Court File No. 31-2295766

ONTARIO
SUPERIOR COURT OF JUSTICE
(IN BANKRUPTCY AND INSOLVENCY)

IN THE MATTER OF THE *BANKRUPTCY AND INSOLVENCY ACT*,
R.S.C., 1985, c. B-3, AS AMENDED

AND IN THE MATTER OF THE BANKRUPTCY OF
DIGITAL UNDERGROUND MEDIA INC.,
A COMPANY INCORPORATED PURSUANT TO THE LAWS OF THE PROVINCE OF ONTARIO,
WITH A HEAD OFFICE IN THE CITY OF VANCOUVER,
IN THE PROVINCE OF BRITISH COLUMBIA

BOOK OF AUTHORITIES OF FORWARD DIMENSION CAPITAL 1 LLP
(For the Application returnable November 14, 2017)

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2012 ONSC 234
Ontario Superior Court of Justice [Commercial List]

Kitchener Frame Ltd., Re

2012 CarswellOnt 1347, 2012 ONSC 234, 212 A.C.W.S. (3d) 631, 86 C.B.R. (5th) 274

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

In the Matter of the Consolidated Proposal of Kitchener Frame Limited and Thyssenkrupp Budd Canada, Inc. (Applicants)

Morawetz J.

Judgment: February 3, 2012
Docket: CV-11-9298-00CL

Counsel: Edward A. Sellers, Jeremy E. Dacks for Applicants
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L.N. Gottheil — Union Representative Counsel
John Porter for Proposal Trustee, Ernst & Young Inc.
Michael McGraw for CIBC Mellon Trust Company
Deborah McPhail for Financial Services Commission of Ontario

Subject: Insolvency

MOTION by applicants for court sanction of proposal under Bankruptcy and Insolvency Act which contained third-party release.

***Morawetz J.*:**

1 At the conclusion of this unopposed motion, the requested relief was granted. Counsel indicated that it would be helpful if the court could provide reasons in due course, specifically on the issue of a third-party release in the context of a proposal under Part III of the *Bankruptcy and Insolvency Act* ("*BIA*").

2 Kitchener Frame Limited ("KFL") and Thyssenkrupp Budd Canada Inc. ("Budd Canada"), and together with KFL, (the "Applicants"), brought this motion for an order (the "Sanction Order") to sanction the amended consolidated proposal involving the Applicants dated August 31, 2011 (the "Consolidated Proposal") pursuant to the provisions of the *BIA*. Relief was also sought authorizing the Applicants and Ernst & Young Inc., in its capacity as proposal trustee of each of the Applicants (the "Proposal Trustee") to take all steps necessary to implement the Consolidated Proposal in accordance with its terms.

3 The Applicants submit that the requested relief is reasonable, that it benefits the general body of the Applicants' creditors and meets all other statutory requirements. Further, the Applicants submit that the court should also consider that the voting affected creditors (the "Affected Creditors") unanimously supported the Consolidated Proposal. As such, the Applicants submit that they have met the test as set out in s. 59(2) of the *BIA* with respect to approval of the Consolidated Proposal.

4 The motion of the Applicants was supported by the Proposal Trustee. The Proposal Trustee filed its report recommending approval of the Consolidated Proposal and indicated that the Consolidated Proposal was in the best interests of the Affected Creditors.

5 KFL and Budd Canada are inactive entities with no operating assets and no material liquid assets (other than the Escrow Funds). They do have significant and mounting obligations including pension and other non-pension post-employment benefit ("OPEB") obligations to the Applicants' former employees and certain former employees of Budcan Holdings Inc. or the surviving spouses of such former employees or others who may be entitled to claim through such persons in the *BIA* proceedings, including the OPEB creditors.

6 The background facts with respect to this motion are fully set out in the affidavit of Mr. William E. Aziz, sworn on September 13, 2011.

7 Affiliates of Budd Canada have provided up to date funding to Budd Canada to enable Budd Canada to fund, on behalf of KFL, such pension and OPEB obligations. However, given that KFL and Budd Canada have no active operations, the *status quo* is unsustainable.

8 The Applicants have acknowledged that they are insolvent and, in connection with the *BIA* proposal, proceedings were commenced on July 4, 2011.

9 On July 7, 2011, Wilton-Siegel J. granted Procedural Consolidation Orders in respect of KFL and Budd Canada which authorized the procedural consolidation of the Applicants and permitted them to file a single consolidated proposal to their creditors.

10 The Orders of Wilton-Siegel J. also appointed separate representative counsel to represent the interests of the Union and Non-Union OPEB creditors and further authorized the Applicants to continue making payments to Blue Cross in respect of the OPEB Claims during the *BIA* proposal proceedings.

11 On August 2, 2011, an order was granted extending the time to file a proposal to August 19, 2011.

12 The parties proceeded to negotiate the terms of the Consolidated Proposal, which meetings involved the Applicants, the Proposal Trustee, senior members of the CAW, Union Representative Counsel and Non-Union Representative Counsel.

13 An agreement in principle was reached which essentially provided for the monetization and compromise of the OPEB claims of the OPEB creditors resulting in a one-time, lump-sum payment to each OPEB creditor term upon implementation of the Consolidated Proposal. The Consolidated Proposal also provides that the Applicants and their affiliates will forego any recoveries on account of their secured and unsecured inter-company claims, which total approximately $120 million. A condition precedent was the payment of sufficient funds to the Pension Fund Trustee such that when such funds are combined with the value of the assets held in the Pension Plans, the Pension Fund Trustee will be able to fully annuitize the Applicants' pension obligations and pay the commuted values to those creditors with pension claims who so elected so as to provide for the satisfaction of the Applicants' pension obligations in full.

14 On August 19, 2011, the Applicants filed the Consolidated Proposal. Subsequent amendments were made on August 31, 2011 in advance of the creditors' meeting to reflect certain amendments to the proposal.

15 The creditors' meeting was held on September 1, 2011 and, at the meeting, the Consolidated Proposal, as amended, was accepted by the required majority of creditors. Over 99.9% in number and over 99.8% in dollar value of the Affected Creditors' Class voted to accept the Consolidated Proposal. The Proposal Trustee noted that all creditors voted in favour of the Consolidated Proposal, with the exception of one creditor, Canada Revenue Agency (with 0.1% of the number of votes representing 0.2% of the value of the vote) who attended the meeting but abstained from voting. Therefore, the

Consolidated Proposal was unanimously approved by the Affected Creditors. The Applicants thus satisfied the required "double majority" voting threshold required by the *BIA*.

16 The issue on the motion was whether the court should sanction the Consolidated Proposal, including the substantive consolidation and releases contained therein.

17 Pursuant to s. 54(2)(d) of the *BIA*, a proposal is deemed to be accepted by the creditors if it has achieved the requisite "double majority" voting threshold at a duly constituted meeting of creditors.

18 The *BIA* requires the proposal trustee to apply to court to sanction the proposal. At such hearing, s. 59(2) of the *BIA* requires that the court refuse to approve the proposal where its terms are not reasonable or not calculated to benefit the general body of creditors.

19 In order to satisfy s. 59(2) test, the courts have held that the following three-pronged test must be satisfied:

(a) the proposal is reasonable;

(b) the proposal is calculated to benefit the general body of creditors; and

(c) the proposal is made in good faith.

See *Mayer, Re* (1994), 25 C.B.R. (3d) 113 (Ont. Bktcy.); *Steeves, Re* (2001), 25 C.B.R. (4th) 317 (Sask. Q.B.); *Magnus One Energy Corp., Re* (2009), 53 C.B.R. (5th) 243 (Alta. Q.B.).

20 The first two factors are set out in s. 59(2) of the *BIA* while the last factor has been implied by the court as an exercise of its equitable jurisdiction. The courts have generally taken into account the interests of the debtor, the interests of the creditors and the interests of the public at large in the integrity of the bankruptcy system. See *Farrell, Re* (2003), 40 C.B.R. (4th) 53 (Ont. S.C.J. [Commercial List]).

21 The courts have also accorded substantial deference to the majority vote of creditors at a meeting of creditors; see *Lofchik, Re*, [1998] O.J. No. 332 (Ont. Bktcy.). Similarly, the courts have also accorded deference to the recommendation of the proposal trustee. See *Magnus One*, *supra*.

22 With respect to the first branch of the test for sanctioning a proposal, the debtor must satisfy the court that the proposal is reasonable. The court is authorized to only approve proposals which are reasonable and calculated to benefit the general body of creditors. The court should also consider the payment terms of the proposal and whether the distributions provided for are adequate to meet the requirements of commercial morality and maintaining the integrity of the bankruptcy system. For a discussion on this point, see *Lofchik*, *supra*, and *Farrell* , *supra*.

23 In this case, the Applicants submit that, if the Consolidated Proposal is sanctioned, they would be in a position to satisfy all other conditions precedent to closing on or prior to the date of the proposal ("Proposal Implementation Date").

24 With respect to the treatment of the Collective Bargaining Agreements, the Applicants and the CAW brought a joint application before the Ontario Labour Relations Board ("OLRB") on an expedited basis seeking the OLRB's consent to an early termination of the Collective Bargaining Agreements. Further, the CAW has agreed to abandon its collective bargaining rights in connection with the Collective Bargaining Agreements.

25 With respect to the terms and conditions of a Senior Secured Loan Agreement between Budd Canada and TK Finance dated as of December 22, 2010, TK Finance provided a secured creditor facility to the Applicants to fund certain working capital requirements before and during the *BIA* proposal proceedings. As a result of the approval of the Consolidated Proposal at the meeting of creditors, TK Finance agreed to provide additional credit facilities to Budd Canada such that the Applicants would be in a position to pay all amounts required to be paid by or on behalf of the Applicants in connection with the Consolidated Proposal.

26 On the issue as to whether creditors will receive greater recovery under the Consolidated Proposal than they would receive in the bankruptcy, it is noted that creditors with Pension Claims are unaffected by the Consolidated Proposal. The Consolidated Proposal provides for the satisfaction of Pension Claims in full as a condition precedent to implementation.

27 With respect to Affected Creditors, the Applicants submit that they will receive far greater recovery from distributions under the Consolidated Proposal than the Affected Creditors would receive in the event of the bankruptcies of the Applicants. (See Sanction Affidavit of Mr. Aziz at para. 61.)

28 The Proposal Trustee has stated that the Consolidated Proposal is advantageous to creditors for the reasons outlined in its Report and, in particular:

> (a) the recoveries to creditors with claims in respect of OPEBs are considerably greater under the Amended Proposal than in a bankruptcy;
>
> (b) payments under the Amended Proposal are expected in a timely manner shortly after the implementation of the Amended Proposal;
>
> (c) the timing and quantum of distributions pursuant to the Amended Proposal are certain while distributions under a bankruptcy are dependent on the results of litigation, which cannot be predicted with certainty; and
>
> (d) the Pension Plans (as described in the Proposal Trustee's Report) will be fully funded with funds from the Pension Escrow (as described in the Proposal Trustee's Report) and, if necessary, additional funding from an affiliate of the Companies if the funds in the Pension Escrow are not sufficient. In a bankruptcy, the Pension Plans may not be fully funded.

29 The Applicants take the position that the Consolidated Proposal meets the requirements of commercial morality and maintains the integrity of the bankruptcy system, in light of the superior coverage to be afforded to the Applicants' creditors under the Consolidated Proposal than in the event of bankruptcy.

30 The Applicants also submit that substantive consolidation inherent in the proposal will not prejudice any of the Affected Creditors and is appropriate in the circumstances. Although not expressly contemplated under the *BIA*, the Applicants submit that the court may look to its incidental, ancillary and auxiliary jurisdiction under s. 183 of the *BIA* and its equitable jurisdiction to grant an order for substantive consolidation. See *Ashley v. Marlow Group Private Portfolio Management Inc.* (2006), 22 C.B.R. (5th) 126 (Ont. S.C.J. [Commercial List]). In deciding whether to grant substantive consolidation, courts have held that it should not be done at the expense of, or possible prejudice of, any particular creditor. See *Ashley* , *supra*. However, counsel submits that this court should take into account practical business considerations in applying the *BIA*. See *A. & F. Baillargeon Express Inc., Re* (1993), 27 C.B.R. (3d) 36 (C.S. Que.).

31 In this case, the Applicants submit that substantive consolidation inherent in the Consolidated Proposal is appropriate in the circumstances due to, among other things, the intertwined nature of the Applicants' assets and liabilities. Each Applicant had substantially the same creditor base and known liabilities (other than certain Excluded Claims). In addition, KFL had no cash or cash equivalents and the Applicants are each dependant on the Escrow Funds and borrowings under the Restated Senior Secured Loan Agreement to fund the same underlying pension and OPEB obligations and costs relating to the Proposal Proceedings.

32 The Applicants submit that creditors in neither estate will be materially prejudiced by substantive consolidation and based on the fact that no creditor objected to the substantial consolidation, counsel submits the Consolidated Proposal ought to be approved.

33 With respect to whether the Consolidated Proposal is calculated to benefit the general body of creditors, TK Finance would be entitled to priority distributions out of the estate in a bankruptcy scenario. However, the Applicants

and their affiliates have agreed to forego recoveries under the Consolidated Proposal on account of their secured and unsecured intercompany claims in the amount of approximately $120 million, thus enhancing the level of recovery for the Affected Creditors, virtually all of whom are OPEB creditors. It is also noted that TK Finance will be contributing over $35 million to fund the Consolidated Proposal.

34 On this basis, the Applicants submit that the Consolidated Proposal is calculated to benefit the general body of creditors.

35 With respect to the requirement of the proposal being made in good faith, the debtor must satisfy the court that it has provided full disclosure to its creditors of its assets and encumbrances against such assets.

36 In this case, the Applicants and the Proposal Trustee have involved the creditors pursuant to the Representative Counsel Order, and through negotiations with the Union Representative Counsel and Non-Union Representative Counsel.

37 There is also evidence that the Applicants have widely disseminated information regarding their *BIA* proposal proceedings through the media and through postings on the Proposal Trustee's website. Information packages have also prepared by the Proposal Trustee for the creditors.

38 Finally, the Proposal Trustee has noted that the Applicants' conduct, both prior to and subsequent to the commencement of the *BIA* proposal proceedings, is not subject to censure in any respect and that the Applicants' have acted in good faith.

39 There is also evidence that the Consolidated Proposal continues requisite statutory terms. The Consolidated Proposal provides for the payment of preferred claims under s. 136(1) of the *BIA*.

40 Section 7.1 of the Consolidated Proposal contains a broad release in favour of the Applicants and in favour of certain third parties (the "Release"). In particular, the Release benefits the Proposal Trustee, Martinrea, the CAW, Union Representative Counsel, Non-Union Representative Counsel, Blue Cross, the Escrow Agent, the present and former shareholders and affiliates of the Applicants (including Thyssenkrupp USA, Inc. ("TK USA"), TK Finance, Thyssenkrupp Canada Inc. ("TK Canada") and Thyssenkrupp Budd Company), as well as their subsidiaries, directors, officers, members, partners, employees, auditors, financial advisors, legal counsel and agents of any of these parties and any person liable jointly or derivatively through any or all of the beneficiaries of the of the release (referred to individually as a "Released Party").

41 The Release covers all Affected Claims, Pension Claims and Escrow Fund Claims existing on or prior to the later of the Proposal Implementation Date and the date on which actions are taken to implement the Consolidated Proposal.

42 The Release provides that all such claims are released and waived (other than the right to enforce the Applicants' or Proposal Trustee's obligations under the Consolidated Proposal) to the full extent permitted by applicable law. However, nothing in the Consolidated Proposal releases or discharges any Released Party for any criminal or other wilful misconduct or any present or former directors of the Applicants with respect to any matters set out in s. 50(14) of the *BIA*. Unaffected Claims are specifically carved out of the Release.

43 The Applicants submit that the Release is both permissible under the *BIA* and appropriately granted in the context of the *BIA* proposal proceedings. Further, counsel submits, to the extent that the Release benefits third parties other than the Applicants, the Release is not prohibited by the *BIA* and it satisfies the criteria that has been established in granting third-party releases under the *Companies' Creditors Arrangement Act* ("*CCAA*"). Moreover, counsel submits that the scope of the Release is no broader than necessary to give effect to the purpose of the Consolidated Proposal and the contributions made by the third parties to the success of the Consolidated Proposal.

44 No creditors or stakeholders objected to the scope of the Release which was fully disclosed in the negotiations, including the fact that the inclusion of the third-party releases was required to be part of the Consolidated Proposal. Counsel advises that the scope of the Release was referred to in the materials sent by the Proposal Trustee to the Affected Creditors prior to the meeting, specifically discussed at the meeting and adopted by the unanimous vote of the voting Affected Creditors.

45 Counsel also submits that there is no provision in the *BIA* that clearly and expressly precludes the Applicants from including the Release in the Consolidated Proposal as long as the court is satisfied that the Consolidated Proposal is reasonable and for the general benefit of creditors.

46 In this respect, it seems to me, that the governing statutes should not be technically or stringently interpreted in the insolvency context but, rather, should be interpreted in a manner that is flexible rather than technical and literal, in order to deal with the numerous situations and variations which arise from time to time. Further, taking a technical approach to the interpretation of the *BIA* would defeat the purpose of the legislation. See *N.T.W. Management Group Ltd., Re* (1994), 29 C.B.R. (3d) 139 (Ont. Bktcy.); *Olympia & York Developments Ltd., Re* (1995), 34 C.B.R. (3d) 93 (Ont. Gen. Div. [Commercial List]); *Olympia & York Developments Ltd., Re* (1997), 45 C.B.R. (3d) 85 (Ont. Bktcy.).

47 Moreover, the statutes which deal with the same subject matter are to be interpreted with the presumption of harmony, coherence and consistency. See *NAV Canada c. Wilmington Trust Co.*, 2006 SCC 24 (S.C.C.). This principle militates in favour of adopting an interpretation of the *BIA* that is harmonious, to the greatest extent possible, with the interpretation that has been given to the *CCAA*.

48 Counsel points out that historically, some case law has taken the position that s. 62(3) of the *BIA* precludes a proposal from containing a release that benefits third parties. Counsel submits that this result is not supported by a plain meaning of s. 62(3) and its interaction with other key sections in the *BIA*.

49 Subsection 62(3) of the *BIA* reads as follows:

> (3) The acceptance of a proposal by a creditor does not release any person who would not be released under this Act by the discharge of the debtor.

50 Counsel submits that there are two possible interpretations of this subsection:

> (a) It prohibits third party releases — in other words, the phrase "does not release any person" is interpreted to mean "cannot release any person"; or
>
> (b) It simply states that acceptance of a proposal does not automatically release any party other than the debtor — in other words, the phrase "does not release any person" is interpreted to mean "does not release any person without more"; it is protective not prohibitive.

51 I agree with counsel's submission that the latter interpretation of s. 62(3) of the *BIA* conforms with the grammatical and ordinary sense of the words used. If Parliament had intended that only the debtor could be released, s. 62(3) would have been drafted more simply to say exactly that.

52 Counsel further submits that the narrow interpretation would be a stringent and inflexible interpretation of the *BIA*, contrary to accepted wisdom that the *BIA* should be interpreted in a flexible, purposive manner.

53 The *BIA* proposal provisions are designed to offer debtors an opportunity to carry out a going concern or value maximizing restructuring in order to avoid a bankruptcy and related liquidation and that these purposes justify taking a broad, flexible and purposive approach to the interpretation of the relevant provisions. This interpretation is supported by *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60 (S.C.C.).

54 Further, I agree with counsel's submissions that a more flexible purposive interpretation is in keeping with modern statutory principles and the need to give purposive interpretation to insolvency legislation must start from the proposition that there is no express prohibition in the *BIA* against including third-party releases in a proposal. At most, there are certain limited constraints on the scope of such releases, such as in s. 179 of the *BIA*, and the provision dealing specifically with the release of directors.

55 In the absence of an express prohibition against including third-party releases in a proposal, counsel submits that it must be presumed that such releases are permitted (subject to compliance with any limited express restrictions, such as in the case of a release of directors). By extension, counsel submits that the court is entitled to approve a proposal containing a third-party release if the court is able to satisfy itself that the proposal (including the third-party release) is reasonable and for the general benefit for creditors such that all creditors (including the minority who did not vote in favour of the proposal) can be required to forego their claims against parties other than the debtors.

56 The Applicants also submit that s. 62(3) of the *BIA* can only be properly understood when read together with other key sections of the *BIA*, particularly s. 179 which concerns the effect of an order of discharge:

> 179. An order of discharge does not release a person who at the time of the bankruptcy was a partner or co-trustee with the bankrupt or was jointly bound or had made a joint contract with the bankrupt, or a person who was surety or in the nature of a surety for the bankrupt.

57 The order of discharge of a bankrupt has the effect of releasing the bankrupt from all claims provable in bankruptcy (section 178(2) *BIA*). In the absence of s. 179, this release could result in the automatic release at law of certain types of claims that are identified in s. 179. For example, under guarantee law, the discharge of the principal debt results in the automatic discharge of a guarantor. Similarly, counsel points out the settlement or satisfaction of a debt by one joint obligor generally results in the automatic release of both joint obligors. Section 179 therefore serves the limited purpose of altering the result that would incur at law, indicating that the rule that the *BIA* generally is that there is no automatic release of third-party guarantors of co-obligors when a bankrupt is discharged.

58 Counsel submits that s. 62(3), which confirms that s. 179 applies to a proposal, was clearly intended to fulfil a very limited role — namely, to confirm that there is no automatic release of the specific types of co-obligors identified in s. 179 when a proposal is approved by the creditors and by the court. Counsel submits that it does not go further and preclude the creditors and the court from approving a proposal which contains the third-party release of the types of co-obligors set out in s. 179. I am in agreement with these submissions.

59 Specific considerations also apply when releasing directors of a debtor company. The *BIA* contains specific limitations on the permissible scope of such releases as set out in s. 50(14). For this reason, there is a specific section in the *BIA* proposal provisions outlining the principles governing such a release. However, counsel argues, the presence of the provisions outlining the circumstances in which a proposal can contain a release of claims against the debtor's directors does not give rise to an inference that the directors are the only third parties that can be released in a proposal. Rather, the inference is that there are considerations applicable to a release or compromise of claims against directors that do not apply generally to other third parties. Hence, it is necessary to deal with this particular type of compromise and release expressly.

60 I am also in agreement with the alternative submissions made by counsel in this area to the effect that if s. 62(3) of the *BIA* operates as a prohibition it refers only to those limitations that are expressly identified in the *BIA*, such as in s. 179 of the *BIA* and the specific limitations on the scope of releases that can benefit directors of the debtor.

