng.pdf>.

18 *Re Canwest Publishing Inc/Publications Canwest*, 2010 ONSC 222, 63 CBR (5th) 115, 2010 CarswellOnt 212 [*Canwest Publishing*].

19 *Northstar Aerospace*, *supra* note 4.

20 *Priszm Income Fund*, *supra* note 5.

21 PricewaterhouseCoopers, *Catalyst Paper Corporation Court Orders*, online <http://www.pwc.com/ca/en/car/catalyst-paper-corporation/court-orders.jhtml> [*Catalyst*].

22 *Re Brainhunter*, [2009] OJ No 5207, 2009 CarswellOnt 7627 (Sup Ct J) [*Brainhunter*].

23 P Belanger, "Critical Suppliers: What Does Section 11.4 CCAA Mean?" (2010) 26 BFLR 1.

24 See *In re CoServ LLC*, 273 BR 487 (Bkrtcy ND Tex 2002); see *In re Kmart*, 291 BR 818 (ND Ill 2003); for a useful summary on critical vendor doctrine see Belanger, *supra* note 22.

25 *Canwest Publishing*, *supra* note 17.

26 *CCAA*, *supra* note 1.

27 *Priszm Income Fund*, *supra* note 5.

28 *Catalyst*, *supra* note 20.

29 *Royal Bank v. Cow Harbour Construction Ltd*, 2011 ABQB 223, 76 CBR (5th) 143, 2011 CarswellAlta 533.

30 *Priszm Income Fund*, *supra* note 5.

31 *Ibid* at paras 31-35.

32 *Ibid.*

33 *Catalyst*, *supra* note 20.

34 Belanger, *supra* note 22.

35 *Catalyst*, *supra* note 20.

36 See *Re Indalex Ltd*, 2011 ONCA 265, 75 CBR (5th) 19; leave to appeal to SCC allowed [2011] SCCA No 274 (at the time of writing this paper, judgment is reserved).

37 See BILR Task Force Report, *supra* note 14, Schedule A at para 13.

38 *Catalyst*, *supra* note 20.

39 *Ibid.*

40 *Ibid.*

41 *Catalyst*, *supra* note 20.

42 *CCAA*, *supra* note 1.

43 *Re Air Canada*, 128 ACWS (3d) 9, 47 CBR (4th) 163, 2003 CarswellOnt 5296 (Sup Ct J).

44 *Cinram International*, *supra* note 6 at para 67, Morawetz J.

45 *Ibid* at para 68.

46 *Ibid* at para 69.

47 *Northstar Aerospace*, *supra* note 4.

48 *Ibid.*

49 *Catalyst*, *supra* note 20.

50 *Ibid.*

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TAB
“13”

2009 CarswellOnt 3657
Ontario Superior Court of Justice [Commercial List]

Eddie Bauer of Canada Inc., Re

2009 CarswellOnt 3657, [2009] O.J. No. 2647, 179 A.C.W.S. (3d) 47, 55 C.B.R. (5th) 33

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF EDDIE BAUER OF CANADA, INC. AND EDDIE BAUER CUSTOMER SERVICES INC. (Applicants)

Morawetz J.

Heard: June 17, 2009
Judgment: June 24, 2009
Docket: 09-8240-CL

Counsel: L.J. Latham, F.L. Myers, C.G. Armstrong for Applicants
A. Kauffman for Rainier Holdings LLP
A. Cobb for Bank of America
M.P. Gottlieb for RSM Richter Inc.

Subject: Insolvency

APPLICATION for initial order under s. 11 of *Companies' Creditors Arrangement Act*.

Morawetz J.:

1 On June 17, 2009, I granted an Initial Order under the *Companies' Creditors Arrangement Act* ("CCAA") which provided CCAA protection to Eddie Bauer of Canada, Inc. ("EB Canada") and Eddie Bauer Customer Services Inc. ("EBCS" and, with EB Canada, the "Applicants"), with brief reasons to follow. These are the reasons.

2 The application was not opposed.

3 Having reviewed the Affidavit of Marvin Toland, the Chief Financial Officer of Eddie Bauer Holdings Inc. ("EB Holdings") and a Vice President of EB Canada and EBCS (the "Toland Affidavit") as well as the Report of RSM Richter Inc. ("RSM"), the proposed Monitor of the Applicants (the "RSM Report"), I am satisfied that the Applicants qualify as proper applicants under the CCAA.

4 EB Holdings and Eddie Bauer Inc. ("EB Inc.") (collectively, the "US Debtors") have filed voluntary petitions (the "Chapter 11 Proceedings") for relief under Chapter 11 in the United States Bankruptcy Court for the District of Delaware.

5 The U.S. Debtors and the Applicants are collectively referred to as the "Eddie Bauer Group".

6 EB Canada is a Canadian corporation and EBCS is an Ontario corporation.

7 EB Canada is a wholly-owned subsidiary of EB Inc. which, in turn, is a wholly-owned subsidiary of EB Holdings.

8 EB Canada is located in Vaughan, Ontario and is the main operating company in Canada, focussing on operating the business of Eddie Bauer's 36 retail stores and its one warehouse store in Canada.

9 EBCS is located in Saint John, New Brunswick. EBCS is also a wholly-owned subsidiary of EB Inc., and is therefore an affiliate of EB Canada. EBCS operates a call centre.

10 The Applicants have liabilities in excess of $5 million and have declared themselves to be insolvent.

11 I am satisfied that, based on a reading of the Toland Affidavit and the RSM Report, that the Applicants cannot carry one business independently from the US Debtors.

12 The Toland Affidavit establishes that the Applicants are fully integrated into the US and except for some Canadian-specific functions, all of the "head office" functions are based out of Eddie Bauer's head office in Bellvue, Washington.

13 The principal indebtedness of each Applicant is the inter-company loan that arises between each Applicant and the US Debtors.

14 The Toland Affidavit also establishes that the Applicants depend on financing from EB Inc. to carry on business.

15 The Toland Affidavit also establishes that the primary purpose of the CCAA Proceedings and the Chapter 11 Proceedings (collectively, the "Restructuring Proceedings") is to allow the Eddie Bauer Group the opportunity to maximize the value of its business and assts in a unified, court-supervised sales process.

16 The US Debtors have, subject to necessary Chapter 11 approvals, obtained DIP Financing.

17 RSM understands that the Applicants do not have any secured creditors (with the possible exception of equipment lessors, if any), nor are the Applicants a borrower or guarantor under the US Debtors' Senior Secured Revolving Credit Facility.

18 The Applicants are funded by the US Debtors on an unsecured basis and the obligation is tracked in the inter-company account.

19 The proposed DIP Facility contemplates the US Debtors to advance up to US $7.5 million to the Applicants and US Debtors be granted a charge over the assets of the Applicants limited to the actual amount of inter-company advances.

20 The DIP Facility is predicated on the US Debtors carrying out a Sale Process, which will include the marketing of the businesses and assets of the US Debtors and the Applicants. The Sales Process will be subject to approval by this Court and the US Court. I am satisfied that the proposed DIP Facility is appropriate in the circumstances as is the creation of the Inter-company Charge as described in the Toland Affidavit and the RSM Report.

21 The proposed form of order is based on the Model Order. It provides for other charges as described in the Toland Affidavit and the RSM Report. These charges are the Administrative Charge and the Directors' Charge. I am satisfied that these charges are reasonable in the circumstances.

22 The proposed order also provides that the Applicants shall be entitled but not required to pay amounts owing for goods and services actually supplied to the Applicants prior to the date of the Order. The RSM Report comments on this point. The Eddie Bauer Group is of the view that operations could be disrupted and its vendor relationships adversely impacted if it does not have the ability to pay pre-filing obligations to certain vendors and it further believes that the value of its business will be maximized if it can pay its pre-filing creditors. RSM has reviewed this issue and is supportive of this provision as the Eddie Bauer Group believes it is a necessary provision and the DIP Lenders are supportive of the Restructuring Proceedings. The relief requested in these proceedings is consistent with the relief sought in the Chapter 11 Proceedings. This provision is unusual but, in the circumstances of this case, appears to be reasonable.

23 As previously noted, I am satisfied that the Applicants qualify as debtor corporations within the meaning of the CCAA. They have obligations in excess of the qualifying limit and have acknowledged they are insolvent. The jurisdiction of the court to receive the CCAA application has been established.

24 The Applicants seek an Initial Order under Section 11 of the CCAA. The Statement of Projected Cash Flow and other financial documents required under Section 11(2) have been filed. RSM Richter has consented to act as Monitor. The application was not opposed by any party appearing.

25 I am satisfied that it is appropriate that the Applicants be granted protection under the CCAA and an order shall issue to that effect.

26 The Applicants are fully integrated into the operations of the US Debtors. The Applicants have not filed under Chapter 11. The Applicants do, however, recognized that it is important to coordinate the activities of the Eddie Bauer Group in the two proceedings and, to this end, the Applicants have proposed the adoption of a Cross-Border Insolvency Protocol (the "Protocol") which incorporates by reference the Guidelines Applicable to Court-to-Court Communication in Cross-Border Cases (the "Guidelines").

27 Mr. Toland stated that he believes the Protocol is needed to ensure that: (i) both the CCAA and Chapter 11 Proceedings are coordinated to avoid inconsistent, conflicting or duplicative rulings by the Courts; (ii) all parties of interest are provided with sufficient notice of key issues in both proceedings; (iii) the substantive rights of all parties in interest are protected; and (iv) the jurisdictional integrity of the Court is preserved.

28 I accept the views of Mr. Toland. It seems to me that all parties would be best served if the Protocol is implemented. Accordingly, I approve the Protocol, in substantially the form included in the Application Record. It is recognized, however, that the implementation of the Protocol cannot take effect until such time as the Protocol has also been approved by the US Bankruptcy Court.

29 An order shall issue to give effect to the foregoing.

30 I appreciate the efforts of the parties involved in this process. The detail contained in the Toland Affidavit and the RSM Report was of great assistance to the Court.

Application granted.

TAB
“14”

2007 ANNREVINSOLV 3

Annual Review of Insolvency Law
Editor: Janis P. Sarra

3 — Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters

Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters

Madam Justice Georgina R. Jackson and Dr. Janis Sarra. [1]

I. — Introduction

The judicial tools used by Canadian courts to advance the enabling objectives of corporate commercial law, and in particular, insolvency law, are the focus of this paper. We address the recurring case where an insolvent corporation, creditor or other interested party asks a court to apply or extend the terms of legislation to circumstances not previously contemplated. A number of tools have been used by the courts to meet the evolving needs of corporate commercial law. These tools include: statutory interpretation, both in determining the extent of judicial authority and the basis of any exercise of judicial discretion to decide a particular case or grant a particular remedy; the gap-filling power of judges; the common law or the evolution of the common law to meet modern cases; equitable jurisdiction; and inherent jurisdiction. We examine the nature of these tools and their appropriate use in the insolvency law context.

The paper advances the thesis that in addressing the problem of under-inclusive or skeletal legislation, there is a hierarchy or appropriate order of utilization of judicial tools. First, the courts should engage in statutory interpretation to determine the limits of authority, adopting a broad, liberal and purposive interpretation that may reveal the authority. We suggest that it is important that courts first interpret the statute before them and exercise their authority pursuant to the statute, before reaching for other tools in the judicial toolbox. Examination of the statutory language and framework of the legislation may reveal a discretion, and statutory interpretation may determine the extent of the discretion or statutory interpretation may reveal a gap. The common law may permit the gap to be filled; if it does, the chambers judge still has a discretion as to whether he or she invokes the authority to fill the gap. The exercise of inherent jurisdiction may fill the gap; if it does, the chambers judge still has a discretion as to whether he or she invokes the authority revealed by the discovery of inherent jurisdiction. This paper considers these issues at some length.

In the past 25 years, we have seen a burgeoning interest in the judicial role in the economy. The resolution of commercial disputes through judicial pronouncements has facilitated commercial activity in Canadian society, and the courts' willingness to recognize the need for practical, effective and expeditious proceedings has been a hallmark of recent developments. One of the first Canadian pronouncements to note and speak of this new reality comes from Saskatchewan on an application to lift the stay on a judgment obtained in a contracts case. Tallis J.A. wrote:

> [10] I am of the opinion that recent authorities in Western Canada display a willingness to re-examine the older authorities in the light of modern economic conditions and commercial practices: vide *Rockwood Enterprises Ltd. v. Grain Ins. & Guar Co.*, [1980] M.J. No. 20, [1980] 4 W.W.R. 319; *Powell v. Guttman*, [1977] M.J. No. 3, [1977] 6 W.W.R. 106; *Robitaille v. Vancouver Hockey Club Ltd.*, [1980] B.C.J. No. 872; (1981), 26 B.C.L.R. 1; *Morrison-Knudsen Co. v. B.C. Hydro & Power Authority* (March 15, 1976) (B.C.C.A.) (unreported). [2]

Words similar to these have been repeated in different commercial contexts. In the proceeding under the *Companies' Creditors Arrangement Act*[3] (CCAA) in *Re Canadian Airlines*, Paperny J., as she then was, observed:

> [137] When presented with a plan, affected stakeholders must weigh their options in the light of commercial reality. Those options are typically liquidation measured against the plan proposed. If not put forward, a hope for a different or more favourable plan is not an option and no basis upon which to assess fairness. On a purposive approach to the CCAA, what is fair and reasonable must be assessed against the effect of the Plan on the creditors and their various claims, in the context of their response to the plan. Stakeholders are expected to decide their fate based on realistic, commercially viable alternatives (generally seen as the prime motivating factor in any business decision) and not on speculative desires or hope for the future.[4]

In similar vein, appellate courts have recognized the speed at which commercial courts must act to be of assistance in restructuring cases and have expressed a willingness to defer to the expertise of specialized divisions of the courts. Rosenberg J.A., speaking for the Ontario Court of Appeal in *Algoma Steel Inc. v. Union Gas Ltd.*, expressed it the following way:

> [16] ... Decisions in the CCAA context must often be made quickly. They are, as in this case, usually made by a judge with considerable expertise in the area who has been managing the CCAA proceedings and is intimately familiar with the context and the issues at stake.[5]

The same Court, this time under the pen of Blair J.A., referred again in *Re Stelco Inc.* to the need to defer to the commercial expertise of the trial courts:

> [63] There is no question that the decisions of judges acting in a supervisory role under the CCAA, and particularly those of experienced commercial list judges, are entitled to great deference: see *Algoma Steel Inc. v. Union Gas Ltd.* (2003), 63 O.R. (3d) 78, [2003] O.J. No. 71, ¶16 (C.A.). The discretion must be exercised judicially and in accordance with the principles governing its operation.[6]

This rise of interest and flexibility in commercial matters raises the question of whether there is something unique about commercial law. Professor D.J. Galligan would answer no. It is not a phenomenon unique to commercial law. He writes:

> There is nothing new about courts changing the law, but it has become of particular interest in recent years, since a number of jurists have detected a widespread tendency whereby existing legal doctrines are being replaced by rather loosely defined standards, which are to be applied according to the merits of particular cases. G.H. Treitel has provided a perceptive analysis of this trend in the law of contract, and similar movements can be seen in various aspects of administrative law, the law of evidence, and, undoubtedly, in any area of modern law.[7]

Professor Galligan sees this phenomenon "as part of a general progression within modern legal systems away from clear and certain rules, towards more discretionary decision-making".[8]

Notwithstanding the recognition given to changes in approach in the law, and the courts' willingness to give effect to these changes, the effort by Canadian courts to provide helpful assistance to advance commercial activity and commercial relationships has not been without its growing pains. Specifically, where the court is faced with pleadings, evidence and submissions that point to a particular appropriate result, the courts have sometimes struggled with the basis of their authority where the statute has not expressly addressed an issue. Interpretation of the CCAA is a quintessential example of this practice, although it also occurs to a lesser degree under the *Bankruptcy and Insolvency Act*[9] (BIA) and other insolvency or corporate statutes.

This paper commences an important and timely discussion regarding the need to articulate more clearly the basis for exercising the court's authority in insolvency matters, a debate that will require considerably more discussion before it is fully resolved. In the course of writing this paper, the authors have had lively discussion in respect of the precise contours of the various tools, and in particular, inherent jurisdiction, a conversation that is continuing.

We advance several propositions in this paper that we hope will facilitate a thoughtful debate regarding the exercise of judicial authority in insolvency and other commercial cases. First, we suggest that it may be useful to consider the tools available, as if in a hierarchy, commencing with the need to exhaust the interpretive tools before considering questions of jurisdiction. By determining first whether the legislation can bear a broad and liberal interpretation, judges may avoid the difficulties associated with the exercise of inherent jurisdiction. The statute, appropriately construed, may reveal both a discretionary power and the limits to be placed on that discretion without resort to inherent jurisdiction.

Second, we suggest that inherent jurisdiction is a misnomer for much of what has occurred in decision making under the CCAA. Appeal court judgments in cases such as *Skeena Cellulose Inc.*,[10] and *Stelco*,[11] discussed below, have begun to articulate this view. As part of this observation, we suggest that for the most part, the exercise of the court's authority is frequently, although not exclusively, made on the basis of statutory interpretation.

Third, in the context of commercial law, a driving principle of the courts is that they are on a quest to do what makes sense commercially in the context of what is the fairest and most equitable in the circumstances. The establishment of specialized commercial lists or rosters in jurisdictions such as Ontario, Québec, British Columbia, Alberta and Saskatchewan are aimed at the same goal, creating an expeditious and efficient forum for the fair resolution of commercial disputes effectively and on a timely basis. Similarly, the standards of review applied by appellate courts, in the context of commercial matters, have regard to the specialized expertise of the court of first instance and demonstrate a commitment to effective processes for the resolution of commercial disputes.

Fourth, we suggest that courts need to articulate the basis of their authority in their judgments better, and to be as specific as possible on the source of the authority. It is important to draw a clear distinction between the court's exercise of power pursuant to the statute and the exercise of inherent jurisdiction. Why is it necessary to articulate the basis of power that courts exercise with greater precision? There are several reasons. The courts have sometimes inappropriately conflated inherent jurisdiction and the exercise of judicial discretion in their reasoning, often relying on both grounds of authority in one sentence in rendering a decision in the commercial context. This conflation can create uncertainty for parties in terms of their understanding of the principles or rationale underlying a judgment of the court. In turn, this failure to articulate clearly the source of authority has implications for future cases, particularly where the authority exercised lacks predictability or certainty. Moreover, counsel in subsequent cases may fail to take the time to articulate the authority on which they rely for a particular remedy, given the existence of prior judgments in which the court has failed to articulate the basis of its authority properly.

Courts of first instance need to have a clear understanding of the basis of the decision, in part because the judgment creates a precedent that other courts will embrace. Even where the statutory framework grants the court discretionary powers, the use of precedent narrows the scope of the court's discretion in future cases through the desire to create consistency and certainty in the case law — a narrowing that will be enforced by an appellate court in an appropriate case notwithstanding the characterization of the decision as being discretionary, as discussed in Part III below.

The failure to pin down precisely the basis of the exercise of the court's authority has implications for appellate review. Appellate courts are more likely to accord deference to the appropriate exercise of discretion granted under a statute. Where inherent jurisdiction is invoked, appellate courts are more likely to scrutinize the basis of the lower court's authority and whether it advances the principles that have been articulated for the use of inherent jurisdiction as a gap-filling technique.

To accomplish the task of articulating the basis of decision making better, judges must tighten the language they utilize. For example, when judges make a determination pursuant to a statute, they are exercising their power or authority, not their discretion. There may be an element of choice, particularly when the courts are choosing from a range of remedies, but for the most part, their judgment is based on their authority to resolve the dispute and should be articulated as such. This clarity will assist with the transparency and certainty of their decisions, a benefit for the parties before them and of assistance to the appellate court in engaging in any review. This approach means that the court must first examine the statute and construe its terms having regard for all of the statutory interpretive rules applicable. It may be that the object and purpose of the statute confer an implicit power or it may be that there is a gap-filling role to be played in the circumstances. If so, is the court filling the gap through use of the common law or its inherent jurisdiction? Where any of these tools are utilized, the court must draw on the purpose of the statutory regime in order to determine what is fair, just and commercially reasonable in the circumstances. If there is not a gap-filling role, the courts are to apply the law, as the Supreme Court of Canada directed in *GMAC Commercial Credit Corp. — Canada v. TCT Logistics Inc.*, discussed below. [12]

The remainder of this paper explores these ideas using the reasoning by Canadian courts to date, as well as scholarly commentary on the nature and scope of statutory interpretation, inherent jurisdiction, and judicial discretion. Part II introduces statutory interpretation and the gap-filling power of judges. Part III considers judicial discretion flexibly applied in commercial matters. Part IV examines the use of inherent jurisdiction in Canadian insolvency law cases. Finally, Part V concludes with some thoughts about how courts might consider the exercise of their power in the future.

II. — Statutory Interpretation and the Gap-Filling Power of Judges

It is important to commence with a discussion of general principles of statutory interpretation. These principles apply to commercial law cases as much as they do to more directly remedial legislation, yet one does not often see these principles articulated in many commercial law judgments, in part because of the need for expeditious answers to time-sensitive questions, notwithstanding that the principles are frequently the operating principles being applied by the court.

In a paper such as this, one cannot hope to do justice to a review of the major works pertaining to statutory interpretation. We have confined ourselves to citing extensively from two Canadian texts: *Sullivan and Driedger on the Construction of Statutes* [13] and *The Interpretation of Legislation in Canada.* [14] In doing so, we also recognize that we cannot resolve the debate about how courts should construe statutory instruments.

Under-inclusive or skeletal legislation can be addressed in a variety of ways by the courts. It can, for example, be considered as an aspect of the application of Driedger's Modern Principle and purposive legislative construction or as gap-filling as a distinct statutory interpretation technique known to the common law. We will address these in turn.

A. — Driedger's Modern Principle as an Aspect of Purposive Legislative Construction

The first formulation of the Modern Principle taken from the second edition of Driedger's text, and cited most frequently by the Supreme Court of Canada, is this:

> Today there is only one principle or approach, namely, the words of an Act are to be read in their entire context, in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament. [15]

We acknowledge the debate surrounding the ambit and use of the Modern Principle in Canada in respect of whether it is used by the court as a means of finding meaning or as a means to justify the meaning selected; and even as to which of the statements of the Principle govern interpretation in Canada, as discussed by both Professors Sullivan [16] and Côté, [17] and more recently, by Professors Coté and Beaulac. [18] However, it is a discussion we need not enter fully. Our concern is not with ambiguous legislation or legislation whose terms do not accord with its stated or implied objects, where the

controversy is most acute, but rather with legislation that is skeletal, granting broad powers to the courts in general terms. The Modern Principle is a tool for construing such legislation.

The utility of the Modern Principle in construing under-inclusive insolvency legislation is best illustrated by the Supreme Court's support for its formulation in *Rizzo & Rizzo Shoes Ltd.* [19] Canadian courts cite *Rizzo* regularly to aid in the interpretation of all legislation, federal and provincial, but it is useful to remember that *Rizzo* is a case emanating from a failed company seeking resolution in bankruptcy. The application of the Modern Principle to the facts of the *Rizzo* decision demonstrate its usefulness in considering legislation like the BIA and the CCAA.

In *Rizzo* the Court was asked to construe these sections of Ontario's *Employment Standards Act* (ESA): [20]

> 40. —
>
> (1) No employer shall terminate the employment of an employee who has been employed for three months or more unless the employer gives [notice according to a certain schedule] and such notice has expired.
>
> . . . . .
>
> (7) Where the employment of an employee is terminated contrary to this section,
>
> **(a)** the employer shall pay termination pay in an amount equal to the wages that the employee would have been entitled to receive at his regular rate for a regular non-overtime work week for the period of notice prescribed by subsection (1) or (2), and any wages to which he is entitled;
>
> 40a. ...
>
> (1a) Where,
>
> **(a)** fifty or more employees have their employment terminated by an employer in a period of six months or less and the terminations are caused by the permanent discontinuance of all or part of the business of the employer at an establishment;
>
> . . . . .
>
> the employer shall pay severance pay to each employee whose employment has been terminated and who has been employed by the employer for five or more years.

In the case before the Court, the employees lost their jobs because their employer had been put into bankruptcy. The issue was whether the loss of employment caused by the bankruptcy of an employer gave rise to a claim provable in bankruptcy for termination pay and severance pay in accordance with the provisions of employment standards legislation. The Ontario Court of Appeal concluded that the provisions of the ESA could not be interpreted or extended to include employees in such a situation. The Supreme Court of Canada unanimously disagreed.

Iacobucci J., writing for the Court in *Rizzo Shoes*, reaffirmed Driedger's Modern Principle as the best approach to interpretation of the legislation and stated that "statutory interpretation cannot be founded on the wording of the legislation alone". [21] He considered the history of the legislation and the benefit-conferring nature of the legislation and examined the purpose and object of the Act, the nature of the legislation and the consequences of a contrary finding, which he labeled an absurd result. [22] Iacobucci J. also relied on s. 10 of the *Interpretation Act*, which provides that every Act "shall be deemed to be remedial" and directs that every Act "shall accordingly receive such fair, large and liberal construction and interpretation as will best ensure the attainment of the object of the Act according to its true intent, meaning and spirit". [23] The Court held:

> 23 Although the Court of Appeal looked to the plain meaning of the specific provisions in question in the present case, with respect, I believe that the court did not pay sufficient attention to the scheme of the ESA, its object or the intention of the legislature; nor was the context of the words in issue appropriately recognized. I now turn to a discussion of these issues.
>
> . . . . .
>
> 40 As I see the matter, when the express words of ss. 40 and 40a of the ESA are examined in their entire context, there is ample support for the conclusion that the words "terminated by the employer" must be interpreted to include termination resulting from the bankruptcy of the employer. Using the broad and generous approach to interpretation appropriate for benefits-conferring legislation, I believe that these words can reasonably bear that construction.

Thus, in *Rizzo Shoes* we see the Court extending the legislation or making explicit that which was implicit only, as it were, by reference to the Modern Principle, the purpose and object of the Act and the consequences of a contrary result. No reference is made to filling the legislative gap, but rather, the Court is addressing a fact pattern not explicitly contemplated by the legislation and extending the legislation to that fact pattern.

Professor Côté also sees the issue of legislative gaps as part of the discussion of "legislative purpose", which finds expression in the codification of the mischief rule by the various Canadian interpretation statutes.[24] The ability to extend the meaning of the provision finds particular expression when one considers the question posed by him: "can the purposive method make up for lacunae in the legislation".[25] He points out, as does Professor Sullivan, that the courts have not provided a definitive answer, but that for him there are two schools of thought.[26] One draws on the "literal rule", which favours judicial restraint, whereas the other, the "mischief rule", "posits correction of the text to make up for lacunae".[27] To temper the extent of the literal rule, Professor Coté states:

> *First, the judge is not legislating by adding what is already implicit. The issue is not the judge's power to actually add terms to a statute, but rather whether a particular concept is sufficiently implicit in the words of an enactment for the judge to allow it to produce effect, and if so, whether there is any principle preventing the judge from making explicit what is already implicit.* Parliament is required to be particularly explicit with some types of legislation such as expropriation statutes, for example.
>
> Second, the Literal Rule suggests that as soon as the courts play any creative role in settling a dispute rather than merely administering the law, they assume the duties of Parliament. But by their very nature, judicial functions have a certain creative component. If the law is silent or unclear, the judge is still required to arrive at a decision. In doing so, he [she] may quite possibly be required to define rules which go beyond the written expression of the statute, but which in no way violate its spirit.
>
> In certain situations, the courts may refuse to correct lacunae in legislation. This is not necessarily because of a narrow definition of their role, but rather because general principles of interpretation require the judge, in some areas, to insist on explicit indications of legislative intent. It is common, for example, for judges to refuse to fill in the gaps in a tax statute, a retroactive law, or legislation that severely affects property rights.[28] [Emphasis added. Footnotes omitted.]

This reasoning has particular significance when one considers the CCAA, which will be discussed more fully later in this paper.

As Professor Sullivan indicates, "[t]he modern principle emphasizes the importance of purposive analysis in statutory interpretation".[29] She goes on to say "[a]n important use of purposive analysis is to help establish the scope of the powers

and discretions conferred by statute on government officials and agencies as well as independent bodies and tribunals". [30] She cites *Bell Canada v. Canadian Radio-Television & Telecommunications Commission* for this proposition. [31] In *Bell Canada*, the Court found that the power to make revisions and the power to order rebates are a necessary adjunct to the power to make interim orders. [32] Much of what courts do in insolvency law cases is determine the scope of their own powers and that of the officers they appoint. Purposive analysis can help determine that scope.

Professor Côté observes that the application by the courts of the mischief rule is on the increase while the grammatical method is on the decline. [33] He places the discussion in historical context and also explains the present approach in terms of Driedger's "one principle" of statutory interpretation:

> In the sixteenth and the seventeenth centuries, the purposive method, then known as "equitable interpretation", was well accepted. The Mischief Rule of *Heydon's Case* gave the judge wide latitude to adjust the statute to the circumstances of each case. It attributed little moderating effect to the text itself. In the eighteenth century, theories of strict interpretation led to an extremely prolix drafting style. Associated with the doctrine of parliamentary sovereignty and the separation of legislature and judiciary, this phenomenon led to the blossoming of literal interpretation, and its ascendancy throughout the nineteenth century. Since then, the purposive approach has been revived, at the expense of the grammatical method. The pendulum seems now to be about midway between the two. As Professor Driedger wrote:
>
> > To-day there is only one principle or approach, namely, the words of an Act are to be read in their entire context in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act and the intention of Parliament. [34]

Quoting Alain-Francois Bisson, Professor Côté states that "all interpretation, whether we realize it or not, is fundamentally oriented towards the purpose of the statute". [35] He lists the factors that help to explain why some courts will favour the spirit of the law in some cases, and the letter of the law in others. [36] In considering insolvency legislation, this observation is pertinent:

> Drafting style can influence the relative weight accorded the letter and the spirit of the law. A meticulous, detailed drafting will by its very nature invite a literal interpretation. The main principles of the statute become difficult to discern. Because the legislature is supposed to have thought of everything, the court is discouraged from adding or removing terms, or speculating about their purpose. *A contrario*, if drafted in general terms, a statute's goals, structure and principles are more accessible. The judge is inspired to cooperate in its implementation. More emphasis is placed on the aim of the legislation.

Professor Côté indicates that the purposive or teleological method, which is what he prefers to call it, may take a variety of forms: (i) to correct obvious material errors; (ii) to remove uncertainty about the meaning of a provision; and (iii) to limit or extend the meaning of a provision. [37]

B. — The Common Law "Gap-filling" Power

Whereas Professor Côté in his text considers gap-filling as an aspect of purposive interpretation, [38] Professor Sullivan discusses gap-filling in a separate chapter entitled "Plausible Meaning, Mistakes and Gaps". [39] She would see a distinction between giving legislation a broad interpretation and gap-filling. [40] Professor Sullivan suggests that there is no general jurisdiction to fill gaps in legislative schemes, but it is a tool the courts resort to in certain circumstances. [41] She divides the cases into: (i) decisions where the judicial response has been "courts have no jurisdiction to disregard the intentions of the legislation, however ill-considered these intentions may be" and "courts have no jurisdiction to cure under-inclusive provisions or gaps in legislative schemes"; [42] and (ii) decisions where courts have chosen to "supplement

under-inclusive provisions by relying on the common law, including, in particular, their inherent jurisdiction". [43] In taking this second route, courts give effect to the principle: "if an activity has been subjected to regulation by the legislature, courts are obligated to make the scheme work". [44]

Professor Sullivan mentions what she calls the "new, more co-operative approach" as articulated by Lord Denning dissenting in *Magor and St. Mellons Rural District Council v. Newport Corp.*: [45]

> We do not sit here to pull the language of Parliament and of Ministers to pieces and make nonsense of it. That is an easy thing to do, and it is a thing to which lawyers are too often prone. We sit here to find out the intention of Parliament and of Ministers and carry it out, and we do this better by filling in the gaps and making sense of the enactment than by opening it up to destructive analysis.

She observes that the attitude expressed in this passage is echoed by Canadian courts, and cites as an example, *Air Canada v. British Columbia*, a taxation powers case. [46] Professor Sullivan indicates that judges do not always articulate the basis on which they are filling a legislative gap, but when judges fill gaps, they will either do so expressly or they will invoke the common law, and in particular the inherent jurisdiction of courts, to supplement under-inclusive legislation or otherwise fill gaps. [47]

When one consults the other major Canadian statutory interpretation text, there is no consideration of inherent jurisdiction at all, let alone as a gap-filling technique. [48] Indeed, the words "inherent jurisdiction" cannot be found in the index. The civilist's approach to filling gaps is outlined thusly:

> Approaching the question of filling lacunae is different in civil law. At common law, when a judge refuses to fill the void of a statute, it is implicitly understood that the situation not covered by the statute is to be resolved through the *jus commune*, which is the common law. However, in Québec the *Civil Code* and the *Code of Civil Procedure* constitute, for their respective subject matters, elements of the *jus commune*. If a strict interpretation was to be afforded them, situations which are not expressly foreseen might fall into the proverbial "judicial void". Evidently, it is expected of a judge to interpret a civil law provision so as to fill these gaps either by the analogous extension of the rules it contains or by recourse to principles induced from specific provisions of the codes. Indeed, the Preliminary Provision of the *Civil Code* recommends that interpreters apply the Code by referring to the general principles of law and by not limiting themselves to the letter of the law, but also seeking its spirit and object. [49]

By way of contrast, a gap-filling power has long been recognized by the common law. In 1972, the Ontario Court of Appeal discussed the scope of authority under the Ontario *Judicature Act* [50] and its relationship to the court's general jurisdiction in the context of deciding whether the court is empowered to order an assignment expunged from the vendor's title upon the vendor furnishing adequate security in lieu of the assignment: [51]

> *As a superior Court of general jurisdiction, the Supreme Court of Ontario has all of the powers that are necessary to do justice between the parties. Except where provided specifically to the contrary, the Court's jurisdiction is unlimited and unrestricted in substantive law in civil matters.* In *Re Michie Estate and City of Toronto et al.*, [1968] 1 O.R. 266 at pp. 268-9, 66 D.L.R. (2d) 213 at pp. 215-6, Stark, J., after considering the relevant provisions of the *Judicature Act* and the authorities, said:
>
> > *It appears clear that the Supreme Court of Ontario has broad universal jurisdiction over all matters of substantive law unless the Legislature divests from this universal jurisdiction by legislation in unequivocal terms.* The rule of law relating to the jurisdiction of superior Courts was laid down at least as early as 1667 in the case of *Peacock v. Bell and Kendall* (1667), 1 Wms. Saund. 73 at p. 74, 85 E.R. 84:

> ... And the rule for jurisdiction is, that nothing shall be intended to be out of the jurisdiction of a Superior Court, but that which specifically appears to be so; and, on the contrary, nothing shall be intended to be within the jurisdiction of an Inferior Court but that which is so expressly alleged.
>
> . . . . .
>
> In addition, and of importance, is that the justice of the situation requires a cause such as this will not fail for want of a remedy ...
>
> . . . . .
>
> In my view, s. 19(1) of the *Judicature Act*, R.S.O. 1970, c. 228, gives to the Court jurisdiction to make a mandatory order, even though interlocutory, directed to a party to the action if it is just and convenient to do so and in this way to require the defendants here to do such acts as may be necessary as to effectively remove the assignment in question from the title to the lands. Here the defendants seek to invoke the Court's equitable jurisdiction by asserting a claim for lien against the lands to secure the return of the moneys which they have paid. [52] [Emphasis added.]

It may be that with the increased codification in statutes, courts have lost sight of their general jurisdiction where there is a gap in the statutory language. Where there is a highly codified statute, courts may conclude that there is less room to undertake gap-filling. This is accurate insofar as the Parliament or Legislative Assembly has limited or directed the court's general jurisdiction; there is less likely to be a gap to fill. However, as the Ontario Court of Appeal observed in the above quote, the court has unlimited jurisdiction to decide what is necessary to do justice between the parties except where legislators have provided specifically to the contrary.

