FILE NO. AI22-30-09741

IN THE COURT OF APPEAL
IN BANKRUPTCY AND INSOLVENCY

IN THE MATTER OF: THE APPOINTMENT OF A RECEIVER PURSUANT TO SECTION 243 OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C., c.B-3, AS AMENDED, AND SECTION 55 OF *THE COURT OF QUEEN'S BENCH ACT*, C.C.S.M., C. C280, AS AMENDED

BETWEEN:

WHITE OAK COMMERCIAL FINANCE, LLC,

(Applicant) Respondent,

– and –

NYGARD HOLDINGS (USA) LIMITED, NYGARD INC., FASHION VENTURES, INC., NYGARD NY RETAIL, LLC., NYGARD ENTERPRISES LTD., NYGARD PROPERTIES LTD., 4093879 CANADA LTD., 4093887 CANADA LTD., and NYGARD INTERNATIONAL PARTNERSHIP,

(Respondents) Applicants.

SUPPLEMENTAL MOTION BRIEF OF THE (RESPONDENTS) APPLICANTS
Hearing Date: Thursday, April 7, 2022, at 10:00 a.m.

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PART I: AUTHORITIES **TAB**

PART 2: SUPPLEMENTAL ARGUMENT

1. This is a supplemental motion brief to the motion brief of the Applicants filed on March 25, 2022.

2. This brief will supplement the Applicants' argument on the arguable grounds of appeal as it relates to their Notice of Motion to Extend by one day the time for filing the appeal.

Ground of Appeal: Allocation

3. The Court erred in law and made palpable and overriding errors in finding there was a proper allocation as between NIP and NPL in respect of revenues generated from the sale of assets of the receivership.

4. As set out before the lower court (hereinafter "the Court"), the leading decision on the allocation of proceeds in these circumstances is *Re Nortel Networks Corp,*[1] the ratio *decidendi* of which was contrary to the Court's conclusion.

5. In *Re Nortel*, Justice Newbould, (formally head of the Commercial List in Toronto), heard an extended trial respecting the cross-border liquidation of the assets of multiple corporations within the Nortel enterprise, and the proper allocation of those proceeds as among those entities (and thus their creditors). Concerning the proceeds themselves (referred to as the "lockbox funds"), Newbould J. held as follows.

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[1] 2015 ONSC 2987 ("***Re Nortel***") (**Tab 1**), leave to appeal refused 2016 ONCA 332 (**Tab 2**), application for leave to appeal filed (and discontinued) 2016 CarswellOnt 14117 (**Tab 3**)

> *[202] This is an unprecedented case involving insolvencies of many corporations and bankrupt estates in different jurisdictions.* ***The intangible assets that were sold, being by far the largest type of asset sold, were not separately located in any one jurisdiction or owned separately in different jurisdictions. They were created by all of the RPEs*** *[Residual Profit Entities]* ***located in different jurisdictions.*** *Nortel was organized along global product lines and global R&D projects pursuant to a horizontally integrated matrix structure and no one entity or region was able to provide the full line of Nortel products and services.* ***R&D took place in various labs around the world in a collaborative fashion.*** *R&D was organized around a particular project, not particular geographical locations or legal entities, and was managed on a global basis. The fact that Nortel ensured that legal entities were properly created and advised in the various countries in which it operated in order to meet local legal requirements does not mean that Nortel operated a separate business in each country. It did not.*

6. In short, the lockbox funds were the proceeds of the assets of the collective, not of assets belonging to specific entities. This was the fact upon which the allocation decision turned. After observing that the *CCAA* grants the Court a broad jurisdiction to do justice between the parties, Justice Newbould held that the lockbox funds should be distributed *pro rata*, in accordance with the ratio of the respective debts of each estate.

> *[250] The allocation each Debtor Estate will be entitled to receive from the lockbox funds is the percentage that all accepted claims against that Estate bear to the total claims against all Debtor Estates.*

7. Justice Newbould settled on a *pro rata* distribution <u>because</u> the lockbox funds represented the property of the collective.

> *[214] A pro rata allocation in this case would not constitute a substantive consolidation, either actual or deemed, for a number of reasons. First, and most importantly, the lockbox funds are largely due to the sale of IP and* ***no one Debtor Estate has any right to these funds. It cannot be said that these funds in whole or in part belonged to any one Estate or that they constituted separate assets of two or more Estates that would be combined. Put another way, there would be no "wealth transfer"*** *as advocated by the bondholders. The IFSA, made on behalf of 38 Nortel debtor entities in Canada, the U.S. and EMEA, recognized that the funds would be put into a single fund undifferentiated as to the Debtor Estates and*

> *then allocated to them on some basis to be agreed or determined in this litigation. Second, the various entities in the various Estates are not being treated as one entity and the creditors of each entity will not become creditors of a single entity. Each entity remains separate and with its own creditors and its own cash on hand and will be administered separately. The inter-company claims are not eliminated.*
>
> *[…]*
>
> *[222] In considering these factors, it is clear beyond peradventure that* ***Nortel has had significant difficulty in determining the ownership of its principal assets****, namely the $7.3 billion representing the proceeds of the sales of the lines of business and the residual patent portfolio. This amount constitutes over 80% of the total assets of all of the Nortel entities. This issue has taken several years of litigation and untoward costs in the parties attempting to establish an entitlement to it. As the MRDA does not govern how the sales proceeds are to be allocated, there is no one right way to separate them.* ***It cannot be said that there is no question which entity is entitled to the sale proceeds or in what amount. It is clear that these assets are in the language of Dr. Janis Sarra "so intertwined that it is difficult to separate them for purposes of dealing with different entities."***[2]

8. The import of *Re Nortel* is clear: since NPL's real properties were owned by NPL alone, (rather than by a collective), the proceeds of the sales of those properties "*belonged*" to NPL's estate: NPL had a "*right*" to those funds.

9. The Applicants argued before the Court that it may not, therefore allocate those proceeds, in whole or in part, to the estate of another entity, as such would constitute an unjustifiable "*wealth transfer*". Those proceeds certainly cannot be "allocated" to the credit of another estate simply by fiat of the Receiver.

10. In the twelfth report, the Receiver began by presuming that a substantial consolidation order had been made, and that it therefore had discretion to allocate the proceeds of the sale of properties belonging to different legal entities as among those

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[2] Emphasis added

legal entities. The Receiver then used that allocation to declare that NPL did not have rights of subrogation. It used that conclusion to argue that substantial consolidation is appropriate.

11. In other words, and as set out in the Applicants' Motion Brief before the Court, the Receiver's logic was circular. Its argument for substantive consolidation presumed, at its first step, the existence of substantive consolidation and thus the discretion arising therefrom.

12. The Court accepted this entirely. The Honorable Mr. Justice Edmond (hereinafter "the Judge") nowhere questions the Receiver's entitlement to allocate the proceeds of sale of assets belonging to a number of legal entities in a manner which does not respect the separate legal personhood of those distinct corporations, and thus their entitlement to the proceeds from the sales of their own assets.

13. The Judge compounds the error by applying the wrong legal test to his assessment of the Receiver's allocation: at paragraph 59, he observes (correctly) that the "*allocation of costs amongst related corporations is an exercise of discretion and the result must be fair and equitable.*" This is fine, but the allocation of the costs of a multi-party receivership is not at all the same thing as the allocation of the *proceeds from the sales of the assets* of those multi-parties.

14. Throughout the Judge's analysis of the Receiver's allocation, he repeats that the Receiver's allocation is "*fair and equitable*", as if that decides the matter. He later explicitly states, at paragraph 75, "*the legal principles applicable to allocations noted above, apply*

equally to the allocation of costs and the allocation of proceeds of the sale of assets." There is simply no analysis on this point.

15. The issue is not whether the Receiver's allocation was fair and equitable, but (a) whether the Receiver had the discretion to allocate proceeds, not costs, and (b) whether the allocation of the proceeds was available in law, in advance of a substantial consolidation order.

16. Resolving the second issue would require the Judge to explain why it was that (unlike *Re Nortel*, which the Judge simply distinguished on its facts, without commentary on the applicability of the general principles articulated therein) the Receiver could (in the absence of a substantial consolidation order or any other order of the court explicitly giving it this jurisdiction) disregard the separate corporate personhood of NPL and NEL.

17. It is therefore submitted that there are arguable grounds of appeal as it relates to the Judge's decision regarding allocation of proceeds by the Receiver.

Ground of Appeal: Subrogation

18. The Court erred in law and made palpable and overriding errors regarding the NPL's rights of subrogation and the correct interpretation of the provisions of *The Mercantile Law Amendment Act*, CCSM c M120. [3]

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[3] *Mercantile Law Amendment Act*, C.C.S.M. c. M120 (**Tab 4**)

(i) The Law of Subrogation Generally

19. As argued before the Court, due to its payment on its guarantee, NPL is entitled to the Lenders' security to the extent of $28 million, and to stand in the Lenders' place relative to the other respondents. This is due to section 2 of the *Act,* and the jurisprudence surrounding this statute and its counterparts in other provinces.

> *Surety entitled to assignment*
>
> *2. **Every person who, being surety for the debt or duty of another, or being liable with another for any debt or duty, pays the debt or performs the duty, is entitled to have assigned to him**, or to a trustee for him, **every judgment, specialty, or other security that is held by the creditor in respect of the debt or duty**, whether the judgment, specialty, or other security is or is not deemed at law to have been satisfied by the payment of the debt or performance of the duty; **and that person is entitled to stand in the place of the creditor, and to use all the remedies, and, if need be, and upon a proper indemnity, to use the name of the creditor, in any action or other proceeding**, at law or in equity, in order to obtain from the principal debtor, or any co-surety, co-contractor, or co-debtor, as the case may be, indemnification for the advances made and loss sustained by the person who has so paid the debt or performed the duty, and the payment or performance so made by the surety is not pleadable in bar of any such action or other proceeding by him.*[4]

20. The leading Canadian textbook on guarantee, McGuinness' *The Law of Guarantee* (Tab 5), elaborates on the significance of the *Act.*

> *§10.40 [...] Under the present rule **not only is a surety who pays off his principal's debt entitled to a transfer of securities held by the creditor, but he or she is also in all respects entitled to all the equities** which the creditor could have enforced.*
>
> *[...]*
>
> *§10.42 A surety is entitled to stand in place of the creditor, and to use all the remedies and, on proper indemnity, to sue in the name of the creditor in any action or other proceeding in order to obtain from the principal debtor,*

[4] Emphasis added

> *or any co-surety, co-contractor or co-debtor, indemnification for the advances made or loss sustained by such person, and the payment or performance made by him is not a defence to such action or other proceeding by him. However, no co-surety, co-contractor or co-debtor is entitled to recover from any other co-surety, co-contractor or co-debtor more than a just proportion to which, as between themselves, the last mentioned person is justly liable. There is no statutory limit on recovery against the principal, since the principal is obliged to indemnify his sureties in full.*
>
> *[...]*
>
> *§10.44 [...] A surety for a limited amount has in respect of that amount the same rights as the creditor. To the extent of his liability, therefore, the surety is entitled to the benefit of any security held by the creditor in respect of the whole debt.*[5]

21. The leading Canadian textbook on insolvency, *The Annotated Bankruptcy and Insolvency Act (Tab 6)*, by L.W. Houlden, Geoffrey B. Morawetz, and Janis P. Sarra, agrees.

> *If a guarantor pays in full the indebtedness of the principal debtor,* ***the guarantor is entitled to any security held by the principal creditor and becomes a secured creditor.*** *There is no necessity for any formal transfer of the security to the guarantor; the guarantor stands in the place of the creditor [citations omitted].*[6]

22. In *Re Windham Sales Ltd. (Tab 7)*, Justice Henry quoted section 2 of the *Mercantile Law Amendment Act* of Ontario (which is identical to section 2 of the *Act*), and then held:

> *5 The law appears to be well settled that upon implementation of the guarantee in a situation such as that before me* ***the guarantor stands in the place of the original creditor without the necessity of any formal transfer of any security interest to the guarantor****. [citations omitted]*[7]

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[5] Kevin McGuinness, *The Law of Guarantee*, Third Edition, 2013, ("***The Law of Guarantee***"), at §10.40-10.44, pages 722-726, citations omitted, emphasis added (**Tab 2**)

[6] *Annotated Bankruptcy and Insolvency Act*, by L.W. Houlden, Geoffrey B. Morawetz, and Janis P. Sarra at G§59(1), emphasis added (**Tab 3**)

[7] (1979), 31 C.B.R. (N.S.) 130 at paragraph 5, emphasis added (**Tab 4**)

23. In *Alberta Treasury Branches v Weatherlock Canada Ltd.*[8], the Court of Appeal for Alberta held:

> *33* ***That subrogation [of the guarantor to the creditor] gives the paying guarantor every remedy, every security, and every means of payment which the creditor had against the other guarantors.*** *That subrogation is automatic, and does not depend in any way on contracts, such as an assignment [citations omitted].*

24. The Applicants therefore argued before the Court that NPL is legally entitled to an assignment of the Lenders' security over the other respondents' assets, and to stand in the place of the Lenders relative to those respondents, to the extent of those respondents' just liability.

(ii) Subrogation in Receivership

25. Receivership does not change the law of subrogation. The guiding case on this point is *Bank of Montreal v. Ladacor AMS Ltd.*[9], in which the facts were as follows. Three companies ("**Ladacor**", "**Nomads**" and "**236**") were in receivership. Nomads had been an Alberta company which manufactured modular buildings and structures. Ladacor was a wholly-owned subsidiary of Nomads, to which Nomads had effectively (but informally) transferred its entire business enterprise. Nomads also owned 90% of 236, which owned and operated a hotel in Ontario. The Bank of Montreal ("**BMO**") had loaned approximately $4 million to Ladacor. Guarantees of Ladacor's debt to BMO were provided by Nomads, 236 and Nomads' majority shareholder. Eventually, the receivership order was made, and

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[8] 2011 ABCA 314 (**Tab 8**)
[9] 2019 ABQB 985 (**Tab 9**)

the receiver sold the physical assets of Nomads and Ladacor, yielding $682,000. Justice Graesser continued:

> *[24] Since 236 was also put into receivership, the Receiver took steps to sell 236's main asset, the Days Inn Hotel in Sioux Lookout.* ***Of the roughly $5,000,000 sale proceeds, $4,000,000 were paid by the Receiver to BMO****.*
>
> *[25] Ultimately, the time of the Fourth Report, the Receiver had paid off the secured debt to BMO, the Receiver's borrowings from BMO to enable it to carry on the Receivership, the WEPP claims, CRA and Service Canada trust/priority claims, along with its and its lawyer's fees and disbursements.*
>
> *[26] The supplemental report and Fifth Report update the figures. As at the time of that report, October 25, the Receiver was holding $10,398 for Nomads, $722,661 for Ladacor, and $637,241 for 236.* ***The Receiver proposes to allocate all of the available proceeds currently in Ladacor's and Nomads' accounts to 236.***

26. Concerning 236's position, Justice Graesser held as follows:

> *46 BMO was a secured creditor, subject only to the superior WEPP claims and CRA source deduction claims, and the costs of the receivership.* ***The Receiver argues on this application that guarantors (such as Nomads and 236) are entitled to be subrogated to the claims they have paid out on behalf of the principal debtor, Ladacor.***
>
> *47 In this case, Nomads and 236 have paid off BMO's claims against Ladacor. Nomads and 236 are entitled to be subrogated to BMO's claim, and to stand in BMO's shoes with respect to any security BMO held against Ladacor.* ***That means, according to the Receiver, that Nomads and 236 are now the primary secured creditors on any of Ladacor's remaining assets.***
>
> *48 Additionally, as between guarantors who have paid out on their guarantees, Nomads and 236 are entitled to be treated proportionately, so the debt paid off should be apportioned between them. Where guarantors are equally liable to the obligee, the guarantors are considered to be responsible for equal shares of the debt.*
>
> *49 Here, that would mean that each of Nomads and 236 should have paid off half of the debt owed to BMO.* ***Since 236 paid more than half of the BMO debt, there should be an adjustment as between Nomads and 236, in 236's favor****.*

> *50 The way the Receiver has accounted for this is that the excess of collections over required payments has left a surplus, some of which now stands to the credit of Ladacor.* ***Because 236 paid more than its half of the obligation, 236 is entitled to recover that excess from Ladacor****.*
>
> *51 Of the $5,834,882 paid to satisfy BMO's claims, $4,000,000 came from 236. The remainder came from Nomads. Because of contribution principles between guarantors, each of the guarantors should have paid $2,917,441. 266 overcontributed by $1,082,559. That amount is owed to it by Nomads.*
>
> *[...]*
>
> *53 This analysis and position is well supported by the Receiver's first brief for this application [citations omitted]*
>
> *[...]*
>
> *55 I am satisfied that for the purposes of finalizing the Receivership accounts,* ***the monies the Receiver holds to the account of Ladacor and Nomads should be transferred to 236's account as a function of a guarantor's right to subrogation and to contribution rights and obligations as between co-guarantors****.*[10]

27. Like the receiver in *Ladacor*, the Receiver should have understood that NPL's payment of $28.59 million toward the debt owed by the Borrowers to the Lenders gave NPL subrogated claims, which claims are in the nature of secured claims, against the Borrowers and the Unlimited Guarantors. Like the receiver in *Ladacor*, the Receiver should have asked this Court for an order compensating NPL in respect of those subrogated claims.

28. The Judge compounds his errors regarding allocation by accepting without question the Receiver's distinction between payments on the Receiver's Borrowing Charge and payments toward the Credit Facility.

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[10] Emphasis added

29. In its second supplementary twelfth report, the Receiver took the position that the dates of the payments meant that none of the proceeds from NPL's properties were used to satisfy amounts owed under the Credit Facility, but instead were used to make payments towards the Receiver's Borrowing Charge. The Applicants made two arguments before the Court against this position.

30. The first was that the distinction between "*payments to the Credit Facility*" and "*payments of the Receiver's Borrowing Charge*" was irrelevant. The analysis must proceed on the basis of the Guarantee and the Credit Facility. For the reasons set out in the Applicants' Reply Motion Brief at great length, the Guarantee obligated NPL to repay "*Obligations*", which obligations included enforcement costs, which enforcement costs explicitly included Receiver's fees and its borrowings. Therefore, the payment of NPL proceeds to the Receiver's Borrowing Charge were payments pursuant to the Guarantee, and entitled NPL to rights of subrogation according to the Act.

31. Further, if the distinction between payments on the Credit Facility and payments on the Receiver's Borrowing Charge were relevant (which is denied) the Credit Facility required that payment of the Receiver's Borrowings be paid ahead of payments of the amounts due to the lenders. Exactly the opposite occurred in this case, which means that the Receiver *prima facie* breached the terms of the Credit Agreement. If they had observed the terms of the Credit Agreement, the Receiver's Borrowing Charge would have been paid off by the time the NPL properties were sold, and therefore the proceeds of the NPL properties all would have been paid toward the repayment of the Credit Facility.

32. All this was put to the Judge in writing and orally, but he simply does not address any of it. The Judge acknowledges that NPL had challenged the Receiver's assertions (see paragraphs 87 and 88) and agrees (in paragraph 90) that "*NPL guaranteed the repayment of Borrowers' obligations, which included "fees, costs, expenses and indemnities that accrue after the commencement by or against any loan party or any affiliate thereof of any proceeding under any Debtor relief laws.*"" However, the Judge does not assign any significance to that fact, instead spending the rest of this section (paragraph 91 through paragraph 98) on the issue of whether the Guarantee was limited to $20 million inclusive of costs enforcement or $20 million plus costs and enforcement. This was a relevant issue, but it is not the issue that was of importance to the court at that time: that issue was whether, and in what amount, NPL had made payments on its Guarantee. This issue is nowhere decided.

33. The Judge does not find as fact how much NPL paid towards its Guarantee, and whether all of its payments were payments under its Guarantee. If they were not payments under the Guarantee, as suggested by the Receiver, then there is no explanation of what those payments were, in law. On what legal basis could NPL be required to pay down the Receiver's Borrowing Charge, if those payments were not payments towards its Guarantee? Was it simply on the basis of the Receivership Order? If so, the Receivership Order was in effect a judgment for tens of millions of dollars against NPL at the outset of the proceeding. How does the court have jurisdiction to do that?

34. In paragraph 113, the Judge states that "*As previously stated, I do not accept that the entire amount of $28,579 million was paid to the Lenders pursuant to the Credit Facility.*" If so, how much was paid pursuant to the Credit Facility? Why is payment

"*pursuant to the Credit Facility*" relevant, and why did the court not conduct its analysis on the basis of the payment of obligations, having agreed that that is what we were to pay? In paragraph 117, the Judge says "*The entire amount of proceeds received from the sale of NPL's properties was not paid to the Lenders to satisfy the Borrowers' obligations.*" But the Judge does not give any reasons for concluding that payment of the Receiver's Borrowings would not be payment of the obligation, given the terms of the Credit Facility.

35. Paragraph 122 is a clear error in law because the Judge concludes that "*even if some of the Net Receivership Proceeds should be allocated to NPL, those funds are subject to claims of NPL's creditors which, in all probability, exceed the proceeds available to satisfy those claims.*" This misstates the legal factors here. As the Judge stated at paragraphs 103 - 104, "*once a surety or a guarantor makes payment of a Borrower's debt, that person or entity becomes subrogated to the rights of the creditor as against the Borrower and any co-guarantor or surety … A claim against a Co-Guarantor is limited to the proportion of the total debt for which each Co-Guarantor is justly liable.*"

36. The Ontario Court of Appeal has established that there is no available set off against the subrogated claim, because the claims were not in the same right (i.e., NPL is making a claim having stepped into White Oak's shoes, and NIP cannot set off a claim against NPL a right originating with White Oak). Further, we argued that the intercompany debts were part of the security assigned to White Oak and therefore by stepping into White Oak's shoes NPL assumed the right to enforce those debts (or conceptually to forgive them). Again, this is nowhere addressed by the Judge.

Ground of Appeal: Consolidation

37. The Court erred in law and made palpable and overriding errors in its order of substantive consolidation.

(i) Substantive Consolidation Generally

38. In a substantive consolidation, a number of affiliated legal entities, typically corporations, are treated as if they were one entity, resulting in the assets of the various debtors being pooled to create a common fund out of which claims of creditors of all the debtors are jointly satisfied:[11] *"[i]n effect, under substantive consolidation, claims of creditors against separate debtors instantly become claims against a single entity."*[12]

39. NPL and NEL should not have been subject to a consolidation order. NPL is asset rich: it has a secured claim against the Borrowers, and a secured claim against the Unlimited Guarantors for contribution. Depending on the accounting, it may have millions in cash to its credit. The Receiver conceded that NPL is solvent.[13] NEL owns NPL.

40. It is *because* NPL is solvent, asset-rich and a secured creditor of other respondents that the Receiver wants to make it subject to a consolidation order. The Receiver wants access to NPL's assets and the extinguishment of NPL's rights so that NIP's unsecured creditors can receive a better return. (NPL has not, of course, guaranteed payment of NIP's unsecured debt.[14]) The Receiver has been frank about this:

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[11] *Re Redstone Investment Corp. (Receiver of)* 2016 ONSC 4453 ("***Re Redstone***") at paragraph 7 (**Tab 10**)
[12] *Re Nortel* at paragraph 213 (**Tab 1**)
[13] Receiver's Brief at paragraph 50(b)
[14] General Order, April 29, 2020 at provisions 2 – 3

> ***[I]f assets and liabilities of each Debtor are treated separately the remaining assets of NPL would not be available to pay (e.g.) employees of NIP who have unsecured claims*** *for unpaid employment amounts, but would only be available to pay unsecured creditors, if any, of NPL. […] In the result, overwhelmingly the unsecured creditors affected by these proceedings…will have debts owed "directly" to them by NIP or Nygard Inc.*[15]
>
> *…employees, landlords, suppliers and other vendors, gift card purchasers, and taxing authorities who are owed debts by NIP, NI and other Debtors* ***(not including NPL)*** *are economically advantaged by substantive consolidation..."*[16]

41. One of the primary reasons that US and Canadian Courts have made substantive consolidation an extraordinary remedy is that they are loath to badly prejudice a particular creditor in order to increase the return for others. In the guiding Canadian case on substantive consolidation, *Re Redstone Investment Corp. (Receiver of)*[17], G.P. Morawetz J. (now Chief Justice of the Ontario Superior Court) conducted a lengthy analysis of the jurisprudence, and observed that in two prior cases in which consolidation had been ordered, *"the court in each decision explicitly noted that consolidation would not be to the prejudice or expense of a particular creditor."* Similar statements (as in *"[a]lthough expediency is an appropriate consideration it should not be done at the potential prejudice or expense of any particular creditor*") are made in the authorities relied upon by the Receiver.[18]

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[15] Ninth Report at paragraph 120, page 36, emphasis added
[16] Receiver's Brief at paragraph 43(b), emphasis added
[17] *Re Redstone* at paragraph 74 (**Tab 10**)
[18] *Bacic v Millennium Educational* 2014 ONSC 5875 at paragraph 112 (**Tab 11**); *Ashley v Marlow Group* 2006 CanLII 31307at paragraph 78 (**Tab 12**); *JP Capital Corp. (Re)* (1995), 31 C.B.R. (3d) 102 at paragraph 18 (**Tab 13**)

42. Accordingly, in refusing to order consolidation in *Re Redstone*, Justice Morawetz held:

> *[86] [...] In this case,* ***substantive consolidation eliminates the secured inter-company receivable, while it is the only material asset of RCC****. The result is, therefore, from an objective standpoint, extremely prejudicial to the RCC Investors [...]*
>
> *[88] As Trainer J. explained in Northland, "****it would be improper for the court to interfere with or appear to interfere with the rights of the creditors****," and that such an appearance would be created if the estates are ordered merged for all purposes. This caution rings true in this case. [...]*
>
> *[90] In this case, I have concluded that it is not appropriate to invoke this extraordinary remedy. The assets are held separately and audited financial statements exist for RIC and RCC. The governing loan documents clearly set out that the corporations are separate and that the obligations of RIC to RCC are subject to a GSA. Referencing Northland, the "elements of consolidation" are not present.* ***Furthermore, there would also be significant financial prejudice to creditors of RCC if substantive consolidation were ordered****.*[19]

43. The facts before Justice Morawetz are in this respect very similar to the facts that were before the Court: one creditor (NPL here, the RCC Investors in *Re Redstone*) has a secured claim that would be eliminated by a consolidation order, and this *by itself* militates against the making of the order sought. The additional factor in this case is that the Receiver's sales of NPL's real properties have created a tax obligation for NPL, which obligation has not been satisfied by the Receiver. As a result, the Receiver is forced to concede that "*CRA and perhaps other direct unsecured creditors of NPL, if any, are economically prejudiced by substantive consolidation...*"

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[19] Emphasis added

44. In short, by selling NPL's properties, the Receiver has paid off the Lenders and created an NPL creditor in CRA. The Receiver now proposes to extinguish the rights granted by statute to NPL as a result of those payments, and to all-but-extinguish CRA's rights against NPL. It proposes to do this for the benefit of NIP's unsecured creditors. This is obviously inequitable.

45. Furthermore, the Receiver cannot, in respect of NPL and NEL, pass any aspects of the legal test for consolidation.

(ii) The Balance of the Test

46. Having completed his review of the law, Justice Morawetz held as follows.

> *78 The following general principles respecting the doctrine of substantive consolidation represent a summary of Canadian case law:*
>
> *(i) Are the elements of consolidation present, such as the intertwining of corporate functions and other commonalities across the group?*
>
> *(ii) Do the benefits of consolidation outweigh the prejudice to particular creditors?*
>
> *(iii) Is consolidation fair and reasonable in the circumstances?*

47. With respect to the aforementioned "elements of consolidation", the factors are as follows.

> *(i) difficulty in segregating assets;*
>
> *(ii) presence of consolidated financial statements;*
>
> *(iii) profitability of consolidation at a single location;*
>
> *(iv) co-mingling of assets and business functions;*

(v) unity of interests in ownership;

(vi) existence of inter-corporate loan guarantees; and

(vii) transfer of assets without observing corporate formalities.[20]

48. The test articulated by Justice Morawetz has not been met in the within case:

(i) The elements of consolidation are not present.

a. There is no difficulty in segregating NPL's assets from those of the other respondents. Its assets consist of the realty and its proceeds. Most of the proceeds were paid to the Lenders, leaving a balance in the hands of the Receiver.[21] NEL's assets consist only of the shares in NPL.[22]

b. NPL and NEL each had their own financial statement. Their financials were <u>not</u> part of the consolidated financial statement of the other respondents.[23]

c. NPL is a real-estate holding company, and did not conduct an active business. NEL is a holding company that does not conduct an active business.[24] There is, thus, no "single location" at which their business could be consolidated.

d. NPL's assets and business functions (real property and the holding of real property) had not been co-mingled with those

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[20] *Re Redstone* at paragraph 47 and 79-85 (**Tab 10**)

[21] Ninth Report at paragraph 11, page 3; Order of this Honourable Court dated August 10, 2020; Ninth Report, at paragraph 9, page 3; Order of this Honourable Court dated June 30, 2020; Twelfth Report, at paragraphs 14 and 20, pages 4-5; Twelfth Report, at paragraph 21, page 5; Twelfth Report, at page 36, "Nygard Group – Separate Corporation Analysis"; Twelfth Report, at paragraph 82, page 27, "Distribution to Lenders"

[22] Affidavit of Robert Dean affirmed March 9, 2020 at paragraph 32(e)

[23] Affidavit of Greg Fenske sworn November 5, 2020, at paragraphs 15 - 17

[24] Affidavit of Robert Dean affirmed March 9, 2020 at paragraph 32(a) and (e), Affidavit of Greg Fenske sworn November 5, 2020, at paragraphs 15 - 17

of the other respondents. The Credit Agreement distinguished between the respondents and their respective liabilities to the Lenders.

e. There is no "unity" of ownership. NPL is owned by NEL, which does not directly own any of the other respondents, save 879.[25]

f. NPL's intercorporate loan guarantee has been satisfied. It does not have any outstanding guarantees of the other respondents' debts.[26] NEL did not guarantee the debts of the other respondents. [Of course, the effect of the Judge's consolidation order is equivalent to NPL having guaranteed the debts of the other respondents].

g. There have been no transfers of assets to or from NPL without corporate formalities.

(ii) NPL (which is subrogated to the Lender's rights) is a secured creditor of the Unlimited Guarantors and a secured creditor of the Borrowers. There can be no argument that NPL will not be seriously prejudiced by an order for consolidation.

(iii) In these circumstances, the answer to Justice Morawetz' third question, (Is consolidation fair and reasonable on all of the circumstances?), must be no. The assets of the respondents should not be substantively consolidated in order to benefit the unsecured creditors of NIP at the expense of NPL, NIP's secured creditor, and NPL's owner, NEL.

49. The Receiver attempted to buttress its argument by citing a series of decisions respecting the "common employer" doctrine. The doctrine is irrelevant to this matter: the

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[25] Affidavit of Robert Dean affirmed March 9, 2020 at paragraph 30
[26] General Order, April 29, 2020 at provisions 2 – 3

Ontario Court of Appeal has made clear, in a case relied upon by the Receiver, that the doctrine applies only "*in the realm of employment law*".[27]

50. The result before the Court should have been the exclusion of NPL and NEL from the order for substantive consolidation or, stated differently, the dismissal of the motion as against NPL and NEL.

51. Regarding specific references to the Judgment itself, the Applicants submit:

a. Paragraph 26(f): the Judge relies on a single individual having effective control. However, as set out in *Redstone*, this is not enough. The Judge departed from *Redstone's* principle without affording any reason for doing so.

b. Paragraphs 30-31: the Judge made a legal error by misdirecting himself. The Judge should have decided whether NPL was subrogated to the Lenders' security before moving on to the substantive consolidation test. As the Lenders' subrogee, consolidation is clearly inappropriate. Further, the statement "I am in substantial agreement with the 12th report" is an example of the Judge not giving any or adequate reasons for decisions he made.

c. Paragraph 32(a): the Judge misdirects himself. Even if NIP has a debt claim against NPL, that does not mean that NIP's assets are legally "commingled" with NPL's assets. The Judge also failed to consider (a)

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[27] *Downtown Eatery (1993) Ltd. v Ontario*, (2001) 54 O.R. (3d) 161 (C.A.) at paragraph 36; see also paragraphs 30-31 (**Tab 14**)

terms of the lease (which obliged NIP to improve the properties) and (b) that some of the properties (Falcon Lake) are not in receivership.

d. Paragraph 33(b): the Judge did not properly consider the absence of consolidated statements as a significant factor weighing against consolidation.

e. Paragraph 34(c): there was no NPL business to consolidate: it owned real property, all of which had been sold. The active business was done by the other respondents.

f. Paragraph 35(d) – 36: most or all of this was also present in *Redstone*, (see para. 56 and 58) but the Judge's conclusions do not follow. At paragraph 77 of *Redstone*, Morawetz J cautions against imposing a consolidation order that avoids the priority arrangement created by contract. If the Judge had done the subrogation analysis first, as he should have, then NPL would have assumed White Oak's rights and a consolidation order would not be available.

g. Paragraph 37(e): The Judge states that "the evidence satisfies me that…" What evidence? This is not a sufficient reason. This "directly or indirectly controlled" argument was rejected in *Redstone* at para. 83.

h. Paragraph 38(f): The Judge conflates "intercorporate loan guarantees" (of which there are none) with intercompany loans – which is not the same thing. This is a clear legal error.

i. Paragraph 43(b): the prejudice if NPL is secured is patently clear.

j. Paragraph 44: there is no material or legal difference between a third-party creditor and a party that has stepped into the shoes of a third-party creditor.

52. Based on the law and argument as set out above, the Applicants submit that the Judge's order for substantive consolidation is incorrect.

53. The Applicants submit that all five questions in the test can be answered in the affirmative and therefore the motion to extend the time for filing the Notice of Appeal by one day should be granted.

Ground of Appeal: Legal Fees to Criminal Defence Counsel

54. The Court misdirected itself in disallowing NPL from using its money to pay the fees of the criminal defence counsel for Peter Nygard.

55. As submitted before the Court, it is the position of NPL that because Peter Nygard is the ultimate owner of NPL, it is in NPL's best interests that Peter Nygard be acquitted.