61 Counsel submits that the Applicants' position regarding the proper interpretation of s. 62(3) of the *BIA* and its place in the scheme of the *BIA* is consistent with the generally accepted principle that a proposal under the *BIA* is a contract. See *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*, 2008 ONCA 587 (Ont. C.A.); *Employers' Liability Assurance Corp. v. Ideal Petroleum (1959) Ltd.* (1976), [1978] 1 S.C.R. 230 (S.C.C.); and *Society of*

Composers, Authors & Music Publishers of Canada v. Armitage (2000), 20 C.B.R. (4th) 160 (Ont. C.A.). Consequently, counsel submits that parties are entitled to put anything into a proposal that could lawfully be incorporated into any contract (see *Air Canada, Re* (2004), 2 C.B.R. (5th) 4 (Ont. S.C.J. [Commercial List])) and that given that the prescribed majority creditors have the statutory right under the *BIA* to bind a minority, however, this principle is subject to any limitations that are contained in the express wording of the *BIA*.

62 On this point, it seems to me, that any provision of the *BIA* which purports to limit the ability of the debtor to contract with its creditors should be clear and explicit. To hold otherwise would result in severely limiting the debtor's ability to contract with its creditors, thereby the decreasing the likelihood that a viable proposal could be reached. This would manifestly defeat the purpose of the proposal provisions of the *BIA*.

63 The Applicants further submit that creditors' interests — including the interests of the minority creditors who do not vote in favour of a proposal containing a third-party release — are sufficiently protected by the overriding ability of a court to refuse to approve a proposal with an overly broad third-party release, or where the release results in the proposal failing to demonstrate that it is for the benefit of the general body of creditors. The Applicants submit that the application of the *Metcalfe* criteria to the release is a mechanism whereby this court can assure itself that these preconditions to approve the Consolidated Proposal contained in the Release have been satisfied.

64 The Applicants acknowledge that there are several cases in which courts have held that a *BIA* proposal that includes a third-party release cannot be approved by the court but submits that these cases are based on a mistaken premise, are readily distinguishable and do not reflect the modern approach to Canadian insolvency law. Further, they submit that none of these cases are binding on this court and should not be followed.

65 In *Kern Agencies Ltd., (No. 2), Re* (1931), 13 C.B.R. 11 (Sask. C.A.), the court refused to approve a proposal that contained a release of the debtor's directors, officers and employees. Counsel points out that the court's refusal was based on a provision of the predecessor to the *BIA* which specifically provided that a proposal could only be binding on creditors (as far as relates to any debts due to them from the debtor). The current *BIA* does not contain equivalent general language. This case is clearly distinguishable.

66 In *Mister C's Ltd., Re* (1995), 32 C.B.R. (3d) 242 (Ont. Bktcy.), the court refused to approve a proposal that had received creditor approval. The court cited numerous bases for its conclusion that the proposal was not reasonable or calculated to benefit the general body of creditors, one of which was the release of the principals of the debtor company. The scope of the release was only one of the issues with the proposal, which had additional significant issues (procedural irregularities, favourable terms for insiders, and inequitable treatment of creditors generally). I agree with counsel to the Applicants that this case can be distinguished.

67 *Cosmic Adventures Halifax Inc., Re* (1999), 13 C.B.R. (4th) 22 (N.S. S.C.) relies on *Kern* and furthermore the Applicants submit that the discussion of third-party releases is technically *obiter* because the proposal was amended on consent.

68 The fourth case is *C.F.G. Construction inc., Re*, 2010 CarswellQue 10226 (C.S. Que.) where the Quebec Superior Court refused to approve a proposal containing a release of two sureties of the debtor. The case was decided on alternate grounds — either that the *BIA* did not permit a release of sureties, or in any event, the release could not be justified on the facts. I agree with the Applicants that this case is distinguishable. The case deals with the release of sureties and does not stand for any broader proposition.

69 In general, the Applicants' submission on this issue is that the court should apply the decision of the Court of Appeal for Ontario in *Metcalfe*, together with the binding principle set out by the Supreme Court in *Ted Leroy Trucking*, dictating a more liberal approach to the permissibility of third-party releases in *BIA* proposals than is taken by the Quebec court in *C.F.G. Construction Inc*. I agree.

70 The object of proposals under the *BIA* is to permit the debtor to restructure its business and, where possible, avoid the social and economic costs of liquidating its assets, which is precisely the same purpose as the *CCAA*. Although there are some differences between the two regimes and the *BIA* can generally be characterized as more "rules based", the thrust of the case law and the legislative reform has been towards harmonizing aspects of insolvency law common to the two statutory schemes to the extent possible, encouraging reorganization over liquidation. See *Ted Leroy Trucking*.

71 Recent case law has indicated that, in appropriate circumstances, third-party releases can be included in a plan of compromise and arrangement that is approved under the *CCAA*. See *Metcalfe*. The *CCAA* does not contain any express provisions permitting such third-party releases apart from certain limitations that apply to the compromise of claims against directors of the debtor company. See *CCAA* s. 5.1 and *Allen-Vanguard Corp., Re*, 2011 ONSC 733 (Ont. S.C.J.).

72 Counsel submits that although the mechanisms for dealing with the release of sureties and similar claimants are somewhat different in the *BIA* and *CCAA*, the differences are not of such significance that the presence of s. 62(3) of the *BIA* should be viewed as dictating a different approach to third-party releases generally from the approach that applies under the *CCAA*. I agree with this submission.

73 I also accept that if s. 62(3) of the *BIA* is interpreted as a prohibition against including the third-party release in the *BIA* proposal, the *BIA* and the *CCAA* would be in clear disharmony on this point. An interpretation of the *BIA* which leads to a result that is different from the *CCAA* should only be adopted pursuant to clear statutory language which, in my view, is not present in the *BIA*.

74 The most recent and persuasive example of the application of such a harmonious approach to the interpretation of the *BIA* and the *CCAA* can be found in *Ted Leroy Trucking*.

75 At issue in *Ted Leroy Trucking* was how to resolve an apparent conflict between the deemed trust provisions of the *Excise Tax Act* and the provisions of the *CCAA*. The language of the *Excise Tax Act* created a deemed trust over GST amounts collected by the debtor that was stated to apply "despite any other Act of Parliament". The *CCAA* stated that the deemed trust for GST did not apply under the *CCAA*, unless the funds otherwise specified the criteria for a "true" trust. The court was required to determine which federal provision should prevail.

76 By contrast, the same issue did not arise under the *BIA*, due to the language in the *Excise Tax Act* specifically indicating that the continued existence of the deemed trust depended on the terms of the *BIA*. The *BIA* contained a similar provision to the *CCAA* indicating that the deemed trust for GST amounts would no longer apply in a *BIA* proceeding.

77 Deschamps J., on behalf of six other members of the court, with Fish J. concurring and Abella J. dissenting, held that the proper interpretation of the statutes was that the *CCAA* provision should prevail, the deemed trust under the *Excise Tax Act* would cease to exist in a *CCAA* proceeding. In resolving the conflict between the *Excise Tax Act* and the *CCAA*, Deschamps J. noted the strange asymmetry which would arise if the *BIA* and *CCAA* were not in harmony on this issue:

> 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.

78 It seems to me that these principles indicate that the court should generally strive, where the language of both statutes can support it, to give both statutes a harmonious interpretation to avoid the ills that can arise from "statute-shopping". These considerations, counsel submits, militate against adopting a strained reading of s. 62(3) of the *BIA* as

a prohibition against third-party releases in a *BIA* proposal. I agree. In my opinion, there is no principled basis on which the analysis and treatment of a third-party release in a *BIA* proposal proceeding should differ from a CCAA proceeding.

79 The Applicants submit that it logically follows that the court is entitled to approve the Consolidated Proposal, including the Release, on the basis that it is reasonable and calculated to benefit the general body of creditors. Further, in keeping with the principles of harmonious interpretation of the *BIA* and the *CCAA*, the court should satisfy itself that the *Metcalfe* criteria, which apply to the approval of a third-party release under the CCAA, has been satisfied in relation to the Release.

80 In *Metcalfe*, the Court of Appeal for Ontario held that the requirements that must be satisfied to justify a third-party release are:

> (a) the parties to be released are necessary and essential to the restructuring of the debtor;
>
> (b) the claims to be released are rationally related to the purpose of the Plan (Proposal) and necessary for it;
>
> (c) the Plan (Proposal) cannot succeed without the releases;
>
> (d) the parties who are to have claims against them released are contributing in a tangible and realistic way to the Plan (Proposal); and
>
> (e) the Plan (Proposal) will benefit not only the debtor companies but creditors generally.

81 These requirements have also been referenced in *Canwest Global Communications Corp., Re* (2010), 70 C.B.R. (5th) 1 (Ont. S.C.J. [Commercial List]) and *Angiotech Pharmaceuticals Inc., Re* (2011), 76 C.B.R. (5th) 210 (B.C. S.C. [In Chambers]).

82 No single requirement listed above is determinative and the analysis must take into account the facts particular to each claim.

83 The Applicants submit that the Release satisfies each of the *Metcalfe* criteria. Firstly, counsel submits that following the closing of the Asset Purchase Agreement in 2006, Budd Canada had no operating assets or income and relied on inter-company advances to fund the pension and OPEB requirements to be made by Budd Canada on behalf of KFL pursuant to the Asset Purchase Agreement. Such funded amounts total approximately $112.7 million in pension payments and $24.6 million in OPEB payments between the closing of the Asset Purchase Agreement and the Filing Date. In addition, TK Finance has been providing Budd Canada and KFL with the necessary funding to pay the professional and other costs associated with the *BIA* Proposal Proceedings and will continue to fund such amounts through the Proposal Implementation Date. Moreover, TK Canada and TK Finance have agreed to forego recoveries under the Consolidated Proposal on account of their existing secured and unsecured intercompany loans in the amount of approximately $120 million.

84 Counsel submits that the releases provided in respect of the Applicants' affiliates are the *quid pro quo* for the sacrifices made by such affiliates to significantly enlarge recoveries for the unsecured creditors of the Applicants, particularly the OPEB creditors and reflects that the affiliates have provided over $135 million over the last five years in respect of the pension and OPEB amounts and additional availability of approximately $49 million to allow the Applicants to discharge their obligations to their former employees and retirees. Without the Releases, counsel submits, the Applicants' affiliates would have little or no incentive to contribute funds to the Consolidated Proposal and to waive their own rights against the Applicants.

85 The Release in favour of Martinrea is fully discussed at paragraphs 121-127 of the factum. The Applicants submit that the third-party releases set out in the Consolidated Proposal are clearly rationally related, necessary and essential to the Consolidated Proposal and are not overly broad.

86 Having reviewed the submissions in detail, I am in agreement that the Released Parties are contributing in a tangible and realistic way to the Consolidated Proposal.

87 I am also satisfied that without the Applicants' commitment to include the Release in the Consolidated Proposal to protect the Released Parties, it is unlikely that certain of such parties would have been prepared to support the Consolidated Proposal. The releases provided in respect of the Applicants' affiliates are particularly significant in this regard, since the sacrifices and monetary contributions of such affiliates are the primary reason that the Applicants have been able to make the Consolidated Proposal. Further, I am also satisfied that without the Release, the Applicants would be unable to satisfy the borrowing conditions under the Amended and Restated Senior Secured Loan Agreement with respect to the Applicants having only certain permitted liabilities after the Proposal Implementation Date. The alternative for the Applicants is bankruptcy, a scenario in which their affiliates' claims aggregating approximately $120 million would significantly erode recoveries for the unsecured creditors of the Applicants.

88 I am also satisfied that the Releases benefit the Applicants and creditors generally. The primary non-affiliated Creditors of the Applicants are the OPEB Creditors and Creditors with Pension Claims, together with the CRA. The Consolidated Proposal, in my view, clearly benefits these Creditors by generating higher recoveries than could be obtained from the bankruptcies of the Applicants. Moreover, the timing of any such bankruptcy recoveries is uncertain. As noted by the Proposal Trustee, the amount that the Affected Creditors would receive in the event of the bankruptcies of the Applicants is uncertain both in terms of quantum and timing, with the Applicants' funding of OPEB Claims terminating on bankruptcy, but distributions to the OPEB Creditors and other Creditors delayed for at least a year or two but perhaps much longer.

89 The Applicants and their affiliates also benefit from the Release as an affiliate of the Applicants may become enabled to use the net operating losses (NOL) following a series of transactions that are expected to occur immediately following the Proposal Implementation Date.

90 I am also satisfied that the Applicants have provided full and adequate disclosure of the Releases and their effect. Full disclosure was made in the proposal term sheet circulated to both Representative Counsel in early August 2011. The Release was negotiated as part of the Consolidated Proposal and the scope of the Release was disclosed by the Proposal Trustee in its Report to the creditors on the terms of the Consolidated Proposal, which Report was circulated by the Proposal Trustee to the Applicants' known creditors in advance of the creditors' meeting.

91 I am satisfied that the Applicants, with the assistance of the Proposal Trustee, took appropriate steps to ensure that the Affected Creditors were aware of the existence of the release provisions prior to the creditors' meeting.

92 For the foregoing reasons, I have concluded that the Release contained in the Consolidated Proposal meets the *Metcalfe* criteria and should be approved.

93 In the result, I am satisfied that the section 59(2) *BIA* test has been met and that it is appropriate to grant the Sanction Order in the form of the draft order attached to the Motion Record. An order has been signed to give effect to the foregoing.

Motion granted.

End of Document

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2012 ONSC 2899
Ontario Superior Court of Justice [Commercial List]

Milan, Re

2012 CarswellOnt 6906, 2012 ONSC 2899, 218 A.C.W.S. (3d) 14, 92 C.B.R. (5th) 262

In the Matter of the Proposal of Arnold Milan, of the City of Vaughan, in the Regional Municipality of York, in the Province of Ontario

L.A. Pattillo J.

Heard: May 15, 2012
Judgment: June 5, 2012
Docket: 31-1580085

Counsel: A. Kauffman for BDO Canada Limited, Proposal Trustee
Harry Fogul for Arnold Milan
G. Benchetrit for Deposit Insurance Corporation of Ontario in its capacity as Liquidator for Croatian (Toronto) Credit Union Limited
Fred Tayar for B. Pfeiffer
Barbara Frederiksa for Bank of Nova Scotia
Jeffrey Spiegelman for 784753 Ontario Ltd., Paulo Holdings, Rogi Holdings and Bany Goldlist
B. Salsberg for 1245094 Ontario Inc.

Subject: Insolvency; Estates and Trusts; Torts

MOTION by debtor for approval of proposal under *Bankruptcy and Insolvency Act*.

***L.A. Pattillo J.*:**

1 This is a motion by Arnold Milan ("Milan") pursuant to s. 58 of the *Bankruptcy and Insolvency Act*, R S. C. 1985, c. B-3, as amended (the "Act") for the approval of a proposal made by him under the Act.

Background

2 On October 5, 2011, the Crotian (Toronto) Credit Union Limited ("CCU"), by its liquidator, the Deposit Insurance Corporation of Ontario ("DICO") commenced an application for a bankruptcy order against Milan. Milan disputed the application and a hearing date was set for January 25, 2012.

3 On January 12, 2012, Milan filed a proposal under the Act dated January 11, 2012 naming BDO Canada Limited as Trustee (the "Proposal"). The Proposal provides, among other things, that Milan will pay to the Trustee sufficient monies to pay 15 cents on the dollar to unsecured creditors who have filed valid proofs of claim. The monies will be provided by a third party and are to be paid as follows: $1 million 60 days after approval of the Proposal by the court; $1 million every 6 months after the initial payment for a period of 18 months; 24 months after the initial payment, an amount sufficient to pay all proven claims 15 cents on the dollar taking into account all previous payments; and a subsequent payment or payments to pay 15 cents on the dollar to any claims finalized as proven claims after the 24 month period within 60 days of being finalized.

4 The Proposal provides in paragraph nine that the provisions of s. 38 and ss. 95 to 101 of the Act and the provisions of the *Fraudulent Conveyances Act* and the *Assignments and Preferences Act* shall not apply if the Proposal is accepted.

5 The Proposal was approved at a meeting of creditors on January 23, 2012 by 19 of 20 creditors eligible to vote representing 90.5% by value.

6 The Trustee has filed its First Report dated March 2, 2012 setting out the background leading up to the Proposal and its recommendations concerning it. The Trustee notes that it met with Milan and his counsel prior to the Proposal being finalized and obtained information concerning his affairs but was not provided with any records relating to such matters including bank account records, lists of payments to creditors and documents relating to his involvement in many companies. Milan advised the Trustee that some documents were lost in a number of physical moves and he has been denied access to others.

7 As a result of not receiving any documentation, the Trustee was unable to express an opinion as to the reasonableness of the exclusions contained in paragraph nine of the Proposal relating to any preferential payments or the improper transfer of assets.

8 Notwithstanding various reservations including the lack of any documentation to enable an independent review of Milan's affairs, the Trustee concluded having regard primarily to the expense and challenge of unraveling the "complex web" of Milan's affairs in a bankruptcy compared with the potential payment of a substantial amount of money over a reasonably short period of time that the terms of the Proposal were more beneficial to the creditors than a bankruptcy.

9 In reaching its recommendation, the Trustee noted that it had received "some comfort" from Milan with respect to the source and financial ability of the third party funder.

10 The approval motion is supported by William Pfeiffer who is the largest creditor by far. Mr. Pfeiffer, who resides in Florida, acquired his claim of $15,238,798 against Milan (approximately 80% of the total unsecured claims accepted for voting) for $375,000.

11 The approval motion is opposed by the DICO in its capacity as Liquidator for CCU which obtained a judgment against Milan on May 19, 2011 for $1,654,228.64 plus interest and costs of $67,207. DICO is also the Liquidator for the Portuguese Canadian Credit Union which has a pending action against Milan and others for fraud.

12 It is also opposed by the Bank of Nova Scotia which obtained a judgment against Milan on September 15, 2011 in the amounts of approximately $772,732 (plus interest) and US $124,515 (plus interest) and by 784753 Ontario Ltd., Paulo Holdings, Rogi Holdings and Barry Goldlist and 1245094 Ontario Inc.

13 The principal grounds of opposition by the opposing creditors are that the Proposal is an abuse of the Act and does not meet the minimum mandatory requirements of the Act.

Preliminary Matter

14 When DICO's original application came before the court on January 25, 2012, because the Proposal had been filed and approved by creditors, a timetable was set for the filing of material in support of the approval motion including the Trustee's Report. On March 6, 2012, the approval motion was set for May 15, 2012.

15 As a result of the way in which the approval motion came about, the Proposal Trustee inadvertently failed to serve notice of the date for the approval motion on all creditors with proven claims as required by s. 58(b) of the Act. Although there are a number of creditors who are represented by counsel and who participated in the court scheduling process, there are a number who did not. When the error was discovered, the Trustee sent notice of the May 15th date by email or fax on May 14, 2012.

16 At the outset of the approval motion, the Trustee requested an order, pursuant to s. 187(9) of the Act validating the late service. That section provides that no proceeding in bankruptcy shall be invalidated by any formal defect or irregularity unless the court is of the opinion that "substantial injustice" has been caused by the defect or irregularity

which cannot be remedied by any order of the court. The Trustee submitted that in the circumstances, no substantial injustice had been caused by the late notice.

17 The creditors who received the late notice of the approval motion all voted in favour of the Proposal at the creditors' meeting. All except one were subsequently examined by counsel for DICO in respect of the approval motion pursuant to an order of the court. It is fair to say those creditors were aware the approval motion was going to take place but not the date. The creditors at the approval motion who are represented by counsel represent the great majority of creditors dollar wise. While that does not excuse the late notice, it reduces the prejudice in my view to those who received the late notice as the positions both for and against approval of the Proposal were well represented on the motion. Any issue that may have been raised by them, whether for or against approval, was amply covered by counsel. Finally, none of the parties appearing before me raised any concern with the Trustee's request or took any issue with it.

18 As a result, it was my view that the defect in service was not such that the approval motion should be delayed. In the circumstances, I was of the opinion that the late notice did not cause a substantial injustice to the creditors who received it. Accordingly, I indicted I would issue an order pursuant to s. 187(9) of the Act validating the late service of the approval motion on the individuals identified by the Trustee.

Background

19 Milan is described by the Trustee in its Report as "a businessman who had investments in a complex web of businesses, including businesses involved in gaming in the United States." Milan is identified as the chair and CEO of the Milan Group on its website which is still active. The Milan Group is described as focusing on three strategic business sectors: financial and technology; commodities & development; and gaming, sports and entertainment. Milan is described as: "a self-built entrepreneur and dynamic leader with an unparalleled reputation and track record of success. He is considered a foremost expert on merchant banking, electronic transactions and electronic cash management. A well versed financier and broker in both national and international business projects and currently doing business through over thirty companies in North America, Central America, Europe, Africa and Asia."

20 A Statement of Personal Net Worth prepared by Milan's accountant as of September 2008 showed total assets valued at over $67 million and net worth valued at approximately $55 million.

21 In his Statement of Affairs dated January 11, 2012, Milan swore under oath that he had incurred debts totaling over $21 million and that his net assets were approximately $50,000. He valued at $1.00 "shares in various private companies which are either dormant, insolvent or not operating." The Trustee has provided a list of 48 corporations which are intended to be the "various private companies" referred to in the Statement of Affairs.

22 The Trustee states in its Report that it was not provided with any records relating to the affairs of Milan such as bank account records or lists of payments. It was further advised by Milan and his counsel that the businesses which Milan was involved in were insolvent and he did not have access to the books and records of the businesses.

23 The proofs of claim filed with the Trustee indicate that various parties were issued promissory notes by Milan at a time when he was insolvent, including several parties who were issued notes within 12 months prior to the "initial bankruptcy event" pertaining to Milan and some who were issued promissory notes after DICO's bankruptcy application.

24 Prior to the return of the approval motion, all that had been disclosed by Milan to the creditors about the source of the approximately $8 million required to enable him to meet the Proposal were two letters from an alleged bank in Mexico with the name of the bank redacted. The first letter dated January 18, 2012 indicated that the bank was loaning the money to Milan and the second dated January 31, 2012, after the approval meeting, indicated that the money was being provided by a "bank client" from the proceeds of a "lawsuit settlement". When asked about the source of funds on his examination under oath, Milan refused to provide the name of the financial institution or information as to the source of the funds other than to say that they were coming from a lawsuit.

25 In a supplementary affidavit sworn by Milan on May 14, 2012, and presented at the approval motion, Milan attached the two bank letters, unredacted. In the affidavit, Milan provided the name of the individual who will be supplying the money, stated he has known him for over 10 years and provided some information concerning the litigation and the settlement.

The Test for Approval of a Proposal

26 The test for approval of a proposal is set out in s. 59(2) of the Act. If the court is of the opinion the terms of the proposal are not reasonable or are not calculated to benefit the general body of creditors, the court shall refuse approval. The court may refuse to approve when it is established that the debtor has committed any of the offences mentioned in ss. 198 to 200 of the Act.

