

**SUPERIOR COURT  
(Commercial division)**

CANADA  
PROVINCE OF QUEBEC  
DISTRICT OF MONTREAL

No: 500-11-055629-188

DATE: July 08, 2019

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**BY THE HONOURABLE CHANTAL TREMBLAY, J.S.C.**

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**IN THE MATTER OF THE NOTICE OF INTENTION TO MAKE A PROPOSAL OF:**

**2964-3277 QUEBEC INC.**

Debtor

and

**RICHTER ADVISORY GROUP INC.**

Trustee

and

**BUSINESS DEVELOPMENT BANK OF CANADA**

Petitioner

and

**CANADIAN IMPERIAL BANK OF COMMERCE**

Respondent

and

**9220-5749 QUEBEC INC.**

Impleaded Party

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**JUDGMENT FOR DETERMINATION OF RIGHTS ON CERTAIN ASSETS**

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[1] 2964-3277 Québec Inc. (hereafter referred to as "**Carpet Art Deco Inc. or CADI or Debtor**") is a manufacturer and distributor of carpets. It imports the vast majority of the carpets sold to its customers in Canada and more recently, in the United States.

[2] CADI uses a movable racking system to store carpets in its five warehouses which was purchased from Ohio Rack Inc. (hereafter referred to as the "**Ohio Racks**").

[3] CADI has purchased, since at least June 2013, USD 737,000.00<sup>1</sup> worth of Ohio Racks

[4] On November 28, 2018, CADI filed a notice of intention to make a proposal (**NOI**) under the *Bankruptcy and Insolvency Act* (**BIA**).<sup>2</sup>

[5] On March 13, 2019, this Court issued an order approving the repurchase of the Ohio Racks by its main supplier (**Ohio Repurchase Agreement**).

[6] Business Development Bank of Canada (**BDC**) asks the Court to rule that the Ohio Racks are parts of CADI's equipment on which it has a valid prior ranking security. It also seeks orders to obtain all of the sale's proceeds related to the Ohio Racks.

[7] Canadian Imperial Bank of Commerce (**CIBC**), for its part, asks the Court to rule that the Ohio Racks are "Inventory [or] accessories thereto" within the meaning of the agreement negotiated by the two secured creditors and to order that the sale proceeds be remitted to CIBC. Alternatively, it seeks an order for BDC to pay all costs, fees and expenses incurred in connection with the realization of the Ohio Racks.

## 1. CONTEXT

[8] BDC is a secured creditor of CADI in the context of the following loans made to its parent company 9220-5749 Quebec inc. (**9220**):

- a) On July 24, 2012, a loan of \$11,360,150 was granted to 9220 (**Loan 059018-02**);
- b) On August 2, 2012, CADI guaranteed all the debts and obligations that 9220 has or might have resulting from the Loan 059018-02;
- c) On the same day, in order to guarantee the payment of its obligations pursuant to the Loan 059018-02, CADI hypothecated in favour of BDC the universality of its movable property (**2012 Hypothec**);
- d) On January 21, 2013, a loan in the amount of \$1,000,000 was granted to 9220 (**Loan 059018-03**);
- e) On February 21, 2013, CADI guaranteed all the debts and obligations that 9220 has or might have resulting from the Loan 059018-03;
- f) On March 12, 2013, in order to guarantee the payment of its obligations pursuant to the Loan 059018-03, CADI hypothecated in favour of BDC the universality of its movable property (**2013 Hypothec**).

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<sup>1</sup> As appears from a summary table prepared by the Trustee using spreadsheets provided by the Debtor's management.

<sup>2</sup> RSC 1985, c B-3.

[9] On June 23, 2015, CIBC provided CADI with short term financing through an asset based lending facility mainly based on CADI's accounts receivables and inventory. Pursuant to the Credit Agreement (D-1), CIBC advanced a commitment of \$30,000,000<sup>3</sup> to be used as working capital and other general corporate purposes of the Debtor.

[10] On that same day, as security for all of its obligations under the Credit Agreement, CADI hypothecated in favour of CIBC the universality of its movable property.

[11] Also, on June 23, 2015, CIBC and BDC entered into an Agreement, to which the Debtor intervened (**Intercreditor Agreement**) whereby the parties determined their respective priorities over the Debtor's movable property subject to their security.

[12] On June 29, 2015, in accordance with the terms of the Intercreditor Agreement, BDC published at the RPMRR a voluntary reduction (**Voluntary Reduction**), pursuant to which BDC released its security on CIBC's Priority Movable Property (as defined in the intercreditor Agreement), including all of the Debtor's "Inventory and all accessories thereto".

[13] On November 28, 2018, Carpet Art Deco filed a NOI and Richter was appointed Trustee under such NOI.

[14] On May 22, 2019, BDC filed the present Motion seeking declaratory relief as well as various other orders in connection with the Ohio Racks.

[15] On May 28, 2019, the Court rendered an order appointing Richter as Receiver to the Debtor's "Property" (as defined in said judgment) and directing that all the sale's proceed of the Ohio Racks be transferred to, and held by Richter pending final determination of the dispute.