56. If Peter Nygard is convicted, NPL's assets would likely be used to pay a judgment obtained by anyone who is successful in the prosecution of a civil claim after a successful criminal prosecution against Peter Nygard. Further, NPL may be added to the criminal proceedings and the work done in defence of Peter Nygard could be useful to NPL (as set out in the Affidavit of Brian Greenspan, affirmed December 9, 2021).

57. The Applicants submit that the Court made palpable and overriding errors regarding NPL's request to indemnify Mr. Nygard for legal costs incurred to defend his criminal charges. The Applicants submit that the Court misdirected itself (at paragraphs 150-151) regarding the best interests of NPL to defend against the criminal allegations

and the application of the case law regarding indemnification. The Applicants submit that based on the law as set out before the Court, the Court should have allowed for the requested indemnification.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 1st DAY OF APRIL, 2022.

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2015 ONSC 2987
Ontario Superior Court of Justice [Commercial List]

Nortel Networks Corp., Re

2015 CarswellOnt 7072, 2015 ONSC 2987, [2015] O.J. No. 2440, 254 A.C.W.S. (3d) 522, 27 C.B.R. (6th) 175

In the Matter of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. c-36, as Amended

In the Matter of a Plan of Compromise or Arrangement of Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation Application under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as Amended

Newbould J.

Heard: May 12-15, 20-22, 27-30, 2014; June 2, 5, 6, 16-20, 23-24, 2014; September 22-24, 2014
Judgment: May 12, 2015
Docket: 09-CL-7950

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Kenneth David Kraft, Karen B. Dine, John Salmas, David Crichlow for Wilmington Trust, National Association, Trustee
Brett Harrison for Bank of New York Mellon, Trustee
John D. Marshall for Law Debenture Trust Company of New York, Trustee

Subject: Contracts; Estates and Trusts; Evidence; Insolvency; Intellectual Property; International; Property
Related Abridgment Classifications
Contracts
VII Construction and interpretation
VII.11 Miscellaneous
Headnote
Bankruptcy and insolvency --- Administration of estate — Sale of assets — Miscellaneous
Distribution of proceeds — Telecommunications corporation with numerous world-wide subsidiaries commenced bankruptcy and insolvency proceedings — At issue was allocation among debtors of proceeds from sale of assets, primarily intellectual property — Master Research and Development Agreement ("MRDA"), which provided for payment of residual profits to certain entities, did not govern allocation — MRDA was driven by transfer pricing concepts, drafted for tax purposes and not intended

to deal with rights after company stopped operating — In unique circumstances of case, it was just to allocate proceeds on pro rata basis — Funds to be directed to each debtor estate based on percentage that claims against that estate bore to total claims against all debtor estates.

Contracts --- Construction and interpretation — Miscellaneous

Telecommunications corporation with numerous world-wide subsidiaries commenced bankruptcy and insolvency proceedings — At issue was allocation among debtors of proceeds from sale of assets, primarily intellectual property — Master Research and Development Agreement ("MRDA"), which provided for payment of residual profits to certain entities, did not govern allocation — MRDA was driven by transfer pricing concepts, drafted for tax purposes and not intended to deal with rights after company stopped operating — In unique circumstances of case, it was just to allocate proceeds on pro rata basis — Funds to be directed to each debtor estate based on percentage that claims against that estate bore to total claims against all debtor estates.

The insolvent corporation was a publicly-traded global networking solutions and telecommunications company, with numerous subsidiaries around the world. NNL, a direct subsidiary of the parent corporation, was the Canadian operating company, which in turn owned 100 per cent of the equity in NNI, the U.S. operating company. Because research and development was the primary driver of the corporation's value and profit, the residual profits were paid to entities ("RPEs") pursuant to a Master Research and Development Agreement ("MRDA"), in accordance with a specified sharing method. Under the MRDA, NNL was the legal owner of the corporation's intellectual property ("IP") and each other RPE was granted an exclusive license by NNL to make and sell products in its territory using or embodying the IP and a non-exclusive license to do so in territories not exclusive to an RPE.

The corporation decided to commence bankruptcy and insolvency proceedings. NNL and the other Canadian debtors filed for protection under the Companies' Creditors Arrangement Act. After sales of the corporation's business lines and residual IP, $7.3 billion ("the lockbox funds") were held in escrow. At issue was how to allocate the lockbox funds among the Canadian, U.S. and Europe, Middle East and Africa ("EMEA") debtors. The differences in the parties' positions arose from the different manner in which each characterized the terms of the MRDA, the interests held by the parties in the IP and the applicability of the terms of the MRDA to the value ascribed to various assets. The trial was held jointly with the U.S. Bankruptcy Court for the District of Delaware, pursuant to a Cross-Border Insolvency Protocol.

Held: Order accordingly.

The MRDA did not govern the allocation of the lockbox funds. The U.S. debtors' attempt to parse the language of the grant of license in the MRDA was unpersuasive. There was only one license and its words had to be read harmoniously. When the MRDA was being considered, the company was not in the business of licensing its services to others for the business of others; it was providing a service to its customers to support the technology being acquired by its customers. The MRDA had to be read in that context. Under the MRDA, while the company operated as a going concern business, NNL had all ownership interests of the IP, subject to: (i) the grant to each licensed participant of a non-exclusive right to assert actions and recover damages in their territory; and (ii) the grant of exclusive and non-exclusive licenses to the licensed participants, which were not licenses of all rights, but were subject to field of use restrictions that gave the licensed participants the right to use the IP to make, use or sell products, as defined in the MRDA. This meant products, software or services that were made or sold by, or for, any of the licensed participants. No product that was part of a third party's business, rather than the corporation's business, fell within the definition of "products".

The MRDA was an operating agreement and was never intended to provide an answer to the question of how to allocate among the bankrupt estates the proceeds of the sale of assets following the world-wide insolvency of the corporation. The MRDA and its predecessor agreements were developed for and driven by transfer pricing concepts and drafted for tax purposes. The construct of legal title to the IP being in NNL in return for NNL granting exclusive licenses to the licensed participants was only for the purpose of supporting the proposed method to split profits or losses on a tax efficient basis while the company operated as a going concern business. The MRDA was intended to apply only to the company while it operated, not to deal with rights after it and its subsidiaries stopped operating their businesses. The position of the EMEA debtors, that the proceeds of sale of the IP assets should be allocated according to a theory of joint ownership of the IP, should also be rejected.

NNL would be unjustly enriched by being entitled to all the proceeds of sale at the expense of the other RPEs who contributed to the creation of the IP, just because the patents were registered in NNL's name. It would also unjustly enrich NNI if it were to be allocated the amount from the IP sales that it claimed based principally on its revenues. NNI was able to sell the company's products based on the research and development and resulting IP performed by other RPEs. This was an unprecedented

case in which the intangible assets that were sold were not separately located in any one jurisdiction or owned separately in different jurisdiction. They were created by all of the RPEs located in different jurisdictions. Research and development was organized around a particular project, not particular geographical locations or legal entities, and was managed on a global basis. The company's matrix structure allowed it to draw on employees from different functional disciplines worldwide. In these circumstances, it was just to allocate the sale proceeds on a pro rata basis. An allocation of the lockbox funds should be directed to each debtor estate based on the percentage that the claims against that estate bore to the total claims against all of the debtor estates. A pro rata allocation in this case would not constitute an impermissible substantive consolidation, either actual or deemed, nor unduly prejudice bondholders who held bonds with covenants of both NNL and NNI.

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TRIAL to determine allocation of proceeds of sale of assets of insolvent corporation in proceedings under *Companies' Creditors Arrangement Act*.

***Newbould J.*:**

Prologue

1 Until January 14, 2009, Nortel Networks Corporation ("NNC") was a publicly-traded Canadian company and the direct or indirect parent of more than 130 subsidiaries located in more than 100 countries, collectively known as the "Nortel Group" or "Nortel". It operated a global networking solutions and telecommunications business.

2 On January 14, 2009 most of the Nortel entities filed for bankruptcy protection. In Canada, the Canadian incorporated entities (the "Canadian Debtors") filed under the *Companies' Creditors Arrangement Act* ("CCAA"). In the United States, most of the U.S. incorporated entities (the "U.S. Debtors") filed under chapter 11 of the *U.S. Bankruptcy Code*. In England, most of the entities incorporated in Europe, the Middle East and Africa (the "EMEA [1] Debtors") were granted administration orders under the *UK Insolvency Act, 1986*.

3 The initial intent of Nortel was to downsize and carry on those portions of its telecommunications business that it thought could be profitable. However that plan quickly evaporated and in June, 2009 Nortel decided to liquidate its assets. It sold its business lines for approximately $3.285 [2] billion of which approximately $2.85 billion is now available to be allocated. It then sold its residual intellectual property for $4.5 billion. These amounts totalling $7.3 billion are held in escrow (the "lockbox funds"). At issue in these proceedings is how to allocate the $7.3 billion among the Canadian Debtors, the U.S. Debtors and the EMEA Debtors.

4 The trial in this case was unique. It was a joint trial of the Ontario Superior Court of Justice (Commercial List) and the U.S. Bankruptcy Court for the District of Delaware [3] . It arose from the arrangements made by the parties as part of the process of selling assets, and from a Cross-border Insolvency Protocol (the "Protocol"). In short:

> (i) The parties agreed in an Interim Funding and Settlement Agreement before any of the Nortel assets were sold to put the proceeds of sale into escrow and then attempt to agree on a protocol for resolving how the proceeds were to be allocated. If no agreement was reached, the issues were to be tried by the Ontario and U.S. Courts pursuant to the Protocol.

(ii) The parties could not agree on the allocation, nor could they agree on a protocol process. By orders of the Ontario and U.S. Courts, the allocation was directed to be determined in a joint trial pursuant to the Protocol. The EMEA Debtors were held to have attorned to the jurisdiction of these courts in the escrow agreements made with respect to the proceeds of the several sales that had occurred. [4]

5 The Protocol was approved early in the CCAA and chapter 15 proceedings by orders the Ontario and U.S. Courts. [5] This type of protocol has become standard in the last number of years to govern the administration of cross-border insolvency proceedings. The Protocol included it its purposes:

> Accordingly, this Protocol has been developed to promote the following mutually desirable goals and objectives in the Insolvency Proceedings:
>
> (a) harmonize and coordinate activities in the Insolvency Proceedings before the Courts;
>
> (b) promote the orderly and efficient administration of the Insolvency Proceedings to, among other things, maximize the efficiency of the Insolvency Proceedings, reduce the costs associated therewith and avoid duplication of effort;
>
> (c) honor the independence and integrity of the Courts and other courts and tribunals of the United States and Canada, respectively;
>
> (d) promote international cooperation and respect for comity among the Courts, the Debtors, the Creditors Committee, the Estate Representatives (which include the Chapter 11 Representatives and the Canadian Representatives as such terms are defined below) and other creditors and interested parties in the Insolvency Proceedings;
>
> (e) facilitate the fair, open and efficient administration of the Insolvency Proceedings for the benefit of all of the Debtors' creditors and other interested parties, wherever located; and
>
> (f) implement a framework of general principles to address basic administrative issues arising out of the cross-border nature of the Insolvency Proceedings.

6 The Protocol contained a number of provisions regarding the independence of the Canadian and U.S. Courts and the exclusive jurisdiction of each Court in the determination of matters arising in the Canadian and U.S. proceedings respectively. Included in the Protocol were the following provisions:

> 7. The approval and implementation of this Protocol shall not divest nor diminish the U.S. Court's and the Canadian Court's respective independent jurisdiction over the subject matter of the U.S. Proceedings and the Canadian Proceedings, respectively...
>
> 8. The U.S. Court shall have sole and exclusive jurisdiction and power over the conduct of the U.S. Proceedings and the hearing and determination of matters arising in the U.S. Proceedings. The Canadian Court shall have sole and exclusive jurisdiction and power over the conduct of the Canadian Proceedings and the hearing and determination of matters arising in the Canadian Proceedings.

7 The Protocol provided in paragraph 12 for the harmonization and co-ordination of the administration of the two proceedings in Canada, including the holding of joint hearings of the two Courts and providing for discussions between the two judges. Included were the following:

> 12. To harmonize and coordinate the administration of the Insolvency Proceedings, the U.S. Court and the Canadian Court each may coordinate activities and consider whether it is appropriate to defer to the judgment of the other Court. In furtherance of the foregoing:

> (a) The U.S. Court and the Canadian Court may communicate with one another, with or without counsel present, with respect to any procedural matter relating to the Insolvency Proceedings.
>
> . . .
>
> (d) The U.S. Court and the Canadian Court may conduct joint hearings (each a "Joint Hearing") with respect to any cross-border matter or the interpretation or implementation of this Protocol where both the U.S. Court and the Canadian Court consider such a Joint Hearing to be necessary or advisable, or as otherwise provided herein, to, among other things, facilitate or coordinate proper and efficient conduct of the Insolvency Proceedings or the resolution of any particular issue in the Insolvency Proceedings. With respect to any Joint Hearing, unless otherwise ordered, the following procedures will be followed:
>
> > (vi) The Judge of the U.S. Court and the Justice of the Canadian Court, shall be entitled to communicate with each other during or after any joint hearing, with or without counsel present, for the purposes of (1) determining whether consistent rulings can be made by both Courts; (2) coordinating the terms upon of the Courts' respective rulings; and (3) addressing any other procedural or administrative matters.

8 A joint hearing was held for this allocation dispute. The court rooms in Toronto and Wilmington were set up electronically so that lawyers and witnesses could and did appear in either courtroom and communicate with a lawyer, witness or the judge in the other courtroom through state of the art telecommunications services.

9 After the evidence was heard, written closing and reply briefs were filed by the parties and oral argument was made. It was agreed that at the conclusion of the case that each Court would release its decision at the same time. This judgment is being released at the same time as the opinion of Judge Gross in Wilmington.

10 Judge Gross in Wilmington and I have communicated with each other in accordance with the Protocol with a view to determining whether consistent rulings can be made by both Courts. We have come to the conclusion that a consistent ruling can and should be made by both Courts. We have come to this conclusion in the exercise of our independent and exclusive jurisdiction in each of our jurisdictions. These insolvency proceedings have now lasted over six years at unimaginable expense and they should if at all possible come to a final resolution. It is in all of the parties' interests for that to occur. Consistent decisions that we both agree with will facilitate such a resolution.

Nortel history and its matrix structure

11 NNC was the successor to a long line of technology companies headquartered in Canada dating back to the founding of Bell Telephone Company of Canada in 1883. Prior to being named Nortel, it was known as Northern Telecom. NNC's principal, direct operating subsidiary, also a Canadian company, was Nortel Networks Limited ("NNL"), which in turn was the direct or indirect parent of operating companies located around the world. [6]

12 From the mid-1980s, Nortel expanded substantially through the continued development of ground-breaking technology. The Nortel Group moved from developing and manufacturing traditional landline phone technology and equipment into digital, wireless and photonic technologies. At the same time, the Nortel Group expanded into Europe, Asia, Africa, the Middle East and Latin America.

13 At the time of its insolvency, Nortel had four main product groups (also known as Lines of Business):

- The "Carrier Networks" segment provided wireless networking solutions that enabled service providers and cable operators to supply mobile voice, data and multimedia communications to individuals and enterprises using mobile phone and other wireless devices. The Carrier Networks business also offered products providing local, toll, long distance and international gateway capabilities to telephone service providers as well as providing support to customers transitioning from one network to another.

- The "Enterprise Solutions" segment provided enterprise communications solutions addressing the headquarters, branch and home office needs of large and small businesses. The Enterprise Solutions segment's offerings included, among other things, Unified Communications, Ethernet routing and multiservice switching, IP and digital telephony (including phones), wireless LANs, security, IP and SIP contact centers, self-service solutions, messaging, conferencing and SIP-based multimedia solutions.

- The Metro Ethernet Networks ("MEN") segment provided carrier-grade Ethernet transport capabilities focused on meeting customers' needs for higher performance and lower cost emerging video-intensive applications. MEN included optical networking, carrier Ethernet switching products and multi-service switching products.

- The "Global Services" segment provided a broad range of services and solutions including network implementation services, network support services, network managed services (which related to the monitoring and management of customer networks and hosted solutions) and network application services.

14 The Nortel Group consists of more than 140 separate corporate entities located in 60 separate sovereign jurisdictions including Canada, the United States and the EMEA region, as well as the Caribbean and Latin America and Asia. NNC, the Nortel Group's ultimate parent holding company, was publicly listed and traded on both the Toronto Stock Exchange and the New York Stock Exchange.

15 One of NNC's direct subsidiaries is NNL, which was the Canadian operating company of the Nortel Group. NNL in turn owns 100% of the equity of each of NNI, which was the Nortel Group's operating company in the United States, NNUK, which was the Nortel Group's operating company in the United Kingdom, NN Ireland, which was the Nortel Group's operating company in Ireland, and 91.17% of the equity of NNSA, which was the Nortel Group's operating company in France.

16 The Nortel Group operated along business lines as a highly integrated multinational enterprise with a matrix structure that transcended geographic boundaries and legal entities organized around the world. Each entity, such as NNL, NNI, NNUK, NN Ireland and NNSA, was integrated into regional and product line management structures to share information and perform research and development ("R&D"), sales and other common functions across geographic boundaries and across legal entities. The matrix structure was designed to enable Nortel to function more efficiently, drawing on employees from different functional disciplines worldwide, allowing them to work together to develop products and attract and provide service to customers, fulfilling their demands globally.

17 As a result of Nortel's matrix structure, no single Nortel entity, either NNL or any of the other Canadian debtors in Canada, NNI or any of the other US debtors in the United States or NNUK or any of the other EMEA debtors, was able to provide the full line of Nortel products and services, including R&D capabilities, on a stand-alone basis. While Nortel ensured that all corporate entities complied with local laws regarding corporate governance, no corporate entity carried on business on its own.

18 R&D was the primary driver of Nortel's value and profit. Together with NNL, the principal companies that performed R&D were NNI, NNUK, NNSA and NN Ireland. These were known as Integrated Entities or, in transfer pricing terms, Residual Profit Entities ("RPEs") due to their participation from 2001 in a residual profit pool in connection with Nortel's transfer pricing arrangements [7] . Other operating companies performed sales and distribution functions and were known as Limited Risk Distributors or Entities ("LREs").

19 R&D was performed at labs around the world. The advanced technology primary research which was intended to develop novel, cutting edge intellectual property technologies was performed mostly in NNL laboratories in Ottawa, which also did R&D for various lines of business. From 2000 to 2009 NNL accounted on average for just under half of all R&D expenditures, more in the latter years than the earlier years. NNI accounted for 38 to 42% and EMEA accounted for 16 to 20% in the earlier years and 11.7 % from 2005 to 2009. The R&D was shared throughout the Nortel Group as needed by the lines of business and customer needs in the various regions and countries.

20 Because R&D was the primary driver of Nortel's value and profit, the residual profits of Nortel, after payment of fixed rates of return to all Nortel companies for sales and distribution functions, were paid to the RPEs under a Master Research and Development Agreement ("MRDA") in accordance with a residual profit split method ("RPSM") based on each RPE's expenditure on R&D relative to the R&D expenditure of all RPEs.

21 Under the MRDA, NNL was the legal owner of the Nortel intellectual property and each RPE other than NNL was granted an exclusive license by NNL to make and sell Nortel products in its territory using or embodying Nortel intellectual property developed by Nortel companies anywhere in the world and a non-exclusive license to do so in territories that were not exclusive to an RPE. What the ownership rights of NNL were and what the license rights were that were granted in the MRDA are highly contested. Also contested is the role that the MRDA should play in this allocation proceeding.

Bankruptcy filings

22 Beginning around 2001, the burst of the dot-com bubble had a severe effect on the global economy and on the telecommunications industry in particular, including Nortel. Market forces led to a decline in Nortel's revenues and market share, and a decline in customer demand for Nortel's products. Subsequently, Nortel was faced with accounting issues which impacted Nortel's credit rating and its cost of financing and required Nortel to restate its financial statements for the fiscal years 2000 to 2005. The rating downgrades affected Nortel's access to capital markets and cost of financing for some years. The fortunes of Nortel improved for a few years but for various reasons, including the financial meltdown in the fall of 2008, Nortel saw its business decline in the two profitable lines of business that it was operating.

23 In light of the impact of the deteriorating market conditions and weakening customer commitments on Nortel's financial outlook, Nortel made the decision to commence formal bankruptcy and insolvency proceedings in Canada, the U.S. and England (respecting various EMEA entities) on January 14, 2009.

24 On January 14, 2009 NNC, NNL, the wholly owned subsidiary of NNC which was its operating subsidiary and a number of other Canadian corporations filed for protection under the CCAA. On the same date, Nortel Network Inc. ("NNI"), the principal US subsidiary of NNL, and a number of other US corporations filed for protection under chapter 11 of the US Bankruptcy Code and Nortel Networks UK Limited ("NNUK"), the principal UK subsidiary of NNL, and certain of their subsidiaries (the "EMEA Debtors") save the French subsidiary Nortel Networks S.A. ("NNSA") were granted administration orders under the *UK Insolvency Act, 1986.* On the following day, a liquidator of NNSA was appointed in France pursuant to Article 27 of the European Union's Council Regulation (EC) No 1346/2000 on Insolvency Proceedings in the Republic of France.

25 Subsequent to the filing date, certain other Nortel subsidiaries have filed for creditor protection or bankruptcy proceedings in the local jurisdiction in which they are located. Certain solvent indirect subsidiaries of NNUK are not in administration, but are represented in these proceedings by the Joint Administrators with respect to the allocation issues.

Decision to liquidate

26 The initial intent on filing was to attempt to restructure the business and downsize it by focusing on Nortel's legacy CDMA (Code Division Multiple Access) wireless business and a potential business based on LTE (Long-Term Evolution) wireless technology with all other Nortel business lines being sold. However, Nortel's major customers did not support this plan and advised they were not prepared to provide new contracts to Nortel for this purpose. As well, it became clear that it would not be possible for Nortel to obtain the funding that would have been required to restructure around a CDMA business.

27 In June 2009, management and the Debtor Estates collectively determined that the best means to maximize value for its creditors was to sell Nortel's lines of business and other assets and to commence a liquidating insolvency. No party in these proceedings has suggested that it was a viable option to restructure along geographic lines or for a country-specific entity to independently continue in Nortel's business.

Interim Funding and Settlement Agreement ("IFSA")

28 From the petition date of January 14, 2009, NNL incurred significant expenses to preserve the value of the business, including R&D expenses, and it was experiencing negative cash flow. It had not received any transfer pricing payments from its subsidiaries under the MRDA as a result of the insolvency proceedings.

29 It was evident that there would be significant issues among the parties as to whom the proceeds of the sale of Nortel's assets should be paid. The parties appreciated that if determining the allocation of proceeds from Nortel's assets were a precondition to their sale, sales would be substantially delayed, and the value of the assets would depreciate, resulting in less money for all creditors. Avoiding a dispute during the sale processes about how to allocate the proceeds allowed the parties to obtain the highest monetary value for the assets being sold.

30 On June 9, 2009, the US Debtors (excluding NN CALA, which had not yet filed for bankruptcy), the Canadian Debtors and the EMEA Debtors (excluding NNSA, which later acceded to the agreement) entered into the Interim Funding and Settlement Agreement ("IFSA") to address both interim funding of NNL as well as principles under which collaborative sales of Nortel's businesses and assets could take place.

31 The IFSA provided for a payment by NNI to NNL of $157 million in full settlement of any transfer pricing and other claims NNL might have had against NNI for the period from the petition date through September 30, 2009. The parties also agreed:

> (a) to cooperate in the anticipated sales of the Nortel Group's assets;
>
> (b) that their execution of sale documentation or the closing of a sale transaction would not be conditioned upon reaching agreement either on allocation of the sale proceeds or on a binding procedure for determining the allocation question;
>
> (c) that the sale proceeds would be deposited into escrow, and that there would be no distribution out of escrow without either the agreement of all of the selling debtors or the determination of any dispute relating thereto by the relevant dispute resolver;
>
> (d) that in order to facilitate the lines of business sales, the U.S. and EMEA Debtors would enter into appropriate license termination agreements which would provide for the termination of the license rights granted by NNL under the MRDA; termination or relinquishment of a license would be deemed a sale with the licensed participants each being deemed a seller; and
>
> (e) that the agreement would not have any impact on the allocation of proceeds to any Debtor from any asset sale and would not prejudice a party's rights to seek its entitlement to the proceeds from any sale.

32 The US and Canadian Courts entered orders approving the IFSA following a joint hearing on June 29, 2009.

33 On December 23, 2009 the Canadian and U.S. Debtors signed a Final Canadian Funding and Settlement Agreement (the "FCFSA") under which NNI agreed to pay NNL $190.8 million in full and final settlement of all claims that NNL might have against NNI. Further, NNL granted NNI an allowed $2 billion unsecured claim in NNL's CCAA proceedings ranking pari passu with other pre-petition unsecured claims against NNL, with such claim not being subject to offset or reduction. This claim had resulted from the tax authorities reviewing requests by the parties for approval of their transfer pricing arrangements. In 2009 NNL and NNI were advised that an agreement between the CRA and IRS sought a reallocation of income from NNL to NNI in the amount of U.S. $2 billion for the tax years ending 2001 to 2005. The tax authorities did not specify on what basis the $2 billion figure was calculated. The FCFSA, including the $2 billion admitted claim of NNI against NNL, was approved by the Canadian Court on January 21, 2010 and by the U.S. Court on the following day.

Asset sales

34 With the IFSA framework in place, the Debtor Estates embarked on a process that resulted in a series of sales of the various business lines, which occurred from mid-2009 through late 2010, with the last transaction closing in March 2011. The

total proceeds were approximately $3.285 billion. There remains approximately $2.85 billion of that amount now available to be allocated.

35 In order to sell the lines of businesses separately, Nortel engaged in a "carve-out process" to identify the bundle of assets, rights and obligations that would have to be conveyed in each sale to enable the lines of business to function on a stand-alone basis.

36 An important aspect of the carve-out process was the identification of which IP rights, principally patent rights, needed to be conveyed. Each prospective purchaser of a business line wished to obtain as many patents as possible as part of each sale transaction and, conversely, the Nortel sellers wanted to ensure that the only patents transferred were those incorporated exclusively or principally in the business line in question so as to retain value within Nortel and not to jeopardize the ability to sell the other business lines that might require rights to the same patents.

37 Ultimately, those patents that were "predominantly used" in any given line of business were transferred to the purchaser of that line of business as part of the transaction. In the end, 2,700 patents were transferred as part of the business line sales.

38 For all other patents that were used in each line of business but not predominantly used, a non-exclusive license was granted to the purchaser for use of those patents in the operations of the particular business line being purchased.

39 By the time that all of the business sales were completed in March 2011, Nortel had no remaining operating businesses. What it did retain was a residual patent portfolio consisting of approximately 7000 patents and patent applications. These were principally patents and patent applications that were not used in any of the lines of business and therefore were not subject to licenses to the business sale purchasers. In addition, the residual IP portfolio included patents used by multiple lines of businesses and licensed to the purchasers of those lines of businesses.

40 On April 4, 2011, after significant negotiations with two prospective purchasers, certain Nortel entities (including NNC, NNL, NNI and NNUK) entered into a stalking horse asset sale agreement with a wholly owned subsidiary of Google Inc. with a purchase price of $900 million.

41 An auction was held at the end of June 2011, and the residual patent portfolio was ultimately sold to Rockstar Bidco, LP, a single purpose entity backed by a consortium of major technology companies (Apple, Microsoft, Ericsson, Blackberry, Sony and EMC), for $4.5 billion.

Position of the parties

42 In this case the Monitor is acting under what is now referred to as a "super monitor" order of October 3, 2012 in which the Monitor was authorized to exercise any powers which may be exercised by a board of directors of any of the applicants, which includes NNC and NNL. This order occurred after NNC and NNL were left without any board of directors or management and it was necessary for the Monitor to be appointed to advance the interests of NNL and NNC in this CCAA proceeding. While I will refer to the Monitor, I do so in recognition that the Monitor is advancing the position of the Canadian Debtors in this litigation.

43 The intellectual property of Nortel represented by far the largest portion of the assets sold. The Rockstar sale of the residual IP generated $4.5 billion. The lines of business generated $3.285 billion of which approximately $2.85 billion is now available. Intellectual property was a substantial part of the assets of the business lines that were sold, although the experts differed as to its value.

44 The parties and their experts for the most part relied on their interpretation of the MRDA in support of their allocation positions for the proceeds from intellectual property for both the Rockstar sale and the lines of business sales. Two parties, the UKPC (the UK pension claimants, being the trustee of the UK pension plan, and the board of the UK Pension Protection Fund) and the Canadian Creditors Committee [8] contended that the MRDA should not govern the allocation and that a pro rata allocation based on a *pari passu* distribution to all creditors should be used to allocate the lockbox funds.

45 It is necessary therefore to consider the MRDA and whether it should govern the allocation.

The MRDA

46 The parties look to the rights of the various Nortel entities to intellectual property under the MRDA as a central issue in this proceeding. What these rights are is contested. Many of its terms have been excruciatingly parsed. I will first deal with the meaning of the MRDA as an operating agreement. I will then deal with the issue as to whether it applies, or was intended to apply, to the allocation of the Nortel assets after the world-wide insolvency of Nortel.

47 The MRDA and its predecessor Cost Sharing Agreements[9] ("CSA") were developed for and driven by transfer pricing concepts. Transfer pricing is the act of assigning a monetary value, or price, to movements of resources or economic contributions that occur within a multinational enterprise across different taxing jurisdictions. Against the risk that companies attempt to use transfer pricing to increase operating income (and therefore taxable income) in jurisdictions with low income tax rates and correspondingly to decrease operating income in high-tax jurisdictions, tax authorities around the world have instituted regulations governing intercompany transfer pricing. These regulations centre on the arm's length principle. The arm's length principle necessitates that intercompany transactions be priced in a manner consistent with the way in which similarly situated uncontrolled parties bargaining at arm's length would price the transactions i.e., within an arm's length range.

48 Dr. Eden, a transfer pricing expert who testified on behalf of the U.S. Debtors, well described in her report the way in which transfer pricing agreements are made in light of the fact that governments have developed a dense regulatory framework for transfer pricing due to worries about the potentially negative impacts that transfer pricing can have on government tax and customs duty revenues. The setting of transfer pricing policies for corporate income tax purposes of a multinational enterprise (MNE) is a highly regulated, data-driven and fact-intensive activity dominated by professionals. The establishment of an MNE's transfer pricing policy typically involves not only MNE group in-house staff, but also accountants, economists, lawyers, tax experts and other consultants. Moreover, an MNE's transfer pricing policy may involve the input of revenue authorities through an advance pricing agreement (APA) procedure.

49 All of this applied to Nortel and much evidence was given by tax people as to the process by which the MRDA was made and changed. Evidence was also given by some of them as to their view of the meaning of the agreement, the admissibility of which is contested.

(i) Governing law of the construction of the contract

50 The MRDA is by its terms to be construed in accordance with and governed by the law of Ontario. The same applied to the predecessor CSAs.

51 A number of authorities have been cited. A brief consideration of them is required in light of the various arguments made about the MRDA, particularly as it involves the principles of interpreting commercial contracts, what can be looked at when considering the factual matrix of the agreement and the use of recitals in an agreement in the interpretive process.

52 Winkler C.J.O. articulated the test for construing a commercial contract in *Salah v. Timothy's Coffees of the World Inc.* (2010), 74 B.L.R. (4th) 161 (Ont. C.A.) as follows:

> **16** The basic principles of commercial contractual interpretation may be summarized as follows. When interpreting a contract, the court aims to determine the intentions of the parties in accordance with the language used in the written document and presumes that the parties have intended what they have said. The court construes the contract as a whole, in a manner that gives meaning to all of its terms, and avoids an interpretation that would render one or more of its terms ineffective. In interpreting the contract, the court must have regard to the objective evidence of the "factual matrix" or context underlying the negotiation of the contract, but not the subjective evidence of the intention of the parties. The court should interpret the contract so as to accord with sound commercial principles and good business sense, and avoid

commercial absurdity. If the court finds that the contract is ambiguous, it may then resort to extrinsic evidence to clear up the ambiguity.

53 In *Kentucky Fried Chicken Canada v. Scott's Food Services Inc.* (1998), 41 B.L.R. (2d) 42 (Ont. C.A.) Goudge J.A. stated the following regarding the interpretation of a commercial agreement at para. 27

> Where, as here, the document to be construed is a negotiated commercial document, the court should avoid an interpretation that would result in a commercial absurdity. [*City of Toronto v. W.H. Hotel Ltd.* (1966), 56 D.L.R. (2d) 539 at 548 (S.C.C.)]. Rather, the document should be construed in accordance with sound commercial principles and good business sense; [*Scanlon v. Castlepoint Development Corporation et al.* (1992), 11 O.R. (3d) 744 at 770 (Ont.C.A.)]. Care must be taken, however, to do this objectively rather than from the perspective of one contracting party or the other, since what might make good business sense to one party would not necessarily do so for the other.

54 I take the principles in *Kentucky Fried Chicken Canada* and in *Salah*, the latter adopted by Cronk J.A. in *Downey v. Ecore International Inc.*, 2012 ONCA 480 (Ont. C.A.) and by Juriansz J.A. in *Ariston Realty Corp. v. Elcarim Inc.*, 2014 ONCA 737 (Ont. C.A.), as the applicable principles governing this case. See also *Unique Broadband Systems Inc., Re*, 2014 ONCA 538 (Ont. C.A.) at para. 88. [10]

55 The factual matrix of the contract is to be considered. What may be considered was expressed in *Kentucky Fried Chicken* as follows:

> **25** ...While the task of interpretation must begin with the words of the document and their ordinary meaning, the general context that gave birth to the document or its "factual matrix" will also provide the court with useful assistance. In the famous passage in *Reardon Smith Line Ltd. v. Yngvar Hansen-Tangen*, [1976] 1 W.L.R. 989 at 995-96 (H.L.) Lord Wilberforce said this:
>
> > No contracts are made in a vacuum: there is always a setting in which they have to be placed. The nature of what is legitimate to have regard to is usually described as "the surrounding circumstances" but this phrase is imprecise: it can be illustrated but hardly defined. In a commercial contract it is certainly right that the court should know the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating.
>
> **26** The scope of the surrounding circumstances to be considered will vary from case to case but generally will encompass those factors which assist the court "... to search for an interpretation which, from the whole of the contract, would appear to promote or advance the true intent of the parties at the time of entry into the contract." *Consolidated Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co.*, [1980] 1 S.C.R. 888 at 901.