The court's role under the CCAA is primarily supervisory and it makes determinations during the process where the parties are unable to agree, in order to facilitate the negotiation process. Thus the role is both procedural and substantive in making rights determinations within the context of an ongoing negotiation process. [53] The court has held that because of the remedial nature of the legislation, the judiciary will exercise its jurisdiction to give effect to the public policy objectives of the statute where the express language is incomplete. [54] The nature of insolvency is highly dynamic and the complexity of firm financial distress means that legal rules, no matter how codified, have not been fashioned to meet every contingency. Unlike rights-based litigation where the court is making determinations about rights and remedies for actions that have already occurred, many insolvency proceedings involve the court making determinations in the context of a dynamic, forward moving process that is seeking an outcome to the debtor's financial distress. [55]

C. — Conclusions to be Drawn with respect to Statutory Interpretation

The exercise of a statutory authority requires the statute to be construed. The plain meaning or textualist approach has given way to a search for the object and goals of the statute and the intentionalist approach. This latter approach makes use of the purposive approach and the mischief rule, including its codification under interpretation statutes that every enactment is deemed remedial, and is to be given such fair, large and liberal construction and interpretation as best ensures the attainment of its objects. This latter approach advocates reading the statute as a whole and being mindful of Driedger's "one principle", that the words of the Act are to be read in their entire context, in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament. It is important that courts first interpret the statute before them and exercise their authority pursuant to the statute, before reaching for other tools in the judicial toolbox. Statutory interpretation using the principles articulated above leaves room for gap-filling in the common law provinces and a consideration of purpose in *Québec* as a manifestation of the judge's overall task of statutory interpretation. Finally, the jurisprudence in relation to statutory interpretation demonstrates the fluidity inherent in the judge's task in seeking the objects of the statute and the intention of the legislature.

III. — Judicial Discretion as a Means of Filling the Gap

There can be no more chameleon concept in law than judicial discretion. Its meaning is variable and derived almost exclusively from context; but despite its myriad meanings and purposes, judicial discretion is another tool to be considered when addressing the fact pattern of under-inclusive or skeletal legislation. The *Oxford Companion to Law* gives the most common definition of discretion, building on it to define "a question of judicial discretion":

> *Discretion.* The faculty of deciding or determining in accordance with circumstances and what seems just, fair, right, equitable, and reasonable in those circumstances. Rules of law frequently vest in a judge the power or duty to exercise his [her] discretion in certain circumstances, sometimes if he [she] finds certain requisites satisfied, and sometimes a discretion within stated limits only.
>
> A question of judicial discretion is accordingly a question not determined, like a question of fact, by evidence, nor one determined, like a question of law, by authorities and argument, but one determined by an exercise of moral judgment. In cases where the discretion has long been vested in judges there is, however, a strong tendency for the ways in which judges have exercised their discretion to be reported and for subsequent judges to exercise their discretion consistently with the ways in which it has been exercised in the past, so that the discretion comes to become, not unfettered, but limited by precedents.
>
> Vesting discretionary power in judges is one of the commonest ways of individualizing the application of law and making it flexible and adaptable to circumstances; without it law would much more often be criticized as harsh, unfeeling, and unjust. [56]

If one considers the judge's task, on the way to arriving at a decision, to be the determination of the facts and the law, and then an application of the law to the facts, the exercise of discretion is not any of this, but is yet a further dimension. A question of judicial discretion is not determined by evidence, as a matter of fact might be, or by argument, as a matter of law, but rather by an exercise of "moral judgment". The judge must of course determine the facts and the law, but then after having done so, in a case that asks for the exercise of discretion, the judge applies reason and discernment, expressed in this definition as an exercise of "moral judgment". It is not our contention that parties are at the mercy of the individual moral judgments of a particular judge when discretion is exercised. Rather, the moral judgment exercised in discretionary decisions is constrained by articulation of principled grounds for its exercise in prior decisions of the courts, in appellate review decisions and, depending on the nature of the case, the equities of the parties and the dictates of fairness. In commercial relations, certainty must also play a role. [57]

Aharon Barak, Chief Justice of Israel, echoes the difficulty in defining judicial discretion:

> [Defining judicial discretion] is by no means an easy task, for the term *discretion* has more than one meaning, and indeed means different things in different contexts. Some authors have despaired of analyzing it and recommended against using the term. Yet we must reject this advice because the concept of discretion is central to an understanding of the judicial process. [58]

He continues:

> To me, discretion is the power given to a person with authority to choose between two or more alternatives, when each of the alternatives is lawful. Justice Sussman referred to this definition, saying, "Discretion means freedom to choose among different possible solutions". Hart and Sacks offered a similar definition: "Discretion means the power to choose between two or more courses of action each of which is thought of as permissible". Judicial discretion, then, means the power the law gives the judge to choose among several alternatives, each of them being lawful. ...

. . . . .

> Discretion assumes the freedom to choose among several lawful alternatives. Therefore, discretion does not exist when there is but one lawful option. In this situation, the judge is required to select that option and has no freedom of choice. No discretion is involved in the choice between a lawful act and an unlawful act. The judge must choose the lawful act, and he [she] is precluded from choosing the unlawful act. Discretion, on the other hand, assumes the lack of an obligation to choose one particular possibility among several. Discretion assumes the existence of several options, of which the judge is entitled to choose the one that most appeals to him [her]. In the words of Justice Cardozo,
>
> > Other cases present a genuine opportunity for choice — not a choice between two decisions, one of which may be said to be almost certainly right and the other almost certainly wrong, but a choice so nicely balanced that when once it is announced, a new right and a new wrong will emerge in the announcement.
> >
> > Thus, discretion assumes a zone of possibilities rather than just one point. It is founded on the existence of a number of options that are open to the judge. ...
> >
> > The zone of lawful options may be narrow, as when the judge is free to choose between only two lawful alternatives. Or the range of lawful options may be considerable, as when the judge stands before many lawful alternatives and combinations of alternatives. In this sense one may distinguish between narrow and broad discretion. This distinction, of course, is only relative. [59] [Footnotes omitted.]

See, too, this observation by McLachlin J., as she then was:

> Discretion may best be defined as the power to make a decision that cannot be determined to be right or wrong in any objective way ... Lord Diplock put it well in a recent case when he said:
>
> > The very concept of administrative discretion involves a right to choose between more than one possible course of action upon which there is room for reasonable people to hold differing opinions as to which is to be preferred.
>
> It would not be incorrect to say that discretion involves the creation of rights and privileges, as opposed to the determination of who holds those rights and privileges. [60]

This is also the sense of discretion reflected in the judgment of Richard C.J. of the New Brunswick Court of Appeal in *Doiron v. Haché*:

> *To exercise discretion means to choose between two or more reasonable options. The choice must be made considering the applicable law and guiding principles and on a proper understanding of the facts.* Where the facts are misapprehended and the error is an overriding factor in the exercise of the discretion such that the foundation for the option chosen no longer exists, then an injustice has been done. [61] [Emphasis added.]

In *Doiron*, the statement of choice was articulated in the context of dismissing an appeal on the basis of the standard of review as it relates to discretionary orders.

But we see in other contexts, the contrary analysis. Sharpe J., as he then was, writes:

> My basic argument is that it is wrong to infer from the flexibility of many doctrines applicable in commercial cases that there is a judicial discretion in the sense that the decision-making function can be accurately

> described as choosing from a range of equally acceptable results. I suggest that judicial choice is constrained in that the judge is duty bound to find the result that best comports with identifiable legal rules and principles. In making this argument, I do not pretend to engage in philosophical speculation on the nature of law or the extent to which it is or is not indeterminate, although I readily concede that debate has an impact on my subject. I speak rather from the perspective of a trial judge, attempting to articulate the legitimate expectations of litigants who come before our courts and the standards I believe our legal regime imposes upon those charged with the responsibility of deciding. In other words, I am attempting to state what I believe to be the working hypothesis of the legal regime and the standard for decision-making to which judges should aspire. [62]

As an ethical exhortation no one can take issue with this statement: Judges must strive to reach the decision that takes into account all the appropriate factors and that arrives at the most correct decision. For much of what judges do in deciding cases, there will be one decision that is more correct than the alternatives. It is also easy to think of all discretionary decisions as attracting the same appellate deference and to forget that over time many so-called discretionary decisions begin to follow a certain pattern and, thereby, are less a matter of discretion and more an application of established precedent. Consider, for example, the case of *Wong v. Lee* [63] where a discretionary rule developed by the common law was under consideration.

The issue in *Wong* was whether the rule in *Tolofson v. Jensen*, [64] which admitted an exception for exceptional cases, and therefore conferred a discretion on a trial judge to say that the law of the forum rather than the law of the accident governs, had been correctly applied. All were agreed that the Supreme Court of Canada had created a "discretion" in that a judge "may" not apply the *Tolofson* rule in exceptional cases, but as a matter of application, the majority of the Court of Appeal, without reference to the standard of appellate review regarding discretionary matters, concluded that the trial judge had erred in finding an exceptional case. Does this mean that the trial judge did not have a discretion to decide as he did?

The more probable response is that there are varying types of discretion. Some will be hedged by more factors than others, making it more likely that there is only one true result in such case, which is more akin to Sharpe J.'s theory as in the above quote. But this does not mean that the judge did not have a discretion. It may mean that the choices were narrowed considerably. *Wong* is illustrative of the principle that not all discretionary decisions are of the same nature either in their exercise at first instance or as a matter of appellate review.

If we return to insolvency context and its legislative framework, the s. 11 stay provisions of the CCAA are illustrative. Section 11(1) specifies:

> 11. Powers of court — (1) Notwithstanding anything in the *Bankruptcy and Insolvency Act* or the *Winding-up Act*, where an application is made under this Act in respect of a company, the court, on the application of any person interested in the matter, may, subject to this Act, on notice to any other person or without notice as it may see fit, make an order under this section.

This section has been interpreted as conferring an authority to do many things, and in empowering the court to make orders as it sees fit, s. 11(1) also confers a discretion on the court. The nature of that discretion will depend on the order being sought. The first significant question is, however, does the judge have the authority to do what is asked?

Consider the matter of when a court is asked to order debtor in possession (DIP) financing under the s. 11 CCAA stay provisions. The courts have found authority for granting super-priority financing under both the CCAA and under the proposal provisions of the BIA, even though there is no express authority. [65] Having once found the authority to order DIP financing, a judge then has to decide whether to exercise that power or not as a matter of discretion. The court balances interests, considers relative prejudice and assesses the reasonableness of a particular process, decision or remedy. In finding that the court has jurisdiction to authorize DIP financing under the CCAA, the British Columbia

Court of Appeal held that the effective achievement of the legislation's objectives requires a broad and flexible exercise of jurisdiction to facilitate a restructuring, and the court's equitable jurisdiction permits orders granting super-priority in some circumstances. [66]

The distinction between authority and discretion is of some meaning to the chambers judge, because he or she needs to know what to do. For an appellate judge, the distinction is crucial because the standard of review with respect to a finding of authority and an exercise of discretion is completely different. The first one will attract a standard of correctness and the second one will be considered with the deferential standard accorded to discretionary decisions in mind.

Discretion, in addition to recognizing authority, is a label that invokes a standard of review, or in the words of the Hon. Roger P. Kerans is "a label for non-intervention on functional grounds". [67] Appeal court judges speak in terms of discretionary orders and it can also be a code for not seeing a basis for intervention or that the nature of the case should preclude intervention. [68]

The Canadian standard of appellate review of truly discretionary decisions is based on a definition of discretion theory, which postulates more than one equally valid choice. The standard of appellate review is stated thus:

> The function of an appellate court ... is not to exercise an independent discretion of its own. It must defer to the judge's exercise of his [her] discretion and must not interfere with it merely on the ground that members of the appellate court would have exercised the discretion differently. The function of the appellate court is initially one of review only. It may set aside the judge's exercise of his [her] discretion on the ground that it was based on a misunderstanding of the law or of the evidence before him [her] or on an inference that particular facts existed or did not exist, which, although it was one that might legitimately have been drawn on the evidence that was before the judge, can be demonstrated to be wrong by further evidence that has become available by the time of the appeal, or on the ground that there has been a change of circumstances after the judge made his [her] order. [69]

In light of articulated reasons, the appellate court reviewing a judge's exercise of discretion may find it appropriate to assess the conclusion on this deferential standard.

An example is the Ontario Court of Appeal judgment in *Naneff v. Con-Crete Holdings Ltd.* [70] The case involved the appeal of the remedy granted in an oppression remedy case under the Ontario *Business Corporations Act*. [71] Blair J., when he was on the Superior Court, awarded an oppression remedy to a director/shareholder who had been ousted from the family business because of his lifestyle. He ordered a public sale of the business, allowing both the son and the father that founded the business the opportunity to bid on the company. The Ontario Court of Appeal affirmed the oppressive conduct, but set aside the remedy on the basis that the discretion to grant a remedy, while broad, can only be exercised to rectify the actual oppressive conduct. [72] The Court held:

> The provisions of s. 248(3) give the court a very broad discretion in the manner in which it can fashion a remedy. *Broad as that discretion is, however, it can only be exercised for a very specific purpose; that is, to rectify the oppression.* This qualification is found in the wording of s. 248(2) which gives the court the power, if it finds oppression or certain other unfair conduct, to "make an order to rectify the matters complained of". Therefore, the result of the exercise of the discretion contained in s. 248(3) must be the rectification of the oppressive conduct. If it has some other result the remedy would be one which is not authorized by law.
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> . . . . .
>
> ... Persons who are shareholders, officers and directors of companies may have other personal interests which are intimately connected to a transaction. However, it is only their interests as shareholder, officer

or director as such which are protected by s. 248 of the O.B.C.A. The provisions of that section cannot be used to protect or to advance directly or indirectly their other personal interests.

I conclude, therefore, that the discretionary powers in s. 248(3) O.B.C.A. must be exercised within two important limitations:

(i) *they must only rectify oppressive conduct*

(ii) *they may protect only the person's interest as a shareholder, director or officer as such.*

The law is clear that when determining whether there has been oppression of a minority shareholder, the court must determine what the reasonable expectations of that person were according to the arrangements which existed between the principals. The cases on this issue are collected and analyzed by Farley J. in *820099 Ontario Inc. v. Harold E. Ballard Ltd.* (1991), 3 B.L.R. (2d) 113 at p. 123 (Ont. Gen. Div.); affirmed (1991), 3 B.L.R. (2d) 113 (Ont. Div. Ct.). I agree with his comment at pp. 185-86:

> Shareholder interests would appear to be intertwined with shareholder expectations. It does not appear to me that the shareholder expectations which are to be considered are those that a shareholder has as his own individual "wish list". They must be expectations which could be said to have been (or ought to have been considered as) part of the compact of the shareholders.

The determination of reasonable expectations will also, in my view, have an important bearing upon the decision as to what is a just remedy in a particular case.

. . . . .

It is my view that the first error in principle in this remedy is that it did more than simply rectify oppression. As I noted above, the O.B.C.A. authorizes a court to rectify oppressive conduct. I think the words of Farley J. in *Ballard, supra*, at p. 197 are very appropriate in this respect:

> The court should not interfere with the affairs of a corporation lightly. *I think that where relief is justified to correct an oppressive type of situation, the surgery should be done with a scalpel, and not a battle axe. I would think that this principle would hold true even if the past conduct of the oppressor were found to be scandalous. The job for the court is to even up the balance, not tip it in favour of the hurt party.* I note that in *Explo* [*Explo Syndicate v. Explo Inc.*, a decision of the Ontario High Court, released June 29, 1989], Gravely L.J.S.C. stated at p. 20:

In approaching a remedy the court, in my view, should interfere as little as possible and *only to the extent necessary to redress the unfairness.*

[Italics in original, emphasis added.]

The Court of Appeal held that the remedy imposed constituted an error in principle in that it did more than rectify oppression, and it did more than protect the son's interest as a shareholder as such in the companies as it sought to protect his interest as a family member. [73] The Court ordered the remedy set aside and substituted a remedy whereby the appellant family members acquired all of the shares that the son owned in any of the companies making up the family business at fair market value, without minority discount. [74]

From an appellate perspective, the treatment of the standard of review for discretionary decision-making will vary depending on a variety of factors, including at what stage of the process discretion is being exercised. This is why it is important in extracting a principle from a decision regarding judicial discretion to ask whether the authority or power in question is being exercised:

1. by a trial judge in rendering a final decision;

2. by a chambers judge as a final order;

3. by a chambers judge as an interlocutory order;

4. by an appellate judge sitting in chambers granting leave to appeal or staying a judgment falling into one of the above categories; or

5. by an appellate court deciding whether to intervene in one of the above contexts.

It is also important to assess the kinds of decisions courts classify as discretionary. It stands to reason that decisions that by their nature permit eventual review of the exercise of authority at a later date or that maintain the *status quo* or involve the management of the trial and the pre-trial process are more easily obtainable and less likely to be overturned on appeal. There will be some discretionary decisions for which there are either equally balanced decisions or decisions that will have less significance to the litigation or the litigants, all of which more easily attract the deferential standard. Examples of decisions in the commercial area most likely to be sustained on appeal are: interim appointment of receivers, monitors and other insolvency professionals as officers of the court; Anton Piller orders; and orders that have a come-back clause. Specialized courts or judges must also be factored into the equation. By way of contrast, examples of decisions that are more closely reviewed are: the interpretation of legislation or agreements; application of a priority structure; enforcement of security; determinations that affect parties not before the courts; and decisions that take away rights without a trial or without an examination on *viva voce* evidence. In such cases, a court of appeal will be more likely to intervene for a variety of reasons, including to avoid the spectre of inconsistent results.

One must not overlook the "law-making" powers of appellate courts. Appellate courts will hesitate to interfere with the lower court's exercise of discretion in the interests of timeliness and finality, but there are cases that demonstrate when appellate courts have found it necessary to provide guidance on the manner in which discretion is being exercised in order to reduce uncertainty for parties. [75] In this sense, the statutory framework envisions that appeals will be limited, and the exercise of judicial discretion determines those limited circumstances in which it is important to review the lower court judgment. [76] This approach is evident in Canadian insolvency case law, in terms of the standards for granting leave to appeal judgments, usually only where there are "serious and arguable grounds that are of real and significant interest to the parties". [77] The Ontario Court of Appeal in *Stelco* held that the appellate courts, in the context of a CCAA proceeding, will only grant leave to appeal where such serious and arguable grounds are determined in accordance with a four-pronged test, namely, whether the point on appeal is of significance to the practice; whether the point is of significance to the action; whether the appeal is *prima facie* meritorious or frivolous; and whether the appeal will unduly hinder the progress of the restructuring process. [78]

In *Re Algoma Steel*, the Ontario Court of Appeal made the following observation in respect of cases in which the statutory language requires leave to appeal and where there is a come-back clause set out in the lower court order. The Court commented that due to the often urgent, complex and dynamic nature of CCAA proceedings, appellate courts should be cautious about intervening in the CCAA process: [79]

> 2 Farley J.'s order was an initial order made pursuant to s. 11(3) of the CCAA, on a motion by Algoma. It was made without notice to the Noteholders. The essence of Farley J.'s order was an authorization to Algoma to obtain additional financing ("the DIP Financing") from its existing bank lenders during the 30 day stay period permitted by s. 11(3) of the CCAA. *The purpose of the order was to respond, on an urgent and interim basis, to a serious negative cash flow crisis at Algoma. Indeed, without short-term financial assistance designed to serve as a base for restructuring Algoma's current indebtedness, Algoma might well have had to*

> *cease operations*. The order also gave priorities (which the parties call superpriorities) to the DIP Financing charge and to certain Administration and Directors Charges over the Noteholders' existing security.
>
> . . . . .
>
> 7 In our view, the motion for leave to appeal is premature. Initial orders, made on a without notice basis, are specifically authorized by s. 11(1) of the CCAA. *Proceedings under the CCAA are often urgent, complex and dynamic*. The Algoma proceedings fit that description. Farley J. was faced with complex facts and a difficult decision potentially implicating the closure of one of the largest companies in Ontario. Moreover, he had to make his decision in a very timely fashion. In these circumstances, he recognized that his initial order might not be acceptable to all interested parties, including some of Algoma's creditors. That is why he included a comeback clause in his order and specifically invited parties to resort to it in his endorsement.
>
> 8 The fact that the CCAA provides that an appeal of an initial order is only available with leave indicates that appeals in CCAA proceedings should be limited. *An Appeal Court should be cautious about intervening in the CCAA process, especially at an early stage*. [Emphasis added.]

A consideration of purpose guides trial courts in determining how a statutory discretion should be exercised and is a basis on which an appellate court will assess a trial court's exercise of discretion.[80] Professor Sullivan cites *Canadian Pacific Ltd. v. Matsqui Indian Band* where Lamer C.J. states that in considering whether the trial judge exercised his discretion reasonably, it is important not to lose sight of Parliament's objective and the underlying purpose and functions of the particular tax assessment scheme under consideration.[81] In the area of commercial law, the Court of Appeal in *Stelco* picks up this idea of "purpose" by referring first to the statutory framework of the CCAA, in which the court is authorized by the stay provisions to extend protection to the company during the workout process:

> [32] The CCAA is remedial legislation and is to be given a liberal interpretation to facilitate its objectives: *Babcock & Wilcox Canada Ltd. (Re)*, [2000] O.J. No. 786, 5 B.L.R. (3d) 75, ¶11 (S.C.J.). See also, *Chef Ready Foods Ltd. v. Hong Kong Bank of Canada*, [1990] B.C.J. No. 2384, 4 C.B.R. (3d) 311 (C.A.), at p. 320 C.B.R.; *Re Lehndorff General Partners Ltd.*, [1993] O.J. No. 14, 17 C.B.R. (3d) 24 (Gen. Div.). Courts have adopted this approach in the past to rely on inherent jurisdiction, or alternatively on the broad jurisdiction under s. 11 of the CCAA, as the source of judicial power in a CCAA proceeding to "fill in the gaps" or to "put flesh on the bones" of that Act: see *Re Dylex Ltd.*, [1995] O.J. No. 595, 31 C.B.R. (3d) 106 (Gen. Div. (Commercial List)), *Royal Oak Mines Inc. (Re)*, [1999] O.J. No. 864, 7 C.B.R. (4th) 293 (Gen. Div. (Commercial List)); and *Westar Mining Ltd. (Re)*, [1992] B.C.J. No. 1360, 70 B.C.L.R. (2d) 6 (S.C.).
>
> . . . . .
>
> [36] In the CCAA context, Parliament has provided a statutory framework to extend protection to a company while it holds its creditors at bay and attempts to negotiate a compromised plan of arrangement that will enable it to emerge and continue as a viable economic entity, thus benefiting society and the company in the long run, along with the company's creditors, shareholders, employees and other stakeholders. *The s. 11 discretion is the engine that drives this broad and flexible statutory scheme, and that for the most part supplants the need to resort to inherent jurisdiction.*[82] [Emphasis added.]

The Court concludes that the CCAA stay provision is intended to extend protection to a company while it attempts to negotiate a plan of arrangement that will enable it to emerge and continue as a viable economic entity, thus benefiting society and the company in the long run, along with the company's creditors, shareholders, employees and other stakeholders. The s. 11 discretion is thus broad and flexible under the statutory scheme.[83]

The Court of Appeal went on to hold that the court's discretion under s. 11 of the CCAA is not open-ended and unfettered; rather, it is guided by the objectives and scheme of the *Act* and by the legal principles that govern corporate

law issues. What the court does under s. 11 is establish the boundaries of the playing field and act as a referee in the process. [84] In the course of acting as referee, the court has authority to maintain the *status quo* in respect of an insolvent company while it attempts to gain the approval of its creditors for the proposed compromise or arrangement. [85]

Professor Waddams similarly acknowledges that the word discretion, when used with reference to judicial decision-making, "is neither a simple nor a single concept". [86] He observes:

> ... "Discretion" is sometimes used to indicate that a legal rule has elements of uncertainty; sometimes it refers to a need for restrictions upon rights of appeal in the interests of expedition and finality; sometimes the word refers to a situation where the nature of the decision is such that the initial decision-maker is as likely as a reviewing court to reach a satisfactory conclusion; and sometimes it refers to situations where the initial decision-maker is thought to have a positive advantage in this respect. These concepts are different from each other, and have differing implications for the proper role of appellate tribunals. In many cases more than one concept is in play at the same time, with, it will be suggested, consequent confusion of ideas.
>
> All legal rules, as has always been recognized, contain elements of uncertainty because the circumstances in which the rules come to be applied cannot be precisely foreseen, nor can any rule, however detailed, describe in advance every possible future case. Many important and fundamental legal rules are necessarily very general, and are "open-textured" in nature, or allow for openended exceptions. It is sometimes said of rules of this kind that they are "discretionary". [87]

In the accompanying footnote, Professor Waddams observes "this [referring to open-textured rules or rules that allow for open-ended exceptions] is the meaning generally intended in discussions of judicial discretion" [88] citing Professor Dworkin's text *Taking Rights Seriously*. [89]

The reference to Professor Dworkin takes us to the timeless debate between Professors Hart and Dworkin regarding what has become known as the debate about "Hard Cases", taking its name from an article written by the latter. [90] In *Taking Rights Seriously*, Professor Dworkin takes up this issue:

> Legal positivism provides a theory of hard cases. When a particular lawsuit cannot be brought under a clear rule of law, laid down by some institution in advance, then the judge has, according to that theory, a "discretion" to decide the case either way. His opinion is written in language that seems to assume that one or the other party had a pre-existing right to win the suit, but that idea is only a fiction. In reality he has legislated new legal rights, and then applied them retrospectively to the case at hand. In the last two chapters I argued that this theory of adjudication is wholly inadequate; in this chapter I shall describe and defend a better theory.
>
> I shall argue that even when no settled rule disposes of the case, one party may nevertheless have a right to win. It remains the judge's duty, even in hard cases, to discover what the rights of the parties are, not to invent new rights retrospectively. I should say at once, however, that it is no part of this theory that any mechanical procedure exists for demonstrating what the rights of parties are in hard cases. On the contrary, the argument supposes that reasonable lawyers and judges will often disagree about legal rights, just as citizens and statesmen disagree about political rights. This chapter describes the questions that judges and lawyers must put to themselves, but it does not guarantee that they will all give these questions the same answer. [91]

Professor Hart responds to Professor Dworkin in a postscript to the second edition of his book on *The Concept of Law*:

> The sharpest direct conflict between the legal theory of this book and Dworkin's theory arises from my contention that in any legal system there will always be certain legally unregulated cases in which on some

> point no decision either way is dictated by the law and the law is accordingly partly indeterminate or incomplete. If in such cases the judge is to reach a decision and is not, as Bentham once advocated, to disclaim jurisdiction or to refer the points not regulated by the existing law to the legislature to decide, he must exercise his discretion and make law for the case instead of merely applying already pre-existing settled law. So in such legally unprovided-for or unregulated cases the judge both makes new law and applies the established law which both confers and constrains his law-making powers.
>
> This picture of the law as in part indeterminate or incomplete and of the judge as filling the gaps by exercising a limited law-creating discretion is rejected by Dworkin as a misleading account both of the law and of judicial reasoning. He claims in effect that what is incomplete is not the law but the positivist's picture of it, and that this is so will emerge from his own "interpretive" account of the law as including besides the explicit settled law identified by reference to its social sources, implicit legal principles which are those principles which both best fit or cohere with the explicit law and also provide the best moral justification for it. On this interpretive view, the law is never incomplete or indeterminate, so the judge never has occasion to step outside the law and exercise a law-creating power in order to reach a decision. It is therefore to such implicit principles, with their moral dimensions, that courts should turn in those "hard cases" where the social sources of the law fail to determine a decision on some point of law.
>
> It is important that the law-creating powers which I ascribe to the judges to regulate cases left partly unregulated by the law are different from those of a legislature: not only are the judge's powers subject to many constraints narrowing his choice from which a legislature may be quite free, but since the judge's powers are exercise only to dispose of particular instant cases he cannot use these to introduce large-scale reforms or new codes. So his powers are interstitial as well as subject to many substantive constraints. Nonetheless there will be points where the existing law fails to dictate any decision as the correct one, and to decide cases where this is so the judge must exercise his law-making powers. But he must not do this arbitrarily: that is he must always have some general reasons justifying his decision and he must act as a conscientious legislator would by deciding according to his own beliefs and values. But if he satisfies these conditions he is entitled to follow standards or reasons for decision which are not dictated by the law and may differ from those followed by other judges faced with similar hard cases. [92]

Judges will fall on one side or the other of the debate depending on how they view the judge's role in general, and how they view it in particular cases. One's views on this topic will also affect and be affected by the extent to which one believes a judge's decisions should be insulated from appellate review. If a judge believes that intervention should be limited, the Hartian expression of discretion will be embraced. For others, who believe that intervention is permissible generally, or in a particular case, Professor Dworkin's analysis will be more palatable. No one view prevails, and as it has already been indicated, much depends on the nature of the issue being decided.

Precision in word definition and use is as important here as it is with relying on "inherent jurisdiction", discussed in Part IV below. It is easy to mistake power or authority with discretion and become confused by the use of the word "may" in a statute. [93] Kerans and Willey write:

> **(a) — Confusion of Discretion with Power**
>
> The "discretion" usage arose about 300 years ago. At that time English judges used it to describe judicial power. Thus, for example, an appeal court with the power to order a new trial would, in 1655, refer to that power as a discretion. To a degree, the practice continues today. A judge may say, for example, "I have the discretion to award or deny costs." In this sense, discretion simply means "choice". Or, a court might use the word "discretion" to describe any new statutory power (e.g., a court "may"). In this context, the term "may" contributes more to confusion than it does to certainty. Indeed, judges do not *always* use the word "discretion" to describe a statutory power. We have never heard the power to convict or acquit,

> for example, described as a discretion! Furthermore, some of the powers commonly called discretionary, including many where the statute now says "the judge in his discretion may," were already categorized as such by the courts long before codification by rule or statute.
>
> The usage does not adequately serve as a guide for a standard of review. Of course, first judges have choices about how to decide cases. But any choice may be reviewed, and reversed, by an appeal court. In that event, the only choice is to be right or wrong. On the other hand, if the appeal court decides not to review the first judge's decision, it must be for some reason other than the mere fact that the first judge had a choice. It would be absurd to say: "I will not intervene because the first judge had a choice." It is equally absurd to say, "I will not intervene because the first judge had a discretion." Something more is required. That something is the reason why an appeal court should not intervene.
>
> Justice Barak uses the term to mean "the power given to a person with authority to choose between two or more alternatives, when each of the alternatives is lawful". That supposes that the source of authority, like a constitution or a statute, is cast in such a way that it permits judges at least two ways to decide a case. It is a way to state the law-making rule of judges. It is not very helpful in the context of appellate review, because the function of review is to decide whether to approve the choice made. It does suffice, however, to emphasize the respect for *ad hoc jurisprudence* built into much of the law of appeals.
>
> [Footnotes omitted]

Thus, it can be said that we tend to label too quickly decisions as discretionary. Another common mistake is to speak as though "discretion" and "discretionary decision" have the same juridical consequences.

If we return to our objective of looking for the appropriate tool to address the problem of under-inclusive or skeletal legislation, judicial discretion, in one or more of its forms, is an important tool, but one must understand in what sense one is using it. Is it being used to indicate an authority or a power? Is it being used in the open-textured way as mentioned by Professor Waddams [94] and Newbury J.A. in *Skeena*? [95] Is it being referred to as a means of identifying those decisions that are sheltered from appellate review either for reasons of an expeditious process or because the judge of first instance is considered to be better able to make the decision? Or are we using judicial discretion as yet another means of filling the gap between principle and policy as contemplated in the debate between Professors Dworkin and Hart?

Whether it is the highly codified BIA or the skeletal CCAA, the court has used its authority to make both procedural and substantive decisions that assist the parties in meeting the overall objectives of the legislation. The court will use tests such as fairness, reasonableness, and a weighing of the equities and/or a balancing of prejudice to make determinations regarding when to exercise its discretion. [96]

The exercise of the court's discretion under insolvency and bankruptcy statutes depends on the nature of the judicial function under the particular proceeding; the statutory framework and specific requirements that are implicated in a particular dispute; and a consideration of what is just and reasonable in the circumstances, including a balancing of the interests of, and prejudice to, the stakeholders with an interest in the financially distressed firm. [97]

The courts have observed the need for flexibility at the same time as being cognizant that they are to ensure a timely process and provide certainty to parties with an interest in the proceeding. The courts have held that "'fairness' is the quintessential expression of the court's equitable jurisdiction — although the jurisdiction is statutory, the broad discretionary powers given to the judiciary by the legislation makes its exercise an exercise in equity — and 'reasonableness' is what lends objectivity to the process". [98] The court will weigh the equities that flow from granting or refusing relief in particular circumstances. [99]

Thus, the courts have developed a number of principles articulating the factors they weigh and apply even in the broadest grant of statutory discretion. These principles have developed over time, with the court's aim of providing the parties with consistency and certainty, while upholding the objectives of the legislation. As Professor Waddams has observed, flexibility in the exercise of judicial discretion is desirable; yet at the same time, the court must develop the law on a rational and consistent basis, applying broad principles to particular issues before them. [100] Arguably, that is what the courts have undertaken in insolvency and bankruptcy matters.

The courts have also recognized the public interests underlying insolvency legislation, finding that "the court is assisted in the exercise of its discretion by the purpose of the CCAA: to facilitate the reorganization of a debtor company for the benefit of the company, its creditors, shareholders, employees and in many instances, a broader constituency of affected persons". [101] Consideration of the public interest is one aspect of the court's assessment of the viability and fairness of the proposed plan within the existing statutory scheme of priorities. [102] The court, in exercising its discretion, has held that there is a broader public dimension that must be considered and weighed in the balance, as well as the interests of those most directly affected. [103]

The principles underlying statutory discretion are applied in both the common law and civil law jurisdictions in Canada. For example, the Québec Superior Court in *MEI Computer Technology Group Inc.* held that the CCAA is a remedial statute that is to be given a liberal interpretation to facilitate its objectives, and that in facilitating the achievement of the CCAA's objectives, courts have relied on their inherent jurisdiction or alternatively, on their broad discretion under s. 11 of the CCAA, as the source of judicial power to "fill the gaps" or "put flesh on the bones" of the statute. [104] While the scope for exercise of that discretion may differ in some circumstances, in part because of the degree of codification of Québec's *Civil Code*, the exercise of both statutory discretion and inherent jurisdiction discretion is common to all Canadian jurisdictions.

Hence we turn next to inherent jurisdiction. It is only where broad statutory authority is unavailable that inherent jurisdiction needs to be considered as a possible judicial tool to utilize in the circumstances. In the ordering of judicial tools, it should necessarily come last as a potential source of authority, given that courts are to seek direction on their authority first from the statutes.

IV. — Inherent Jurisdiction as a Gap-Filling Tool

A starting point for a discussion of inherent jurisdiction as a gap-filling tool is I.H. Jacob's article "The Inherent Jurisdiction of the Court", [105] written in 1970 and recognized by the Supreme Court of Canada as the foundational work in the area. [106] I.H. Jacob articulated the importance of a court's inherent jurisdiction:

> ... The jurisdiction which is inherent in a superior court of law is that which enables it to fulfill itself as a court of law. The juridical basis of this jurisdiction is therefore the authority to uphold, to protect and to fulfill the judicial function of administering justice according to law in a regular, orderly and effective manner. [107]

He summarizes its nature in contradistinction to the general jurisdiction of the court, of which it forms a part:

> To understand the nature of the inherent jurisdiction of the court, it is necessary to distinguish it first from the general jurisdiction of the court, and next from its statutory jurisdiction.
>
> The term "inherent jurisdiction of the court" does not mean the same thing as "the jurisdiction of the court" used without qualification or description: the two terms are not interchangeable, for the "inherent" jurisdiction of the court is only a part or an aspect of its general jurisdiction. The general jurisdiction of the High Court as a superior court of record is, broadly speaking, unrestricted and unlimited in all matters of substantive law, both civil and criminal, except in so far as that has been taken away in unequivocal terms

by statutory enactment. The High Court is not subject to supervisory control by any other court except by due process of appeal, and it exercises the full plenitude of judicial power in all matters concerning the general administration of justice within its area. Its general jurisdiction thus includes the exercise of an inherent jurisdiction.