[16] On May 29, 2019, the Debtor was deemed to have made an assignment in bankruptcy as a consequence of not having filed a proposal within the delays provided for in the BIA.

## **2. ANALYSIS**

[17] Both parties agree that the Intercreditor Agreement is the primary document which governs the contested issue raised by the present dispute as it determines CIBC and BDC's priorities over the Debtor's movable property as well as the scope of the first ranking charges held by each of these secured creditors.

[18] Pursuant to the Intercreditor Agreement, the parties agreed that BDC would release its security on CIBC's Priority Movable Property such that CIBC would have first-ranking security on such property. The relevant terms are defined as follows:

**a) CIBC's Priority Movable Property** (section 1.8):

collectively, Accounts Receivable, Bank Accounts, Intellectual Property Rights and Inventory and all accessories thereto, including all proceeds, insurance indemnities, resulting rights or revenues related thereto, as well

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<sup>3</sup> As adjusted from time to time.

as all insurance indemnities related thereto and all claims, proceeds or sums relating to the lease, sale or other disposition.

**b) Inventory** (section 1.14):

in respect of the Debtor, all of the Debtor's present and hereafter acquired inventory and property in stock and including all raw materials, merchandise, inventory and goods, and all additions, substitutions and replacements thereof, wherever located, together with all goods and materials used or usable in manufacturing, processing, packaging or shipping same in all stages of production from raw materials through work in process to finished goods, and all "stores" inventory or "operating and maintenance supplies".

[19] BDC pleads that the Ohio Racks constitute equipment because CADI is in the business of selling carpets and the Ohio Racks are in fact used to store carpets and are not sold to its customers. Consequently, the proceeds of the sale of same are covered by its prior ranking hypothecs<sup>4</sup> and should be remitted to it and applied in reduction of the 9220 loans.

[20] In BDC's view, the Ohio Racks meet the CPA Accounting Standards' definition of "Equipment" and cannot be characterized as "Inventory" for the purpose of the lenders' security since they were never sold by CADI in the ordinary course of business.

[21] According to the "CPA Canada Standards and Guidance Collection – Part II Accounting Standards for Private Enterprises – Accounting Standards – Section 3061 "Property, plant and equipment" and Section 3031 "Inventories", the characterization of assets as inventory or equipment is governed by the following principles and definitions:

**Section 3061 "Property, plant and equipment":**

"DEFINITIONS

.03 The following terms are used in this Section with the meanings specified:

(a) **Property, plant and equipment** are identifiable tangible assets that meet all of the following criteria:

(i) are held for use in the production or supply of goods and services, for rental to others, for administrative purposes or for the development, construction, maintenance or repair of other property, plant and equipment;

(ii) have been acquired, constructed or developed with the intention of being used on a continuing basis; and

(iii) are not intended for sale in the ordinary course of business.

[...]"

**Section 3031 "Inventories":**

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<sup>4</sup> 2012 Hypothec and 2013 Hypothec.

## “DEFINITIONS

.07 The following terms are used in this Section with the meanings specified:

(a) **Inventories** are assets:

- (i) Held for sale in the ordinary course of business;
- (ii) in the process of production for such sale; or
- (iii) in the form of materials or supplies to be consumed in the production process or in the rendering of services;

[...]

.09 Inventories encompass goods purchased and held for resale (for example, merchandise purchased by a retailer and held for resale, or land and other property held for resale). Inventories also encompass finished goods produced, or work in progress being produced, by the entity and include materials and supplies awaiting use in the production process.”

[22] CIBC rather views the Ohio Racks as part of CADI’s inventory. It submits that the terms of the Intercreditor Agreement are clear and unambiguous and should be applied by this Court to reflect the common intention of the parties.<sup>5</sup>

[23] In CIBC’s view, the definition of “Inventory” employed in the Intercreditor Agreement is broad enough to include the Ohio Racks.

[24] CIBC also argues that the surrounding circumstances support the interpretation of the words “Inventory and all accessories thereto”, found in section 1.08 of the Intercreditor Agreement, to include the Ohio Racks. In particular, the Debtor:

- (a) treated the Ohio Racks as inventory in its books and records, including on the Inventory List and in its electronic inventory system;
- (b) used the CIBC Facilities, granted for general working capital purposes, to purchase the Ohio Racks over the years;
- (c) accounted for the Ohio Racks as inventory in its annual financial statements;
- (d) reported the Ohio Racks as Inventory.

[25] For the following reasons, the Court is of the view that the Ohio Racks are not part of the CADI’s inventory and should not be considered as “accessories thereto” within the meaning of the Intercreditor Agreement.

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<sup>5</sup> *Pépin v. Pépin*, 2012 QCCA 1661; *Bisignano v. Système électronique Rayco Ltée*, 2014 QCCA 292; *Messageries de presse Benjamin inc. v. Publications TVA inc.*, 2007 QCCA 75 (leave to appeal to SCC denied, 31945, 2007-07-05); *Gregory v. Château Drummond inc.*, 2012 QCCA 601.