56 More recently, Rothstein J. in *Creston Moly Corp. v. Sattva Capital Corp.*, 2014 SCC 53 (S.C.C.) referred to the use of surrounding circumstances and cautioned as to the extent they can be considered:

> **57** While the surrounding circumstances will be considered in interpreting the terms of a contract, they must never be allowed to overwhelm the words of that agreement (*Hayes Forest Services*, at para. 14; and Hall, at p. 30). The goal of examining such evidence is to deepen a decision-maker's understanding of the mutual and objective intentions of the parties as expressed in the words of the contract. The interpretation of a written contractual provision must always be grounded in the text and read in light of the entire contract (Hall, at pp. 15 and 30-32). While the surrounding circumstances are relied upon in the interpretive process, courts cannot use them to deviate from the text such that the court effectively creates a new agreement (*Glaswegian Enterprises Inc. v. B.C. Tel Mobility Cellular Inc.* (1997), 101 B.C.A.C. 62).
>
> **58** The nature of the evidence that can be relied upon under the rubric of "surrounding circumstances" will necessarily vary from case to case. It does, however, have its limits. It should consist only of objective evidence of the background facts at the time of the execution of the contract (*King*, at paras. 66 and 70), that is, knowledge that was or reasonably ought to have been within the knowledge of both parties at or before the date of contracting. Subject to these requirements and

the parol evidence rule discussed below, this includes, in the words of Lord Hoffmann, "absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man" (*Investors Compensation Scheme*, at p. 114). Whether something was or reasonably ought to have been within the common knowledge of the parties at the time of execution of the contract is a question of fact.

57 It is clear that the factual matrix that can be considered may not include evidence of the subjective intent of a party or what a party believed a contract to mean. See *Sattva*, *supra*, at para. 59. It may also not include evidence of negotiations or create an ambiguity where none exists in an agreement. See also *Primo Poloniato Grandchildren's Trust (Trustee of) v. Browne* (2012), 115 O.R. (3d) 287 (Ont. C.A.) in which Feldman J.A. stated:

> **71** While the scope of the factual matrix is broad, it excludes evidence of negotiations, except perhaps in the most general terms, and evidence of a contracting party's subjective intentions: Geoff R. Hall, *Canadian Contractual Interpretation Law*, 2d ed. (Markham: LexisNexis, 2012), at p. 27. As the cases above suggest, the factual matrix includes only objective facts known to the parties at or before the date of the agreement, and what is common to both parties: Hall, p. 30. Hall goes on to state that while the factual matrix can "be used to clarify the parties' intentions as expressed in a written agreement, it cannot be used to contradict that intention, create an ambiguity which otherwise does not exist in the written document, or have the effect of making a new agreement": p. 31 (footnotes omitted). Ultimately, the words of the agreement are paramount.

58 The recitals in the MRDA are the subject of debate in this case. A clear statement of how recitals may be used in the interpretation of an agreement can be found in *Elliott Estate, Re*, [1962] O.J. No. 164 (Ont. C.A.); aff'd [1963] S.C.R. 305 (S.C.C.). In that case, Kelly J.A. stated that a recital could be used only if there is an ambiguity in the operative parts of the agreement and the recital is clear. He stated:

> **11** I turn therefore to consider to what extent the recital may be used to overcome the patent deficiencies of clauses 6 and 7 and in fact of the whole operative parts of the agreement. In the first instance it must be borne in mind that a recital is not a necessary part of a document and its use in the interpretation of the document as a whole is strictly limited.
>
> > The reciting Part of a Deed is not at all a necessary Part either in Law or Equity. It may be made use of to explain a Doubt of the Intention and Meaning of the Parties but it hath no Effect or Operation. But when it comes to limit the estate, there the Deed is to have its Effect according to what Limitations are therein set forth.
>
> Per Holt, C.J., *Bath and Mountague's Case* (1693) 3 Cas. in Ch. 55 at 101; 22 E.R. 963 at 991. An oft quoted statement of the extent to which reference may be had to recitals is contained in the judgment of Lord Esher, M.R. in *Ex Parte Dawes. In Re Moon*, (1886) 17 Q.B.D. 275 at p. 286:
>
> > Now there are three rules applicable to the construction of such an instrument. If the recitals are clear and the operative part is ambiguous, the recitals govern the construction. If the recitals are ambiguous, and the operative part is clear, the operative part must prevail. If both the recitals and the operative part are clear, but they are inconsistent with each other, the operative part is to be preferred.
>
> It is to be noted that the qualifying condition for the use of a recital in the interpretation of the operative parts is that there must be ambiguity in the operative parts; in such a case the preferred meaning to be given to the operative words should be that consistent with the intention expressed in the recital, provided that the words of the operative part are by themselves capable of such an interpretation. *MacKenzie v. Duke of Devonshire*, (1896) App. Cas. 400; *Ex Parte Dawes. In Re Moon, Supra*; *In re Sugden's Truts, Sugden v. Walker*, (1917) 2 Ch. 92. It is essential, however, that the construction to be placed upon the operative part in the light of the recital be a construction which the words themselves of the operative part are capable of bearing. Where, however, the operative parts of a document, due to the lack of appropriate words, are incapable of a construction which will fulfil the intention expressed in recitals, the recital may not be used for the purpose of reading into the operative clause a meaning which it is incapable of conveying when considered by itself.

59 It was held in *PUC Distribution Inc. v. Brascan Energy Marketing Inc.*, 2008 ONCA 176 (Ont. C.A.), that an elevation of a recital to a mutual promise or operative provision was an error.

60 *Eli Lilly & Co. v. Novopharm Ltd.*, [1998] 2 S.C.R. 129 (S.C.C.) at para. 57, in which Iacobucci J. in discussing the meaning of an agreement referred to the recitals, was referred to in argument. Iacobucci J. did not discuss the principles to be used in considering recitals. *Sistem Mühendislik İnsaat Sanayi Ve Ticaret Anonim Sirketi v. Krygyz Republic*, 2012 ONSC 4983 (Ont. S.C.J. [Commercial List]), has also been referred to in argument, a decision in which I did not refer to the principles to be used in considering recitals in interpreting contracts. I consider the decision in *Sistem* to be consistent with the principles enunciated by Kelly J.A. in *Elliott Estate*. I do not see either *Eli Lilly* or *Sistem* establishing any different criteria for the use of recitals from *Elliott Estate*.

61 I turn now to the interpretation of the MRDA and the rights accorded in it keeping these interpretive principles in mind.

(ii) Position of the parties

62 The essential differences in allocation positions advanced by the parties flow from the different manner in which each characterizes the terms of the MRDA, the interests held by the parties in Nortel's IP, and the applicability of terms of the MRDA to the value ascribed to various assets.

63 The Monitor, supported by the CCC, contends that under the MRDA, NNL owned the IP and the interests of NNI and the other participants to the MRDA were restricted to certain exclusive and non-exclusive license rights granted to them by NNL pursuant to the terms of the MRDA. The Monitor says that the license rights were not unlimited, as they did not cover all rights in the IP in question, but rather covered only a subset (albeit a substantial subset) of the IP rights, on certain terms, all of which have valuation implications. In particular, the Monitor says that the license rights granted to NNI and the other licensed participants were not all rights to the IP but were subject to "field of use" restrictions that gave the licensees the right to use the IP to make, use or sell "Products" as defined in the MRDA, which meant products, software or services that were made or sold by, or for, any of the licensees. This meant that the Products must have been created or marketed by or for the Nortel Group. No product that was part of a third party's business rather than the business of Nortel could fall within the definition of Products. While the license gave the licensees the right to sublicense, this could not permit the licensees to sublicense what they did not have.

64 The Monitor's position, supported by the CCC, is that what was sold in the Rockstar sale of IP was the ownership of residual patents and patent applications owned by NNL. The purchasers would not have bought the residual IP to make Nortel products, and that as the license rights held by NNI and the other licensees would not have permitted them to sublicense to the Rockstar consortium the right to use the IP for the Rockstar consortium's own purposes, the proceeds of the Rockstar sale belong to NNL.

65 The position of NNI, supported by the other U.S. interests, asserts that each of NNI and the other licensees held all of the rights and all of the value in the IP in their respective exclusive territories as defined in the MRDA. The U.S. Debtors assert that the license rights NNI held were not subject to any field of use or scope restriction or limitation, resulting in an assertion that all of the economic value in the IP in the exclusive territory belonged to the licensee. They contend that the legal title held in the IP under the MRDA was a purely "bare" legal title with no monetary value. They also rely on a right to sue for damages in the U.S. for infringement of NN Technology by others.

66 The position of the EMEA debtors is that each of the parties to the MRDA jointly owned all of the IP in proportion to their financial contributions to research and development, and that all share in the sale proceeds attributable to IP in those same proportions. The joint ownership is said to arise independent of, but recognized in, the MRDA.

(iii) Analysis

(a) The meaning of the exclusive license

67 The agreement is headed MASTER R&D AGREEMENT. It was entered into on December 22, 2004 with an effective date of January 1, 2001 and states that it confirms and formalizes the operating arrangements of the participants as and from that date. It provided that NNL was the legal owner of the NN Technology (the IP), and it contained grants of licenses from NNL to the other participants, referred to as the Licensed Participants. Each Licensed Participant was given an exclusive license for

its territory and a non-exclusive license for those parts of the world other than Canada and where the Licensed Participants had their exclusive territory. The exclusive territory for NNI was the U.S. and Puerto Rico, for NNUK was the United Kingdom, for NNSA was France and for Nortel Ireland was the Republic of Ireland.

68 At its core, so far as the ownership and licensing of the IP is concerned are articles 4(a) and 5(a) and (b). The original language remained in substance but was amended from time to time. These articles as amended are as follows:

> **Article 4 — Legal Title to NN Technology**
>
> (a) Except as otherwise specifically agreed, legal title to any and all NN Technology whether now in existence or hereafter acquired, or developed pursuant to the terms of this Agreement, shall be vested in NNL. In consideration therefor, NNL agrees to enter into an Exclusive License and a Non-Exclusive License with each of the Licensed Participants as set forth in Article 5.
>
> **Article 5 — Grant of Exclusive Licenses by NNL**
>
> (a) To the extent of its legal right to do so, and subject to the rights of relevant third parties, NNL hereby:
>
> (i) continues to grant to each Licensed Participant an exclusive, royalty-free license, including the right to sublicense, which except as hereinafter provided shall be in perpetuity, rights to make, have made, use, lease, license, offer to sell, and sell Products using or embodying NN Technology in and for the Exclusive Territory designated for that Licensed Participant, and all rights to patents, industrial designs (or equivalent) and copyrights, and applications therefor, and technical know-how, as necessary or appropriate in connection therewith ("Exclusive License"); and
>
> (ii) grants to each Licensed Participant, as of January 1, 2009 (the "Non-Exclusive License Effective Date"), a non-exclusive, royalty-free license, including the right to sublicense, which except as hereinafter provided shall be in perpetuity, rights to make, have made, use, lease, license, offer to sell, and sell Products using or embodying NN Technology in and for the Non-Exclusive Territory, and all rights to patents, industrial designs (or equivalent) and copyrights, and applications therefor, and technical know-how, as necessary or appropriate in connection therewith ("Non-Exclusive License").

69 To support their differing interpretations of these provisions, the parties augment to some extent their arguments by reference to other provisions in the MRDA. It will be necessary to deal with these. As can be seen from article 5(i), NNL "continues to grant", a reflection of the fact that prior to the MRDA, the parties were governed by Cost Sharing Agreements (CSAs) [11] . Recitals to the MRDA make this clear:

> WHEREAS legal title to all NN Technology is held in the name of NNL;
>
> WHEREAS each Licensed Participant held and enjoyed equitable and beneficial ownership of certain exclusive rights under NT Technology for a Specified Territory pursuant to the Amended Research and Development Cost Sharing Agreement entered into on January 1, 1992, and it is the intent of NNL and the Licensed Participants that the Licensed Participants continue, as of the effective date of this Agreement, to hold and enjoy such rights;

70 In considering the various interpretations of the MRDA put forward by the parties, it is helpful to compare those provisions with the earlier CSA provisions. Under the CSA, the parties split the costs of R&D by a certain formula. That agreement did not purport to split profits in any way. However, the tax authorities made it clear that they no longer would permit a cost sharing arrangement at Nortel and instead wanted an arrangement whereby profits would be shared among the participants by a residual profit split method (RPSM) that allocated profits according to the amount each participant spent on R&D. Relevant recitals in the MRDA that were not contained in the previous CSA are:

> WHEREAS each Participant bears the full entrepreneurial risks and benefits for the Nortel Networks business;

WHEREAS each Participant has performed, in the past, and intends to continue to perform R&D Activity with respect to the Nortel Products;

WHEREAS each Participant desires to avoid the duplication of R&D Activity;

WHEREAS each Participant believes that it is appropriate that each Participant should benefit from its contribution to R&D activity commensurate with the value of its contribution to that R&D activity in the context of the manner in which the Nortel Networks business is conducted and that the residual profit split methodology (RPSM) is the best arm's length measure, in the circumstances of NNL and the Participants, of such contributions with reference to such benefits;

WHEREAS this Agreement reflects the Participants' intent and agreement since January 1, 2001 to enter a license arrangement with the Licensed Participants, and the Participants have operated from January 1, 2001 in accordance with the terms set forth herein;

WHEREAS Participants acknowledge that as a result of a collective review by the Canadian Customs and Revenue Agency, the US Internal Revenue Service, and the UK Inland Revenue regarding the application of the RPSM, the calculation of the RPSM as set forth in Amended Schedule A may be amended which amendments would require the consent of the Participants;

71 These recitals and the RPSM method contained in the MRDA were driven by transfer pricing considerations. The language, for example, that each Participant (NNL and the Licensed Participants) bears the full entrepreneurial risks and benefits for the Nortel Networks business was not in the prior CSA and was part of the rationalization adopted to support a RPSM.

72 The MRDA provided in article 2 that each Participant would perform R&D at a level consistent with past practices and share the results of its R&D with the other participants. Article 3 provided payment for the R&D as follows:

Article 3 — R&D Activity Payments

(a) For and as a consequence of the performance of R&D Activity, each Participant shall be entitled to receive a payment in an amount equal to the allocation determined under the RPSM (the "R&D Allocation") as the measure of the benefit to which it is entitled commensurate with its performance of, and contribution to, R&D Activity.

(b) Each Participant hereby accepts and agrees to make the payment determined under the RPSM in Amended Schedule A [12] Participant's share of the R&D Allocation. as representing such

(c) The R&D Allocation will be computed pursuant Amended Schedule A which sets forth the basis of the RPSM as originally proposed to the Revenue Authorities. The Participants understand that the RPSM is the subject of review, discussions and negotiations with the Revenue Authorities. The Participants agree to amend this Agreement and to adjust the RPSM to the extent necessary to reflect any negotiated determination with the Revenue Authorities as to the final R&D Allocation.

73 The U.S. Debtors and EMEA take the position that the legal title that is vested in NNL under article 4 of the MRDA is bare legal title given to NNL for administrative convenience to enable it to administer all NN Technology and that the licensed participants own the equitable and beneficial interest in the NN Technology. It draws on the recital that provides:

WHEREAS each Licensed Participant held and enjoyed equitable and beneficial ownership of certain exclusive rights under NT Technology [13] for a Specified Territory pursuant to the Amended Research and Development Cost Sharing Agreement entered into on January 1, 1992, and it is the intent of NNL and the Licensed Participants that the Licensed Participants continue, as of the effective date of this Agreement, to hold and enjoy such rights;

74 I do not see this recital as clearly stating that a Licensed Participant has equitable and beneficial ownership of the NT Technology. It states that a Licensed Participant held equitable and beneficial ownership of "certain exclusive rights under NT

Technology" and would continue to have such rights. The recital does not say what the "certain exclusive rights" were and it is just as consistent with those rights being license rights rather than ownership rights in the technology. As well, having equitable and beneficial ownership of certain exclusive rights "*under* NT Technology" would seem to be something different from having equitable and beneficial ownership of certain exclusive rights "of" or "in" the NT Technology.

75 In the CSA referred to in the recital, the language used is as follows:

> **ARTICLE 4 LEGAL TITLE TO NT TECHNOLOGY**
>
> The Parties hereto acknowledge that, except as otherwise specifically agreed, legal title to all NT Technology whether now in existence or developed pursuant to the terms of this Cost Sharing Agreement, except patents owned by Participant [Northern Telecom Inc., now NNI] on January 1, 1980, shall be vested in Northern Telecom [now NNL]. With respect to patentable inventions and copyrightable property encompassed by NT Technology, Northern Telecom shall have the exclusive right but not the obligation to file and prosecute applications in its name for patent or copyright protection in every country of the world. Participant shall execute or cause to be executed such documents reasonably requested by Northern Telecom as may be necessary or desirable to give effect to the foregoing. (Underlining added).

76 The exception in this provision for patents owned by Northern Telecom Inc., now NNI, suggests that the legal title vested in Northern Telecom (now NNL) was ownership rather than bare legal title. Otherwise there would have been no purpose in excluding the patents owned by Northern Telecom Inc. It would not have been necessary.

77 In article 6 of the CSA, dealing with confidential information, it is stated:

> Participant acknowledges that Northern Telecom is the legal owner of the NT Technology developed pursuant to this Cost Sharing Agreement and that the NT Technology is proprietary and constitutes a trade secret. Participant shall hold the NT Technology in confidence and only make use of or disclose it as permitted by this Cost Sharing Agreement.

78 This provision refers to Northern Telecom being the "legal owner". This is consistent with the language of article 4 of the CSA. If, as stated in the recital to the MRDA, it was the intent of NNL and the Licensed Participants that the Licensed Participants would continue under the MRDA to hold and enjoy such rights as they held under the CSA, those rights would not include legal ownership of the NN Technology.

79 NNI also relies on language in Schedule A of the MRDA to assert its beneficial ownership of the NN Technology. It provides in part:

> **Calculation of Arm's Length R&D Allocation to each Participant**
>
> The purpose of this section is to provide a brief summary of Nortel's transfer pricing policy and to provide clarity as to how each Participant is to be compensated under this Agreement.
>
> The current transfer pricing methodology is the residual profit split method ("RPSM") which was adopted by the Participants at the request of the tax authorities as the most appropriate method for determining the arm's length compensation to each of the Participants for the R&D Activity to be provided pursuant to the Master R&D Agreement. The RPSM acknowledges the fact that the key profit driver in the Nortel business is the development and maintenance of rapidly depreciating intellectual property ("IP").
>
> Accordingly, the R&D Allocation provided to Participants under the RPSM reflects the fact that the Participants bear the full entrepreneurial risk of the Nortel business such as the risks attendant with the substantial and continuous development and ownership of the NN Technology. Mathematically, the RPSM accords the Participants all the upside risk in the Nortel business as well as the downside risk. (Underlining added).

80 Schedule A is part of the MRDA. I do not, however, read it as granting rights. The rights are granted in the operative provisions of the MRDA. Schedule A states at the outset that its purpose is to give a brief summary of Nortel's transfer pricing

policy and to provide clarity as to how each participant is to be compensated. Schedule A provides in some detail how the residual profit is to be calculated and split amongst the Participants. Stating that Participants bear risks such as risks attendant with the development and ownership of the NN Technology does not state that ownership of the technology is being granted. What the Licensed Participants were granted in the MRDA were license rights.

81 Various dictionary definitions were resorted to in arguing what the meaning of "legal title" to the NN Technology was that was vested in NNL under article 4 of the MRDA. In the end, I do not think it necessary to get into that debate. NNL had ownership of NN Technology to the extent that NN Technology was not licensed to the Licensed Participants. Rights in inventions were assigned by the inventors to NNL and NNL applied for the patents and was named as owner of them. It was NNL who granted licenses to the Licensed Participants. NNUK, for example, did not provide a license to NNI for IP developed by NNUK. It was NNL that did so. Although NNL had the exclusive right to the NN Technology in Canada under the MRDA, the MRDA did not grant any license to NNL. That was recognition that it was NNL that owned the NN Technology.

82 A licensee does not enjoy property rights. Its rights are contractual. A licence is merely a permission to do that which would otherwise amount to trespass. See *Kraft Canada Inc. v. Euro Excellence Inc.*, [2007] 3 S.C.R. 20 (S.C.C.) at para. 27. A licensee's rights are not necessarily equivalent to those of the patentee; rather, they are limited to, and qualified by, the express terms of the license. See *Eli Lilly & Co. v. Novopharm Ltd.*, [1998] 2 S.C.R. 129 (S.C.C.) at para. 49. It is the determination of what those license rights were that were granted to the Licensed Participants in the MRDA that is important because it is those license rights that were given up by Licensed Participants to permit the business line sales and the sale of the residual IP to Rockstar.

83 The grant of the exclusive license in the MRDA in article 5(i) is:

> ...NNL hereby:
>
> (i) continues to grant to each Licensed Participant an exclusive, royalty-free license, including the right to sublicense, which except as hereinafter provided shall be in perpetuity, rights to make, have made, use, lease, license, offer to sell, and sell Products using or embodying NN Technology in and for the Exclusive Territory designated for that Licensed Participant, and all rights to patents, industrial designs (or equivalent) and copyrights, and applications therefor, and technical know-how, as necessary or appropriate in connection therewith (Exclusive License") (Underlining added);

84 The license is not a license of NN Technology, but rather a license "to make... and sell Products using or embodying NN Technology". Thus the MRDA definition of "Products" is of central importance and the Monitor says that "Products" is defined to mean products, software or services that were made or sold by, or for, NNL and the Licensed Participants. The Monitor contends that products not made for NNL or the Licensed Participants, such as products that would be made by the Rockstar consortium members or their licensees are not covered by the license.

85 The definition of "Products" at Article 1(g) of the MRDA is:

> "Products" shall mean all products, software and services designed, developed, manufactured or marketed, or proposed to be designed, developed, manufactured or marketed, at any time by, or for, any of the Participants, and all components, parts, sub-assemblies, features, software associated with or incorporated in any of the foregoing, and all improvements, upgrades, updates, enhancements or other derivatives associated with or incorporated in any of the foregoing. (Underlining added).

86 The U.S. Debtors parse the language of the license grant and contend that the Licensed Participants obtained all of the rights to the NN Technology. They break down the grant of the exclusive license into four clauses as follows:

> NNL hereby:
>
> continues to grant to each Licensed Participant an exclusive, royalty-free license, including
>
> the right to sublicense, which except as hereinafter provided shall be in perpetuity,

> rights to make, have made, use, lease, license, offer to sell, and sell Products using or embodying NN Technology in and for the Exclusive Territory designated for that Licensed Participant, and
>
> all rights to patents, industrial designs (or equivalent) and copyrights, and applications therefor, and technical know-how, as necessary or appropriate in connection therewith ("Exclusive License").

87 The U.S. Debtors stated in their opening brief that the opening grant of an exclusive, royalty-free license in the first clause is not limited by the word "including". They say the word "including" does not create a limitation, that the word "including" follows the words "exclusive, royalty-free license" and thus the words that follow cannot, and do not purport to, limit the broad exclusive licenses granted to the licensed participants under the MRDA. In effect they argue that the opening words before the word "including" created a complete grant of a license without reserve.

88 I cannot accept that argument. The words "continues to grant an exclusive, royalty-free license", on their own, do not say what the license is, or what it is for, or for how long. Given that a licensee's rights are limited to, and qualified by, the express terms of the license (*Eli Lilly & Co.* at para. 49), a license grant of uncertain scope, such as proposed by the U.S. Debtors, would have no meaning. Moreover, the words "in and for the Exclusive Territory designated for that Licensed Participant" appear after "including". On the U.S. Debtors' reading of the license, the territorial limitation would only apply to the license to make Products, and would not apply to a broad exclusive license that they say is already created before one gets to the word "including". It would also mean that the words "in perpetuity" which follow the reference to a sublicense would not apply to the broad exclusive license, which is inconsistent with what the U.S. Debtors say is the case.

89 There would be no commercial purpose in the MRDA granting a broad unrestrictive license and then providing more specific grants in the license that are restricted. For example, the third clause restricts the licensee to selling Products, which contains terms of limitation.

90 The U.S. Debtors also contend that the third clause permits NNI or any other Licensed Participant to make or have made for it Products using NN Technology and that the sublicense rights contained in the second clause are not so limited to Products using NN Technology. I cannot accept that contention. A sublicense could not sublicense more than the licensee had under its license and the second clause could not purport to do so. This argument of the U.S. Debtors relies on its argument that the first clause was a broad unrestrictive grant of a license, which argument I cannot accept.

91 The U.S. Debtors contend that the fourth clause is a free-standing or "catch-all" license grant of all rights to patents etc. unconnected to the license to make, use or sell Products. The language of this provision is:

> all rights to patents, industrial designs (or equivalent) and copyrights, and applications therefor, and technical know-how, as necessary or appropriate in connection therewith ("Exclusive License");

92 The U.S. Debtors say that the concluding words "in connection therewith" refer to the preceding words "technical know-how". The contention of the U.S. Debtors is that this last clause is like the first clause, being a separate grant not limited by the right to make, use or sell Products. The Monitor says that these all of these words in the clause relate to the license to make, use or sell Products and that the words "in connection therewith" do not relate only to the reference to technical know-how.

93 I must say that I find it difficult to accept that the concluding words "in connection therewith" modify only the words "technical know-how". There would be no need for a comma after the words technical know-how". Those words, even if only applicable to the last clause, could apply equally to "industrial designs (or equivalent)" and "applications therefor".

94 I do not find persuasive at all the attempt of the U.S. Debtors to parse the language of the grant of license as they have done. On their reading, there are several different grants of license. Yet at the end of the paragraph are the words "Exclusive License" in parenthesis. There is only one license and the words should be read together harmoniously.

95 The U.S. Debtors make the point that what they refer to as the last clause in the license grant would be superfluous on the reading of the Monitor. That is because the definition of Products and NN Technology includes patents and the other things

contained in that last clause. The U.S. Debtors say that because in interpreting a contract one should strive to give meaning to all of its terms, the last clause should be read as providing rights different from the rights to make, use or sell Products. While this argument on its face has a certain attractiveness, I do not think it right in this case.

96 The grant of license rights in article 5 is one grant. It does not in the paragraph expressly spell out the definition of Product or NN Technology. The draftsman may have thought it prudent to include the final clause. The words "in connection therewith" must be given some meaning and I do not accept the meaning given to them by the U.S. Debtors. I read the words as relating to the grant of a license to make, use and sell Products employing NN Technology, which in my view was the intent of the entire license granted in clause 5(i).

97 The Monitor refers to a statement of Lord Hoffman, no stranger to contract interpretation and a legal giant of his day, in *Beaufort Developments (NI) Ltd. v. Gilbert-Ash (NI) Ltd.* (1998), [1999] 1 A.C. 266 (Ireland H.L.), at 274 that arguments of redundancy should be treated with caution. He stated:

> I think, my Lords, that the argument from redundancy is seldom an entirely secure one. The fact is that even in legal documents (or, some might say, especially in legal documents) people often use superfluous words. Sometimes the draftsmanship is clumsy; more often the cause is a lawyer's desire to be certain that every conceivable point has been covered. One has only to read the covenants in a traditional lease to realise that draftsmen lack inhibition about using too many words.

98 In *Long v. Delta Catalytic Industrial Services Inc.*, [1998] 6 W.W.R. 792 (Alta. Q.B.), Fruman J. (as she then was) said much the same thing:

> Some might argue that this interpretation makes the provision redundant...That may well be the case, but it won't be the first time that a repetitive provision has been inserted into an agreement.

99 Redundancy could also be laid at the feet of the U.S. Debtors in their interpretation of the license grant. If their reading is correct, all of the second, third and fourth clauses would be redundant as the first clause was an unrestricted grant of a license. I think in this case redundancy arguments are just that, arguments that do not deal with the commercial purpose of the agreement.

100 An addendum to the MRDA dated December 14, 2007 with effect from January 1, 2006 was made to adopt changes to the terms of the MRDA that had been reflected in the financial statements of the Participants. The first two recitals of this addendum stated:

> Whereas each Participant holds and enjoys equitable and beneficial ownership of NN Technology as defined in the Prior Agreement,
>
> Whereas this Addendum continues each Participant's rights and obligations in the NN Technology,

101 The reason for this addendum was stated in the third recital

> Whereas given changes in the Nortel business, NNL and certain other Participants are seeking governmental approval of modifications to the RPSM.

102 This was the first of two addenda that changed the way of calculating the residual profit split each year from an amortized 30% spend of each Participant each year on R&D to a five year rolling average spend by each Participant on R&D. The operative parts of this addendum did not change the operative terms of the prior MRDA relating to the licence rights granted to the participants. I do not read the first two recitals that "each Participant holds and enjoys equitable and beneficial ownership of NN Technology as defined in the Prior Agreement" and the addendum "continues each Participant's rights ... in the NN Technology" as changing anything with respect to those rights in the prior MRDA. It is how the prior MRDA defines the rights of the participants that is important.

103 Confidentiality provisions are contained in the MRDA. The Monitor contends that because under article 6(a) the licensed participants owe a duty of confidentiality to NNL regarding the NN Technology but NNL does not owe such a duty to the Licensed Participants is an indication of the ownership by NNL of the NN Technology. The U.S. Debtors contend that because exceptions to the duty of confidentiality in article 6(d) give the right to the Licensed Participants to communicate to suppliers, customers and third persons licensing rights to use the NN Technology that they must have been given the authority to license to such third parties.

104 I think too much is made by each side of these confidentiality provisions. There is something perhaps in each side's argument, but I would not read article 6 as expanding on or limiting the ownership or license rights of the NN Technology. That was not its purpose. Regarding article 6(d)(iii), it begs the question as to whom the rights were given to license to third parties, and in light of the evidence of sub-licensing prior to the MRDA, to which I will refer in dealing with surrounding circumstances or the factual matrix, it is clear that NNL was a party to all such sub-licensing and NNI alone never sub-licensed.

105 The U.S. debtors contend that what was intended by IPCo comfortably falls within the definition of a Product and that therefore what was sold to Rockstar embodied rights that NNI had. They contend:

> IPCo was a licensing service business that the Participants proposed to be developed and indeed were actively developing, and which indisputably embodied the entirety of the Patent Portfolio sold to Rockstar, fits comfortably within the plain meaning of a "service" and thus the definition of "Products".

106 I do not agree. IPCo was considered for a time after the insolvency filings in January 2009. It could not be considered to have been part of the operating arrangements of Nortel while it carried on its business or intended to be governed by the MRDA. IPCo was not intended to be a "licensing service" business. The evidence of Sharon Hamilton, which I accept, is that the proposed business of IPCo was to use threatened or actual litigation against technology companies making their own products which arguably used or embodied NN Technology, in an attempt to encourage them to take and pay for a license to NN Technology. That was not a business contemplated in any meaningful way at any time that the MRDA or its predecessor was negotiated or signed.

107 The economic analysis prepared by Horst Frisch in 2002 as part of its work in devising the RPSM for the MRDA referred to Nortel customers choosing Nortel products and services because Nortel is committed to using its R&D resources in providing full pro-active service and support to its customers. A functional analysis for the years 2000 to 2004 sent by Nortel to the tax authorities in 2004 said the same thing. It also stated:

> Nortel's networking solutions generally bring together diverse networking products from its various product families, and related services, to create either a customized or "off the shelf" solution for customers. Nortel's business consists of the design, development, manufacture, assembly, marketing, sale, licensing, servicing and support of these networking solutions.

108 The definition of Products in the MRDA is:

> "**Products**" shall mean all products, software and services designed, developed, manufactured or marketed, or proposed to be designed, developed, manufactured or marketed, at any time by, or for, any of the Participants, and all components, parts, sub-assemblies, features, software associated with or incorporated in any of the foregoing, and all improvements, upgrades, updates, enhancements or other derivatives associated with or incorporated in any of the foregoing.

109 Taken this definition, the license to NNI and the other participants was to "make, use..., license...sell" Products using or embodying NN Technology by, or for, the Participants. The Monitor contends that giving someone else (i.e. not any of the Participants) the right to use or embody NN Technology in their own products are not "services" within the Products definition in the MRDA. The Monitor contends that on the U.S. Debtors' reading of the word "services" in the MRDA, NNI could have provided a "service" to competitors of Nortel by permitting them to use in the U.S. the entirety of Nortel's patent pool to make their own products to compete with Nortel. The plain reading of the MRDA and common sense are contrary to this interpretation.

110 I agree with the Monitor's interpretation of the MRDA. At the time the MRDA was being considered, Nortel was not in a business of licensing its services to others for the business of others. It was providing a service to its customers to support the technology being acquired by its customers. The MRDA must be read in that context. What was contemplated for a relatively short period of time after the world wide insolvency of the Nortel Group was simply not in the cards prior to that time.

(b) The right to sue for infringement

111 The U.S. Debtors contend that the right to sue is central to their rights as exclusive licensee in the U.S. The right to sue is contained under Article 4 which is headed Legal Title to NN Technology. The right is not contained in the exclusive or non-exclusive licenses under article 5. I cannot read this right to sue as being part of the licenses granted to the licensed participants in article 5. Articles 4 (a) and (e) are relevant, and provide:

> (a) Except as otherwise specifically agreed, legal title to any and all NN Technology whether now in existence or hereafter acquired, or developed pursuant to the terms of this Agreement, shall be vested in NNL. In consideration therefor, NNL agrees to enter into an Exclusive License and a Non-Exclusive License with each of the Licensed Participants as set forth in Article 5.
>
> (e) Licensed Participants have the right to assert actions and recover damages or other remedies in their respective Territories for infringement or misappropriation of NN Technology by others.

112 This right was not contained in the prior CSA. It first appeared in the MRDA.

113 This right in sub-article 4 (e) does not state that the Licensed Participants have the exclusive right to bring action in their territories. The exclusive rights which the Licensed Participants have are contained in the exclusive license rights in article 5. There is no provision in the MRDA that precluded NNL from suing for patent infringement in a territory in which Licensed Participants had exclusive license rights. Indeed, the limited practice in the U.S. before the MRDA was signed was that both NNL and NNI were named as plaintiffs in infringement actions. To the extent those actions can be considered to be part of the factual matrix, it explains why the right to sue granted to NNI was not an exclusive right.