Moreover, the term "inherent jurisdiction of the court" is not used in contradistinction to the jurisdiction conferred on the court by statute. The contrast is not between the common law jurisdiction of the court on the one hand and its statutory jurisdiction on the other, for *the court may exercise its inherent jurisdiction even in respect of matters which are regulated by statute or by rule of court, so long as it can do so without contravening any statutory provision.* There is, nevertheless, an important difference between the nature of the inherent jurisdiction of the court and its statutory jurisdiction. The source of the statutory jurisdiction of the court is of course the statute itself, which will define the limits within which such jurisdiction is to be exercised, whereas *the source of the inherent jurisdiction of the court is derived from its nature as a court of law, so that the limits of such jurisdiction are not easy to define, and indeed appear to elude definition.*

Perhaps the true nature of the inherent jurisdiction of the court is not a simple one but is to be found in a complex of a number of features, some of which may be summarized as follows:

(1) The inherent jurisdiction of the court is exercisable as part of the process of the administration of justice. *It is part of procedural law, both civil and criminal, and not of substantive law; it is invoked in relation to the process of litigation.*

(2) The distinctive and basic feature of the inherent jurisdiction of the court is that it is exercisable by summary process, *i.e.*, without a plenary trial conducted in the normal or ordinary way, and generally without waiting for the trial or for the outcome of any pending or other proceeding.

(3) *Because it is part of the machinery of justice, the inherent jurisdiction of the court may be invoked not only in relation to the litigant parties in pending proceedings, but in relation also to anyone, whether a party or not, and in respect of matters which are not raised as issues in the litigation between the parties.*

(4) *The inherent jurisdiction of the court is a concept which must be distinguished from the exercise of judicial discretion. These two concepts resemble each other, particularly in their operation, and they often appear to overlap, and are therefore sometimes confused the one with the other. There is nevertheless a vital juridical distinction between jurisdiction and discretion, which must always be observed.*

(5) The inherent jurisdiction of the court may be exercised in any given case, notwithstanding that there are Rules of Court governing the circumstances of such case. The powers conferred by Rules of Court are, generally speaking, additional to, and not in substitution of, powers arising out of the inherent jurisdiction of the court. The two heads of powers are generally cumulative, and not mutually exclusive, so that in any given case, the court is able to proceed under either or both heads of jurisdiction. [108] [Emphasis added.]

Finally, he summarizes his views in this conclusion:

It will be seen therefore that the inherent jurisdiction of the court exists as a separate and independent basis of jurisdiction, apart from statute or Rules of Court. *It has developed and now exists not only as a separate independent doctrine from the jurisdiction in contempt, but also from any provision dealing with practice and procedure made by statute or Rules of Court.* It stands upon its own foundation, and the basis for its exercise is put on a different and perhaps even wider footing from the jurisdiction in contempt, namely, to prevent oppression or injustice in the process of litigation and to enable the court to control and regulate its own proceedings. Parliament has now recognized the existence of inherent jurisdiction of the court as a separate doctrine, but has not attempted to define its nature or its limits.

> *In this light, the inherent jurisdiction of the court may be defined as being the reserve or fund of powers, a residual source of powers, which the court may draw upon as necessary whenever it is just or equitable to do so, and in particular to ensure the observance of the due process of law, to prevent improper vexation or oppression, to do justice between the parties and to secure a fair trial between them.* A definition somewhat to this effect may be found in the Indian *Code of Civil Procedure*, which provides
>
> > Nothing in this code shall be deemed to limit or otherwise affect the inherent power of the court to make such orders as may be necessary for the ends of justice or to prevent abuse of the process of the court.
>
> It may be objected that this view of the nature of the inherent jurisdiction of the court postulates the existence of an amplitude of amorphous powers, which may be arbitrary in operation and which are without limit in extent. The answer is that a jurisdiction of this kind and character is a necessary part of the armoury of the courts to enable them to administer justice according to law. *The inherent jurisdiction of the court is a virile and viable doctrine which in the very nature of things is bound to be claimed by the superior courts of law as an indispensable adjunct to all their other powers, and free from the restraints of their jurisdiction in contempt and the Rules of Court, it operates as a valuable weapon in the hands of the court to prevent any clogging or obstruction of the stream of justice.* [109] [Emphasis added.]

While much of this reasoning is significant for our purposes, and is itself a summary, we wish to underscore the following points. First, the source of the inherent jurisdiction of a superior court is derived from its nature as a court of law. Second, a court may exercise its inherent jurisdiction even in respect of matters that are regulated by statute or by rule of court, so long as it can do so without contravening any statutory provision. Third, inherent jurisdiction may be invoked by anyone, whether a party or not, and in respect of matters that are not raised as issues in the litigation between the parties. Fourth, there is a vital juridical distinction between jurisdiction and discretion, which must always be observed. Finally, inherent jurisdiction of the court may be defined as "being the reserve or fund of powers, a residual source of powers, which the court may draw upon as necessary whenever it is just or equitable to do so, and in particular to ensure the observance of the due process of law, to prevent improper vexation or oppression, to do justice between the parties and to secure a fair trial between them". [110]

Master Jacob also states that the inherent jurisdiction of the court "is part of procedural law ... and not of substantive law; it is invoked in relation to the process of litigation". [111] This point has been the subject of recent debate, including at the level of the Supreme Court of Canada, as we will now discuss.

In areas apart from commercial law, the Supreme Court of Canada has embraced the concept of inherent jurisdiction to grant leave to appeal to a non-party; [112] to determine which of two operationally conflicting decisions of an administrative tribunal should take precedence where compliance with one necessitates violation of the other; [113] to grant a required remedy that an arbitrator is not empowered to grant; [114] and as the means to modify or extend the common law in order to comply with prevailing social conditions and values. [115] In this last case, *Hill v. Church of Scientology of Toronto*, the Supreme Court held:

> 83 In emphasizing that the common law should develop in a manner consistent with *Charter* principles, a distinction was drawn between private litigants founding a cause of action on the *Charter* and judges exercising their inherent jurisdiction to develop the common law.
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> . . . . .
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> 91 It is clear from *Dolphin Delivery*, *supra*, that the common law must be interpreted in a manner which is consistent with Charter principles. This obligation is simply a manifestation of the inherent jurisdiction of

> the courts to modify or extend the common law in order to comply with prevailing social conditions and values. As was said in *Salituro*, supra, [[1991] 3 S.C.R. 654] at p. 678:
>
> > The courts are the custodians of the common law, and it is their duty to see that the common law reflects the emerging needs and values of our society.
>
> 92 Historically, the common law evolved as a result of the courts making those incremental changes which were necessary in order to make the law comply with current societal values. The *Charter* represents a restatement of the fundamental values which guide and shape our democratic society and our legal system. It follows that it is appropriate for the courts to make such incremental revisions to the common law as may be necessary to have it comply with the values enunciated in the *Charter*.

More recently, in *Western Canadian Shopping Centres Inc. et al v. Dutton et al* we see this statement:

> 34. *Absent comprehensive legislation, the courts must fill the void under their inherent power to settle the rules of practice and procedure as to disputes brought before them*: *Bell v. Wood*, [1927] 1 W.W.R. 580 at pp. 581-82 (B.C.S.C.); *Langley v. North West Water Authority*, [1991] 3 All E.R. 610 (C.A.); leave denied [1991] 1 W.L.R. 711n (H.L.); *Newfoundland Association of Public Employees v. Newfoundland* (1995), 132 Nfld. & P.E.I.R. 205; W.A. Stevenson and J.E. Côté, *Civil Procedure Guide*, 1996, at p. 4. However desirable comprehensive legislation on class action practice may be, if such legislation has not been enacted, the courts must determine the availability of the class action and the mechanics of class action practice.
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> . . . . .
>
> 44. Where the conditions for a class action are met, the court should exercise its discretion to disallow it for negative reasons in a liberal and flexible manner, like the courts of equity of old. The court should take into account the benefits the class action offers in the circumstances of the case as well as any unfairness that class proceedings may cause. In the end, the court must strike a balance between efficiency and fairness.
>
> . . . . .
>
> 48 To summarize, class actions should be allowed to proceed under Alberta's Rule 42 where the following conditions are met: (1) the class is capable of clear definition; (2) there are issues of fact or law common to all class members; (3) success for one class member means success for all; and (4) the proposed representative adequately represents the interests of the class. If these conditions are met the court must also be satisfied, in the exercise of its discretion, that there are no countervailing considerations that outweigh the benefits of allowing the class action to proceed. [116]

Arguably many of these uses of inherent jurisdiction find their thrust in "procedural law ... and not ... substantive" law to use the words of Master Jacob above quoted, but several involve findings of substantive law or, perhaps, an expression of the court's willingness to use its inherent jurisdiction to modify or extend the common law in order to fill gaps in legislation or otherwise do justice to the parties and to comply with prevailing social conditions and values.

In commercial matters, there has been, at least until recently, a particular willingness at least by trial courts to use inherent jurisdiction to fill gaps in legislation, particularly in restructuring matters. The early history of this exercise of jurisdiction has been gathered elsewhere. [117] Of this early history, we note *Re Westar Mining Ltd.*; [118] MacDonald J. of the British Columbia Supreme Court used inherent jurisdiction to find authority to grant a secured charge to suppliers that continued to supply during a CCAA proceeding to ensure that the company could carry on business pending development of a plan:

> 17. The issue is whether or not those suppliers who are prepared (or have been compelled, between May 14 and June 10) to extend the credit which will hopefully keep the Company operating during the period of

> the stay, should be secured. I have concluded that "justice dictates" they should, and that the circumstances call for the exercise of this court's inherent jurisdiction to achieve that end. (See, *Winnipeg Supply & Fuel v. Genevieve Mortgage Corp.*, [1972] 1 W.W.R. 651 at p. 657 (Man. C.A.).
>
> 18. *The circumstances in which this court will exercise its inherent jurisdiction are not the subject of an exhaustive list.* The power is defined by Halsbury's (4th ed., volume 23, para. 14) as:
>
> > ... the reserve or fund of powers, a residual source of powers, which the Court may draw upon as necessary whenever it is just or equitable to do so ...
>
> 19. *Proceedings under the CCAA are a prime example of the kind of situations where the court must draw upon such powers to "flesh out" the bare bones of an inadequate and incomplete statutory provision in order to give effect to its objects.*
>
> The analogy to the powers and priority which may be granted by the court to a receiver-manager is not necessary to support the exercise of this court's inherent jurisdiction to create the charge in question here. (See, *Lochson Holdings. v. Eaton Mechanical* (1984), 55 B.C.L.R. 54 at pp. 57/8 (B.C.C.A.)). Indeed, different considerations apply. In the receiver-manager cases it is the property which is being safeguarded by the court. *Under the CCAA it is the survival of the company which owns the property, for long enough to present a plan of reorganization, that is the court's concern.* In my view, the three exceptions to the "general rule" discussed in *Lochson Holdings* do not exhaust the circumstances, under the CCAA, in which the court may "authorize expenses for the carrying on of the business".
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> . . . . .
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> 23. *This court "has inherent powers in respect to any matter within its jurisdiction ... and may draw [thereon] to give effect to the provisions of [a] statute".* [119]
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> . . . . .
>
> 25. Whether a reorganization plan for the Company can be successful remains to be seen. In the meantime, this court should do whatever can be done to provide such an opportunity. The importance of the Company's operations to the south-east corner of the province in particular, and to the economy of the province as a whole, justifies that approach. [Emphasis added.]

This reasoning was subsequently endorsed by Farley J. of the Ontario Court of Justice (General Division) in *Re Dylex Ltd.*:

> In the interim between the filing and the approval of a plan, the court has the inherent jurisdiction to fill in gaps in legislation so as to give effect to the objects of CCAA, including the survival program of a debtor until it can present a plan: see *Re Westar Mining Ltd.* (1992), 14 C.B.R. (3d) 88 at pp. 93-4 (B.C.S.C.). [120]

Consistent with this earlier authority, we note the decision of Topolniski J. in *Residential Warranty Co. of Canada Inc., Re* in 2006. [121] In *Re Residential Warranty*, the applicant insurance company sought an order declaring that the trustee in bankruptcy was not entitled to use the realization of any property for the purpose of paying its fees in respect of the proceedings relating to a disputed trust claim. The Alberta Court of Queen's Bench held that the BIA expressly preserves the court's equitable and ancillary powers and that accordingly, inherent jurisdiction is maintained and available as an important but sparingly used tool. [122] The Court held that there are two preconditions to the court exercising its inherent jurisdiction: the BIA must be silent on the point or not have dealt with it exhaustively; and after balancing the competing interests, the benefit of granting the relief must outweigh the relative prejudice to those affected by it. [123] The Court held

that: "inherent jurisdiction is available to ensure fairness in the bankruptcy process and fulfillment of the substantive objectives of the BIA, including the proper administration and protection of the bankrupt's estate". [124]

The Court held that while the BIA is detailed legislation, Parliament did not take away any inherent jurisdiction from the court, but in fact provided that the court may direct an interim receiver "to take such other action as the court considers advisable" to do not only what justice dictates, but practicality demands. [125] The trustee's responsibility is to ensure that only valid claims to the assets under administration are recognized. [126] The Court held that the trustee was a necessary party to the appeal, in order to participate as an officer of the court and present the relevant facts in a non-adversarial manner; and that "to rule otherwise would be to open the door for possible abuse of the system by rogue claimants filing spurious proprietary claims". [127] The Court contrasted exercise of inherent jurisdiction under the BIA and the CCAA: [128]

> [78] Except in the context of commercial restructuring cases under the BIA, caution must be exercised when considering developments concerning inherent jurisdiction emanating from the CCAA. The BIA and CCAA are very different in degree of specificity and the policy considerations involved. For example, courts in CCAA proceedings routinely rationalize financing for commercial restructuring that compromises creditors' traditional interests in the name of the greater good. There is an overarching policy concern favouring the possibility of a going concern solution and the potential of a long-term upside value for a broad constituency of stakeholders. Arguably, in some cases, super-priority financing and priming charges must be available if restructuring is to be a possibility. [Footnotes omitted.]

Here, the policy consideration was not to facilitate a potential business survival, but rather, to maintain the integrity of the bankruptcy system and to be fair, while recognizing established trust law. [129] On the facts, it was appropriate to fashion a charge that respected the limitations previously imposed by the courts in terms of the trustee's work for the general estate administration. [130]

The Alberta Court of Appeal, in affirming this judgment, held that the judge had inherent jurisdiction pursuant to the BIA to permit the trustee's fees to be paid from property that was subject to undetermined trust claims in appropriate circumstances, and that she did not err in the exercise of jurisdiction in the circumstances. [131] The Court of Appeal held that the ultimate purpose of the administrative powers granted a trustee under the BIA was to manage the estate in order to provide equitable satisfaction of the creditors' claims. As a result of the assistance that the trustee provided to the court and all of the claimants in the bankruptcies, it was just and practical that inherent jurisdiction be used to grant the charge for its fees.

The Court of Appeal noted that section 183(1) of the BIA preserves the inherent jurisdiction of the superior court; it specifies that the 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 the BIA. The Court of Appeal held that inherent jurisdiction is not without limits, and that it cannot be used to negate the unambiguous expression of legislative will. Moreover, because it is a special and extraordinary power, it should be exercised only sparingly and in a clear case. [132] The Court observed that further limitations are based on the nature of the BIA, which 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. [133] The Court of Appeal held that inherent jurisdiction has been used where it is necessary to promote the objects of the BIA; [134] where there is no other alternative available; and to accomplish what justice and practicality require. [135]

The Court of Appeal held that generally, inherent jurisdiction should only be exercised where it is necessary to further fairness and efficiency in legal process and to prevent abuse. The Court listed the non-exhaustive factors that should be considered before invoking inherent jurisdiction:

[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 fore-front. The court should recognize the expertise of the trustee in this regard and in effective management of bankruptcy: see *GMAC* at para. 50 [*GMAC Commercial Credit Corp. v. T.C.T. Logistics Inc.*, [2006] 2 S.C.R. 123]. 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.

The Court of Appeal dismissed the appeal, finding that the case management judge recognized the power must be used sparingly, considered the relevant factors and the applicable law, and carefully constructed a limited charge suitable in the circumstances. [136]

The Alberta court appears to be viewing inherent jurisdiction expansively; however, in the above-cited case, the parties did not make submissions in respect of whether statutory authority may have been sufficient to find jurisdiction. The case may also illustrate the court's reluctance to gap-fill where a statute is highly codified and hence the judge may have wanted to ensure that all the grounds of authority were relied on. Under our analysis, gap-filling can still occur under statutory authority and the common law where there is truly a gap in statutory language, even for a more codified statute. The other issue to note is that courts, in the exigencies of real time litigation, may not be able easily to discern the basis of their authority. While this paper is a call for more clarity and precision in the grounds relied on, we appreciate the challenge that such precision may pose in the circumstances of a particular case.

The Ontario courts are returning to the more traditional base with extensive reference to I.H. Jacob's theories, which may very well be where British Columbia has been throughout. In *Re United Used Auto & Truck Parts Ltd.*, Mackenzie J.A., writing for the British Columbia Court of Appeal, discussed the court's authority to order costs of administration on a primed basis, based not on inherent jurisdiction, preferring instead to refer to the "equitable jurisdiction of the Court":

> 15 The function of the monitor is set out in some detail but the only reference to the cost of carrying out the monitor's function is the oblique reference in s. 11.8(2) that costs of statutory claims on the debtor arising before the monitor's appointment will not rank as a cost of administration. I do not think that it can be inferred that the monitor's costs of administration were otherwise overlooked by Parliament or that Parliament intended that the court have no authority to provide for those costs. The only reasonable conclusion in my opinion is that Parliament was aware of the court's general jurisdiction in equity and assumed that jurisdiction remained available except as inconsistent with the Act. Indeed, by requiring the appointment of a monitor Parliament made a jurisdiction to provide for the monitor's costs of administration even more necessary.
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> . . . . .
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> 18 Neither *Canadian Asbestos* (1992), 16 C.B.R. (3d) 114 nor *Starcom* (1998), 3 C.P.R. (4th) 177 specifically referred to the source of the jurisdiction. Macdonald J. in *Re Westar Mining Ltd.* (1992), 14 C.B.R.(3d) 88, relied on in *Starcom*, referred to the jurisdiction simply as inherent jurisdiction (at 93). Macdonald J. noted that Dickson J., speaking for the Supreme Court of Canada in *Baxter Student Housing Ltd. v. College Housing Co-operative Ltd.*, [1976] 2 S.C.R. 475, held that inherent jurisdiction with respect to receiver-managers could not be exercised in conflict with a statute. The origins of the receivers' jurisdiction are located in the equitable jurisdiction of the Court of Chancery and *while that jurisdiction cannot be exercised contrary to a statute nothing precludes its exercise to supplement a statute and effect a statutory object.*
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> . . . . .
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> 30 *In my opinion, an equitable jurisdiction is available to support the monitor which is sufficiently flexible to be adapted to the monitor's role under the CCAA. It is a time honoured function of equity to adapt to new exigencies.* At the same time it should not be overlooked that costs of administration and DIP financing can erode the security of creditors and CCAA orders should only be made if there is a reasonable prospect of a successful restructuring. That determination is largely a matter of judgment for the judge at first instance and appellate courts normally will be slow to interfere with an exercise of discretion.
>
> 31 *In my opinion, super-priority for DIP financing rests on the same jurisdictional foundation in equity.* Priority for the reasonable restructuring fees and disbursements could have been allowed as part of DIP financing. It is immaterial that they have been allowed here as part of the administration charge. [137]
>
> [Emphasis added.]

This reasoning was expanded in another judgment of the British Columbia Court of Appeal in *Skeena* in which Newbury J.A., writing for the Court, marked a preference for statutory interpretation and judicial discretion conferred by the statute rather than inherent jurisdiction:

> 37 In the exercise of their "broad discretion" under the CCAA, it has now become common for courts to sanction the indefinite, or even permanent, affecting of contractual rights. Most notably, in *Re Dylex Ltd.* (1995), 31 C.B.R. (3d) 106 (Ont. Ct. (Gen. Div.)), Farley J. followed several other cases in holding that in "filling in the gaps" of the CCAA, a court may sanction a plan of arrangement that includes the termination of leases to which the debtor is a party. (See also the cases cited in Dylex, at para. 8; *Re T. Eaton Co.* (1999), 14 C.B.R. (4th) 288 at 293-4 (Ont. S.C.); *Smoky River Coal*; *supra* [[1991] 11 W.W.R. 734], and *Re Armbro Enterprises Inc.* (1993), 22 C.B.R. (3d) 80, ¶13 (Ont. Ct. (Gen. Div.)).) In the latter case, R.A. Blair J. said he saw nothing in principle that precluded a court from "interfering with the rights of a landlord under a lease, in the CCAA context, any more than from interfering with the rights of a secured creditor under a security document. Both may be sanctioned when the exigencies of the particular re-organization justify such balancing of the prejudices". In its recent judgment in *Syndicat national de l'amiante d'Asbestos inc. v. Jeffrey Mines Ltd*, [2003] Q.J. No. 264, the Quebec Court of Appeal observed that "A review of the jurisprudence shows that the debtor's right to cancel contracts prejudicial to it can be provided for in an order to stay proceedings under s. 11." (para. 74.)
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> . . . . .
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> 40 Of course, there are also statutory and constitutional limitations on the court's exercise of its authority under the CCAA. The Supreme Court of Canada's decision in *Baxter Student Housing Ltd. v. College Housing Cooperative Ltd.*, [1976] 2 S.C.R. 475 confirmed that it is beyond the authority of a CCAA court to provide for a priority that runs contrary to the express terms of a statute (in that case, the *Mechanics Lien Act* of Manitoba.) Thus in *Baxter*, the fact that the provincial legislation created a lien having priority over "all judgments, executions, assignments, attachments, garnishments and receiving orders", precluded an order granting CMHC priority for new advances over and above all prior registered liens. Dickson J. (as he then was) stated for the Court:
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> > ... the inherent jurisdiction of the Court of Queen's Bench is not such as to empower a judge of that Court to make an order negating the unambiguous expression of the legislative will. The effect of the order made in this case was to alter the statutory priorities *which a Court simply cannot do*. [at 480; emphasis added.]
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> 41 *Baxter* continues to be applied today: see *Re Royal Oak Mines Inc.* (1999), 7 C.B.R. (4th) 293 (Ont. Ct. (Gen. Div.)) and *Re Westar Mining Ltd.* (1992), 70 B.C.L.R. (2d) 6 (B.C.S.C.). However, the Court in *United Used Auto* distinguished *Baxter* on the basis that the former did not involve an express statutory priority that could not be overcome by the Court's equitable jurisdiction. Mackenzie J.A. noted that the receiver's jurisdiction originates in the "equitable jurisdiction of the Court of Chancery and [that] while that jurisdiction cannot be exercised contrary to a statute, nothing precludes its exercise to supplement a statute and effect a statutory object". (para. 18.)
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> 42 It may be unnecessary to add that in cases of direct or express conflict between the CCAA itself and a provincial statute, the doctrine of paramountcy would apply and the federal statute would prevail.
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> . . . . .
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> 45 It is true that in "filling in the gaps" or "putting flesh on the bones" of the CCAA — for example, by approving arrangements which contemplate the termination of binding contracts or leases — courts have often purported to rely on their "inherent jurisdiction". Farley J. did so in *Dylex*, for example, at

> para. 8, and in *Royal Oak*, *supra*, at para. 4, the latter in connection with the granting of a "superpriority"; and Macdonald J. did so in *Westar*, supra, at 8 and 13. *The court's use of the term "inherent jurisdiction" is certainly understandable in connection with a statute that confers broad jurisdiction with few specific limitations. But if one examines the strict meaning of "inherent jurisdiction", it appears that in many of the cases discussed above, the courts have been exercising a discretion given by the CCAA rather than their inherent jurisdiction. ...*
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> . . . . .
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> 46 ... I think the preferable view is *that when a court approves a plan of arrangement under the CCAA which contemplates that one or more binding contracts will be terminated by the debtor corporation, the court is not exercising a power that arises from its nature as a superior court of law, but is exercising the discretion given to it by the CCAA*. (As to the meaning of "discretion" in this context, see S. Waddams, "Judicial Discretion", (2001) 1 Cmnwth. L.J. 59.) *This is the discretion, given by s. 11, to stay proceedings against the debtor corporation and the discretion, given by s. 6, to approve a plan which appears to be reasonable and fair, to be in accord with the requirements and objects of the statute, and to make possible the continuation of the corporation as a viable entity*. It is these considerations the courts have been concerned with in the cases discussed above, rather than the integrity of their own process.
>
> 47 In saying this, I leave to one side the jurisdiction of the court to make special provision for the payment of the fees and expenses of a monitor appointed under the CCAA. The monitor's functions are of course analogous to those of a receiver — traditionally a creature of Equity. I suspect that this particular power may be properly described as both an equitable jurisdiction and a statutory discretion. *As this court said in United Used Auto, nothing precludes the exercise of the equitable jurisdiction of the Court of Chancery to "supplement a statute and effect a statutory object"*. (para. 18.) In any event, the distinction between these two sources of authority is one that, in my mind at least, "eludes definition".
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> [Emphasis added.] [138]

Writing in similar vein, in *Stelco*, Blair J.A. overturned a chambers decision in which the supervising judge in a CCAA proceeding made an order removing directors from the board of an insolvent company. [139] The Court of Appeal held that an order to remove directors could not be founded on inherent jurisdiction, as inherent jurisdiction is a power derived from the nature of the superior court, which permits the court to maintain its authority; control its own process and fulfill the judicial function of administering justice according to law in a regular, orderly and effective manner. However, inherent jurisdiction is not limitless and if the statutes have not left a functional gap or vacuum, then inherent jurisdiction should not be brought into play: [140]

> [33] It is not necessary, for purposes of this appeal, to determine whether inherent jurisdiction is excluded for all supervisory purposes under the CCAA, by reason of the existence of the statutory discretionary regime provided in that Act. In my opinion, however, *the better view is that in carrying out his or her supervisory functions under the legislation, the judge is not exercising inherent jurisdiction but rather the statutory discretion provided by s. 11 of the CCAA and supplemented by other statutory powers that may be imported into the exercise of the s. 11 discretion from other statutes through s. 20 of the CCAA.*

Inherent jurisdiction

> [34] *Inherent jurisdiction is a power derived "from the very nature of the court as a superior court of law", permitting the court "to maintain its authority and to prevent its process being obstructed and abused". It embodies the authority of the judiciary to control its own process and the lawyers and other officials connected*

> *with the court and its process, in order "to uphold, to protect and to fulfill the judicial function of administering justice according to law in a regular, orderly and effective manner"* ...
>
> [35] *In spite of the expansive nature of this power, inherent jurisdiction does not operate where Parliament or the legislature has acted. As Farley J. noted in Royal Oak Mines, supra, inherent jurisdiction is "not limitless*; if the legislative body has not left a functional gap or vacuum, then inherent jurisdiction should not be brought into play" (para. 4). See also, *Baxter Student Housing Ltd. v. College Housing Co-operative Ltd.*, [1976] 2 S.C.R. 475, 57 D.L.R. (3d) 1, at p. 480 S.C.R.; *Richtree Inc. (Re)* (2005), 74 O.R. (3d) 174, [2005] O.J. No. 251 (S.C.J.).
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> [36] In the CCAA context, Parliament has provided a statutory framework to extend protection to a company while it holds its creditors at bay and attempts to negotiate a compromised plan of arrangement that will enable it to emerge and continue as a viable economic entity, thus benefiting society and the company in the long run, along with the company's creditors, shareholders, employees and other stakeholders. The s. 11 discretion is the engine that drives this broad and flexible statutory scheme, and that for the most part supplants the need to resort to inherent jurisdiction. In that regard, I agree with the comment of Newbury J.A. in *Clear Creek Contracting Ltd. v. Skeena Cellulose Inc.*, [2003] B.C.J. No. 1335, 43 C.B.R. (4th) 187 (C.A.), at para. 46, that:
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> > ... the court is not exercising a power that arises from its nature as a superior court of law, but is exercising the discretion given to it by the CCAA. ... This is the discretion, given by s. 11, to stay proceedings against the debtor corporation and the discretion, given by s. 6, to approve a plan which appears to be reasonable and fair, to be in accord with the requirements and objects of the statute, and to make possible the continuation of the corporation as a viable entity. It is these considerations the courts have been concerned with in the cases discussed above, rather than the integrity of their own process. [footnote omitted]
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> . . . . .
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> [38] I do not mean to suggest that inherent jurisdiction can never apply in a CCAA context. The court retains the ability to control its own process, should the need arise. There is a distinction, however — difficult as it may be to draw — between the court's process with respect to the restructuring, on the one hand, and the course of action involving the negotiations and corporate actions accompanying them, which are the company's process, on the other hand. The court simply supervises the latter process through its ability to stay, restrain or prohibit proceedings against the company during the plan negotiation period "on such terms as it may impose". Hence the better view is that a judge is generally exercising the court's statutory discretion under s. 11 of the Act when supervising a CCAA proceeding. The order in this case could not be founded on inherent jurisdiction because it is designed to supervise the company's process, not the court's process. [Emphasis added.]

The Court of Appeal further held that while s. 11 does not provide the authority for a CCAA judge to order the removal of directors, section 20 of the CCAA offers a gateway to the oppression remedy and other provisions of the *Canada Business Corporations Act* (CBCA) and similar provincial and territorial corporations statutes. [141] Hence, the Court held that there is no "legislative gap" to fill, and that where another applicable statute confers jurisdiction with respect to a matter, a broad and undefined discretion provided in one statute cannot be used to supplant or override the other applicable statute. [142] The powers of a judge under s. 11 of the CCAA may be applied together with the provisions of the CBCA, including the oppression remedy provisions of that statute.

The Ontario Court of Appeal took the same view of the court's powers under s. 11 of the CCAA in *Re Ivaco Inc.* [143] While the Court in that case upheld the chamber judge's decision to move the head office of two companies from Québec to

Ontario, it did so taking pains to say that the court's authority did not rest in s. 11, but in s. 191(2) of the *Canada Business Corporations Act*. It expressly distinguished *Stelco* on the basis that in the latter case there was no power elsewhere to accomplish the chamber judge's goals. Laskin J.A., speaking for the Court in *Ivaco*, wrote: "[t]he discretion under s. 11 must be used to control the court's processes, not the company's processes".

In *Mine Jeffrey inc., Re*, the Québec Court of Appeal endorsed the flexible approach of other Canadian courts in respect of jurisdiction under the CCAA in a case where the monitor had become the person designated by the court to act in the stead of the debtor's directors during the arrangement negotiation period: [144]

> 30 Contrary to a winding-up under the *Winding-up and Restructuring Act* (R.S.C. (1985), c. W-11) (hereinafter referred to as the "*Winding-up Act*") or to an assignment under the BIA, the aim of the CCAA is not the termination of the debtor's operations and the distribution of its assets to creditors; rather, as indicated in its very title, the aim is to conclude arrangements between the insolvent company and its creditors so as to enable the company to survive, the whole under the supervision of the court. Chief Justice Duff wrote in *Attorney General of Canada*, *supra*, at 661:
>
> > Furthermore, the aim of the Act is to deal with the existing condition of insolvency, in itself, to enable arrangements to be made, in view of the insolvent condition of the company under judicial authority which, otherwise, might not be valid prior to the initiation of proceedings in bankruptcy.
>
> 31 To achieve that aim, the CCAA allows the court to make all orders necessary to maintain the *status quo* during the period required for a proposal to be made to the creditors. The Court of Appeal of British Columbia wrote in *United Used Auto and Truck Parts Ltd. v. Aziz*, [2000] BCCA 146:
>
> > The legislation is intended to have wide scope and allow a judge to make orders which will effectively maintain the status quo for a period while the insolvent company attempts to gain the approval of its creditors for a proposed arrangement which will enable the company to remain in operation for what is, hopefully, the future benefit of both the company and its creditors.
>
> 32 In *PCI Chemicals Canada Inc.* (Plan d'arrangement de transaction ou d'arrangement relatif à), [2002] R.J.Q. 1093 (S.C.), *Danièle Mayrand J. did a remarkable job of summarizing the jurisprudence, making the following comments, with which I agree*:

[Translation]

> [52] The vitality of the CCAA is due in part to the way it has been interpreted by the courts, primarily in Ontario, British Columbia and Alberta. *These courts opted for a broad and liberal interpretation of the CCAA and the notion of "inherent jurisdiction" and "equity" in order to give effect to the aims of the CCAA, which are to enable companies to remain in operation so that they can find a solution to their insolvency and turn their financial situation around. The courts concluded that the CCAA must be interpreted and applied in this way in order to provide a flexible tool for restructuring insolvent companies.*
>
> [53] On the basis of these concepts, the courts have not hesitated in recent years to render orders-such as the debtor's right to cancel contracts-that have become almost routine under the CCAA.
>
> [54] A number of these judgments draw on the Supreme Court decision in *Baxter Student Housing Ltd. v. College Housing Co-operative Limited*, for the purpose of exercising their inherent jurisdiction and giving effect to the objectives of the CCAA. The Supreme Court stated that a court's inherent jurisdiction does not allow it to render an order negating the unambiguous expression of the legislative will. In *Re Westar*

Mining Ltd., Macdonald J. referred to *Baxter* and established the principle that would be followed in several judgments:

> *Proceedings under the CCAA are a prime example of the kind of situation where the Court must draw such powers to "flesh out" the bare bones of an inadequate incomplete statutory provision in order to give effect to its objectives11.*

[58] Certain decisions rendered by the Court of Appeal on other CCAA related matters show that the Court of Appeal shares the same vision as the other Canadian courts regarding the need for a broad, liberal interpretation in order to give effect to the objectives of the CCAA.

. . . . .

> [74] A review of the jurisprudence shows that the debtor's right to cancel contracts prejudicial to it can be provided for in an order to stay proceedings made under section 11.

. . . . .

35 Section 11.7(3)(d) CCAA, cited above, recognizes that the court can also entrust other functions to the monitor. Examples include control over property, which was awarded in this case under the initial order. Similarly, the court can authorize the monitor to carry on the business of the debtor's company, as explicitly recognized under section 11.8 CCAA ("where a monitor carries on in that position the business of a debtor company"). That was allowed under paragraph 7 of the impugned order. Thus, in the case at bar, the debtor's affairs are administered by a monitor further to orders rendered by the court. That was, of course, made necessary by the resignation of the debtor's directors and the need to resume operations in order to follow through on the Thiokol project and generate a substantial profit while preserving business relations with a very important client of the debtor, which is crucial to any effort to revitalize the company.

. . . . .

44 There is nothing in the orders rendered about the abolishment or modification of the [union] certifications. Thus, the appellants' certifications are still valid and in effect. Furthermore, it is doubtful that the Superior Court would have jurisdiction to rule on such matters, as determined by the majority in conjunction with the winding-up of the Coopérants (*Syndicat des employés de coopératives d'assurance-vie v. Raymond, Chabot, Fafard, Gagnon inc.*, [1997] R.J.Q. 776 (C.A.)), unless that were allowed under a constitutionally valid provision in the CCAA. It follows that the appellants' exclusive representation continues, which, incidentally, is recognized in paragraph 6 of the initial order, where it is stated that a notice to their union constitutes a notice to their employees.

. . . . .

53 I would add that I find it difficult to apply the monitor's power to disclaim a contract, with or without the authorization of the court, to a collective agreement because of the attendant legislative framework, whether federal or provincial as the case may be, which makes such an agreement a truly original instrument rather than a mere bilateral contract. Besides, why cancel collective agreements if the certifications remain in effect and, as a result, the employer is obliged to negotiate with the appropriate union the conditions applicable to a new delivery of services by employees contemplated by the said certifications? Negotiating a new agreement is equivalent to agreeing on amendments to an existing agreement. [Emphasis added, footnotes omitted.]

Not surprisingly, given the civilist's approach to under-inclusive legislation, [145] the court relies primarily on the purpose and aims of the legislation.

The Supreme Court of Canada decision in *GMAC Commercial Credit Corporation — Canada v. T.C.T. Logistics Inc.* offers an analysis of inherent jurisdiction in the context of insolvency legislation interacting with other remedial legislation. In *GMAC Commercial Credit Corporation — Canada v. T.C.T. Logistics Inc.*, the Supreme Court of Canada considered the extent to which the collective bargaining rights of employees as creditors in a bankruptcy must yield to the overall objective in a bankruptcy of maximizing the ability of creditors to minimize their losses; and in particular, whether employees should be entitled to the same access to a remedy as other stakeholders who attempt to challenge a trustee's conduct. [146] Abella J. writing for the Court held that the powers granted to the bankruptcy court under s. 47(2) of the BIA to direct an interim receiver's conduct do not explicitly or implicitly confer authority on the bankruptcy court to make unilateral declarations about the rights of third parties affected by other statutory schemes. [147] The effect of s. 72(1), which specifies that unless there is a conflict with the BIA, any legislation relating to property and civil rights is deemed to be supplemental to, and not abrogated by, the BIA, is that the BIA is not intended to extinguish legally protected labour relations rights that are not in conflict with the BIA. [148] Hence the bankruptcy court does not have jurisdiction to decide whether an interim receiver is a successor employer within the meaning of labour relations legislation.