27 In *Mister C's Ltd., Re*, [1995] O.J. No. 1390 (Ont. Bktcy.) at para. 5, MacPherson J. (as he then was) set out the three interests that the court should take into account in approving a proposal: the interests of the debtor in making settlement with creditors; the interests of the creditors in procuring a settlement which is reasonable and which does not prejudice their rights; and the interests of the public in the fashioning of a settlement which preserves the integrity of the bankruptcy process and complies with the requirements of commercial morality. See too: *Mernick, Re* (1994), 24 C.B.R. (3d) 8 (Ont. Gen. Div. [Commercial List]).

28 At first blush, the payment of 15 cents on the dollar may appear reasonable to creditors and in their best interests, particularly given Milan's listed assets at the time of the Proposal. In my view, however, in the absence of the production by Milan of any books and records and other relevant documentation to enable the Trustee to do an independent review of his affairs, there is no basis to permit the court or the creditors to determine that the amount being offered as a settlement is reasonable.

29 This is particularly so in the circumstances of this matter given the substantial nature of Milan's assets as at September 2008 including his interest in many businesses and companies around the world when compared with his stated assets at the time of the Proposal.

30 I am also of the view that the Proposal is not reasonable because of the proposed exclusion in paragraph nine of the application of s. 38 and ss. 95 to 101 of the Act and the provisions of the *Fraudulent Conveyances Act* and the *Assignments and Preferences Act* is not reasonable.

31 Section 50(10)(b) of the Act requires the Proposal Trustee to provide its opinion as to the reasonableness of the exclusion of ss. 95 to 101 in a proposal. Milan advised the Trustee that the exclusion was not done to cover any specific transaction but to avoid continued litigation and legal costs. In its Report, the Trustee states at paragraph 38:

> As indicated in this report, the Trustee has not been provided with any records relating to the affairs of the Proponent such as bank account records or lists of payments to creditors. Consequently, the Trustee has been unable to independently review or consider payments made by the Proponent or transfers of assets made by the Proponent in the relevant time periods. Accordingly, the Trustee is unable to express an opinion as to the reasonableness of the exclusions contained in paragraph nine of the Proposal.

32 The requirement in s. 50(10)(b) of the Act that the Trustee give its opinion as to the reasonableness of the exclusions of the claims recognized in ss. 95 to 101 of the Act emphasizes the importance of ensuring such exclusion is reasonable. In my view, the absence of such an opinion in circumstances such as here where Milan has provided no records or independent means of verification by itself results in exclusion provision in paragraph nine of the Proposal being unreasonable. Improper preferences and/or transfers of property may form a significant part of Milan's recoverable assets. The creditors may be giving up significant rights to such recovery which they are unaware of. In the absence of any independent information from Milan to enable the Trustee to conclude that the exclusion of such rights is reasonable and does not prejudice creditors' rights, I am unable to conclude that paragraph nine of the Proposal is reasonable.

33 The opposing creditors further submit, having regard to the evidence in this case, that s. 59(3) of the Act requiring security for the payment applies and the court must refuse approval of the Proposal because Milan has failed to provide any security in the Proposal. In response, Milan submits that sufficient security has been provided and, in the alternative, if the court determines that is not the case, requests that the amount of the security required by s. 59(3) be reduced to match the security provided.

34 Section 59(3) of the Act provides that the court shall refuse to approve the proposal where any of the facts mentioned in s. 173 are proved against the debtor unless it provides reasonable security for the payment of not less that 50 cents on the dollar on all the unsecured claims or such other percentage as the court may direct.

35 Based on the evidence, I find the following facts mentioned under s. 173 of the Act have been proved:

> a) Milan's assets are not equal to a value of fifty cents on the dollar on the amount of his unsecured liabilities and Milan has not established that he should not be held responsible for such failure;
>
> b) Milan has either omitted to keep proper books of account for his projects and businesses or has chosen not to provide them to the Trustee as required by s. 50 of the Act;
>
> c) Milan continued to incur liabilities when he was insolvent. Milan through his lawyer indicated to the Trustee that he was insolvent dating back to the 2008/2009 period. Subsequent to that period, Milan issued personal promissory notes which have not been repaid; and
>
> d) Milan has failed to account satisfactorily for the loss of his assets or for any deficiency of assets to meet his liabilities.

36 As a result, s. 59(3) of the Act applies and Milan is required to provide security for the payments under the Proposal of not less than 50 cents on the dollar on all unsecured claims, unless the court orders otherwise.

37 The Proposal itself does not provide for any security for the proposed payments. When the opposing creditors raised the issue of lack of security, Milan responded by stating in his supplementary affidavit sworn May 14, 2012, that the person who is putting up the money has agreed to make a loan advance of US $4 million within 60 days of court approval of the Proposal. It is submitted on Milan's behalf that because the proposed payment is 50% of the total of the estimated $8 million to be paid under the Proposal, sufficient security has been provided.

38 In my view, the $4 million amount offered does not amount to the security required by s. 59(3) of the Act. The Proposal calls for an initial payment of $1 million 60 days from approval. As a result, assuming payment of the $4 million as indicated, the security which will be in place (after the first $1 million payment) to secure the remaining payments of $7 million is really $3 million which is less than 50% of the remaining monies to be paid.

39 In the absence of the security being sufficient, Milan requests that I exercise the discretion provided for in s. 59(3) and reduce the amount of security required to accommodate the monies to be paid on Milan's behalf. In the circumstances, I am not prepared to do that. I say this for a number of reasons. First is my general concern arising from Milan's failure to produce any books and records relating to his affairs. I am unable to accept that Milan has no records or access to records in respect of his personal affairs and of his many and varied businesses. I am also concerned with the secrecy surrounding the details of where the monies are coming from to fund the Proposal. The initial information that was provided is both contradictory and lacking in detail. It was only at the argument that the name of the bank and the third party were provided. While the Trustee may have received "some comfort" concerning the source of the funds and the financial ability of the funder, I have not. At the very least, I would have expected information about the agreement between the third party and Milan concerning the provision of the funds. Finally, the proposal for "security" has only come forward at the last minute and suffers, in my view, from the same concerns as the funding proposal itself.

40 The integrity of the bankruptcy proposal process requires full and complete disclosure by the proponent to enable the creditors and the court to determine whether the proposal is reasonable and in the best interests of all interested parties. That has not happened here. Milan has failed to provide any books and records to enable the Trustee to confirm his statements to the Trustee about his affairs or the reasonableness of the Proposal. He has also been very guarded about the source of the money to enable him to fund the Proposal and how he is able to obtain such money.

41 In my view, by proceeding as he has, Milan is attempting to use the proposal process to compromise all claims against him, including claims for fraud and breach of trust, without properly accounting for his assets and any transactions that may constitute a preference or an improper transfer of property. Given the substantial nature of his assets as at September 2008 including his interest in many companies, his Statement of Affairs raises many questions as to what happened and what, if anything remains. It is important for the creditors and the bankruptcy process generally that a proper review of Milan's assets take place. The circumstances of this case cry out for such a review.

42 For the above reasons, therefore, it is my view that the terms of the Proposal are not reasonable having regard to both the interests of the creditors and the interests of the public in maintaining the integrity of the bankruptcy proposal process. I am also of the view that Milan has not provided reasonable security for the proposed payments under the Proposal as required pursuant to s. 59(3) of the Act.

43 As a result, Milan's approval motion is dismissed.

Motion dismissed.

End of Document

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1987 CarswellNB 26
New Brunswick Court of Queen's Bench

Sumner Co. (1984), Re

1987 CarswellNB 26, [1987] N.B.J. No. 205, 201 A.P.R. 191,
4 A.C.W.S. (3d) 349, 64 C.B.R. (N.S.) 218, 79 N.B.R. (2d) 191

Re SUMNER COMPANY (1984) LIMITED

Richard C.J.Q.B.

Heard: April 7, 1987
Judgment: April 30, 1987
Docket: Moncton No. N.B. 3257

Counsel: *G.B. MacLean*, for applicant and trustee.
W. Vail, for Sumner and Ideal.
K. Bethel, for Sumner.
R.B. Johnson, R. Mungall and *M. Sheehan*, for creditors opposing the application for approval.

Subject: Corporate and Commercial; Insolvency

Application for approval of proposal.

***Richard C.J.Q.B.*:**

1 Coopers & Lybrand Limited applies, as substitute trustee ("the trustee") for Sumner Company (1984) Limited ("Sumner") for court approval of a proposal made by Sumner under the Bankruptcy Act of Canada, R.S.C. 1970, c. B-3 ("the Act").

2 The pertinent sections of the Act are the following:

> 40. Upon acceptance of the proposal by the creditors, the trustee shall apply to the court forthwith for its approval and shall send notice of the hearing of the application by registered mail, not less than fourteen days before the date of the hearing, to the debtor, to every creditor who has proved his claim and to the Superintendent; and the trustee, not less than three days before the date of the hearing, shall file in the prescribed form a report to the court on the proposal and shall forward a copy to the Superintendent not less than ten days before the date of the hearing.
>
> 41. (1) The court shall, before approving the proposal, hear a report of the trustee in the prescribed form as to the terms thereof and as to the conduct of the debtor, and, in addition, shall hear the trustee, the debtor, any opposing, objecting or dissenting creditor and such further evidence as the court may require.
>
> (2) Where the court is of the opinion that the terms of the proposal are not reasonable or are not calculated to benefit the general body of creditors, the court shall refuse to approve the proposal, and the court may refuse to approve the proposal whenever it is established that the debtor has committed any one of the offences mentioned in sections 169 to 171.
>
> (3) *Where any of the facts mentioned in sections 143 and 147 are proved against the debtor, the court shall refuse to approve the proposal* unless it provides reasonable security for the payment of not less than fifty cents in the dollar on all the unsecured claims provable against the debtor's estate or such percentage thereof as the court may direct.

73. (1) Every conveyance or transfer of property or charge thereon made, *every payment made*, every obligation incurred, and every judicial proceeding taken or suffered by any insolvent person *in favour of any creditor or of any person in trust for any creditor with a view to giving such creditor a preference over the other creditors shall, if the person making, incurring, taking, paying or suffering the same becomes bankrupt within three months after the date of making, incurring, taking, paying or suffering the same, be deemed fraudulent and void as against the trustee in the bankruptcy*.

(2) Where any such conveyance, transfer, payment, obligation or judicial proceeding has the effect of giving any creditor a preference over other creditors, or over any one or more of them, it shall be presumed *prima facie* to have been made, incurred, taken, paid or suffered with a view to giving such creditor a preference over other creditors, whether or not it was made voluntarily or under pressure and evidence of pressure shall not be receivable or avail to support such transaction. (3) For the purposes of this section, the expression "creditor" includes a surety or guarantor for the debt to such creditor.

143. (1) The facts referred to in section 142 are

(*a*) the assets of the bankrupt are not of a value equal to fifty cents in the dollar on the amount of his unsecured liabilities, unless he satisfies the court that the fact that the assets are not of a value equal to fifty cents in the dollar on the amount of his unsecured liabilities has arisen from circumstances for which he cannot justly be held responsible;

(*h*) the bankrupt has, within the three months preceding the date of his bankruptcy, when unable to pay his debts as they became due, given an undue preference to any of his creditors.

144. For the purposes of section 143 the assets of a bankrupt shall be deemed of a value equal to fifty cents in the dollar on the amount of his unsecured liabilities when the court is satisfied that the property of the bankrupt has realized or is likely to realize or, with due care in realization, might have realized an amount equal to fifty cents in the dollar on his unsecured liabilities.

169. Any bankrupt who

(*b*) makes any fraudulent disposition of his property before or after bankruptcy; is guilty of an offence ... (emphasis added)

The Facts

3 Sumner was incorporated in 1984 to acquire the assets of Sumner Company, a division of Sumner Company Limited, a company controlled by Triarch Maritime Inc. ("Triarch"), for approximately $16,800,000, as shown in Sumner's financial statements for the period ending 30th November 1984. Sumner's equity contribution to the purchase price was $700,000, the balance being financed by debt with the principal lender being the Continental Bank of Canada ("the bank"). From the beginning of its operation Sumner registered deficits as follows:

for the first 6 months to 30th November 1984 ..... $ 78,061

for the next 12 months to 30th November 1985 ..... $867,589

for the next 11 months to 30th October 1986 ..... $771,000

4 As shown by these figures, Sumner was, by January 1986, insolvent.

5 On 3rd November 1986 the bank placed Sumner in receivership and Price Waterhouse Limited ("Price") was appointed receiver-manager. The bank was then owed approximately $7.2 million.

6 On 10th December 1986 G.S.W. Building Products Limited ("G.S.W."), a trade creditor, issued a petition for bankruptcy against Sumner, and Coopers & Lybrand Limited ("Coopers") was appointed trustee. According to the

report of the trustee to the court, the liabilities to unsecured creditor then totalled $8,631,321 against assets of $2,626,000 for a deficiency of $6,005,321.

7 Commencing 7th November 1986, the receiver-manager began soliciting offers to purchase the various divisions of Sumner on a going-concern basis. The sporting goods division was sold to Les Entreprises Chasse et Pêche de Beauce Inc., the hardware division was sold to Cochrane-Dunlop Limited and the plumbing and heating division was sold to Ideal Plumbing Supplies (Canada) Inc. ("Ideal"). The realization from these sales was sufficient to repay the bank in full.

8 On 16th January 1987 Sumner filed a proposal in bankruptcy which was subsequently amended to read as follows:

1. THAT secured claims shall be paid in accordance with arrangements existing between the COMPANY and the holders of secured claims, or as may be arranged between the COMPANY and the holders of secured claims.

2. THAT payment in priority to all other claims of all claims (hereinafter referred to as the "PREFERRED CLAIMS") directed by the *Bankruptcy Act* to be so paid in the distribution of the property of an insolvent person shall be provided for as follows:

PREFERRED CLAIMS, without interest, shall be paid in priority to all claims of ordinary unsecured creditors (hereinafter referred to as the "ORDINARY CLAIMS") or as may be arranged.

3. THAT payment in full in priority to all PREFERRED CLAIMS and ORDINARY CLAIMS be made with respect to the fees, expenses, liabilities and obligations and solicitor and client legal costs and expenses (hereinafter referred to as the "PROPOSAL EXPENSES") of the following parties:

(i) the trustee named herein;

(ii) the interim receiver appointed with respect to the assets of the COMPANY;

(iii) the TRUSTEE named in the ORIGINAL PROPOSAL and his solicitor;

(iv) the TRUSTEE named in the petition for receiving order issued by GSW INC.;

(v) the petitioning creditor GSW INC.;

(vi) the COMPANY'S advisors, RICHER & ASSOCIATES and their solicitors;

(vii) the members of the informal CREDITORS' COMMITTEE elected subsequent to the filing of the PROPOSAL at an informal meeting of major creditors held in Montreal, on the same basis as if they had been duly elected inspectors of the estate insofar as such expenses, including travel expenses of attending a meeting of the Committee in Toronto, relate to the members' involvement on the CREDITORS' COMMITTEE up to and including the date of acceptance of the AMENDED PROPOSAL;

(viii) the members of the INSPECTORS' COMMITTEE to be elected hereunder, pursuant to the provisions of paragraph 10 hereof.

4. THAT provision for payment of all PROPOSAL EXPENSES, PREFERRED CLAIMS and ORDINARY CLAIMS, including claims of every nature and kind whatsoever, whether due or not due for payment, as of the date of the ORIGINAL PROPOSAL, and including contingent and unliquidated claims arising out of any transaction entered into by the COMPANY prior to the date of the ORIGINAL PROPOSAL, will be made as follows:

(A) The COMPANY hereby cedes, assigns, transfers and conveys to and vests in the TRUSTEE, for the benefit of the creditors of the COMPANY (hereinafter referred to as the "CREDITORS"), the following rights and assets (hereinafter referred to as the "ASSIGNED ASSETS"):

(i) All the COMPANY'S right, title and interest in and to the surplus realization of CONTINENTAL BANK or PRICE WATERHOUSE LIMITED (hereinafter referred to as the "RECEIVER") as receiver-manager of the COMPANY (after payment of the proper claim of the secured creditor for which the RECEIVER was acting, the RECEIVER'S proper fees and expenses and any amounts which the RECEIVER is or may be obliged to pay in respect of PREFERRED CLAIMS), as well as any and all rights of any nature whatsoever which the COMPANY has or might have against the RECEIVER or CONTINENTAL BANK with respect thereto; and

(ii) Any and all rights, demands, claims, actions, rights of action or choses in action, including, without limitation, damages and proceeds of any negotiated settlement (the whole hereinafter referred to as "C.A. RIGHTS") which the COMPANY has or might have against THORNE RIDDELL, Chartered Accountants, or any successor firm, (hereinafter referred to as the "CHARTERED ACCOUNTANTS"), directly or indirectly relating to or arising out of financial statements or information concerning SUMNER COMPANY, LIMITED (now known as TRIARCH MARITIMES, INC.), which emanated from or was certified by the CHARTERED ACCOUNTANTS or with which the CHARTERED ACCOUNTANTS were associated, including, without limiting the generality of the foregoing, any such rights, demands, claims, actions, rights of action, choses in action, damages or proceeds described in an action instituted by the COMPANY in the Supreme Court of Ontario under Court File Number 5139/85 against, inter alia, the CHARTERED ACCOUNTANTS; and

(iii) Any and all rights, demands, claims, actions, rights of action or choses in action, including, without limitation, damages and proceeds of any negotiated settlement (the whole hereinafter referred to as the "CONTINENTAL BANK RIGHTS") which the COMPANY has or might have against CONTINENTAL BANK OF CANADA (hereinafter referred to as "CONTINENTAL BANK"), or any successor entity, with respect to a TWO HUNDRED THOUSAND DOLLAR ($200,000.00) payment made to CONTINENTAL BANK by the COMPANY in October 1986;

(B) The COMPANY will make the following payments to the TRUSTEE in the aggregate amount of FIVE HUNDRED AND THIRTY-FIVE THOUSAND DOLLARS ($535,000.00), without interest (hereinafter referred to as the "PROPOSAL PAYMENTS"):

(i) TWO HUNDRED AND FIFTY THOUSAND DOLLARS ($250,000.00), SIXTY (60) days subsequent to the approval of the AMENDED PROPOSAL by the Court;

(ii) ONE HUNDRED AND TWENTY-FIVE THOUSAND DOLLARS ($125,000.00) on December 31, 1987; and

(iii) ONE HUNDRED AND SIXTY THOUSAND DOLLARS ($160,000.00) on January 2, 1991, with the option to the COMPANY to prepay this final PROPOSAL payment on January 2, 1988, or January 2, 1989, or January 2, 1990.

5. THAT the cession, assignment, transfer, conveyance and vesting of the ASSIGNED ASSETS by the COMPANY to and in the TRUSTEE and the payment by the COMPANY to the TRUSTEE of the PROPOSAL PAYMENTS will constitute full and final settlement of all ORDINARY CLAIMS.

6. THAT the TRUSTEE will have the right to deal with and realize the ASSIGNED ASSETS as owner, for the benefit of the creditors, without the necessity of reference to the COMPANY, in the same manner and to the same extent as if the TRUSTEE were the trustee under the bankruptcy of the COMPANY and without limiting the generality of the foregoing, the TRUSTEE may undertake or continue proceedings, with respect to the ASSIGNED ASSETS, or with respect to the payment of $200,000 referred to in paragraph 4(A)(iii), in the same manner as if it were a trustee in bankruptcy of the COMPANY, and may avail itself of all provisions of the *Bankruptcy Act*, including, without limitations, those dealing with preferential payments, settlements, fraudulent conveyance, or

reviewable transactions as if the COMPANY were bankrupt. The TRUSTEE may also avail itself of the rights, in respect of the ASSIGNED ASSETS, and with respect to the payment of $200,000 referred to in 4(A)(iii), available to creditors of the COMPANY, under the Assignments and Preferences Act, Statute of Elizabeth, or Statute of Frauds as they apply in the Province of New Brunswick or similar legislation in other jurisdictions which may be applicable. By accepting the PROPOSAL, the CREDITORS expressly assign such rights to so proceed to the TRUSTEE, and nominate the TRUSTEE as their agent to proceed with such action as it is instructed to do by the INSPECTORS COMMITTEE, the whole without prejudice to the status of the TRUSTEE to so proceed without regard to such assignment.

7. THAT subject to prior payment of the PROPOSAL EXPENSES and PREFERRED CLAIMS, the TRUSTEE will, from time to time, pay dividends from the proceeds of the ASSIGNED ASSETS and the PROPOSAL PAYMENTS.

8. THAT as a pre-condition of the approval of the AMENDED PROPOSAL by the Court, but conditionally upon such approval, the TRUSTEE will have received, in form and substance satisfactory to it, the guarantee of payment of the PROPOSAL PAYMENTS by IDEAL PLUMBING SUPPLIES (CANADA) INC. In the event the guarantee is not delivered or expires in accordance with its terms, this PROPOSAL is null and void as if never made and all parties hereby consent to an order rescinding any court approval that may have occurred prior to the lapse of the guarantee or consent to an order allowing any appeal from such order as the case may be.

9. THAT at the meeting to be held to consider the AMENDED PROPOSAL, the creditors may appoint ONE (1) or more, but not more than FIVE (5), individuals to serve as a committee of inspectors (herein referred to as the "INSPECTORS' COMMITTEE"). The CREDITORS' COMMITTEE will have the following powers:

(A) to advise the TRUSTEE on all matters relating to the ASSIGNED ASSETS and the conduct of litigation relating to the C.A. RIGHTS and the CONTINENTAL BANK RIGHTS, with respect to which the INSPECTORS' COMMITTEE will have the same powers as if they were inspectors appointed to a Bankrupt Estate under the *Bankruptcy Act*;

(B) to advise the TRUSTEE on the timing of payment of any amount of dividends to be distributed from time to time; and

(C) to advise the TRUSTEE on all matters relating to the AMENDED PROPOSAL.

10. THAT COOPERS & LYRAND LIMITED of the City of Halifax, Province of Nova Scotia, is the TRUSTEE and will serve as Trustee under the AMENDED PROPOSAL. The TRUSTEE will receive and realize the ASSIGNED ASSETS and SETTLEMENT PAYMENTS and will distribute dividends, the whole in accordance with the terms of the AMENDED PROPOSAL.

11. THAT the terms of this AMENDED PROPOSAL are not severable.

DATED AT TORONTO, THIS 5th DAY OF APRIL, 1987.

Sumner Company (1984) Limited
(signed)

_____ Per: _____
Witness James Stewart

9 The guarantee referred to in the above proposal reads as follows:

FOR PURPOSES HEREOF, terms in capital letters, which are not defined herein, will have the same meaning as in the AMENDED PROPOSAL dated March 5, 1987 filed by SUMNER COMPANY (1984) LIMITED ("COMPANY"), under the provisions of the *Bankruptcy Act*.