114 The right to sue for damages given to the Licensed Participants in their exclusive territories would obviously require a Licensed Participant to establish that it had been damaged. If the suit involved a breach of rights which the Licensed Participant had under its license, damages could presumably be proven. However, if the suit involved a breach of rights which the Licensed Participant did not have under its license, damages could not be proven.

115 If a Licensed Participant were the only plaintiff, which does not appear to have ever been the case, presumably it would be open to a defendant to contend that the Licensed Participant had not suffered any damages as what was being done by the defendant was not something that the Licensed Participants could have done under its license. That defence would not likely be run if both NNL and the Licensed Participant such as NNI were plaintiffs.

116 The Licensed Participants were not given any right to sue for damages for patent infringement in non-exclusive territories. This right was held by NNL.

(iv) Surrounding circumstances or the factual matrix

117 What may be looked at in constructing an agreement is objective evidence of the background facts at the time of the execution of the contract. It may not include evidence of the subjective intent of a party or what a party believed a contract to mean. Whether something was or reasonably ought to have been within the common knowledge of the parties at the time of execution of the contract is a question of fact.

118 There is an issue regarding the timing of the evidence that may be looked at. The exclusive licence to the Licensed Participants was contained in the 1985 CSA between Northern Telecom Limited [now NNL] and Northern Telecom Inc. [now NNI] signed in December 1984 and continued with no substantive changes in the 1992 CSA and in the MRDA and its later

addenda. I would not, however, limit the time of the surrounding circumstances to the time that the CSAs were signed. The MRDA was made on December 22, 2004 effective January 1, 2001. Thereafter, while there were a number of changes to the MRDA in various addenda, no changes of substance were made to the operative provisions regarding the rights of the participants in NN Technology. I think the surrounding circumstances to the time of the signing of the MRDA in December 2004 can be looked at. Although there were some modifications to the MRDA after that, none involved any substantive change to the rights of NNL or to the exclusive licenses given to the Licensed Participants.

119 There was a great deal of evidence led by the U.S. and EMEA interests as to the subjective views of the witnesses, mostly tax personnel, regarding the rights of the parties under the CSA or MRDA or what the witnesses understood the language to mean, or in one case as to the witness's understanding of what others understood the documents to mean. Apart from the latter being inadmissible hearsay, all of this evidence was not admissible as it amounted to subjective views as to the meaning of an agreement. Nor was it admissible under the factual matrix rule permitting objective surrounding circumstances at the time of the execution of the agreement to be considered, and I do not consider it [14] . For example, what Mr. Henderson thought about the rights under the CSA license, that he copied from an earlier version of the CSA, or what others thought the MRDA meant or what they thought the intent of it was is not to be taken into account. See *Sattva*, *supra*, at para. 59.

120 I think it right to point out that not all of the evidence was one way. For example, the evidence of Angela De Wilton, the director of Intellectual Property in the Nortel IP law group and the director of IP strategy, was that Nortel was the owner of the patents and not just for administrative reasons. This evidence, elicited on cross-examination, also suffers from it being her subjective view of the rights of the parties under the MRDA. There were other witnesses who said much the same thing, such as Mr. Binning, the Executive Vice-President and CFO of NNC and NNL from November, 2007 to March, 2010 who said on his cross-examination that he understood that NNL owned the IP. This evidence suffers from the same problem of being a subjective view of the rights of the parties. The point is that that not all witnesses agreed with the subjective views of other witnesses.

121 There was also some evidence led of a prior draft of the MRDA and the views of an outside tax lawyer at Oslers who acted for NNL as to the particular draft language. This evidence is also inadmissible as being a prior draft and as constituting that particular lawyer's subjective views as to what the MRDA should contain.

122 A great deal of evidence, including evidence of statements made to tax authorities, had to do with economic theories of transfer pricing. As the transfer pricing principles changed from a cost sharing approach to a residual profit sharing approach, the economic theories and statements to tax authorities changed. One thing that did not change from the CSA approach to the RPSM approach was the language of the license grant from NNL to the other participants. It is that language that must be considered.

(a) 1996 APA

123 The 1992 CSA between Northern Telecom Limited (now NNL) and Northern Telecom Inc. (now NNI) was made with effect from January 1, 1992 but was not drafted until 1996 after the negotiations with the CCRA in Canada and the IRS is the U.S. in the advance pricing agreement process, so as to reflect the terms of the APA made with each of those tax authorities.

124 The U.S. Debtors say that the APA makes clear that NNI was entitled to all of the benefits of the NN Technology in the U.S., including all sub-licensing rights. I think they draw too long a bow. The APA between Northern Telecom and the CCRA was an agreement which by its terms was to "establish a cost sharing methodology which will result in the allocation of expenses to NNI by [NNL] for R&D done by [NNL] and its subsidiaries...which will constitute reasonable amounts in the circumstances for the purposes of section 69 of the Income Tax Act". The concern of the tax authorities was that the costs of R&D be properly allocated between NNL and NNI. The purpose of the APA was not to agree how the income of NNL and NNI was to be shared or allocated, but how to apply R&D expenditures to whatever the income was for each of NNL and NNI.

125 Article 1.1 of the APA stated that the allocation of R&D expenses was to be determined in accordance with the cost sharing methodology described in appendix A. Appendix A is headed Cost Sharing Methodology. It contains detailed formulae to determine how R&D is to be allocated. At the outset, it has a section headed Understandings. The first understanding is that all benefit derived from R&D expenses is recognized either in the selling of a finished product to an unrelated customer or from

the licensing of the technology resulting from the R&D expense (the "Benefit") within a defined geographical market by a Cost Sharing Participant ("CSP"). It goes on to state that "[NNL], as a CSP, "is entitled to all Benefits in all geographical markets except for the part(s) thereof granted to another CSP" and "NNI is also a CSP and its geographical market is the united States of America and the Commonwealth of Puerto Rico".

126 This statement that NNL is entitled to all Benefits in all geographical markets except for the part(s) thereof granted to another CSP is somewhat unclear. It could refer to all Benefits except for parts thereof granted to another CSP, or to all geographical markets except for those parts granted to another CSP. The former would seem to make sense because there would be no purpose in stating that NNL was entitled to all benefits in all geographical markets except those granted to another CSP as the following sentence states that the geographical market of NNI is the U.S. and Puerto Rico. If as I read it the understanding was that NNL was entitled to all benefits except for those granted to a CSP, the document begs the question as to what benefits were granted to NNI, which is the issue in this case.

127 It is understandable, as Mr. Henderson testified, that the parties needed to wait until the APA was settled with the tax authorities before the 1992 CSA was settled as the APA stated that it was to apply to the taxation years 1992 to 1999. That does not mean, however, that the parties needed to know how revenue was to be allocated by the APA. The purpose of the APA was to obtain an agreement from the revenue authorities how to allocate R&D costs, not revenues. This is borne out by Mr. Henderson's admissions on cross-examination that the 1992 CSA just adopted the license language of the 1985 CSA and that all operative provisions were the same.

(b) Sub-licences

128 Both sides refer to the evidence of sub-licensing as refuting the case of the other. In this I think they are incorrect. Not a great deal is clear from this evidence.

129 The reply closing argument of the U.S. Debtors contains a list of "Sublicenses Involving NNI". None were made only by NNI. Many were made by NNL and NNI and others were made by NNL on behalf of itself and its subsidiaries.

130 The sublicenses made by NNL and NNI recited that NNL has granted to NNI "certain rights to license said patents" in the U.S. In the body of the agreement it provides that NNL and NNI "to the extent of their legal right to do so" grants a license to the licensee for the countries and jurisdictions in which Nortel now or in the future holds the Nortel patent. What rights had been licensed to NNI is not stated in the sublicense. Some sublicenses provided that the royalties were payable to NNI, with NNI having the right to direct some or all of the payments to NNL. Others, being a majority of them, provided for the royalties to be payable to NNL with NNL having the right to direct some or all of the payments to NNI. In the case of cross-license agreements, the royalties were payable to NNL and there was no provision for NNL to direct some or all of the payments to NNI.

131 In agreements made by Nortel, defined as NNL on behalf of itself and its subsidiaries, regarding U.S. patents, it was stated that Nortel was the owner of the patents and that Nortel granted world-wide license rights for the patents. Other agreements involving other patents made by Nortel, also defined as NNL on behalf of itself and its subsidiaries, recited that Nortel was the owner of the patents. The effect of the language in this form of agreement is that the patents are owned by Nortel on behalf itself and its subsidiaries, which supports the position of EMEA that all patents were jointly owned by the MREs.

132 The U.S. Debtors point to some evidence of certain Nortel tax personnel to explain the forms of sublicensing agreements used by Nortel. One is an e-mail exchange in 2002 involving two different views from two different tax persons, in which subjective views as to what the license in the CSAs from NNL to the other participants meant and what the theory of the sublicensing agreements was. The other is an e-mail in 2000 from someone professing not to be an expert in tax and passing on his understanding of what the tax people's view was. Apart from the latter being hearsay and inadmissible, this e-mail evidence contains subjective views of the extent of the license in the CSAs from Nortel to the other participants in the CSAs and is inadmissible.

133 Nortel's IP team prepared a presentation after the sale of the business lines in connection with the stalking horse bid process for the residual intellectual property. The presentation reviewed the history of Nortel's portfolio including its past

licensing activities. It stated that Nortel previously had a small licensing group which was not a core focus of the company. There were virtually no assertions against major players, customers or partners and they focused on smaller companies with limited ability to fight back. They had earned approximately $37 million per year in royalty income. The licensing operations ceased in 2007 for budgetary reasons but in 2008 Nortel made a decision to restart the licensing organization. Mr. Binning, the Executive Vice-President and CFO of NNC and NNL from November 2007 to March 10, 2010 said that during that time Nortel was not in the license business. I take it from this evidence that for a business as large as the Nortel business, it would appear that sublicensing was an insignificant business for Nortel prior to its bankruptcy.

134 If one follows the money from the sublicenses, the evidence is that the royalties were split on the basis of the MRDA participant's contributions to R&D. The royalties were incorporated into the RPSM calculations even although they were not mentioned in Schedule A to the MRDA. Why this was done was not made clear by Mr. Stephens who gave the evidence of this happening. With one exception, we were not pointed to any evidence as to what was done with any royalties received prior to 2006, which is perhaps a more germane period as being prior to the signing of the MRDA. In 2004 a settlement of $35 million with Foundary Networks, Inc. was split on the basis of the RPSM.

135 In sum, there were no sublicenses when the license was granted by NNL to NNI at the time of the 1985 CSA. There were a number after that which do not indicate any clear pattern of what sublicense rights either NNL or the other participants were recognized to have. Sublicensing was a very insignificant part of the Nortel business prior to its insolvency.

(c) Representations to tax authorities

136 I have already discussed the 1996 APA process.

137 In connection with the switch from a CSA approach to a RPSM approach, Horst Frisch, a leading firm of transfer pricing economists, was retained to advise Nortel. Horst Frisch prepared a report dated March 14, 2002 titled Economic Analysis of Nortel Networks' Intercompany Transactions and this report was given to the tax authorities.

138 The U.S. interests point to a statement at page 10 of the report that stated from an economic standpoint, each participant could be considered to "own" the NT Technology. The paragraph in question made clear that what was being discussed was the situation under the CSA that existed up to the end of 1999. It stated:

> Prior to 2000 Nortel shared it global R&D expenses pursuant to its R&D cost sharing arrangement ("R&D CSA"), which dates back to the mid-1970's (with several amendments). Under the arrangement, each cost sharing participant ("CSP") had the right to use the intangible property developed pursuant to the R&D cost sharing arrangement (i.e., the NT Technology") in its respective market. From an economic standpoint, each R&D cost sharing participant could be considered to "own" the NT technology as it related to its specific region.

139 What is meant by "from an economic standpoint" each participant could be considered to "own" the NT technology as it related to its specific region is not clear. The OECD Guidelines and transfer pricing regulations in the U.S. and Canada all define intangible property to include licenses or rights to use assets. The statement of Horst Frisch that each participant had the right to use the IP and from an economic standpoint could be considered to "own" the NT technology could well have referred to owning the license rights held by each participant rather than referring to the underlying NT technology. The U.S. Debtors in their opening brief acknowledged case law to the effect that the rights an exclusive licensee holds are referred to as beneficial ownership.

140 Horst Frisch was clearly not talking about legal rights, nor were they discussing particular language in the CSA. Even had they purported to give their views as to what legal rights the parties had under the CSA or the MRDA, which they were not, those views would not have been admissible. Horst Frisch was discussing economic theory.

141 A few pages further in the report, when Horst Frisch were discussing what would occur under the RPSM method of allocating profits under the MRDA, they stated that the economic theory underlying the CSA was not applicable to the RPSM of allocating profits. The report stated:

> As noted above, under the prior R&D CSA the CSP which ultimately made the sale to a third party in its exclusive territory was deemed to have economic ownership of the NT Technology since the third party sale attracted an R&D allocation under the CSA.
>
> In the absence of the R&D CSA, with the two exceptions noted above, each old CSP will incur R&D expense which should entitle it to share in Nortel's global profits or losses. We have not attempted to attach these R&D expenses to the manufacturing or the distribution operation of the old CSPs since there will no longer be a formula by which global R&D expenses are shared (i.e., a third party sale will not attract an R&D allocation so it is not reasonable to assume that only the selling entity will continue to own the valuable intangibles). The amount of R&D performed is not necessarily correlated with third party sales or manufacturing activity. Rather, each entity will perform and pay for its own R&D expenses, and has the ability to sell Nortel products worldwide and share in global profits or losses.

142 What Horst Frisch were saying was that the economic theory of the participant in a third party sale in its territory "owning" the intangibles would not apply to such a sale under the MRDA. Perhaps implicitly they were saying that the economic "ownership" of the intangibles would be owned by all of the participants in accordance with their R&D spend under the MRDA, although this is not expressly stated. If so, from an economic point of view, it would be more consistent with the position of EMEA rather than the U.S. or Canadian interests. [15]

143 After the APAs were applied for in 2002, the tax authorities visited various Nortel sites. They then posed a number of questions. In September 2003 Nortel send a 45 page response to these questions. One of the questions was to update the authorities on any developments since the APA submission was made and whether any changes to the proposed transfer pricing methodology were anticipated. One of the responses of Nortel had to do with restructuring charges. The U.S. interests point to a statement that the residual entities are the owners of the intangible property. The context is important to see what was being said. Included was the following:

> In 2000 and later years, the telecommunications industry experienced a decline in demand unlike any other substantial industry in modem history. For that reason, there does not appear to be any precedent for analyzing the above issues. Accordingly, a reliance on basic economic principles was deemed necessary.
>
> In an arm's length situation, it was determined that the residual entities would agree to reimburse the distribution entities for a portion of their restructuring charges rather than have those entities become insolvent and forced into receivership. Generally, the underlying economic rationale for this argument is this: the residual entities, as the owners of the intangible property, as well as the manufacturers of the tangible goods, would recognize that its distribution network is critically necessary for their long-term survival. Should members of the distribution network become insolvent/cease operations, the residual entities' ability to offer their products for sale may be severely impacted. Therefore, it is in their best economic interests to ensure that a strong global distribution network exists.

144 This is a discussion of economic theory. It cannot be construed as a discussion of legal principles or the meaning of the MRDA. The reference to being owners of the intangible property could well be a reference to license rights rather than the underlying intangibles, as license rights are intangible property.

145 Dr. Timothy Reichert, a transfer pricing expert called by the Monitor, made the following statement about economic ownership as considered in transfer pricing, a statement not contradicted by any witness:

> A central concept in transfer pricing is that of "economic ownership" (referred to, alternatively, as "beneficial ownership," and simply "ownership"). Economic ownership is not a reference to ownership in a legal sense, but rather refers to a party's right to benefit from an income stream attributable to a defined undertaking or activity.

146 This statement cannot be disregarded. An economic right to an income stream attributable to a defined undertaking or activity requires one to know what is the defined undertaking or activity. The economic statements made to the taxing authorities did not purport to define the precise limits to the license granted by NNL to the participants under either the CSA or

the MRDA. As seen, the statements made to the taxing authorities did not at all make clear what rights were being referred to and in particular, whether the "economic or beneficial ownership" was in the underlying NN Technology or in the license rights to that technology. They cannot be taken as statements that under the MRDA the licensees legally owned the NN Technology.

147 To the contrary, Mr. Weisz, the Leader of International Tax at NNI who was involved in Nortel's transfer pricing policies, and who was asked by Mr. Dolittle, the VP of Tax for Nortel to become involved in the APA process that had stalled, told the IRS during that process that it was NNL that was the legal owner of the IP.

148 It must also be recognized that the APA process with the tax authorities was to arrive at an agreement with them regarding the Nortel operating business. It was an operating business with profits and losses that the tax authorities were interested in. This was the case both for the APA processes for both the CSA and MRDA. There were no discussions with the tax authorities as to what would happen on the insolvency of the entire business of Nortel. The discussion of the economic theory of economic or beneficial ownership must be considered in that light. They were not discussing such a theory in so far as it might apply to the situation of a cessation of business as occurred with Nortel.

149 The issue in this case has to do with the breadth of the licenses granted to the Licensed Participants and whether that included the right to sublicense the residual patent portfolio that was eventually sold to Rockstar. However at the time of the APA processes, sublicensing was a miniscule part of the business of Nortel and not surprisingly I have been pointed to no presentation to the tax authorities that discussed this issue. It was not on the Nortel radar.

150 The MRDA was provided to the tax authorities. They also had the prior CSA. The U.S. interests do not say that NNI rights were obtained other than in the CSA and then the MRDA. The tax authorities had these agreements and were able to read them, and were in as good a position as anyone to form their own view of what the agreements did or did not do. It cannot be suggested that the tax authorities did not understand transfer pricing. It was their business to know it.

151 There is evidence relied on by the EMEA debtors to support their position that the proceeds of the sale of the residual IP should be allocated in accordance with the relative expenditure on R&D by NNL and the licensed participants. After the APS application was filed by Nortel with the tax authorities in 2002, planning for a June 19, 2002 joint meeting with the three tax authorities took place in earnest, including the preparation of answers to questions Nortel anticipated might be raised by the tax authorities. In preparation for the meeting, Nortel engaged advisors from Deloitte & Touche LLP, KPMG LLP, Horst Frisch, and Sutherland Asbill & Brennan LLP to assist. Mr. O'Connor of Deloitte's prepared the following answer to an anticipated question regarding the sale of any IPCo, an answer that was circulated and agreed before the meeting:

> [Q:] How does Nortel propose to account for any future sale of intellectual property developed prior to or during the term of the APA? Which entities are considered the legal owner of IP and which are considered the economic owners?
>
> [A:] Proceeds from the sale of IP will be allocated to residual profit split participants on the basis of their economic ownership of the IP — that is, on the basis of their share of total R&D capital stock in the year of sale.

152 The document was taken to the joint meeting. There is no evidence one way or the other as to whether the question was asked. While the question does not deal with what would happen if all of the Nortel IP was sold on a world-wide insolvency of Nortel, it is evidence that at the time of the APA process, Nortel was prepared to say that any sale of IP would be split in accordance with the RPSM in the year of the sale.

(d) Avoiding permanent establishment status in the U.S.

153 The U.S. interests contend that it was important to NNI not to be considered a U.S. resident for U.S. tax purposes and thus not have "permanent establishment" in the U.S. It is contended that it was this concern that drove separate legal entities to be set up for each country and for the license to be exclusive to the Participants for their territory so that the Participants would be the only ones dealing with customers in that territory.

154 Taken that as the situation, I do not see that it gets very far. There is no question that the exclusive license gave NNI the exclusive right to sell Nortel products in the U.S. The important issue in this case is what rights NNI had to sub-license and whether it was restricted to Nortel "Products" as defined in the MRDA. Sub-licensing was a miniscule part of the business of Nortel and there is no evidence at all that sublicensing issues drove the setting up of companies in different jurisdictions.

(e) Patent litigation

155 I have previously referred to the patent litigation that had taken place prior to the MRDA. Both NNL and NNI were plaintiffs in the actions in the U.S. Why that was so does not really matter. It explains why the right given to licensed participants to sue in their territories for damages for patent infringement was not an exclusive right.

156 As to what was done with the proceeds of patent litigation, there was a settlement in October, 2004 of an action commenced by NNL and NNI against Foundary Networks, Inc. $35 million was paid for past infringement and for future royalties under a license agreement. The entire payment was treated as royalty income and allocated to NNL and the Licensed Participants in accordance with the RPSM in the MRDA.

(f) Conclusion of factual matrix evidence

157 I do not consider the surrounding circumstance or factual matrix evidence to provide much clear assistance in construing the meaning of the terms in the MRDA. Even if it did, I would be required to be guided by the dictates of *Sattva* that while the surrounding circumstances will be considered in interpreting a contract and the goal of examining such evidence is to deepen a decision-maker's understanding of the mutual and objective intentions of the parties as expressed in the words of the contract, they must never be allowed to overwhelm the words of the contract and the interpretation of a contract must always be grounded in the text. While the surrounding circumstances are relied upon in the interpretive process, courts cannot use them to deviate from the text such that the court effectively creates a new agreement.

(v) Commercial reasonableness

158 The U.S. interests and EMEA say that the Monitor's interpretation of the MRDA is commercially unreasonable. They contend that no party at arm's length would agree to spend large amounts to develop patents but only one party would be entitled to all of the proceeds from the sale of those patents.

159 It must be remembered that the MRDA and its predecessor CSA were drafted to come to terms with the tax authorities. The parties to the negotiations were Nortel on the one hand and the tax authorities on the other. The resulting CSA and then MRDA were operating agreements premised on cost sharing under the CSA and profit or loss sharing under the MRDA. The tax authorities were interested in the tax that each Nortel entity would pay each year. The tax authorities dealt in only limited periods of time. The 1992 CSA was settled with the tax authorities only in 1996, yet in 1999 they made it clear they wanted Nortel to abandon the CSA agreement and instead change to a RPS method of transfer pricing.

160 Nortel and the tax authorities were not negotiating on what would happen if Nortel stopped operating or in the event of a world-wide insolvency of Nortel. More particularly, they were not negotiating on how the proceeds of the sale of the entire Nortel world-wide patent portfolio would be allocated amongst the various Nortel companies in the event of the insolvency of Nortel. That was not discussed. This is not surprising because, as Dr. Eden testified, transfer pricing rules were developed only in connection with ongoing entities for purposes of determining their corporate tax.

161 The issue of commercial reasonableness must be considered in the context of who was involved in the preparation of the MRDA. It was not the technology people. Mr. Brian McFadden, the Chief Technology Officer of Nortel at the time the MRDA was drafted and signed, was not consulted about its terms and never heard of the MRDA while at Nortel. Ms. Angela de Wilton, the Nortel Director of Intellectual Property had no recollection of ever seeing the MRDA. In order to make the argument that it would have been commercially unreasonable for a Nortel company to agree to do R&D leading to patents and not be paid for the patents on the sale of the business, one would think that the people responsible for the R&D would have at least known of the

agreement and its terms. The fact that they did not indicates that a trade-off of R&D for future receipts on a sale of the business was not on the radar screen at all so far as the operating people were concerned. The language of the MRDA was all tax driven.

162 So far as what was on the radar of the tax people at Nortel at the time the terms of the MRDA were settled, in so far as the quid pro quo for doing R&D was concerned, the MRDA expressly provided in Article 2(c) that any compensation for R&D was to be based solely on the RPSM allocation. It stated:

> (c) All costs incurred directly or indirectly by each Participant for R&D Activity shall be borne exclusively by it. Any reimbursement for costs including any other compensation shall be provided to such Participant for its R&D Activity solely as provided in Article 3 below.

163 Article 3 that the annual sharing of profits or losses under the residual profit split method was what was to be received for each participants R&D that year. It stated:

> **Article 3 — R&D Activity Payments**
>
> (a) For and as a consequence of the performance of R&D Activity, each Participant shall be entitled to receive a payment in an amount equal to the allocation determined under the RPSM (the "R&D Allocation") as the measure of the benefit to which it is entitled commensurate with its performance of, and contribution to, R&D Activity.

164 In the context of what the parties were dealing with in the MRDA, I do not see how it can be said that it was commercially unreasonable for them to agree that in return for doing R&D each year, they would share only in the profits or losses in accordance with the RPSM allocation. That is all they had in mind. While Nortel had suffered losses by 2004 when the MRDA was signed, there is no evidence that Nortel expected to have only losses in the future. To the contrary, the operating people at Nortel expected that Nortel would return to profitability.

165 Mr. Henderson testified that a bankruptcy or insolvency of Nortel was not in their minds at the time the RPSM in the MRDA was created. The fact that they did not consider or provide what was to happen to the proceeds if all of the IP was sold after a world-wide insolvency does not make the agreement commercially unreasonable. The time for considering whether an agreement properly interpreted is commercially reasonable or unreasonable is surely the time when it was agreed, not in hindsight.

166 The U.S. Debtors called Dr. Catherine Tucker, a transfer pricing expert, whose evidence was to the effect that under the Monitor's interpretation of the MRDA, the Licensed Participants would lack appropriate incentives to undertake expensive and speculative R&D for the next potential generation of products. I do not think her evidence helpful. It is really an inadmissible subjective view as to how the MRDA license should be interpreted.

167 There is no basis for Professor Tucker's assumption that the MRDA was intended to create incentives for the Licensed Participants to make forward-looking innovations. The fact that Mr. McFadden, the Chief Technology Officer of Nortel at the time of the MRDA, was not consulted about the MRDA and knew nothing about it belies any such assumption. Professor Tucker's assumption also ignores the way in which R&D was carried out at Nortel.

168 The majority of Nortel R&D was directed by the various Business Lines, which had to prepare annual R&D plans for approval. The remaining R&D, the advanced technology research (the "leap from one S-curve to the next" that Professor Tucker describes), was coordinated by the Chief Technology Officer. The evidence of Mr. McFadden was that all advanced technology programs were based in Ottawa and were operated by NNL. While product development R&D groups within each of Nortel's lines of business reported directly to the heads of their business units, the advanced technology programs personnel within each line of business reported directly to the CTO's office at NNL. The R&D was not the bailiwick of any Licensed Participant.

(vi) Conclusions on the meaning of the MRDA

169 I interpret the MRDA, and find, that under it, and while Nortel operated as a going concern business, NNL had all ownership interests of the NN Technology subject to grants, being (i) the grant to each Licensed Participant of a non-exclusive

right to assert actions and recover damages in their territory under article 4(e) and (ii) the grant of exclusive and non-exclusive licenses to the Licensed Participants under article 5(a).

170 The licenses under article 5(a) were not licenses of all rights to the NN Technology but were subject to field of use restrictions that gave the Licensed Participants the right to use the NN Technology to make, use or sell Products as defined in the MRDA, which meant products, software or services that were made or sold by, or for, any of the Licensed Participants. The Products must have been created or marketed by or for the Nortel Group. No product that was part of a third party's business rather than the business of Nortel fell within the definition of Products. The business considered by IPCo was not covered by the licenses. The Licensed Participants' rights to sublicense were subject to these restrictions.

Applicability of the MRDA to the allocation issues

171 Nortel Networks UK Pension Trust Limited and the Board of the UK Pension Protection Fund (the "UKPC") contend that the MRDA was never intended to provide an answer to the question of how to allocate among the bankrupt estates the proceeds of the sale of the Nortel Group's assets following the world-wide insolvency of Nortel.

172 I agree. The MRDA was an operating agreement and was not intended to, nor did it, deal with the disposal of all of Nortel's assets in a situation in which no revenue was being earned and no profit or losses were occurring. The MRDA provided in its opening line that it was an agreement "confirming and formalizing the operating arrangements" of the parties.

173 There is a provision in schedule A to the MRDA added in the third addendum effective January 1, 2006 but signed by the parties late in late December 2008 or early January 2009 that indicates that sales of property were not intended to be dealt with under the MRDA. That schedule A provided that in dealing with the calculations of the Nortel earnings/losses to be used in the RPSM calculation, there was to be deducted "gain/loss on the sale of business". A gain or loss would normally be taken into account on the particular company's statement of profit and loss and the Participants decided they did not want any such gain or loss to influence the calculation of profits or losses for the purposes of calculating the allocation of profits or losses in the RPSM calculation. Mr. Orlando testified that the sale of a business was seen to be a non-operating activity. This provision is an indication that the MRDA was not intended to deal with the sale of any assets, let alone the world-wide assets of the Nortel Group.

174 The MRDA and its predecessor Cost Sharing Agreements ("CSAs") were developed for and driven by transfer pricing concepts. They were drafted to come to terms with the tax authorities. The MRDA expressly provided in a recital that the calculation of the RPSM might have to be adjusted as a result of its review by the tax authorities. The MRDA was drafted by tax lawyers and tax advisors. The primary external counsel involved, and lead drafter of the MRDA, Giovanna Sparagna, testified that the MRDA is "primarily focused on transfer pricing," which is "part of tax law," and it is "primarily [a] tax law document[]." The MRDA was signed on behalf of NNL by John Doolittle, Nortel's Vice-President of Tax. All parties acknowledge that the MRDA was a tax-driven document designed to implement Nortel's transfer pricing policies.

175 Following the insolvency proceedings on January 14, 2009, no transfer pricing payments were made under the MRDA. The two special cash payments made by NNI to NNL were made under different agreements, being the IFSA dated June 9, 2009 and the FCFSA dated December 23, 2009.

176 Dr. Eden, who testified on behalf of the U.S. Debtors, testified that transfer pricing was only for ongoing businesses. She also testified that she saw the MRDA as a transfer pricing document and that the RPSM method contained in it was only used for corporate income tax purposes. She and other transfer pricing experts such as Dr. Richard Cooper, Dr. Steven Felgran and Dr. Timothy Reichert testified to the effect that transfer pricing does not address entitlement to the proceeds of the sale of assets on insolvency.

177 I accept that the MRDA was a transfer pricing document created for tax purposes. The licenses were a part of it. The licenses granted under it were never dealt with separately from the MRDA. Their only purpose was to support the intended tax treatment resulting from the MRDA.

178 It can perhaps be argued that under article 9 of the MRDA the rights of NNL under article 4 and of the Licensed Participants under article 5 continued on the expiry or termination of the agreement, indicating a purpose other than tax that survives the insolvency of the Nortel enterprise. I would not construe those provisions that way.

179 The relevant provisions of article 9 of the MRDA provide:

> **Article 9 — Duration and Continuing Rights and Obligations**
>
> (a) This Agreement shall be effective from January 1, 2001 until December 31, 2004, provided however that this Agreement will automatically renew for additional and unlimited one-year terms until terminated by the mutual written consent of all Participants.
>
> (b) Upon the expiry or termination of this Agreement as provided herein, each Licensed Participant shall be deemed to have acquired a fully paid up license permitting it to continue to exercise the rights granted to it herein, and, in particular, the rights granted to it in Article 5 as though this Agreement had continued.
>
> (c) The provisions of Article 4 (Legal Title to NN Technology) with respect to NN Technology acquired or developed pursuant to this Agreement from the Effective Date of this Agreement up to and including its expiry or termination date, Article 6 (relating to confidentiality) and Article 7 (relating to liability) shall survive notwithstanding the expiry of this Agreement, or any termination of this Agreement for any cause whatsoever.

180 Under article 9, the MRDA automatically renewed after 2004 unless terminated by mutual consent of all parties to it. If terminated, the Licensed Participants were to be deemed to have acquired a fully paid up license "permitting it to continue to exercise the rights granted to it herein... as though this Agreement had continued". This provision by its terms contemplated the business of the Licensed Participants continuing to operate. It did not contemplate a situation in which all of the Licensed Participants liquidated their assets and went out of business.

181 The CSAs contained a similar provision regarding the rights of the Licensed Participants on termination to a fully paid up license. At the end of 1999, the tax authorities did not want to renew the APAs and they encouraged Nortel to adopt a RPSM. In December, 2001, Nortel's CSAs for R&D were terminated effective January 1, 2001. In spite of the termination of these agreements, Nortel continued to operate and it was only on December 22, 2004 after negotiations with the tax authorities that the MRDA was executed with an effective date of January 1, 2001. The MRDA stated that it confirmed and formalized the operating arrangements of the Participants as and from that date. That is, the license rights under the CSAs continued to be used in accordance with the terms of the CSAs, and Nortel's tax advisors told that to the tax authorities on April 26, 2004. This was contemporaneous with the MRDA being settled.

182 One can see from this that the purpose of continuing rights under article 9 of the MRDA after a termination was to permit the Participants to continue operating, during which a new agreement would have to be negotiated. Nortel was a multi-national enterprise that had to live with tax authorities where it operated and could not live without a transfer pricing agreement of some kind. As previously discussed, there was no thought at the time of the MRDA being settled that Nortel was not going to return to profitability.

183 Article 11(a) of the MRDA provided that any Participant that was not a party to an APA with the tax authorities could elect to withdraw from the MRDA. Article 11(c)(iv) of the MRDA provided that it was a defaulting event if one of the Participants became insolvent, in which case the Participant automatically was terminated from participation in the agreement. A fourth addendum was made to the MRDA effective December 31, 2008 and signed in early January 2009. It was headed *Standstill Provision* and provided that in the event of an occurrence of an event described at Section (sic) 11(c)(iv), i.e. if a Participant became insolvent, (i) no Participant effected by such insolvency shall be automatically terminated from participating in the agreement, (ii) no Participant shall elect to withdraw from the agreement under Article 11(a), and (iii) NNL would have the right in its sole discretion to terminate participation in the MRDA of any Participant affected by such event, i.e. of a defaulting Participant by reason of its insolvency.

184 This provision did not contain provisions expressed to apply in the event of a world-wide insolvency of all of the Nortel companies. It contained provisions of a standstill nature dealing with a situation in which one Participant became insolvent. It was obviously designed to prevent a Participant from declaring insolvency and then trying to take positions contrary to other Participants and to prevent the other Participants in such an event trying to take positions contrary to other Participants. I do not read this provision as an indication that in the event of a world-wide insolvency of all of the Nortel companies with no operations, the agreement was to continue to govern the affairs of a non-operating enterprise. Had that been the parties' intention, they could have said so in the addendum. They did not.