The Supreme Court held that trustees and receivers are entitled to a measure of deference consistent with their expertise in the effective management of a bankruptcy; however, the Court held that guarding the flexibility given to such officers with boilerplate immunizations that inoculate against the assertion of rights is beyond the therapeutic reach of the BIA. [149] The right to seek a successor employer declaration pursuant to provincial labour relations legislation does not conflict with the bankruptcy court's authority under s. 47(2). The Court held that if the s. 47 net were interpreted widely enough to permit interference with all rights that, though protected by law, represent an inconvenience to the bankruptcy process, it could be used to extinguish all rights; and explicit language would be required before such a sweeping power could be attached to s. 47. [150] This ruling was consistent with the reasoning of Slatter J. of the Alberta Court of Queen's Bench in *Re Big Sky Living Inc.* [151]

Hence, the courts are trying to articulate the contours of their use of inherent jurisdiction in insolvency matters. The Court of Appeal judgments in *Skeena* and *Stelco* serve to alert courts to the necessity of specifying the grounds for their judicial decision making, and provided some direction on the breadth and scope of the statutory discretion under the CCAA, building on the earlier judgment of the British Columbia Court of Appeal in *Re United Used Auto & Truck Parts*. The Supreme Court of Canada, rounding out consideration of the interaction of different statutory schemes in *GMAC Commercial Credit Corporation — Canada v. T.C.T. Logistics Inc.*, makes clear that there are limits to the court's exercise of jurisdiction, and that the courts are to be diligent to ensure that any exercise of that jurisdiction does not affect the rights of parties under other statutory schemes, unless they are in conflict with federal insolvency legislation.

V. — Conclusion

The court's jurisdiction in insolvency matters has long been the subject of debate, focused particularly on the question of the scope and limits of the court's exercise of its inherent jurisdiction. Recent judgments of Canadian appellate courts have sought to clarify the use of both statutory discretion under insolvency legislation and use of inherent jurisdiction as a gap-filling technique in the determination of issues. Both the British Columbia Court of Appeal and the Ontario Court of Appeal have expressed a preference for the court relying on the exercise of its statutory authority and discretion in insolvency matters, rather than a broad expansion of the use of inherent jurisdiction. [152] The exercise of the court's authority or discretion depends on the nature of the judicial function under the particular proceeding; the statutory framework and specific requirements that are implicated in a particular dispute; and a consideration of what is just and reasonable in the circumstances, including a balancing of the interests of, and prejudice to, the stakeholders with an interest in the financially distressed firm. [153]

On the authors' reading of the commercial jurisprudence, the problem most often for the court to resolve is that the legislation in question is under-inclusive. It is not ambiguous. It simply does not address the application that is before the court, or in some cases, grants the court the authority to make any order it thinks fit. [154] While there can be no magic formula to address this recurring situation, and indeed no one answer, it appears to the authors that practitioners have available a number of tools to accomplish the same end. In determining the right tool, it may be best to consider the judicial task as if in a hierarchy of judicial tools that may be deployed. The first is examination of the statute, commencing with consideration of the precise wording, the legislative history, the object and purposes of the Act, perhaps a consideration of Driedger's principle of reading the words of the Act in their entire context, in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament, and a consideration of the gap-filling power, where applicable. It may very well be that this exercise will reveal that a broad interpretation of the legislation confers the authority on the court to grant the application before it. Only after exhausting this statutory interpretive function should the court consider whether it is appropriate to assert an inherent jurisdiction. Hence, inherent jurisdiction continues to be a valuable tool, but not one that is necessary to utilize in most circumstances.

Courts must clearly articulate the basis for their authority in order to create transparency, certainty and predictability for parties, having regard to commercial realities and public policy notions of the public interest in a fair and timely resolution of commercial disputes. A driving principle of commercial law is that courts should do what makes sense commercially in the context of what is the fairest and most equitable in the circumstances. Courts need to be as specific as possible on the source of the authority. If the statute confers discretion on the court, the basis for the choices made should be clearly articulated so as to ensure appropriate appellate treatment. This means judges must tighten the language they utilize in exercising their authority. When courts are making a determination pursuant to a statute, they are exercising their power or authority, not their discretion. As noted in the introduction, there is a difference between the court exercising its power or authority under a statute and the exercise of its discretion under a statute, although the difference is not always apparent. There may be an element of discretion, particularly when the courts are choosing from a range of remedies, but for the most part, their judgment is based on their authority to resolve the dispute and should be articulated as such. This clarity in language will assist with the transparency and certainty of their decisions, a benefit for the parties before them and of assistance to the appellate court in engaging in any review.

Appellate courts are more likely to accord deference to the appropriate exercise of discretion granted under a statute. It is important to draw a clear distinction between the court's exercise of power pursuant to the statute or its equitable jurisdiction to fill gaps in insolvency legislation and the exercise of inherent jurisdiction. Where inherent jurisdiction is invoked, appellate courts are more likely to scrutinize the basis of the lower court's authority and whether it advances the principles that have been articulated for the use of inherent jurisdiction as a gap-filling technique. In respect of statutory authority, it is also important to distinguish when a choice is being made from a range of remedies authorized by the statute, based on what is the most fair and reasonable in the circumstances and the exercise of a discretion where there may be two equally compelling remedies or outcomes, based on the statutory language and the facts as found.

As noted at the outset, this discussion of selecting the appropriate judicial tool is ongoing and our understanding of the use of tools such as gap-filling powers under legislation, inherent jurisdiction, and judicial discretion is evolving. Much more can be written on many of the points raised in this paper. A conscious effort over the next period to define more clearly the source of authority will continue the process of enhancing the insolvency law regime, having regard to fairness, equity, the public interest and commercial reasonableness.

> 12. Every enactment shall be deemed remedial, and shall be given such fair, large and liberal construction and interpretation as best ensures the attainment of its objects.
>
> 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; ...

Footnotes

1 Madam Justice Georgina R. Jackson, Court of Appeal for Saskatchewan; Dr. Janis P. Sarra, University of British Columbia Faculty of Law and Director, National Centre for Business Law. An earlier version of this paper was presented in discussion format at the National Judicial Institute's annual Civil Law Seminar. The authors would like to thank NJI for that opportunity. Justice Jackson would like to acknowledge the research assistance of Ms. Kristy Pozniak, Student-at-law, Court of Appeal for Saskatchewan with respect to that earlier draft. Dr. Sarra would like to thank Bettina Ruhstein, UBC law student for her research assistance. This paper, in part, reflects the further development of Professor Sarra's earlier analysis of the use of judicial authority and discretion, discussed in *Rescue! The Companies' Creditors Arrangement Act* (Toronto, Carswell, 2007). Our sincere thank you also to the reviewers, who provided extremely insightful comments on the draft of the paper.

2 *Bank of Nova Scotia v. Omni Construction Co.* (1981), 14 Sask. R. 81 (Sask. C.A.).

3 *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 as amended.

4 *Canadian Airlines Corp., Re* (2000), [2000] A.J. No. 771, 2000 CarswellAlta 662 (Alta. Q.B.); leave to appeal refused (2000), 2000 CarswellAlta 919 (Alta. C.A. [In Chambers]); affirmed (2000), 2000 CarswellAlta 1556 (Alta. C.A.); leave to appeal refused (2001), 2001 CarswellAlta 888 (S.C.C.).

5 *Algoma Steel Inc. v. Union Gas Ltd.* (2003), 63 O.R. (3d) 78 (Ont. C.A.).

6 *Stelco Inc., Re* (2005), [2005] O.J. No. 1171, 75 O.R. (3d) 5, 2005 CarswellOnt 1188 (Ont. C.A.).

7 D.J. Galligan, *Discretionary Powers: A Legal Study of Official Discretion* (Oxford: Clarendon Press, 1990) at 40. Footnotes omitted but see in particular P.S. Atiyah, *From Principles to Pragmatism: Changes in the Function of the Judicial Process and the Law* (Oxford: Clarendon Press, 1978).

8 *Ibid.* at 40.

9 *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended (BIA).

10 *Re Skeena Cellulose Inc.* (2003), [2003] B.C.J. No. 1335, 43 C.B.R. (4th) 187 (B.C. C.A.).

11 *Stelco*, *supra*, note 6.

12 *GMAC Commercial Credit Corp. — Canada v. TCT Logistics Inc.* (2006), [2006], 2 S.C.R. 123, 2006 CarswellOnt 4621 (S.C.C.).

13 Ruth Sullivan, *Sullivan and Driedger on the Construction of Statutes*, 4th ed. (Markham: Butterworths, 2002).

14 Pierre-André Côté, *The Interpretation of Legislation in Canada*, 3rd. ed. (Toronto: Carswell, 2000).

15 Elmer A. Driedger, *The Construction of Statutes* (Toronto: Butterworths, 1974), at 67.

16 Sullivan, *supra*, note 13 at 1 to 18; Ruth Sullivan "Statutory Interpretation in the Supreme Court of Canada" (1998-1999) 30 Ottawa L.Rev. 175.

17 Côté, *supra*, note 14 at 287 to 294.

18 Stephane Beaulac and Pierre-Andre Côté, "Driedger's Modern Principle at the Supreme Court of Canada: Interpretation, Justification, Legitimization" (2006) 40 R.J.T. 131. Available at SSRN: http://ssrn.com/abstract=987199. In brief capsule, Beaulac and Côté point out that Canadian courts have not been consistent in the application of the principle. Much more

could be said about this article, which merits close reading. See, too, Randal N. Graham *Statutory Interpretation* (Toronto: Emond Montgomery Publications Limited, 2001) at 110, 111.

19 *Re Rizzo & Rizzo Shoes Ltd.*, [1998] 1 S.C.R. 27 (S.C.C.).

20 Ontario *Employment Standards Act*, R.S.O. 1980, c. 137, as amended.

21 *Re Rizzo & Rizzo Shoes Ltd.*, *supra*, note 19, at para. 21.

22 *Ibid.*, at para. 27.

23 Ontario *Interpretation Act*, R.S.O. 1990, c. I.11.

24 Coté, *supra*, note 14 at 375 to 405. See, for example, s.12 of the federal *Interpretation Act*, R.S.C., 1985, c. I-21:

25 *Ibid.*, at 399.

26 *Ibid.*

27 *Ibid.*

28 *Ibid.*, at 403.

29 Sullivan, *supra*, note 13 at 195.

30 *Ibid.*, at 228.

31 *Bell Canada v. Canada (Canadian Radio-Television & Telecommunications Commission)*, [1989] 1 S.C.R. 1722 (S.C.C.).

32 *Ibid.*, at 1762.

33 Coté, *supra*, note 14 at 380.

34 *Ibid.*, at *386*.

35 *Ibid.*, at 387.

36 *Ibid.*, at 388.

37 *Ibid.* at 390.

38 *Ibid.* at 375 to 405.

39 Sullivan, *supra*, note 13 at 123 to 150.

40 *Ibid.* at 135.

41 *Ibid.* at 125 and 136.

42 *Ibid.* at 136.

43 *Ibid.*

44 *Ibid.*

45 *Magor and St. Mellons Rural District Council v. Newport Corp.*, [1950] 2 All E.R. 1226 at 1236 (Eng. C.A.). But note what Lord Simonds said about this when the matter was heard in House of Lords: "This proposition. ... cannot be supported. It

appears to me to be a naked usurpation of the legislative function under the thin guise of interpretation." *Magor & St. Mellons Rural District Council v. Newport (Borough)*, [1952] A.C. 189 at 191.

46 *Air Canada v. British Columbia*, [1989] 1 S.C.R. 1161 at 1193 (S.C.C.).

47 Sullivan, *supra*, note 13 at 138, 139.

48 Coté, *supra*, note 14.

49 *Ibid.* at 405.

50 Ontario *Judicature Act*, R.S.O. 1970, c. 228.

51 *80 Wellesley St. East Ltd. v. Fundy Bay Builders Ltd.* (1972), 25 D.L.R. (3d) 386 (Ont. C.A.).

52 *Ibid.* at 388-390.

53 Sarra, *supra*, note 1.

54 *Dylex Ltd., Re* (1995), 31 C.B.R. (3d) 106 at 110 (Ont. Gen. Div. [Commercial List]); *Olympia & York Developments Ltd.* (2001), [2001] O.J. No. 3394, 2001 CarswellOnt 2954 (Ont. S.C.J. [Commercial List]); additional reasons at (2001), 2001 CarswellOnt 4739 (Ont. S.C.J. [Commercial List]); affirmed (2003), 2003 CarswellOnt 5210 (Ont. C.A.). *NsC Diesel Power Inc., Re* (1990), 79 C.B.R. 1 (N.S. T.D.); *Westar Mining Ltd., Re* (1992), 14 C.B.R. (3d) 88 (B.C. S.C.); *Interpretation Act*, R.S.C. 1985, c. I-21, s.12.

55 Sarra, *supra*, note 1.

56 David M. Walker, *The Oxford Companion to Law* (Oxford: Clarendon Press, 1980) *s.v.* discretion.

57 See: J.A.G. Griffith, *The Politics of the Judiciary* (5th ed.) (London: *Fontana Press*, 1997) at 340 where the author quotes "And in Duport Steels Ltd. v. Sirs Lord Scarman said: 'If people and parliament come to think that the judicial power is to be confined by nothing other than the Judge's sense of what is right ... confidence in the judicial system will be replaced by fear of it becoming uncertain and arbitrary in its application. Society will then be ready for Parliament to cut the power of the judges.'". There is also the old saying that "Capital is a coward; money flees uncertainty."

58 Aharon Barak, *Judicial Discretion* (New Haven: Yale University Press, 1987) at 7.

59 *Ibid.* at 7-9.

60 B. McLachlin, "Rules and Discretion in Governance of Canada", (1992) 56 Sask.L.Rev. 167 at 170-171.

61 *Doiron v. Haché*, 2005 NBCA 75, 290 N.B.R. (2d) 79, ¶57 (N.B. C.A.). Borins J.A quotes Chief Justice Barak in his dissenting judgment in *Wong v. Lee* (2002), 58 O.R. (3d) 398 (Ont. C.A.).

62 The Honourable Mr. Justice Robert J. Sharpe, "The Application and Impact of Judicial Discretion in Commercial Litigation" (1997-98) 17 Advocates' Soc. J. No. 1, 4-11.

63 *Wong v. Lee*, *supra*, note 61.

64 *Tolofson v. Jensen*, [1994] 3 S.C.R. 1022 (S.C.C.)

65 *Royal Oak Mines Inc., Re* (1999), 1999 CarswellOnt 792 (Ont. Gen. Div. [Commercial List]). *United Used Auto & Truck Parts Ltd., Re* (1999), 12 C.B.R. (4th) 144 (B.C. S.C. [In Chambers]); affirmed (2000), [2000] B.C.J. No. 409, 16 C.B.R. (4th) 141, 2000 CarswellBC 414 (B.C. C.A.); leave to appeal allowed (2000), [2000] S.C.C.A. No. 142, 2000 CarswellBC 2132, 2000 CarswellBC 2133 (S.C.C.). In the matter of a Bankruptcy Proposal of *Bearcat Explorations Ltd.* (2004), 2004 CarswellAlta 1183 (Alta. Q.B.); *Charon Systems Inc. / Charon Systemes inc., Re* (2001), [2001] O.J. No. 5129, 2001 CarswellOnt 4556 (Ont.

S.C.J.). In exercising its discretion, the court will consider: adequate notice to affected creditors; sufficient disclosure; timeliness of the request; the prospects for a viable restructuring; balancing the prejudice to stakeholders; and the principle of granting priority financing as an extraordinary remedy; *Les Boutiques San Francisco Incorporées, Re* (2003), [2003] Q.J. No. 18940, 2003 CarswellQue 13882 (Que. S.C.).

66 *United Used Auto & Truck Parts Ltd., ibid.*

67 The Hon. R. P. Kerans, "Standards of Review employed by Appellate Courts" (Edmonton: Juriliber, 1994) at 134. See also the Hon. R.P. Kerans and K.M. Wiley *Standards of Appellate Review Employed by Appellate Courts* (2d ed.) (Edmondton: Juriliber, 2006) at 228.

68 *Ibid.*

69 Lord Diplock in *Hadmor Productions Ltd. v. Hamilton* (1982), [1982] 1 All E.R. 1042 at 1046, [1983] 1 A.C. 191 at 220 (U.K. H.L.), cited by Bayda C.J.S. in *Smart v. South Saskatchewan Hospital Centre* (1989), 75 Sask. R. 34 (Sask. C.A.) beginning at para. 22.

70 *Naneff v. Con-Crete Holdings Ltd.* (1995), 23 O.R. (3d) 481 (Ont. C.A.).

71 Ontario *Business Corporations Act*, R.S.O. 1990, c. B.16, s. 248.

72 *Naneff v. Con-Crete Holdings Ltd.*, *supra*, note 70 at 488-91.

73 *Ibid.*, at 491, 492.

74 *Ibid.*, at 493.

75 Stephen Waddams, "Judicial Discretion", (2001) 1 Oxford University Commonwealth Law Journal 58 at 60. See *Skeena*, *supra*, note 10 and *Stelco*, *supra*, note 6 as examples.

76 *Waddams, ibid.*, at 64.

77 *Algoma Steel Inc., Re* (2001), [2001] O.J. No. 1943, 25 C.B.R. (4th) 194, 2001 CarswellOnt 1742, ¶8 (Ont. C.A.); *Pacific National Lease Holding Corp., Re* (1992), 15 C.B.R. (3d) 265 (B.C. C.A. [In Chambers]); *Stelco*, *supra*, note 6 at para. 24, citing *Country Style Food Services Inc., Re* (2002), [2002] O.J. No. 1377, 158 O.A.C. 30, 2002 CarswellOnt 1038, ¶15 (Ont. C.A. [In Chambers]).

78 *Stelco*, *ibid.*

79 *Algoma*, *supra*, note 77 at para. 8.

80 *Sullivan*, *supra*, note 13 at 229.

81 [1995] 1 S.C.R. 3 at 24 (S.C.C.).

82 *Stelco*, *supra*, note 6 at paras. 35-36, citing *Skeena*, *supra* note 10.

83 *Stelco*, *ibid.*, at para. 38.

84 *Ibid.*, at para. 44.

85 *Ibid.*

86 Waddams, *supra*, note 75 at 59.

87 *Ibid.*

88 *Ibid.*

89 R. Dworkin, *Taking Rights Seriously* (Cambridge: Harvard University Press, 1977).

90 R. Dworkin, *Hard Cases* (1975) 88 Harv. L. Rev. 1057.

91 R. Dworkin, *Taking Rights Seriously*, (Cambridge: Harvard University Press, 1977, 1978 re-printing) at 81.

92 H.L.A. Hart, *The Concept of Law* (2d ed.) (Oxford: Clarendon Press, 1994) at 272-273.

93 Kerans and Willey, *supra*, note 67 at 215 & 216.

94 Waddams, *supra*, note 75 at 59.

95 *Skeena*, *supra*, note 10 at para. 46.

96 Sarra, *supra*, note 1.

97 *Ibid.*

98 *Olympia & York Developments Ltd. (Trustee of) v. Olympia & York Realty Corp.* (2001), [2001] O.J. No. 3394, 2001 CarswellOnt 2954 (Ont. S.C.J. [Commercial List]); additional reasons at (2001), 2001 CarswellOnt 4739 (Ont. S.C.J. [Commercial List]); affirmed (2003), 2003 CarswellOnt 5210 at 1 (Ont. C.A.).

99 *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 2 C.B.R. (3d) 303 at 314 (B.C. C.A.); leave to appeal refused (1991), 7 C.B.R. (3d) 164 (note) (S.C.C.).

100 Waddams, *supra*, note 75 at 61.

101 *Re Canadian Airlines Corp.* (2000), [2000] A.J. No. 771, 2000 CarswellAlta 662 (Alta. Q.B.); leave to appeal refused (2000), [2000] A.J. No. 1028, 2000 CarswellAlta 919 (Alta. C.A. [In Chambers]); affirmed (2000), 2000 CarswellAlta 1556 (Alta. C.A.); leave to appeal refused (2001), 2001 CarswellAlta 888, ¶144 (S.C.C.); *Anvil Range Mining Corp., Re* (1998), 1998 CarswellOnt 5319, ¶2, Blair J. (Ont. Gen. Div. [Commercial List]). See also *Skydome Corp., Re* (1998), 1998 CarswellOnt 5922 (Ont. Gen. Div. [Commercial List]); *Enterprise Capital Management Inc. v. Semi-Tech Corp.* (1999), 1999 CarswellOnt 2213, ¶21, 22 (Ont. S.C.J. [Commercial List]); *Royal Bank v. Fracmaster Ltd.* (1999), 1999 CarswellAlta 539, ¶36, 40 (Alta. C.A.).

102 Janis Sarra, *Creditor Rights and the Public Interest, Restructuring Insolvent Corporations* (Toronto, University of Toronto Press, 2003).

103 *Skydome Corp., Re* (1998), 1998 CarswellOnt 5922 (Ont. Gen. Div. [Commercial List]).

104 *MEI Computer Technology Group Inc., Re* (2005), [2005] Q.J. No. 5744, 2005 CarswellQue 3675 (Que. S.C.) at para. 18, citing the Court of Appeal in *Stelco.*, *supra*, note 6 at para. 32 and *United Used Auto & Truck Parts Ltd., Re* (2000), [2000] B.C.J. No. 409, 2000 CarswellBC 414 (B.C. C.A.); leave to appeal allowed (2000), 2000 CarswellBC 2132, ¶12, 19-20 (S.C.C.).

105 I.H. Jacob, "The Inherent Jurisdiction of the Court" (1970), 23 Current Legal Problems 23. This article has been quoted with approval in *Assn. of Parents for Fairness in Education, Grand Falls District 50 Branch v. Société des Acadiens du Nouveau-Brunswick Inc.*, [1986] 1 S.C.R. 549 (S.C.C.) and in numerous lower court decisions.

106 *MacMillan Bloedel Ltd. v. Simpson*, [1995] 4 S.C.R. 725, ¶29 (S.C.C.).

107 Jacob, *supra*, note 105 at 27-28.

108 *Ibid.* at 23-24.

109 *Ibid.*, at 50-52.

110 *Ibid.*

111 *Ibid.*

112 *Assn. of Parents for Fairness in Education, Grand Falls District 50 Branch v. Société des Acadiens du Nouveau-Brunswick Inc.*, [1986] 1 S.C.R. 549, 27 D.L.R. (4th) 406 (S.C.C.).

113 *British Columbia Telephone Co. v. Shaw Cable Systems (B.C.) Ltd.*, [1995] 2 S.C.R. 739, 183 N.R. 184 (S.C.C.).

114 *St. Anne-Nackawic Pulp & Paper Co. v. C.P.U., Local 219*, [1986] 1 S.C.R. 704; *Weber v. Ontario Hydro*, [1995] 2 S.C.R. 929 (S.C.C.).

115 *Hill v. Church of Scientology of Toronto*, [1995] 2 S.C.R. 1130, 126 D.L.R. (4th) 129 (S.C.C.).

116 *Western Canadian Shopping Centres Inc. v. Dutton*, [2001] 2 S.C.R. 534 (S.C.C.)

117 K. Yamauchi: *The Court's Inherent Jurisdiction and the CCAA: A Beneficent or Bad Doctrine?*, (2004) 40 C.B.L.J. (Part Number 2) at 250; Janis P. Sarra: *Judicial Exercise of Inherent Jurisdiction Under the CCAA*, (2004) 40 C.B.L.J. (Part Number 2) at 280.

118 *Westar Mining Ltd., Re* (1992), [1992] B.C.J. No. 1360, 1992 CarswellBC 508, [1992] 6 W.W.R. 331 (B.C. S.C.).

119 *Ibid.*

120 *Dylex*, *supra*, note 54.

121 *Residential Warranty Co. of Canada Inc., Re* (2006), [2006] A.J. No. 349, 2006 CarswellAlta 383, 21 C.B.R. (5th) 57 (Alta. Q.B.); affirmed (2006), [2006] A.J. No. 1304, 25 C.B.R. (5th) 38, 2006 CarswellAlta 1354 (Alta. C.A.).

122 *Ibid.*, at para. 26, citing s.183(1) of the BIA, which reads, in material part:

123 *Ibid.*, at para. 26.

124 *Ibid.*

125 *Ibid.*, at para. 27, quoting from Mr. Justice Farley in *Canada (Minister of Indian Affairs & Northern Development) v. Curragh Inc.* (1994), 27 C.B.R. (3d) 148 (Ont. Gen. Div. [Commercial List]).

126 *Ibid.*, at para. 36.

127 *Ibid.*, at para. 59.

128 *Ibid.*, at para. 78.

129 *Ibid.*, at paras. 79, 80 and 81.

130 *Ibid.*, at paras. 80, 81, citing *Robert F. Kowal Investments Ltd. v. Deeder Electric Ltd.* (1975), 21 C.B.R. (N.S.) 201 (Ont. C.A.).

131 *Residential Warranty Co. of Canada Inc.*, *supra*, note 121 (C.A.).

132 *Ibid.*, at para. 20, citing *Baxter Student Housing Ltd. v. College Housing Cooperative Ltd.* (1975), [1976] 2 S.C.R. 475 at 480 (S.C.C.); *Wasserman, Arsenault Ltd. v. Sone* (2002), 33 C.B.R. (4th) 145 (Ont. C.A.); additional reasons at (2002), 2002 CarswellOnt 3230 (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. Both the Ontario Superior Court and the Ontario Court of Appeal concluded that inherent jurisdiction could not be used to conflict with that legislative expression.

133 *Ibid.*, at para. 21.

134 *Ibid.*, citing *Tlustie, Re* (1923), 3 C.B.R. 654 (Ont. S.C.); *Canada (Minister of Indian Affairs & Northern Development) v. Curragh Inc.* (1994), 27 C.B.R. (3d) 148 (Ont. Gen. Div. [Commercial List]).

135 *Ibid.*, citing *Olympia & York Developments Ltd., Re* (1997), 18 C.B.R. (4th) 243 (Ont. Bktcy.); affirmed (1998), 1998 CarswellOnt 3408 (Ont. C.A.); leave to appeal refused (1999), 123 O.A.C. 399 (note) (S.C.C.); *City Construction Co., Re* (1961), 2 C.B.R. (N.S.) 245 (B.C. C.A.); *Canada v. Curragh*, *supra*, note 125.

136 *Ibid.*, at para. 41.

137 *Re United Used Auto*, *supra*, note 65.

138 *Skeena*, *supra*, note 10.

139 *Stelco*, *supra*, note 6 at para. 34.

140 *Ibid.*, at para. 35, citing Farley J. in *Royal Oak Mines Inc., Re* (1999), [1999] O.J. No. 864, 1999 CarswellOnt 792, ¶4 (Ont. Gen. Div. [Commercial List]).

141 *Ibid.*, at para. 52; *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 (CBCA).

142 *Ibid.*, at para. 48.

143 *Ivaco Inc., Re* (2006), 275 D.L.R. (4th) 132 (Ont. C.A.); leave to appeal allowed (2007), 2007 CarswellOnt 2855 (S.C.C.).

144 *Mine Jeffrey inc., Re* (2003), [2003] Q.J. No. 264, 2003 CarswellQue 90, 40 C.B.R. (4th) 95 (Que. C.A.).

145 Coté, *supra*, note 14 at 27-28.

146 *GMAC*, *supra*, note 12 at para. 2.

147 *Ibid.*, at para. 45. There was one dissenting opinion by Deschamps, J.

148 *Ibid.*, at para. 47.

149 *Ibid.*, at para. 50.

150 *Ibid.*, at para. 51.

151 *Big Sky Living Inc., Re* (2002), 37 C.B.R. (4th) 42 (Alta. Q.B.), in which the court held at para. 57 that an applicant had established that it is entitled to an interim receivership order in accordance with s. 47 of the BIA. However, the court held that the order tendered was overly broad, and overly declaratory and legislative in nature, and that it purported to affect in general terms the rights of broad and undefined classes of parties that had not received notice of this application. It went far beyond what was necessary for the protection of the estate of the debtor and attempted to provide the interim receiver with immunities and protections that are not authorized by statute.

152 *Skeena*, *supra*, note 10; *Stelco*, *supra*, note 6.

153 Sarra, *supra*, notes 1 and 102.

154 See for example, the oppression remedy provision discussed earlier.

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TAB
“15”

2010 SCC 60
Supreme Court of Canada

Ted Leroy Trucking [Century Services] Ltd., Re

2010 CarswellBC 3419, 2010 CarswellBC 3420, 2010 SCC 60, [2010] 3 S.C.R. 379, [2010] G.S.T.C. 186, [2010] S.C.J. No. 60, [2011] 2 W.W.R. 383, [2011] B.C.W.L.D. 533, [2011] B.C.W.L.D. 534, 12 B.C.L.R. (5th) 1, 196 A.C.W.S. (3d) 27, 2011 D.T.C. 5006 (Eng.), 2011 G.T.C. 2006 (Eng.), 296 B.C.A.C. 1, 326 D.L.R. (4th) 577, 409 N.R. 201, 503 W.A.C. 1, 72 C.B.R. (5th) 170, J.E. 2011-5

Century Services Inc. (Appellant) and Attorney General of Canada on behalf of Her Majesty The Queen in Right of Canada (Respondent)

Deschamps J., McLachlin C.J.C., Binnie, LeBel, Fish, Abella, Charron, Rothstein, Cromwell JJ.

Heard: May 11, 2010
Judgment: December 16, 2010
Docket: 33239

Proceedings: reversing *Ted Leroy Trucking Ltd., Re* (2009), 2009 CarswellBC 1195, 2009 G.T.C. 2020 (Eng.), 2009 BCCA 205, 270 B.C.A.C. 167, 454 W.A.C. 167, [2009] 12 W.W.R. 684, 98 B.C.L.R. (4th) 242, [2009] G.S.T.C. 79 (B.C. C.A.); reversing *Ted Leroy Trucking Ltd., Re* (2008), 2008 CarswellBC 2895, 2008 BCSC 1805, [2008] G.S.T.C. 221, 2009 G.T.C. 2011 (Eng.) (B.C. S.C. [In Chambers])

Counsel: Mary I.A. Buttery, Owen J. James, Matthew J.G. Curtis for Appellant
Gordon Bourgard, David Jacyk, Michael J. Lema for Respondent

Subject: Estates and Trusts; Goods and Services Tax (GST); Tax — Miscellaneous; Insolvency

APPEAL by creditor from judgment reported at 2009 CarswellBC 1195, 2009 BCCA 205, [2009] G.S.T.C. 79, 98 B.C.L.R. (4th) 242, [2009] 12 W.W.R. 684, 270 B.C.A.C. 167, 454 W.A.C. 167, 2009 G.T.C. 2020 (Eng.) (B.C. C.A.), allowing Crown's appeal from dismissal of application for immediate payment of tax debt.

***Deschamps J.*:**

1 For the first time this Court is called upon to directly interpret the provisions of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). In that respect, two questions are raised. The first requires reconciliation of provisions of the *CCAA* and the *Excise Tax Act*, R.S.C. 1985, c. E-15 ("*ETA*"), which lower courts have held to be in conflict with one another. The second concerns the scope of a court's discretion when supervising reorganization. The relevant statutory provisions are reproduced in the Appendix. On the first question, having considered the evolution of Crown priorities in the context of insolvency and the wording of the various statutes creating Crown priorities, I conclude that it is the *CCAA* and not the *ETA* that provides the rule. On the second question, I conclude that the broad discretionary jurisdiction conferred on the supervising judge must be interpreted having regard to the remedial nature of the *CCAA* and insolvency legislation generally. Consequently, the court had the discretion to partially lift a stay of proceedings to allow the debtor to make an assignment under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*"). I would allow the appeal.

1. Facts and Decisions of the Courts Below

2 Ted LeRoy Trucking Ltd. ("LeRoy Trucking") commenced proceedings under the *CCAA* in the Supreme Court of British Columbia on December 13, 2007, obtaining a stay of proceedings with a view to reorganizing its financial affairs. LeRoy Trucking sold certain redundant assets as authorized by the order.

3 Amongst the debts owed by LeRoy Trucking was an amount for Goods and Services Tax ("GST") collected but unremitted to the Crown. The *ETA* creates a deemed trust in favour of the Crown for amounts collected in respect of GST. The deemed trust extends to any property or proceeds held by the person collecting GST and any property of that person held by a secured creditor, requiring that property to be paid to the Crown in priority to all security interests. The *ETA* provides that the deemed trust operates despite any other enactment of Canada except the *BIA*. However, the *CCAA* also provides that subject to certain exceptions, none of which mentions GST, deemed trusts in favour of the Crown do not operate under the *CCAA*. Accordingly, under the *CCAA* the Crown ranks as an unsecured creditor in respect of GST. Nonetheless, at the time LeRoy Trucking commenced *CCAA* proceedings the leading line of jurisprudence held that the *ETA* took precedence over the *CCAA* such that the Crown enjoyed priority for GST claims under the *CCAA*, even though it would have lost that same priority under the *BIA*. The *CCAA* underwent substantial amendments in 2005 in which some of the provisions at issue in this appeal were renumbered and reformulated (S.C. 2005, c. 47). However, these amendments only came into force on September 18, 2009. I will refer to the amended provisions only where relevant.

4 On April 29, 2008, Brenner C.J.S.C., in the context of the *CCAA* proceedings, approved a payment not exceeding $5 million, the proceeds of redundant asset sales, to Century Services, the debtor's major secured creditor. LeRoy Trucking proposed to hold back an amount equal to the GST monies collected but unremitted to the Crown and place it in the Monitor's trust account until the outcome of the reorganization was known. In order to maintain the *status quo* while the success of the reorganization was uncertain, Brenner C.J.S.C. agreed to the proposal and ordered that an amount of $305,202.30 be held by the Monitor in its trust account.

5 On September 3, 2008, having concluded that reorganization was not possible, LeRoy Trucking sought leave to make an assignment in bankruptcy under the *BIA*. The Crown sought an order that the GST monies held by the Monitor be paid to the Receiver General of Canada. Brenner C.J.S.C. dismissed the latter application. Reasoning that the purpose of segregating the funds with the Monitor was "to facilitate an ultimate payment of the GST monies which were owed pre-filing, but only if a viable plan emerged", the failure of such a reorganization, followed by an assignment in bankruptcy, meant the Crown would lose priority under the *BIA* (2008 BCSC 1805, [2008] G.S.T.C. 221 (B.C. S.C. [In Chambers])).

6 The Crown's appeal was allowed by the British Columbia Court of Appeal (2009 BCCA 205, [2009] G.S.T.C. 79, 270 B.C.A.C. 167 (B.C. C.A.)). Tysoe J.A. for a unanimous court found two independent bases for allowing the Crown's appeal.

7 First, the court's authority under s. 11 of the *CCAA* was held not to extend to staying the Crown's application for immediate payment of the GST funds subject to the deemed trust after it was clear that reorganization efforts had failed and that bankruptcy was inevitable. As restructuring was no longer a possibility, staying the Crown's claim to the GST funds no longer served a purpose under the *CCAA* and the court was bound under the priority scheme provided by the *ETA* to allow payment to the Crown. In so holding, Tysoe J.A. adopted the reasoning in *Ottawa Senators Hockey Club Corp. (Re)*, [2005] G.S.T.C. 1, 73 O.R. (3d) 737 (Ont. C.A.), which found that the *ETA* deemed trust for GST established Crown priority over secured creditors under the *CCAA*.

8 Second, Tysoe J.A. concluded that by ordering the GST funds segregated in the Monitor's trust account on April 29, 2008, the judge had created an express trust in favour of the Crown from which the monies in question could not be diverted for any other purposes. The Court of Appeal therefore ordered that the money held by the Monitor in trust be paid to the Receiver General.

2. Issues

9 This appeal raises three broad issues which are addressed in turn:

(1) Did s. 222(3) of the *ETA* displace s. 18.3(1) of the *CCAA* and give priority to the Crown's *ETA* deemed trust during *CCAA* proceedings as held in *Ottawa Senators*?

(2) Did the court exceed its *CCAA* authority by lifting the stay to allow the debtor to make an assignment in bankruptcy?

(3) Did the court's order of April 29, 2008 requiring segregation of the Crown's GST claim in the Monitor's trust account create an express trust in favour of the Crown in respect of those funds?