FOR GOOD AND VALUABLE CONSIDERATION, the receipt and sufficiency of which are hereby acknowledged, the undersigned IDEAL PLUMBING SUPPLIES (CANADA) INC. ("GUARANTOR") hereby guarantees, jointly and severally with the COMPANY, payment to COOPERS & LYBRAND LIMITED ("TRUSTEE"), in its quality as trustee under the AMENDED PROPOSAL, of the PROPOSAL PAYMENTS payable under the AMENDED PROPOSAL in an aggregate amount of FIVE HUNDRED AND THIRTY-FIVE THOUSAND DOLLARS ($535,000.00).

The present guarantee is irrevocable, but it is subject and conditional upon the Amended Proposal being approved by the Court of Queen's Bench of New Brunswick, and all necessary appeal periods having expired and there being no appeals pending by 5:00 p.m. on *April 25, 1987* ("FINAL APPROVAL"), or such other later date as is agreed to in writing by the GUARANTOR, failing which it shall be null and void and of no effect.

The TRUSTEE will have a direct action against the GUARANTOR for any amount payable under this guarantee.

In the event that after FINAL APPROVAL the AMENDED PROPOSAL is annulled, the present guarantee will remain in full force and effect, and the GUARANTOR will immediately pay to the TRUSTEE, or to any successor trustee under the bankruptcy of the COMPANY, the entire unpaid balance of the PROPOSAL PAYMENTS.

DATED AT MONCTON, THIS 7th DAY OF APRIL, 1987.

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                                                  Ideal Plumbing Supplies
                                                            (Canada) Inc.
                                                  Per:      (signed)
                                                       -----------------
        (signed)                                         Mark Ronttenberg
  ---------------------                                  Secy Treas.
  Witness
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10 The proposal was accepted at the first meeting of creditors held in Montreal on 5th March 1987 where 150 creditors representing $4,609,029.41 or 79 per cent of the number voting and 78.2 per cent of the value voted for the proposal and 40 creditors representing $1,284,975.59 or 21 per cent of the number voting and 21.8 per cent of the value voted against the proposal.

The Issue

11 The question in this application is whether the proposal should be approved by the court.

12 The submission made in favour of approving the proposal is based on the facts that (1) a majority of the creditors have accepted the proposal; (2) the trustee is mildly in favour of the proposal; and (3) the creditors will recover a part of their losses within 60 days of approval, a further part on 31st December 1987 and a last part on 31st December 1990.

13 The submission made against approval of the proposal is based on allegations that (1) the unsecured creditors will recover less than 50 cents on the dollar; (2) it is not a reasonable proposal; (3) it does not provide a clear advantage over bankruptcy; (4) there is no reasonable security of payment under the proposal; (5) the conduct of the debtor and the interest of public and commercial morality weighs heavily against approval; and (6) the proposal is in fact not a proposal as contemplated under the Act.

14 I will begin by examining the submissions made against approval of the proposal. The most serious such submission seems to be the conduct of the debtor and I shall accordingly deal with it first.

The Conduct of Sumner

15 Counsel for the respondent-creditors submits that Sumner, while insolvent and about to be petitioned into bankruptcy, committed a series of facts and offences mentioned in ss. 73, 143 to 147 and 169 to 171 of the Act. These alleged facts and offences are as follows:

16 1. Between the end of June 1986 through to November 1986, while insolvent, Sumner increased its trade accounts payable by $2.2 million. These trade accounts are now amongst the unsecured creditors. On this issue Mr. Dowdall, of the Toronto law firm of Lang, Michener, Lash & Johnston and counsel for the trustee, reported to the first meeting of creditors held in Montreal on 5th March 1987 as follows:

> It is clear that the Bank was paid down significantly during a period in which the trade suppliers continued to ship goods but were not being paid.

17 2. In August 1985 Sumner had taken legal action against Triarch and its accountants, Thorne Riddell, alleging, inter alia, misrepresentation of the collectability of receivables. The claim arose from the facts that certain accounts receivable acquired by Sumner from Triarch, proved to be uncollectable. Both Triarch and Sumner had relied on an audited financial statement of Thorne Riddell which included these accounts at full value, while approximately $2.9 million of them proved to be uncollectable. One of Triarch's employees had allegedly altered Triarch's books so as to show these receivables as being current, when in fact one quarter of them were extremely old and of marginal collectability. Sumner claimed in excess of $6 million against Triarch and Thorne Riddell and, at some time after commencement of the action, rejected an offer made by Triarch of a cash settlement of $1.5 million because it was thought to be inadequate. Yet, on 17th October 1986, less than three weeks before receivership, the action was settled by Sumner paying $500,000 to Triarch. At p. 3 of his report to the court, the trustee reported as follows on this issue:

> 10. That I am further of the opinion that ... b) The conduct of the debtor (Sumner) may be subject to censure in the following respect:
>
> > (i) That the debtor settled a lawsuit filed against Triarch, the vendor of the assets that formed the business of the debtor, by a natural release of claims and payment to Triarch of $500,000 which may in whole or in part represent amounts owing Triarch.
>
> This settlement did not appear to be in the interest of the debtor inasmuch as previous offers of settlement which had included cash payment of $1.5 million by Triarch to the debtor (Sumner) and reduction of vendor financing had been rejected as inadequate. As a concurrent transaction a company related to Triarch paid $500,000 to acquire the shares of the debtor, as a result of which two principal shareholders were able to recover their investment and one of the principals was also relieved of a $1 million personal guarantee. At the time of the transactions, the company was not paying its liabilities as they came due, and within three weeks the debtor's banker had called their loans and appointed a Receiver with the consent of the debtor.

18 The trustee sought and received advice from Mr. Garry MacLean, the senior member of the law firm of MacLean, Chase, McNichol & Blair, and from Mr. Dowdall, of the law firm of Lang, Michener, Lash & Johnson, on this issue and other matters relating to the bankruptcy of Sumner. On the settlement of the Sumner-Triarch-Thorne action, Mr. MacLean reported to the meeting of creditors:

> That a payment of $500,000 to Triarch in mid October, 1986, which appears to have flowed back to the shareholders of Sumner was a fraudulent preference and if pursued there was a strong likelihood of recovery;

19 Mr. Dowdall reported that:

This settlement was a reviewable transaction and the Bankruptcy Courts would likely reopen the action if requested by a Trustee in Bankruptcy.

20 The trustee, Mr. Wide, stated in his report under the proposal that:

It is our view that at the time of the payment, Triarch and Sumner were related parties as defined in the Bankruptcy Act. The payment was made when other creditors were not getting paid. It is our present view this transaction can be set aside as a reviewable transaction or a preference ... it is our present view the effect of the settlement may have been to enhance Triarch's position in the ensuing failure of Sumner, to the detriment of the trade creditors.

21 In a letter of opinion to the trustee, Mr. MacLean, on 4th March 1987, further stated as follows with respect to this settlement:

The chain of events leading to the Receivership and liquidation of the assets of Sumner Company (1984) Limited have benefited the Continental Bank, have helped extricate Triarch from its liabilities in the law suit with Sumner Company (1984) Limited and have directly benefited the directors of Sumner Company (1984) Limited by returning to them their initial investment. Sumner Company (1984) Limited and its unsecured creditors have not benefited from the resulting events. In discussing this matter with Mr. Wide, it would appear that under the purported settlement arrangement, Sumner Company (1984) Limited paid the sum of $500,000.00 to Triarch. *Triarch, through an associate company, paid the sum of $500,000.00 to the holding company controlled by Messrs. DesBrisay and Fraser, which effectively gave them a 100% recovery of their initial investment*. Shareholder and director, Mr. O'Sullivan, apparently has not received the return of his investment and his conduct throughout the transaction appears to be questioned by all parties. The $500,000.00 payment appears to be part of an overall settlement package and although it should not be regarded in isolation, *it appears that its true purpose was to set in motion a chain of payments ending with reimbursement of the shareholders' investment of Messrs. DesBrisay and Fraser. The payment was clearly made at a time when Triarch was directing the Company's affairs for the financial benefit of Triarch and not for the financial benefit of Sumner Company (1984) Limited*. It is clear that Triarch knew Sumner Company (1984) Limited to be insolvent, that this was a transaction outside the ordinary course of business, that a financial preference was being received, and that the sum paid did not assist Sumner Company (1984) Limited in continuing in business. There further appears to be a lack of consideration flowing to Sumner Company (1984) Limited for the payment made. Once again, *we believe this transaction to come within the ambient* [sic] *of Section 73 of the Bankruptcy Act as a fraudulent preference and information provided us to date would indicate it highly unlikely that Triarch could rebut the provisions of Section 73 of the Bankruptcy Act*. (emphasis added)

22 Mr. Dowdall also gave a letter of opinion to the trustee dated 4th March 1987 in which he commented as follows on the settlement of the action:

We have had the opportunity of reviewing the pleadings in the lawsuit between Triarch and Sumner. We have attempted to talk to Sumner's solicitors, Cassels, Brock. Although they have patently acted for Sumner throughout Cassels, Brock has refused to have any meaningful discussions with us or for that matter, even to provide copies of the relevant pleadings. They are concerned to protect Mr. Desbrisay's interests and essentially view him as their sole client, although clearly this is incorrect. Should we decide to proceed with action against Triarch, we would recommend that they be examined pursuant to the provisions of Section 133 of *The Bankruptcy Act*.

In summary, it appears that there is very little question but that the books of the Sumner division of Triarch were seriously misstating its affairs.

On balance, *it is our view that Sumner had a good law suit against Triarch*. We understand that Triarch has advised you that its solicitor thought that there was a 60% chance that it would lose the lawsuit. Insofar as the question of liability is concerned, we would rate the chances of success slightly higher.

It is clear that Desbrisay went along with the Triarch settlement because he was getting $500,000.00 for his shares which otherwise would be worthless as well as a release from his $1 million bank guarantee. Sumner as an entity gained virtually nothing as a result of the settlement. (emphasis added)

23 3. On 17th October 1986, well within five months of being petitioned into bankruptcy, Sumner paid $200,000 to the bank. Mr. Desbrisay stated to the trustee that this payment was made for the purpose of having the bank agree to maintain the company's (Sumner) credit lines and not to call its loans and appoint a receiver. Yet on 30th October 1986, less than two weeks later, the bank did call its loans and appointed Price as receiver on 3rd November 1986. On this matter the trustee reported that:

A $200,000 payment to Continental Bank described as "Commitment Fee", was made on October 17, 1986 as consideration for not calling their loans and appointing a Receiver forthwith or alternatively as a "re-negotiation fee". This is possibly recoverable as a preference.

24 Mr. MacLean advised the trustee that:

We have seen no evidence of any written documents clearly outlining the true purpose for this payment. Since the Bank called its loans and appointed the Receiver a little over two weeks after receiving the $200,000.00 sum, we do not see the payment as constituting consideration for any extended accommodation by the Bank. We have been advised by Mr. Wide that the Bank, during the several weeks preceding the payment in question, received an abnormally high rate of paydown of its loans and, as a result of the Receivership, has been paid in full of all indebtedness owed by the Company. Because of this, *we can see no consideration flowing to Sumner Company (1984) Limited from the Continental Bank because of the payment made. The effect of the payment is to remove a sum of $200,000.00 from the general creditors of the Company in favour of the Continental Bank at a time when the Company was clearly insolvent and for which Sumner Company (1984) Limited received no consideration*. (emphasis added)

25 Mr. Dowdall advised the trustee that:

During October of 1986, several transactions of note occurred. The Continental demanded and received a one time special payment of $200,000.00. Mr. Desbrisay has advised that he thought this payment was in consideration of the Bank forbearing to put Sumner into receivership. *This was not a loan reduction and has been apparently referred to as the "commitment fee"*. (emphasis added)

26 4. In late October 1986, again within weeks, if not days, before its receivership, Sumner paid $50,000 to the law firm of Goodman & Goodman which was reported by Mr. MacLean to the creditors as "a payment to Triarch's solicitor". Mr. MacLean reported to the creditors that this payment was "a fraudulent preference which could be pursued with a strong likelihood of success". Mr. Dowdall, in his letter of opinion, agreed. The trustee reported to the creditors on this payment, as follows:

A payment of $50,000 was made to the law firm of Goodman and Goodman, Triarch solicitors, on October 24, 1986 on the instruction of Triarch who then controlled Sumner. *This appears to us to be a preference and recoverable for the benefit of creditors, as other creditors were not at this point being paid.* (emphasis added)

27 Finally, Mr. MacLean stated in his opinion to the trustee that:

Goodman & Goodman apparently at all material times were the chief counsel and solicitors for Triarch. We have seen no evidence that they were retained by Sumner Company (1984) Limited, nor that they performed any legal services for the benefit of Sumner Company (1984) Limited. *The payment of Triarch's law firm on October 24, 1986, appears to have been directed by Triarch to pay its own accounts at a time when the officers and directors of Sumner Company (1984) Limited were no longer in de facto control of the Company*. Unless documentation appears to the

contrary, *it is our opinion this transaction comes within he ambient of Section 73 of the Bankruptcy Act as a fraudulent preference*. (emphasis added)

28 5. On various actions taken in this matter by the shareholders and by the directors of Sumner, Mr. Dowdall has advised the trustee as follows:

These have been discussed to some degree above with respect to the possible action against the Bank. The following additional actions would appear to exist:

(i) On one argument of the facts, the settlement with Triarch amounted to a redemption of Triarch's preference shares (subject to the issue of whether these shares were ever issued). Such a redemption would have been in contravention of both Section 79 of the *Bankruptcy Act* and the provisions of the *Canada Business Corporation Act* which prevent the payment of dividends or redemption of shares by insolvent companies. These provisions impose director liability;

(ii) The second cause of action against the directors relate [sic] to the $500,000.00 purchase of shares by a Triarch subsidiary from the Sumner shareholders. *We believe that it is more than coincidence that the $500,000.00 paid out by Sumner to Triarch as part of the Triarch settlement happens to be the same amount of money as Triarch paid for the shares of Sumner at a time Sumner was patently insolvent and the shares valueless*. We believe that an argument could be made that this really amounted to a dividend by Sumner to its shareholders in contravention of Section 79 and the *Canada Business Corporation Act* which would be invalid for the reasons set out above;

(iii) We believe that there may be a possibility of commencing proceedings against directors related to loss that Sumner may have suffered as a result of The Triarch settlement. (emphasis added)

29 It should be noted that the letters of opinion of Mr. MacLean and Mr. Dowdall were exhibits attached to the affidavit of Nancy L. Hall, the credit analyst of creditor Olin Corporation, Defense System Group, Winchester Division ("Olin"). The affidavit was introduced into evidence at the outset without objections from any of the counsel present. Furthermore, no evidence, either viva voce or by way of affidavits, was offered from any of the three shareholders and directors of Sumner to rebut or explain any of these very serious allegations of facts and offences committed under the Act. From the evidence before me, the only conclusion that I can reach is that certain facts and offences as contemplated in ss. 73, 143(1)(*h*) and 169(*b*) of the Act have indeed been committed. I find in this case that s. 41(3) applies and makes it therefore mandatory for the court to refuse to approve the proposal "unless it [the proposal] provides reasonable security for the payment of not less than fifty cents in the dollar on all unsecured claims provable against the debtor's estate or such percentage thereof as the court may direct". Accordingly, I shall now examine the issue of what the proposal provides for.

The Proposal

30 In order to determine what security and reimbursement prospect the proposal provides for, I shall refer myself to the evidence given on the issue and to the figures made available to the court. In the trustee's first report to the creditors dated 19th February 1987 (Ex. R-1), Mr. James A. Kirby stated at p. 3:

It is estimated that if the preliminary figures provided by Price ... are realized, the ultimate dividend to creditors will be *between 21% and 28%*. (emphasis added)

31 In a second or subsequent report of the trustee under the proposal, dated 2nd March 1987, Mr. M.A. Wide stated at p. 2:

Total unsecured claims are in the range of $8.6 million. Therefore *unsecured creditors can expect to realize 15%-22% of their claims* from the surplus. (emphasis added)

32 The condensed statement of assets and liabilities states as follows:

Liabilities

Unsecured creditors	$8,631.321
Assets	
Stock in trade at net realizable value	500,000
Book debts, etc.	560,000
Cash on hand with Receiver-Manager	1,566,000
Total assets	$2,626,000
Deficiency	$6,005,321

33 Even if it could be assumed that all of the $2.6 million left in total assets together with the additional $535,000 offered in the proposal would eventually be paid to the unsecured creditors, that which, as I shall examine hereinafter, is unlikely, the percentage of payment would only be $8,631,321 of unsecured liabilities against $3,161,000 of satisfaction, or, in round figure, 36 per cent. That is mathematically the maximum possible recovery that the unsecured creditors could hope for. It is a considerably lower figure than the 50 cents on the dollar mentioned in s. 41(3) of the Act. But that is not all. In the report of the trustee to the court, it is stated at p. 2 that:

> The secured creditors' claims have been paid in full from the sale of assets. The principal debt secured was approximately $7.2 million *to which will be added costs of realization, prior claims, and on-going interest, which are presently estimated to be approximately $930,000*. (emphasis added)

34 That means that approximately $1 million more must be paid out to secured creditors, thus reducing the maximum available for distribution to the unsecured creditors to $2,161,000 or, in round figure, 25 per cent of their claims.

35 Then we must look carefully at the terms of the proposal. They provide that full payment shall be made, in priority to the unsecured creditors, to just about everyone who has been involved in one capacity or another in the affairs of the bankrupt, including "the company's advisors, Richer & Associates and their solicitors ... of all proposal expenses ... of every nature and kind whatsoever, whether due or not due for payment, as of the date of the original proposal, and including contingent and unliquidated claims arising out of any transaction entered into by the company prior to the date of the original proposal" (ss. 3(vi) and 4). I have reproduced the proposal herein and it speaks for itself. In addition to the proposal (Ex. A-1) and forming part of it, there are three agreements (Ex. A-3), one between Triarch and Coopers, another between Triarch, Sumner and Coopers and a third one between Coopers and Sumner. These agreements, when read carefully, add on considerable expenses that will have to be paid out of the residue of the bankruptcy, in priority to payments to the unsecured creditors. Furthermore, these agreements would absolve Triarch and the directors of Sumner of any liability for their actions as described above, and leave the unsecured creditors in an obviously much more difficult and complicated situation than they presently are. The combined effect of the content of the proposal and these agreements, besides being mind boggling, is definitely not designed to serve the best interest of the unsecured creditors. These documents have obviously been skilfully and craftily drafted to serve the interest of people and corporations other than the unsecured creditors of Sumner.

36 I accordingly conclude that the proposal fails to meet the requirements of s. 41(3) in that it does not provide "reasonable security for the payment of not less than fifty cents in the dollar on all the unsecured claims provable against the debtor's estate". On this issue, I prefer the evidence of Mr. Kirby and Mr. Wide to that given by Mr. Swidler, whose evidence, along with that of Mr. Taite, did not impress me in the least.

37 Although it is now unnecessary to examine all of the other submissions made in favour and against court approval of the proposal, I will, nevertheless, out of respect and concern for the unsecured creditors, briefly examine the one and only really valid submission made in favour of approval, that is, the fact that a majority of the creditors have voted to accept the proposal. The question being, if a majority of the creditors are agreeable to go along with the proposal, why should the court not follow suit? First, I doubt very much that the creditors were able to study and appreciate the full implication of the proposal and the conditions attached to it. Indeed it would have been next to impossible to do so without an in-depth study of the fine prints of this proposal and the agreements and all related matters. The law is clear that the court must look beyond the wishes of creditors when considering a proposal. In vol. 1 of Houlden and Morawetz on Bankruptcy Law of Canada, it is stated at p. E-16 that:

> Section 41(2) raises two questions for the court to consider on an application for approval of a proposal. (1) Are the terms of the proposal reasonable? (2) Are the terms of the proposal calculated to benefit the general body of creditors? *In determining whether or not to approve the proposal, the court must consider not only the wishes and interest of creditors but the conduct of the debtor and the interest of the public and future creditors and the requirements of commercial morality* ... [emphasis added]

38 In *Re Stone* (1976), 22 C.B.R. (N.S.) 152 (Ont. S.C.), at p. 152, Henry J. stated that:

> The first interest is that of the debtor: to give him an opportunity to meet with his creditors and to find a way of producing assets or revenue which will provide them with a dividend outside of bankruptcy. The second interest is that of the creditors: to protect the creditors generally by ensuring that what is put up by way of a proposal is a reasonable one, but bearing in mind that by the time it gets to the court the proposal has been supported by and is therefore desired by the majority of creditors. The third interest is that of the public at large in the integrity of the bankruptcy legislation.

39 In *Re Gareau (English & Scotch Woollen Co.)* (1922), 61 Que. S.C. 57, 2 C.B.R. 265 at 267, Maclennan J. referred to several authorities and stated as follows:

> In *Ex parte Rogers; In re Rogers* (1884) 13 Q.B.D. 438, at p. 449, 1 Morrell 159, Cave, J. said:
>
> > It is for those who propound the scheme, and who have to obtain the approval of the judge, to satisfy him that it is reasonable, and calculated to benefit the general body of the creditors.
>
> In *Ex parte Reed; In re Reed, Bowen & Co.* (1886) 17 Q.B.D. 244, at p. 250, 3 Morrell 90, Lord Esher, M.R., said:
>
> > A great deal has been said about the opinion of a large majority of the creditors, and the case has been argued much as it might have been if the Bankruptcy Act of 1883 had never been passed.
> >
> > In my opinion this Act was passed because it had been proved to the satisfaction of the legislature that a majority of creditors, however large, was not careful, and was not to be trusted; that on the contrary, the creditors were generally utterly careless, that they wrote off their debts as bad, and agreed to terms which might give some possibility — an evanescent chance — of their getting something out of the wreck. It was because of the known and proved behaviour of creditors with regard to their insolvent debtors that this Act was passed, taking away from the majority of creditors that power which they had so recklessly and carelessly used, and putting a controlling power into the hands of the Court for the purpose of protecting the creditors against their own recklessness; for the purpose of preventing a majority of creditors from dealing thus recklessly, not only with their own property, but with that of the minority, and of enforcing, so far as the legislature could, *a more careful and moral conduct on the part of debtors*.
>
> *In re Burr; Ex parte Board of Trade*, [1892] 2 Q.B. 467, at p. 473, 9 Morrell 133, Lord Esher, M.R., said:

> In deciding whether the scheme ought to be approved, the Court ought not to consider one fact alone — as, for instance, the fact that the creditors, or a majority of them, are willing to accept the scheme — the Court ought not to regard that fact alone, and then blindly say that, because the creditors wish the scheme to be carried out, therefore the Court will approve it. *The fact that the creditors wish for it is only one of the facts which ought to be considered.*

In *In re Webb; Ex parte Board of Trade*, [1914] 3 K.B. 387, 83 L.J.K.B. 1386, at p. 1391, 21 Manson 169, Cozens-Hardy, M.R. said:

> *It is not sufficient that the creditors have approved the scheme. That is so in every case where the scheme comes before the Court*. It is after the approval of the creditors that the Court has to decide whether it will or will not approve the scheme. (emphasis added)

40 In the Bankruptcy Law of Canada it is further stated at p. H-42 that:

> Section 143(1)(*h*) is wider than the preferences covered by s. 73. If the effect of the transaction with a creditor is to give him an undue preference, even though the transaction itself might stand, the debtor has brought himself within s. 143(1)(*h*). The section speaks of an "undue preference" as contrasted with "fraudulent preferences". Even though the creditor who receives the preference would have had a preferential claim in the bankruptcy, the payment will be an undue preference within the meaning of s. 143(1)(*h*) as the creditor is not to take upon himself the administering of his estate: *Re Rinder and Bloem* (1922), 2 C.B.R. 572 (Ont. S.C.).