185 I conclude that the circumstances surrounding the creation of the MRDA lead to no other result but that the construct of legal title to the NN Technology being in NNL in return for NNL granting exclusive licenses to the Licensed Participants was only for the purpose of supporting the proposed method to split profits or losses on a tax efficient basis while Nortel operated as a going concern business. The agreement in its application was intended to apply only to Nortel while it operated and not to deal with rights after Nortel and its subsidiaries stopped operating its businesses.

EMEA position on ownership of the Nortel IP

186 The EMEA Debtors' position is different from the position of the Canadian and U.S. Debtors. They say that the Participants, or RPEs, have joint ownership of all Nortel IP under common law principles by reason of the IP belonging to the RPEs that employed the inventors. They say that the MRDA recognizes that joint ownership and that the joint ownership should be the basis for allocating the proceeds of the sale of the Nortel residual IP.

187 The basic premise of the EMEA Debtors' argument is that the Participants or RPEs were joint owners of all Nortel IP by reason of law. They argue that under Canadian law, the inventor is the first owner of an invention and is the legal title holder entitled to apply for any related patent. However, where the inventor is employed to invent, as the Nortel Group's researchers were, then the employer by operation of law beneficially owns any resulting IP. While the employee inventor who is listed on the patent application holds legal title, the employer is the beneficial owner. Given the integrated nature of Nortel and its R&D created in multiple jurisdictions, the EMEA Debtors argue that each participant beneficially owned not the IP created in its jurisdiction, but rather a share of the indivisible pool of the Nortel Group's IP.

188 Canadian and U.K. law appears to support the principle that where an employee creates an invention as part of his or her employment, the employer is the beneficial owner of the patent. [16] U.S. law is otherwise. Under U.S. law, unless there is agreement to the contrary, it is the inventor and not the employer who is the owner of his or her invention until he or she assigns it [17] .

189 All Nortel employees, whether employed by NNL or a subsidiary, were required to assign directly or indirectly to NNL any intellectual property which they generated during the course of their employment. At least 98% of the patents and patent applications sold to Rockstar had been assigned by the inventors to NNL.

190 The EMEA Debtors say that while the inventors assigned their rights to NNL, the subsidiaries that employed the inventors did not. Thus they say that NNUK, the employer of inventors in the U.K., continued to have beneficial ownership of the patents for inventions created by its employees. I do not accept that. NNUK was required under article 4 (b) of the MRDA to execute such documents as NNL reasonably required to give effect to article 4 (a), which provided for legal title to NN Technology to be vested in NNL. In light of that obligation, NNUK is in no position now to say that the assignment of the IP from its employees to NNL was ineffective.

191 This argument of the EMEA Debtors would not apply to NNI in the U.S. as under U.S. law NNI did not have any such common law rights to IP developed by its employees who assigned their rights to NNL. Nor would it apply to patents invented by employees of NNL who assigned their rights to NNL. The EMEA Debtors' argument, if accepted, would mean that NNUK would only have rights to the IP developed by its employees and would have no joint ownership interest in the IP developed by employees of NNL, NNI, NNSA or Nortel.

192 I cannot accept the joint ownership theory of the Nortel IP or use that theory as a basis for allocating the proceeds of sale of the Nortel IP assets.

Appropriate method to allocate the proceeds of sale

193 While the Monitor on behalf of the Canadian Debtors and the U.S. Debtors take diametrically different views as to their rights under the MRDA, they each look to the MRDA and the rights they say were given to them as the basis of their allocation positions. I have not accepted their position that they obtained rights under the MRDA that determine their right to the proceeds of the sale of Nortel's assets.

194 Nor have I accepted the position of the EMEA Debtors that the RPEs have joint ownership of all Nortel IP under common law principles recognized in the MRDA and that such joint ownership should be the basis for allocating the proceeds of the sale of the Nortel residual IP.

195 Without the MRDA to govern the allocation, and without the joint ownership theory of the EMEA Debtors, the issue becomes one of deciding what metric should be used to allocate the proceeds of sale.

196 In so far as the IP is concerned, while the patents were registered in the name of NNL, I would not for that reason hold that NNL is entitled to the proceeds of the IP sales. The patents and application rights to apply for patents were held in the name of IP for administrative purposes. It was best practices in a multi-national enterprise to have all patents assigned to one company, in this case to NNL, as explained by Ms. Anderson and Ms. De Walton, and made management of the portfolio much easier. While these witnesses expressed subjective views that it was NNL who owned the patents, these views are not determinative, as acknowledged in the Monitor's reply brief at paras 65-66.

197 This was not one corporation and one set of employees inventing IP that led to patents. Nortel was a highly integrated multi-national enterprise with all RPEs doing R&D that led to patents being granted. It was R&D that drove Nortel's business. R&D and the intellectual property created from it was the primary driver of Nortel's value and profits. All parties agree on that. It would unjustly enrich NNL to deprive all of the other RPEs of the work that they did in creating the IP just because the patents were registered in NNL's name.

198 Canadian law permits recovery for unjust enrichment whenever a plaintiff can establish three elements: an enrichment of or benefit to the defendant, a corresponding deprivation of the plaintiff, and the absence of a juristic reason for the enrichment: *Kerr v. Baranow*, 2011 SCC 10 (S.C.C.) at para. 32.

199 U.S. law provides that unjust enrichment occurs where a party obtains a benefit which, under the circumstances and in light of the relationship between the parties, it would be inequitable to retain: *Counihan v. Allstate Insurance Co.*, 194 F.3d 357 (U.S. C.A. 2nd Cir. 1999), 361. It requires the retention of a benefit to the loss of another or the retention of money or property of another against the fundamental principles of justice or equity and good conscience. It is not available if there is a contract that governs the relationship between the parties that gives rise to the claim: *Kuroda v. SPJS Holdings, L.L.C.*, 971 A.2d 872 (U.S. Del. Ch. 2009), 891.

200 On either test, I find that NNL would be unjustly enriched by being entitled to all of the proceeds of the sale of Nortel IP at the expense of the other RPEs who contributed to the creation of that IP just because the patents were registered in NNL's name. It would be inequitable. There would be no juristic reason for the enrichment as the MRDA as I have interpreted it does not deal with the allocation rights of the parties in this world-wide insolvency of Nortel.

201 It would also unjustly enrich NNI if it were to be allocated the amount from the IP sales that it claims based principally on its revenues, which is the basis of the claim by the U.S. Debtors. NNI was able to sell Nortel products based on the R&D and resulting IP performed by other RPEs.

202 This is an unprecedented case involving insolvencies of many corporations and bankrupt estates in different jurisdictions. The intangible assets that were sold, being by far the largest type of asset sold, were not separately located in any one jurisdiction

or owned separately in different jurisdictions. They were created by all of the RPEs located in different jurisdictions. Nortel was organized along global product lines and global R&D projects pursuant to a horizontally integrated matrix structure and no one entity or region was able to provide the full line of Nortel products and services. R&D took place in various labs around the world in a collaborative fashion. R&D was organized around a particular project, not particular geographical locations or legal entities, and was managed on a global basis. The fact that Nortel ensured that legal entities were properly created and advised in the various countries in which it operated in order to meet local legal requirements does not mean that Nortel operated a separate business in each country. It did not.

203 Nortel's matrix structure also allowed Nortel to draw on employees from different functional disciplines worldwide (*e.g.* sales, R&D, operations, finance, general and administrative, etc.), regardless of region or country according to need. Individuals could be part of a team with horizontal responsibility without removing them from their respective position vertically (or departmentally) within the Nortel group. [18]

204 In these circumstances, what principles should be applied to determine the allocation of the proceeds of the asset sales? In my view, doing what is just in the unique circumstances of this case should govern the allocation.

205 A court has wide powers in a CCAA proceeding to do what is just in the circumstances. Section 11(1) provides that a court may make any order it considers appropriate in the circumstances. Although this section was provided by an amendment that came into force after Nortel filed under the CCAA, and therefore by the amendment the new section does not apply to Nortel, it has been held that the provision merely reflects past jurisdiction. In *Century Services*, Deschamps J. stated:

> **65** I agree with Justice Georgina R. Jackson and Professor Janis Sarra that the most appropriate approach is a hierarchical one in which courts rely first on an interpretation of the provisions of the *CCAA* text before turning to inherent or equitable jurisdiction to anchor measures taken in a *CCAA* proceeding (see G. R. Jackson and J. Sarra, "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters", in J. P. Sarra, ed., *Annual Review of Insolvency Law 2007* (2008), 41, at p. 42). The authors conclude that when given an appropriately purposive and liberal interpretation, the *CCAA* will be sufficient in most instances to ground measures necessary to achieve its objectives (p. 94).
>
> **67** The initial grant of authority under the *CCAA* empowered a court "where an application is made under this Act in respect of a company ... on the application of any person interested in the matter ..., subject to this Act, [to] make an order under this section" (*CCAA*, s. 11(1)). The plain language of the statute was very broad.
>
> **68** In this regard, though not strictly applicable to the case at bar, I note that Parliament has in recent amendments changed the wording contained in s. 11(1), making explicit the discretionary authority of the court under the *CCAA*. Thus in s. 11 of the *CCAA* as currently enacted, a court may, "subject to the restrictions set out in this Act, ... make any order that it considers appropriate in the circumstances" (S.C. 2005, c. 47, s. 128). Parliament appears to have endorsed the broad reading of *CCAA* authority developed by the jurisprudence. (underlining added)

206 This Court has a broad inherent jurisdiction to make orders as required to fill in gaps or lacunae not covered by specific provisions in the CCAA. As a superior court of general jurisdiction, the Superior Court of Justice has all of the powers that are necessary to do justice between the parties. Except where provided specifically to the contrary, the Court's jurisdiction is unlimited and unrestricted in substantive law in civil matters. See *80 Wellesley St. East Ltd. v. Fundy Bay Builders Ltd.*, [1972] 2 O.R. 280 (Ont. C.A.) at para. 9. See also *TCR Holding Corp. v. Ontario*, 2010 ONCA 233 (Ont. C.A.) at para. 26, *Beach v. Moffatt* (2005), 75 O.R. (3d) 383 (Ont. C.A.) at para. 8, *M. (J.) v. Bradley* (2004), 71 O.R. (3d) 171 (Ont. C.A.) at para. 43 and *McVan General Contracting Ltd. v. Arthur* (2002), 61 O.R. (3d) 240 (Ont. C.A.) at para. 56.

207 In *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60 (S.C.C.) at paras. 57-61, it was recognized by the Supreme Court and stated by Justice Deschamps that the CCAA is skeletal in nature and does not contain a comprehensive code that lays out all that is permitted, that the incremental exercise of judicial discretion with respect to the CCAA has been adapted and has evolved to

meet contemporary business and social needs and that when large companies encounter difficulty and reorganizations become increasingly complex, CCAA courts have been called upon to innovate accordingly.

208 In this case, insolvency practitioners, academics, international bodies, and others have watched as Nortel's early success in maximizing the value of its global assets through cooperation has disintegrated into value-erosive adversarial and territorial litigation described by many as scorched earth litigation.[19] The costs have well exceeded $1 billion. A global solution in this unprecedented situation is required and perforce, as this situation has not been faced before, it will by its nature involve innovation. Our courts have such jurisdiction.

209 It is a fundamental tenet of insolvency law that all debts shall be paid *pari passu* and all unsecured creditors receive equal treatment. See *Shoppers Trust Co. (Liquidator of) v. Shoppers Trust Co.* (2005), 74 O.R. (3d) 652 (Ont. C.A.) at para. 25, per Blair J.A., *Indalex Ltd., Re* (2009), 55 C.B.R. (5th) 64 (Ont. S.C.J. [Commercial List]), at para. 16 per Morawetz J. and my comments in *Nortel Networks Corp., Re* (2014), 121 O.R. (3d) 228 (Ont. S.C.J. [Commercial List]) at para.12. A pro rata allocation in this case goes partway towards such a result.

210 According to the various protocols, the task in this proceeding is to determine the amount that is to be allocated to each of the Canadian, U.S. and EMEA Debtors' Estates. I do not read the protocols or the IFSA as precluding a pro rata allocation. While payment to the Selling Debtors is to be made from the $7.3 billion in the lockbox funds, neither the protocols nor the IFSA determine how the allocation is to be made.

211 Directing a pro rata allocation will constitute an allocation as required. Once the lockbox funds have been allocated, it will be up to each Nortel Estate acting under the supervision of its presiding court to administer claims in accordance with its applicable law. A pro rata allocation can be achieved by directing an allocation of the lockbox funds to each Debtor Estate based on the percentage that the claims against that Estate bear to the total claims against all of the Debtor Estates.

212 It is argued that a pro rata allocation would constitute an impermissible substantive consolidation of the Estates, or as put by the U.S. Debtors, an impermissible "global substantive consolidation". I do not agree. A pro rata allocation in this case would not constitute a substantive consolidation and, even if it did, it would in my view be permissible within established case law.

213 In a liquidation or reorganization of a corporate group, the doctrine of substantive consolidation has emerged in order to provide a mechanism whereby the court may treat the separate legal entities belonging to the corporate group as one. In particular, substantive consolidation allows for the combination of the assets and liabilities of two or more members of the group, extinguishes inter-company debt and creates a single fund from which all claims against the consolidated debtors are satisfied. In effect, under substantive consolidation, claims of creditors against separate debtors instantly become claims against a single entity.

214 A pro rata allocation in this case would not constitute a substantive consolidation, either actual or deemed, for a number of reasons. First, and most importantly, the lockbox funds are largely due to the sale of IP and no one Debtor Estate has any right to these funds. It cannot be said that these funds in whole or in part belonged to any one Estate or that they constituted separate assets of two or more Estates that would be combined. Put another way, there would be no "wealth transfer" as advocated by the bondholders. The IFSA, made on behalf of 38 Nortel debtor entities in Canada, the U.S. and EMEA, recognized that the funds would be put into a single fund undifferentiated as to the Debtor Estates and then allocated to them on some basis to be agreed or determined in this litigation. Second, the various entities in the various Estates are not being treated as one entity and the creditors of each entity will not become creditors of a single entity. Each entity remains separate and with its own creditors and its own cash on hand and will be administered separately. The inter-company claims are not eliminated.

215 Even if it could be said that a pro rata allocation involved substantive consolidation, which it cannot, I do not see case law precluding it in the unique circumstances of this case international case. Even in domestic cases, CCAA plans involving substantive consolidation are not unknown.

216 In Canada, neither the CCAA nor the BIA contains express provisions authorizing substantive consolidation. Similarly, the U.S. Bankruptcy Code does not explicitly permit substantive consolidation. However, courts in both jurisdictions have rendered consolidating orders on the basis of their equitable jurisdiction. See *See* M. MacNaughton and M. Azoumanidis, *Substantive Consolidation in the Insolvency of Corporate Groups: A Comparative Analysis, Annual Review of Insolvency Law, 2007*, J. Sarra, ed. (Carswell: 2008). [20]

217 In *Rescue! The Companies' Creditors Arrangement Act*, by Dr. Janis Sarra, Carswell 2007, the grounds for permitting substantive consolidation were described as follows at page 242:

> The court will allow a consolidated plan of arrangement or compromise to be filed for two or more related companies in appropriate circumstances. For example, in *PSINet Ltd.* the Court allowed consolidation of proceedings for four companies that were intertwined and essentially operated as one business. The Court found the filing of a consolidated plan avoided complex issues regarding the allocation of the proceeds realized from the sale of the assets, and that although consolidation by its nature would benefit some creditors and prejudice others, the prejudice had been ameliorated by concessions made by the parent corporation, which was also the major creditor. Other cases of consolidated proceedings such as Philip Services Canadian Airlines, Air Canada and Stelco, all proceeded without issues in respect of consolidation.
>
> Generally, the courts will determine whether to consolidate proceedings by assessing whether the benefits will outweigh the prejudice to particular creditors if the proceedings are consolidated. In particular, the court will examine whether the assets and liabilities are so intertwined that it is difficult to separate them for purposes of dealing with different entities. The court will also consider whether consolidation is fair and reasonable in the circumstances of the case.

218 In *Lehndorff General Partner Ltd., Re* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]), Justice Farley held that a consolidated plan was appropriate, noting that there was significant intertwining of the debtor companies, including multiple instances of inter-company debt, cross-default provisions and guarantees and the existence and operation of a centralized cash-management system. All of these features were present in Nortel.

219 In *PSINET Ltd., Re* (2002), 33 C.B.R. (4th) 284 (Ont. S.C.J. [Commercial List]), Justice Farley noted that a plan of arrangement based on substantive consolidation avoided the "complex and likely litigious issues" that could result from the allocation of the proceeds of the sale of substantially all of the debtor companies' assets. He also noted that the consolidated plan reflected the intertwined nature of the debtors and their operation. In that case, Farley J. stated that the overall effect of a consolidation was required:

> In the circumstances of this case, the filing of a consolidated plan is appropriate given the intertwining elements discussed above. See *Northland Properties Ltd., Re*, 69 C.B.R. (N.S.) 266 (B.C.S.C.), affirmed (B.C.C.A.), *supra*, at p. 202; *Lehndorff General Partner Ltd., Re*, 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]) at p. 31. While consolidation by its very nature will benefit some creditors and prejudice others, it is appropriate to look at the overall general effect.

220 In *Northland Properties Ltd., Re* [1988 CarswellBC 531 (B.C. S.C.)], a case involving a proposed plan for several companies that operated as a single entity, Justice Trainor considered the tests for permitting a substantive consolidation. He looked to U.S. law for guidance and began his analysis by adopting the balancing test articulated in *Baker & Getty Financial Services Inc., Re*, 78 B.R. 139 (U.S. Bankr. N.D. Ohio 1987):

> The propriety of ordering substantive consolidation is determined by a balancing of interests. The relevant enquiry asks whether "the creditors will suffer greater prejudice in the absence of consolidation than the debtors (and any objecting creditors) will suffer from its imposition".

221 Trainor J. then went on to list seven factors which had been developed to assist in the balancing of interests. Those factors were:

1. difficulty in segregating assets;

2. presence of consolidated financial statements;

3. profitability of consolidation at a single location;

4. commingling of assets and business functions;

5. unity of interests in ownership;

6. existence of intercorporate loan guarantees; and

7. transfer of assets without observance of corporate formalities.

222 In considering these factors, it is clear beyond peradventure that Nortel has had significant difficulty in determining the ownership of its principle assets, namely the $7.3 billion representing the proceeds of the sales of the lines of business and the residual patent portfolio. This amount constitutes over 80% of the total assets of all of the Nortel entities[21] . This issue has taken several years of litigation and untoward costs in the parties attempting to establish an entitlement to it. As the MRDA does not govern how the sales proceeds are to be allocated, there is no one right way to separate them. It cannot be said that there is no question which entity is entitled to the sale proceeds or in what amount. It is clear that these assets are in the language of Dr. Janis Serra "so intertwined that it is difficult to separate them for purposes of dealing with different entities".

223 Moreover, the evidence in this case is clear and uncontested that Nortel (a) had fully integrated and interdependent operations; (b) had intercompany guarantees for its primary indebtedness; (c) operated a consolidated treasury system in which generated cash was used throughout the Nortel Group as required; (d) disseminated consolidated financial information throughout its entire history, save for the year before its bankruptcy; and (e) created IP through integrated R&D activates that were global in scope.

224 When consolidation occurs, some creditors may be prejudiced if they would have had a greater recovery of so many cents on the dollar against their debtor if there had been no consolidation. Conversely, other creditors may be benefitted by consolidation if they would have had a lesser recovery against their debtor if there had been no consolidation. In this case, even if a pro rata allocation amounted to a consolidation, the issue would be moot because it cannot be said that without consolidation one class of creditors, including the bondholders, would necessarily have had a greater recovery than with consolidation. The reason for this is that there has been no recognized measurable right in any one of the selling Debtor Estates to all or a fixed portion of the proceeds of sale.

225 The bondholders who hold bonds with covenants of both NNL and NNI contend that they would be unduly prejudiced by a pro rata allocation of the lockbox funds as they are entitled to look to both NNL and NNI for payment of their claims and if one of these companies did not have sufficient funds to pay the bonds in full, they could look to the other. I agree that they are entitled to claim against both companies and this will be recognized in the pro rata allocation that will be ordered.

226 The bondholders have the legal right to be paid in full on their bonds. But so do all of the other creditors. Like the pensioners and other creditors, the bondholders are not secured. Because of a shortfall in funds, all of these creditors cannot be paid in full. The issue is how the pain is to be shared.

227 The total cash on hand in the U.S. Debtors' and Canadian Debtors' Estates as of June 2014 was a little over 25% of the face amount of the outstanding bonds. Without an allocation from the lockbox funds of a sufficient amount to enable NNL and NNI to pay the bonds in full, the bondholders could not be paid in full. The bondholders, however, have no covenants in their bonds requiring the lockbox funds to be allocated in any manner, and specifically, no right to have lockbox funds allocated to NNL or NNI. Nor do NNL or NNI have any such rights. The lockbox funds are not the property of any one of NNL or NNI or any other RPE.

228 The bondholders are like other creditors in this regard. The other creditors of the Canadian Debtors could likewise argue that they will be prejudiced if the argument of the Monitor that all of the IP proceeds should be paid to NNL as the owner of

the IP is not accepted. But the prejudice to be considered is not this kind of prejudice, but prejudice to legal rights. Neither the bondholders nor the other creditors of the Canadian Debtors have any legal right to have the lockbox funds allocated in a way that will benefit them.

229 The bondholders with covenants of NNL and NNI contend that their expectations will be disregarded by a pro rata allocation and that it will harm the bond markets if they are not somehow paid in full. I think this argument is overblown in this case and in any event not supported by any evidence of their expectations.

230 The evidence of Peter Currie, the CFO of NNC and NNL from 2005-2007, which is not contested, was that until the early to mid-2000s, Nortel's public debt was issued by NNL without guarantee from any other Nortel entity. In 2006, while Nortel's credit rating was still adversely affected by various factors, NNL issued notes having an aggregate principal amount of US$2 billion, which notes were conditionally guaranteed by NNI. NNI was a conditional guarantor in large part because at that time it carried certain hard assets on its balance sheet and because Nortel could obtain slightly better debt terms given that NNI was domiciled in the same place as the ultimate lenders, that is, the United States.

231 Thus it is quite clear from the evidence that when Nortel went to the bond market in 2006 and 2007 to raise funds, Nortel believed that it required the covenant of NNI in order to get the financing on terms and at a cost that Nortel wanted. However, prior to the Nortel insolvency in January, 2009, the market place did not differentiate in any material way the bonds that were guaranteed by NNI and the bonds not carrying a NNI guarantee.

232 From June, 2006 to December, 2008, Moody's and DBRS issued nine credit ratings for Nortel that did not distinguish between Nortel bonds guaranteed by NNI and those that were not. The UCC's expert witness Robert Kilimnik [22] agreed on his deposition that if a guarantee is a risk differentiator from DBRS's point of view, and there were a series of bonds with a guarantee and a series of bonds without a guarantee, he would expect them to be rated differently. This is an indication that the market did not differentiate between the NNC bonds guaranteed by NNI from those that were not guaranteed.

233 Another indication is the evidence of the Nortel bond spreads compared to U.S. government bonds contained in Ex. 58. The chart demonstrates that that Nortel bonds that carried an NNI guarantee traded at higher or equal spreads to Nortel bonds that did not carry an NNI guarantee. Mr. Kilimnik, an experienced bond trader, said on his deposition testimony was that bonds with a lower spread are considered less risky in the marketplace and that if guarantees were recognized by creditors as reducing the risk of issuances by the same company, he would have expected to see that expectation reflected in spread comparisons.

234 Mr. Paviter Binning, the Executive Vice-President and CFO of NNC from 2007 to March 2010 and an impressive witness to be sure, agreed with that conclusion of Mr. Kilimnik and testified that the data implied that the market was giving no value to the guarantees. He also testified that in his experience, investors generally looked to the overall quality of the company and that the guarantees were neither here nor there. He agreed that part of the reason why the guarantees may have had no meaning for the market was that the bonds were sub-investment grade in the first place. His evidence, which I accept, means that after the bonds were issued, the guarantees by NNI did not have a material effect on the marketplace.

235 John McConnell, a professor of business (finance) at Purdue University, delivered a report and testified on behalf the unsecured creditor's committee of NNI in response to a report of Leif M. Clark and Jay L. Westbrook, the latter of whom did not testify at the trial. Professor McConnell's report contained data from the date that the Nortel Group filed for protection on January 14, 2009 to January 2014 which indicated that the bonds not guaranteed by NNI traded at prices below the bonds guaranteed by NNI.

236 I do not see this data as relevant. Counsel for the bondholders in his opening asserted that the expectations of bondholders that are relevant are the expectations pre-petition and not post-petition.

237 If the expectations of those who purchased bonds post-petition were relevant, there was no evidence at all from such purchasers. Professor McConnell spoke to no bondholder and on cross-examination admitted that he had no way of knowing

what factors went into the purchase and/or sale of any of the Nortel bonds by any of the current bondholders in the market post-filing. No bondholder testified or gave any evidence of expectations in acquiring bonds.

238 The evidence of Professor McConnell is based entirely on the fact that after the insolvency filings, bonds without a NNI guarantee traded at a lower price than those with a NNI guarantee. There are two points that can be made. The first is that his conclusion is an inference drawn from the trading price of the bonds after the insolvency as to what motivated those purchasers of the bonds after the insolvency. Second, there was no analysis of Professor McConnell that would lead to the conclusion that his inference of bondholder purchaser expectations could apply to purchasers of bonds prior to the onset of insolvency. He said he could not do such an analysis because before insolvency the bonds had different attributes which would not permit him to draw inferences as to the effect of guarantees. Be that as it may, I would not accept the inference drawn by Professor McConnell regarding the effect of the guarantees on a purchaser of bonds. I prefer the evidence of Mr. Binning to which I have referred. [23]

239 Moreover, the evidence is clear that bonds trade on a much different basis after insolvency. Mr. Binning testified that prior to the threat of insolvency, the bonds traded on a yield to maturity basis, meaning that bondholders take all of the payments that would be expected to be made if the bond is held to maturity, and then calculate a percentage yield based upon the price paid for the bonds. Once insolvency or financial distress is anticipated, Mr. Binning testified that bonds trade in the hands of distressed investors who trade not on a yield to maturity basis but in a classic arbitrage market based upon price and expectations of future price and what they think they can make on the bonds during insolvency. He advised the board of Nortel on September 30, 2008, three and a half months before the Nortel filing, that RBC had advised that approximately 50% of the bonds had traded into the hands of distressed investors.

240 Professor McConnell also testified that as new information came into the marketplace about the likely recoveries, that would be reflected in the price of the bonds. That is another way of saying that distressed investors have bet on the future outcome of this case. This is reflected in the volumes and trading prices of the bonds at various times between January 14, 2009 and June, 2014, including (i) in the immediate aftermath of the Filing Date when the bonds were trading at very low prices, (ii) during the prolonged three-day auction resulting in the residual IP sale to Rockstar at the beginning of July 2011 as purchasers placed bets on bond price increases and recoveries following the completion of that sale; and (iii) in reaction to Delaware Bankruptcy Court Judge Walrath's September 2011 decision in *In re Washington Mutual* holding that post-petition interest must be awarded at the federal judgment rate and not at the rates in the various bonds.

241 The bondholders group that at the time of the trial held a majority of the unsecured guaranteed bonds purchased the vast majority of their holdings after the filing date of January 14, 2009 and at a significant discount to par. Certain members purchased when the bonds were trading at as low as 30 cents on the dollar and others received smaller, but still substantial, discounts. This can be seen in exhibits 59 and 60. The vast majority of their collective holdings were acquired in the period between July 31, 2009, at or around the time when Nortel began to liquidate its assets, and July 18, 2011, at or around the time of the Residual IP Sale.

242 The creditor expectations of the current bondholders, who acquired their bonds post-petition, even if known or supported by evidence, is not something I would take into account in this case. I infer from the evidence that any such expectations would have been based on their views as to litigation outcomes and should not be the basis of any decision by the courts.

243 In considering potential prejudice to the bondholders in the event of a pro rata allocation, consideration must be given to what the bondholders would gain. The bonds provide access to the assets of the issuer and guarantor. They do not provide any right to assets of any other entity in the Nortel Group. The 2006, 2007 and 2008 offering memoranda for the guaranteed bonds set out risks associated with the bonds, including the following notice regarding the lack of access to other Nortel entities:

> The Issuers' subsidiaries are separate and distinct legal entities and any subsidiary that is not a Guarantor will have no obligation, contingent or otherwise, to pay amounts due under the Notes or the Guarantees or to make any funds available to pay those amounts, whether by dividend, distribution, loan or other payment.

244 The offering memoranda also contained the following risk that investors would face in the event of insolvency of Nortel entities and the lack of access to the assets of those entities:

> In the event of a bankruptcy, liquidation or reorganization of any direct or indirect non-guarantor subsidiary of NNC, all of the creditors of that subsidiary (including trade creditors and creditors holding secured or unsecured indebtedness or guarantees issued by that subsidiary) and third parties having the benefit of liens (including statutory liens) against that subsidiary's assets will generally be entitled to payment of their claims from the assets of such non-guarantor subsidiary before any of those assets are made available for distribution to any Issuer that is a shareholder of such subsidiary. As a result, the Notes and the Guarantees are effectively junior to the obligations of non-guarantor subsidiaries.

245 Whereas the investors who acquired their bonds pursuant to the offering memoranda were specifically made aware that in the situation in which Nortel now finds itself, they would not have access to assets of other Nortel entities that had not guaranteed the bonds, the effect of a pro rata allocation is to provide the current bondholders with such access. The lockbox funds represent the proceeds of sale of all of the assets of all of the 38 entities under the IFSA. Creditors holding guarantees have access under a pro rata allocation to not only the assets of the principal obligor and guarantor corporations, but the proceeds of sale of all the assets of the selling debtors. This is access to more pools of asserts than that for which the holder of a guarantee bargained.

246 While the current bondholders may have thought, or bet on an outcome, that NNL or NNI would likely achieve a win in this litigation that would provide those two companies with sufficient assets to pay the bonds in full and with post-filing interest, there was no guarantee at all that this would be achieved. The bonds contained no covenants that required the assets of NNL or NNI to be maintained at a certain level and no covenants that required the lockbox funds to be allocated in any manner. Mr. Binning had advised the Nortel board in September, 2008 that there were no maintenance covenants in the bonds, meaning that Nortel did not have to live up to any debt servicing ration. He testified that what the guarantees under these bonds essentially gave the bondholders was access to the assets in Canada and in the US without a great degree of comfort as to what those assets would be from time to time. I accept that evidence.

247 As to the effect of a pro rata allocation on the ability of issuers to issue bonds in the future, Professor McConnell on his cross-examination said that he had no opinion on that subject and that he had not tried to quantify what effect a pro rata allocation would have on the capital markets. Thus there is no evidence that a pro rata allocation in this case will detrimentally affect the capital markets and the ability of issuers to issue bonds in the future. Professor McConnell's statement that he had no opinion on the subject is perhaps not too surprising taken the highly unusual facts surrounding the Nortel insolvency and the difficulty of determining ownership of the IP that was sold.

248 It is said that the $2 billion claim of NNI against NNL that was approved by both courts is an impediment to a pro rata allocation. I do not think that is the case. The $2 billion claim will be treated as one of the unsecured liabilities of NNL.

249 The same principles that apply to the US$ 2 billion claim by NNI against NNL will apply to the admitted claim of NNUK and Nortel Networks SpA against NNL pursuant to the Agreement Settling EMEA Canadian Claims and Related Claims dated July 9, 2014, and to the claim of the UKPC for £339.75 million recognized in my judgment of December 9, 2014.

Appropriate pro rata allocation method

250 The allocation each Debtor Estate will be entitled to receive from the lockbox funds is the percentage that all accepted claims against that Estate bear to the total claims against all Debtor Estates.

251 In determining what the claims against a Debtor Estates are, a claim that can be made against more than one Debtor Estate can only be calculated and recognized once. The one that is known is the bondholder claim for $4 billion, referred to as the claim on cross-over bonds. All but one of such bond issues was issued by NNC or NNL and guaranteed by NNI. One bond issue for $150 million was issued by NNCC, a subsidiary of NNI, and guaranteed by NNL [24] . The claims on the bonds in determining the claims are to be made on the Debtor Estate of the issuer. If a claim on a guaranteed bond is not paid in full

by the issuer Debtor Estate, a claim for the shortfall can be recognized by the Debtor Estate that guaranteed the bond, but that shortfall claim will not be taken into account in determining the claims against the Debtor Estates.

252 One of the known claims is the claim of the UKPC for the approximately £2.2 billion deficit in the NNUK pension plan. If the UKPC makes a claim for this amount against NNUK and also against other EMEA Debtors, those claims against the other EMEA Debtors will not be taken into account in determining the claims against the Debtor Estates. The claim may be taken into account only once in the pro rata allocation.

253 I understand that for the Canadian Debtors and the U.S. Debtors, the claims for the most part are generally known although there are some claims still unresolved, such as the SNMPRI claim. The U.K. Administrator has not yet instituted a claims procedure, apparently awaiting a determination of this allocation proceeding. In my view, the process should be undertaken now and I expect this will happen.

254 Interim distributions have been proposed. In my view, this would be especially important for the predominantly elderly pensioner population and disabled employees who have endured hardship as a result of the loss of their benefits but also for other creditors who have waited more than five years for a distribution on their claims. An interim distribution should be made if possible.

255 Briefs should now be filed by those parties supporting an interim distribution with full details of what is requested. Opposing briefs would of course be required. The procedures and timing could be discussed at a 9:30 am appointment.

Allocation on a basis other than pro rata

256 The evidence on this subject was complex and varied dramatically from party to party. To wit:

(a) The Monitor on behalf of the Canadian Debtors contended for an allocation of $6.034 billion to the Canadian Debtors, $1.001 billion to the U.S. Debtors and $300.7 million to the EMEA Debtors. [25]

(b) The U.S. Debtors contended for an allocation of $0.77 billion to the Canadian Debtors, $5.3 billion to the U.S. Debtors and $1.23 billion to the EMEA Debtors.

(c) The EMEA Debtors contended for an allocation of $2.32 billion to the Canadian Debtors, $3.636 billion to the U.S. Debtors and $1.325 billion to the EMEA Debtors.