3. Analysis

10 The first issue concerns Crown priorities in the context of insolvency. As will be seen, the *ETA* provides for a deemed trust in favour of the Crown in respect of GST owed by a debtor "[d]espite ... any other enactment of Canada (except the *Bankruptcy and Insolvency Act*)" (s. 222(3)), while the *CCAA* stated at the relevant time that "notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be [so] regarded" (s. 18.3(1)). It is difficult to imagine two statutory provisions more apparently in conflict. However, as is often the case, the apparent conflict can be resolved through interpretation.

11 In order to properly interpret the provisions, it is necessary to examine the history of the *CCAA*, its function amidst the body of insolvency legislation enacted by Parliament, and the principles that have been recognized in the jurisprudence. It will be seen that Crown priorities in the insolvency context have been significantly pared down. The resolution of the second issue is also rooted in the context of the *CCAA*, but its purpose and the manner in which it has been interpreted in the case law are also key. After examining the first two issues in this case, I will address Tysoe J.A.'s conclusion that an express trust in favour of the Crown was created by the court's order of April 29, 2008.

3.1 Purpose and Scope of Insolvency Law

12 Insolvency is the factual situation that arises when a debtor is unable to pay creditors (see generally, R. J. Wood, *Bankruptcy and Insolvency Law* (2009), at p. 16). Certain legal proceedings become available upon insolvency, which typically allow a debtor to obtain a court order staying its creditors' enforcement actions and attempt to obtain a binding compromise with creditors to adjust the payment conditions to something more realistic. Alternatively, the debtor's assets may be liquidated and debts paid from the proceeds according to statutory priority rules. The former is usually referred to as reorganization or restructuring while the latter is termed liquidation.

13 Canadian commercial insolvency law is not codified in one exhaustive statute. Instead, Parliament has enacted multiple insolvency statutes, the main one being the *BIA*. The *BIA* offers a self-contained legal regime providing for both reorganization and liquidation. Although bankruptcy legislation has a long history, the *BIA* itself is a fairly recent statute — it was enacted in 1992. It is characterized by a rules-based approach to proceedings. The *BIA* is available to insolvent debtors owing $1000 or more, regardless of whether they are natural or legal persons. It contains mechanisms for debtors to make proposals to their creditors for the adjustment of debts. If a proposal fails, the *BIA* contains a bridge to bankruptcy whereby the debtor's assets are liquidated and the proceeds paid to creditors in accordance with the statutory scheme of distribution.

14 Access to the *CCAA* is more restrictive. A debtor must be a company with liabilities in excess of $5 million. Unlike the *BIA*, the *CCAA* contains no provisions for liquidation of a debtor's assets if reorganization fails. There are three ways of exiting *CCAA* proceedings. The best outcome is achieved when the stay of proceedings provides the debtor with some breathing space during which solvency is restored and the *CCAA* process terminates without reorganization being needed. The second most desirable outcome occurs when the debtor's compromise or arrangement is accepted by its creditors and the reorganized company emerges from the *CCAA* proceedings as a going concern. Lastly, if the compromise or arrangement fails, either the company or its creditors usually seek to have the debtor's assets liquidated under the applicable provisions of the *BIA* or to place the debtor into receivership. As discussed in greater detail below,

the key difference between the reorganization regimes under the *BIA* and the *CCAA* is that the latter offers a more flexible mechanism with greater judicial discretion, making it more responsive to complex reorganizations.

15 As I will discuss at greater length below, the purpose of the *CCAA* — Canada's first reorganization statute — is to permit the debtor to continue to carry on business and, where possible, avoid the social and economic costs of liquidating its assets. Proposals to creditors under the *BIA* serve the same remedial purpose, though this is achieved through a rules-based mechanism that offers less flexibility. Where reorganization is impossible, the *BIA* may be employed to provide an orderly mechanism for the distribution of a debtor's assets to satisfy creditor claims according to predetermined priority rules.

16 Prior to the enactment of the *CCAA* in 1933 (S.C. 1932-33, c. 36), practice under existing commercial insolvency legislation tended heavily towards the liquidation of a debtor company (J. Sarra, *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations* (2003), at p. 12). The battering visited upon Canadian businesses by the Great Depression and the absence of an effective mechanism for reaching a compromise between debtors and creditors to avoid liquidation required a legislative response. The *CCAA* was innovative as it allowed the insolvent debtor to attempt reorganization under judicial supervision outside the existing insolvency legislation which, once engaged, almost invariably resulted in liquidation (*Reference re Companies' Creditors Arrangement Act (Canada)*, [1934] S.C.R. 659 (S.C.C.), at pp. 660-61; Sarra, *Creditor Rights*, at pp. 12-13).

17 Parliament understood when adopting the *CCAA* that liquidation of an insolvent company was harmful for most of those it affected — notably creditors and employees — and that a workout which allowed the company to survive was optimal (Sarra, *Creditor Rights*, at pp. 13-15).

18 Early commentary and jurisprudence also endorsed the *CCAA's* remedial objectives. It recognized that companies retain more value as going concerns while underscoring that intangible losses, such as the evaporation of the companies' goodwill, result from liquidation (S. E. Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act" (1947), 25 *Can. Bar Rev.* 587, at p. 592). Reorganization serves the public interest by facilitating the survival of companies supplying goods or services crucial to the health of the economy or saving large numbers of jobs (*ibid.*, at p. 593). Insolvency could be so widely felt as to impact stakeholders other than creditors and employees. Variants of these views resonate today, with reorganization justified in terms of rehabilitating companies that are key elements in a complex web of interdependent economic relationships in order to avoid the negative consequences of liquidation.

19 The *CCAA* fell into disuse during the next several decades, likely because amendments to the Act in 1953 restricted its use to companies issuing bonds (S.C. 1952-53, c. 3). During the economic downturn of the early 1980s, insolvency lawyers and courts adapting to the resulting wave of insolvencies resurrected the statute and deployed it in response to new economic challenges. Participants in insolvency proceedings grew to recognize and appreciate the statute's distinguishing feature: a grant of broad and flexible authority to the supervising court to make the orders necessary to facilitate the reorganization of the debtor and achieve the *CCAA's* objectives. The manner in which courts have used *CCAA* jurisdiction in increasingly creative and flexible ways is explored in greater detail below.

20 Efforts to evolve insolvency law were not restricted to the courts during this period. In 1970, a government-commissioned panel produced an extensive study recommending sweeping reform but Parliament failed to act (see *Bankruptcy and Insolvency: Report of the Study Committee on Bankruptcy and Insolvency Legislation* (1970)). Another panel of experts produced more limited recommendations in 1986 which eventually resulted in enactment of the *Bankruptcy and Insolvency Act* of 1992 (S.C. 1992, c. 27) (see *Proposed Bankruptcy Act Amendments: Report of the Advisory Committee on Bankruptcy and Insolvency* (1986)). Broader provisions for reorganizing insolvent debtors were then included in Canada's bankruptcy statute. Although the 1970 and 1986 reports made no specific recommendations with respect to the *CCAA*, the House of Commons committee studying the *BIA*'s predecessor bill, C-22, seemed to accept expert testimony that the *BIA*'s new reorganization scheme would shortly supplant the *CCAA*, which could then be repealed, with commercial insolvency and bankruptcy being governed by a single statute (*Minutes of Proceedings*

and Evidence of the Standing Committee on Consumer and Corporate Affairs and Government Operations, Issue No. 15, October 3, 1991, at pp. 15:15-15:16).

21 In retrospect, this conclusion by the House of Commons committee was out of step with reality. It overlooked the renewed vitality the *CCAA* enjoyed in contemporary practice and the advantage that a flexible judicially supervised reorganization process presented in the face of increasingly complex reorganizations, when compared to the stricter rules-based scheme contained in the *BIA*. The "flexibility of the *CCAA* [was seen as] a great benefit, allowing for creative and effective decisions" (Industry Canada, Marketplace Framework Policy Branch, *Report on the Operation and Administration of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (2002), at p. 41). Over the past three decades, resurrection of the *CCAA* has thus been the mainspring of a process through which, one author concludes, "the legal setting for Canadian insolvency restructuring has evolved from a rather blunt instrument to one of the most sophisticated systems in the developed world" (R. B. Jones, "The Evolution of Canadian Restructuring: Challenges for the Rule of Law", in J. P. Sarra, ed., *Annual Review of Insolvency Law 2005* (2006), 481, at p. 481).

22 While insolvency proceedings may be governed by different statutory schemes, they share some commonalities. The most prominent of these is the single proceeding model. The nature and purpose of the single proceeding model are described by Professor Wood in *Bankruptcy and Insolvency Law*:

> They all provide a collective proceeding that supersedes the usual civil process available to creditors to enforce their claims. The creditors' remedies are collectivized in order to prevent the free-for-all that would otherwise prevail if creditors were permitted to exercise their remedies. In the absence of a collective process, each creditor is armed with the knowledge that if they do not strike hard and swift to seize the debtor's assets, they will be beat out by other creditors. [pp. 2-3]

The single proceeding model avoids the inefficiency and chaos that would attend insolvency if each creditor initiated proceedings to recover its debt. Grouping all possible actions against the debtor into a single proceeding controlled in a single forum facilitates negotiation with creditors because it places them all on an equal footing, rather than exposing them to the risk that a more aggressive creditor will realize its claims against the debtor's limited assets while the other creditors attempt a compromise. With a view to achieving that purpose, both the *CCAA* and the *BIA* allow a court to order all actions against a debtor to be stayed while a compromise is sought.

23 Another point of convergence of the *CCAA* and the *BIA* relates to priorities. Because the *CCAA* is silent about what happens if reorganization fails, the *BIA* scheme of liquidation and distribution necessarily supplies the backdrop for what will happen if a *CCAA* reorganization is ultimately unsuccessful. In addition, one of the important features of legislative reform of both statutes since the enactment of the *BIA* in 1992 has been a cutback in Crown priorities (S.C. 1992, c. 27, s. 39; S.C. 1997, c. 12, ss. 73 and 125; S.C. 2000, c. 30, s. 148; S.C. 2005, c. 47, ss. 69 and 131; S.C. 2009, c. 33, ss. 25 and 29; see also *Alternative granite & marbre inc., Re*, 2009 SCC 49, [2009] 3 S.C.R. 286, [2009] G.S.T.C. 154 (S.C.C.); *Quebec (Deputy Minister of Revenue) c. Rainville* (1979), [1980] 1 S.C.R. 35 (S.C.C.); *Proposed Bankruptcy Act Amendments: Report of the Advisory Committee on Bankruptcy and Insolvency* (1986)).

24 With parallel *CCAA* and *BIA* restructuring schemes now an accepted feature of the insolvency law landscape, the contemporary thrust of legislative reform has been towards harmonizing aspects of insolvency law common to the two statutory schemes to the extent possible and encouraging reorganization over liquidation (see *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*, S.C. 2005, c. 47; *Gauntlet Energy Corp., Re*, 2003 ABQB 894, [2003] G.S.T.C. 193, 30 Alta. L.R. (4th) 192 (Alta. Q.B.), at para. 19).

25 Mindful of the historical background of the *CCAA* and *BIA*, I now turn to the first question at issue.

3.2 GST Deemed Trust Under the CCAA

26 The Court of Appeal proceeded on the basis that the *ETA* precluded the court from staying the Crown's enforcement of the GST deemed trust when partially lifting the stay to allow the debtor to enter bankruptcy. In so doing, it adopted the reasoning in a line of cases culminating in *Ottawa Senators*, which held that an *ETA* deemed trust remains enforceable during *CCAA* reorganization despite language in the *CCAA* that suggests otherwise.

27 The Crown relies heavily on the decision of the Ontario Court of Appeal in *Ottawa Senators* and argues that the later in time provision of the *ETA* creating the GST deemed trust trumps the provision of the *CCAA* purporting to nullify most statutory deemed trusts. The Court of Appeal in this case accepted this reasoning but not all provincial courts follow it (see, e.g., *Komunik Corp., Re*, 2009 QCCS 6332 (C.S. Que.), leave to appeal granted, 2010 QCCA 183 (C.A. Que.)). Century Services relied, in its written submissions to this Court, on the argument that the court had authority under the *CCAA* to continue the stay against the Crown's claim for unremitted GST. In oral argument, the question of whether *Ottawa Senators* was correctly decided nonetheless arose. After the hearing, the parties were asked to make further written submissions on this point. As appears evident from the reasons of my colleague Abella J., this issue has become prominent before this Court. In those circumstances, this Court needs to determine the correctness of the reasoning in *Ottawa Senators*.

28 The policy backdrop to this question involves the Crown's priority as a creditor in insolvency situations which, as I mentioned above, has evolved considerably. Prior to the 1990s, Crown claims largely enjoyed priority in insolvency. This was widely seen as unsatisfactory as shown by both the 1970 and 1986 insolvency reform proposals, which recommended that Crown claims receive no preferential treatment. A closely related matter was whether the *CCAA* was binding at all upon the Crown. Amendments to the *CCAA* in 1997 confirmed that it did indeed bind the Crown (see *CCAA*, s. 21, as am. by S.C. 1997, c. 12, s. 126).

29 Claims of priority by the state in insolvency situations receive different treatment across jurisdictions worldwide. For example, in Germany and Australia, the state is given no priority at all, while the state enjoys wide priority in the United States and France (see B. K. Morgan, "Should the Sovereign be Paid First? A Comparative International Analysis of the Priority for Tax Claims in Bankruptcy" (2000), 74 *Am. Bank. L.J.* 461, at p. 500). Canada adopted a middle course through legislative reform of Crown priority initiated in 1992. The Crown retained priority for source deductions of income tax, Employment Insurance ("EI") and Canada Pension Plan ("CPP") premiums, but ranks as an ordinary unsecured creditor for most other claims.

30 Parliament has frequently enacted statutory mechanisms to secure Crown claims and permit their enforcement. The two most common are statutory deemed trusts and powers to garnish funds third parties owe the debtor (see F. L. Lamer, *Priority of Crown Claims in Insolvency* (loose-leaf), at § 2).

31 With respect to GST collected, Parliament has enacted a deemed trust. The *ETA* states that every person who collects an amount on account of GST is deemed to hold that amount in trust for the Crown (s. 222(1)). The deemed trust extends to other property of the person collecting the tax equal in value to the amount deemed to be in trust if that amount has not been remitted in accordance with the *ETA*. The deemed trust also extends to property held by a secured creditor that, but for the security interest, would be property of the person collecting the tax (s. 222(3)).

32 Parliament has created similar deemed trusts using almost identical language in respect of source deductions of income tax, EI premiums and CPP premiums (see s. 227(4) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) ("*ITA*"), ss. 86(2) and (2.1) of the *Employment Insurance Act*, S.C. 1996, c. 23, and ss. 23(3) and (4) of the *Canada Pension Plan*, R.S.C. 1985, c. C-8). I will refer to income tax, EI and CPP deductions as "source deductions".

33 In *Royal Bank v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411 (S.C.C.), this Court addressed a priority dispute between a deemed trust for source deductions under the *ITA* and security interests taken under both the *Bank Act*, S.C. 1991, c. 46, and the Alberta *Personal Property Security Act*, S.A. 1988, c. P-4.05 ("*PPSA*"). As then worded, an *ITA* deemed trust over the debtor's property equivalent to the amount owing in respect of income tax became effective at the

time of liquidation, receivership, or assignment in bankruptcy. *Sparrow Electric* held that the *ITA* deemed trust could not prevail over the security interests because, being fixed charges, the latter attached as soon as the debtor acquired rights in the property such that the *ITA* deemed trust had no property on which to attach when it subsequently arose. Later, in *First Vancouver Finance v. Minister of National Revenue*, 2002 SCC 49, [2002] G.S.T.C. 23, [2002] 2 S.C.R. 720 (S.C.C.), this Court observed that Parliament had legislated to strengthen the statutory deemed trust in the *ITA* by deeming it to operate from the moment the deductions were not paid to the Crown as required by the *ITA*, and by granting the Crown priority over all security interests (paras. 27-29) (the "*Sparrow Electric* amendment").

34 The amended text of s. 227(4.1) of the *ITA* and concordant source deductions deemed trusts in the *Canada Pension Plan* and the *Employment Insurance Act* state that the deemed trust operates notwithstanding any other enactment of Canada, except ss. 81.1 and 81.2 of the *BIA*. The *ETA* deemed trust at issue in this case is similarly worded, but it excepts the *BIA* in its entirety. The provision reads as follows:

> **222.** (3) Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act*), any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed ....

35 The Crown submits that the *Sparrow Electric* amendment, added by Parliament to the *ETA* in 2000, was intended to preserve the Crown's priority over collected GST under the *CCAA* while subordinating the Crown to the status of an unsecured creditor in respect of GST only under the *BIA*. This is because the *ETA* provides that the GST deemed trust is effective "despite" any other enactment except the *BIA*.

36 The language used in the *ETA* for the GST deemed trust creates an apparent conflict with the *CCAA*, which provides that subject to certain exceptions, property deemed by statute to be held in trust for the Crown shall not be so regarded.

37 Through a 1997 amendment to the *CCAA* (S.C. 1997, c. 12, s. 125), Parliament appears to have, subject to specific exceptions, nullified deemed trusts in favour of the Crown once reorganization proceedings are commenced under the Act. The relevant provision reads:

> **18.3** (1) Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

This nullification of deemed trusts was continued in further amendments to the *CCAA* (S.C. 2005, c. 47), where s. 18.3(1) was renumbered and reformulated as s. 37(1):

> **37.** (1) Subject to subsection (2), despite any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

38 An analogous provision exists in the *BIA*, which, subject to the same specific exceptions, nullifies statutory deemed trusts and makes property of the bankrupt that would otherwise be subject to a deemed trust part of the debtor's estate and available to creditors (S.C. 1992, c. 27, s. 39; S.C. 1997, c. 12, s. 73; *BIA*, s. 67(2)). It is noteworthy that in both the *CCAA* and the *BIA*, the exceptions concern source deductions (*CCAA*, s. 18.3(2); *BIA*, s. 67(3)). The relevant provision of the *CCAA* reads:

> **18.3** (2) Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act*....

Thus, the Crown's deemed trust and corresponding priority in source deductions remain effective both in reorganization and in bankruptcy.

39 Meanwhile, in both s. 18.4(1) of the *CCAA* and s. 86(1) of the *BIA*, other Crown claims are treated as unsecured. These provisions, establishing the Crown's status as an unsecured creditor, explicitly exempt statutory deemed trusts in source deductions *(CCAA*, s. 18.4(3); *BIA*, s. 86(3)). The *CCAA* provision reads as follows:

> **18.4** (3) Subsection (1) [Crown ranking as unsecured creditor] does not affect the operation of
>
> (a) subsections 224(1.2) and (1.3) of the *Income Tax Act*,
>
> (b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution ....

Therefore, not only does the *CCAA* provide that Crown claims do not enjoy priority over the claims of other creditors (s. 18.3(1)), but the exceptions to this rule (i.e., that Crown priority is maintained for source deductions) are repeatedly stated in the statute.

40 The apparent conflict in this case is whether the rule in the *CCAA* first enacted as s. 18.3 in 1997, which provides that subject to certain explicit exceptions, statutory deemed trusts are ineffective under the *CCAA*, is overridden by the one in the *ETA* enacted in 2000 stating that GST deemed trusts operate despite any enactment of Canada except the *BIA*. With respect for my colleague Fish J., I do not think the apparent conflict can be resolved by denying it and creating a rule requiring both a statutory provision enacting the deemed trust, and a second statutory provision confirming it. Such a rule is unknown to the law. Courts must recognize conflicts, apparent or real, and resolve them when possible.

41 A line of jurisprudence across Canada has resolved the apparent conflict in favour of the *ETA*, thereby maintaining GST deemed trusts under the *CCAA*. *Ottawa Senators*, the leading case, decided the matter by invoking the doctrine of implied repeal to hold that the later in time provision of the *ETA* should take precedence over the *CCAA* (see also *Solid Resources Ltd., Re* (2002), 40 C.B.R. (4th) 219, [2003] G.S.T.C. 21 (Alta. Q.B.); *Gauntlet*

42 The Ontario Court of Appeal in *Ottawa Senators* rested its conclusion on two considerations. First, it was persuaded that by explicitly mentioning the *BIA* in *ETA* s. 222(3), but not the *CCAA*, Parliament made a deliberate choice. In the words of MacPherson J.A.:

> The *BIA* and the *CCAA* are closely related federal statutes. I cannot conceive that Parliament would specifically identify the *BIA* as an exception, but accidentally fail to consider the *CCAA* as a possible second exception. In my view, the omission of the *CCAA* from s. 222(3) of the *ETA* was almost certainly a considered omission. [para. 43]

43 Second, the Ontario Court of Appeal compared the conflict between the *ETA* and the *CCAA* to that before this Court in *Doré c. Verdun (Municipalité)*, [1997] 2 S.C.R. 862 (S.C.C.), and found them to be "identical" (para. 46). It therefore considered *Doré* binding (para. 49). In *Doré*, a limitations provision in the more general and recently enacted *Civil Code of Québec*, S.Q. 1991, c. 64 ("*C.C.Q.*"), was held to have repealed a more specific provision of the earlier Quebec *Cities and Towns Act*, R.S.Q., c. C-19, with which it conflicted. By analogy, the Ontario Court of Appeal held that the later in time and more general provision, s. 222(3) of the *ETA*, impliedly repealed the more specific and earlier in time provision, s. 18.3(1) of the *CCAA* (paras. 47-49).

44 Viewing this issue in its entire context, several considerations lead me to conclude that neither the reasoning nor the result in *Ottawa Senators* can stand. While a conflict may exist at the level of the statutes' wording, a purposive and contextual analysis to determine Parliament's true intent yields the conclusion that Parliament could not have intended to restore the Crown's deemed trust priority in GST claims under the *CCAA* when it amended the *ETA* in 2000 with the *Sparrow Electric* amendment.

45 I begin by recalling that Parliament has shown its willingness to move away from asserting priority for Crown claims in insolvency law. Section 18.3(1) of the *CCAA* (subject to the s. 18.3(2) exceptions) provides that the Crown's deemed trusts have no effect under the *CCAA*. Where Parliament has sought to protect certain Crown claims through statutory deemed trusts and intended that these deemed trusts continue in insolvency, it has legislated so explicitly and elaborately. For example, s. 18.3(2) of the *CCAA* and s. 67(3) of the *BIA* expressly provide that deemed trusts for source deductions remain effective in insolvency. Parliament has, therefore, clearly carved out exceptions from the general rule that deemed trusts are ineffective in insolvency. The *CCAA* and *BIA* are in harmony, preserving deemed trusts and asserting Crown priority only in respect of source deductions. Meanwhile, there is no express statutory basis for concluding that GST claims enjoy a preferred treatment under the *CCAA* or the *BIA*. Unlike source deductions, which are clearly and expressly dealt with under both these insolvency statutes, no such clear and express language exists in those Acts carving out an exception for GST claims.

46 The internal logic of the *CCAA* also militates against upholding the *ETA* deemed trust for GST. The *CCAA* imposes limits on a suspension by the court of the Crown's rights in respect of source deductions but does not mention the *ETA* (s. 11.4). Since source deductions deemed trusts are granted explicit protection under the *CCAA*, it would be inconsistent to afford a better protection to the *ETA* deemed trust absent explicit language in the *CCAA*. Thus, the logic of the *CCAA* appears to subject the *ETA* deemed trust to the waiver by Parliament of its priority (s. 18.4).

47 Moreover, a strange asymmetry would arise if the interpretation giving the *ETA* priority over the *CCAA* urged by the Crown is adopted here: the Crown would retain priority over GST claims during *CCAA* proceedings but not in bankruptcy. As courts have reflected, this can only encourage statute shopping by secured creditors in cases such as this one where the debtor's assets cannot satisfy both the secured creditors' and the Crown's claims (*Gauntlet*, at para. 21). If creditors' claims were better protected by liquidation under the *BIA*, creditors' incentives would lie overwhelmingly with avoiding proceedings under the *CCAA* and not risking a failed reorganization. Giving a key player in any insolvency such skewed incentives against reorganizing under the *CCAA* can only undermine that statute's remedial objectives and risk inviting the very social ills that it was enacted to avert.

48 Arguably, the effect of *Ottawa Senators* is mitigated if restructuring is attempted under the *BIA* instead of the *CCAA*, but it is not cured. If *Ottawa Senators* were to be followed, Crown priority over GST would differ depending on whether restructuring took place under the *CCAA* or the *BIA*. The anomaly of this result is made manifest by the fact that it would deprive companies of the option to restructure under the more flexible and responsive *CCAA* regime, which has been the statute of choice for complex reorganizations.

49 Evidence that Parliament intended different treatments for GST claims in reorganization and bankruptcy is scant, if it exists at all. Section 222(3) of the *ETA* was enacted as part of a wide-ranging budget implementation bill in 2000. The summary accompanying that bill does not indicate that Parliament intended to elevate Crown priority over GST claims under the *CCAA* to the same or a higher level than source deductions claims. Indeed, the summary for deemed trusts states only that amendments to existing provisions are aimed at "ensuring that employment insurance premiums and Canada Pension Plan contributions that are required to be remitted by an employer are fully recoverable by the Crown in the case of the bankruptcy of the employer" (Summary to S.C. 2000, c. 30, at p. 4a). The wording of GST deemed trusts resembles that of statutory deemed trusts for source deductions and incorporates the same overriding language and reference to the *BIA*. However, as noted above, Parliament's express intent is that only source deductions deemed trusts remain operative. An exception for the *BIA* in the statutory language establishing the source deductions deemed trusts accomplishes very little, because the explicit language of the *BIA* itself (and the *CCAA*) carves out these source deductions deemed trusts and maintains their effect. It is however noteworthy that no equivalent language maintaining GST deemed trusts exists under either the *BIA* or the *CCAA*.

50 It seems more likely that by adopting the same language for creating GST deemed trusts in the *ETA* as it did for deemed trusts for source deductions, and by overlooking the inclusion of an exception for the *CCAA* alongside the *BIA* in s. 222(3) of the *ETA*, Parliament may have inadvertently succumbed to a drafting anomaly. Because of a statutory lacuna

in the *ETA*, the GST deemed trust could be seen as remaining effective in the *CCAA*, while ceasing to have any effect under the *BIA*, thus creating an apparent conflict with the wording of the *CCAA*. However, it should be seen for what it is: a facial conflict only, capable of resolution by looking at the broader approach taken to Crown priorities and by giving precedence to the statutory language of s. 18.3 of the *CCAA* in a manner that does not produce an anomalous outcome.

51 Section 222(3) of the *ETA* evinces no explicit intention of Parliament to repeal *CCAA* s. 18.3. It merely creates an apparent conflict that must be resolved by statutory interpretation. Parliament's intent when it enacted *ETA* s. 222(3) was therefore far from unambiguous. Had it sought to give the Crown a priority for GST claims, it could have done so explicitly as it did for source deductions. Instead, one is left to infer from the language of *ETA* s. 222(3) that the GST deemed trust was intended to be effective under the *CCAA*.

52 I am not persuaded that the reasoning in *Doré* requires the application of the doctrine of implied repeal in the circumstances of this case. The main issue in *Doré* concerned the impact of the adoption of the *C.C.Q.* on the administrative law rules with respect to municipalities. While Gonthier J. concluded in that case that the limitation provision in art. 2930 *C.C.Q.* had repealed by implication a limitation provision in the *Cities and Towns Act*, he did so on the basis of more than a textual analysis. The conclusion in *Doré* was reached after thorough contextual analysis of both pieces of legislation, including an extensive review of the relevant legislative history (paras. 31-41). Consequently, the circumstances before this Court in *Doré* are far from "identical" to those in the present case, in terms of text, context and legislative history. Accordingly, *Doré* cannot be said to require the automatic application of the rule of repeal by implication.

53 A noteworthy indicator of Parliament's overall intent is the fact that in subsequent amendments it has not displaced the rule set out in the *CCAA*. Indeed, as indicated above, the recent amendments to the *CCAA* in 2005 resulted in the rule previously found in s. 18.3 being renumbered and reformulated as s. 37. Thus, to the extent the interpretation allowing the GST deemed trust to remain effective under the *CCAA* depends on *ETA* s. 222(3) having impliedly repealed *CCAA* s. 18.3(1) because it is later in time, we have come full circle. Parliament has renumbered and reformulated the provision of the *CCAA* stating that, subject to exceptions for source deductions, deemed trusts do not survive the *CCAA* proceedings and thus the *CCAA* is now the later in time statute. This confirms that Parliament's intent with respect to GST deemed trusts is to be found in the *CCAA*.

54 I do not agree with my colleague Abella J. that s. 44(*f*) of the *Interpretation Act*, R.S.C. 1985, c. I-21, can be used to interpret the 2005 amendments as having no effect. The new statute can hardly be said to be a mere re-enactment of the former statute. Indeed, the *CCAA* underwent a substantial review in 2005. Notably, acting consistently with its goal of treating both the *BIA* and the *CCAA* as sharing the same approach to insolvency, Parliament made parallel amendments to both statutes with respect to corporate proposals. In addition, new provisions were introduced regarding the treatment of contracts, collective agreements, interim financing and governance agreements. The appointment and role of the Monitor was also clarified. Noteworthy are the limits imposed by *CCAA* s. 11.09 on the court's discretion to make an order staying the Crown's source deductions deemed trusts, which were formerly found in s. 11.4. No mention whatsoever is made of GST deemed trusts (see Summary to S.C. 2005, c. 47). The review went as far as looking at the very expression used to describe the statutory override of deemed trusts. The comments cited by my colleague only emphasize the clear intent of Parliament to maintain its policy that only source deductions deemed trusts survive in *CCAA* proceedings.

55 In the case at bar, the legislative context informs the determination of Parliament's legislative intent and supports the conclusion that *ETA* s. 222(3) was not intended to narrow the scope of the *CCAA's* override provision. Viewed in its entire context, the conflict between the *ETA* and the *CCAA* is more apparent than real. I would therefore not follow the reasoning in *Ottawa Senators* and affirm that *CCAA* s. 18.3 remained effective.

56 My conclusion is reinforced by the purpose of the *CCAA* as part of Canadian remedial insolvency legislation. As this aspect is particularly relevant to the second issue, I will now discuss how courts have interpreted the scope of their discretionary powers in supervising a *CCAA* reorganization and how Parliament has largely endorsed this interpretation.

Indeed, the interpretation courts have given to the *CCAA* helps in understanding how the *CCAA* grew to occupy such a prominent role in Canadian insolvency law.

3.3 Discretionary Power of a Court Supervising a CCAA Reorganization

57 Courts frequently observe that "[t]he *CCAA* is skeletal in nature" and does not "contain a comprehensive code that lays out all that is permitted or barred" (*ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*, 2008 ONCA 587, 92 O.R. (3d) 513 (Ont. C.A.), at para. 44, *per* Blair J.A.). Accordingly, "[t]he history of CCAA law has been an evolution of judicial interpretation" (*Dylex Ltd., Re* (1995), 31 C.B.R. (3d) 106 (Ont. Gen. Div. [Commercial List])), at para. 10, *per* Farley J.).

58 *CCAA* decisions are often based on discretionary grants of jurisdiction. The incremental exercise of judicial discretion in commercial courts under conditions one practitioner aptly describes as "the hothouse of real-time litigation" has been the primary method by which the *CCAA* has been adapted and has evolved to meet contemporary business and social needs (see Jones, at p. 484).

59 Judicial discretion must of course be exercised in furtherance of the *CCAA's* purposes. The remedial purpose I referred to in the historical overview of the Act is recognized over and over again in the jurisprudence. To cite one early example:

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

60 Judicial decision making under the *CCAA* takes many forms. A court must first of all provide the conditions under which the debtor can attempt to reorganize. This can be achieved by staying enforcement actions by creditors to allow the debtor's business to continue, preserving the *status quo* while the debtor plans the compromise or arrangement to be presented to creditors, and supervising the process and advancing it to the point where it can be determined whether it will succeed (see, e.g., *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 51 B.C.L.R. (2d) 84 (B.C. C.A.), at pp. 88-89; *Pacific National Lease Holding Corp., Re* (1992), 19 B.C.A.C. 134 (B.C. C.A. [In Chambers]), at para. 27). In doing so, the court must often be cognizant of the various interests at stake in the reorganization, which can extend beyond those of the debtor and creditors to include employees, directors, shareholders, and even other parties doing business with the insolvent company (see, e.g., *Canadian Airlines Corp., Re*, 2000 ABQB 442, 84 Alta. L.R. (3d) 9 (Alta. Q.B.), at para. 144, *per* Paperny J. (as she then was); *Air Canada, Re* (2003), 42 C.B.R. (4th) 173 (Ont. S.C.J. [Commercial List]), at para. 3; *Air Canada, Re* [2003 CarswellOnt 4967 (Ont. S.C.J. [Commercial List])], 2003 CanLII 49366, at para. 13, *per* Farley J.; Sarra, *Creditor Rights*, at pp. 181-92 and 217-26). In addition, courts must recognize that on occasion the broader public interest will be engaged by aspects of the reorganization and may be a factor against which the decision of whether to allow a particular action will be weighed (see, e.g., *Canadian Red Cross Society / Société Canadienne de la Croix Rouge, Re* (2000), 19 C.B.R. (4th) 158 (Ont. S.C.J.), at para. 2, *per* Blair J. (as he then was); Sarra, *Creditor Rights*, at pp. 195-214).

61 When large companies encounter difficulty, reorganizations become increasingly complex. *CCAA* courts have been called upon to innovate accordingly in exercising their jurisdiction beyond merely staying proceedings against the debtor to allow breathing room for reorganization. They have been asked to sanction measures for which there is no explicit authority in the *CCAA*. Without exhaustively cataloguing the various measures taken under the authority of the *CCAA*, it is useful to refer briefly to a few examples to illustrate the flexibility the statute affords supervising courts.

62 Perhaps the most creative use of *CCAA* authority has been the increasing willingness of courts to authorize post-filing security for debtor in possession financing or super-priority charges on the debtor's assets when necessary

for the continuation of the debtor's business during the reorganization (see, e.g., *Skydome Corp., Re* (1998), 16 C.B.R. (4th) 118 (Ont. Gen. Div. [Commercial List]); *United Used Auto & Truck Parts Ltd., Re*, 2000 BCCA 146, 135 B.C.A.C. 96 (B.C. C.A.), aff'g (1999), 12 C.B.R. (4th) 144 (B.C. S.C. [In Chambers]); and generally, J. P. Sarra, *Rescue! The Companies' Creditors Arrangement Act* (2007), at pp. 93-115). The *CCAA* has also been used to release claims against third parties as part of approving a comprehensive plan of arrangement and compromise, even over the objections of some dissenting creditors (see Metcalfe & Mansfield). As well, the appointment of a Monitor to oversee the reorganization was originally a measure taken pursuant to the *CCAA's* supervisory authority; Parliament responded, making the mechanism mandatory by legislative amendment.

63 Judicial innovation during *CCAA* proceedings has not been without controversy. At least two questions it raises are directly relevant to the case at bar: (1) what are the sources of a court's authority during *CCAA* proceedings? (2) what are the limits of this authority?

64 The first question concerns the boundary between a court's statutory authority under the *CCAA* and a court's residual authority under its inherent and equitable jurisdiction when supervising a reorganization. In authorizing measures during *CCAA* proceedings, courts have on occasion purported to rely upon their equitable jurisdiction to advance the purposes of the Act or their inherent jurisdiction to fill gaps in the statute. Recent appellate decisions have counselled against purporting to rely on inherent jurisdiction, holding that the better view is that courts are in most cases simply construing the authority supplied by the *CCAA* itself (see, e.g., *Skeena Cellulose Inc., Re*, 2003 BCCA 344, 13 B.C.L.R. (4th) 236 (B.C. C.A.), at paras. 45-47, *per* Newbury J.A.; *Stelco Inc. (Re)* (2005), 75 O.R. (3d) 5 (Ont. C.A.), paras. 31-33, *per* Blair J.A.).

65 I agree with Justice Georgina R. Jackson and Professor Janis Sarra that the most appropriate approach is a hierarchical one in which courts rely first on an interpretation of the provisions of the *CCAA* text before turning to inherent or equitable jurisdiction to anchor measures taken in a *CCAA* proceeding (see G. R. Jackson and J. Sarra, "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters", in J. P. Sarra, ed., *Annual Review of Insolvency Law 2007* (2008), 41, at p. 42). The authors conclude that when given an appropriately purposive and liberal interpretation, the *CCAA* will be sufficient in most instances to ground measures necessary to achieve its objectives (p. 94).