41 At p. E-17 of Bankruptcy Law of Canada it is further stated that:

> ... the court should exercise great care and caution before giving its approval and this will be the case where the debtor has committed any of the offences mentioned in ss. 169 to 171 or *facts are proved in ss. 143 and 148 or where reasonable security is not provided for, if the dividend is not 50 cents in the dollar*. (emphasis added)

42 On a careful consideration of all the facts and circumstances placed before the court, I am satisfied that the creditors' interest will be better protected under a general bankruptcy than will be the case under the proposal. At p. E-20 of Bankruptcy Law of Canada, it is again stated that:

> Creditors must be better off under a proposal than in bankruptcy, and if this is not so, the court should not approve the proposal: *Re Rideau Carleton Raceway Holdings Ltd.*

43 Also in *Re Allen Theatres Ltd.* (1922), 23 O.W.N. 74, 3 C.B.R. 147 at 152 (S.C.), Fisher J. stated that:

> Creditors should get some advantage by the terms of the proposal ...

44 For all of the reasons stated herein, the application for approval of the proposal is refused.

45 Since I have concluded that the application for the proposal is refused, I therefore conclude that the effective date of the bankruptcy shall be 10th December 1986 in accordance with an order of Mr. Justice Meldrum dated 19th February 1987.

Costs

46 Counsel for creditors opposing approval of the proposal have been successful and are therefore entitled to costs. The issue of costs was not addressed at the hearing and I therefore fix the time and day for a further hearing with respect to costs at 9:30 a.m. on Tuesday, 2nd June 1987, in my chambers.

Application dismissed.

End of Document

4

1995 CarswellOnt 372
Ontario Court of Justice (General Division), In Bankruptcy

Mister C's Ltd., Re

1995 CarswellOnt 372, [1995] O.J. No. 1390, 32 C.B.R. (3d) 242, 55 A.C.W.S. (3d) 245

Re PROPOSAL OF MISTER C's LIMITED, A COMPANY INCORPORATED UNDER THE LAWS OF THE PROVINCE OF ONTARIO, HAVING ITS HEAD OFFICE IN THE TOWN OF MARKHAM, IN THE PROVINCE OF ONTARIO

MacPherson J.

Heard: May 3, 1995
Judgment: May 17, 1995
Docket: Doc. 31/292901

Counsel: *A. Schorr*, for applicant.
G. Gringorten, for trustee (supporting).
J. Eversley, for Afton Foods Group Ltd. (supporting).
I. Duncan, for S.G. Cunningham (Kitchener) Ltd. (opposing creditor).
C. Rasbach, for Attorney General of Canada (opposing creditor).
J. Schelling, for Madorin, Snyder (opposing creditor).
G.A. Moffat, for DCA Canada Ltd. (taking no position).

Subject: Corporate and Commercial; Insolvency

Application for approval of proposal.

MacPherson J. **(Endorsement):**

1 The trustee of an insolvent corporation, Mister C's Limited ("Mister C"), applies for approval of a proposal pursuant to ss. 50-66 of the *Bankruptcy and Insolvency Act*. The corporation is a franchisor of retail donut stores throughout Ontario. It currently has approximately 38 franchise contracts with franchisees, down from a high of 53. It also has four or five franchise buildings under construction. The president and vice-president of the company are Martin Cohen and Morris Feder who are also personally insolvent.

2 The trustee has filed a detailed proposal on behalf of Mister C. There have been two meetings of creditors. The first on February 10, 1995 was adjourned so that Mister C could amend its proposal. At the second meeting on February 24, 1995 all three classes of unsecured creditors represented at the meeting voted in favour of the proposal as follows:

> Class 1: One creditor voted to accept — total value of $162,000 (100 per cent)
>
> Class 2: Thirty-six creditors voted to accept — total value of $1,829,610 (78.7 per cent); seven creditors voted to reject — total value of $495,707 (21.3 per cent)
>
> Class 3: Six creditors voted to accept with claims totalling $1,564 (100 per cent)

Accordingly, the proposal has been approved by the requisite majority of creditors mandated by s. 54 of the Act.

3 The proposal is opposed by three creditors — Revenue Canada, S.G. Cunningham (Kitchener) Limited, a construction company owed about $103,000, and Madorin, Snyder, owed about $50,000.

4 Section 59(2) of the Act provides, inter alia:

> Where the court is of the opinion that the terms of the proposal are not reasonable or are not calculated to benefit the general body of creditors, the court shall refuse to approve the proposal ....

5 In forming its opinion about the factors prescribed by this provision, a court should take three interests into account:

> (1) the interests of the debtor in making a settlement with creditors;
>
> (2) the interests of the creditors in procuring a settlement which is reasonable and which does not prejudice their rights; and
>
> (3) the interests of the public in the fashioning of a settlement which preserves the integrity of the bankruptcy process and complies with the requirements of commercial morality.

See *Re Gardner* (1921), 1 C.B.R. 424 (Ont. S.C.), at p. 426 and *Re Mernick* (1994), 24 C.B.R. (3d) 8 (Ont. Gen. Div. [Commercial List]), at p. 13.

6 Although substantial deference should be accorded to the majority vote of creditors at a meeting of creditors, in my view this is a case where the proposal should not receive judicial approval. I reach this conclusion for two reasons.

7 First, I believe that the process leading up to the vote of creditors at the second meeting was seriously defective and taints the resulting vote. I attach significance to the following factors:

> (a) One unsecured creditor, a numbered company owned by the wives of Cohen and Feder, stands to benefit far more than all the other creditors — secured and unsecured — under the proposal. Indeed, if the proposal unfolds according to the trustee's scenario, most unsecured creditors will receive about 20 cents on the dollar whereas the wives' numbered company will receive about $425,000 on an unsecured claim of $295,000.
>
> However, it is not this discrepancy alone that troubles me. In its initial report to creditors, the trustee did not inform the creditors that the numbered company that stood to benefit most from the proposal was owned by the wives of Cohen and Feder. When challenged about this at the first meeting of creditors, the trustee acknowledged the error but called it "an oversight". I find it difficult to accept this explanation in light of the fact that in the trustee's report to creditors there is a separate section titled "*Related Parties*" which discusses the status, as creditors of Mister C, of Cohen and Feder.
>
> The trustee also contends that the "oversight" was cured by the fact that the creditors at the second meeting knew that the wives owned the numbered company and voted in favour of the proposal in any event. I disagree. The minutes of the first meeting were not prepared and circulated to the creditors before the second meeting. Hence many of the creditors had no knowledge of this issue before they sent in voting letters and proxies which were used by the trustee to vote in favour of the proposal. In his supplementary report the trustee acknowledged that if the votes in the voting letters were recorded against the proposal, the vote in favour of the proposal would still be 67.3 per cent which is above the statutory minimum. My observation is that it is *barely* above *a minimum*. Moreover, the non-disclosure in the original report to creditors of such a fundamental relationship, and the failure to take vigorous steps to correct it before the second meeting, taint the entire process. Decisions about voting letters, proxies and attendance at the meetings might have been different if *all* the creditors had known that the exceptional treatment proposed for one unsecured creditor would, in fact, benefit a numbered company owned by the wives of the principals of Mister C.
>
> (b) Under the proposal, one secured creditor, C. Douglas Cardoza Limited, is treated differently from all other secured creditors and in priority to all unsecured creditors. Its claim of about $162,000 will be paid in full, even though the trustee admits that at no time before the creditors' meeting did it investigate this claim to determine its validity.

(c) In the ranks of the unsecured creditors is one company, M.S.C. Food Brokers Inc., which is owned by Cohen and claims to be an unsecured creditor for $25,170. This relationship was not disclosed in the Related Parties section of the trustee's report to creditors.

8 Second, the proposal places a very heavy emphasis on the personal financial situation of Cohen and Feder which detracts, in my view, from the principal focus of most proposals, namely the fair and equitable treatment of creditors. I attach significance to the following factor:

(a) Under the proposal, a "Condition Precedent" (para. 12) is acceptance by the creditors and approval by the court of the personal proposals of Cohen and Feder.

(b) Under the proposal, another "Condition Precedent" (para. 12) is that all creditors will release Cohen and Feder from any claims that could be made against them. I agree with the critical commentary on, and rejection of, a proposal which included this type of clause in *Re Kern Agencies Ltd. (No. 2)* (1931), 13 C.B.R. 11 (Sask. C.A.).

(c) Cohen and Feder are listed as unsecured creditors of Mister C for $136,534 and $131,634 respectively. Yet, the trustee admitted in his testimony that he has not been provided with documentation to support these claims; however, he said Feder had told him that he was "working on" the relevant documentation. In my view this is not good enough for such a large claim made by the principals of an insolvent company, especially in light of the fact that they are not prepared to waive their claims because they intend to use any money they obtain under the proposal to fund their personal proposals.

9 For these reasons I do not think that, pursuant to s. 59(2) of the Act, Mister C's proposal is "reasonable" or "calculated to benefit the general body of creditors". The process leading up to the second meeting of creditors was marred by serious non-disclosure of relevant and important information and by failure to investigate the validity of large claims, including one that would take precedence over those of all unsecured creditors. And the proposal itself, when all the evidence is examined, is not really intended to benefit the general body of creditors. Rather, it is designed to benefit Cohen and Feder, both directly and through the mechanisms of undisclosed related companies, releases and coerced approvals of their personal proposals.

10 In my view, two of the three factors set out in *Re Gardner* and *Re Mernick* — the interests of debtors and the integrity of the bankruptcy process — tell against judicial approval of the proposal. Accordingly, approval of Mr. C's proposal is refused.

Approval denied.

End of Document

5

2017 QCCS 1928
Superior Court of Quebec

Liquid Nutrition Franchising Corp., Re

2017 CarswellQue 3963, 2017 QCCS 1928, 281 A.C.W.S. (3d) 466, 48 C.B.R. (6th) 300, EYB 2017-279657

In the Matter of the Proposal of: Liquid Nutrition Franchising Corporation (Debtor) and Litwin Boyadjian Inc. (Trustee) Noubar Boyadjian CPA, C.A. C.I.R.P. (Trustee) and Lqd Ottawa inc. having its head office at 12, Craigmohr CT, on the City of Ottawa, Province of Ontario, K2G 5P3 and Lqd Glebe Inc., having its head office at 12, Craigmohr CT, on the City of Ottawa, Province of Ontario, K2G 5P3 (Claimants-Creditors)

Mongeon J.

Heard: February 14, 2017
Judgment: May 15, 2017
Docket: S.C. Montreal 500-11-048727-156

Counsel: Ian R. Rudnikoff, for the Debtor Liquid Nutrition Franchising Corporation
Nicholas D'Aoust, for the Claimants-Creditors LQD Ottawa Inc. and LQD Glebe Inc.

Subject: Insolvency

MOTION by group of creditors seeking declaration of refusal to approve proposal.

***Mongeon J.*:**

INTRODUCTION

1 The Court is seized of two Motions, one by the Trustee asking for the ratification of a Proposal on behalf of the Debtor company and another, by the Claimants-Creditors asking for the dismissal of the Trustee's Motion and a declaration of refusal to approve the Proposal. Such a declaration would automatically cause the Debtor company to be "deemed" to have thereupon made an assignment [1] .

2 Originally, the Motion of Claimants-Creditors raised two issues. The first issue dealt with the fact that they were not allowed to vote against the Proposal because their proof of claim had been filed too late and also because their claim was unliquidated. This first issue was subsequently corrected by a previous judgment of this Court allowing their appeal from a disallowance of their claims by the Trustee [2] . The Court then found that the claim of the Claimants-Creditors should have been allowed to be voted against the Proposal at a value of $500,000.00.

3 The second portion of the Motion of Claimants-Creditors seeks the dismissal of the Proposal itself and is based on the following submissions:

a) The Proposal was submitted to all the Creditors of the Debtor but only four creditors did file proofs of claim;

b) The Claimants-Creditors allege that they were treated unfairly and unequally by the Trustee who did accept proofs of claim from other creditors having similar unliquidated claims which were taken at full face value;

c) The Claimants-Creditors as well as other creditors of the Debtor were offered a settlement in money in exchange for their favourable vote on the Proposal. The Claimants-Creditors refused the settlement offered but allege that other creditors of the Debtor having filed proofs of claim accepted such offers. In doing so, their claim should not have been counted at their original face value but at a much reduced value;

d) By concluding these settlements, the Debtor (or persons related to the Debtor) secured votes in support of the Proposal based on the full value of the proofs of claim of such creditors whilst those same creditors had already bargained and transacted on a much reduced value of their claim, i.e. the dollar value of the settlement offered and accepted.

4 The following paragraphs of the Motion of Claimants-Creditors are noteworthy (transcribed *verbatim*):

34. By concluding these settlements, the Debtor secured votes to assure the acceptation of the Proposal;

...

36. The settlements gave an advantage to the Other Creditors and constitute a preferential treatment and disadvantage to the mass of creditors;

37. The Trustee knew about this advantage considering the general discharge part of the Proposal;

38. The Trustee recommended the approval of the Proposal;

39. The Trustee did not investigate on those transactions and the Claimants-Creditors believe they should be considered as transfers at undervalue;

...

41. Moreover, the Proposal also provides a release of not only the Debtor, but also of the Parent Corporation, Mr. Greg Chamandy, Chantal Chamandy and Glenn Young, administrators and directors, which are third parties to the Proposal;

42. This release of liability is extremely large, hence abusive and against the general benefit of the creditors;

43. The purpose of the Proposal is evidently to discharge the Parent Corporation and individuals of their liabilities, to the prejudice of the mass of creditors;

44. The Proposal reflects the collusion and secret advantages to the Other Creditors;

45. The Proposal is not made in good faith, is unreasonable and is not to the general advantage of the creditors;

46. The Proposal does not respect the integrity of the bankruptcy process and does not comply with the requirements of commercial morality;

47. It is also an attempt to confuse the other creditors of their rights against the Debtor, the Parent Corporation and their Directors and Officers;

...

49. The acceptance of the Proposal would not gain advantage over a bankruptcy;

50. In summary, the Proposal is a bargain between the Debtor and the Other Creditors to the disadvantage of the mass of creditors and a scheme to protect the parent people of the Debtor;

5 On that basis, the Claimants-Creditors seek an order of refusal of the Proposal and a declaration of bankruptcy of the Debtor.

6 For the reasons set forth below, the Court is of the opinion that the Proposal cannot be approved. Consequently, the Motion of the Trustee to obtain approval of the Proposal is dismissed, the Motion of Claimants-Creditors seeking the refusal of the Proposal is granted and the Debtor company is henceforth deemed to have made an assignment in bankruptcy.

HISTORY OF THE PROCEEDINGS

7 On May 4th, 2015, Liquid Nutrition Franchising Corporation (LNFC) elected to file a Notice of Intention to Make a Proposal pursuant to Section 50.4 of the BIA.

8 On May 27, 2015, a Proposal was in fact filed pursuant to Section 62, BIA. It should be noted that the Proposal was filed 23 days after the filing of the Notice of Intention above-noted. The minimum delay allowed under the BIA is 21 days. LNFC and all persons and corporations related thereto benefitting from the Proposal obviously wanted this matter to proceed swiftly.

9 The first meeting of creditors to consider and approve the Proposal was scheduled for the June 12, 2015. It was, however, postponed several times, firstly to June 19, 2015 and again to July 3rd, 2015; then to July 8, 2015, mainly to allow the Claimants-Creditors to complete the filing of their proof of claim.

10 Despite the opposition of Mr. MacDonald, the representative of the Claimants-Creditors, they were unable to be registered as voting creditors. The expected result was, therefore, that the Proposal was approved by three creditors having filed proofs of claim amounting to $2 684,953.84. No one voted against the Proposal.

11 A Notice of Hearing of LNFC's Application for Court Approval of its Proposal was filed on July 13, 2015, returnable before the Bankruptcy Court on August 4, 2015.

12 This proceeding was postponed several times until February 14, 2017 when it finally proceeded before the undersigned.

13 In the meantime, the Claimants-Creditors LQD Ottawa Inc. and LQD Glebe Inc. filed Motions to examine the Debtor, the Trustee and certain creditors (August 15, 2015).

14 On August 12, 2015, the Claimants-Creditors also filed a Motion to Appeal Notices of Disallowance of Claims and Rejection of the Debtor's Proposal.

15 The first part of the said Motion (appeal of Notice of Disallowance of Claims) was allowed in part by Mr. Justice Jean-François Michaud on February 16, 2016, granting the Appeal of Claimants-Creditors on the disallowance of their claims and ordering the Trustee to admit the proof of claim of the Claimants-Creditors at a value of $500,000.00.

16 At first glance, the balance of the contestation of the Claimants-Creditors dealing with the rejection of the Debtor's Proposal could appear to be fruitless upon its face. More than $2.6 million in various claims were voted in favour of the approval of the Proposal. Even if the Trustee would have allowed the claimants to vote against the Proposal at its value of $500,000.00, the Proposal would have been approved by a very comfortable margin. Why, therefore, was this matter so vigorously contested before the undersigned?

17 Here's why.

WHAT REALLY TOOK PLACE

18 Let us go back in time.

19 LNFC operates a franchising operation in the field of health food and drink.

20 The two Claimants-Creditors, LQD Ottawa Inc. and LQD Glebe Inc. are franchisees of the Debtor LNFC.

21 LNFC is a subsidiary of LNGI.

22 The franchising operation is functioning but with some difficulties. The Claimants-Creditors allege that both LNFC and its parent LNGI are inducing their franchisees in signing franchise agreements based on representations which are either misleading or false.

23 Under the "*Arthur Wishart Act*" [3] of Ontario, directors and officers of franchising companies are statutorily liable personally if it is proven that the franchisors have so misled franchisees.

24 As a result, LNFC and LNGI have been sued by the Claimants-Creditors and by other franchisees, all of them collectively claiming several millions of dollars under various heads of damages. In some instances, the directors and officers of LNFC and LNGI have also been named as joint and several defendants to these actions under the provisions of the *Arthur Wishart Act* of Ontario.

25 Having very few assets and important liabilities, LNFC elected to get rid of its liabilities by using an approach whereby a Proposal would be made to its creditors which, if accepted, not only purge the debts of the Debtors and liabilities, but would also cause its directors and officers to be released from their personal liabilities incurred as a result of their involvement marketing the franchise operation and, more particularly, their liability arising from the *Arthur Wishart Act* of Ontario.

26 More particularly but without limitation, LNFC and LNGI were sued in the following proceedings.

a) Ontario Superior Court of Justice, no. CV-14-504601: 2308818 Ontario Limited and Kurt Khan, Plaintiffs vs Liquid Nutrition Franchising Corporation, Liquid Nutrition Group Inc. Gregory Chamandy, Chantal Chamandy and Glenn Young, Defendants [4] (hereinafter referred to as the 2308818 Claim);

i) This action alleges that the Defendant LNFC is the franchisor of the "Liquid Nutrition" franchising system whereas Defendant LNGI is the corporate parent of the Franchisor and, in that capacity, LNGI controls LNFC.

ii) As for Defendants Greg and Chantal Chamandy, as well as Glenn Young, they are directors and/or officers of both LNFC and LNGI. Their liability is sought under the *Arthur Wishart Act* (Franchise Disclosure) of Ontario, 2000, S.O. 2000, C-3 ("The Act") and more particularly sections 4, 5, 6 and 7 of the Act.

iii) After purchasing two franchises on or about December 1 st , 2011, Plaintiff Kurt Khan, acting for and on behalf of 2308818 Limited commenced operations on or about May 24, 2013 and realized that the franchises were not profitable by reason of misrepresentations of the Franchisor, more particularly with respect to sales which they were made to reasonably expect to realize.

iv) The Plaintiffs, therefore, claim an aggregate of $784,680.77 as direct expenses, fees and royalties.

v) In addition, the Plaintiffs claim damages from all Defendants, jointly and severally of $1,000,000.00 pursuant to section 7 of the Act as well as damages of $500,000.00 pursuant section 4 of the *Act*.

vi) The total claim of the Plaintiffs, therefore, amounts to $2 284,680.77 plus interest and costs.

b) Ontario Superior Court of Justice, no. 13-58876: LQD Ottawa Inc. and LQD Glebe Inc., Plaintiffs, vs Liquid Nutrition Group Inc. and Liquid Nutrition Franchising Corporation, Defendants [5] (i.e. the Claimants-Creditors claim);

i) This claim is also based on similar facts as the precedent and generally alleges the same nature of complaints made against the corporate Defendants (i.e. misrepresentations of material facts).

ii) This reduced claim asks for a condemnation of total aggregate damages of $600,000.00 plus interest and costs. This amount was subsequently valuated at $500,000.00 by Michaud J. for the purposes of the Proposal. [6]

iii) Unlike the precedent case, the individual Defendants Greg Chamandy and Chantal Chamandy could not be sued under the provisions of the *Arthur Wishart Act*, the reason being that any claim against directors or officers under the said Act is statute-barred after two years.

c) Arbitration between 2365599 Ontario Inc. and Robert William as Plaintiffs is Liquid Nutrition Group Inc., Liquid Nutrition Franchising Corporation, Greg Chamandy, Chantal Chamandy and Glenn Young as Defendants;

i) This case, although not documented in the present file, is valued by the Trustee at an amount of $349,784.14.

27 As stated above, facing these actions together with the large debt of more than $4 million to its parent [7], LNFC proceeded to make a Proposal to its creditors on the following basis:

a) Payment upon approval by the Court of $150,000.00 over a period of two years of all "Claims" against LNFC, except the Excluded Claims. These Excluded Claims are defined as being limited to "professional fees".