257 I have given consideration to the valuation issues. To a great extent, they are dependent on the various interpretations of the MRDA asserted by the parties. For that reason I would not use any of the valuations for the purpose of the pro rata allocation as I have found that the MRDA does not govern the allocation. However, my views and findings on the valuations are set out in Appendix A for the business line sales and Appendix B for the residual IP sale to Rockstar.

Conclusion

258 A judgment is to go that the lockbox funds are to be allocated on a pro rata allocation basis with the following principles to govern:

(1) Each Debtor Estate is to be allocated that percentage of the lockbox funds that the total allowed claims against that Estate bear to the total allowed claims against all Debtor Estates.

(2) In determining what the claims are against the Debtor Estates, a claim that can be made against more than one Debtor Estate can only be calculated and recognized once in accordance with these reasons for judgment. Claims on bonds are to be made on the Debtor Estate of the issuer. A claim for any shortfall can be recognized by the Debtor Estate that guaranteed the bond, but that shortfall claim will not be taken into account in determining the claims against the Debtor Estates. If the UKPC makes a claim against more than one Debtor Estate, such additional claims will not be taken into account in determining the claims against the Debtor Estates.

(3) Intercompany claims against a Debtor Estate are to be included in the determination of the claims against that Estate.

(4) Cash on hand in any Debtor Estate will not be taken into account in the pro rata allocation. Each Debtor Estate with cash on hand will continue to hold that cash and deal with it in accordance with its administration.

(5) An interim distribution may be allowed upon further submissions. Briefs in favour of and opposed to an interim distribution are to be filed on a time-line to be considered at a 9:30 am appointment.

(6) Proposed schedules for expediting any remaining claims procedures are to be provided without delay.

Epilogue

259 I cannot leave these reasons without commenting on the persons who made this unique case possible.

260 First, to the technical staff who provided the facilities to permit this trial to be conducted in two different countries at the same time, I say it was a job more than well done. It was outstanding and we are indebted to you all. Judge Gross and I have no idea how it was all set up and operated, but I know he is as grateful for the facilities as I am. Thank you.

261 Second, to the reporters and their staff, it was also a job more than well done. Apart from the instantaneous real time reporting that permitted all parties to see the evidence as it was being given, we were blessed with draft transcripts being electronically sent to us shortly after the evidence concluded each day and final transcripts later that evening.

262 Third, to the lawyers. We were blessed with outstanding counsel on both sides of the border. In a case such as this with the amount at stake, one can understand the pressures on counsel and how those pressures could get in the way of a smooth preparation and presentation of the case. From what I could see, all acted in a professional manner that does them credit. Without that, the case could not have proceeded as well as it did. Their staff should also be congratulated for the smooth way in which the case was electronically presented. It was a marvel.

263 Finally, I want to thank Judge Gross for his courtesies and good humour. It has been a pleasure to work with him. Without such a good relationship and the trust that we developed for each other, this trial and its conclusion would not have been possible.

Order accordingly.

Appendix A

Allocation of the proceeds of the line of business sales

The experts for the various parties differ on the way that the proceeds of the sales of the LOB should be allocated amongst the Canadian estate, the U.S. estate and the EMEA estate.

Mr. Kinrich, the valuer called by the U.S. Debtors, did not value the various assets sold and attempt to allocate them by any particular method. Rather he allocated the entire sale proceeds by taking the revenues of each company whose businesses were sold and allocating to each company (and the group they were in) the percentage of its revenues to the total revenues of all companies whose businesses were sold. His resulting allocation was 11.9% or $340 million to the Canadian Debtors, 18% or $510 million to the EMEA debtors and 70% or $1.99 billion to the U.S. Debtors.

Mr. Malackowski called by the EMEA debtors valued the IP rights sold by using a revenue or license valuation method. His valuation of the IP sold in the business sales was $765.2 million.

Mr. Huffard called by the EMEA debtors then allocated the various kinds of assets sold. He valued the tangible assets that were sold at $118 million and allocated this amount to the companies that sold them. He allocated the IP that was sold and valued by Mr. Malackowski at $765.2 million by a contribution approach which allocated the IP according to the amount of R&D expenditures of each of the RPEs. He attributed the balance of the LOB sale proceeds as "customer related assets and goodwill"

and allocated them on the basis of the percentage of revenues generated by each entity in 2008. Mr. Huffard did not give a separate total figure in his report for the allocation of the LOB sale proceeds.

Mr. Green called by the Canadian Debtors dealt with each kind of the various assets sold. He allocated the tangible assets sold by giving to the companies that sold them their book value, which he calculated to be $534.19 million. He valued the workforces sold by their cost that the selling companies would incur to replace them at $255.33 million and allocated those costs to the companies. He allocated the IP and customer relations by valuing what the licensed participants gave up to enable the sales on the basis that their license rights were limited to the "Products" "by or for the Participants" as defined in the MRDA, and allocated the balance of the sale proceeds to NNL as the "owner" of the IP. His resulting allocation was 54.8% or $1.58 billion to the Canadian Debtors, 10.4% or $300.97 million to the EMEA debtors and 34.7% or $1001.5 billion to the U.S. Debtors.

(i) Mr. Kinrich

Mr. Kinrich's view is that the RPEs that were licensed participants had all license and sublicense rights as owners. Assuming that to be the case for this analysis, I have some concerns with his analysis. Mr. Kinrich allocated all of the assets sold in the business sales on a revenue basis. He stated in his report that the value of the sold assets is reflected in the revenue generated by each entity that sold the assets. That is, value he said was reflected in revenue figures.

Mr. Kinrich himself in his report said that financial economists agree that a discounted cash flow analysis is the preferred technique for asset valuation and that one of the requirements is to have projected future cash flows less costs. In his report he did not say why he had not done such an analysis when dealing with the business sales. At trial he relied on texts to support his use of a revenue approach in firms with losses, one of which is *Valuing Small Businesses and Professional Practices*, which suggests gross revenue multiples may be used in restricted situations, being to approximate a range of possible values with a minimum effort, conclude an estimate of value when other data are unavailable or inadequate or as one indicator of value used in conjunction with more rigorous valuation methods. The text also said that for companies with losses or erratic earnings, multiples of price to revenue for other comparative companies may give some indication of how others asses the future of the industry or profession. But that is not what Mr. Kinrich did. He did not look at revenue multiples from the sale of any comparable companies. I viewed his attempt to bolster his revenue approach by resort at trial to texts to be an attempt at *ex post facto* rationalization. It would have been a little more persuasive if these rationales has been provided in his report, particularly as in his report he did a sensitivity check based on gross margin (revenue less cost of goods sold) and contribution margin (revenue less selling, general and administrative expenses).

Mr. Kinrich said at trial that he did not have available forecasts that would divide income streams by territory but that is beside the point so far as a gross revenue valuation is concerned. The issue is whether it would have been preferable to take costs into account in his revenue approach to allocation.

Because the U.S. market had the highest revenues, it follows that using a revenue approach as Mr. Kinrich did will result in the high allocation of the business sale proceeds to the U.S. (70%) and a low allocation to Canada (11.9%). However, because revenue does not consider costs, this result ignores the way in which Nortel operated as a matrix structure and the reliance by all operating areas, including the U.S., on IP generated by R&D elsewhere. The 2009 revenue that Mr. Kinrich used in his analysis to compare revenues, the basis of which was assumed license rights under the MRDA, was subject to the obligation in the MRDA to make payments pursuant to the RPSM measured by R&D expenditures of each RPE. Mr. Kinrich did not take into account.

Mr. Kinrich acknowledged on his cross-examination that while he assumed that the set of license rights as he saw them would continue in the future to exist, he gave no effect to sharing obligations that might arise under the MRDA, his reason being that he understood that the sharing provisions did not apply to sales proceeds. That in my view was no answer. What he undertook was to determine the relative value surrendered by each of the selling entities, including the RPEs. To determine the value of rights of each of the RPEs without taking into account the RPSM sharing obligations failed to properly determine relative values among the RPEs. I accept the opinion of others, including Dr. Bazelon and Mr. Green, on the point. The various businesses in Nortel historically operated on varied operating margins.

Mr. Green pointed out, with reference to texts including those that Mr. Kinrich referred to at trial, that a disadvantage of focusing on revenues is that it can lull one into assigning high values to firms generating high revenue growth while losing money and that the method assumes that the businesses are equally profitable. His view was that a revenue based allocation was inappropriate in a matrix structure such as Nortel with interrelated operating businesses in which certain entities bore disproportionate shares of expenses like R&D which would be ignored.

EMEA and the UKPC contend that Mr. Kinrich should not have used 2009 revenue figures as 2009 was an anomalous year for Nortel. Nortel filed for insolvency protection in January 2009 and from then on was operating under the supervision of courts in Canada, the US, the UK, and elsewhere. Throughout 2009, Nortel was actively engaged in selling its businesses, signing seven out of eight of its sale agreements in that year. All of this affected its ability to generate revenues. Four of the business sales were concluded before the year's end. Because of these dispositions, complete financials for 2009 were not even available for certain businesses and revenues had to be estimated based upon performance prior to the sale closing date.

Dr. Bazelon's evidence was that NNI's share of global revenue plateaued by 2008 at about 65% but in 2009 it increased by about 4%. In my view, EMEA and the UKPC have a valid point. 2009 was not a typical year for Nortel. While NNI contends that 2009 resembles the weighted average over the years 2001 to 2008, but that ignores the steadily declining trend from NNI having 74% in 2001 to about 65% in 2008. Using 2009 for his revenue analysis was overly aggressive. The effect was to shift about 4%, or $100 million, from EMEA to the U.S. Debtors.

(ii) Mr. Malackowski and Mr. Huffard

The allocation of the proceeds of the LOB sales on behalf of the EMEA Debtors is based on the evidence of Mr. Malackowski who valued the IP sold at $765.2 million and on the evidence of Mr. Huffard who allocated all of the sales proceeds using different methods for each type of asset sold. There are problems with the EMEA allocation.

Mr. Malackowski used a discounted cash flow analysis to value the IP. He said there was a defensive component and a synergistic component to the IP. To measure the defensive component, he took the revenue forecasts of Nortel in the "deal books", market derived growth rates, and royalty rates from an IPCo model. For a discount rate he used an average of weighted average cost of capital rates of the industry in which the Nortel business operated. To measure the synergistic component, he used revenues of a hypothetical market participant for each line of business sold, market derived growth rates, and royalty rates derived from what he said was the implied rate paid by Ericcson as a member of the Rockstar consortium. He added 15% to the discount rate used in his defensive component.

Mr. Malackowski's valuation of the IP sold at $765.2 million, if accepted, means that the IP represented roughly 25 % of the total sales proceeds of $3.1 billion. Yet, the evidence is overwhelming that IP created by Nortel's R&D was the driver of the profitability of the business. Even Mr. Huffard view was that within Nortel, IP was considered the driver of revenue in each of the businesses and purchasers of the businesses would have considered the acquisition of IP as a critical aspect. Mr. Britven, an expert called by the CCC, arrived at figures based on the purchase price allocations made by the purchasers that stated what the purchasers considered the fair value of the various acquired assets to be. Those figures put the percentage of the IP of the total business sale proceeds at 40%.

In his rebuttal report, Mr. Malackowski in an attempt to show the size of what he considered to be a windfall if the position of Mr. Green were accepted, said that all of the Nortel the IP in total in the hands of Nortel could be worth $10.4 billion, of which he allocated $3.761 to the business sales and $6.6 billion to the residual sale to Rockstar. His reason for this extra value in his report was that some of the residual IP sold to Rockstar was encumbered by the non-exclusive licenses given to the purchasers of the lines of business. Rockstar paid $4.5 billion. If Mr. Malackowski's figures are right, it means that the non-exclusive licenses given to the purchasers of the lines of business reduced the value of the residual IP sold to Rockstar from $6.6 billion to $4.5 billion, or by $2.1 billion. That reduction in value to Rockstar attributed to the non-exclusive licenses granted in the business sales means that those non-exclusive licenses were worth $2.1 billion, and it does not make sense that Mr. Malackowski valued both the outright licenses and the non-exclusive licenses given to the purchasers of the lines of business at only $765.2 billion.

The Monitor points out that the royalty rates used by Mr. Malackowski in establishing revenues to be valued were taken from the IPCo litigation light model and that within that litigation light model he chose the lowest of three rates. He did not use any Nortel intercompany-stated royalty rates. The Monitor suggests that is an explanation why the IP valuation of Mr. Malackowski is too low. For certain the royalty rates charged directly affect the revenues and thus the value obtained by a DCF method of valuation. Whether it is the only reason for the low valuation is another matter. There are many inputs in a valuation.

Mr. Huffard was the expert called by EMEA to opine on the allocation to be made of each component of the business sales. The Monitor is critical of his qualifications. Mr. Huffard is an investment banker with considerable experience advising distressed companies who has "led valuation analyses" for companies and their assets. He holds a Master of Management degree from Kellogg Graduate School of Management at Northwestern University. Mr. Huffard is not accredited as a valuator and said that in the field of investment banking that is typical.

I must say that Mr. Huffard was not forthcoming in his evidence about his experience. When asked if he had done any valuations or the allocating of assets in connection with intellectual property companies, he said several times that he had trouble understanding what an intellectual property company was and asked if Nortel was an intellectual property company. Yet when asked on his deposition whether he had done any valuations or the allocating of assets in connection with intellectual property companies, he answered "Not in connection with intellectual property companies." I think it fair to consider this answer in dealing with his evidence.

Mr. Huffard believed that there were three classes of assets to be valued and examined in the business sales. The first is net tangible assets. The second is the IP. The third is customer-related assets and goodwill not otherwise encompassed in goodwill. Mr. Huffard did not do any valuation exercise for his third class. Rather he just took the balance of the purchase price and allocated it. The values attributed to the first two classes therefore directly affected the value of his third class.

For the tangible assets, Mr. Huffard took the book values of the assets, which consisted of accounts receivable and prepaid expenses, inventory and fixed assets. This book value in his report totalled $403 million. At trial, in his demonstrative exhibit, his total was $361 million. Why the difference was not explained. From the book values, Mr. Huffard deducted liabilities assumed by the purchasers of the lines of business, the largest of which was deferred revenue. He viewed the assumed liabilities as a fourth asset class that resulted in an increase in the purchase price from the buyer's perspective and a reduction from the seller's perspective. They had to be deducted from the assets and he did this the tangible asset class. This resulted in net tangible assets in his report of $124 million, being $39 million for Canada, a negative $27 million for EMEA, $106 million for the U.S. and $6 million for Asia and the Caribbean. At trial, his demonstrative showed the net tangible assets at $118 million with the same net figures for Canada, EMEA and the U.S. as in his report. How this occurred on the different book values in his report and in his demonstrative was not explained.

For the allocation of the IP, Mr. Huffard took Mr. Malackowski's figure of $765.2 billion. He allocated them amongst the RPEs using Mr. Malackowski's contribution approach using historical R&D spending from 1992 to 2008. His view was that the portions of the sale proceeds attributable to IP were, in effect, a capitalization of future revenues that would otherwise have been shared among the RPEs in accordance with the RPS methodology. This resulted in 40.8% or $312.2 million being allocated to Canada, 42.6% or $326 million being allocated to the U.S. and 16.5% or $126.2 million being allocated to EMEA. In his demonstrative at trial, these percentages were rounded, with 41% to Canada, 43% to the U.S. and 16% to EMEA.

Mr. Huffard then included the balance of the sale proceeds of $2.198 billion into his third class of customer-related assets and goodwill. He did no analyses of the value of either the customer-related assets or of the goodwill and allocated them based on the revenue generated by each entity in fiscal year 2008. He said he did not use net revenues to allocate among the entities because in his view cash flows are influenced by transfer pricing and inter-company arrangements for tax purposes. Based on the revenues alone, he allocated 9.2% or $202 million to Canada, 62.6% or $1.375 million to the U.S., 18.6% or $155 million to EMEA, 2.6% or $57 million to the Caribbean and 7.1% or $155 million to Asia.

While Mr. Huffard did not provide a total for the business sales allocation, by adding up the different classes, his total allocation to Canada was $553.2 million to Canada, $1.807 billion to the U.S. and $254.2 million to EMEA. This is somewhat less than the $2.85 billion available from the business sales proceeds.

As Mr. Huffard did not undertake any valuation of his third residual category, his conclusion of the amount to be included in it is dependent upon the amount of his tangible asset valuation and Mr. Malackowski's IP valuation. If Mr. Mr. Malackowski's IP valuation is too low, then the amount in this residual class allocated by Mr. Huffard will be too high.

There are problems with allocating this residual class entirely by revenues of each company or groupings of companies. Mr. Huffard described it as the value of customer-related assets and goodwill not otherwise associated with IP. He acknowledged that these assets, like any other assets, have their value fundamentally related to their ability to generate profits, and that while Nortel operated the businesses, it was not revenue that allocated those values but the RPS method of sharing profits after revenues and costs were calculated. This is the same criticism made of Mr. Kinrich in using a revenue tool to allocate the sales proceeds rather than a profitability tool.

Mr. Huffard acknowledged that in circumstance where, because of decisions made and cost-effectiveness and historic reasons, sales and customer support was done in a country which had low domestic revenues, his revenue allocation method for the customer-related assets and goodwill category was not going to compensate that country because it had low revenues. This circumstance was commonplace in Nortel with its matrix structure, with customer support carried out in one country for sales in another. He acknowledged if a large percentage of the workforce is in a place like Canada, which does R&D and which does sales support and supports the global organization but doesn't have a large native revenue stream, he was allocating the value of that workforce to the other entities where there is a revenue stream and not to Canada.

(iii) Mr. Green

Mr. Green valued different asset classes differently. He first valued tangible assets by taking their book value and allocating them to the companies which owned them. This was the same method used by Mr. Huffard. However, different from Mr. Huffard, he did not deduct any deferred liabilities from the tangible asset amount. His evidence was that deferred liabilities are essentially amounts that would be due that are related to projects that have already been billed and perhaps paid for and so they didn't offset the physical assets, the tangible assets such as the accounts receivable, the other things that were sold. He pointed out that by his not deducting deferred liabilities, it was to the relative benefit to the U.S. Debtors because they had the highest deferred revenues and, accordingly, deducting the liabilities would most significantly decrease the U.S. Debtors' share of the value of net tangible assets. He also pointed out in his rebuttal report that not all liabilities recorded on the books of Nortel were assumed by the purchasers and for those that were it was not possible to determine on which entity's books those liabilities were recorded. I accept this position of Mr. Green in not deducting assumed liabilities in valuing and allocating the tangible assets on the basis of book values recorded on each entity's books.

Mr. Green's value for the tangible assets was $534.19 million, and he allocated $121.74 million to the Canadian Debtors, $317.59 million to the U.S. Debtors and $94.86 million to the EMEA Debtors.

Mr. Green next valued the workforce in the lines of businesses that were transferred to purchasers. His opinion was that generally speaking, the cost approach is applied to the valuation of an assembled or in-place workforce. He valued the workforce by calculating the cost to replace the work force. He concluded that the total value of the work force was $255.33 million and he allocated $78.68 million to the Canadian Debtors, $134.74 million to the U.S. Debtors and $41.91 million to the EMEA Debtors.

In the sale of the Enterprise business, several corporate entities owned by NNI were sold. Mr. Green valued these assets based on contemporaneous fair market valuations done at the time these businesses were sold. There is no evidence that these assets had a value other than as set out by Mr. Green. Mr. Green made an allocation to NNI of proceeds attributable to the sale of its subsidiaries in the amount of $110,970,000. No other valuer dealt with this asset.

Mr. Green was of the view that once the tangible assets and the workforce were valued, the balance of the business sale proceeds was attributable to IP, the primary driver of Nortel's value, and customer relationships. He valued and allocated the IP and customer relationships sold in the business sales by valuing the license rights of NNI and the EMEA RPEs surrendered by them to permit the sales to take place on the basis that their licenses were restricted to Products by or for the Participants as defined in the MRDA and as contended by the Monitor. The balance he attributed to NNL as the owner of the IP.

Mr. Green performed a DCF valuation. He projected revenues and expenses for each business sold and for this to project the future revenues of the Nortel businesses he used forecasts prepared by Nortel that were referred to as "Retained by Nortel" forecasts. They projected the revenues that would have been earned and the expenses that would have been incurred, if the operating businesses had been retained by Nortel. After calculating the operating profits of each business sold, Mr. Green aggregated those profits and applied the RPSM on the assumption that the MRDA would have remained in place, using the capital stock percentage for the first quarter of 2010, which covered a rolling average from 2005 to 2009. He applied a discount rate of 12% for the operating profits derived from existing technology and 30% for operating profits to be derived from yet to be invented technology and thus more risky. He concluded that the value of the license rights surrendered by NNI was $438.2 million and by the EMEA RPEs was $164.2 million. The balance of his residual amount, being $1.379 billion was allocated to NNL.

Mr. Green's resulting allocation was 54.8% or $1.58 billion to the Canadian Debtors, 10.4% or $300.97 million to the EMEA debtors and 34.7% or $1001.5 billion to the U.S. Debtors.

EMEA and the U.S. Debtors contend that a basic problem with Mr. Green's analysis is his conclusion or assumption that NNL was the owner of the IP and entitled to its residual value after deducting the license rights of EMEA and NNI which he limited to Nortel Products by or for the Participants. This is a basic legal issue.

EMEA argues that customer relationships were very important to Nortel and that they should have been valued and allocated separately from IP and not included in Mr. Green's residual category. Mr. Green's explanation for not doing so was that customer intangibles represented historical relationships in which customer files and ongoing agreements exist, the value of which was represented in his revenue figures that he used and were thus subsumed in the IP license rights which he valued. He said that a separate valuation of customer relationships would be duplicative of the values of the license rights surrendered because it would be based on the same revenues and profits as used in the license rights valuation.

Mr. Malackowski argued that the MRDA did not transfer customer relationships to NNL. This does not strike me as a valuation concept and one can argue, as the Monitor does, that NN Technology was owned by NNL and it included all intangibles.

This is a valuation issue. There is no question that customer relationships were important to Nortel. However that is not the issue. The issue is how to value them. Mr. Berenblut was of the opinion that customer relations were co-mingled with IP rights because the value to use them depended on the ability to sell Nortel products and that their value would be included in the value of rights to sell Nortel products. Dr. Bazelon, an EMEA expert, agreed on cross-examination that goodwill and customer relationships are entangled with the IP and take their value from the IP, at least in part. Brian McFadden, the Chief Technology Officer at Nortel for some time, said that R&D was crucial in initiating relationships with and developing sales from customers for Nortel products. I accept Mr. Green's opinion that no separate valuation needed to be made for customer relationships.

It is also argued that Mr. Green should have separately valued and allocated goodwill. Mr. Huffard included goodwill in his residual class, although he did not attempt to value it. Mr. Britven, called by the CCC, included a value for goodwill in his business sales analysis. He took what the purchasers had allocated in their PPAs as goodwill, and referred to it as Purchaser Goodwill.

Mr. Green's response to this is that Nortel wrote off all of its acquired goodwill at the end of 2008. This indicated that, at the time, Nortel management did not believe it would be able to realize the value of the goodwill from these acquisitions in the future. As for its own "internal goodwill," Nortel was suffering losses from its operations and was not generating positive cash flows. Thus, from an accounting and finance perspective, Nortel had no goodwill from its own operations. By classifying the

residual value as goodwill, Mr. Huffard accounted for an asset that did not exist within Nortel and was not transferred to the buyers. By applying the buyer's perspective, Mr. Huffard failed to answer the question of how to allocate the sales proceeds according to the value of the interests each of the Debtors transferred and rights each of them relinquished.

There is actually support for Mr. Green's position in Mr. Britven's report in which he included a value for goodwill taken from the purchasers' PPAs. These purchaser allocations are done by purchasers for accounting purposes and usually are driven in part at least by tax considerations. Mr. Britven said that Nortel wrote off the value of substantially all of the goodwill that it had on its balance sheet. He said that Nortel did not have sufficient value to support any significant goodwill value and that the goodwill in the business sales related to the attributes of the buyer, not the attributes of Nortel. He said that any goodwill recognized by purchasers in their PPAs did not reflect amounts that could have been realized by the licensed participants through the continued operations of their lines of business.

I agree with Mr. Green's approach to goodwill and accept his opinion that there was no goodwill value in the Nortel businesses that were sold.

Regarding the DCF method used by Mr. Green to value the U.S. and EMEA license rights, Mr. Kinrich was critical of the revenue forecasts used by Mr. Green and stated that he had not followed the International Financial Reporting Standards which state that in measuring value in use, an entity shall base cash flow projections on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the useful life of the asset.

This IFRS material was not put to Mr. Green on his cross-examination, which it should have been for this argument to be made. However, I do not think the criticism is justified. Mr. Green used projections made by Nortel. He used projections referred to as a "Retained by Nortel" scenario which projected what revenues and expenses would be either retained by Nortel or spun-out on its own as a stand-alone company. He declined to use Nortel's "Safe Hands" projections for several reasons that he explained, including the fact that they forecasted the businesses in the hands of a well-capitalized third party who could invest adequate capital in the business and who could earn greater profits than if they remained in Nortel's hands. Mr. Green did no DCF analysis as he allocated the business sales solely on revenues.

Mr. Kinrich was also critical of Mr. Green for not including a terminal value in his DCF valuation. Mr. Green's explanation for this on his deposition was that in his present value analysis, at year nine the present value factors were close to zero. So even if there were a terminal value, it would be virtually of no value in a present value computation. In his report, he said he thought that to include potential profits after nine years was too speculative. There is no competing DCF valuation to indicate what Mr. Green did was wrong.

Mr. Green's analysis in part is dependent on the interpretation of the MRDA advanced by the Monitor on behalf of the Canadian Debtors. One cannot quarrel with the logic of it if that interpretation were to govern the allocation.

Appendix B

Residual IP proceeds allocation

The residual IP was sold to Rockstar for $4.5 billion. After payment of a break fee and expense reimbursement to Google, the remaining net proceeds held for allocation amount to $4.45 billion.

There is differing expert opinion as to how to allocate the proceeds of the Rockstar sale amongst the Canadian debtors, the U.S. debtors and the EMEA debtors.

Mr. Green allocated the proceeds on the basis of his interpretation of the MRDA under which it was NNL that owned all of the patent rights that were sold to Rockstar.

Mr. Kinrich for the U.S. debtors allocated the proceeds on a revenue approach on the basis that each Participant owned all of the economic rights to the patent rights sold to Rockstar in their exclusive jurisdictions and that their revenue streams that they

gave up should be valued. Mr. Green as an alternative analysis for the Canadian debtors and Mr. Malackowsi as an alternative analysis for the EMEA debtors prepared valuations correcting what they saw as errors by Mr. Kinrich.

Mr. Malackowski allocated the proceeds on a contribution basis by calculating what he saw as the contributions by each of the Participants to R&D over the life of the patents that were sold to Rockstar.

(i) Mr. Kinrich's license approach to value

Mr. Kinrich assumed that each of NNL, NNI and the EMEA debtors owned all of the economic benefits of the residual IP. He allocated all of the Rockstar proceeds to NNL, NNI and EMEA by taking what he said would be the revenue earned in each of those three geographical areas and then doing what he said was a discounted cash flow analysis ("DCF") on those revenue streams. I have held that the Licensed Participants did not own all of the economic benefits of the residual IP. However, on the assumption that they did, I will consider Mr. Kinrich's analysis.

Mr. Kinrich obtained his revenue streams by taking one of the IPCo revenue model assumptions. He then apportioned the net revenues after costs and taxes to each of the three geographical areas by using those countries' relative telecom infrastructure expenditures for six of the eight IPCo franchises that Nortel had and apportioning all of the net revenues after costs and taxes for two of the franchises (PC and Internet advertising) to the U.S. He then applied a discount rate to those net cash flows allocated to each country.

I have considerable difficulty with a number of aspects of Mr. Kinrich's analysis. If the value of the net cash flows as stated by Mr. Kinrich is overstated, the overstated amount would belong to NNL, as the amount of the sales proceeds from the Rockstar transaction would represent more than the value of the net cash flows, which on Mr. Kinrich's assumption is what the Licensed Participants gave up in the Rockstar sale. The expert evidence called by the Monitor is exactly to that effect, contending that Rockstar paid more than the value of the cash flow projections from the IPCo model for other motives.

Nortel had no material business licensing its IP or monetizing its technology by suing others, either before or after filing for protection from creditors in early 2009. Mr. John Veschi had been hired in July 2008 to take responsibility for Nortel's IP group and to look at options for licensing its IP.

Development of the IPCo option was led by Mr. Veschi after the insolvency filings. The premise of IPCo was that the residual patents would be monetized by the threat of patent infringement litigation and, if necessary, actual infringement proceedings against various technology companies in an attempt to force such companies to pay royalties to IPCo. It was considered important that IPCo not carry on any telecommunications or other technology business, because, if it did, it would be vulnerable to counterclaims for alleged infringement being brought by the targets of its infringement litigation, which would undercut its revenue generating ability.

Over the course of 2009 and 2010, Mr. Veschi and his team, assisted by Lazard Frères & Co, Nortel's financial advisor, and Global IPCo, a law firm specializing in patent sales, prepared several versions of a preliminary financial model, in an attempt to forecast the operating profit that could be earned by IPCo so that the potential economic benefits could be weighed against value expected to be received on a sale of the portfolio.

The various versions of the preliminary financial model had three sub-models, with differing assumptions relating to how much litigation IPCo would pursue. The scenarios were dubbed "Harvest" (assuming very little litigation), "Litigation Light" and "Litigation Heavy". More litigation resulted in greater forecast revenues, at greater forecast cost. Assumptions regarding litigation success of 60 percent, 70 percent and 100 percent were used. A wide variety of assumed net cash flows were used and a variety of discount rates to value the cash flows were used.

There is a difference in the evidence of Sharon Hamilton, a partner of Ernst & Young, the Monitor, and Mr. John Ray, the principal officer of NNI, as to how reliable the IPCo forecasts were. Ms. Hamilton was of the view that the projected cash flows were largely guesswork, given that Nortel had little experience in licensing and there were no good precedents about the estimated cash flow. Mr. Ray was more confident of the forecasts taken the work that went into them.

What is clear is that there were a number of different models. Version 1 was presented on March 10 2010, version 2 on April 27, 2010, version 2.2 on May 6, 2010, version 3 undated, version 3.1 on October 25, 2010 and version 4 on November 18, 2010. Each version had different cash flow forecasts.

I think it fair to conclude that the forecasts were not considered to be in any way certain. There were many permutations and combinations, and at no time did Nortel agree that any one forecast was the appropriate one. The process never got that far before the decision was made not to operate IPCo but rather to sell the residual IP.

Mr. Kinrich chose to use version 3.1, although he did not explain why. Version 3.1 had the highest cash flows of all versions. It is noteworthy that the latest version 4 had projected cash flow forecasts of approximately half of what was projected in the earlier version 3.1 used by Mr. Kinrich.

Mr. Green, an expert valuer called by the Monitor, points out that version 3.1 itself was not a finalized document or accepted by Nortel or its advisors. Within it there were a number of scenarios and options still being explored. The unreliability of the forecasts in the various models can be seen by the wide disparity in discount rates used. Lazard used discounts of 25, 35 and 45% to value the various projected cash flows. These are very high discounts, as more than one expert testified, and indicated a high risk to the cash flows being achieved. Mr. Kinrich used much lower discount rates of 12% and 15%, which I will come back to, which did not reflect the risks in the IPCo forecasts and which caused a higher valuation of the cash flows than would be the case if the discounts used by Lazard in the IPCo models were used.

While there were multiple scenarios in the version 3.1 model, Mr. Kinrich used only the most aggressive case that maximized revenue. Mr. Green's view is that there is inadequate explanation by Mr. Kinrich why the specific scenarios of Version 3.1 were selected for the analysis as opposed to other lower cash flow scenarios or the later Version 4 model with lower cash flows and as the analysis is unsupported, it makes the valuation unreliable. I must say that in reviewing the details of Mr. Kinrich's report it is not at all apparent what his justification was for using the cash flows that he did. It leaves an open question as to the reliability of what Mr. Kinrich was doing.

The value allocated to each of the debtors by Mr. Kinrich is based on the attribution to the geographic regions of the debtors of the projected operating cash flows in the IPCo model chosen by Mr. Kinrich. Those cash flows projected royalty payments on a regional level, namely North America, EMEA and China.

The IPCo model estimated North American licensing revenue based on sales in Canada and the U.S. Mr. Kinrich apportioned the revenue to Canada and the U.S. using those countries' relative telecom infrastructure expenditures, saying that relative telecom expenditures were a reasonable basis on which to estimate relative market size and were consistent with the structure of the IPCo model that used market size as the driver of royalty revenues. He did the same thing for EMEA as the IPCo model estimated EMEA revenue based on sales in France, Germany and the U.K.

Global IPCo, the IPCo law firm retained to assist in preparing the models, stated early on in their work that they had no opinion regarding the territorial split of patents or patent-related revenue. There was certainly no agreement by any of the Nortel entities as to how the projected IPCo cash flows would be split territorially.

Mr. Kinrich then deducted costs from the revenue streams including a number of litigation costs. It is not possible from looking at his report to know exactly what level of litigation costs was assumed by him.

After calculating the net cash flows for each country, Mr. Kinrich then said he did a discounted cash flow calculation to arrive at a valuation for each country. In my view, Mr. Kinrich did not carry out a valid DCF valuation. The discount rate he used was not appropriate and was not derived by any conventional valuation approach.

Mr. Kinrich acknowledged in his evidence that a DCF analysis requires knowledge about the cash flows over time and requires a discount rate to take those cash flows over time and convert them to present value. He acknowledged in his report that typically a discount rate is derived from the cost of capital (the cost of debt and equity split on some basis), referred to by valuators as

the weighted average cost of capital. However, he did not do this. Instead he said that the value of the residual IP was known from the $4.5 billion paid for it by Rockstar and by taking his projected cash flows that he used from the IPCo model, he could back into (or reverse-engineer) a discount rate, being 12.2% when China is not included and 15% when China is included.