66 Having examined the pertinent parts of the *CCAA* and the recent history of the legislation, I accept that in most instances the issuance of an order during *CCAA* proceedings should be considered an exercise in statutory interpretation. Particularly noteworthy in this regard is the expansive interpretation the language of the statute at issue is capable of supporting.

67 The initial grant of authority under the *CCAA* empowered a court "where an application is made under this Act in respect of a company ... on the application of any person interested in the matter ..., subject to this Act, [to] make an order under this section" (*CCAA*, s. 11(1)). The plain language of the statute was very broad.

68 In this regard, though not strictly applicable to the case at bar, I note that Parliament has in recent amendments changed the wording contained in s. 11(1), making explicit the discretionary authority of the court under the *CCAA*. Thus in s. 11 of the *CCAA* as currently enacted, a court may, "subject to the restrictions set out in this Act, ... make any order that it considers appropriate in the circumstances" (S.C. 2005, c. 47, s. 128). Parliament appears to have endorsed the broad reading of *CCAA* authority developed by the jurisprudence.

69 The *CCAA* also explicitly provides for certain orders. Both an order made on an initial application and an order on subsequent applications may stay, restrain, or prohibit existing or new proceedings against the debtor. The burden is on the applicant to satisfy the court that the order is appropriate in the circumstances and that the applicant has been acting in good faith and with due diligence (*CCAA*, ss. 11(3), (4) and (6)).

70 The general language of the *CCAA* should not be read as being restricted by the availability of more specific orders. However, the requirements of appropriateness, good faith, and due diligence are baseline considerations that a court should always bear in mind when exercising *CCAA* authority. Appropriateness under the *CCAA* is assessed by inquiring whether the order sought advances the policy objectives underlying the *CCAA*. The question is whether the order will usefully further efforts to achieve the remedial purpose of the *CCAA* — avoiding the social and economic losses resulting from liquidation of an insolvent company. I would add that appropriateness extends not only to the purpose of the order, but also to the means it employs. Courts should be mindful that chances for successful reorganizations are enhanced where participants achieve common ground and all stakeholders are treated as advantageously and fairly as the circumstances permit.

71 It is well-established that efforts to reorganize under the *CCAA* can be terminated and the stay of proceedings against the debtor lifted if the reorganization is "doomed to failure" (see *Chef Ready*, at p. 88; *Philip's Manufacturing Ltd., Re* (1992), 9 C.B.R. (3d) 25 (B.C. C.A.), at paras. 6-7). However, when an order is sought that does realistically advance the *CCAA's* purposes, the ability to make it is within the discretion of a *CCAA* court.

72 The preceding discussion assists in determining whether the court had authority under the *CCAA* to continue the stay of proceedings against the Crown once it was apparent that reorganization would fail and bankruptcy was the inevitable next step.

73 In the Court of Appeal, Tysoe J.A. held that no authority existed under the *CCAA* to continue staying the Crown's enforcement of the GST deemed trust once efforts at reorganization had come to an end. The appellant submits that in so holding, Tysoe J.A. failed to consider the underlying purpose of the *CCAA* and give the statute an appropriately purposive and liberal interpretation under which the order was permissible. The Crown submits that Tysoe J.A. correctly held that the mandatory language of the *ETA* gave the court no option but to permit enforcement of the GST deemed trust when lifting the *CCAA* stay to permit the debtor to make an assignment under the *BIA*. Whether the *ETA* has a mandatory effect in the context of a *CCAA* proceeding has already been discussed. I will now address the question of whether the order was authorized by the *CCAA*.

74 It is beyond dispute that the *CCAA* imposes no explicit temporal limitations upon proceedings commenced under the Act that would prohibit ordering a continuation of the stay of the Crown's GST claims while lifting the general stay of proceedings temporarily to allow the debtor to make an assignment in bankruptcy.

75 The question remains whether the order advanced the underlying purpose of the *CCAA*. The Court of Appeal held that it did not because the reorganization efforts had come to an end and the *CCAA* was accordingly spent. I disagree.

76 There is no doubt that had reorganization been commenced under the *BIA* instead of the *CCAA*, the Crown's deemed trust priority for the GST funds would have been lost. Similarly, the Crown does not dispute that under the scheme of distribution in bankruptcy under the *BIA*, the deemed trust for GST ceases to have effect. Thus, after reorganization under the *CCAA* failed, creditors would have had a strong incentive to seek immediate bankruptcy and distribution of the debtor's assets under the *BIA*. In order to conclude that the discretion does not extend to partially lifting the stay in order to allow for an assignment in bankruptcy, one would have to assume a gap between the *CCAA* and the *BIA* proceedings. Brenner C.J.S.C.'s order staying Crown enforcement of the GST claim ensured that creditors would not be disadvantaged by the attempted reorganization under the *CCAA*. The effect of his order was to blunt any impulse of creditors to interfere in an orderly liquidation. His order was thus in furtherance of the *CCAA's* objectives to the extent that it allowed a bridge between the *CCAA* and *BIA* proceedings. This interpretation of the tribunal's discretionary power is buttressed by s. 20 of the *CCAA*. That section provides that the *CCAA* "may be applied together with the provisions of any Act of Parliament... that authorizes or makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them", such as the *BIA*. Section 20 clearly indicates the intention of Parliament for the *CCAA* to operate *in tandem* with other insolvency legislation, such as the *BIA*.

77 The *CCAA* creates conditions for preserving the *status quo* while attempts are made to find common ground amongst stakeholders for a reorganization that is fair to all. Because the alternative to reorganization is often bankruptcy, participants will measure the impact of a reorganization against the position they would enjoy in liquidation. In the case at bar, the order fostered a harmonious transition between reorganization and liquidation while meeting the objective of a single collective proceeding that is common to both statutes.

78 Tysoe J.A. therefore erred in my view by treating the *CCAA* and the *BIA* as distinct regimes subject to a temporal gap between the two, rather than as forming part of an integrated body of insolvency law. Parliament's decision to maintain two statutory schemes for reorganization, the *BIA* and the *CCAA*, reflects the reality that reorganizations of differing complexity require different legal mechanisms. By contrast, only one statutory scheme has been found to be needed to liquidate a bankrupt debtor's estate. The transition from the *CCAA* to the *BIA* may require the partial lifting of a stay of proceedings under the *CCAA* to allow commencement of the *BIA* proceedings. However, as Laskin J.A. for the Ontario Court of Appeal noted in a similar competition between secured creditors and the Ontario Superintendent of Financial Services seeking to enforce a deemed trust, "[t]he two statutes are related" and no "gap" exists between the two statutes which would allow the enforcement of property interests at the conclusion of *CCAA* proceedings that would be lost in bankruptcy *Ivaco Inc. (Re)* (2006), 83 O.R. (3d) 108 (Ont. C.A.), at paras. 62-63).

79 The Crown's priority in claims pursuant to source deductions deemed trusts does not undermine this conclusion. Source deductions deemed trusts survive under both the *CCAA* and the *BIA*. Accordingly, creditors' incentives to prefer one Act over another will not be affected. While a court has a broad discretion to stay source deductions deemed trusts in the *CCAA* context, this discretion is nevertheless subject to specific limitations applicable only to source deductions deemed trusts (*CCAA*, s. 11.4). Thus, if *CCAA* reorganization fails (e.g., either the creditors or the court refuse a proposed reorganization), the Crown can immediately assert its claim in unremitted source deductions. But this should not be understood to affect a seamless transition into bankruptcy or create any "gap" between the *CCAA* and the *BIA* for the simple reason that, regardless of what statute the reorganization had been commenced under, creditors' claims in both instances would have been subject to the priority of the Crown's source deductions deemed trust.

80 Source deductions deemed trusts aside, the comprehensive and exhaustive mechanism under the *BIA* must control the distribution of the debtor's assets once liquidation is inevitable. Indeed, an orderly transition to liquidation is mandatory under the *BIA* where a proposal is rejected by creditors. The *CCAA* is silent on the transition into liquidation but the breadth of the court's discretion under the Act is sufficient to construct a bridge to liquidation under the *BIA*. The court must do so in a manner that does not subvert the scheme of distribution under the *BIA*. Transition to liquidation requires partially lifting the *CCAA* stay to commence proceedings under the *BIA*. This necessary partial lifting of the stay should not trigger a race to the courthouse in an effort to obtain priority unavailable under the *BIA*.

81 I therefore conclude that Brenner C.J.S.C. had the authority under the *CCAA* to lift the stay to allow entry into liquidation.

3.4 Express Trust

82 The last issue in this case is whether Brenner C.J.S.C. created an express trust in favour of the Crown when he ordered on April 29, 2008, that proceeds from the sale of LeRoy Trucking's assets equal to the amount of unremitted GST be held back in the Monitor's trust account until the results of the reorganization were known. Tysoe J.A. in the Court of Appeal concluded as an alternative ground for allowing the Crown's appeal that it was the beneficiary of an express trust. I disagree.

83 Creation of an express trust requires the presence of three certainties: intention, subject matter, and object. Express or "true trusts" arise from the acts and intentions of the settlor and are distinguishable from other trusts arising by operation of law (see D. W. M. Waters, M. R. Gillen and L. D. Smith, eds., *Waters' Law of Trusts in Canada* (3rd ed. 2005), at pp. 28-29 especially fn. 42).

84 Here, there is no certainty to the object (i.e. the beneficiary) inferrable from the court's order of April 29, 2008, sufficient to support an express trust.

85 At the time of the order, there was a dispute between Century Services and the Crown over part of the proceeds from the sale of the debtor's assets. The court's solution was to accept LeRoy Trucking's proposal to segregate those monies until that dispute could be resolved. Thus there was no certainty that the Crown would actually be the beneficiary, or object, of the trust.

86 The fact that the location chosen to segregate those monies was the Monitor's trust account has no independent effect such that it would overcome the lack of a clear beneficiary. In any event, under the interpretation of *CCAA* s. 18.3(1) established above, no such priority dispute would even arise because the Crown's deemed trust priority over GST claims would be lost under the *CCAA* and the Crown would rank as an unsecured creditor for this amount. However, Brenner C.J.S.C. may well have been proceeding on the basis that, in accordance with *Ottawa Senators*, the Crown's GST claim would remain effective if reorganization was successful, which would not be the case if transition to the liquidation process of the *BIA* was allowed. An amount equivalent to that claim would accordingly be set aside pending the outcome of reorganization.

87 Thus, uncertainty surrounding the outcome of the *CCAA* restructuring eliminates the existence of any certainty to permanently vest in the Crown a beneficial interest in the funds. That much is clear from the oral reasons of Brenner C.J.S.C. on April 29, 2008, when he said: "Given the fact that [*CCAA* proceedings] are known to fail and filings in bankruptcy result, it seems to me that maintaining the status quo in the case at bar supports the proposal to have the monitor hold these funds in trust." Exactly who might take the money in the final result was therefore evidently in doubt. Brenner C.J.S.C.'s subsequent order of September 3, 2008, denying the Crown's application to enforce the trust once it was clear that bankruptcy was inevitable, confirms the absence of a clear beneficiary required to ground an express trust.

4. Conclusion

88 I conclude that Brenner C.J.S.C. had the discretion under the *CCAA* to continue the stay of the Crown's claim for enforcement of the GST deemed trust while otherwise lifting it to permit LeRoy Trucking to make an assignment in bankruptcy. My conclusion that s. 18.3(1) of the *CCAA* nullified the GST deemed trust while proceedings under that Act were pending confirms that the discretionary jurisdiction under s. 11 utilized by the court was not limited by the Crown's asserted GST priority, because there is no such priority under the *CCAA*.

89 For these reasons, I would allow the appeal and declare that the $305,202.30 collected by LeRoy Trucking in respect of GST but not yet remitted to the Receiver General of Canada is not subject to deemed trust or priority in favour of the Crown. Nor is this amount subject to an express trust. Costs are awarded for this appeal and the appeal in the court below.

***Fish J. (concurring)*:**

I

90 I am in general agreement with the reasons of Justice Deschamps and would dispose of the appeal as she suggests.

91 More particularly, I share my colleague's interpretation of the scope of the judge's discretion under s. 11 of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). And I share my colleague's conclusion that Brenner C.J.S.C. did not create an express trust in favour of the Crown when he segregated GST funds into the Monitor's trust account (2008 BCSC 1805, [2008] G.S.T.C. 221 (B.C. S.C. [In Chambers])).

92 I nonetheless feel bound to add brief reasons of my own regarding the interaction between the *CCAA* and the *Excise Tax Act*, R.S.C. 1985, c. E-15 ("*ETA*").

93 In upholding deemed trusts created by the *ETA* notwithstanding insolvency proceedings, *Ottawa Senators Hockey Club Corp. (Re)* (2005), 73 O.R. (3d) 737, [2005] G.S.T.C. 1 (Ont. C.A.), and its progeny have been unduly protective of Crown interests which Parliament itself has chosen to subordinate to competing prioritized claims. In my respectful view, a clearly marked departure from that jurisprudential approach is warranted in this case.

94 Justice Deschamps develops important historical and policy reasons in support of this position and I have nothing to add in that regard. I do wish, however, to explain why a comparative analysis of related statutory provisions adds support to our shared conclusion.

95 Parliament has in recent years given detailed consideration to the Canadian insolvency scheme. It has declined to amend the provisions at issue in this case. Ours is not to wonder why, but rather to treat Parliament's preservation of the relevant provisions as a deliberate exercise of the legislative discretion that is Parliament's alone. With respect, I reject any suggestion that we should instead characterize the apparent conflict between s. 18.3(1) (now s. 37(1)) of the *CCAA* and s. 222 of the *ETA* as a drafting anomaly or statutory lacuna properly subject to judicial correction or repair.

II

96 In the context of the Canadian insolvency regime, a deemed trust will be found to exist only where two complementary elements co-exist: first, a statutory provision *creating* the trust; and second, a *CCAA* or *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*") provision *confirming* — or explicitly preserving — its effective operation.

97 This interpretation is reflected in three federal statutes. Each contains a deemed trust provision framed in terms strikingly similar to the wording of s. 222 of the *ETA*.

98 The first is the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) ("*ITA*") where s. 227(4) *creates* a deemed trust:

> **227 (4) Trust for moneys deducted** — Every person who deducts or withholds an amount under this Act is deemed, notwithstanding any security interest (as defined in subsection 224(1.3)) in the amount so deducted or withheld, to hold the amount separate and apart from the property of the person and from property held by any secured creditor (as defined in subsection 224(1.3)) of that person that but for the security interest would be property of the person, in trust for Her Majesty and for payment to Her Majesty in the manner and at the time provided under this Act. [Here and below, the emphasis is of course my own.]

99 In the next subsection, Parliament has taken care to make clear that this trust is unaffected by federal or provincial legislation to the contrary:

> **(4.1) Extension of trust** — Notwithstanding any other provision of this Act, the *Bankruptcy and Insolvency Act* (except sections 81.1 and 81.2 of that Act), any other enactment of Canada, any enactment of a province or any other law, where at any time an amount deemed by subsection 227(4) to be held by a person in trust for Her Majesty is not paid to Her Majesty in the manner and at the time provided under this Act, property of the person ... equal in value to the amount so deemed to be held in trust is deemed
>
> > (a) to be held, from the time the amount was deducted or withheld by the person, separate and apart from the property of the person, in trust for Her Majesty whether or not the property is subject to such a security interest, ...
> >
> > ...
>
> ... and the proceeds of such property shall be paid to the Receiver General in priority to all such security interests.

100 The continued operation of this deemed trust is expressly *confirmed* in s. 18.3 of the *CCAA*:

18.3 (1) Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

(2) Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act*....

101 The operation of the *ITA* deemed trust is also confirmed in s. 67 of the *BIA*:

67 (2) Subject to subsection (3), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a bankrupt shall not be regarded as held in trust for Her Majesty for the purpose of paragraph (1)(*a*) unless it would be so regarded in the absence of that statutory provision.

(3) Subsection (2) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act*....

102 Thus, Parliament has first *created* and then *confirmed the continued operation of* the Crown's *ITA* deemed trust under *both* the *CCAA* and the *BIA* regimes.

103 The second federal statute for which this scheme holds true is the *Canada Pension Plan*, R.S.C. 1985, c. C-8 ("*CPP*"). At s. 23, Parliament creates a deemed trust in favour of the Crown and specifies that it exists despite all contrary provisions in any other Canadian statute. Finally, and in almost identical terms, the *Employment Insurance Act*, S.C. 1996, c. 23 ("*EIA*"), creates a deemed trust in favour of the Crown: see ss. 86(2) and (2.1).

104 As we have seen, the survival of the deemed trusts created under these provisions of the *ITA*, the *CPP* and the *EIA* is confirmed in s. 18.3(2) the *CCAA* and in s. 67(3) the *BIA*. In all three cases, Parliament's intent to enforce the Crown's deemed trust through insolvency proceedings is expressed in clear and unmistakable terms.

105 The same is not true with regard to the deemed trust created under the *ETA*. Although Parliament creates a deemed trust in favour of the Crown to hold unremitted GST monies, and although it purports to maintain this trust notwithstanding any contrary federal or provincial legislation, it does not *confirm* the trust — or expressly provide for its continued operation — in either the *BIA* or the *CCAA*. The second of the two mandatory elements I have mentioned is thus absent reflecting Parliament's intention to allow the deemed trust to lapse with the commencement of insolvency proceedings.

106 The language of the relevant *ETA* provisions is identical in substance to that of the *ITA*, *CPP*, and *EIA* provisions:

222. (1) [Deemed] Trust for amounts collected — Subject to subsection (1.1), every person who collects an amount as or on account of tax under Division II is deemed, for all purposes and despite any security interest in the amount, to hold the amount in trust for Her Majesty in right of Canada, separate and apart from the property of the person and from property held by any secured creditor of the person that, but for a security interest, would be property of the person, until the amount is remitted to the Receiver General or withdrawn under subsection (2).

...

(3) Extension of trust — Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act*), any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property

held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed

(a) to be held, from the time the amount was collected by the person, in trust for Her Majesty, separate and apart from the property of the person, whether or not the property is subject to a security interest, ...

...

... and the proceeds of the property shall be paid to the Receiver General in priority to all security interests.

107 Yet no provision of the *CCAA* provides for the continuation of this deemed trust after the *CCAA* is brought into play.

108 In short, Parliament has imposed *two* explicit conditions, or "building blocks", for survival under the *CCAA* of deemed trusts created by the *ITA*, *CPP*, and *EIA*. Had Parliament intended to likewise preserve under the *CCAA* deemed trusts created by the *ETA*, it would have included in the *CCAA* the sort of confirmatory provision that explicitly preserves other deemed trusts.

109 With respect, unlike Tysoe J.A., I do not find it "inconceivable that Parliament would specifically identify the *BIA* as an exception when enacting the current version of s. 222(3) of the *ETA* without considering the *CCAA* as a possible second exception" (2009 BCCA 205, 98 B.C.L.R. (4th) 242, [2009] G.S.T.C. 79 (B.C. C.A.), at para. 37). *All* of the deemed trust provisions excerpted above make explicit reference to the *BIA*. Section 222 of the *ETA* does not break the pattern. Given the near-identical wording of the four deemed trust provisions, it would have been surprising indeed had Parliament not addressed the *BIA* at all in the *ETA*.

110 Parliament's evident intent was to render GST deemed trusts inoperative upon the institution of insolvency proceedings. Accordingly, s. 222 mentions the *BIA* so as to *exclude* it from its ambit — rather than to *include* it, as do the *ITA*, the *CPP*, and the *EIA*.

111 Conversely, I note that *none* of these statutes mentions the *CCAA* expressly. Their specific reference to the *BIA* has no bearing on their interaction with the *CCAA*. Again, it is the confirmatory provisions *in the insolvency statutes* that determine whether a given deemed trust will subsist during insolvency proceedings.

112 Finally, I believe that chambers judges should not segregate GST monies into the Monitor's trust account during *CCAA* proceedings, as was done in this case. The result of Justice Deschamps's reasoning is that GST claims become unsecured under the *CCAA*. Parliament has deliberately chosen to nullify certain Crown super-priorities during insolvency; this is one such instance.

III

113 For these reasons, like Justice Deschamps, I would allow the appeal with costs in this Court and in the courts below and order that the $305,202.30 collected by LeRoy Trucking in respect of GST but not yet remitted to the Receiver General of Canada be subject to no deemed trust or priority in favour of the Crown.

***Abella J. (dissenting)*:**

114 The central issue in this appeal is whether s. 222 of the *Excise Tax Act*, R.S.C. 1985, c. E-15 ("*EIA*"), and specifically s. 222(3), gives priority during *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"), proceedings to the Crown's deemed trust in unremitted GST. I agree with Tysoe J.A. that it does. It follows, in my respectful view, that a court's discretion under s. 11 of the *CCAA* is circumscribed accordingly.

115 Section 11 [1] of the *CCAA* stated:

> **11.** (1) Notwithstanding anything in the *Bankruptcy and Insolvency Act* or the *Winding-up Act*, where an application is made under this Act in respect of a company, the court, on the application of any person interested in the matter, may, subject to this Act, on notice to any other person or without notice as it may see fit, make an order under this section.

To decide the scope of the court's discretion under s. 11, it is necessary to first determine the priority issue. Section 222(3), the provision of the *ETA* at issue in this case, states:

> **222 (3) Extension of trust** — Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act*), any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed
>
> (a) to be held, from the time the amount was collected by the person, in trust for Her Majesty, separate and apart from the property of the person, whether or not the property is subject to a security interest, and
>
> (b) to form no part of the estate or property of the person from the time the amount was collected, whether or not the property has in fact been kept separate and apart from the estate or property of the person and whether or not the property is subject to a security interest
>
> and is property beneficially owned by Her Majesty in right of Canada despite any security interest in the property or in the proceeds thereof and the proceeds of the property shall be paid to the Receiver General in priority to all security interests.

116 Century Services argued that the *CCAA's* general override provision, s. 18.3(1), prevailed, and that the deeming provisions in s. 222 of the *ETA* were, accordingly, inapplicable during *CCAA* proceedings. Section 18.3(1) states:

> **18.3** (1) ... [N]otwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

117 As MacPherson J.A. correctly observed in *Ottawa Senators Hockey Club Corp. (Re)* (2005), 73 O.R. (3d) 737, [2005] G.S.T.C. 1 (Ont. C.A.), s. 222(3) of the *ETA* is in "clear conflict" with s. 18.3(1) of the *CCAA* (para. 31). Resolving the conflict between the two provisions is, essentially, what seems to me to be a relatively uncomplicated exercise in statutory interpretation: does the language reflect a clear legislative intention? In my view it does. The deemed trust provision, s. 222(3) of the *ETA*, has unambiguous language stating that it operates notwithstanding any law except the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*").

118 By expressly excluding only one statute from its legislative grasp, and by unequivocally stating that it applies despite any other law anywhere in Canada *except* the *BIA*, s. 222(3) has defined its boundaries in the clearest possible terms. I am in complete agreement with the following comments of MacPherson J.A. in *Ottawa Senators*:

> The legislative intent of s. 222(3) of the *ETA* is clear. If there is a conflict with "any other enactment of Canada (except the *Bankruptcy and Insolvency Act*)", s. 222(3) prevails. In these words Parliament did two things: it decided that s. 222(3) should trump all other federal laws and, importantly, it addressed the topic of exceptions to its trumping decision and identified a single exception, the *Bankruptcy and Insolvency Act* .... The *BIA* and the *CCAA* are closely related federal statutes. I cannot conceive that Parliament would specifically identify the *BIA* as an exception, but accidentally fail to consider the *CCAA* as a possible second exception. In my view, the omission of the *CCAA* from s. 222(3) of the *ETA* was almost certainly a considered omission. [para. 43]

119 MacPherson J.A.'s view that the failure to exempt the *CCAA* from the operation of the *ETA* is a reflection of a clear legislative intention, is borne out by how the *CCAA* was subsequently changed after s. 18.3(1) was enacted in 1997. In 2000, when s. 222(3) of the *ETA* came into force, amendments were also introduced to the *CCAA*. Section 18.3(1) was not amended.

120 The failure to amend s. 18.3(1) is notable because its effect was to protect the legislative *status quo*, notwithstanding repeated requests from various constituencies that s. 18.3(1) be amended to make the priorities in the *CCAA* consistent with those in the *BIA*. In 2002, for example, when Industry Canada conducted a review of the *BIA* and the *CCAA*, the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals recommended that the priority regime under the *BIA* be extended to the *CCAA* (Joint Task Force on Business Insolvency Law Reform, *Report* (March 15, 2002), Sch. B, proposal 71, at pp. 37-38). The same recommendations were made by the Standing Senate Committee on Banking, Trade and Commerce in its 2003 report, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act*; by the Legislative Review Task Force (Commercial) of the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals in its 2005 *Report on the Commercial Provisions of Bill C-55*; and in 2007 by the Insolvency Institute of Canada in a submission to the Standing Senate Committee on Banking, Trade and Commerce commenting on reforms then under consideration.

121 Yet the *BIA* remains the only exempted statute under s. 222(3) of the *ETA*. Even after the 2005 decision in *Ottawa Senators* which confirmed that the *ETA* took precedence over the *CCAA*, there was no responsive legislative revision. I see this lack of response as relevant in this case, as it was in *R. v. Tele-Mobile Co.*, 2008 SCC 12, [2008] 1 S.C.R. 305 (S.C.C.), where this Court stated:

> While it cannot be said that legislative silence is necessarily determinative of legislative intention, in this case the silence is Parliament's answer to the consistent urging of Telus and other affected businesses and organizations that there be express language in the legislation to ensure that businesses can be reimbursed for the reasonable costs of complying with evidence-gathering orders. I see the legislative history as reflecting Parliament's intention that compensation not be paid for compliance with production orders. [para. 42]

122 All this leads to a clear inference of a deliberate legislative choice to protect the deemed trust in s. 222(3) from the reach of s. 18.3(1) of the *CCAA*.

123 Nor do I see any "policy" justification for interfering, through interpretation, with this clarity of legislative intention. I can do no better by way of explaining why I think the policy argument cannot succeed in this case, than to repeat the words of Tysoe J.A. who said:

> I do not dispute that there are valid policy reasons for encouraging insolvent companies to attempt to restructure their affairs so that their business can continue with as little disruption to employees and other stakeholders as possible. It is appropriate for the courts to take such policy considerations into account, but only if it is in connection with a matter that has not been considered by Parliament. Here, Parliament must be taken to have weighed policy considerations when it enacted the amendments to the *CCAA* and *ETA* described above. As Mr. Justice MacPherson observed at para. 43 of *Ottawa Senators*, it is inconceivable that Parliament would specifically identify the *BIA* as an exception when enacting the current version of s. 222(3) of the *ETA* without considering the *CCAA* as a possible second exception. I also make the observation that the 1992 set of amendments to the *BIA* enabled proposals to be binding on secured creditors and, while there is more flexibility under the *CCAA*, it is possible for an insolvent company to attempt to restructure under the auspices of the *BIA*. [para. 37]

124 Despite my view that the clarity of the language in s. 222(3) is dispositive, it is also my view that even the application of other principles of interpretation reinforces this conclusion. In their submissions, the parties raised the following as being particularly relevant: the Crown relied on the principle that the statute which is "later in time" prevails;

and Century Services based its argument on the principle that the general provision gives way to the specific (*generalia specialibus non derogani*).

125 The "later in time" principle gives priority to a more recent statute, based on the theory that the legislature is presumed to be aware of the content of existing legislation. If a new enactment is inconsistent with a prior one, therefore, the legislature is presumed to have intended to derogate from the earlier provisions (Ruth Sullivan, *Sullivan on the Construction of Statutes* (5th ed. 2008), at pp. 346-47; Pierre-André Côté, *The Interpretation of Legislation in Canada* (3rd ed. 2000), at p. 358).

126 The exception to this presumptive displacement of pre-existing inconsistent legislation, is the *generalia specialibus non derogant* principle that "[a] more recent, general provision will not be construed as affecting an earlier, special provision" (Côté, at p. 359). Like a Russian Doll, there is also an exception within this exception, namely, that an earlier, specific provision may in fact be "overruled" by a subsequent general statute if the legislature indicates, through its language, an intention that the general provision prevails (*Doré c. Verdun (Municipalité)*, [1997] 2 S.C.R. 862 (S.C.C.)).

127 The primary purpose of these interpretive principles is to assist in the performance of the task of determining the intention of the legislature. This was confirmed by MacPherson J.A. in *Ottawa Senators*, at para. 42:

> [T]he overarching rule of statutory interpretation is that statutory provisions should be interpreted to give effect to the intention of the legislature in enacting the law. This primary rule takes precedence over all maxims or canons or aids relating to statutory interpretation, including the maxim that the specific prevails over the general (*generalia specialibus non derogant*). As expressed by Hudson J. in *Canada v. Williams*, [1944] S.C.R. 226, ... at p. 239 ...:
>
> > The maxim *generalia specialibus non derogant* is relied on as a rule which should dispose of the question, but the maxim is not a rule of law but a rule of construction and bows to the intention of the legislature, if such intention can reasonably be gathered from all of the relevant legislation.

(See also Côté, at p. 358, and Pierre-Andre Côté, with the collaboration of S. Beaulac and M. Devinat, *Interprétation des lois* (4th ed. 2009), at para. 1335.)

128 I accept the Crown's argument that the "later in time" principle is conclusive in this case. Since s. 222(3) of the *ETA* was enacted in 2000 and s. 18.3(1) of the *CCAA* was introduced in 1997, s. 222(3) is, on its face, the later provision. This chronological victory can be displaced, as Century Services argues, if it is shown that the more recent provision, s. 222(3) of the *ETA*, is a general one, in which case the earlier, specific provision, s. 18.3(1), prevails (*generalia specialibus non derogant*). But, as previously explained, the prior specific provision does not take precedence if the subsequent general provision appears to "overrule" it. This, it seems to me, is precisely what s. 222(3) achieves through the use of language stating that it prevails despite any law of Canada, of a province, or "any other law" *other than the BIA*. Section 18.3(1) of the *CCAA*, is thereby rendered inoperative for purposes of s. 222(3).

129 It is true that when the *CCAA* was amended in 2005, [2] s. 18.3(1) was re-enacted as s. 37(1) (S.C. 2005, c. 47, s. 131). Deschamps J. suggests that this makes s. 37(1) the new, "later in time" provision. With respect, her observation is refuted by the operation of s. 44(f) of the *Interpretation Act*, R.S.C. 1985, c. I-21, which expressly deals with the (non) effect of re-enacting, without significant substantive changes, a repealed provision (see *Canada (Attorney General) v. Canada (Public Service Staff Relations Board)*, [1977] 2 F.C. 663 (Fed. C.A.), dealing with the predecessor provision to s. 44(f)). It directs that new enactments not be construed as "new law" unless they differ in substance from the repealed provision:

> **44.** Where an enactment, in this section called the "former enactment", is repealed and another enactment, in this section called the "new enactment", is substituted therefor,
>
> ...

> (f) except to the extent that the provisions of the new enactment are not in substance the same as those of the former enactment, the new enactment shall not be held to operate as new law, but shall be construed and have effect as a consolidation and as declaratory of the law as contained in the former enactment;

Section 2 of the *Interpretation Act* defines an enactment as "an Act or regulation or *any portion of an Act or regulation*".

130 Section 37(1) of the current *CCAA* is almost identical to s. 18.3(1). These provisions are set out for ease of comparison, with the differences between them underlined:

> **37.**(1) Subject to subsection (2), despite any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.
>
> **18.3** (1) Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

131 The application of s. 44(*f*) of the *Interpretation Act* simply confirms the government's clearly expressed intent, found in Industry Canada's clause-by-clause review of Bill C-55, where s. 37(1) was identified as "a technical amendment to reorder the provisions of this Act". During second reading, the Hon. Bill Rompkey, then the Deputy Leader of the Government in the Senate, confirmed that s. 37(1) represented only a technical change:

> On a technical note relating to the treatment of deemed trusts for taxes, the bill [*sic*] makes no changes to the underlying policy intent, despite the fact that in the case of a restructuring under the CCAA, sections of the act [*sic*] were repealed and substituted with renumbered versions due to the extensive reworking of the CCAA.
>
> (*Debates of the Senate*, vol. 142, 1st Sess., 38th Parl., November 23, 2005, at p. 2147)

132 Had the substance of s. 18.3(1) altered in any material way when it was replaced by s. 37(1), I would share Deschamps J.'s view that it should be considered a new provision. But since s. 18.3(1) and s. 37(1) are the same in substance, the transformation of s. 18.3(1) into s. 37(1) has no effect on the interpretive queue, and s. 222(3) of the *ETA* remains the "later in time" provision (Sullivan, at p. 347).

133 This means that the deemed trust provision in s. 222(3) of the *ETA* takes precedence over s. 18.3(1) during *CCAA* proceedings. The question then is how that priority affects the discretion of a court under s. 11 of the *CCAA*.

134 While s. 11 gives a court discretion to make orders notwithstanding the *BIA* and the *Winding-up Act*, R.S.C. 1985, c. W-11, that discretion is not liberated from the operation of any other federal statute. Any exercise of discretion is therefore circumscribed by whatever limits are imposed by statutes *other* than the *BIA* and the *Winding-up Act*. That includes the *ETA*. The chambers judge in this case was, therefore, required to respect the priority regime set out in s. 222(3) of the *ETA*. Neither s. 18.3(1) nor s. 11 of the *CCAA* gave him the authority to ignore it. He could not, as a result, deny the Crown's request for payment of the GST funds during the *CCAA* proceedings.

135 Given this conclusion, it is unnecessary to consider whether there was an express trust.

136 I would dismiss the appeal.

Appeal allowed.

Pourvoi accueilli.

Appendix

***Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (as at December 13, 2007)**

11. (1) Powers of court — Notwithstanding anything in the *Bankruptcy and Insolvency Act* or the *Winding-up Act*, where an application is made under this Act in respect of a company, the court, on the application of any person interested in the matter, may, subject to this Act, on notice to any other person or without notice as it may see fit, make an order under this section.

...

(3) Initial application court orders — A court may, on an initial application in respect of a company, make an order on such terms as it may impose, effective for such period as the court deems necessary not exceeding thirty days,

(a) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (i);

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

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

(4) Other than initial application court orders — A court may, on an application in respect of a company other than an initial application, make an order on such terms as it may impose,

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

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

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

...

(6) Burden of proof on application — The court shall not make an order under subsection (3) or (4) unless

(a) the applicant satisfies the court that circumstances exist that make such an order appropriate; and

(b) in the case of an order under subsection (4), the applicant also satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence.

11.4 (1) Her Majesty affected — An order made under section 11 may provide that

(a) Her Majesty in right of Canada may not exercise rights under subsection 224(1.2) of the *Income Tax Act* or any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, in respect of the company if the company is a tax debtor under that subsection or provision, for such period as the court considers appropriate but ending not later than

(i) the expiration of the order,

(ii) the refusal of a proposed compromise by the creditors or the court,

(iii) six months following the court sanction of a compromise or arrangement,

(iv) the default by the company on any term of a compromise or arrangement, or

(v) the performance of a compromise or arrangement in respect of the company; and\

(b) Her Majesty in right of a province may not exercise rights under any provision of provincial legislation in respect of the company where the company is a debtor under that legislation and the provision has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

for such period as the court considers appropriate but ending not later than the occurrence or time referred to in whichever of subparagraphs (*a*)(i) to (v) may apply.

(2) When order ceases to be in effect — An order referred to in subsection (1) ceases to be in effect if

(a) the company defaults on payment of any amount that becomes due to Her Majesty after the order is made and could be subject to a demand under

(i) subsection 224(1.2) of the *Income Tax Act*,

(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(iii) under any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection; or

(b) any other creditor is or becomes entitled to realize a security on any property that could be claimed by Her Majesty in exercising rights under

(i) subsection 224(1.2) of the *Income Tax Act*,

(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(iii) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection.

(3) Operation of similar legislation — An order made under section 11, other than an order referred to in subsection (1) of this section, does not affect the operation of

(a) subsections 224(1.2) and (1.3) of the *Income Tax Act*,

(b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(c) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

18.3 (1) Deemed trusts — Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

(2) Exceptions — Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* (each of which is in this subsection referred to as a "federal provision") nor in respect of amounts deemed to be held in trust under any law of a province that creates a deemed trust the sole purpose of which is to ensure remittance to Her Majesty in right of the province of amounts deducted or withheld under a law of the province where

(a) that law of the province imposes a tax similar in nature to the tax imposed under the *Income Tax Act* and the amounts deducted or withheld under that law of the province are of the same nature as the amounts referred to in subsection 227(4) or (4.1) of the *Income Tax Act*, or

(b) the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan*, that law of the province establishes a "provincial pension plan" as defined in that subsection and the amounts deducted or withheld under that law of the province are of the same nature as amounts referred to in subsection 23(3) or (4) of the *Canada Pension Plan*,

and for the purpose of this subsection, any provision of a law of a province that creates a deemed trust is, notwithstanding any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as the corresponding federal provision.