However, "*Claims*" are defined as including "*any right of any Person against the Debtor and the respective current and former directors and officers of the Debtor*" of any nature whatsoever, based on facts existing prior to the Date of Proposal or which are claims provable pursuant to section 121 of the BIA [8].

b) In addition and prior to any distribution of any dividend, the following shall apply [9]:

Released Claims: On the Implementation Date, the Released Parties shall be released and discharged from any and all demands, claims, actions, causes of action, counterclaims, suits, debts, sums of money, accounts, covenants, damages, judgments, expenses, executions, liens and other recoveries on account of any liability, obligation, demand of cause of action of whatever nature which any Person may be entitled to assert including, without limitation, whether known or unknown, matured or unmatured, foreseen or unforeseen, existing or hereafter arising, based in whole or in part on any act or omission, transaction, dealing or other occurrence existing or taking place on or prior to the Claim, to the full extent permitted by law, and all Claims arising out of such actions or omission shall be forever waived and released (other than the right to enforce the Debtors' obligations under this Proposal or any related document) provided that nothing herein shall release or discharge the Debtor from any Excluded Claim. Without limitation, the release provided for, hereunder, shall include a full and final release and discharge of all claims made or which could have been made against the Released Parties in the following proceedings:

a) Ontario Superior Court File no. 13-58876 (Ottawa), *LQD Ottawa Inc. and LQD Glebe Inc. vs. Liquid Nutrition Group Inc. and Liquid Nutrition Franchising Corporation*;

b) Ontario Superior Court File No. CV-14-504601 (Toronto) 2308818 Ontario Ltd. and Kurt Khan vs. Liquid Nutrition Franchising Corporation et al.;

> c) In the matter of the Arbitration between 2365599 Ontario Inc. & Robert Williams and Liquid Nutrition Franchising Corporation, Liquid Nutrition Group Inc., Greg Chamandy, Chantal Chamandy and Glenn Young.
>
> It is understood however that nothing herein shall be interpreted as an acknowledgment of any liability or obligation on the part of the Debtor or the Released Parties, any such liability or obligation being specifically denied.

where the "Released Parties" above referred to are defined as meaning "collectively" the Debtor, its parent corporation Liquid Nutrition Group Inc., Mr. Greg Chamandy, Mrs Chantal Chamandy and Mr. Glenn Young.

28 As a result of the foregoing, all of the parties to the three instances above-noted including those directors and officers of the Debtor and its parent who could become liable under the *Arthur Wishart Act* of Ontario, would, upon ratification of the Proposal by this Court, be completely discharged of, or released from, any recourse whatsoever except the payment of a dividend on a *pro rata* basis.

29 But, even that is far from being certain.

30 The evidence made before the undersigned shows that, for the most part, the person who will benefit from any dividend payable under the terms of this Proposal is Greg Chamandy, personally.

31 The Claimants-Creditors allege that all of the foregoing is a scheme or stratagem put forward by Greg Chamandy for his own personal benefit and that of his wife Chantal Chamandy, the two being exposed to potential liabilities of several millions of dollars. Here is how the stratagem was set up:

> a) Firstly, it should be noted that the largest creditor of LNFC is its parent. However, as a "related person", the parent LNGI cannot vote for the acceptance of the Proposal. Furthermore, its claim is subordinated to all other claims against the Debtor LNFC. Consequently, LNGI will not receive any dividend payable under the Proposal.
>
> b) In order to ensure that the Proposal, as drafted, would be successfully adopted, Greg Chamandy then communicated with the second largest creditor of LNFC, namely 2308818 Ontario Limited and Kurt Khan, and offered to settle that claim for $210,000.00, provided that the said creditor would vote its proof of claim in favour of the Proposal. The settlement funds of $210,000.00 were to be deposited in trust ahead of the vote and once the Proposal passed the 50% in number and 66% in value test, the said funds would be paid to Khan and his company. In addition, the parties agreed to execute a full and mutual release as well as a complete transfer and assignment of 2308818/Khan's entitlement to all dividends due under the Proposal. Consequently, the Claimants-Creditors allege when this creditor entered his vote, he was no longer voting its own claim but, instead, it was acting as an agent for Chamandy. All of the foregoing is evidenced in a series of agreements filed as Exhibit D-7 [10] .

The Vote on the Proposal

32 The record shows that only three creditors were able to enter a proof of claim allowing them to vote for the approval of the Proposition.

33 The vote of the creditors having filed a proof of claim was recorded as follows:

> a) 2308818 Ontario Limited/Khan: $2,284,680.77
>
> b) 2365599 Ontario Inc./Robert Williams: $ 349,784.14

c) Solutions Inc./Luc Labbé: $ 39,288.99

Total: $2,673,753.90

34 The record now shows that a fourth group of creditors, namely the Claimants-Creditors, should have been allowed to enter a vote for their claim in an amount of $500,000.00.

35 But for the massive impact of the vote of the claim of 2308818 Ontario Limited/Khan in the amount of $2 284,680.77, it is clear that the Proposal would not have been approved by 50% of voting creditors aggregating 66% in value of valid proofs of claim.

36 The question then becomes whether 2308818 Ontario Limited/Khan entered its vote for its own benefit or whether it was voting in its capacity as creditor but in its capacity as agent for Greg Chamandy, and, if so, whether Greg Chamandy is entitled to vote, directly or indirectly, in favour of the Proposal. This question then raises the question of whether Greg Chamandy is a "related person" under the provisions of the BIA..

37 Greg Chamandy is a director of the Debtor and a direct beneficiary of the terms of the Proposal. An affirmative vote in favour of the Proposal releases him and his wife, Chantal Chamandy, from any personal liability as directors towards all creditors of LNFC and LNGI

38 Section 54(3) BIA states the following:

A creditor who is related to the debtor may vote against but not for the acceptance of the Proposal.

39 A "related person" is a person who falls within the criteria of Section 4, BIA.

40 To determine if two persons are related to one another, one has to look at the facts. The Court has a large discretion to determine whether or not two persons are dealing at arm's length and/or are "related" to one another.

41 A person related to the Debtor may not vote in favour of the Proposal. The issue here may now be formulated as follows: is Greg Chamandy related to the Debtor and, if so, can a representative of Greg Chamandy vote in his place and stead in support of the Proposal?

42 Furthermore, the record also shows that LNGI is the parent of LNFC and that Greg Chamandy is a director and officer of both companies. During the hearing, it was further suggested that Greg Chamandy founded LNGI and its subsidiary LNFC and is the beneficial owner thereof through various corporations.

43 The matter was raised by the undersigned during the "délibéré" and, at the Court's request, the parties were asked to furnish further written representations. The contents of these representations will be addressed later.

Is Greg Chamandy a "related person" under section 4 of the BIA?

44 The Proposal of LNFC, once ratified by the Court, will not only protect the Debtor from its creditors. It will also protect Greg Chamandy and his wife from any liability under the Arthur Whishart Act, such liability potentially amounting to the full amount of the 2308818 Ontario Limited/Khan Claim of $2,284,680.77, as well as any other statutory liability which he may be confronted with in his capacity of director of the Debtor [11] .

45 Section 4 of the BIA reads as follows:

(2) **Definition of « related persons » - For the purposes of this Act, persons are related to each other and are *related persons* if they are**

(a) **individuals connected by blood relationship, marriage, common-law partnership or adoption;**

(b) **an entity and**

(i) **a person who controls the entity, if it is controlled by one person,**

(ii) **a person who is a member of a related group that controls the entity, or**

(iii) **any person connected in the manner set out in paragraph (a) to a person described in subparagraph (i) or (ii); or**

(c) **two entities**

(i) **both controlled by the same person or group of persons,**

(ii) **each of which is controlled by one person and the person who controls one of the entities is related to the person who controls the other entity,**

(iii) **one of which is controlled by one person and that person is related to any member of a related group that controls the other entity,**

(iv) **one of which is controlled by one person and that person is related to each member of an unrelated group that controls the other entity,**

(v) **one of which is controlled by a related group a member of which is related to each member of an unrelated group that controls the other entity, or**

(vi) **one of which is controlled by an unrelated group each member of which is related to at least one member of an unrelated group that controls the other entity.**

(3) **Relationships - For the purposes of this section,**

(a) **if two entities are related to the same entity within the meaning of subsection (2), they are deemed to be related to each other;**

(b) **if a related group is in a position to control an entity, it is deemed to be a related group that controls the entity whether or not it is part of a larger group by whom the entity is in fact controlled;**

(c) **a person who has a right under a contract, in equity or otherwise, either immediately or in the future and either absolutely or contingently, to, or to acquire, ownership interests, however designated, in an entity, or to control the voting rights in an entity, is, except when the contract provides that the right is not exercisable until the death of an individual designated in the contract, deemed to have the same position in relation to the control of the entity as if the person owned the ownership interests;**

(d) **if a person has ownership interests in two or more entities, the person is, as holder of any ownership interest in one of the entities, deemed to be related to himself or herself as holder of any ownership interest in each of the other entities;**

(e) **persons are connected by blood relationship if one is the child or other descendant of the other or one is the brother or sister of the other;**

(f) **persons are connected by marriage if one is married to the other or to a person who is connected by blood relationship or adoption to the other;**

(f.1) persons are connected by common-law partnership if one is in a common-law partnership with the other or with a person who is connected by blood relationship or adoption to the other; and

(g) **persons are connected by adoption if one has been adopted, either legally or in fact, as the child of the other or as the child of a person who is connected by blood relationship, otherwise than as a brother or sister, to the other.**

(4) **Question of fact - It is a question of fact whether persons not related to one another were at a particular time dealing with each other at arm's length.**

(5) **Presumptions - Persons who are related to each other are deemed not to deal with each other at arm's length while so related. For the purpose of paragraph 95(1)(b) or 96(1)(b), the persons are, in the absence of evidence to the contrary, deemed not to deal with each other at arm's length.**

(emphasis added)

46 Houlden, Morawetz and Sarra [12] state the following:

Section 4(4) specifies that it is a question of fact whether persons that are not related to one another were at the relevant time dealing with one another at arm's length. There is a presumption in s. 4(5) that persons who are related are deemed not to be dealing with each other at arm's length. . . .

The court has a wide discretion to determine whether or not persons who are not related were dealing at arm's length when a particular transaction took place : *Gingras, Robitaille, Marcoux Ltd. v. Beaudry* (1980), 36 C.B.R. (N.S.) lll (Que. S.C.)

A transaction at arm's length is a transaction between persons whom there are no bonds of dependence, control or influence in the sense that neither of the two co-contracting parties has available any moral or psychological leverage sufficient to diminish or possibly influence the free decision-making of the other. Conversely, the transaction is not at arm's length where one of the co-contracting parties is in a situation where he or she may exercise a control, influence or moral pressure on the free will of the other. Where one of the co-contracting parties is by reason of his or her influence or superiority in a position to pervert the ordinary rule of supply and demand and force the other to transact for a consideration that is substantially different than adequate, normal or fair market value, the transaction is not at arm's length. . . .

(emphasis added)

47 Here, the Debtor and Chamandy are the direct beneficiaries of the Proposal. They both stand to be protected against major personal liabilities if the Proposal is ratified.

48 It is admitted that Chamandy will personally advance the funds to be provided to fund the Proposal ($150,000.00). Also, if the agreements entered into between 2308818 and Chamandy apply, as they will if the Court approves the Proposal, Chamandy will, in turn, receive a very substantial portion of the said advance of $150,000.00 in the form of a dividend, leaving only pennies for the other creditors of the Debtor.

49 The above-noted situation is such that the Court must take a close look into the validity of the vote approving the Proposal.

50 In other words, the Court must be satisfied that the vote is valid under the terms of the BIA. If Chamandy is a « related person » to the Debtor, then the vote on the Proposal [13] has to ber e-evaluated in its entirety and may not be sufficient to approve same [14] .

Is the vote of 2308818 Ontario Limited/Khan claim in favour of the Proposal to be considered to be made on behalf and for the benefit of Chamandy?

51 A closer look at the series of documents filed as Exhibit D-7 show that, once construed together, these documents are in fact the exact same equivalent of an assignment and transfer of the said claim.

52 Exhibit D-7 contains three separate documents which must be read and interpreted as one in order to determine their true nature and meaning.

53 The first document entitled « minutes of settlement » states in part as follows :

> 1. **The defendant, Gregory Chamandy, or a corporation or entity on his behalf, will deposit or cause to be deposited the sum of $210,000 with the law firm Stein & Stein Inc. (« Stein ») In Trust (the « Escrow Funds ») prior to the meeting of creditors In The Matter Of The Proposal of the Defendant, Liquid Nutrition Franchising Corporation (« LNFC »), Estate No. : 41-1990657, currently scheduled for July 3, 2015, or a later date if adjourned. Stein will confirm receipt of the Escrow Funds prior to the meeting of creditors and will undertake to hold the Escrow Funds in escrow pending the release of the Escrow Funds in accordance with these Minutes of Settlement.**
>
> 2. **If the Escrow Funds are lodged as required, at the meeting of creditors, the plaintiffs will vote their proofs of claim in favour of the proposal as filed.**

54 By this provision, 2308818 Ontario Limited/Khan agree to be paid the sum of $210,000.00 in exchange for its vote in favour of the Proposal. In so doing, this creditor is relinquishing its right title and interest to vote on the Proposal, in favour of Chamandy, who now controls the vote of this particular claim.

55 If the vote on the Proposal passes the test of 50% in number and 66.6% in value, then the present Motion to Ratify the Proposal is presented to the Court. If ratified, then the folloiwng occurs :

> 5. **The parties agree to execute the Full and Final Mutual Release attached hereto as Schedule « A », to be held in escrow pending the payment of the Escrow Funds as described in paragraph 4 above. Upon receipt of the Escrow Funds by Sotos LLP In Trust, the Full and Final Mutual Release will be released from escrow and will be a complete bar to any claim by or against the plaintiffs or defendants.**
>
> 6. **The plaintiffs will concurrent with the payment described at paragaph 4 above, transfer and assign to Gregory Chamandy or an entity on his behalf, without warranty as to collectability all of their right and entitlement to all dividents due under the proposal of LNFC, the whole pursuant to the claims which the plaintiffs have filed.**

56 By these two provisions, 2308818 Ontario Limited/Khan renounce to any right of action against LNFC, LNGI, Greg Chamandy and Chantal Chamandy and give full and final release therefor. In addition, Greg Chamandy obtains all of the benefits and/or advantages related to these claims through the assignment of all of 2308818 Ontario Limited/ Khan's rights into any dividends which may flow from the approval and ratification of the Proposal.

57 If the Proposal is not ratified by the Court, then the parties are put back into their original position :

> **8. It is understood that should the proposal of LNFC as filed not be accepted by the statutory majority of creditors or be refused by the court upon the hearing of the motion for ratification for any reason which causes LNFC to be bankrupt, then and in such event the Escrow Funds will be released back to Gregory Chamandy and this settlement will be null and void. In such a circumstance, the Full and Final Mutual Release wil be destroyed. The parties understand that it is an essential condition of LNFC's proposal that the releases provided for therein form part of the ratification judgment by the court.**

58 The second document contains the terms and conditions of the "full and final mutual release" referred to in paragraph 5 of the first document, cited above whereby all claims of both parties against each other are completely and forever released and discharged. The parties covered by this release are 2308818 Ontario Limited, Kurt Khan, LNFC, LNGI, Gregory Chamandy and Chantal Chamandy.

59 This second document provides also as follows:

> 1. **... Nothing herein shall be interpreted to cause or create a release or discharge of the amount claimed by the Claimants in the Proposal of Liquid Nutrition Franchising Corporation hereinafter referred to and the right to all dividends that may be paid from time to time in virtue of the proof of claim filed therein by the Claimants.**
>
> **...**
>
> 4. **The LNG Parties acknowledge that this Release is expressly not intended to prevent the Khan Parties, or any of them, from voting in the proposal filed by Liquid Nutrition Franchising Corporation in the Superior Court of Quebec (Court No. 500-11-048727-156, Estate No. 41-1990657), or from transferring and assigning their rights to all dividends payable under the said proposal.**

60 But, of course, there is a third document, part of D-7. This third document part of Exhibit D-7 contains the terms and conditions of the specific assignment of dividends payable in virtue of the 2308818/Khan Proof of Claim filed in the context of the proposal of the Debtor, to Greg Chamandy.

61 These three documents, taken and read together, have the same final effect of a complete assignment and transfer of the 2308818/Khan claim in favour of Chamandy. Consequently, when 2308818/Khan votes its claim of $2,284,680.77 in favour of the proposal, it does so at the behest of, and in favour of, Greg Chamandy. This whole transaction becomes, in fact, the exact same equivalent of a vote by Greg Chamandy of the claim in question. At the end of the scheme above-described, 2308818/Khan is in the same position as it would be if it had "sold" its claim of $2.2 million to Chamandy for $210,000.00 and Chamandy (and others) benefits from a full release plus all dividends which may accrue to the real beneficial owner of the $2.2 million claim in question.

62 Even if it is true that there is no express assignment of the 2308818/Khan claim to Chamandy but the end result is exactly the same.

63 In *Oulahen, Re* (2000), 16 C.B.R. (4th) 262 (Ont. Bktcy.), Mr. Justice Farley of the Ontario Superior Court of Justice denied approval of a Proposal on the basis that one of the creditors voting in favour of the Proposal was the assignee of persons related to the Debtor.

64 The facts of that case are as follows: before the meeting of creditors called to approve the debtor Oulahen's proposal, his wife, his father and his mother-in-law, all creditors of the debtor, assigned their claim to their friends. Oulahen's wife assigned her claim of $1,194,862.00 to a friend, Catherine Ecker, for an amount of $15,000.00 in the form of an uncashed cheque and demand note. His father assigned his claim of $295,883.01 to another friend, Peter Kilkenny, in exchange of $5,000.00 and his mother-in-law assigned her claim of $26,794.62 in exchange for a payment of $250.00. All assignees voted in favour of the Proposal.

65 As for the Claimant-creditor, one Richard Williams, his claim of $159,512.03 was voted against the Proposal.

66 Mr. Justice Farley refused to approve the Proposal. He wrote:

> **The hearing on March 1st was adjourned to March 17th to allow the assignees and others to testify viva voce as to the understandings, if any, involved in these assignments. Ecker and Kilkenny were able to do so. In their affidavits the assignees had stated that they voted in favour of the proposal because it gave a better return to the creditors than would a bankruptcy.**

Ecker testified that she felt that she was free to vote against the proposal and that if she had done so, her friend Norah would be happy to know that this situation had finished. I have no doubt that Ecker was well intentioned, but based on the circumstances and her general testimony, including the whole premise of the favour as outlined in the affidavit in context of the circumstances, I would have to conclude that there was an unspoken understanding that the favour (implicit that the favour would be voting for the proposal) was a guiding light - and that loyalty to her friend Norah would prevail over any monetary gain.

In the case of Kilkenny, he acknowledged straightforwardly that he was going to vote for the proposal as a favour for his friend James Oulahen and hat there was an understanding implicit that he would so vote in favour of the proposal.

Thus in the case of these two assignees, while they were not related to Oulahen, they were in essence acting as proxy for Norah and James Oulahen who were related and so prohibited from voting in favour. This assignment arrangement was therefore nothing more than a device to inappropriately attempt to avoid the provisions of s.54(3). I would wish to make it clear that a *bona fide* assignment with no strings attached as to voting in favour of a proposal would not create such a proxy problem. However any such assignment would have to be carefully scrutinized as to its merits and its warts.

Given that conclusion, I do not see that it is necessary to deal further with the other grounds which may be advanced against the court approving the Proposal. I would conclude that it would be inappropriate to so approve the proposal given that, even ignoring the vote of Ecker and Kilkenny, the proposal would have been defeated by a substantial margin but if the votes of Ecker and Kilkenny were treated as voted, then they could only be voted against the proposal.

67 The rationale behind this decision is that if the assignor of a claim ends up controlling the vote of the assignee, such vote is equivalent to the vote of the assignor.

68 While the Court acknowledges that there is no assignment of a claim by a related person in favour of a third party, as in the Oulahen case cited above, the result is exactly the same: here, prior to the vote, Chamandy enters into a series of contracts pursuant to which he literally purchases the third party's rights, title and interests into a very substantial claim (more than 2.3 million) for roughly 10% of its face value. In exchange for cash, 2308818 agrees to vote its full unliquidated claim in favour of the Proposal as well as surrendering its right into any dividend resulting from the approval of the Proposal. In the opinion of the undersigned, Chamandy is now in full control of the 2308818 claim and, therefore, Chamandy is in the exact same position of a person voting in favour of the Proposal.

69 It should not be forgotten that the "related person" test is a test that applies not to the claim itself but to the person exercising the rights attached to the claim [15] . Therefore, if Chamandy is a related person and if he exercises the rights attached to the 2308818 claim, then that claim cannot be voted in favour of the Proposal.

70 Reflecting back on the question of whether or not Chamandy is a related person within the meaning of section 4 BIA, the Court has also taken the following into account:

a) Chamandy is a director and officer of both LNFC and LNGI;

b) Chamandy is not the named "Debtor" in the Proposal but he benefits from the Proposal to the same extent as the Debtor LNFC with respect to his acts, errors or omissions as director and officer of LNFC and/or LNGI.

c) This is also true, in part, with respect to LNGI's potential liability.

d) In the course of the "délibéré", the question arose as to whether Chamandy was in control of LNGI and, by extension, LNFC. The record now shows that LNGI appears to be a public company traded on the Toronto Stock Exchange Venture Exchange (TSXV) with "hundreds of shareholders" of which one in particular, Oxbridge Bank and Trust", owned 3,555,000 shares of LNGI, or 24.27% of its total issued share capital of 14,642,864 shares. Oxbridge Bank & Trust is no longer in operation and its shares in LNGI were

rolled into Oxbridge Group Inc., a corporation 100% owned by Greg Chamandy. In addition, Greg Chamandy appears to have been Chairman of Oxbridge Bank & Trust at the time.

71 All of the foregoing stems from documents transmitted to the undersigned by counsel for LNFC/LNGI. See letters and e-mails of 29 March 2017 and April 19, 2017.

72 The Court concludes that control of 24.27% of the shares of a publicly traded company while the balance of the share capital is spread amongst "hundreds of shareholders", coupled to the fact that Greg Chamandy is a director of LNFC, LNGI and Chairman of the board of the principal shareholder of LNGI, all of this amounts to effective control of the Debtor and that such effective control is exercised by Greg Chamandy, making him a "related person" to the Debtor LNFC.

73 As a result of all of the foregoing, the Court holds that 2308818/Khan acted not for its own behalf but for and on behalf of Chamandy when it voted in favour of the Proposal. Chamandy being a related person to the Debtor, could not, either directly or indirectly, vote in favour of the Proposal and, as a result, the vote on same must be set aside.