This analysis proceeds on the assumption that the amount paid by Rockstar was based on the revenues taken by Mr. Kinrich from the particular IPCo model that he used. However, neither Mr. Kinrich nor anyone else knew what revenue streams were used by Rockstar to base their purchase price on or indeed, if Rockstar based their purchase price solely on anticipated revenues they could earn from the patent portfolio they acquired. Without knowing that, it is not possible to say that the Rockstar purchase was based on a discount rate of 12.2% or 15%. A discount rate, as Mr. Kinrich conceded, should reflect the risk of the cash flows being achieved, but without knowing what cash flows Rockstar based its purchase price on, saying the Rockstar purchase reflected a certain discount rate is artificial. Rockstar did not even know what the various IPCo cash flow models were.

Mr. Green, Mr. Berenblut and Dr. Cox and Mr. Malackowski, all expert valuers, were critical of the method used by Mr. Kinrich to arrive at his discount rates of 12.2% and 15%. I accept their criticism. These discount rates were much lower than the rates used by Lazard in the IPCo models, including the very net cash flow model used by Mr. Kinrich, of 25% to 45%. Mr. Berenblut testified that he would expect the range of discount rates to be between 30% and 70%, recognizing the fact that this was a contemplated rather than an established business and recognizing the risks associated with it.

Mr. Malackowski used a discount rate of 30% in his analysis of the potential revenue from the residual IP portfolio. He derived that rate by examining risk-adjusted hurdle rates associated with implementation of technology-based IP. These rates account for a buyer's required rate of return or the associated risk of commercializing a technology.

Mr. Kinrich in his report stated that the inferred rates of 12.2% and 15% that he obtained were consistent with discount rates observed in the market place at the time, being the median weighted average cost of capital for communication equipment companies. However, even Mr. Kinrich noted in his report that IPCo would not have been a communications equipment manufacturer. There was no analysis by Mr. Kinrich to lead to a conclusion that the cost of capital for a start-up litigation and licensing business would be comparable to an established communications equipment manufacturer. Messrs. Berenblut and Cox in their reply report stated:

> The Kinrich Report's use of discount rates for established publicly traded companies in the communications industry as benchmarks for its selection of discount rates for its valuation of a yet-to-be established business to exploit the Residual IP is not supportable. A discount rate of 30 percent or more for this type of business is consistent with our understanding and experience and is also consistent with the discount rates used in the IP Co Model. The academic literature reports venture capital discount rates in the range of 30 to 70 percent.

I accept the criticism of Messrs. Green, Berenblut and Malackowski that the discount rates obtained by Mr. Kinrich were too low. Had Mr. Kinrich used higher rates such as those used by Lazard in the IPCo models, or the rate used by Mr. Malackowski, the value of the revenues given up by the Licensed Participants, assuming they belonged to the Licensed Participants, would have been far less than opined by Mr. Kinrich.

Mr. Green calculated the values from the IPCo models using the discount rates used by Lazard in the models. Taking the most optimistic cash flows from the IP Co. model, the lowest discount rate used by Nortel and its advisors, and a litigation success rate of 100%, the maximum DCF value of IP Co. is only $2.7 billion, compared to the $4.5 billion paid by Rockstar. Messrs. Berenblut and Cox calculated that if a 30 percent discount rate is used to discount the cash flows used by Mr. Kinrich, the resulting net present value of the expected cash flows from the IP Co Model is $1.8 billion. They think this figure is overstated because of the range of values for all of the various scenarios in the IPCo models with various discounts of 25 to 45% and litigation strategies and assumed success rates of the litigation strategies from 60 to 75 to 100%. That range went from $424 million to $2.7 billion. Mr. Green put the range of values in the IPCo models from $400 million to $2.7 billion.

The report of Messrs. Berenblut and Cox explains why Rockstar would be likely to have paid more for the residual IP than Nortel could have made from it, that is, on the theory that the Licensed Participants owned all of the benefits sold to Rockstar,

more than what the Licensed Participants gave up in the Rockstar transaction. The defensive value of the residual IP to the members of the Rockstar consortium made the residual IP far more valuable to Rockstar than it was in the hands of Nortel.

As explained by them, Rockstar obtained ownership of the residual IP and each of the members of the consortium (including Apple, Microsoft, Ericsson and Blackberry) received a license to the residual IP. The structure enabled Rockstar to exercise all rights of ownership of the residual IP against third parties, while providing the individual consortium members with the defensive benefits to prevent others from suing them for patent infringement. As a single company, Nortel was less likely to be able to derive defensive benefits equal to the combined and cumulative defensive benefits that could be gained by several large companies with extensive product and service lines that ranged well beyond what Nortel offered. Several members participating in the Rockstar portfolio are more likely to find patents contained in the Residual IP that will be useful to responses to litigation. Furthermore, as a company in financial difficulty, Nortel was less likely to be an attractive target for patent litigation and therefore less in need of patents to assert in response.

Mr. Green also made the same this point. He stated that the members of the Rockstar consortium purchased the residual IP portfolio, at least in part, as a defensive measure. It was his experience that having access to a large patent portfolio can help protect a large technology firm from lawsuits from other large companies. Access to a large patent portfolio, like the residual IPCo portfolio, can act as a deterrent because potential opposing parties must factor in the probability of a counter-suit. The defensive value of access to a significant patent portfolio is valuable to purchasers like the Rockstar consortium members, but would not be relevant to an entity like IPCo which intended to pursue an offensive licensing and litigation strategy, but had no operating business in the technology sector as all such businesses had been sold. The defensive value of such a portfolio to large companies is not measured exclusively by the present value of the cash flows from licensing.

Dr. Catherine Tucker, an economist called by the U.S. Debtors with considerable technology experience, stated the same thing. In her report she said that patents are not just used in litigation to assert rights to a particular technology or domain. There is also the important role of a patent being used in a counter-suit should the company itself be sued for patent infringement. She referred to Kent Walker, Google's General Counsel, who wrote at the time of the Rockstar bid that it was supposed to create a disincentive for others to sue Google. This defensive attribute, of course, would not have been available to IPCo if it decided to operate a patent licensing business as it would not have been in a product producing business that would be vulnerable to patent suits.

Mr. Green also expressed the view that the identity of the bidders themselves in the residual IP auction also illustrates that the basis on which value of the residual IP portfolio was determined is not consistent with that in the Kinrich report. The bidders included Google, Apple, Microsoft, Ericsson and other large technology companies with worldwide operations rather than companies whose primary business model was patent licensing and litigation. If the value of the residual IP sale was closely related to the cash flows from a licensing/litigation strategy, one would expect licensing/litigation businesses to have been bidders in the auction. Instead, the bidders in the auction were operating technology companies, which suggests that the value of the residual IP was determined in the market on some strategic basis in addition to the value of the IP in a licensing/ litigation business.

I accept the evidence of Messrs. Berenblut and Cox and Mr. Green that the approach of Mr. Kinrich of allocating proceeds based on cash flows from a licensing /litigation business model such as the IPCo models is inappropriate and that what Rockstar paid for was more than the value of the potential revenues from the business that was being considered by IPCo. That is, it was more than what the Licensed Participants gave up in the Rockstar sale, assuming it was theirs to give up.

The U.S. Debtors contend that it is wrong to say that Rockstar paid more than the value of what the Licensed Participants gave up when they terminated their licenses in anticipation of the Rockstar sale and to say that the extra value belongs to NNL as the owner of the NN Technology. They say that NNL could not transfer its rights without the consent of NNI and the EMEA Licensed Participants, just as NNI and the EMEA Licensed Participants required the consent of NNL to do so. They say that all parties consented to the transfer of their MRDA interests as part of the Rockstar sale, effectively agreeing to the assignment of their rights under article 14(e) of the MRDA which permitted an assignment of a party's rights under the MRDA only with the consent of all of the other parties.

I do not accept that contention. The MRDA did provide in article 14(a) that the MRDA could not be assigned by any licensed participant without the consent of the other Licensed Participants. But neither the MRDA nor the licenses of the Licensed Participants were assigned to Rockstar. Rockstar would not have taken an assignment of the MRDA with its obligations and duties amongst the participants. I accept the evidence of Mr. Britven, an expert valuer and the national intellectual property consulting practice leader with Duff & Phelps in Houston, that no third party would want to step into the shoes of a Licensed Participant by taking a transfer of the MRDA with its obligations to share profits and transfer ownership of patents to NNL, among other things. Even Mr. Ray eventually admitted that there was no transfer of license rights to Rockstar.

What occurred was a sale of the residual IP to Rockstar with NNI and the EMEA debtors terminating their licenses under the MRDA as a condition precedent to the sale. What is at issue is the value of those licenses that were terminated. If the value of what could be earned from the licenses was less than Rockstar paid for the residual IP, the difference would belong to NNL, the legal owner of that IP.

Mr. Green did an alternative valuation on the assumption, with which he disagreed, that IPCo would have operated on a stand-alone business and that the licenses surrendered by U.S. Debtors and EMEA debtors would have included the rights to the residual IP portfolio. He used version 3.1 of the IPCo model, as Mr. Kinrich had, but made some changes. He used the three discount rates that had been used by Lazard in the various IPCo models and used the three assumptions in the IPCo models as to the anticipated success in litigation against infringing third parties. He also deducted from the revenue streams going out to 2020 the RPS percentages for 2010 under the MRDA on the theory that if the Licensed Participants had rights under their licenses to earn the revenues proposed in the IPCo models, those licenses came with an obligation to make RPS adjustments in favour of the other Licensed Participants. Any gain on the sale above the DCF valuations on the revenue streams was allocated to Canada.

If one assumed the median discount rate (of 35%) and the median litigation success rate (of 70%), and excluding the revenues from China, then Mr. Kinrich's allocation of the Rockstar Sale proceeds, as adjusted by Mr. Green, would be as follows. Also shown is the allocation advocated by Mr. Kinrich.

	Adjusted Kinrich Allocation of Rockstar Sale Proceeds	***Kinrich's Actual Proposed Allocation of Rockstar Sale Proceeds***
Canada	$4,003.06 million	$430 million
U.S.	$346.12 million	$3,310 million
EMEA	$105.19 million	$710 million
Total	$4,454.37 million	

If revenues from China were included, the results would be an allocation of $3905.44 million to Canada, $420.99 million to the U.S. and $127.94 million to EMEA.

The U.S. Debtors contend that Mr. Green was wrong to apply the RPSM to the value of the cash flows. They say firstly that the MRDA expressly provided in the third addendum signed in December 2008 that it does not apply to the sale of a business. What that amendment provided was that the operating income or loss used to calculate the RPSM was to exclude "gain/loss on the sale of business". That is not a reference to the proceeds of the sale of a business, but rather a reference to the gain or loss, presumably capital gain or loss, recognized on a sale of a business. That makes sense because the RPSM was dealing with the split of profits or losses from operating earnings to be allocated to the participants under the MRDA. Ordinarily the gain or loss on the sale of capital assets would be recognized in an earnings statement but the parties to the MRDA did not want that taken into account in the RPSM.

However, what Mr. Green was valuing in this analysis was the annual profits that would be earned by the Licensed Participants from operating IPCo in the future, assuming the Licensed Participants had the right to do so under their licenses. He was assuming that the profits would be split in accordance with the RPSM in the MRDA. I agree with the theory that if one is to value the benefits that could have been earned by the Licensed Participants if they had operated IPCo, which is what the U.S. Debtors say they would have done but for the Rockstar sale, the Licensed Participants would have been subject to some profit split.

The U.S. debtors point out that what the profit split would be is a matter of conjecture and that it is not possible to assume, as Mr. Green did, that it would be the same in the future. The RPSM under the MRDA was based on the amount of R&D spend each year by Nortel and the Licensed Participants. After Nortel became insolvent, the R&D expenditures essentially stopped after 2009 and there is no evidence of what R&D would have been undertaken if IPCo had been run as a business by Nortel.

Certainly there would have had to be some transfer pricing in place if Nortel had run IPCo as a business. What the parties would have worked out is unknown. The tax authorities would certainly have been interested in the transfer pricing associated with the running of the IPCo had that occurred and it does not mean that the parties would not have had to agree on a profit split of some sort. They would have been required to do so.

It is perhaps fair to be critical of Mr. Green for assuming the transfer pricing would continue to be the same under an IPCo business run by Nortel as it had been before. It is also fair, however, to ask that if the U.S. debtors contend, as they do, that they are entitled to be paid for what they gave up in the Rockstar sale and that the present value of the anticipated net cash flows is what they gave up, one may have expected them to lead some transfer pricing evidence as to what transfer pricing would have been appropriate.

The assumption that the transfer pricing that the parties would have worked out in the event that Nortel operated IPCo would have been the same as provided in the MRDA has some logic to it. The residual IP was created by R&D conducted by the parties, at least in part, during the MRDA that split profits on the basis of the R&D expenditures of NNL and the Licensed Participants. R&D was the driver of the profitability of Nortel and the RPSM was chosen at the request of the tax authorities as the most appropriate method for determining the compensation to each of the participants for the R&D performed by them. The profits to be earned from operating IPCo could perhaps be seen to be an extension of the results of the R&D that had been spent.

The lack of transfer pricing evidence and analysis on the point, however, as to how the profits would be split in an IPCo business casts some doubt on the accuracy of Mr. Green's alternative analysis. It is not a basis, however, to reject it out of hand as contended by the U.S. debtors.

Mr. Malackowski's preferred allocation approach is a contributions approach based on R&D expenditures made by each of the participants to the MRDA. He prepared an alternative revenue or licensed based allocation which contained dramatically different results from his contributions approach. His revenue approach allocated 33.6% of the Rockstar sale proceeds to the EMEA debtors versus 17.6% using his contribution approach. It allocated 11% to the Canadian debtors versus 39.5% using his contribution approach and it allocated 55.4% to the U.S. debtors versus 42.9% using his contribution approach.

For his revenue or license approach, Mr. Malackowski used the data generated as a result of his valuation methodology to allocate the proceeds of the Residual IP Sale. He valued the Residual IP Portfolio by determining what revenues were expected to be generated by a worldwide licensing strategy in specific geographic territories and allocating the values to those territories. He estimated global revenues for the business areas in which the technology was used, royalty rates, licensing expenses, tax and discount rates. Mr. Malackowski concluded that the value of the residual IP was $3.570 billion, approximately one billion less than actually paid by Rockstar. He then "reconciled" this value with the actual purchase price of $4.5 billion by increasing pro rata the values he had calculated for each business franchise.

For the exclusive territories of Canada, United States, Britain, Ireland and France, he allocated all of the value for those territories to each of the countries. For the rest of the world ("ROW") he allocated 20% to each of the countries. It was this latter allocation of ROW that was the main cause of the increase in the allocation to EMEA as it had what he called "three seats at the table of five".

I have difficulty with Mr. Malackowski's revenue or license model of allocating the Rockstar sale proceeds. The first is that there is no explanation by Mr. Malackowski why his market based valuation was $1 billion less than the actual sale proceeds. Rather than simply grossing his value up to "reconcile" it with the actual proceeds, it seems to me that his valuation was an indication that Rockstar paid for more than what could be achieved in revenues from the acquired IP portfolio. Mr. Green expressed the

opinion that the adjustment was inappropriate and unsupported by valuation principles, and assumed that Rockstar just used different royalty or revenue assumptions. I accept that criticism.

Mr. Green also expressed other criticisms of Mr. Malackowski's calculations, all of which appear logical and which I accept. For example:

> (i) Mr. Malackowski assumed all revenues for a country should be included in the royalty base, whereas he should have considered that only revenues from products and not services on which no patent royalty would likely be available.
>
> (ii) Mr. Malackowski assumed that revenues from all licensees will begin to be earned in 2011 i.e. he assumed that all licensing efforts against dozens of targets across multiple jurisdictions would be 100% successful within a few months of the portfolio being sold. Mr. Green's view is that his assumption is hard to credit and is inconsistent with the fact that the royalty rates selected by Mr. Malackowski are the IPCo "litigation light" rates, which would, by definition, require at least some form of enforcement action, which would necessarily delay the receipt of royalty payments.
>
> (iii) Mr. Malackowski assumed increasing royalties through 2022 without considering that the patents and technologies are wasting assets and many are likely to expire before the end of the period used by Mr. Malackowski.
>
> (iv) Mr. Malackowski deducted costs of 20% of royalty revenues, stating that he based the rate on the observed financial performance of sophisticated non-practicing entities such as Acacia Research Group. Mr. Green reviewed Acacia's public filings and those of other licensing entities and have found a significant discrepancy between their reported costs and those that the Malackowski Report asserts are representative. The Acacia public filings disclosed that the company's costs of operation from 2005 through 2012 have ranged from 112% of revenue in 2005 to a low of 52% of revenue in 2012. Other licensing entities, such as Interdigital and Rambus, report operating costs from 2005 to 2012 ranging from a low of 28% of revenues to as much as 164% of revenues.

These errors lead to the conclusion that Mr. Malackowski's valuation of $3.570 billion of the residual IP sold to Rockstar was likely overstated, indicating an even greater discrepancy between his value and the actual sale price. It also indicates issues with the territorial split of the revenues. The assumption of Mr. Malackowski that the entire sale proceeds were based on revenue forecasts by Rockstar, permitting him to simply increase his $3.570 billion value by another $1 billion without analyses ignores the likelihood that Rockstar paid what it did in part as a defensive move for its participants to protect their operating businesses, which Nortel no longer had. I do not have confidence in using Mr. Malackowski's analysis to allocate the proceeds of the Rockstar sale on a license or revenue basis.

In the end, I also cannot accept Mr. Kinrich's calculation of the amounts from the Rockstar sale to be allocated to NNL, NNI and EMEA. Assuming the Licensed Participants had a right to the value of the residual IP that Nortel could have achieved, and looking at the various scenarios in the IPCo models, I would recalculate those values and allocate the proceeds by adjusting the calculations of Mr. Kinrich and averaging them with the calculations of Mr. Green in his alternative approach.

I would take the mid-point between the low value of $400 million to $2.7 billion, or $1.5 billion using the discount rates of Mr. Green and Messrs. Berenblut and Cox. Using the same split as Mr. Kinrich, on the assumption that value would not be realized in China, would result in an allocation of 9.3% or $139.5 million to the Canadian debtors, 14% or $210 million to EMEA and 76.7% or $1.15 billion to the U.S. debtors. The balance of the $4.45 billion, or $2.9 billion, would be allocated to Canada. On the assumption that value could be realized in China, the resulting allocation would be 11.1% or $166.5 million to the Canadian debtors, 22% or $330 million to EMEA and 66.9% or $1.0 billion to the U.S. debtors. The balance of the $4.45 billion, or $2.9 billion, would be allocated to the Canadian debtors.

I would then average these allocations with the allocations arrived at by Mr. Green in his alternative analysis, set out in paragraphs 358 and 359 above, which were based on the median discount rates and litigation success rates used in the IPCo models.

The results of that allocation, assuming the revenues from China are included, would be an allocation to Canada of $3,485.97 million, to EMEA of $228.97 million and to the U.S. of $710.5 million, or a total of $4,425.44 million. I would round these figures up on a pro rate basis to arrive at the proceeds available of $4,454.37.

The results of that allocation, assuming the revenues from China are not included, would be an allocation to Canada of $3,521.28 million, to EMEA of $157.6 million and to the U.S. of $748.06, or a total of $4,426.94 million. I would round these figures up on a pro rate basis to arrive at the proceeds available of $4,454.37.

The U.S interests assert that on a license or revenue analysis, very little revenue should be attributed to China. They assert that the IPCo models included both a "China in" and "China out" option. I must say I have carefully looked at the IPCo model 3.1 used by Mr. Kinrich and I cannot find a China out option. On cross-examination of Mr. Malackowski, who thinks China revenues should be included, it was put to him that the IPCo model had a "toggle" for China, which I take to be a sheet with revenues for China.

In any event, Mr. Kinrich testified that he at first took the mid-point of the particular China forecasts he used after doing an economic literature search on patent value and speaking with Mr. Zenkich, who told him that the market would pay little to nothing for a China patent, he reduced his revenues for China downward more towards the US in some qualitative fashion. He reduced then by 75%. Mr. Zenkich, an expert in valuing patents, testified that in 2009-2010 participants in the market for patent portfolios assigned little to no value to Chinese patents.

The thinking of Nortel's patent people changed over time. In December 2000, Angela Anderson, Director, Intellectual Property Law in the U.K stated that China was a sizeable and growing market accessible at moderate cost. She said that the target filing % (3% of cases) would be higher but for enforcement issues. "Show the flag, but don't over-invest." She testified that at that time, it was clear that China was going to become more of a potential marketplace for Nortel products. In addition, the patent system was starting to look like a real patent system, so it made sense to start using the patent system in China at that time.

By 2006, Nortel intended to file far more patents in China. The plan was to file up to 30% of the top patents in China and in 18 months' time raise this to up to 50%, selecting those having the highest commercial potential. In the IPCo model of May, 2010 that included revenues from China, it stated that early 2010 modelling did not include China in its royalty base but the new plan included China but only in the years 2015 to 2020. It stated that 80% of its patents and 70 % of the applications in China were for wireless 4G technology. The logic of waiting until 2015 was the time for 4G market maturity. EMEA contends, and I have no reason to question it, that the assumptions in the IPCo model regarding China were conservative.

Mr. Malackowski's view was that in doing a revenue or license approach, it would be wrong to exclude China revenues. His reasoning was that Nortel had decided to file high interest patents in China, that patent protection was improving in China and had improved over the past five to ten years and that China was a very important and large market. He has had experience in China. His firm has a partner in Shenzhen for addressing the work they do in China.

Mr. Zenkich testified that the basis for his conclusion that no one would pay anything for a Chinese patent was based on his business of being a patent broker. He testified that when his clients had large patent portfolios, there was no interest expressed in the Chinese patents that were part of those portfolios. Similarly, they were never asked by clients who looked to purchase patents to identify Chinese assets for purchase. I take this to be no evidence of knowledge of values that could be achieved for a Chinese patent, but only that Mr. Zenkich had no knowledge of a client being interested in in a Chinese patent. Included in material referred to in his report was a 2011 report entitled "China's Emerging Patent Trading Market" that referred to a patent auction in China in 2010 which sold 38 lots and the intention of the seller to hold another auction in 2011. The article also referred to efforts being made to set up an exchange in China with the support of governments that would facilitate transactions. That article was contradictory of the view expressed by Mr. Zenkich.

Mr. Zenkich referred to a 2012 publication by the U.S. Patent Office that referred to comments it had received to the effect that there were difficulties with enforcing Chinese patents. That is certainly anecdotal evidence of statements made by others, and it cannot be belittled. How accurate are all of the statements is perhaps a matter of some debate. For example, a comment by

one person as to the cap on damages in China was shown during the evidence to be incorrect. While Mr. Zenkich had stated in his report his belief that that significant interest in patent granting activity in China over the last ten years has increased the risk that patents may be challenged as invalid, even if granted, he acknowledged on cross-examination that he had no experience in trying to enforce patents in China and that his company had no experience in trying to enforce a patent anywhere in the world. He also acknowledged that he did not independently conduct surveys or seek out patent data of this kind of activity and that he was unable to identify a single instance where a Chinese patent was found invalid and its US or European counterpart was not. One of the documents cited by Mr. Zenkich in his report was a publication by a Beijing law firm of October 2009 that stated that the major cities, in particular Beijing, Shanghai and Guangzhou, can be considered as a reliable forum for patent infringement actions. Mr. Zenkich chose instead to rely on the U.S. Patent Office document that contained comments regarding the difficulty of enforcing patents in China.

I am afraid that I cannot put a great deal of reliance on Mr. Zenkich's evidence of the unreliability of the Chinese patent system. I accept he may be of the view that it is unreliable, but his view was not supported by any cogent, reliable and admissible evidence. The views of Mr. Kinrich are also not supported by any cogent evidence. He appears to have largely relied on Mr. Zenkich.

In my view, if a license or revenue approach to value is to be used to value the residual IP, it should include revenues from China that were used in the IPCo model, mainly for the reasons expressed by Mr. Malackowski and the fact that the projections were somewhat conservative.

The conclusion I come to, if an allocation of the proceeds of the Rockstar sale were to be based on a license or revenue approach, would be an allocation to Canada of $3,485.97 million, to EMEA of $228.97 million and to the U.S. of $710.495 million, or a total of $4,425.435 million. I would round these figures up slightly on a pro rate basis to equate to the proceeds available of $4,454.37.

(ii) Mr. Malackowski's contribution approach to value

The EMEA debtors contend that the allocation of the proceeds of the Rockstar sale should be made on the basis of the contribution to R&D made by each of the RPE entities that created the residual IP sold to Rockstar. They contend that the contributions by each RPE to measure this should not be the contributions made during the five year look-back period used to allocate the residual profits under the MRDA but rather the contributions made during the period of time that the residual IP that was sold to Rockstar was invented. Based on the evidence of Mr. Malackowski, they say the look-back period should be from 1991 to 2006[26] .

There are two fundamental issues that have been raised to the calculations if the contribution approach to allocation is to be used. The Canadian Debtors contend that there is no basis to use a contribution approach to allocate the proceeds of the Rockstar sale or the business line sales. They say that if a contribution approach is nevertheless used, the look-back period for looking at R&D contributions should be the five year look-back period under the MRDA from 2005 to 2009. The U.S. Debtors also disagree that a contribution approach should be used to allocate the Rockstar and business line sale, but contend that if a contribution approach is used, they agree with the EMEA debtors as to the length of look-back period but contend that all R&D spending must be taken into account. They contend that what must be taken into account is not only the R&D costs incurred by each RPE in their own exclusive territory, but also all transfer pricing adjustments made by an RPE, particularly the adjustments made under the CSA agreements prior to the MRDA coming into force.

Mr. Malackowski said in his report that to measure contribution, ideally, the contributions of the RPE's labs to the development of the patented technologies could be fully and accurately determined by interviewing all of the firm's R&D staff, and by reviewing all the documentation related to the firm's research (e.g. lab notebooks, invention disclosures, meeting minutes, research presentations etc.). This approach was not possible for Nortel's IP due to the size of the portfolio, the limitations on time and the availability of information. Mr. Malackowski did not have access to lab notebooks and R&D staff. Moreover, as R&D was organized across the Nortel Group and carried out in a highly coordinated and integrated manner across the various RPEs, it was even more difficult to separate out the distinct contributions of the various RPEs. In these circumstances he said he had to select a proxy data that reasonably reflected the research efforts of the various RPE's labs.

Mr. Malackowski chose to measure contributions to the development of the IP by measuring each RPE's spending on R&D. He stated that in a large organization, where R&D funding supports a large number of R&D personnel and results in a large number of patents over time, this funding can be valid and indeed the most accurate proxy measurement for determining the contribution of each research group to the development of IP. He stated that it is common practice to regard each dollar spent on R&D as fungible for the purposes of measuring relative contribution to R&D in a group, as Nortel did under the RPSM.

Mr. Malackowski stated that in his experience, in large IP portfolios the vast majority of the value of the portfolio is usually derived from a minority of the patents. This is due in part to the fact that technology IP can be overlapping and duplicative. Value is often derived from a relatively small number of patents that are essential to industry standard technology or that cover an essential process or solution to a common problem. Mr. Malackowski expressed the view that the patents that were categorized as high interest by Global IP likely represented the vast majority of the value of the residual patent portfolio. Approximately 37% of the total residual patent portfolio was identified as high interest.

The evidence was that it generally took one year for Nortel R&D spending to result in a patent application for an invention. He therefore thought it appropriate to determine contribution to the creation of Nortel's IP by measuring R&D spending starting the year before the filing of the earliest unexpired patent categorized by Global IP as high interest, i.e. in 1991. He stated that the most logical end point was in 2006, the year before the last high interest patent was filed. He provided calculations for four look back periods produced by two different start points and end points. His two start points were 1991, reflecting the year before the earliest unexpired high interest patent in the residual patent portfolio, and 2001. His two end points were 2006, representing the year before the last high interest patent in the residual patent portfolio, and 2008, representing the last year of ordinary course operations[27] . 2001 was the start of the MRDA.

By looking at the expenditures on R&D for this period from 1991 to 2006, Mr. Malackowski allocated 39.5% or $1.777 billion to Canada, 42.9% or $1.930 billion to U.S. and 17.6% or $793 million to EMEA. For the period 1991 to 2008, he allocated 40.6% or $1.827 billion to Canada, 43% or $1.935 billion to U.S. and 16.4% or $738 million to EMEA.

The effect of using the longer look-back period substantially reduces the amount allocated to Canada, the reason being that the R&D expenditures from 2005 to 2009 during the five year RPSM were proportionally done more by Canada than EMEA and the U.S. The percentages from 2005 to 2009 were 49.5 for Canada, 38.8 for the U.S. and 11.7 for EMEA.

Mr. Malackowski's report contains discussion why he looked at a long period back to 1991 to measure R&D spending. He said that old patents maybe more valuable than recently filed ones. He said that technologies are adopted by the market slowly over time and do not realize their full value until later in the life of the patent. He did recognize that newer patents will have longer life before they expire and they may have favour due to technological obsolescence, but pointed out that there is risk in newer technologies that they may not be accepted by the market. Based on these considerations he concluded that he should take into account R&D spending from the year before the first high interest patent.

Mr. Malackowski did not consider what Nortel's thinking was about the life to its technology. In the first version of the MRDA the R&D spending used to split residual profits was calculated using an amortized 30% rate, with expenditures from any one year declining by 30% in the following years. In Nortel's response to questions from the tax authorities in 2003 in connection with its request for an APA for that MRDA, Nortel stated:

> It is difficult to ascertain the exact useful life of R&D developed at Nortel; however, Nortel's analyses indicated that a 30% amortization was conservative yet reasonable. Numerous sources suggest that the useful life of telecommunications R&D is short; however, there is no one definitive external source that explicitly determines that a 30% amortization rate is correct.

The tax authorities did query this response in a question that referred to information from Nortel that it said seemed to suggest that the useful life of R&D is equivalent to product useful life. "However, isn't it the case that benefits from R&D may persist beyond product useful life? For instance, value may result from further developing the intangible."

In preparation for APA negotiations with the tax authorities, Gilles Fortier, NNL's taxation manager for transfer pricing, circulated a document among Nortel tax executives dated May 10, 2002 summarizing the "key drivers" for Nortel, on the one hand, and the tax authorities, on the other, with regard to the APA. The position of the tax authorities was stated to be that the life of Nortel's intellectual property was 7-10 years or more whereas Nortel was suggesting 4-7 years. This position of Nortel was consistent with using a 30% amortization rate for R&D spending in allocating profits under the CSA. Nortel wanted a shorter period because using a longer period would increase the profits in NNI for tax purposes that Nortel did not want. Canada had a lower tax rate due to its generous research and development policies.

A later application by NNL and NNI for an APA with the tax authorities for the years 2007 to 2011, in which a straight five year R&D expenditure would be used to allocate profits, indicated that NNL and NNI thought that the useful life of the Nortel intangibles was estimated to be approximately five years with a gestation lag of one year. Included in the APA request was the following:

> The economic life of technology is difficult to measure because as long as the technology is being sold, it is also being continuously updated and enhanced. Indeed, software and hardware development in the telecommunications industry is widely understood to be an iterative process, because of the tendency to superimpose improvements upon older versions of the technology. Therefore, any discussion of product useful life must consider when an individual product was originated, how to apportion the impact of successive improvements, and when the product was completely superseded.
>
> Nortel's telecommunications technology consists of hardware and software, and it continues to grow and change as demand for bandwidth and functionality grows. As a result, there has been an evolution in the commercial and economic life span of technologies from longer to shorter cycles.
>
> Nortel's Chief Technology Office estimated that a dollar spent on R&D typically has a shelf life of about five years, and additionally, the time from when the investment in the R&D is made to the time when revenue can be generated from the investment ranges from about 6 to 12 months.
>
> Recognizing the difficulties inherent in estimating the useful life, based on information obtained in our discussion with Nortel management, and our review of the R&D policy documents, the useful life of the Nortel intangibles is estimated to be approximately five years with a gestation lag of one year.

The evidence from Mr. Malackowski's report is that 99% of the high-interest patents sold to Rockstar had an invention date prior to 2006 and the bulk were from 1995 to 2004. This is considerable evidence that what Nortel was telling the tax authorities did not turn out to be the case. This is not to suggest that Nortel did not believe what it was representing to the tax authorities, or perhaps more appropriately put, that Nortel's transfer pricing tax people did not think that a legitimate tax case could be asserted supporting its 30% declining amortization calculation in the first MRDA and then its five year look-back period in the second version of the MRDA. It is clear, however, that Nortel expected negotiations with the tax authorities would take place that could alter the 30% amortization rate and the later five year flat rate, and the MRDA expressly contemplated that in Schedule A. It cannot be said that Nortel as an enterprise conclusively concluded that its profit allocation keys of 30% or five years were necessarily correct. It was a tax position prepared by Nortel and its advisors.

If a contribution theory is to be used to measure the value of what the parties gave up, I think it inevitable that a longer look-back period would be appropriate. The market has indicated that. However, I would lengthen the time to be taken into account. One of the weaknesses of using a contribution approach is that not every dollar spent results in valuable technology. The theory then must be that what one loses in the corners is gained in the straights. That being the case, I see no reason to disregard the R&D expenditures in 2007 to 2009. They were real and cannot be said to have contributed to the residual IP sold to Rockstar [28] . The fact that Rockstar has started out by enforcing earlier patents does not mean that later patents or patent applications will not be of value or that Rockstar did not pay anything for them.

I would take the R&D expenditures from 1991 to 2009. The data is available from exhibit B.1.7.1 of Mr. Malackowski's report. The resulting percentage of expenditures is 40.93% for Canada, 42.87% for the U.S. and 16.2% for EMEA.

The U.S. Debtors contend that because under the CSA agreement NNI was required to allocate transfer payments to other RPEs, those payments should be included in what is considered to have been contributed to R&D. They rely on upon the opinion of Laureen Ryan, a forensic accountant who went through the transfer pricing worksheets and calculated $4.4 billion allocated to other RPEs under the CSA agreement. On her figures, the percentages for R&D expenditures for 1989 to 2000 would be 21% for Canada, 6% for EMEA and 73% for the U.S.