18.4 (1) Status of Crown claims — In relation to a proceeding under this Act, all claims, including secured claims, of Her Majesty in right of Canada or a province or any body under an enactment respecting workers' compensation, in this section and in section 18.5 called a "workers' compensation body", rank as unsecured claims.

...

(3) Operation of similar legislation — Subsection (1) does not affect the operation of

(a) subsections 224(1.2) and (1.3) of the *Income Tax Act*,

(b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(c) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

...

20. [Act to be applied conjointly with other Acts] — The provisions of this Act may be applied together with the provisions of any Act of Parliament or of the legislature of any province, that authorizes or makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them.

***Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (as at September 18, 2009)**

11. General power of court — Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.

...

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

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

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

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

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

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

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

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

(3) Burden of proof on application — The court shall not make the order unless

(a) the applicant satisfies the court that circumstances exist that make the order appropriate; and

(b) in the case of an order under subsection (2), the applicant also satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence.

...

11.09 (1) Stay — Her Majesty — An order made under section 11.02 may provide that

(a) Her Majesty in right of Canada may not exercise rights under subsection 224(1.2) of the *Income Tax Act* or any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, in respect of the company if the company is a tax debtor under that subsection or provision, for the period that the court considers appropriate but ending not later than

(i) the expiry of the order,

(ii) the refusal of a proposed compromise by the creditors or the court,

(iii) six months following the court sanction of a compromise or an arrangement,

(iv) the default by the company on any term of a compromise or an arrangement, or

(v) the performance of a compromise or an arrangement in respect of the company; and

(b) Her Majesty in right of a province may not exercise rights under any provision of provincial legislation in respect of the company if the company is a debtor under that legislation and the provision has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

for the period that the court considers appropriate but ending not later than the occurrence or time referred to in whichever of subparagraphs (*a*)(i) to (v) that may apply.

(2) When order ceases to be in effect — The portions of an order made under section 11.02 that affect the exercise of rights of Her Majesty referred to in paragraph (1)(*a*) or (*b*) cease to be in effect if

(a) the company defaults on the payment of any amount that becomes due to Her Majesty after the order is made and could be subject to a demand under

(i) subsection 224(1.2) of the *Income Tax Act*,

(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(iii) any provision of provincial legislation that has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection; or

(b) any other creditor is or becomes entitled to realize a security on any property that could be claimed by Her Majesty in exercising rights under

(i) subsection 224(1.2) of the *Income Tax Act*,

(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(iii) any provision of provincial legislation that has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection.

(3) Operation of similar legislation — An order made under section 11.02, other than the portions of that order that affect the exercise of rights of Her Majesty referred to in paragraph (1)(*a*) or (*b*), does not affect the operation of

(a) subsections 224(1.2) and (1.3) of the *Income Tax Act*,

(b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(c) any provision of provincial legislation that has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

37. (1) Deemed trusts — Subject to subsection (2), despite any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

(2) Exceptions — Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* (each of which is in this subsection referred to as a "federal provision"), nor does it apply in respect of amounts deemed to be held in trust under any law of a province that creates a deemed trust the sole purpose of which is to ensure remittance to Her Majesty in right of the province of amounts deducted or withheld under a law of the province if

(a) that law of the province imposes a tax similar in nature to the tax imposed under the *Income Tax Act* and the amounts deducted or withheld under that law of the province are of the same nature as the amounts referred to in subsection 227(4) or (4.1) of the *Income Tax Act*, or

(b) the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan*, that law of the province establishes a "provincial pension plan" as defined in that

subsection and the amounts deducted or withheld under that law of the province are of the same nature as amounts referred to in subsection 23(3) or (4) of the *Canada Pension Plan*,

and for the purpose of this subsection, any provision of a law of a province that creates a deemed trust is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as the corresponding federal provision.

***Excise Tax Act*, R.S.C. 1985, c. E-15 (as at December 13, 2007)**

222. (1) [Deemed] Trust for amounts collected — Subject to subsection (1.1), every person who collects an amount as or on account of tax under Division II is deemed, for all purposes and despite any security interest in the amount, to hold the amount in trust for Her Majesty in right of Canada, separate and apart from the property of the person and from property held by any secured creditor of the person that, but for a security interest, would be property of the person, until the amount is remitted to the Receiver General or withdrawn under subsection (2).

(1.1) Amounts collected before bankruptcy — Subsection (1) does not apply, at or after the time a person becomes a bankrupt (within the meaning of the *Bankruptcy and Insolvency Act)*, to any amounts that, before that time, were collected or became collectible by the person as or on account of tax under Division II.

...

(3) Extension of trust — Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act)*, any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed

(a) to be held, from the time the amount was collected by the person, in trust for Her Majesty, separate and apart from the property of the person, whether or not the property is subject to a security interest, and

(b) to form no part of the estate or property of the person from the time the amount was collected, whether or not the property has in fact been kept separate and apart from the estate or property of the person and whether or not the property is subject to a security interest

and is property beneficially owned by Her Majesty in right of Canada despite any security interest in the property or in the proceeds thereof and the proceeds of the property shall be paid to the Receiver General in priority to all security interests.

***Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (as at December 13, 2007)**

67. (1) Property of bankrupt — The property of a bankrupt divisible among his creditors shall not comprise

(a) property held by the bankrupt in trust for any other person,

(b) any property that as against the bankrupt is exempt from execution or seizure under any laws applicable in the province within which the property is situated and within which the bankrupt resides, or

(b.1) such goods and services tax credit payments and prescribed payments relating to the essential needs of an individual as are made in prescribed circumstances and are not property referred to in paragraph (*a*) or (*b*),

but it shall comprise

(c) all property wherever situated of the bankrupt at the date of his bankruptcy or that may be acquired by or devolve on him before his discharge, and

(d) such powers in or over or in respect of the property as might have been exercised by the bankrupt for his own benefit.

(2) Deemed trusts — Subject to subsection (3), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a bankrupt shall not be regarded as held in trust for Her Majesty for the purpose of paragraph (1)(*a*) unless it would be so regarded in the absence of that statutory provision.

(3) Exceptions — Subsection (2) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* (each of which is in this subsection referred to as a "federal provision") nor in respect of amounts deemed to be held in trust under any law of a province that creates a deemed trust the sole purpose of which is to ensure remittance to Her Majesty in right of the province of amounts deducted or withheld under a law of the province where

(a) that law of the province imposes a tax similar in nature to the tax imposed under the *Income Tax Act* and the amounts deducted or withheld under that law of the province are of the same nature as the amounts referred to in subsection 227(4) or (4.1) of the *Income Tax Act*, or

(b) the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan*, that law of the province establishes a "provincial pension plan" as defined in that subsection and the amounts deducted or withheld under that law of the province are of the same nature as amounts referred to in subsection 23(3) or (4) of the *Canada Pension Plan*,

and for the purpose of this subsection, any provision of a law of a province that creates a deemed trust is, notwithstanding any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as the corresponding federal provision.

86. (1) Status of Crown claims — In relation to a bankruptcy or proposal, all provable claims, including secured claims, of Her Majesty in right of Canada or a province or of any body under an Act respecting workers' compensation, in this section and in section 87 called a "workers' compensation body", rank as unsecured claims.

...

(3) Exceptions — Subsection (1) does not affect the operation of

(a) subsections 224(1.2) and (1.3) of the *Income Tax Act*;

(b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts; or

(c) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

Footnotes

1 Section 11 was amended, effective September 18, 2009, and now states:

11. Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.

2 The amendments did not come into force until September 18, 2009.

End of Document

TAB
“16”

2003 CarswellOnt 3514
Ontario Superior Court of Justice

Wiggins, Re

2003 CarswellOnt 3514, [2003] O.J. No. 3685, [2003] O.T.C. 837, 125 A.C.W.S. (3d) 563, 50 C.B.R. (4th) 306, 67 O.R. (3d) 133

IN THE MATTER OF the Consumer Proposal of Sally Teresa Wiggins

Swinton J.

Heard: September 16, 2003
Judgment: September 18, 2003
Docket: 31-388321

Counsel: Sanjeev P.R. Mitra for Administrator
Valerie Anderson for Superintendent of Bankruptcy

Subject: Insolvency

APPLICATION by administrator of consumer proposal for declaration that court had inherent jurisdiction to waive default in consumer proposal more than three months following default.

***Swinton J.*:**

1 The Administrator of the Consumer Proposal of Sally Teresa Wiggins and other individuals listed in Schedules A, B and C of the Motion Record sought a declaration that this Court has the inherent jurisdiction to waive default in a consumer proposal more than three months following the default and for other relief.

2 Section 66.31(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended, provides:

> Independently of section 66.3,
>
> > (a) where payments under a consumer proposal are to be made monthly or more frequently and the consumer debtor is in default to the extent of three months payments, or
> >
> > (b) where payments under a consumer proposal are to be made less frequently than monthly and the consumer debtor is in default for more than three months on any payment,
>
> the consumer proposal shall thereupon be deemed to be annulled unless the court has previously ordered otherwise or unless an amendment to the consumer proposal has previously been filed, and the administrator shall forthwith so inform the creditors and file a report thereof in the prescribed form with the official receiver.

3 In this case, Ms. Wiggins failed to make payments for three months. She then resumed payments and made up the arrears. However, pursuant to s. 66.3(1), her consumer proposal was deemed annulled. Nevertheless, the Administrator allowed her to pay the arrears and has continued to make distributions to creditors as if the consumer proposal remained in effect.

4 Mr. Justice Ground approved the omnibus procedure for this motion, which groups individuals like Ms. Wiggins in Schedule A and seeks an order waiving the default and setting aside the deemed annulment. Schedule B includes individuals who were in arrears over three months and who are making progress to make up the arrears. The

Administrator seeks an order of waiver of the default, the setting aside of the deemed annulment and filing of an amended proposal, or the granting of leave to file a second consumer proposal. Finally, Schedule C consists of individuals who were in arrears over three months and who made unsuccessful attempts to catch up. An order is sought with respect to the distribution of funds held by the Administrator which were received after the deemed annulment.

5 Decisions of the Registrar in both Nova Scotia and Ontario have held that there is no specific authority under the *BIA* to allow a court to waive the default by the debtor following the deemed annulment of a consumer proposal (*Schrader, Re* (1999), 13 C.B.R. (4th) 256 (N.S. S.C.); *Dziewiacien, Re* (2002), 37 C.B.R. (4th) 250 (Ont. S.C.J.)). Deputy Registrar Nettie in *Dziewiacien, Re* held that s. 187(11) of the Act does not permit the court to extend a time period in the Act where there has been an intervening statutory event consequent upon default. That decision was not appealed.

6 Section 183(1) of the Act vests the Superior Court of Justice in Ontario and the named courts in other jurisdictions with "such jurisdiction at law and in equity as will enable them to exercise original, auxiliary and ancillary jurisdiction in bankruptcy". The Administrator argued that this section confers inherent jurisdiction on this Court, which should be exercised in this case to waive the default and set aside the deemed annulment under the Act for debtors in Schedule A and B. Counsel for the Superintendent agreed with this position, based on the facts before me in this motion.

7 The Bankruptcy Court may authorize and sanction acts required to be done by a trustee for the due administration and protection of the bankrupt estate, even though there is no specific provision in the Act (*Tlustie, Re* (1923), 3 C.B.R. 654 (Ont. S.C.)). However, inherent jurisdiction can not be exercised if the exercise conflicts with the provisions of the Act (*Wasserman, Arsenault Ltd. v. Sone* (2000), 22 C.B.R. (4th) 153 (Ont. S.C.J. [Commercial List]), aff'd (2000), 33 C.B.R. (4th) 145 (Ont. C.A.)). Here, s. 66.31 deals specifically with what follows if the consumer debtor is in default in payments for three months: the consumer proposal is deemed annulled unless the court has ordered otherwise or unless an amendment to the proposal has been filed *before* the three month period expires.

8 In my view, there is no inherent jurisdiction to waive a default like that of Ms. Wiggins and to set aside the deemed annulment of her consumer proposal, given the express terms of the Act. While Ontario courts may have granted the relief sought in this motion prior to the decision in *Dziewiacien, Re*, in my view, they had no inherent jurisdiction to do so.

9 Given that individuals like Ms. Wiggins and those in Schedule A have continued to make payments as if the consumer proposal were still in effect, and the Administrator has continued to make distributions, leave is given to this group to file a second consumer proposal, and I order that they are entitled to the relief in ss. 69-69.2. Given the payment history since the default, it appears that there is a reasonable prospect of the new proposal being accepted by the creditors.

10 Given the history of the Schedule B debtors, I also grant leave to this group to file a second consumer proposal, and I order that they are entitled to the relief in ss. 69-69.2 for the same reason.

11 With respect to Schedule C, the Administrator has asked for directions with respect to the distribution of funds which it received after the deemed annulment. According to *White, Re* (2001), 31 C.B.R. (4th) 128 (N.S. S.C.), those funds should be distributed to the creditors.

Application dismissed.

TAB
“17”

1913 CarswellOnt 36
Ontario Supreme Court

Maple Leaf Portland Cement Co. v. Owen Sound Iron Works Co.

1913 CarswellOnt 36, 10 D.L.R. 33, 23 O.W.R. 907, 4 O.W.N. 721

Maple Leaf Portland Cement Company, Limited, et al v. The Owen Sound Iron Works Company, Limited, et al.

Hon. Mr. Justice Kelly.

Judgment: January 31, 1913

Counsel: *W. G. Thurston, K.C.* , for plaintiffs.
R. McKay, K.C. , for defendants.

Subject: Contracts; Torts; Civil Practice and Procedure

Action for damages for breach of a contract alleged to have been entered into with the defendants for the sale and delivery of certain machines, an Emerick Pulverizer and an Emerick Separator, for use in the plaintiffs' cement business at Atwood, Ont.

The defence of the defendant company was, that there was no contract between them and plaintiffs, that plaintiffs' dealings were with the defendant Moyer only, who, they alleged, had a contract with the defendant company to do certain work upon such machines as were sold to plaintiffs, and that Moyer was not their agent. Moyer's defence as set up in the statement of defence, was in effect that the contract for the sale and delivery of the machinery in question, had been fulfilled. He was unrepresented at the trial.

***Hon. Mr. Justice Kelly*:**

1 Moyer, who held himself out as representing the defendant company, had several interviews with plaintiff Pearson, president of the plaintiff company, with a view to inducing that company to purchase machines such as were afterwards purchased, and of which he stated the defendant company were the makers.

2 On December 16th, 1910, he made a written proposal to Pearson to supply these machines for $3,000, the machines to be shipped on March 1st, 1911, payment to be made by promissory note for $1,000 at sixty days from January 1st, 1911, and a further note for $2,000 to be dated on date of the delivery of the machines and to be payable on May 20th, 1911.

3 Three copies of the proposal were made, one of which, (exhibit 1 at the trial) was signed by Moyer for himself and the defendant company, and the others (exhibit 13 at the trial) by the name of Moyer only. All these were accepted in writing by Pearson "subject to confirmation by the Owen Sound Iron Works Co., Ltd." Pearson then gave to Moyer his promissory note, dated January 1st, 1911, for $1,000, payable to the order of the defendant company at sixty days, on which was written "on account of one Emerick Grinder, to be delivered 1st March, 1911." Moyer took the three copies of acceptance to have them confirmed by defendant company.

4 On March 15th, the $1,000 note not having been paid, defendant company drew on Pearson for the amount, and he, on March 23rd, accepted the draft. That draft not having been paid, defendant company on March 27th again drew on him at thirty days. He did not accept this draft. On April 11th, the machinery about that time having been delivered at plaintiffs' works (but not installed), Moyer went to Pearson and received from him a cheque payable to defendant company for $1,000 expressed on the face to be "account Maple Leaf Portland Cement Company, Emerick

Coal Grinder," in payment of his note of January 1st and his acceptance of March 23rd, Pearson also then gave to Moyer his promissory note to defendant company for $2,000, representing the balance of the purchase money.

5 Delay having occurred in the delivery of the machinery to the plaintiffs, Pearson, on April 6th, wrote to defendant company complaining that there was delay, and stating that "according to our arrangement" the time for delivery had passed, threatening to cancel the contract immediately if delivery was not made, and adding, "if you are not going to deliver the one you agreed to, just say so immediately." The reply of the defendant company dated April 7th was this:

6 Mr. Jas. Pearson, Toronto, Ont. Dear Sir, — We have yours of the 6th inst. to hand, and in reply would say that we are shipping your pulverizer together with the separator on Monday, 10th inst.

7 We would say that we would have made the shipment weeks ago, were it not that we only received the steel parts from the Bethlehem Steel Co. only three weeks ago, and we have used every possible means to forward the construction of the outfit since the time the steel parts came to hand.

We remain, yours truly,

The Owen Sound Iron Works Co., Ltd.

Per . . Wilson.

8 Letters were sent by Pearson to defendant company on April 21st, April 29th, and May 10th, to none of which was any reply made. In the letter of April 21st he again complain of the delay in delivery and drew attention to the serious loss plaintiff company would sustain through not being able to fill their customers' orders, for which loss he declared his intention of holding defendant company liable, and he referred to a statement made by "your Mr. Moyer when selling the mill."

9 In the letter of April 29th he asks defendant company to send him "one ocpy of the agreement that was signed between us," mentioning that Moyer had taken both away on the understanding that they were to be returned signed by the defendant company.

10 The letter of May 10th again complains of the delay and notifies defendant company of his intention to claim against them for damages; he also draws attention to their not having returned the copy of agreement, and their not having replied to his former letter asking for it.

11 About this time the machinery was installed, and its operation being unsatisfactory, Pearson, on May 27th, again wrote the defendant company referring to this and to the damage he claimed plaintiffs were sustaining, and adding: "I think your conduct in refusing to send me back one copy of the agreement is reprehensible," etc. This brought from defendant company a letter of May 25th (the first communication of any kind from them to plaintiffs from April 7th), in which they, in effect, repudiated any liability to plaintiffs on the ground that they were working under a contract with Moyer to supply him with cement grinders and separators and had nothing to do with the sale or installation of machinery, and assumed no responsibility for its operation to anyone but Moyer.

12 The offer and acceptance by Pearson (exhibit 10) were not returned to him until after May 27th, when it was brought to him by Moyer. The other copies (exhibit 13) were left with the defendant company by Moyer about the end of December, 1910, and remained in their possession until the time of the trial. The managing director of the company admits they were left with them for the purpose of their being confirmed by the company, and that no notice was sent to plaintiffs of the neglect or refusal to confirm.

13 The machines which were delivered were "second-hand" and not manufactured by defendants; they were not such as the contract called for and were unfit for the purposes for which they were intended; they were useless in plaintiffs' business, and for that reason they were discarded after having been subjected to a test of several weeks, during which they were under the control of Fry, who for vendors superintended their installation and their operation for several weeks

afterwards. He failed to make them work and the evidence further establishes that it was impossible for anyone to make them work properly. It became necessary for plaintiffs to replace them by others. It is under these circumstances that defendant company now seeks to escape liability to the plaintiffs.

14 Some evidence of damages was given at the trial, but that branch of the case was not fully gone into until the question of liability should be determined.

15 I am unable to see how defendant company can escape liability in view of the combination of circumstances which is found in these dealings. When it is considered that that company, from December, 1910, until after the machines were delivered and installed, had in their possession Pearson's acceptances of the proposal to sell which were stated to be subject to confirmation by the company, that the company at the time they received the proposal and acceptances also received Pearson's $1,000 note payable to their order, and bearing on its face the statement that it was on account of machinery agreed to be purchased; that the draft for $1,000 was made upon Pearson by defendant company; that the $1,000 payment made by Pearson was by cheque payable to them; that the $2,000 note also was made payable to them; that the several letters clearly intimated that the plaintiffs believed they were dealing with defendant company; and that there was no repudiation of contractual relationship, or even a reply to many of these letters, until it became apparent that the machinery was not satisfactory, no other conclusion can be reached but that defendant company must have known, and did know, that plaintiffs were dealing on the understanding and in the belief that they were contracting with the defendant company.

16 It is beyond belief that any business man could be so obtuse as not to have realized from plaintiffs' course of dealings and Pearson's correspondence, that plaintiffs believed their contract was with defendant company. I think, too, that until the position of vendor became undesirable owing to the unsatisfactory working of the machines, defendant company was quite satisfied to be a party to the contract with plaintiffs and so intended it; they were satisfied to take the benefit without bearing the burden.

17 On these facts the defendant company is in my opinion liable.

18 In *Keen v. Priest* (1858), 1 F. &. F. 314 (at p. 315) Bramwell, B., says: — "Silence may sometimes be conduct," the meaning of which I assume to be that there must be some act or circumstance which can be considered in connection with silence. This is borne out by what is said in *British Linen Co. v. Cowan* (1906) 8 F. 704 (at p. 710): — "Passivity can never constitute an unreal obligation into a real, can never make a man into a debtor who has neither said nor done anything to make him a party to the obligation, which has no existence apart from some action on his part. What action might be sufficient is a different question. It is possible that very little in the way of overt action, if it was unmistakable, might be sufficient."

19 Kay, L.J., in *Weidemann v. Walpole*, [1891] 2 Q.B. 534 (at p. 541), lays it down that "the only fair way of stating the rule of law is that in every case you must look at all the circumstances under which the letter was written, and you must determine for yourself whether the circumstances are such that the refusal to reply alone amounts to an admission."

20 Reference may also be made to *Freeman v. Cooke*, 2 Ex. 653 (particularly at 663); *Carr v. London & North Western Railway Co.* , L. R. 10 C. P. 307 (at 316 and 317).

21 In the present case there was much more than mere passivity, there were positive acts of the defendant company which have estopped them from denying liability.

22 The manager of the defendant company stated that he turned over to Moyer all communications which were received from plaintiffs; Moyer did not in any way communicate this to plaintiffs, and did nothing to remove any impression they had that they were contracting with defendant company. I think I am not going too far in holding Moyer liable as well as his co-defendants.

23 There will, therefore, be judgment in favour of plaintiffs for re-payment of the $1,000 paid by Pearson to defendant company, and interest thereon from the date of such payment; for a return of the $2,000 promissory note made to defendant company, with costs of the action to the present time; and a reference to the Master in Ordinary to ascertain the damages sustained by plaintiffs. Further direction and further costs are reserved until the Master shall have made his report.

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THE LAW OF CONTRACTS

FIFTH EDITION

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intent shall have the effect of operating as an acceptance of the offeror's terms.[224] In *Hamilton Gear and Machine Co. Ltd. v. Lewis Bros. Ltd.*,[225] Mulock C.J.O. said: "It is, I think, the law that if an offer . . . does not require acceptance in any particular way, then such conduct by the person to whom it is made as warrants the inference . . . of acceptance . . . is equivalent to acceptance."

93 Some actions which have been held to be "equivalent to acceptance" are shipment of the goods requested,[226] acceptance of delivery,[227] payment of money,[228] "receiving printed forms without objection"[229] and abandonment of a legal right to object to the transaction.[230] Further, if one party is aware of the other's belief in the existence of a contract, and does nothing to deny it, but acts as though there were a contract, that party may be estopped from later denying that a contract exists.[231]

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[224] In *Haney v. Winnipeg & Northern Rwy. Co.* (1912), 1 D.L.R. 387 (Man. K.B.), the plaintiff informed a railway company that if it took possession of his land to build a railway he would expect it to pay $40,000. The railway's taking possession was held not to manifest an agreement to that sum. But in *Carr v. Canadian Northern Rwy. Co.* (1907), 6 W.L.R. 720 (Man. K.B.), on similar facts a railway was held to have accepted the offer by taking possession of the land. See also *Taylor v. Allon*, [1966] 1 Q.B. 304; *Vail and Spriel v. Keddy's Motor Inns* (1981), 38 N.B.R. (2d) 361 (Q.B.T.D.); *J.D. Irving Ltd. v. Fraser-Brace Engineering Co. Ltd.* (1980), 29 N.B.R. (2d) 147 (Q.B.), vard 39 N.B.R. (2d) 181 (C.A.); *Hill v. Peter Gorman Ltd.* (1957), 9 D.L.R. (2d) 124 (Ont. C.A.) (employee continuing after proposed variation in terms of employment).

[225] [1924] 3 D.L.R. 367 (Ont. S.C.A.D.), at pp. 370-71. See also *Lanca Contracting Ltd. v. Brant County Board of Education* (1986), 26 D.L.R. (4th) 708, 54 O.R. (2d) 44 (C.A.); *Nicholas v. Pictou Landing Band Council* (2001), 193 N.S.R. (2d) 130, 602 A.P.R. 130 (C.A.).

[226] *Hamilton Gear & Machine Co. v. Lewis Bros. Ltd., supra*, footnote 225; *Re Hudson Fashion Shoppe Ltd.; ex p. Royal Dress Co.*, [1926] 1 D.L.R. 199 (Ont. S.C. App. Div.).

[227] *Howard Marine & Dredging Co. Ltd. v. A. Ogden & Sons (Excavations) Ltd.*, [1978] Q.B. 574 (C.A.); *Irving Oil v. Incan Ships Ltd.* (1979), 26 N.B.R. (2d) 512 (Q.B. Div.), vard 30 N.B.R. (2d) 319 (C.A.); and see para. 76, *supra*.

[228] *Brodey v. Arnold* (1923), 25 O.W.N. 286 (Chamb.); *Flynn v. Benson* (1923), 24 O.W.N. 617 (H. Ct.), affd 25 O.W.N. 358 (Div. Ct.). But see *North Vancouver (District of) v. Tracy* (1903), 34 S.C.R. 132.

[229] *Glendale (Atlantic) Ltd. v. Gentleman* (1977), 76 D.L.R. (3d) 303 (N.S.S.C. App. Div.).

[230] *Greenberg v. Manitoba Hudson-Essex Ltd.*, [1934] 1 W.W.R. 790 (Man. C.A.).

[231] *Maple Leaf Portland Cement Co. v. Owen Sound Iron Works Co.* (1913), 10 D.L.R. 33 (Ont. S.C.), affd 24 O.W.R. 790 (S.C. App. Div.); *Grimsby Steel Furniture Co. v. Columbia Gramophone Co.* (1922), 23 O.W.N. 188 (S.C.); *McCool v. Grant & Dunn* (1921), 58 D.L.R. 373 (Ont. S.C. App. Div.); *Commonwealth Drilling Co. Ltd. v. Community Petroleums Ltd.*, [1951] 4 D.L.R. 328 (Sask. C.A.); *Rocca Group Ltd. v. Consumers Distributing* (1977), 21 N.S.R. (2d) 371 (S.C. App. Div.) (letter declaring "substantial agreement has been reached" estopped party from denying the contract); *Lawson v. Utan Enterprises Ltd.* (1979), 10 B.C.L.R. 163 (S.C.), vard 39 B.C.L.R. 1 (C.A.) (party who had begun farming operations estopped from declaring interim agreement to buy farm to be unenforceable); *Beer v. Townsgate I Ltd.* (1997), 152

Where a cheque is sent on certain terms such as "in full settlement" of an account, the retention of the cheque may amount to an agreement to the sender's terms.[232] However, it has been regularly held that the recipient is quite entitled, if the intention is not to agree, to accept the cheque on account and sue for the balance owing.[233] In cases where unsolicited goods are sent with a note stating that a certain price is to be paid if the goods are not returned, the recipient may, without contractual liability, simply ignore the note and keep the goods for the sender to collect. Use of the goods might amount to an agreement to pay for them,[234] but it is now provided by statute in several jurisdictions that the recipient may use the goods in such circumstances without liability.[235]

In some cases a party is held to assent to a variation of a contract by "acquiescence". In *Johnson v. Trobak*,[236] a document evidencing a lease with an option to purchase was altered by a third party so as to enlarge the option. It was held that the lessor, by permitting the lessee to take possession without objecting to the alteration, had acquiesced, and was bound by the amendment. 94

In a case where an offer states that the silence of the offeree shall constitute acceptance it may often be held that the offeree can ignore the offer without contractual liability. To hold otherwise would be to allow the offeror to impose unfairly. But suppose that the offeree, desiring the encyclopedia on the terms offered, remains silent intending to accept the offer. Should the offeror escape liability? There seems to be no compelling reason why the offeror should escape. Perfect symmetry 95

D.L.R. (4th) 671 (Ont. C.A.), leave to appeal to S.C.C. refused 175 D.L.R. (4th) vi. But see *Zeismann v. W.P.W. Developments Ltd.* (1976), 78 D.L.R. (3d) 619 (B.C.S.C.) (estoppel cannot create cause of action).

[232] *Phillip v. Massey-Ferguson Finance Co. of Canada Ltd.*, [1973] 1 W.W.R. 443 (Sask. D.C.); *Lowden v. Martin* (1888), 12 P.R. 496 (Ont. C.A.).

[233] *Mason v. Johnston* (1893), 20 O.A.R. 412; *Day v. McLea* (1889), 22 Q.B.D. 610 (C.A.); *McPherson v. Copeland* (1908), 1 Sask. L.R. 519; *Shearer v. Reeder* (1915), 9 O.W.N. 155 (S.C. App. Div.); *Peterson v. Flack*, [1923] 3 D.L.R. 132 (Sask. C.A.); *Decelle v. Lloyds of London* (1973), 33 D.L.R. (3d) 743 (Sask. Q.B.); *Brilliant Silk Mfg. Co. Inc. v. Kaufman*, [1925] 2 D.L.R. 91, [1925] S.C.R. 249; *Neuchatel Asphalte Co. Ltd. v. Barnett*, [1957] 1 All E.R. 362 (C.A.); *Champlain Ready-Mixed Concrete v. Beaupre* (1971), 21 D.L.R. (3d) 164 (Ont. C.A.); *Tingley v. Price Bros. Ltd.*, [1927] 1 D.L.R. 1036 (N.B.S.C. App. Div.); *Woodlot Services Ltd. v. Flemming* (1977), 83 D.L.R. (3d) 201 (N.B.S.C. App. Div.).

[234] *Restatement of Contracts (Second)*, §69(2), "An offeree who does any act inconsistent with the offeror's ownership of offered property is bound in accordance with the offered terms unless they are manifestly unreasonable."

[235] See *Business Practices and Consumer Protection Act* (B.C.), s. 12; *Consumer Protection Act* (Ont.), s. 36(3) (note: at the time of going to press this Act was expected to be repealed on July 30, 2005, with the coming into force of the new *Consumer Protection Act, 2002*); N.S., s. 23(4); P.E.I., s. 17; Sask., ss. 72, 73; *Unsolicited Goods and Credit Cards Act* (Nfld.) & Lab., s. 3.

[236] (1977), 79 D.L.R. (3d) 684 (B.C.C.A.).

TAB
“19”

2000 SCC 29
Supreme Court of Canada

R. c. Jolivet

2000 CarswellQue 805, 2000 CarswellQue 806, 2000 SCC 29, [2000] 1 S.C.R. 751, [2000] S.C.J. No. 28, 144 C.C.C. (3d) 97, 185 D.L.R. (4th) 626, 254 N.R. 1, 33 C.R. (5th) 1, 46 W.C.B. (2d) 97

Her Majesty the Queen, Appellant v. Daniel Jolivet, Respondent

L'Heureux-Dubé, Gonthier, McLachlin, Bastarache, Binnie JJ.

Heard: February 19, 1999
Judgment: May 18, 2000
Docket: 26646

Proceedings: reversing (1998), (sub nom. R. v. Jolivet) 125 C.C.C. (3d) 210, 20 C.R. (5th) 326, [1998] Q.J. No. 1221 (Que. C.A.)

Counsel: *Henri-Pierre Labrie* and *Jacques Pothier*, for Appellant.
Alain Brassard, for Respondent.

Subject: Criminal; Evidence

APPEAL and CROSS-APPEAL from judgment reported at (1998), *(*sub nom. *R. v. Jolivet)* 125 C.C.C. (3d) 210, 20 C.R. (5th) 326 (Que. C.A.), allowing appeal by accused from conviction for murder and ordering new trial.

POURVOI et POURVOI INCIDENT à l'encontre d'un jugement rapporté à (1998), *(*sub nom. *R. v. Jolivet)* 125 C.C.C. (3d) 210, 20 C.R. (5th) 326 (C.A. Qué.), accueillant le pourvoi de l'accusé sur une condamnation de meurtre et ordonnant un nouveau procès.

The judgment of the court was delivered by *Binnie J.*:

1 This appeal requires the Court to consider the circumstances in which the Crown's failure to call an important witness at a criminal trial can be the subject of comment in the defence jury address or the basis of a trial judge's "missing witness" jury instruction.

2 The issue arises in this way. The respondent, Daniel Jolivet, was found guilty by a jury of four counts of murder in killings that were described as a settling of scores in the stolen goods and drug trade. The conviction was based largely on the testimony of an informer named Claude Riendeau. In the course of the trial, Crown counsel indicated to the jury on two separate occasions that the Crown would be calling one of the respondent's sometime "business" associates, Gérald Bourgade, to corroborate important admissions said to be made by the respondent in the presence of Riendeau and Bourgade. Just prior to the close of the case for the prosecution, he advised the court that the Crown no longer intended to call Bourgade.

3 This surprising reversal of position by the Crown was accompanied by an explanation that the Quebec Court of Appeal described as "astonishing". Crown counsel said that even though he had put Bourgade on the list of Crown witnesses for trial, and had twice referred to Bourgade's expected appearance before the jury, he had concluded, somewhat belatedly, that he did not consider truthful the testimony given by Bourgade at the preliminary inquiry.

4 The defence wished to comment on the missing Bourgade in its closing address, but was effectively prevented from doing so by the trial judge, who also declined to give any jury instruction on the point. The Quebec Court of Appeal held unanimously that this refusal to allow defence counsel to comment on the missing witness was an error.

5 A majority of the Quebec Court of Appeal ordered a new trial. Robert J.A., dissenting, concluded that there was no reasonable possibility that the verdict would have been different had the trial judge permitted the defence to make its comment. He would therefore have refused a new trial and dismissed the appeal. On appeal as of right to this Court, the respondent took the position that such a division of opinion in an appellate court does not raise any question of law, and that this Court lacked jurisdiction to continue with the appeal. The Crown relied on the statement of the Court in *R. v. Mahoney*, [1982] 1 S.C.R. 834 (S.C.C.) at p. 852, that "[t]he Court of Appeal must give substance to the concept of miscarriage of justice' and this involves a legal determination". The panel of the Court hearing this appeal reserved the question as to whether the reasonableness of a possible verdict raises a question of law to be revisited by the full Court on a comparable objection in *R. v. Biniaris*, 2000 SCC 15 (S.C.C.), in relation to s. 686 (1)(*a*)(i) of the *Criminal Code*, R.S.C. 1985, c. C-46. Judgment in *Biniaris* was recently released on April 13, 2000. For the reasons given in that case, the correctness of the dictum from *Mahoney* is affirmed and the preliminary objection to jurisdiction is therefore dismissed.

6 On the substantive issues, for the reasons which follow, my view is that the Quebec Court of Appeal was correct in concluding that the trial judge ought to have permitted defence counsel to comment on the Crown's failure to call the corroborative witness, but that the majority erred in refusing to apply the curative proviso of s. 686(1)(*b*)(iii). I would therefore set aside the majority decision of the Quebec Court of Appeal on the narrow issue of whether or not the curative proviso applies and allow the Crown's appeal, notwithstanding the error of law committed by the trial judge. The jury verdict of guilt is therefore reinstated.

Relevant Statutory Provisions

7 *Criminal Code*

> **686.** (1) On the hearing of an appeal against a conviction or against a verdict that the appellant is unfit to stand trial or not criminally responsible on account of mental disorder, the court of appeal
>
> (*a*) may allow the appeal where it is of the opinion that
>
> . . . . .
>
> (ii) the judgment of the trial court should be set aside on the ground of a wrong decision on a question of law,
>
> . . . . .
>
> (*b*) may dismiss the appeal where
>
> . . . . .
>
> (iii) notwithstanding that the court is of the opinion that on any ground mentioned in subparagraph (*a*) (ii) the appeal might be decided in favour of the appellant, it is of the opinion that no substantial wrong or miscarriage of justice has occurred;

Facts

The Trial - Quebec Superior Court - Biron J.