74 Debtor's counsel has argued that Greg Chamandy did not vote his own claim in support of the Proposal but merely arranged for the support of 2308818 Ontario Limited/Khan to vote its own claim in favour of the Proposal. This argument does not hold.

75 Greg Chamandy has, for all intents and purposes, "purchased" the 2308818/Khan claim for $210,000.00, has obtained a full release in his favour (as well as in favour of his wife) and has even contracted to receive the greater portion of the net dividends to be paid by LNFC if the Proposal was ratified. In short, Greg Chamandy has used the provisions of the BIA on proposals to obtain what he could not obtain otherwise.

76 Under section 59(2) BIA, the Court may refuse to approve this Proposal when "...*the court is of the opinion that the terms of the Proposal are not reasonable or are not calculated to benefit the general body of creditors*"... Here, the Court must not only refuse its approval because of the manner in which the vote was conducted but because the terms of the Proposal do not benefit the general body of creditors and, instead, only benefits the personal intents of Greg Chamandy.

77 Before a Court accepts to ratify a Proposal, it must be convinced that the terms thereof are reasonable, that the terms are calculated to benefit the general body of creditors and that the Proposal is made in good faith. In addition, the Court must ensure that the formalities of the BIA have been complied with.

78 See Ref: *Magnus One Energy Corp., Re* (2009), 53 C.B.R. (5th) 243 (Alta. Q.B.).

79 In the present instance, the terms of the Proposal appear to unduly favour the parent company, LNGI, as well as its directors and officers, with literally nothing going to the creditors. If approved, the sum of $150,000.00 will firstly go to the payment of professional fees incurred in the file and a very large portion of the balance will be returned to Greg Chamandy as sole beneficiary of the dividends which will flow from the 2308818/Khan claim. Consequently, the general body of creditors of LNFC will be left with next to nothing.

80 Consequently, the Court believes that the integrity of the bankruptcy process is being put to use in a manner inconsistent with the general commercial morality of the BIA. One party, Greg Chamandy, is driving this matter in such a fashion that he is now able to obtain a substantial financial advantage not otherwise available to him, in the form of a release of liability for both he and his wife.

81 No doubt that Chamandy is funding the Debtor with an advance of $150,000.00 in order to formulate the Proposal. But the execution of the three agreements filed as D-7 clearly indicate that out of the $150,000.00 so advanced, professional fees will have to be paid and then a very large portion of the balance will come back in the hands of Chamandy.

FOR THESE REASONS, the Court

83 *GRANTS* that part of the Motion of Claimants-Creditors seeking a declaration of refusal to approve the Proposal of LNFC;

84 *DISMISSES* the Motion of the Trustee asking for ratification of the Debtor's Proposal;

85 *DECLARES* that Liquid Nutrition Franchising Corporation is deemed to have made an assignment, the whole pursuant to section 62(2)(a) of the BIA;

86 *THE WHOLE* with costs against the mass.

Motion granted.

Footnotes

1 See section 61(2) of the *Bankruptcy and Insolvency Act* (the BIA).

2 Judgment of Michaud J. dated February 16, 2016.

3 Arthur Whisart Act (Franchise Disclosure), 2000, S.O. 2000 C.3. See also Regulations made pursuant to this Act O.Reg 581100.

4 See Claimants' Book of Exhibits, item C-5.

5 See Claimants' Book of Exhibits, item C-1.

6 See judgment of Michaud J. cited *supra*, note 1.

7 It should be noted that this debt is subordinated to the claims of all creditors in the Proposal. It cannot be voted in favour of the Proposal nor can it be taken into account in the payment of any dividend.

8 See paragraphs 1.3 and 1.6 of the Proposal.

9 Paragraph 6 of the Proposal.

10 While it is true that there was no formal assignment of the 2308818/Khan debt in favour of Chamandy, the end result is exactly the same : by releasing the Debtor, its parent and their Directors and officers and by assigning all dividends which may accrue to it once, the Proposal is ratified. 2308818/Khan no longer have any right title and/or interest into the claim of $2,284,680.77 above-noted. For all intents and purposes, this claim was « sold » to Greg Chamandy who has become the only beneficial owner thereof.

11 Although not fully documented in this record, it is not impossible that other creditors may have filed claims against the Debtor, its parent as well as its directors and officers.

12 The 2015-2016 Annotated Bankruptcy and Insolvency Act, paragraphs B§49, page 23.

13 If the claim of 2308818 Ontario Limited is set aside, the vote on the Proposal would be $500,000.00 against and $389,073.13 in favour, fo the Proposal.

14 See Sect. 54(2)(d) BIA which requires a majority of two-thirds in value.

15 Per Farley J. in Re : Oulahen at paragraph 3, page 263.

6

2006 QCCS 5129
Québec Superior Court

Magi, Re

2006 CarswellQue 10099, 2006 QCCS 5129, 166 A.C.W.S. (3d) 819, 34 C.B.R. (5th) 268, J.E. 2006-2185, EYB 2006-109791

Antonio Magi (Debtor/Respondent) and Le Groupe Fuller Landau Inc. (Trustee) and 373571 Canada Inc. (Creditor/Petitioner) and 1208074 Ontario Ltd., 2077-85 Ste-Catherine Holdings Inc., 3539474 Canada Inc., 5255-75 Ferrier Holdings Inc., Theatre Seville Holding Inc., Maroche Investment Inc. and Gilles Tremblay (mis en cause)

Gascon S.C.J.

Heard: May 15-16, 2006
Judgment: August 29, 2006
Docket: C.S. Montréal 500-11-026290-052

Counsel: Me Jacques Darche for Debtor and Trustee
Me Allen Feldman for Creditor/Petitioner

Subject: Insolvency; Civil Practice and Procedure

APPLICATION of debtor seeking court approval of proposal.

***Gascon S.C.J.*:**

Introduction

1 The Debtor, Antonio Magi, presents an Application for Court Approval [1] of a proposal that he filed with the Trustee, Le Groupe Fuller Landau Inc., on September 12, 2005 [2] (the "Proposal").

2 The Debtor submitted the Proposal to his creditors following the Notice of Intention that he filed on August 12, 2005, in accordance with Section 50.4 of the *BIA* [3].

3 In short, the Proposal provided for the full payment, without interest, of all preferred claims within sixty (60) days of its approval. It also envisaged a lump sum payment of $200,000 in full and final settlement of all unsecured claims within the same delay.

4 A creditors' meeting to vote on the Proposal was called for October 3, 2005. In the report that it circulated to the creditors with the Proposal, the Trustee recommended its approval [4].

5 Prior to the meeting, unsecured claims totaling $18,229,399 were filed with the Trustee [5]. In the end, 85% of the unsecured creditors (17 in favor, 3 against), representing 86% in value of the unsecured claims ($15,584,850 in favor, $2,402,223 against, and $242,326 not admitted), approved the Proposal [6].

6 Given the levels of creditors' approval in number and in value, and considering the recommendation of the Trustee, the Debtor submits that this is a situation where the Court should approve and ratify the Proposal.

7 3739571 Canada Inc. ("373 Inc.") is an unsecured creditor who is owed $2,297,523.12 by the Debtor pursuant to a default judgment [7]. It voted against the Proposal and now, by its Contestation [8], opposes the Debtor's Application. In addition, in a separate proceeding, it presents a Motion to have the vote on the Proposal declared invalid [9].

8 373 Inc. raises three arguments in support of both its Contestation and Motion.

9 First, it alleges that the Trustee should have rejected, or at least substantially reduced, the unsecured claims of seven (7) creditors totaling $15,488,109. At the creditors' meeting, it formally objected to those claims, to no avail.

10 According to 373 Inc., the following claims (the "Disputed Claims") should have been disallowed for voting purposes, as they were not substantiated with proper documentation and appeared highly suspicious:

CREDITORS	**AMOUNTS OF CLAIMS**
1208074 Ontario Ltd.	$5,060,259
2077-85 St. Catherine Holdings Inc.	$1,316,020
3539474 Canada Inc.	$2,890,606
5255-75 Ferrier Holdings Inc.	$2,110,202
Theatre Seville Holding Inc.	$2,494,738
Maroche Investments Inc.	$96,284
Gilles Tremblay	$1,520,000
Total	**$15,488,109**

11 373 Inc. contends that the first six Disputed Claims were filed by corporations controlled by Mr. David Stein or his family. Mr. Stein is a close business partner of the Debtor, and his offices occupied the same physical space as those of the Debtor. The seventh claim was filed by Mr. Gilles Tremblay for commissions owed. He was also, allegedly, someone who had a close business relationship with the Debtor.

12 373 Inc. argues that, had these seven Disputed Claims been rejected, the Proposal would not have been approved.

13 Second, it pleads that, in any event, the recovery for the unsecured creditors is minimal and almost non-existent. As a result, it would be inappropriate for the Court to give its blessing to the Proposal, since it is totally unreasonable.

14 Finally, 373 Inc. argues that this is a situation where the Debtor should rather be subjected to the scrutiny and investigative process that the *BIA* permits in matters of bankruptcy. The Debtor will completely avoid this process should the Court ratify his Proposal.

Analysis and Discussion

15 The Debtor's Application is made pursuant to Sections 54(2)(d) and 58 of the *BIA*, while the Contestation and related Motion of 373 Inc. rely on Sections 59, 107 and 108(1) of the sa me Act:

> 54.(1) [...]
>
> (2) [..]
>
> (d) the proposal shall be deemed to be accepted by the creditors if, and only if, all classes of unsecured creditors vote for the acceptance of the proposal by a majority in number and two thirds in value of the unsecured creditors of each class present, personally or by proxy, at the meeting and voting on the resolution.
>
> [...]

58. On acceptance of a proposal by the creditors, the trustee shall

(a) within five days after the acceptance, apply to the court for an appointment for a hearing of the application for the court's approval of the proposal:

(b) send a notice of the hearing of the application, in the prescribed manner and at least fifteen days before the date of the hearing, to the debtor, to every creditor who has proved a claim, whether secured or unsecured, to the person making the proposal and to the official receiver;

(c) forward a copy of the report referred to in paragraph (*d*) to the official receiver at least ten days before the date of the hearing; and

(d) at least two days before the date of the hearing, file with the court, in the prescribed form, a report on the proposal.

59. (1) The court shall, before approving the proposal, hear a report of the trustee in the prescribed form respecting the terms thereof and the conduct of the debtor, and, in addition, shall hear the trustee, the debtor, the person making the proposal, any opposing, objecting or dissenting creditor and such further evidence as the court may require.

(2) Where the court is of the opinion that the terms of the proposal are not reasonable or are not calculated to benefit the general body of creditors, the court shall refuse to approve the proposal, and the court may refuse to approve the proposal whenever it is established that the debtor has committed any one of the offences mentioned in sections 198 to 200.

(3) Where any of the facts mentioned in section 173 are proved against the debtor, the court shall refuse to approve the proposal unless it provides reasonable security for the payment of not less than fifty cents on the dollar on all the unsecured claims provable against the debtor's estate or such percentage thereof as the court may direct.

[...]

107. Every class of creditors may express its views and wishes separately from every other class and the effect to be given to those views and wishes shall, in case of any dispute and subject to this Act, be in the discretion of the court.

108. (1) The chairman of any meeting of creditors has power to admit or reject a proof of claim for the purpose of voting but his decision is subject to appeal to the court.

[...] (Emphasis added)

16 Pursuant to Subsection 54(2)(d) of the *BIA*, in order to be ratified by a court, a proposal must first be accepted by a majority in number and two-thirds in value of the unsecured creditors. This is the case here.

17 Notwithstanding this acceptance, Sections 58 and 59 provide that a court could still refuse to approve a proposal if its terms are not reasonable or are not calculated to benefit the general body of creditors.

18 For the purposes of making this assessment, the case law [10] has long recognized that three interests must be considered by a court on an application to approve a proposal:

a) the interest of the debtor;

b) the interest of the creditors generally; and

c) the interest of the public with respect to the integrity of the bankruptcy legislation.

19 According to this jurisprudence, the main guidelines to be followed by a court in this respect can be summarized as follows:

a) the burden of proof to convince a court to approve a proposal rests upon the debtor [11];

b) in deciding whether or not to approve a proposal, a court must weigh the effects of approving the proposal and of not approving it;

c) in the exercise of its discretion in assessing the reasonableness of an approval, a court must be convinced that the creditors will obtain some advantage over bankruptcy [12];

d) in making this assessment, the conduct of the debtor is a factor to be considered; if there is any suggestion of collusion or secret advantage, the matter should be particularly scrutinized;

e) in assessing the reasonableness of a proposal and in weighing these three interests, a court will be influenced by the level of recovery for the unsecured creditors; when the amounts offered to unsecured creditors are minimal and the payout represents a small fraction of what is owed to them, it will be taken into account in the analysis;

f) similarly, when the circumstances seem to indicate that an investigation under the *BIA* will assist in clarifying otherwise cloudy issues in the context of the proposal, it is a factor that will influence the exercise of the discretion of a court.

20 Bearing these guidelines in mind, the Court concludes that the three grounds of contestation raised here by 373 Inc. are well founded. Simply put, this is not a case where it is reasonable for the Court to approve the Debtor's Proposal.

21 There are indeed serious issues with and valid concerns about the legitimacy, validity or real extent of the seven Disputed Claims. Also, the recovery for the unsecured creditors under the terms of the Proposal is minimal. In all likelihood, they stand a better chance to recover more following a bankruptcy, if only because of the conditions for discharge that a court would likely impose on the Debtor.

22 Finally, when one considers the facts alleged by 373 Inc. with respect to at least two reviewable transactions involving the Debtor, an investigation into his affairs pursuant to the provisions of the *BIA* may well lead to an even higher recovery for the unsecured creditors.

23 In other words, in the context of unsecured claims that contain so many mistakes, raise so many questions and provide so few answers, faced with a Proposal that allows for such minimal recovery, and in light of the assistance that an investigation in a bankruptcy process could provide, the Court considers that the Trustee and the Debtor have failed to establish the reasonable character of the Proposal.

24 Some explanations on each of these three findings are in order,

a) The Disputed Claims

25 A review and analysis of the Disputed Claims show that many unresolved queries did indeed exist with respect to each of them. They should not have been accepted "as is" by the Trustee for voting purposes on the Proposal.

26 Overall, the basis of the six Disputed Claims of the companies related to Mr. Stein was the same. It was a personal guaranty signed by the Debtor on April 10, 2003 (the "Guaranty") [13] with respect to amounts owed by Gescor Construction Inc. ("Gescor"), HarbourTeam Developments Inc. ("HarbourTeam") or 9068-9118 Quebec Inc. ("9068 Inc.") to each of these six unsecured creditors.

27 Gescor, HarbourTeam and 9068 Inc. were companies in which the Debtor had an important involvement. They participated in the construction and development of an unsuccessful condominium project in Old Montreal.

28 While the Guaranty was clear, it remains that, for it to apply, these creditors needed to show that there was, in fact, some sort of indebtedness by one or more of the three companies towards them.

29 However, the documentation provided by these six creditors to establish their claim in capital, be it to the Trustee prior to the meeting of October 2005 or later on at hearing, was, for the most part, unsatisfactory and incomplete.

30 Furthermore, the interest portion of these six claims was based on an annual rate of 18%, with no supporting documentation to justify it. Indeed, the testimonies of Mr. Stein, on the one hand, and Mr. Magi, on the other, were contradictory on that specific issue. The first claimed that the agreed rate was 18%, while the second testified that it was, rather, 10% to 12%.

31 Despite this, and without any real investigation, the Trustee simply recognized all the claims as valid for voting purposes on the Proposal, including interest at 18%.

32 That was not all. Prior to the Debtor's making the Proposal, two of the companies for which he signed his Guaranty, Gescor and HarbourTeam, had applied for Court protection [14], be it under the *CCAA* [15] or the *BIA*.

33 However, interestingly, only two of these six unsecured creditors (namely 1208074 Ontario Ltd. and 3539474 Canada Inc.) filed proofs of claims in the context of the plans of arrangement or proposals presented by Gescor and HarbourTeam. This is in spite of the fact that the dividends payable to the creditors under those plans or proposals were much higher than what these six creditors would end up receiving if the Court now ratifies the Proposal.

34 This behavior and positioning is rather bizarre, to say the least. It does not help the credibility of these Disputed Claims, especially when one considers that the documentation in support of them is anything but clear and simple. Moreover, a perusal of these claims confirms that their real value is far less than what the Trustee ended up accepting.

i) 1208074 Ontario Ltd.

35 The Trustee accepted this claim as filed, for a proven amount of $5,060,259.29 [16]. It included a first amount of $750,000 in capital, plus interest at the rate of 18% from February 22, 2001 to September 22, 2005, for a total of $1,567,669.75, as well as a second amount of $1,000,000 in capital, plus interest at the rate of 18% from October 2, 1998 to October 2, 2005, for a total of $3,492,589.54.

36 At trial, the attorney for the Debtor and the Trustee argued that, in the process of revisiting the decision of the Trustee to accept or reject a proof of claim, the Court was acting *de novo*. Consequently, it could consider new evidence in addition to what the Trustee saw and retained.

37 Based on the recent case law, the Court agrees with this proposition [17].

38 So, it would appear, do the Debtor and the Trustee also. At trial, applying these principles, they conceded that, with respect to this unsecured creditor, the second amount claimed of $3,492,589.54 was ill-founded, as no documentation supported it. They agreed that the only amount due to 1208074 Ontario Ltd. was the first amount of capital of $750,000, plus interest at 18%.

39 With respect to the capital portion, there is an acknowledgement of debt by Gescor to 1208074 Ontario Ltd. for that amount [18]. In the Guaranty, the Debtor personally guaranteed to 1208074 Ontario Ltd. the reimbursement of any loan made to Gescor [19]. Accordingly, this amount of capital appears to be covered by the Guaranty.

40 With respect to the interest portion, the Debtor and the Trustee maintained that a sum of $699,981.78 is owed, on the basis of an interest rate of 18% per annum. As already stated, no document supports that. The only basis for this rate of interest is the deposition of Mr. Stein, where he stated that he "believed" this was the amount of interest to be paid [20] .

41 This evidence is not convincing at all. In addition, it was contradicted at trial by the Debtor, who twice testified that the agreed rate of interest was between 10% and 12%.

42 Short of any documentation establishing this interest rate, and faced with this conflicting evidence, the Court is of the view that, at best, the interest recognized for this claim should not have exceeded 10%. Applying this rate to the amount of capital of $750,000 would reduce the interest portion of that claim by 45%, namely from $699,981.78 to $384,989.

43 As well, this does not take into consideration any payments received by 1208074 Ontario Ltd. on the capital of the loan. Yet, Mr. Stein, in his same deposition [21] , acknowledged that some payments had indeed been made.

44 Consequently, ignoring, for the moment, the amount of the partial payments admitted by Mr. Stein, the amount of capital and interest of the unsecured claim of 1208074 Ontario Ltd. should have been set at a maximum of $1,134,989, and certainly not at the amount of $5,060,259.29 retained by the Trustee for voting purposes on the Proposal.

ii) 2077-85 St. Catherine Holdings Inc.

45 The Trustee recognized the proof of claim of this second unsecured creditor at an amount of $1,316,020.79 [22] .

46 Nevertheless, there is simply no evidence of any sort establishing a debt towards this entity by any of the three companies personally guaranteed by the Debtor. Furthermore, this entity did not submit any proof of claim in the context of the plans of arrangement of Gescor or HarbourTeam. Mr. Stein tried to explain this by stating that he forgot to do so. This is hardly convincing.

47 In order to establish that the Guaranty covered amounts owed to it, 2077-85 St. Catherine Holdings Inc. needed to file documentation establishing that the companies identified in the Guaranty did indeed owe it money. This was not done.

48 As well, and similarly to the situation of 1208074 Ontario Ltd., not a single document supported the interest rate of 18% claimed by this purported creditor.

49 This proof of claim should have been rejected by the Trustee and valued at zero. At trial, when asked by the Court to explain the basis for recognizing this claim notwithstanding the total absence of documentation, the Trustee's answer consisted in a long silence, as eloquent a response as possible in the circumstances.

iii) 3539474 Canada Inc.

50 The proof of claim of this third unsecured creditor was for an amount of $2,890,606.47. It comprised a principal amount of $1,250,000, plus accrued interest at the rate of 18% from October 10, 2000 to September 10, 2005 [23] .

51 In the documents filed at trial by the Debtor, there was a Deed of Loan and Subrogation confirming that HarbourTeam and 3539474 Canada Inc. had agreed to a term loan for the principal amount of $1,250,000, which was to bear interest at the rate of 9% per annum [24] .

52 Thus, while the capital portion of this unsecured claim was validly established at trial, the interest calculated and recognized at the rate of 18% was unjustified. The relevant documents indicate that the rate of interest was, rather, 9%.

53 Therefore, the interest of $1,515,606 claimed by this creditor should have been reduced by half. Its claim should have been limited to a total amount of $1,250,000 in capital, plus $757,803 in interest, for an aggregate of $2,007,803.

iv) 5255-75 Ferrier Holdings Inc.

54 The fourth Disputed Claim contested was that of 5255-75 Ferrier Holdings Inc. for an amount of $2,110,202,09 [25] . It includes a capital amount of $750,000, plus accrued interest at the rate of 18% per annum from December 26, 1999 to September 26, 2005.

55 The documentation filed did establish that this entity advanced $250,000 to Gescor on December 17,1999 [26] . The other $500,000 in principal allegedly comes from an advance it made to 9077-8044 Québec Inc. for the benefit of Gescor.

56 No documentation established that this second advance was for the benefit of Gescor, as the Debtor and the Trustee asserted. The relationship between 9077-8044 Québec Inc. and Gescor is unknown, save for an unsupported and vague verbal assertion to that effect.

57 Such evidence is hardly sufficient to establish the validity of a debt by Gescor to 5255-75 Ferrier Holdings Inc. for which the Debtor would be liable on the basis of his Guaranty.

58 Here again, as in the situations of the other three creditors discussed above, the interest claimed at the rate of 18% is unsupported by any documentation. Mr. Stein refers to such a rate, but the Debtor contradicts him and sets the interest in the neighborhood of 10% to 12%. As noted above, the Court will set the interest rate in such circumstances at 10%.

59 Consequently, this unsecured claim should have been recognized only to the extent of $250,000 in capital, plus interest at 10% for the period identified, or $249,370, for an aggregate of $499,370. This is the most that could be owed to 5255-75 Ferrier Holdings Inc. Still, we note again that this entity failed to file a proof of claim in the context of the plan of arrangement of Gescor. In light of that, the Court questions the legitimacy of this claim even to that limited extent.

v) Theatre Seville Holding Inc. and Van Home Theatre Holding Inc.