[26] The Court heard four witnesses being the Vice President of Operations of CADI, the CFO of CADI, the Trustee and a director in restructuring at the BDC involved with the Debtor's file since September 2018. CADI's CFO was involved with the CIBC's financing and the preparation of the weekly Borrowing Base Reports (**BBR**) pursuant to the Credit Agreement.

[27] None of these witnesses were involved in the negotiations of the Intercreditor Agreement. Therefore, they could not address the issue of the common intention of the parties regarding the definitions stated above.

[28] The evidence showed that the Ohio Racks are a movable racking system used by CADI to store its carpet inventory in anyone of its five warehouses. They are easily moved and stacked and provide a flexible racking system. They can also be moved from one warehouse to another. As opposed to other movable racks used to deliver carpets to the clients, the Ohio Racks are never sold or delivered to CADI's clients with the carpets in the course of its business. They are generally used to unload carpets upon their arrival by trucks or containers and to regroupe them by customers' orders for handling efficiency. They are also used to store raw material as examples, recyclable cardboard boxes and yarn spools.

[29] Therefore, such evidence does not support that the Ohio Racks would be contained within the following terms of the defined Inventory, as argued by CIBC : *"all goods and materials used or usable in manufacturing, processing, packaging or shipping [of the inventory and property in stock] in all stages of production from raw materials through work in process to finished goods"*.

[30] CADI also uses a fixed racking system to store carpets in its warehouses. The fixed racking system is considered by both parties as equipment which fall into BDC's prior ranking hypothecs. CIBC's position to consider the Ohio Racks as "Inventory or accessories thereto" relies on the Debtor's qualification of same in the BBR and in its annual Financial Statements.

[31] The BBR are excel templates provided by the CIBC in execution of the Credit Agreement. CADI's CFO explained that the information provided in these reports comes from their internal inventory and account receivable reports. According to CADI's Vice President of Operations and the CFO, the Ohio Racks were recorded in the company's electronic inventory system to be able to track them in the warehouses. Given the fact that these racks are moved from one warehouse to another, the most efficient manner to know how many they have in each location was to post them in the company's inventory tracking system.

[32] The Ohio Racks were considered by CIBC as ineligible inventory which means that they are excluded from CADI's borrowing base under the Credit Agreement. Indeed, in October 2015, the management of CADI was made aware by CIBC's field examiner that the Ohio Racks must be reported as ineligible inventory as they are used internally and not meant to be sold to customers.

[33] CADI's qualification of the Ohio Racks in the BBR and financial statements does not change the nature of the goods. It is interesting to note that CADI reported the Ohio Racks in the BBR as "Inventory for Internal Use" under the heading "Raw Material". Needless to say that both parties agree that these assets do not constitute raw material.

[34] Up until October 2018, BDC was not made aware of the fact that CADI was reporting the Ohio Racks as inventory in the BBR and financial reports. That information was also not available in the year end audited financial statements.

[35] CADI's representatives were not questioned as to why the Ohio Racks are accounted for as inventory in the financial statements of the company. It seems that no adjustments were made by the auditors with regard to these assets. This situation may be explained by the fact that their value fall within the cumulative material level for adjustments.

[36] CIBC's pretention that CADI purchased the majority of the Ohio Racks with funds available under its operating line of credit is not supported by CADI's CFO's testimony to the effect that CADI had access to a comingle of funds during the period the Ohio Racks were purchased, including BDC loans, capital invested from entities related to the shareholders and cash flow generated by its activities. The Ohio Racks were not taken into consideration in the borrowing base of CADI. As ineligible inventory, they were specifically excluded from the calculation and therefore not directly financed by CIBC. In any event, the source of funds or financing used to purchase the Ohio Racks is not relevant for the qualification of same as equipment or inventory.

[37] Also, the fact that CADI proceeded with a Motion to sell the Ohio Racks outside the ordinary course of business while under the NOI is revealing as of the real nature of these assets.

[38] Lastly, the Court is of the view that CIBC's request for the issuance of an order for BDC to pay all costs, fees and expenses incurred in connexion with the realization of the Ohio Racks is premature at this point in time. In the event of a dispute between the parties in this regard, the Court can deal with it at a later date.

[39] The evidence showed that the Debtor already remitted to CIBC a sum of USD 48,000 pursuant to the sale of Ohio Racks. All other sale's proceeds from Ohio Racks are detained in the Debtor's attorneys trust account or the Trustee's trust account, as agreed by the parties and ordered by this Court.

**WHEREFORE, THE COURT:**

[40] **DECLARES** that the "Ohio Racks" are part of the Debtor's equipment against which BDC has a valid prior ranking security;

[41] **ORDERS** the Debtor to remit to the BDC all the sale's proceeds detained by its attorney in its trust account, from Ohio Racks already sold or to be sold;

[42] **ORDERS** CIBC to remit to BDC the sum of USD 48,000 that was received by the Debtor pursuant to the sale of Ohio Racks;

[43] **ORDERS** to the Trustee to remit to BDC the sale's proceeds of the Ohio Racks detained in his trust account, from Ohio Racks already sold or to be sold;

[44] **THE WHOLE**, with costs.

  
CHANTAL TREMBLAY, J.S.C.

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Hearing dates: June 19 and 25, 2019