8 At trial, the circumstances leading to the four killings were recounted by the Crown's principal witness, Claude Riendeau, an informer. A detailed account of that testimony is found in the meticulous reasons for judgment of Robert J.A., dissenting, reported at (1998), 125 C.C.C. (3d) 210 (Que. C.A.), and will not be repeated here. The respondent chose not to testify.

9 On two separate occasions during the trial, counsel for the Crown made reference to an additional witness, Gérald Bourgade, who he said would be called to testify and who was expected to confirm in part the testimony of Riendeau. The first reference to this witness was made in the Crown's opening address to the jury:

> [TRANSLATION] You will hear two people, Riendeau and Bourgade, who heard the accused announce his intention to get rid of two of the victims, Leblanc and Lemieux, and were there when he made certain preparations for that crime. Riendeau will then tell you that on the day after the crime, he met Jolivet, who admitted having made a clean sweep. You will also see that Riendeau, at that time, saw narcotics — cocaine from the victims — in the possession of the accused or other people under his control. And we will then present you with circumstantial evidence that partly relates to the accused, and other circumstantial evidence, all kinds of minor circumstances to show you that the witnesses Riendeau and Bourgade could not have made up their story and that it is based on independent facts we can prove to you. [Emphasis added.]

The Crown again stated that Bourgade would be called by way of an objection during the defence's cross-examination of Riendeau:

> [TRANSLATION]
>
> Q.: And the reason Mr. Bourgade called you to tell you that is because ...
>
> [The Crown]:
>
> I object. The reason Bourgade called him, it's Bourgade who will tell us that. It's not him.. [Emphasis added.]

Crown counsel later declined to call Bourgade but, as mentioned, failed to explain why, given his disbelief in Bourgade's testimony, he had subsequently put Bourgade's name on the list of Crown witnesses to be called at trial and at the trial itself had affirmed his intention of calling Bourgade on two separate occasions in front of the jury.

10 During discussions with the trial judge and Crown counsel in the absence of the jury, defence counsel indicated that he wished to comment in his jury address on the Crown's failure to call Bourgade. The trial judge pointed out that the Crown is under no obligation to call every witness who may have some knowledge of the relevant events and that it was his practice to so instruct the jury. Instead, the trial judge offered defence counsel the opportunity to call Bourgade and cross-examine him, but that offer was rejected. The trial judge then indicated that if defence counsel commented on the Crown's failure to call Bourgade, the trial judge would instruct the jury that Bourgade could have been called by the respondent as well as the Crown. Faced with this warning, defence counsel did not raise the issue in the jury address and the trial judge said nothing on the point in his charge.

Quebec Court of Appeal (1998), 125 C.C.C. (3d) 210 (Que. C.A.)

11 The Court of Appeal was unanimous in its finding that defence counsel should have been allowed to comment on the Crown's failure to call its previously announced witness, Bourgade. Fish J.A. held (at p. 219) that the curative proviso should not be applied in the present case because the accused's right to a "fair trial" had been compromised by the *combined* effect of:

> (1) the Crown's repeated statements that Bourgade would be called as a witness; (2) the Crown's disclosure to the jury of the incriminating evidence Bourgade was expected to give; (3) the Crown's failure to call Bourgade; (4) the astonishing reason invoked for this decision; and (5) the impairment of defence counsel's right, in these circumstances, to comment on Bourgade's absence.

The trial judge's error caused a substantial wrong to the accused and the trial judge's offer of the witness in cross-examination was not enough to cure that wrong. Vallerand J.A., in concurring reasons, agreed with Fish J.A. The appeal was therefore allowed, Robert J.A. dissenting, and a new trial ordered.

Analysis

12 Counsel generally avoid leading a jury to anticipate more than he or she can deliver. Jurors are likely to remember unfulfilled promises and draw their own conclusions, whether or not the shortfall is specifically brought to their attention. Here the Crown told the jury about the existence of Gérald Bourgade and his expected corroborative testimony and subsequently failed to deliver. The respondent was nevertheless convicted. Defence counsel argues that he was entitled to rely on expectations induced by the statements of Crown counsel that an important witness would be called, and to shape his trial strategy accordingly. If Crown counsel, as here, resiles from a position plainly stated, what is the precise mischief and what is the appropriate remedy?

13 It is important to emphasize at the outset that the defence does not pretend that the evidence of Gérald Bourgade would have been exculpatory. Defence counsel had received full disclosure on this point and had heard Bourgade's testimony at the preliminary inquiry. There is no suggestion in this case that the Crown's conduct prevented the defence from having timely access to relevant information. While Bourgade's statement to the police and his evidence at the preliminary inquiry were inconsistent in some respects with the testimony of Riendeau, Bourgade's testimony nevertheless incriminated the respondent. Defence counsel clearly had no intention of accepting the trial judge's offer at the conclusion of the case to allow Bourgade to be called for the purpose of a defence cross-examination:

> [TRANSLATION]
>
> Mr. MacDONALD:
>
> I have the name Bourgade as a witness.
>
> THE COURT:
>
> Yes. Counsel, you have known since last Thursday that the Crown was not calling him. Did you ask to cross-examine him?
>
> Mr. MacDONALD:
>
> I have no request...
>
> THE COURT:
>
> Are you requesting that now?
>
> Mr. MacDONALD:
>
> No. Am I ...? Pardon?
>
> THE COURT:
>
> Are you asking that he be called...
>
> Mr. MacDONALD:
>
> I have no...
>
> THE COURT:
>
> ... so that you can cross-examine him?
>
> Mr. MacDONALD:

> ... I do not wish to have Mr. Bourgade called.

The underlying defence complaint relates to trial tactics. The defence claims that the Crown's failure to follow through on what the defence sees as a commitment to call Bourgade deprived it of an opportunity to attempt to create conflicts between the evidence of the Crown's principal witnesses. Such conflicts between two incriminating witnesses could potentially raise a reasonable doubt in the mind of the jury that the prosecution had proved its case. This *potential* benefit, however, has to be seen in light of the *actual* benefit to the defence of having the Crown decide to go to the jury on the basis of the uncorroborated evidence of one unsavoury witness, Riendeau. Defence counsel was astute to play up the silver lining in the threatened black cloud of Bourgade's corroborative evidence, but in the end it seems he was not unhappy to see Bourgade fail to materialize. In addition, the defence says that statements to the jury by the Crown about what Bourgade was expected to say in effect put Bourgade's testimony before the jury unsworn and without any benefit of cross-examination. At a minimum, the defence says it ought to have been allowed to call the jury's attention to the Crown's inconsistencies and failed promises.

1. The Crown Was Under No Obligation to Call Bourgade

14 It was established in *R. v. Lemay* (1951), [1952] 1 S.C.R. 232 (S.C.C.), affirmed in *R. v. Yebes*, [1987] 2 S.C.R. 168 (S.C.C.), and reaffirmed in *R. v. Cook*, [1997] 1 S.C.R. 1113 (S.C.C.), that the Crown is under no obligation to call a witness it considers unnecessary to the prosecution's case. In *Lemay*, *supra*, Kerwin J. stated, at p. 241:

> Of course, the Crown must not hold back evidence because it would assist an accused but there is no suggestion that this was done in the present case or, to use the words of Lord Thankerton, "that the prosecutor had been influenced by some oblique motive."

15 The reference to evidence that "would assist an accused" was made, of course, before the enhanced disclosure obligations on the Crown were laid down in *R. v. Stinchcombe*, [1991] 3 S.C.R. 326 (S.C.C.), and in any event referred, in context, to evidence that was exculpatory, not, as here, to evidence which offers only the potential for raising inconsistencies among witnesses who have only inculpatory evidence to offer. In general witnesses should be called by the party that wants their evidence.

16 In *Cook*, L'Heureux-Dubé J., for the Court, stated that the Crown had no duty to call witnesses "regardless of their truthfulness, desire to testify, or of their ultimate effect on the trial" (para. 19), and endorsed what was said on that point by LeBel J.A. (as he then was) in *R. c. V. (J.)* (1994), 91 C.C.C. (3d) 284 (Que. C.A.), at pp. 287-88:

> [TRANSLATION] Crown counsel, of course, while bound by strict duties so as to ensure the preservation of the integrity of the criminal justice system, however must operate in the context of an adversarial procedure. Once he has satisfied the obligation to disclose the evidence, it is for him, in principle, to choose the witnesses necessary to establish the factual basis of his case. If he does not call the necessary witnesses or evidence, he exposes the prosecution to dismissal of the charge for having failed to establish its case completely and in accordance with the reasonable doubt rule. However, once this obligation has been met and if improper motives cannot be imputed to him, such as the desire, for example, to hide exculpatory evidence, as a general rule, he will be considered to have properly executed this part of his function in the criminal trial. The defence may, at that time, do its work and call its own witnesses, if it considers it appropriate to do so.

L'Heureux-Dubé J. thus stated in *Cook* that "[a]s a general principle, we have recognized that for our system of criminal justice to function well, the Crown must possess a fair deal of discretion" (para. 19). Imposition of a duty to call particular witnesses would unnecessarily constrain the exercise of the Crown's prosecutorial discretion. The statements made in opening and in the course of trial were consistent only with the Crown's intention at that time to call Bourgade, but a statement of intention does not necessarily amount to an undertaking or commitment and the trial judge found in favour of the Crown on that point. Fish and Vallerand JJ.A. considered that in light of the Crown's statements in front of the jury, Bourgade should have been called "[a]bsent an unforeseen impediment or other satisfactory explanation" (p. 222). I

agree that the Crown's conduct called for an explanation, but Crown counsel explained that he believed Bourgade would not be a truthful witness. If the Crown's explanation is believed (as it was), I think the trial judge was correct to shift the focus from the dispute about whether the witness should be called to whether and what remedial steps needed to be taken to address any unfairness created by the Crown's change of position.

17 At that stage, the trial court had a number of options to address any unfairness created by the Crown's change of position, as pointed out by L'Heureux-Dubé J. in *Cook*, at para. 39:

> In my view, placing an obligation upon the Crown to call all witnesses with information bearing on the case would disrupt the inherent balance of our adversary system. I note, however, that the accused is also not obliged to call the witness. ... [T]here are other options which are available to the accused in an appropriate case including, but not limited to, asking the trial judge to call the witness, commenting in closing on the witness' absence, or asking the trial judge to comment. [Emphasis in last sentence added.]

It is these "other options" that we are required to address more fully in this case.

2. The Crown's Conduct Did Not Amount to an Abuse of Process

18 The Court recognized in *Cook* that, in some circumstances, a perverse or oppressive exercise of the prosecutorial discretion could amount to an abuse of process. Concern about the truthfulness of a witness is not a perverse consideration. In this case, Crown counsel explained to the trial judge why he did not wish to call Bourgade:

> [TRANSLATION] Bourgade testified at the preliminary inquiry. What do you want from me if I did not believe him at the end of the preliminary inquiry? Am I going to be forced to put him on the witness stand?

Fish J.A. found it hard to reconcile this explanation with Crown counsel's subsequent decision to put Bourgade's name on the list of Crown witnesses to be called at trial if "he had already concluded that Bourgade was a liar" (p. 220). Even more damaging were his subsequent affirmations in front of the jury that Bourgade would be called. While I share some of Fish J.A.'s misgivings, the fact is the trial judge was there and accepted the explanation and I am not prepared to find that Crown counsel misled the trial court on this point. It is certainly possible that Crown counsel went through the early stages of the trial with the intention of calling Bourgade, and that it was only at the point of actually putting Bourgade in the witness box that he faced up to serious professional misgivings about asking the jury to rely on the man's credibility.

19 The onus to establish an abuse of process on a balance of probabilities rests on an accused: *R. v. O'Connor*, [1995] 4 S.C.R. 411 (S.C.C.), at p. 461. As the trial judge accepted Crown counsel's explanation that he did not call Bourgade because he considered him untruthful, there can be no question here of an abuse of process. Crown counsel, on this view, was acting to protect the integrity of the judicial system, not to compromise it.

20 L'Heureux-Dubé J. observed in *Cook*, *supra*, at para. 58, that "oblique motive" (the phrase used in *Lemay*, *supra*) generally implies improper conduct on the part of the Crown, and where it exists would likely give rise to a legitimate claim for an abuse of process. She added, however, that a concern about the Crown's motive that does not constitute an abuse of process may nevertheless be a factor in deciding what remedial action is appropriate, including the trial judge exercising his or her discretion to have the witness called.

21 Apart from his concern about Bourgade's truthfulness, Crown counsel may have reasoned that Riendeau's evidence went into the record better than he expected and at that stage he had no desire to expose it to inconsistent statements (which may themselves have been untruthful) emanating from Bourgade. If this was a concern that entered into the exercise by Crown counsel of his discretion, it is a concern shared by any prudent counsel faced with running his case effectively in an adversarial system. It is not the duty of the Crown to bend its efforts to provide the defence with the opportunity to develop and exploit potential conflicts in the prosecution's testimony. This is the stuff of everyday trial tactics and hardly rises to the level of an "oblique motive". Crown counsel is entitled to have a trial strategy and to modify

it as the trial unfolds, *provided that the modification does not result in unfairness to the accused.* Where an element of prejudice results (as it did here), remedial action is appropriate.

3. Was the Jury Entitled to Draw an Adverse Inference from the Crown's Failure to Call Bourgade?

22 *Cook*, *supra*, listed some possible options to rectify any prejudice created by the Crown's failure to call a witness. These included a defence comment on that failure in its closing jury address. The purpose of making such a comment to the jury is inevitably to invite the jury to draw an adverse inference against the Crown's case. The questions at this point are, therefore, What circumstances justify such a comment, and What is the precise content of the adverse inference against the Crown's case that the defence is entitled to request?

23 Put at its highest, the Crown's failure to call Bourgade could in theory have led the jury to draw the adverse inference that Bourgade's testimony, if called, would have been unfavourable to the Crown. In my view, there was no basis to ask the jury to draw such a strong inference in this case.

24 Neither the defence nor the Crown have suggested that Bourgade would in fact have offered exculpatory evidence. The "adverse inference" principle is derived from ordinary logic and experience, and is not intended to punish a party *who exercises its right not to call the witness* by imposing an "adverse inference" which a trial judge in possession of the explanation for the decision considers to be wholly unjustified.

25 The general rule developed in civil cases respecting adverse inferences from failure to tender a witness goes back at least to *Blatch v. Archer* (1774), 1 Cowp. 63, 98 E.R. 969 (Eng. K.B.), where, at p. 65, Lord Mansfield stated:

> It is certainly a maxim that all evidence is to be weighed according to the proof which it was in the power of one side to have produced, and in the power of the other to have contradicted.

26 The principle applies in criminal cases, but with due regard to the division of responsibilities between the Crown and the defence, as explained below. It is subject to many conditions. The party against whom the adverse inference is sought may, for example, give a satisfactory explanation for the failure to call the witness as explained in *R. v. Rooke* (1988), 40 C.C.C. (3d) 484 (B.C. C.A.), at p. 513, quoting *Wigmore on Evidence* (Chadbourn rev. 1972), vol. 2, at para. 290:

> In any event, the party affected by the inference may of course explain it away by showing circumstances which otherwise account for his failure to produce the witness. There should be no limitation upon this right to explain, except that the trial judge is to be satisfied that the circumstances thus offered would, in ordinary logic and experience, furnish a plausible reason for nonproduction. [Underlining added.]

27 The party in question may have no special access to the potential witness. On the other hand, the "missing proof" may lie in the "peculiar power" of the party against whom the adverse inference is sought to be drawn: *Graves v. United States*, 150 U.S. 118 (U.S. Ark. 1893), at p. 121. In the latter case there is a stronger basis for an adverse inference.

28 One must also be precise about the exact nature of the "adverse inference" sought to be drawn. In J. Sopinka, S. N. Lederman and A. W. Bryant, *The Law of Evidence in Canada* (2nd ed. 1999), at p. 297, para. 6.321, it is pointed out that the failure to call evidence may, depending on the circumstances, amount "to an implied admission that the evidence of the absent witness would be contrary to the party's case, *or at least would not support it*" (emphasis added), as stated in the civil case of *Murray v. Saskatoon (City) (No. 2)* (1951), [1952] 2 D.L.R. 499 (Sask. C.A.), at p. 506. The circumstances in which trial counsel decide not to call a particular witness may restrict the nature of the appropriate "adverse inference". Experienced trial lawyers will often decide against calling an available witness because the point has been adequately covered by another witness, or an honest witness has a poor demeanour, or other factors unrelated to the truth of the testimony. Other jurisdictions also recognize that in many cases the most that can be inferred is that the testimony would not have been helpful to a party, not necessarily that it would have been adverse: *United States v. Hines*, 470 F.2d 225 (U.S. 3rd Cir. Pa. 1972), at p. 230, cert. denied, 410 U.S. 968 (U.S. Pa. 1973); and the Australian

cases of *The Duke Group Ltd. (in Liquidation) v. Pilmer & Ors* (1998), 144 F.L.R. 1 (Australia S.C.), and *O'Donnell v. Reichard*, [1975] V.R. 916 (Australia Vic. Sup. Ct.), at p. 929.

29 Applying these principles to the present facts, I think that if Crown counsel's explanation of his change of intention is accepted, the Crown acted in accordance with its ethical responsibilities, and an adverse inference that Bourgade would have given evidence unfavourable to the Crown would not be justified. If nothing had been said about Bourgade to the jury, that would have been an end to the matter. The complicating factor is that Crown counsel, despite his misgivings, twice announced to the jury that Bourgade would be called, and these announcements perhaps led the jury to anticipate that the Crown's case was stronger than it turned out to be. It is because of those announcements that I think a defence comment would have been appropriate.

30 Crown counsel's comment had produced an element of prejudice by asserting the existence of corroborative evidence. An adverse inference of "unhelpfulness" would have been a fair result of the Crown's failure to substantiate its assertion.

4. Was the Defence Therefore Entitled to Comment on the Crown's Change of Position in its Jury Address?

31 The defence was asked by the trial judge to state precisely what he intended to say to the jury about the missing witness. Defence counsel made clear the very limited nature of his proposed comment:

> [TRANSLATION] All that I want to point out to the jury is that we would have been perhaps more enlightened if the Crown had called Mr. Bourgade who, according to Mr. Riendeau, was present when St-Pierre returned to the scene. Mr. St-Pierre could have been called, Mr. St-Pierre who was at the scene of the incident, according to what Mr. Riendeau said. Why did the Crown not call these witnesses? Period.

(I note, parenthetically, that none of the judges accepted the defence objection to the Crown's failure to call St-Pierre, whose evidence had been rejected as untruthful in other Superior Court proceedings).

32 The trial judge took the view that even this limited defence comment would contradict his standard jury instruction on the matter of calling witnesses, as follows:

> [TRANSLATION] In a criminal trial, the Crown is not obliged to call all the witnesses who may have knowledge of the questions in issue. ... The accused is no more obliged than the Crown in this regard. At this point in time, the Crown's case as well as the accused's case is closed. Even if you would like the evidence to be more complete on certain points, you will have to render a verdict on the evidence as it is at this time.

The trial judge therefore said that if defence counsel made the proposed comment (reproduced above), the trial judge would instruct the jury that it was equally open to the defence to call Bourgade. The trial judge's comment had the effect of precluding the defence from commenting on a weakness in the Crown's case, and thereby took away the appropriate remedy to address any unfairness created by the Crown's conduct.

33 The trial judge's reaction (as well as his standard charge that "[t]he accused is *no more* obliged than the Crown in this regard" (emphasis added)) wrongly equated the position of the Crown and the defence. The accused, on these facts, was not "obliged" at all. He was entitled to the presumption of innocence and the burden was on the Crown to prove him guilty beyond a reasonable doubt. The Crown had a burden of proof to discharge and *was* obliged to call witnesses to deal with the disputed facts. *Wigmore on Evidence, supra*, at para. 290, underlines the importance of the burden of proof in relation to the adverse inference issue:

> The opponent whose case is a denial of the other party's affirmation has no *burden of persuading the jury*. A party may legally sit inactive, and expect the proponent to prove his own case. Therefore, until the burden of producing evidence has shifted, the opponent has no call to bring forward any evidence at all, and may go to the jury trusting solely to the weakness of the first party's evidence. Hence, though he takes a risk in so doing, yet his failure to

> produce evidence cannot at this stage afford any inference as to his lack of it; otherwise the first party would virtually be evading his legitimate burden. This distinction has been recognized and is reasonable. [Underlining added.]

34 In light of the importance of Bourgade's expected "corroboration", and the emphasis put on it by the Crown in its opening statement, it was open to the defence to comment on the "missing witness" as well as any other aspect of the Crown's case that might lead to a reasonable doubt. The defence, it will be recalled, merely wanted to point out to the jury "that we would have been perhaps more enlightened if the Crown had called Mr. Bourgade who, according to Mr. Riendeau, was present when St-Pierre returned to the scene". The right of the defence to make such a comment was not dependent on showing the Crown had acted on an "oblique motive" in failing to call the expected witness. In its opening the Crown apparently considered it necessary to call Bourgade to make its case, and had then failed to call Bourgade, arguably acknowledging by its reversal of plans that the case presented against the respondent was not as broadly based as originally anticipated. This was relevant information for the jury to consider. The Crown, not the defence, told the jury about the existence of Bourgade and that he would be part of the Crown's case. The defence was entitled to suggest to the jury that the failure to call Bourgade left an unspecified hole in the Crown's proof.

35 The defence, for the reasons mentioned, was not entitled to suggest that an adverse inference should be drawn that the testimony of Bourgade would have been favourable to the respondent, but defence counsel specifically disavowed any intention of going that far.

36 The right of the defence to address the jury on what the Crown chooses to put before the jury is fundamental to a fair trial and should only be limited for good and sufficient reason. There was no such reason here.

5. Did the Trial Judge Err by Failing to Deal in His Jury Instructions With the Crown's Failure to Call Bourgade?

37 In *Cook*, *supra*, L'Heureux-Dubé J. mentioned that one option "in an appropriate case" would be for the trial judge to comment in his or her instruction to the jury on the missing witness (para. 39). An instruction by the trial judge is more significant than a defence comment because it lends the judge's authority to what would otherwise be merely a piece of defence advocacy. As pointed out by Robert J.A. in this appeal, the reference in *Cook* to an "appropriate case" invokes the prior jurisprudence which warns of the dangers of commentary by the trial judge on what is, in effect, counsel's conduct of the case. In *R. v. Zehr* (1980), 54 C.C.C. (2d) 65 (Ont. C.A.), Brooke J.A. emphasized this point, at p. 68:

> While permissible in some cases, comment on the failure to call a witness should only be used with great caution. This kind of comment from a trial Judge can seriously affect what might otherwise be the jury's assessment of the credibility of those who do testify and perhaps, more importantly the integrity of the case. Such comment and instruction whether referable to the prosecution or the defence is really a comment on the conduct of the case and the instruction gives it some evidentiary significance.

38 A similar caution was expressed by Martin J.A. in *R. v. Koffman* (1985), 20 C.C.C. (3d) 232 (Ont. C.A.); and by Esson J.A. in *Rooke*, *supra*, at pp. 517-18.

39 It is clear from these authorities that it will rarely be "appropriate" for the trial judge to comment on the failure of the Crown to call a particular witness, and even more rare to do so with respect to the defence. As Brooke J.A. went on to say in *Zehr*, *supra*, at pp. 68-69:

> There are many reasons why counsel may choose not to call a witness, and our Courts will rarely question the decision of counsel, for the system proceeds on the basis that counsel conducts the case. Often a witness is not called, and if the reason was known it would not justify an instruction that an adverse inference might be drawn from the witness not being called. Of importance under our system, counsel is not called upon, or indeed permitted, to explain his conduct of a case [to the jury].

Nevertheless, cases calling for judicial comment will arise. Here, for instance, if defence counsel had not been content to pick holes in the prosecution's case and had gone further to suggest that an adverse inference could appropriately be

drawn that Bourgade's evidence, if called, would have supported the respondent, a correcting instruction would have been warranted. An inappropriate comment by Crown counsel on a missing defence witness would similarly warrant a judicial correction: *R. v. D. (J.C.)* (1995), 98 C.C.C. (3d) 496 (Ont. C.A.).

40 Much, of course, must be left to the discretion of the trial judge who has a "feel" for the nuances of the trial as it proceeds, and is in the best position to ensure its fairness. Here defence counsel was effectively prevented from alluding to the missing Bourgade. Neither defence nor prosecution made any comment and thus no "correction" was called for.

6. Did the Trial Judge Err in Failing to Warn the Jury Specifically to Disregard Crown Counsel's Opening Statement Regarding the Nature of Bourgade's Evidence?

41 The trial judge gave the jury the usual instruction that statements by counsel do not constitute evidence, but did not specifically link this instruction to Crown counsel's opening statement that [translation] "You will hear *two* people, Riendeau *and Bourgade*, who heard the accused announce his intention to get rid of two of the victims, Leblanc and Lemieux, and were there when he made certain preparations for that crime" (emphasis added).

42 Although this statement signalled the nature of Bourgade's evidence, it did not add anything of substance to what the jury was told it could expect to hear from Riendeau, who was subsequently called. In other words, Bourgade was presented to the jury as a corroborative witness who could support in some respects, but not go beyond, Riendeau's evidence. The trial judge dealt at length in his instruction with the dangers of relying on Riendeau's uncorroborated testimony, including the warning contemplated in *R. v. Vetrovec*, [1982] 1 S.C.R. 811 (S.C.C.). In my view, the trial judge's decision to deal with the problem raised by the Crown's opening with a *Vetrovec* warning rather than by dealing specifically with the missing Bourgade was within the ambit of his discretion.

7. Error of the Trial Judge

43 I therefore agree that the trial judge erred in effectively (if not explicitly) preventing defence counsel from commenting on the missing witness Bourgade, but otherwise I would reject, for these reasons and the reasons given by Robert J.A., the various additional objections to the fairness of the trial urged by the respondent in the main appeal and in his cross-appeal.

8. Availability of the Curative Proviso in This Case

44 Section 686 of the *Criminal Code* (variously called "the curative proviso" or "the proviso") allows an appellate court to dismiss an appeal notwithstanding that "the appeal might be decided in favour of the appellant" on an error of law if the court is of the opinion that "no substantial wrong or miscarriage of justice has occurred". More precisely, the relevant text of s. 686 provides as follows:

> **686.** (1) On the hearing of an appeal against a conviction or against a verdict that the appellant is unfit to stand trial or not criminally responsible on account of mental disorder, the court of appeal
>
> (a) may allow the appeal where it is of the opinion that
>
> . . . . .
>
> (ii) the judgment of the trial court should be set aside on the ground of a wrong decision on a question of law,
>
> . . . . .
>
> (b) may dismiss the appeal where
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> . . . . .
>
> (iii) notwithstanding that the court is of the opinion that on any ground mentioned in subparagraph (*a*) (ii) the appeal might be decided in favour of the appellant, it is of the opinion that no substantial wrong or miscarriage of justice has occurred;

45 In its written submissions to the Quebec Court of Appeal, the Crown defended the rulings of the trial judge on their merits and did not raise the curative proviso as an alternative submission. The possibility of its application was raised in oral argument by that court, and belatedly pursued by the Crown. The respondent contends that, in these circumstances, the Court of Appeal did not have the authority to apply s. 686(1)(*b*)(iii). He relies primarily on two recent decisions of this Court: *R. c. Pétel*, [1994] 1 S.C.R. 3 (S.C.C.), and *R. v. McMaster*, [1996] 1 S.C.R. 740 (S.C.C.). In the *Pétel* case, Lamer C.J. found that the trial judge had erred in the answer he provided to a question from the jury and declined to apply the curative proviso of the *Criminal Code*, stating, at p. 17:

> In the Court of Appeal and in this Court, however, counsel for the Crown did not argue that, given the evidence in this case, no substantial wrong or miscarriage of justice occurred, and that s. 686(1)(*b*)(iii) of the *Criminal Code* should thus be applied. The Crown has the burden of showing that this provision is applicable: *Colpitts v. The Queen*, [1965] S.C.R. 739. This Court cannot apply it *proprio motu*. Having found an error of law in the judge's answer to the question by the jury, I must accordingly dismiss the appeal and affirm the order for a new trial. [Emphasis added.]

In the *McMaster* appeal, Lamer C.J. relied on the above passage and ordered a new trial for both appellants. Again, the Crown had not raised s. 686(1)(*b*)(iii) of the *Code* in argument.

46 This aspect of the respondent's argument must be rejected. The onus rests upon the Crown to satisfy the court that there is no reasonable possibility that the verdict would have been different had the trial judge not committed an error of law. It is true that if the Crown does not offer the court oral or written submissions with respect to the application of this statutory provision, the court will not second-guess that exercise of the prosecutor's discretion. That being said, Lamer C.J. did not suggest in *Pétel* or *McMaster* that it would be wrong for a Court of Appeal to raise the issue of the curative proviso, and leave the ultimate decision up to the Crown. The Court would be failing its institutional responsibilities by withholding such a suggestion in circumstances where it thought the issue ought at least to be considered. Ordering a new trial raises significant issues for the administration of justice and the proper allocation of resources. Where the evidence against an accused is powerful and there is no realistic possibility that a new trial would produce a different verdict, it is manifestly in the public interest to avoid the cost and delay of further proceedings. Parliament has so provided.

47 The facts of this appeal differ from those in *Pétel* or *McMaster*. While Crown counsel did not raise the curative proviso in his written material to the Court of Appeal, he did so during his oral argument. As Robert J.A. notes at pp. 277-78:

> [TRANSLATION] However, the [Crown] at the hearing before us raised the application of the curative proviso and advanced reasons which tend to show that the [accused] had not suffered any prejudice from the error committed.
>
> . . . . .
>
> Counsel for the [Crown] argued that if there was an error, this error had not caused the [accused] any prejudice. [Emphasis added.]

The Crown having accepted the court's invitation to invoke s. 686(1)(*b*)(iii) at the time of the hearing, it went on to attempt to satisfy the onus, and joined issue on that point with the defence. In these circumstances, there is no valid procedural objection to the Court of Appeal, after considering the submissions of both sides, addressing the issue whether no substantial wrong or miscarriage of justice had occurred.

9. Application of Section 686(1)(b)(iii) to the Facts of This Case

48 In this Court, the Crown conceded that the trial judge's conduct amounted, for all practical purposes, to a refusal of defence counsel's request to address the jury on the issue of the Crown's failure to deliver on its stated and restated intention to call Bourgade. The question at this stage is whether there is any reasonable possibility that the verdict would have been different if this error had not been made: *R. v. Bevan*, [1993] 2 S.C.R. 599 (S.C.C.), *per* Major J., at pp. 616-17.

49 In my view, the curative proviso applies in this case because I do not think that the respondent suffered any significant prejudice to the fairness of his trial by reason of the judge's error. Bourgade's evidence was purely corroborative. Without Bourgade the Crown risked an acquittal because it relied on the evidence of an unsavoury witness, Riendeau, uncorroborated by any other testimony. The Crown's failure to call Bourgade created a potential advantage for the defence.

50 The defence had no right to compel the Crown to call Bourgade, and waived its own right to do so. There is no issue here of evidence improperly admitted or improperly withheld. There is only an unanswered question put to Riendeau in cross-examination, and the unfulfilled announcement of Bourgade's evidence in the Crown's opening. As to the former issue, the defence question put to Riendeau on cross-examination ("[what is] the reason Mr. Bourgade called you to tell you that ...?") interrupted by the Crown ("I object. The reason Bourgade called him, it's Bourgade who will tell us that") was, as framed, plainly designed to elicit hearsay and ought not to have been answered irrespective of the Crown's misconceived reference to Bourgade. The case therefore comes down to the prejudicial impact, if any, of the judge's refusal to allow defence counsel to remind the jury of something that *didn't* happen, i.e., Bourgade's appearance. While the missing Bourgade had not been put in the box to corroborate Riendeau's testimony as originally anticipated, the trial judge did remind the jury in his *Vetrovec* warning that Riendeau was an unsavoury witness whose evidence had not been corroborated at all in material aspects. The bottom line is that the jury convicted the respondent largely on the basis of Riendeau's testimony notwithstanding the monumental defence attack on Riendeau's credibility and repeated warnings by the trial judge to approach Riendeau's evidence with great caution. On this point, I agree with Professor Mewett that:

> It does not usurp the function of the jury to hold that the verdict must necessarily have been the same so long as consideration is given not only to the amount of the evidence against the accused, but also to any finding that the jury must have made on the basis of the evidence properly before them.
>
> (A. W. Mewett, "No Substantial Miscarriage of Justice" in A. N. Doob and E. L. Greenspan, eds., *Perspectives in Criminal Law* (1985), 81, at p. 102.)

51 The alleged prejudice to defence tactics was defence counsel's loss of opportunity to work Riendeau and Bourgade into contradicting each other in their collective incrimination of the respondent. It would be speculative in the extreme to suggest that the damage to the defence by Bourgade's corroboration of significant parts of Riendeau's testimony could (or would) have been outweighed by such contradictions (if any) on secondary matters.

52 The contrary view accepted by the majority of the Court of Appeal was that "the appellant's right to a fair trial was compromised" because of "the *combined* effect" of a number of factors, only one of which was the judge's "impairment of defence counsel's right, in the circumstances, to comment on Bourgade's absence". The other factors that concerned the Court of Appeal related to the conduct of Crown counsel in promising, then failing to call, Bourgade's evidence, with an explanation which the trial judge (albeit not the Court of Appeal) was prepared to accept. With respect, I do not see these factors as cumulative. Without the Crown's comments in relation to Bourgade, the defence would not have had the basis to make its proposed comment in the first place. The original complaints merged, in a manner of speaking, in the remedy. The only question at this stage is whether and to what extent the effective denial of that remedy impacted on the outcome of the trial.

53 In my view, there is no reasonable possibility that the verdict would have been any different if the trial judge's error had not been made. While there were some inconsistencies in the testimony of the Crown's main witness, Riendeau, explanations were offered for these inconsistencies and it was open to the jury to accept or reject them. In the three days it took to cross-examine Riendeau, the defence had ample opportunity to effectively challenge his credibility in the eyes of the jury, and did a thorough job with what they had to work with. The trial judge thoroughly instructed the jury on the theories of both the defence and the Crown, as well as the dangers of relying solely on Riendeau's testimony. The fact defence counsel was not permitted to comment on the missing witness does not mean the jury had forgotten that what had been promised by the Crown had not been delivered.

54 The application of s. 686(1)(*b*)(iii) requires the court to consider the seriousness of the error in question, the effect it likely had upon the jury's inference-drawing process and the probable guilt of the accused on the basis of the legally admissible evidence untainted by the error (Mewett, *supra*, at p. 98). While the trial judge erred, the error did not vitiate the fairness of the trial in any significant way. Nor is there any *reasonable* possibility that the proposed defence comment would have changed the outcome of the trial. The fact is that the jury was willing to convict the respondent on the basis of Riendeau's uncorroborated evidence. Despite the defence attack and the judge's warning, the jury clearly must have accepted Riendeau's version of events. Even if the trial judge had allowed defence counsel to criticize the Crown's failure to call a further Crown witness, there is no reasonable possibility, in my view, that the jury's verdict would have been different. I would therefore allow the appeal.

The Cross-Appeal

55 The respondent cross-appeals on two separate grounds, both of which were dismissed by Robert J.A. for a unanimous Court of Appeal. Firstly, the respondent argues that, during their deliberations, the members of the jury had inappropriate contacts with several police officers which called for a stay of proceedings. Secondly, the respondent submits that the late disclosure by the Crown of Nicole Lalonde's statement to police deprived the respondent of his right to make full answer and defence. The respondent asks this Court to order a new trial on these grounds as well. For the reasons expressed by Robert J.A. in the court below, I would dismiss the cross-appeal.

Disposition

56 The Crown's appeal is allowed. The Quebec Court of Appeal's order for a new trial is set aside and the guilty verdict against the respondent restored. The respondent's cross-appeal is dismissed for the reasons of Robert J.A.

Appeal allowed and conviction restored; cross-appeal dismissed.

Pourvoi accueilli et condamnation rétablie; pourvoi incident rejeté.

IN THE MATTER OF NOTICES OF INTENTION TO MAKE A PROPOSAL OF 1732427 ONTARIO INC. AND 1787930 ONTARIO INC. BOTH OF THE CITY OF ST. THOMAS, IN THE PROVINCE OF ONTARIO

Court of Appeal File No. C6687
Court File Nos. 35-2395487 and 35-239548

COURT OF APPEAL FOR ONTARIO

Proceeding commenced at London

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