60 These unsecured creditors filed a proof of claim in the amount of $2,494,738.35 [27] . It included a principal amount of $1,100,000, plus accrued interest at the rate of 18% from February 20, 2001 to September 20, 2005.

61 The advances to Gescor by these entities were properly evidenced by the documentation filed in the record and, accordingly, they are covered by the Guaranty.

62 However, as before, the rate of interest claimed was unsupported. It should not stand at 18%. It should rather be limited to the rate of interest acknowledged by the Debtor, which the Court has set at 10%.

63 Thus, this Disputed Claim should have been recognized only for a capital amount of $1,100,000 and for interest of $767,105, calculated at a rate of 10%, for an aggregate of $1,867,105.

vi) Maroche Investment Inc.

64 For this last unsecured creditor related to Mr. Stein, the proof of claim filed stood at $96,284,56 [28] . It included a principal amount of $40,000, plus accrued interest at the rate of 18% from October 10, 2000 to September 10, 2005.

65 Two cheques evidenced advances totaling $40,000 by Maroche Investments Inc. to Gescor [29] . Together with the proof of claim filed and sworn to, this proves the capital portion of the indebtedness of Gescor. As well, this debt is covered by the Guaranty.

66 However, with respect to interest, similar comments to those already made for the five previous Disputed Claims apply here. The applicable rate should be limited to 10%.

67 Consequently, this claim should have been accepted for an amount of $40,000 in capital, plus $30,956 in interest, for an aggregate of $70,956.

68 As a result, these first six Disputed Claims that the Trustee recognized for an aggregate amount of $13,968,109 should have been valued at no more than $5,580,223.

69 The difference is huge. It stands at $8,387,886, close to half of the total unsecured claims of $18,229,399 filed at the creditors' meeting.

70 At that meeting of October 3, 2005, despite being called upon to do so by 373 Inc., the Trustee simply decided to look the other way when the evidence overwhelmingly supported the contestations raised by this creditor. This was unacceptable. The Trustee did not even attempt to explain this questionable behavior at trial.

71 That was not all. As 373 Inc. rightly pointed out, there was a seventh unsecured creditor whose claim was also incorrect on its face.

vii) Gilles Tremblay

72 This seventh Disputed Claim concerns a person to whom the Debtor acknowledged owing $1,520,000 for commissions on sales of condominiums for the project known as "1, Avenue du Port". By a document dated October 18, 2003 [30], the Debtor personally guaranteed the payment of such commissions.

73 This guaranty is rather surprising. It relates to commissions allegedly earned on sales on the project developed by HarbourTeam. However, when it was given, the sales were apparently not yet finalized and HarbourTeam had already filed a plan of arrangement under the *CCAA*.

74 The reasons why such a guaranty was signed at that point in time are difficult to understand. Mr. Magi claimed that he did it for the protection of the customers involved. One wonders how this guaranty would have helped them in any way in respect of their pending offers to buy condominiums in that project.

75 Be that as it may, at trial, Mr. Tremblay admitted having received from the new group who acquired this project an amount of $300,000 in partial payment of these commissions. Furthermore, the documentation filed in support of his proof of claim indicates that the precise commissions allegedly owed to him stood at $1,460,798, and not $1,520,000.

76 Thus, at best, Mr. Tremblay's claim should have been limited to an amount of $1,160,798. This represents another reduction of $359,202 that escaped the Trustee's attention at the creditors' meeting.

77 This analysis reveals that out of the $15,584,850 in value of the unsecured claims that voted in favour of the Proposal, an aggregate of no less than $8,747,088 should have been disregarded. This would have changed drastically the percentages of approval of the Proposal.

78 Even there, the reduced value of these seven unsecured claims would not have taken into account the following elements which, in all likelihood, could well have entailed further reductions in value:

a) no information was provided as to the amounts in capital or interest received by Mr. Stein and his group of companies with respect to the first six unsecured claims;

b) even assuming these revised amounts, the documentation evidencing any receipts, any payments, any disbursements and any rate of interest was still highly unsatisfactory;

c) no financial documentation from the books and records of the relevant companies was filed to evidence the nature of their claims and the receivables allegedly owed to them;

d) no explanation was given as to why, for those entities related to Mr. Stein who had claims against Gescor, no proofs of claim whatsoever were filed in the context of the plan of arrangement of that company under the *CCAA*, notwithstanding the fact that a 10% dividend was paid therein. This certainly raises some questions as to the validity or legitimacy of the claims that Mr. Magi ended up personally guarantying on April 10, 2003, *after* HarbourTeam and Gescor had respectively applied for Court protection under the *CCAA* or the *BIA* [31]

79 All in all, the numerous mistakes in the relevant proofs of claims, coupled with all the questions in relation thereto that remain unanswered, oblige the Court to conclude that it would be unreasonable to ratify a proposal whose approval process at the creditors' level was so deficient.

b) The minimal recovery

80 In addition to this, the unreasonable character of the Proposal is shown by the negligible recovery that the unsecured creditors would end up getting if it were ratified.

81 If one were to accept the level of the claims recognized by the Trustee for voting purposes (namely $17,987,073), a $200,000 payout would represent a return of slightly more than one cent on the dollar (barely over 1 %).

82 If one were rather to consider the level of the unsecured claims that, in the best scenario, should have been recognized for voting purposes (namely $9,239,985), the return would be a little more than two cents on the dollar (barely over 2%).

83 The case law has held that such low returns, or even higher unsatisfactory returns, confirm the unreasonable character of a proposal [32].

84 The courts have emphasized that, in a proposal, it is not reasonable to have returns of only a few cents on the dollar. These fall well below any appropriate threshold in this regard or, for that matter, in regard to Subsections 172(2) and 173(1)(a) of the *BIA*:

> 172. (1) [...]
>
> (2) The court shall on proof of any of the facts mentioned in section 173
>
> (a) refuse the discharge of a bankrupt;
>
> (b) suspend the discharge for such period as the court thinks proper; or
>
> (c) require the bankrupt, as a condition of his discharge, to perform such acts, pay such moneys, consent to such judgments or comply with such other terms as the court may direct.
>
> [...]
>
> 173. (1) The facts referred to in section 172 are:
>
> (a) the assets of the bankrupt are not of a value equal to fifty cents on the dollar on the amount of the bankrupt's unsecured liabilities, unless the bankrupt satisfies the court that the fact that the assets are not of a value equal to fifty cents on the dollar on the amount of the bankrupt's unsecured liabilities has arisen from circumstances for which the bankrupt cannot justly be held responsible;
>
> [...]

85 Such low returns offend the principles of equity and integrity that the bankruptcy process is designed to uphold and protect.

86 Here, this reasoning squarely applies. Not only is the amount offered minimal at best, but the threshold of Subsections 172(2) and 173(1)(a) is far from being met.

87 One could even reasonably venture to say that, in the context of a discharge proceeding pursuant to a bankruptcy, there is a high probability that a court would, in fact, require the Debtor to make much higher payments to the unsecured creditors before being discharged. This is especially relevant when one considers that, according to the evidence, the Debtor presently works and earns commissions that, he says, are in the neighborhood of $6,000 monthly.

c) The investigative process of the BIA

88 Finally, as this analysis shows, there still remain serious unanswered questions with respect to the validity of many of these Disputed Claims, even after reducing them.

89 For instance, a good part of their value is made up of interest accrued over several years, while most, if not all, of the debts were in existence well prior to the signing of the Guaranty in April 2003. Thus, the mere delay in filing the Proposal resulted in major increases in the value of these claims, simply by the accrual of interest.

90 No doubt, some explanation should be given for that.

91 Further, the filing of the Proposal followed not only the default judgment obtained by 373 Inc. [33], but also, and in particular, the service of its Motion to Institute Proceedings to Declare Inopposable a Disposition of Property made by Mr. Magi [34].

92 This timing of events requires some explaining by the Debtor.

93 In fact, the latter motion raised apparently legitimate questions concerning two transactions involving the Debtor. The first was the transfer to his brother of equity interest in capital stocks, while the second dealt with the transfer to his 26 year old niece of his 50% undivided ownership of a property that he continued to occupy as his principal residence subsequent to that transfer.

94 The Trustee has not investigated these matters any more than he investigated the real extent and value of the Disputed Claims. Notwithstanding the partial explanations offered at trial by the Debtor and his attorney, these transactions certainly warrant further investigation.

95 Considering this, as was rightly noted by Lemelin J., Parley J. and Lissaman J. in the three judgments already cited [35], it would be both in the public interest and in the interest of the creditors that they be given the opportunity to examine the affairs of the Debtor with the investigative assistance possible in a bankruptcy process.

96 When one is faced, as here, with a situation where many questions still remain unanswered, where there is not an overwhelming vote in favour of a proposal, where the recovery offered to the unsecured creditors is minimal, and where many issues remain yet to be investigated, the requirements of commercial morality and the integrity of the proposal process would not be served by the approval of the Proposal submitted by the Debtor.

97 To the contrary, approving this Proposal in such a context could well affect the trust of the public in the proposal process allowed under the *BIA*.

FOR THESE REASONS, THE COURT:

99 DISMISSES the Application for Court Approval of the Debtor;

100 MAINTAINS the Contestation and the Motion of 373 Inc. to Have the Vote on the Proposal Declared Invalid;

101 REFUSES to approve the Proposal of the Debtor dated September 12, 2005 as unreasonable and not calculated to benefit the general body of creditors;

102 WITH COSTS in favor of 373 Inc.

Application dismissed.

Footnotes

1 Application for Court Approval dated October 19, 2005.

2 Tab 1 of the Debtor's Book of Exhibits.

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

4 Tab 1 of the Debtor's Book of Exhibits.

5 Tab 6 of the Debtor's Book of Exhibits.

6 Tab 6 of the Debtor's Book of Exhibits.

7 Tab 3 of the Debtor's Book of Exhibits.

8 Contestation of Application for Court Approval of Proposal dated October 18, 2005.

9 Motion to Have Vote Declared Invalid on Proposal dated October 18, 2005.

10 *Laforce (Proposition concordataire de)*, AZ-50104507, B.E. 2001BE-1035, para. 19 to 24; *Mernick, Re* (1994), 24 C.B.R. (3d) 8 (Ont. Gen. Div. [Commercial List]); *Stone, Re* (1976), 22 C.B.R. (N.S.) 152 (Ont. S.C.).

11 *First Toronto Mining Corp., Re* (1991), 3 C.B.R. (3d) 246 (Ont. Bktcy.), 250.

12 *Mernick, Re*, *supra*, note 10, p. 13.

13 See the Proofs of Claims at Tabs 8, 9, 10,11,12 and 13 of the Debtor's Book of Exhibits.

14 See tabs 20 and 21 of the Debtor's Book of Exhibits.

15 *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36.

16 See tab 8 of the Debtor's Book of Exhibits.

17 *In Re Saine*, EYB 2005-97593, 2005-11 -11 (S.C.).

18 Tab 25 of the Debtor's Book of Exhibits.

19 Tab 26 of the Debtor's Book of Exhibits.

20 Deposition of Mr. Stein, April 4, 2006, p. 12ff.

21 Deposition of Mr. Stein, April 4, 2006, p. 55.

22 Tab 9 of the Debtor's Book of Exhibits.

23 Tab 10 of the Debtor's Book of Exhibits.

24 Exhibit AM-20, file entitled "Renova Construction & 3539474 Canada Inc.", Deed of Loan and Subrogation Nº 10,208 dated December 21, 2000.

25 Tab 11 of the Debtor's Book of Exhibits.

26 Tab 26, section 5, of the Debtor's Book of Exhibits.

27 Tab 12 of the Debtor's Book of Exhibits.

28 Tab 13 of the Debtor's Book of Exhibits.

29 Tab 26, section 2, of the Debtor's Book of Exhibits.

30 Tab 14 of the Debtor's Book of Exhibits.

31 Tabs 20 and 21 of the Debtor's Book of Exhibits.

32 See *Mernick, Re* and *Laforce (Proposition concordataire de)*, *supra*, note 10.

33 Tab 3 of the Debtor's Book of Exhibits.

34 Tab 4 of the Debtor's Book of Exhibits.

35 *Supra*, note 10.

7

2000 BCSC 1443
British Columbia Supreme Court

Maple Homes Canada Ltd., Re

2000 CarswellBC 2017, 2000 BCSC 1443, 2000 B.C.T.C. 738, [2000] B.C.J. No. 1958, [2001] B.C.W.L.D. 172, 21 C.B.R. (4th) 87, 99 A.C.W.S. (3d) 909

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

Smith J.

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

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

Subject: Civil Practice and Procedure; Insolvency; Torts

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

***Smith J.*:**

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

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

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

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

5 The Proposal includes provisions that the debtor will liquidate its assets and pay the net proceeds of sale (after satisfaction of valid security interests) to the Trustee; cause Brad Grindler to sell his interest in a property on Pender Island and pay the net proceeds to the Trustee for the general benefit of unsecured creditors; cause Brad Grindler to pay

to the Trustee from his future income the sum of $30,000 at the rate of not less than $500 per month; and cause Brad Grindler to waive any right he may have to a dividend under the Proposal. Paragraph 5 of the Proposal states:

> By accepting this Proposal, the unsecured creditors shall agree to accept the amounts paid and payable under paragraph 2, coupled with the waiver referred to in paragraph 4 above as payment in full for an assignment of their provable claims against the debtor under the Act, together with all rights of recovery they may have against Brad and Cathie Grindler in that regard. The assignment aforesaid shall be made to the debtor or to whomever it may direct.

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

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

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

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

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

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

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

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

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

ISSUES

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

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

ANALYSIS

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

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

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

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

13 The Trustee is recommending approval of the Proposal, pointing out that it will bring the unsecured creditors some return (a dividend of 7 - 8.5%) rather than no return. The Trustee estimated that if Mr. Grindler were petitioned into

bankruptcy he would be required to make payments of $500 per month for between nine and twenty-one months (thus, a total of $4,500 - $10,500), rather than the total of $30,000 under the Proposal.

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

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

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

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

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

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

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

> (a) who is for any reason unable to meet his obligations as they generally become due,
>
> (b) who has ceased paying his current obligations in the ordinary course of business as they generally become due, or
>
> (c) the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due ...

Mr. Scouten pointed to the evidence that the sales of Maple Homes had been in serious decline since September of 1999, having plummeted to 10% of previous levels, that a large prospective order from a German customer had fallen through at the end of February, that the company's suppliers had put it on a "C.O.D." basis, that Mr. Grindler had ceased to draw a salary, had borrowed money from family to put into the company and had laid off employees, and that Mr. Gomez had been demanding shipment of the goods worth roughly $100,000 for which he had already paid. I note

that for Maple Homes to have reached the state of $13,000 assets and $664,758.14 liabilities by the date of the Trustee's report in June 2000, it would have to have been in something approaching that state by early March. I also note that, as counsel for Maple Homes urged, the evidence suggests that Mr. Grindler adopted the tactic of lying to Mr. Gomez about his shipment out of desperation.

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

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

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

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

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

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

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

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

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

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

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

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

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

25 Mr. Scouten's submissions, urging that persons in financial difficulty have an obligation to keep optimism in check and to be candid with their creditors, have force. Nevertheless, I have concluded that the evidence does not establish that this debtor continued to trade after it knew it was insolvent. The length of time for which the company had been in business, the concentrated efforts Mr. Grindler was making to solve the business's problems including continued bids on work, and the fact that a large order such as the one that fell through at the beginning of March could have permitted the company to continue, are consistent with good faith and reasonable efforts to carry on, rather than with knowledge that the business would fail. I am satisfied that, within a reasonable time of knowing that Maple Homes was insolvent, its principal, Mr. Grindler, gave notice of intention to make a Proposal and that a "fact" mentioned in s., 173(*c*) has not been proved.

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

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

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

> 69 (1) Subject to subsections (2) and (3) and sections 69.4 and 69.5, on the filing of a notice of intention under section 50.4 by an insolvent person,
>
> (a) no creditor has any remedy against the insolvent person or the insolvent person's property, or shall commence or continue any action, execution or other proceedings, for the recovery of a claim provable in bankruptcy,
>
> ...
>
> until the filing of a Proposal under subsection 62(1) in respect of the insolvent person or the bankruptcy of the insolvent person.
>
> 69.1(1) Subject to subsections (2) to (6) and sections 69.4 and 69.5, on the filing of a Proposal under subsection 62(1) in respect of an insolvent person,
>
> (a) no creditor has any remedy against the insolvent person or the insolvent person's property, or shall commence or continue any action, execution or other proceedings, for the recovery of a claim provable in bankruptcy, until the trustee has been discharged or the insolvent person becomes bankrupt; ...

69.3(1) Subject to subsection (2) and sections 69.4 and 69.5, on the bankruptcy of any debtor, no creditor has any remedy against the debtor or the debtor's property, or shall commence or continue any action, execution or other proceedings, for the recovery of a claim provable in bankruptcy, until the trustee has been discharged.

69.31(1) Where a notice of intention under subsection 50.4(1) has been filed or a Proposal has been made by an insolvent corporation, no person may commence or continue any action against a director of the corporation on any claim against directors that arose before the commencement of proceedings under this Act and that relates to obligations of the corporation where directors are under any law liable in their capacity as directors for the payment of such obligations, until the Proposal, if one has been filed, is approved by the court or the corporation becomes bankrupt.

(2) Subsection (1) does not apply in respect of an action against a director on a guarantee given by the director relating to the corporation's obligations or an action seeking injunctive relief against a director in relation to the corporation.

...

69.4 A creditor who is affected by the operation of sections 69 to 69.31 or any other person affected by the operation of section 69.31 may apply to the court for a declaration that those sections no longer operate in respect of that creditor or person, and the court may make such a declaration, subject to any qualifications that the court considers proper, if it is satisfied

(a) that the creditor or person is likely to be materially prejudiced by the continued operation of those sections; or

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

> The facts of the case are similar to those in *J.B. Allen*, *supra*, where the Court relied upon the earlier decision in *Cravit, Re* (1984), 54 C.B.R. (N.S.) 214 (Ont. S.C.) where Master Ferron stated at p. 215:
>
> > ... in order to come to a conclusion that the plaintiffs should not be permitted to proceed I would have to conclude that the plaintiffs could either not succeed in the action in question or that if they succeeded they could not recover against the [bankrupt's] insurer.
> >
> > The function of the bankruptcy court is not to inquire into the merit of the action sought to be commenced or continued but rather to be assured that such an action, falling within the s. 49(1) [now s. 69.3] stay, should continue for the reasons which I detailed in *Re Advocate Mines Ltd.*
>
> The bankrupt, Mr. Biller, is a necessary party to the action as he was an officer and director of many, if not all of the plaintiff companies. Further, the claim is based upon a cause of action for which, if successful, will not be defeated by the bankruptcy. Lastly, the Judicial Trustee ought to be able to pursue the action against the other defendants, the bankrupt's wife and their holding company.

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

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

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

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

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

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

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

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

35 Should the exemption be granted in this case?

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

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

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

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

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

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

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

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

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

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

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

> Regarding paragraphs 16 through 20 of the Grindler Affidavit, when I met with Mr. Grindler in Vancouver, he specifically informed me that Maple Homes was not a manufacturer and he and Maple Homes would purchase for me and ship materials from different suppliers. I knew there would be a price mark-up for these services. Bradley Grindler took me to see a number of manufacturers/suppliers' show room locations and display facilities, including two display houses, while I was in Vancouver. At that time Mr. Grindler again confirmed the terms of our agreement: He told me "you select what you want and we will buy it for you". At these locations I then selected specific items

> which Bradley Grindler and Maple homes would purchase and ship to me. These included such items as the Jacuzzi, shower stalls, faucets, kitchen sink, the stairs ... and the mouldings for the walls and ceilings....
>
> Further Bradley Grindler took me and my wife for lunch and at that luncheon meeting, I specifically asked Mr. Grindler how I could be certain that if I paid him my money he would in fact purchase the house materials and ship them to me. He assured me he was a trustworthy person who had been in business for several years, operated a reputable company and I could trust him to buy and deliver all materials to me. I relied on those representations and I trusted that he would, for the price mark-up of Maple Homes, use my monies for the specific purpose of purchasing the materials, paying all suppliers and deliver the Materials to me.
>
> These statements, and Mr. Grindler's conduct in dealing with me throughout, left me with the clear understanding that Maple would be using the money that I sent to it to purchase and pay for the goods from his third party suppliers, and I understood this to be an important and central feature of the arrangement between us for the purchase and supply of products to me.

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

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

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

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

These cases do not detract, the court said, from the principle that in the absence of some special arrangement creating a trust, payments of this kind are made upon the basis that they are to be included in the company's assets. Further, the

court rejected the argument that if a transaction was one of loan, giving rise to a legal action of debt, this necessarily excluded the implication of any trust relationship. Lord Wiberforce wrote at p. 581-82:

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

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

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

> It is clear that if the terms upon which the person receives the money are that he is bound to keep it separate, either in a bank or elsewhere, and to hand that money so kept as a separate fund to the person entitled to it, then he is a trustee of that money and must hand it over to the person who is his cestui que trust. If on the other hand he is not bound to keep the money separate, but is entitled to mix it with his own money and deal with it as he pleases, and when called upon to hand over an equivalent sum of money, then, in my opinion, he is not a trustee of the money, but merely a debtor.

He referred to *Bank of Montreal v. British Columbia (Milk Marketing Board)* (1994), 94 B.C.L.R. (2d) 281 (B.C. S.C.). There the Court held that the principle that where A gives money to B for the specific purpose of paying C, the money is impressed with a trust and may not be appropriated by him, is undoubted. Newbury J. observed, however, that in both the *Quistclose Investments Ltd.* case itself and in *Lowndes Lambert Group Ltd. v. Specialty Underwriting Services Ltd.* (1986), 11 B.C.L.R. (2d) 308 (B.C. S.C.) which applied it, that it appeared that (1) the recipient of the funds was required, either by express terms or the course of dealings between the parties, to keep the money separate from its own funds; and (2) the funds were paid on express conditions of trust which the payees later tried to repudiate. The Court, having commented that the case at bar involved a claim that a trust should be implied from the course of dealings, concluded at p. 288:

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

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

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

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

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

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

CONCLUSIONS

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

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

Order accordingly.

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IN THE MATTER OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C., 1985, c. B-3, AS AMENDED

AND IN THE MATTER OF THE PROPOSAL OF DIGITAL UNDERGROUND MEDIA INC a company incorporated pursuant to the laws of the Province of Ontario, with a head office in the City of Vancouver, in the Province of British Columbia

Court File No: CV-16-11363-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(IN BANKRUPTCY AND INSOLVENCY)
Proceeding commenced at Toronto

BOOK OF AUTHORITIES OF FORWARD DIMENSION CAPITAL 1 LLP (For the Application returnable November 14, 2017)

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