There is a problem with Ms. Ryan's evidence. The first is that she did no cash analysis to determine if NNI actually paid out any cash to any other RPE as part of its transfer pricing requirements under the CSA and later MRDA. There is no evidence in the record that anything allocated to any party was actually transferred by way of cash and Ms. Ryan conceded that she could not say if anything was actually paid. She did speak to her general understanding that money was transferred by NNI to NNL but I take that to be hearsay evidence and not any cogent evidence that any funds were transferred in fact. Just as important, there was no evidence as to how cash transferred from NNI or any other RPE was actually used. Cash was moved throughout the Nortel Group as required, but what those requirements were at any time is not a matter of record or available evidence. Ms. Ryan also conceded that she was not able to say where any of the money came from to actually do the R&D spending, whether from customers, governments, shareholders or other Nortel entities.

While Ms. Ryan in her report and evidence calculated what she said were allocations for R&D made by NNI to the other RPEs under the MRDA, the U.S. Debtors made no argument in their closing briefs that these payments should be attributed to NNI. One problem with the evidence on this point is that Ms. Ryan assumed that the RPEs used transfer pricing adjustments for only for only two types of expenses: direct R&D spending figures, and sales, general, and administrative costs. Ms. Ryan pro-rated the intercompany funding between those two expenses. That assumption was obviously incorrect because, as Ms. Ryan conceded, it ignores very significant additional costs incurred by the RPEs, including restructuring costs, costs of revenues, manufacturing, and distribution. The very need for an assumption to be made was because Nortel never kept records of what transferred cash from one Nortel company to another was used for. Ms. Ryan also erred in failing to deduct the $2 billion settlement with the IRS and CRA regarding the $2 billion that was deemed to be a dividend paid by NNI to NNL. She also failed to take into account the sale of Nortel's UMTS business to Alcatel.

As stated above, Mr. Malackowski thought that ideally to determine contribution to R&D by any particular RPE, he would need to have access to lab notebooks and other records and to Nortel R&D personnel. As he did not have that he had to select a proxy data that reasonably reflected the research efforts of the various RPE's labs. He chose to measure contributions to the development of the IP by measuring each RPE's spending on R&D. He testified that this would be reflective of the types of activities that we know lead directly to the inventive process. It is the engineering time and the related expenses that result in the innovation. He testified that a transfer pricing adjustment is an allocation that is done for other purposes, specifically tax efficiency, not for recording the matching between the inventive nature of contribution and results, and he viewed it as inappropriate.

Ms. Ryan is a specialist in accounting and forensic investigations. I prefer the evidence of Mr. Malackowski on this point that for his contribution analysis, it is not appropriate to add to any RPE's contribution amounts that were allocated from that RPE under the transfer pricing regimes in the CSA or MRDA.

Mr. Malackowski did an "inventorship" analysis in his reply report of the countries in which the inventors of the residual patent portfolio resided. He stated that while he did not consider inventorship to be the appropriate basis for allocation, it was a useful metric for testing the allocations of the various parties.

The results of Mr. Malackowski's analysis indicated that for the high interest patents, 46.3% were from Canada, 33% from the U.S., 18.7% from EMEA and 2.6% from ROW. For the entire portfolio, 51.9% were from Canada, 27.4% were from the U.S., 17.7% were from EMEA and 2.9% were from ROW. Using the percentages for the entire residual patent portfolio, which is

what was sold, and allocating ROW equally to the others, would give Canada 52.9% of $4.45 billion or $2.35 billion, U.S. 28.4% or $1.26 billion and EMEA 18.7% or $832 million.

Mr. Britven, an expert called by the Monitor, while of the opinion that a contribution allocation theory was not correct, also did an inventor based analysis. That analysis allocated 51.3% to Canada, 28.9% to the U.S., 18.2% to EMEA and 1.6% to others. That is very close to the figures from Mr. Malackowski's inventorship analysis

I conclude that if the contribution allocation theory asserted by the EMEA debtors is accepted, the percentage allocation of the residual IP sold to Rockstar of $4.45 billion is 40.93% or $1.82 billion for Canada, 42.87% or $1.92 billion for the U.S. and 16.2% or $720 million for EMEA to be rounded down pro rate to get a total of $4.45 billion.

(iii) Mr. Green's approach

Mr. Green allocated virtually all of the proceeds of the Rockstar sale to Canada. [29] There were two categories of patents involved in the sale:

1. patents that had been used in several business lines and in respect of which non-exclusive licenses had been granted to the business line purchasers; and

2. the remaining patents, which had not been used in any Nortel business.

For the group of patents identified in (1) i.e. patents that had been used in several business lines and in respect of which non-exclusive licenses had been granted to the business line purchasers, the value of the U.S. and EMEA Debtors' licenses with respect to those patents (which is the value that they would have earned had they continued to operate the businesses) was determined by Mr. Green and allocated to them as part of his allocation of the business line sale proceeds.

With respect to those patents described in (2) that were not used in any of Nortel's operating businesses, Mr. Green considered whether there was any evidence that the U.S. and EMEA Debtors had any prospect of generating earnings through the exercise of their license rights in connection with those patents. He concluded that they did not because the U.S. and EMEA Debtors' license rights were limited to the right to make Products — i.e. products made or designed (or proposed to be made or designed) by or for a Participant, embodying or using the Nortel IP. This was consistent with the position taken by the Monitor in this case. Thus he allocated none of the proceeds of the Rockstar sale to the U.S. and EMEA Debtors and all of the proceeds to Canada.

Mr. Green's valuation is a straight result of the interpretation put on the MRDA by the Monitor. One cannot quarrel with the logic of it if that interpretation were to govern the allocation.

Footnotes

1 EMEA is an acronym for 19 Nortel subsidiaries in Europe, the Middle East and Africa.

2 All reference to dollars is to U.S. currency.

3 Judge Kevin Gross is the U.S. bankruptcy judge.

4 See *Nortel Networks Corp., Re* (2013), 2 C.B.R. (6th) 1 (Ont. S.C.J. [Commercial List]); aff'd (2013), 5 C.B.R. (6th) 254 (Ont. C.A.); 2013 WL 1385271; aff'd 737 F.3d 265 (U.S. C.A. 3rd Cir. 2013).

5 A later Allocation Protocol which set out procedural matters to govern the allocation hearing was made and approved by orders of both Courts in May, 2013.

6 Unless otherwise indicated, statements of fact in these reasons are findings of fact.

7 Nortel Networks Australia was also a RPE until December 31, 2007.

8 This was an alternative argument for the CCC to its first argument that the MRDA should govern the allocation.

9 There were different CSAs for different types of costs. The relevant CSAs were the R&D CSAs that provided for the sharing of costs of the R&D carried out by the Nortel entities doing R&D. NNL made a separate CSA with each of those entities.

10 I prefer this test to that articulated in *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust* (2007), 85 O.R. (3d) 254 (Ont. C.A.), in which it was said that interpreting a contract that accords with sound commercial principles is limited to situations in which there is some ambiguity. I do not think that is correct and it is not what other cases of appellate authority have stated. See my comments in *Thomas Cook Canada Inc. v. Skyservice Airlines Inc.* (2011), 83 C.B.R. (5th) 106 (Ont. S.C.J. [Commercial List]) at para. 13 and *Oncap L.P. v. Computershare Trust Co. of Canada* (2011), 94 B.L.R. (4th) 314 (Ont. S.C.J. [Commercial List]) at paras. 21 to 24. See also Geoff R. Hall, *Canadian Contractual Interpretation Law*, 2nd ed. (Markham Ont.:LexisNexis 2012 at p. 46 fn. 191.

11 There was a separate R&D CSA made with each participant. They were the same. Reference during argument was to the CSA made between Northern Telecom Limited [now NNL] and Northern Telecom Inc. [now NNI], and I refer to it in these reasons.

12 The amended Schedule A was effective January 1, 2006 and reflected a change in the calculation of the amount spent on R&D by each participant.

13 The NN Technology in the MRDA was called the NT Technology in the CSA as the parties at the time of the CSA in 1992 were Northern Telecom, later changed to Nortel Networks.

14 Rulings on admissibility of evidence were left for decision to be made after argument at the conclusion of the trial.

15 At page 30 of the report, Horst Frisch, in referring to intercompany transactions between participants under a RPSM allocation, state-"The old CSPs possess and will continue to possess valuable intangible property." What property is being referred to is not stated. It could be a reference to license rights.

16 *C.I. Covington Fund Inc. v. White*, [2000] O.J. No. 4589 (Ont. S.C.J.) paras. 38-39), *aff'd* [2001] O.J. No. 3918 (Ont. Div. Ct.). *G.D. Searle & Co. v. Novopharm Ltd.*, [2007] F.C.J. No. 625 (F.C.A.), *leave to appeal to SCC refused* [2007] S.C.C.A. No. 340 (S.C.C.). *Sterling Engineering Co. v. Patchett* (1955), 72 R.P.C. 50 (U.K. H.L.). This has now been codified in section 39 of the *Patents Act 1977* (U.K.), c. 37.

17 *Board of Trustees of the Leland Stanford Junior University v. Roche Molecular Systems, Inc.* (2011), 131 S.Ct. 2188, 98 U.S.P.Q.2d 1761 (U.S. Sup. Ct. 2011) at p. 2195-2196, quoting *United States v. Dubilier Condenser Corp.*, 289 U.S. 178 (U.S. Sup. Ct. 1933) at p. 189.

18 See the affidavit of Peter Currie sworn April 11, 2014 for a full description of Nortel's matrix structure and operations.

19 Early in these proceedings, on the motion in 2009 to approve the IFSA, counsel to the U.S. Debtors stated in its written brief that NNL owned the IP. The report of the administrators for the EMEA Debtors of June 14, 2009 stated that all IP rights belonged to NNL. Once the size of the sale proceeds became known, these positions of the U.S. Debtors and EMEA Debtors changed.

20 In *Corning, Re*, 419 F.3d 196 (U.S. C.A. 3rd Cir. 2005), at 205 the U.S. Court of Appeals observed that substantive consolidation "treats separate legal entities as if they were merged into a single survivor left with all the cumulative assets and liabilities, (save for inter-entity liabilities which are erased). The result is that claims of creditors against separate debtors morph to claims against the consolidated survivor."

21 The projected cash on hand in all of the Nortel entities as of June 30, 2014 after payment of secured creditors was $1.525 billion, being $343 million in the Canadian Debtors, $744 million in the U.S. Debtors and $438 million in the EMEA Debtors. See schedule 5 of the Britven report, ex. 45.

22 Mr. Kilimnik prepared an expert report on which he was deposed prior to the trial. At the opening of the trial, counsel for the ad hoc group of bondholders said that Mr. Kilimnik would be called as a witness. However, on the day before he was scheduled to testify, his report was withdrawn by the bondholders and he was not called as a witness at the trial.

23 I also prefer the evidence of Mr. Kilimnik and Mr. Binning as to the data in exhibit 58 that compared Nortel bond spreads to government yields and what could be drawn from it. Professor McConnell said he could not draw an inference from the data but also said that he was not contradicting Mr. Binning.

24 There was one series of bonds for $200 million issued by NNL with a NNC guarantee but no guarantee by NNI.

25 The CCC contended for an "ownership" allocation very similar to the Monitor, being $5.805 billion to the Canadian Debtors, $1.009 billion to the U.S. Debtors and $488 million to the EMEA Debtors.

26 For the IP sold in the business line sales, EMEA says that the look-back period should be from 1991 to 2008, two years longer than for the Rockstar sale.

27 Mr. Malackowski said he did not think it appropriate to look at 2009 R&D expenditures post-filing as he understood that little basic research was being performed during this time given that R&D spending was cut dramatically and none of the patents designated as high interest by Global IP were filed during this time period. The R&D expenditures in 2008 were $1.458 billion and in 2009 were $1.076 billion. Mr. Malackowski also said an appropriate look-back period for the business sales would be 2001 to 2008.

28 The Canadian expenditure in 2009 was not just to preserve the business lines as asserted by EMEA. Canada spent $564 million in 2009 on R&D, far more than the $180 million spent on the CDMA and LTE businesses.

29 He allocated $426,097 to the U.S. representing the value of the workforce transferred to Rockstar, being very few people.

(2)

Most Negative Treatment: Application/Notice of Appeal
Most Recent Application/Notice of Appeal: Nortel Networks Inc. v. Pension Protection Fund | 2016 CarswellOnt 14117 | (S.C.C., Jul 29, 2016)

2016 ONCA 332
Ontario Court of Appeal

Nortel Networks Corp., Re

2016 CarswellOnt 6785, 2016 ONCA 332, 130 O.R. (3d) 481,
265 A.C.W.S. (3d) 834, 348 O.A.C. 131, 36 C.B.R. (6th) 1

In the Matter of the Companies' Creditors Arrangement Act, R.S.C. 1985 c. C-36, as amended

In the Matter of a Plan of Compromise or Arrangement of Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation Application under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended

Alexandra Hoy A.C.J.O., R.A. Blair, S.E. Pepall JJ.A.

Judgment: May 3, 2016
Docket: CA M45307, M45309, M45310 M45311, M45312, M45313

Proceedings: refusing leave to appeal *Nortel Networks Corp., Re* (2015), 27 C.B.R. (6th) 175, 2015 CarswellOnt 7072, 2015 ONSC 2987, Newbould J. (Ont. S.C.J. [Commercial List]); and refusing leave to appeal *Nortel Networks Corp., Re* (2015), 27 C.B.R. (6th) 51, 2015 ONSC 4170, 2015 CarswellOnt 10304, Newbould J. (Ont. S.C.J. [Commercial List])

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Shayne Kukulowicz, Michael Wunder, Ryan Jacobs, Geoffrey Shaw, Jane Dietrich, for Moving party, Official Committee of Unsecured Creditors of Nortel Networks Inc. et al.
Andrew Kent, Brett Harrison, Laura Brazil, for Moving party, Bank of New York Mellon as Indenture Trustee
Steven L. Graff, Ian Aversa, Miranda Spence, for Moving party, Nortel Trade Claims Consortium
Michael E. Barrack, D.J. Miller, John L. Finnigan, Michael S. Shakra, Andrea McEwan, for Responding parties, Board of the Pension Protection Fund and Nortel Networks U.K. Pension Trust Ltd.
Benjamin Zarnett, Jessica Kimmel, Peter Ruby, Peter Kolla, for Responding party, Monitor, Ernst & Young Inc.
Kenneth Kraft, John Salmas, for Responding party, Wilmington Trust, National Association
Derrick Tay, Jennifer Stam, for Responding parties, Canadian Debtors(2)
Kenneth Rosenberg, Lily Harmer, Massimo Starnino, for Responding party, Superintendent of Financial Services as Administrator of the Pension Benefits Guarantee Fund
Mark Zigler, Ari Kaplan, for Responding parties, Former Employees of Nortel and LTD Beneficiaries
Arthur O. Jacques, Paul Steep, Byron Shaw, for Responding party, Canadian Creditors' Committee
Barry E. Wadsworth, for Responding party, CAW-Canada
Matthew P. Gottlieb, Matthew Milne-Smith, for Responding parties, Joint Administrators of the EMEA Debtors(3) other than Nortel Networks S.A.

Subject: Contracts; Estates and Trusts; Evidence; Insolvency; Intellectual Property; International; Property

Related Abridgment Classifications

Bankruptcy and insolvency
XIV Administration of estate
XIV.6 Sale of assets
XIV.6.h Miscellaneous
Bankruptcy and insolvency
XIX Companies' Creditors Arrangement Act
XIX.4 Appeals

Headnote

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Appeals

Debtor group of companies (N group) operated as highly-integrated multinational enterprise — Cross-border insolvency proceedings went on for over seven years — Debtor group's assets, primarily intellectual property (IP), had been sold and proceeds had been placed in escrow (Lockbox Funds) — Ontario Commercial List judge (trial judge) and Judge of U.S. Bankruptcy Court presided over joint trial and both concluded that Lockbox Funds should be allocated among various N debtor estates on pro rata basis — Judges diverged on issue of IP rights under Master Research and Development Agreement (MRDA), which provided for payment of residual profits to certain entities — Trial judge held that MRDA did not govern allocation of Lockbox funds — Moving parties brought motions for leave to appeal trial judge's judgment — Motions dismissed — Test for leave to appeal was not met — There was no prima facie merit to arguments that pro rata allocation constituted substantive consolidation, that trial judge erred by failing to recognize distinct and separable property rights various N companies allegedly had in N group's IP, that allocation was arbitrary, or that trial judge erred in interpreting MRDA — Facts of case were unique and exceptional, so granting leave would not allow court to provide guidance on legal issues of significance to practice — Fact that allocation of Lockbox Funds was significant issue to parties was insufficient to warrant granting leave.

Bankruptcy and insolvency --- Administration of estate — Sale of assets — Miscellaneous

Distribution of proceeds of sale — Debtor group of companies (N group) was highly integrated multinational enterprise — During lengthy cross-border insolvency proceedings, debtor group's assets, primarily intellectual property (IP), had been sold and proceeds had been placed in escrow (Lockbox Funds) — Ontario Commercial List judge (trial judge) and Judge of U.S. Bankruptcy Court presided over joint trial and both concluded that Lockbox Funds should be allocated among various N debtor estates on pro rata basis — Judges diverged on issue of IP rights under Master Research and Development Agreement (MRDA), which provided for payment of residual profits to certain entities — Trial judge held that MRDA did not govern allocation of Lockbox Funds — Moving parties brought motions for leave to appeal — Motions dismissed — Test for leave to appeal was not met — Grounds of appeal had no prima facie merit — There was no prima facie merit to arguments that pro rata allocation constituted substantive consolidation, that trial judge erred by failing to recognize distinct property rights various N companies allegedly had in N group's IP, that allocation was arbitrary, or that trial judge erred in interpreting MRDA — There was no reason to interfere with trial judge's interpretation of MRDA — Trial judge was alive to fairness concerns and gave reasons for adopting approach he did.

Table of Authorities

Cases considered:

Creston Moly Corp. v. Sattva Capital Corp. (2014), 2014 SCC 53, 2014 CSC 53, 2014 CarswellBC 2267, 2014 CarswellBC 2268, 373 D.L.R. (4th) 393, 59 B.C.L.R. (5th) 1, [2014] 9 W.W.R. 427, 461 N.R. 335, 25 B.L.R. (5th) 1, 358 B.C.A.C. 1, 614 W.A.C. 1, (sub nom. *Sattva Capital Corp. v. Creston Moly Corp.)* [2014] 2 S.C.R. 633 (S.C.C.) — followed

Housen v. Nikolaisen (2002), 2002 SCC 33, 2002 CarswellSask 178, 2002 CarswellSask 179, 286 N.R. 1, 10 C.C.L.T. (3d) 157, 211 D.L.R. (4th) 577, [2002] 7 W.W.R. 1, 219 Sask. R. 1, 272 W.A.C. 1, 30 M.P.L.R. (3d) 1, [2002] 2 S.C.R. 235, 2002 CSC 33 (S.C.C.) — referred to

Lehndorff General Partner Ltd., Re (1993), 17 C.B.R. (3d) 24, 9 B.L.R. (2d) 275, 1993 CarswellOnt 183 (Ont. Gen. Div. [Commercial List]) — referred to

Nortel Networks Corp., Re (2013), 2013 ONCA 427, 2013 CarswellOnt 8231, 5 C.B.R. (6th) 254 (Ont. C.A.) — referred to

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Ted Leroy Trucking Ltd., Re (2010), 2010 SCC 60, 2010 CarswellBC 3419, 2010 CarswellBC 3420, 12 B.C.L.R. (5th) 1, (sub nom. *Century Services Inc. v. A.G. of Canada*) 2011 D.T.C. 5006 (Eng.), (sub nom. *Century Services Inc. v. A.G. of Canada*) 2011 G.T.C. 2006 (Eng.), [2011] 2 W.W.R. 383, 72 C.B.R. (5th) 170, 409 N.R. 201, (sub nom. *Ted LeRoy Trucking Ltd., Re*) 326 D.L.R. (4th) 577, (sub nom. *Century Services Inc. v. Canada (A.G.)*) [2010] 3 S.C.R. 379, [2010] G.S.T.C. 186, (sub nom. *Leroy (Ted) Trucking Ltd., Re*) 296 B.C.A.C. 1, (sub nom. *Leroy (Ted) Trucking Ltd., Re*) 503 W.A.C. 1 (S.C.C.) — referred to

Timminco Ltd., Re (2012), 2012 CarswellOnt 9633, 2012 ONCA 552, 2 C.B.R. (6th) 332 (Ont. C.A.) — referred to

Statutes considered:

Bankruptcy Code, 11 U.S.C.

ss. 1101-1174 — referred to

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

Generally — referred to

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

Generally — referred to

s. 11 — considered

s. 13 — considered

Insolvency Act, 1986, c. 45

Generally — referred to

Proceeding: Motion/Application for Leave to Appeal.

MOTIONS for leave to appeal from decisions reported at *Nortel Networks Corp., Re* (2015), 2015 ONSC 2987, 2015 CarswellOnt 7072, 27 C.B.R. (6th) 175 (Ont. S.C.J. [Commercial List]) and *Nortel Networks Corp., Re* (2015), 2015 ONSC 4170, 2015 CarswellOnt 10304, 27 C.B.R. (6th) 51 (Ont. S.C.J. [Commercial List]), regarding allocation of proceeds of sale of debtor's assets.

***Per curiam*:**

A. Introduction

1 January 14, 2009 was not a good day. At that time, Nortel Networks Corp. ("NNC") and the other Nortel Canadian Debtors filed for insolvency protection under the *Companies Creditors' Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). That same day, Nortel Networks Inc. ("NNI") and other U.S. Debtors filed voluntary petitions for relief under Chapter 11 of the U.S. *Bankruptcy Code*, 11 U.S.C. §§1101 - 1174, and other Nortel entities incorporated in Europe, the Middle East and Africa ("EMEA") were placed under administration in England by the High Court of England and Wales under the U.K. *Insolvency Act 1986*, c. 45. Shortly afterwards, courts in Canada and the United States approved a cross-border, court-to-court protocol that established procedures for the co-ordination of cross-border proceedings in Canada and the U.S.

2 More than seven years later, many Januarys have come and gone and these insolvency proceedings continue. During that time:

- more than 6,800 Nortel former employees or pensioners have died;
- well in excess of $1 billion has been incurred in costs; and

• Nortel's assets have been sold and some $7.3 billion [1] in sale proceeds have been placed in escrow (the "Lockbox Funds").

3 The leave motions now before this court arise from the joint trial dealing with the allocation of the Lockbox Funds. Newbould J. (the "trial judge) of Ontario's Superior Court of Justice (Commercial List) and Judge Gross of the U.S. Bankruptcy Court for the District of Delaware presided over the joint trial. [2] It was held over the course of six weeks. Each judge rendered separate decisions on May 12, 2015. Each concluded that the Lockbox Funds should be allocated on a *pro rata* basis among the various Nortel debtor estates. Although their analysis differed somewhat, the outcome was the same.

4 Appeal proceedings were initiated in Canada and the U.S. The moving parties were authorized to file their leave materials in the absence of an issued judgment on the basis that counsel would subsequently file the formal judgment. The formal judgment was issued on April 26, 2016 and filed with this court on April 27, 2016.

5 Before this court, the six moving parties, led by the U.S. Debtors, seek leave to appeal the trial judge's judgment pursuant to s. 13 of the *CCAA*. They submit that the trial judge made fundamental errors and that the proposed appeal is of significance to the practice of insolvency and to the parties, and will not delay the completion of the *CCAA* proceedings.

6 The responding parties, led by the Board of the Pension Protection Fund and Nortel Networks UK Pension Trust Limited ("UKPC"), submit that the record supports the trial judge's factual findings, which were integral to his analysis, including his findings that Nortel's assets were jointly created, that the Nortel group of companies operated on a fully-integrated global basis and that Nortel did not operate separate businesses in separate countries. In their submission, the proposed appeal is not *prima facie* meritorious. In addition, the remaining elements of the test for leave to appeal under the *CCAA* have not all been met.

7 After consideration of each of the factums [3] and other materials filed on the leave motions, we agree with the responding parties that the test for leave has not been met. For the reasons that follow, we dismiss the moving parties' motions for leave to appeal.

B. Genesis of Dispute

8 NNC was a publicly-traded Canadian corporation at the helm of a global networking solutions and telecommunications business, and the direct or indirect parent of more than 130 subsidiaries located in more than 100 countries. These companies were collectively referred to as the "Nortel Group" or "Nortel".

9 NNC was the successor to a long line of companies, headquartered in Canada, that date back to the founding of the Bell Telephone Company of Canada in 1883. NNC's principal, direct operating subsidiary was Nortel Networks Limited ("NNL"), also a Canadian company. NNL was the direct or indirect parent of operating companies located around the world. It owned 100 percent of the equity of each of the following entities: NNI, Nortel's operating company in the United States; Nortel Networks UK Ltd. ("NNUK"), Nortel's operating company in the United Kingdom; and, Nortel Networks (Ireland) Ltd. ("NN Ireland"), Nortel's operating company in Ireland. It also owned 91.17 per cent of the equity of Nortel Networks S.A. ("NNSA"), Nortel's operating company in France.

10 Following the insolvency filings, Nortel's initial plan was to downsize and carry on portions of the telecommunications business. However, by June 2009, the decision was made to liquidate Nortel's assets.

11 On June 29, 2009, an Interim Funding and Settlement Agreement ("IFSA") was approved by both the Canadian and American courts. Among other things, it addressed interim funding for NNL and the anticipated sales of Nortel's business lines and residual intellectual property ("IP"). The parties, consisting of the Canadian Debtors, the U.S. Debtors [4], and the EMEA Debtors [5], agreed to cooperate with the sales process and also agreed that the proceeds of sale would be held in escrow. The issue of allocation was deferred.

12 Under the IFSA, there would be no distribution out of escrow without "either (i) agreement of all of the Selling Debtors [6] or (ii) ... determination by the relevant dispute resolver(s) under the terms of the Protocol ... applicable to the Sale Proceeds". The parties were then to negotiate and attempt to reach agreement "on a protocol for resolving disputes concerning the allocation of Sale Proceeds from Sale Transactions (the "Interim Sales Protocol")". Despite numerous attempts at resolution, agreement on both an Interim Sales Protocol and allocation proved to be elusive.

13 Meanwhile, over $7 billion was generated from various asset sales and other realizations. From mid-2009 until March 2011, proceeds of $3.285 billion were generated from the sale of Nortel's various business lines, including some patents. Of that amount, $2.85 billion is available for allocation. In June 2011, proceeds of approximately $4.5 billion were generated from the sale of Nortel's residual intellectual property, consisting of approximately 7,000 patents and patent applications, to the Rockstar consortium. In total, approximately $7.3 billion is currently held in escrow.

14 By orders dated January 21, 2010, the Canadian and U.S. courts approved a "Final Canadian Funding and Settlement Agreement". The Agreement addressed a number of issues and allowed NNI a $2 billion claim against NNL in NNL's *CCAA* proceeding, which claim is not subject to offset or counterclaims.

15 The parties still could not agree on an Interim Sales Protocol or on allocation. In the spring of 2013, the Canadian court and the U.S. bankruptcy court granted orders approving an "Allocation Protocol". The purpose of this Protocol was to set out "binding procedures for determining the allocation of the Sale Proceeds among the Selling Debtors" [7]. It provided for a joint hearing to determine allocation before the Canadian court and the U.S. bankruptcy court. [8] Any party in interest was at liberty to advance any theory on allocation. Leave to appeal that order was denied by this court on June 20, 2013.

16 The issue of allocation of the Lockbox Funds then proceeded to trial.

C. Trial Judge's Decision

(1) Trial Decision

17 The trial judge's reasons may be summarized. He commenced by reviewing the history of the Nortel Group. He described the operations and the four main product groups or lines of business. Before turning to his analysis of the legal issues, he made a number of important findings about the Nortel Group's structure. He found, and repeatedly reiterated, that the Nortel Group operated as a highly-integrated multinational enterprise. For instance, he stated:

> [16] The Nortel Group operated along business lines as a highly integrated multinational enterprise with a matrix structure that transcended geographic boundaries and legal entities organized around the world. Each entity, such as NNL, NNI, NNUK, NN Ireland and NNSA, was integrated into regional and product line management structures to share information and perform research and development ("R&D"), sales and other common functions across geographic boundaries and across legal entities. The matrix structure was designed to enable Nortel to function more efficiently, drawing on employees from different functional disciplines worldwide, allowing them to work together to develop products and attract and provide service to customers, fulfilling their demands globally.
>
> [17] As a result of Nortel's matrix structure, no single Nortel entity, either NNL or any of the other Canadian debtors in Canada, NNI or any of the other US debtors in the United States or NNUK or any of the other EMEA debtors, was able to provide the full line of Nortel products and services, including R&D capabilities, on a stand-alone basis. While Nortel ensured that all corporate entities complied with local laws regarding corporate governance, no corporate entity carried on business on its own.

18 The trial judge also found that R&D, which was performed at labs around the world, was the primary driver of Nortel's value and profit.

19 After reviewing the necessary background, the trial judge turned to the legal issues before him, starting with the interpretation of the Master Research and Development Agreement ("MRDA"). The MRDA dealt with transfer-pricing arrangements, effective from 2001 onwards, among NNL, NNI, NNUK, NNSA and NN Ireland, who were parties to the agreement. [9]

20 The parties took differing and competing positions on the meaning and application of the MRDA:

- The Monitor (on behalf of the Canadian Debtors), supported by the Canadian Creditors' Committee ("CCC"), took the position that under the MRDA, NNL owned the IP whereas other participants to the MRDA were simply licensees. They argued that the proceeds derived from the sale of the residual IP belonged exclusively to NNL.

- The U.S. Debtors and other U.S. interests, including the Bondholders, argued that NNI and the other licensees held all of the rights and value in the IP in their respective exclusive territories as defined in the MRDA.

- The EMEA Debtors asserted that parties to the MRDA jointly owned all of the IP in proportion to their financial contributions to R&D and that all should share in the sale proceeds attributable to IP in those same proportions. The joint ownership arose independent of, but was recognized in, the MRDA.

- The UKPC took the position that the MRDA should not govern allocation and that a *pro rata* allocation based on a *pari passu* distribution should be used. The CCC also adopted this as its alternative position.

21 The trial judge found that, by its terms, the MRDA was to be construed in accordance with, and governed by, Ontario law. He reviewed the applicable principles of contractual interpretation, including the law on factual matrix (surrounding circumstances), commercial reasonableness, and recitals. In reviewing the law, he considered the recent authority from the Supreme Court of Canada on contractual interpretation, *Creston Moly Corp. v. Sattva Capital Corp.*, 2014 SCC 53, [2014] 2 S.C.R. 633 (S.C.C.), which was released during the course of the trial. He considered in detail the parties' positions, the language of the MRDA and evidence on factual matrix.

22 He concluded that the MRDA was an operating agreement and was not intended to, nor did it, deal with the disposal of all of Nortel's assets in a situation in which no revenue was being earned and no profits or losses were occurring. Rather, he found that the MRDA was developed for, and driven by, transfer-pricing concepts for tax purposes and did not govern allocation after Nortel ceased operations:

> [177] I accept that the MRDA was a transfer pricing document created for tax purposes. The licenses were a part of it. The licenses granted under it were never dealt with separately from the MRDA. Their only purpose was to support the intended tax treatment resulting from the MRDA.
>
> . . . . .
>
> [185] I conclude that the circumstances surrounding the creation of the MRDA lead to no other result but that the construct of legal title to the NN Technology being in NNL in return for NNL granting exclusive licenses to the Licensed Participants was only for the purpose of supporting the proposed method to split profits or losses on a tax efficient basis while Nortel operated as a going concern business. The agreement in its application was intended to apply only to Nortel while it operated and not to deal with rights after Nortel and its subsidiaries stopped operating its businesses.

23 Thus, he rejected the primary positions of the Monitor, the CCC, the U.S. Debtors and other U.S. interests, as well as the EMEA Debtors' joint ownership theory.

24 Having found that the MRDA did not govern allocation on Nortel's insolvency and having rejected the joint ownership theory, the trial judge turned to the metric to be used to allocate the Lockbox Funds. He found that the intangible assets that were sold were not separately located or owned in any one jurisdiction. Rather, they were created by all of the so-called "Residual Profit Entities" or "RPEs" (namely, NNL, NNI, NNUK, NNSA and NN Ireland), which were located in different jurisdictions. In

addition, the matrix structure allowed Nortel to draw on employees from different functional disciplines worldwide, regardless of region or country, according to need.

25 He held that NNL was not entitled to the proceeds of sale simply because the patents were in its name:

> [197] This was not one corporation and one set of employees inventing IP that led to patents. Nortel was a highly integrated multi-national enterprise with all RPEs doing R&D that led to patents being granted. It was R&D that drove Nortel's business. R&D and the intellectual property created from it was the primary driver of Nortel's value and profits. All parties agree on that. It would unjustly enrich NNL to deprive all of the other RPEs of the work that they did in creating the IP just because the patents were registered in NNL's name.

26 He determined that he had wide powers under the *CCAA* to do what was just in the circumstances. Section 11 of the *CCAA*, which reflected prior jurisprudence, expressly provides that a court may make any order it considers appropriate in the circumstances, subject to the provisions of the Act. He wrote:

> [208] In this case, insolvency practitioners, academics, international bodies, and others have watched as Nortel's early success in maximizing the value of its global assets through cooperation has disintegrated into value-erosive adversarial and territorial litigation described by many as scorched earth litigation. The costs have well exceeded $1 billion. A global solution in this unprecedented situation is required and perforce, as this situation has not been faced before, it will by its nature involve innovation. Our courts have such jurisdiction. [Footnote omitted.]

27 He observed that it is a fundamental tenet of insolvency law that all debts be paid *pari passu* and that all unsecured creditors receive equal treatment. In his view, a *pro rata* allocation could be achieved by directing an allocation of the Lockbox Funds to each Debtor Estate based on the percentage that the claims against that Estate bore to the total claims against all of the Debtor Estates.

28 In reaching this conclusion, the trial judge dealt with the argument that a *pro rata* allocation would amount to substantive consolidation. He concluded that a *pro rata* allocation would not constitute substantive consolidation in the unique circumstances of this case. In any event, even if it were substantive consolidation, there was precedent that justified substantive consolidation in this case: *Lehndorff General Partner Ltd., Re* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]); *PSINET Ltd., Re* (2002), 33 C.B.R. (4th) 284 (Ont. Gen. Div. [Commercial List]); *Northland Properties Ltd., Re* (1988), 29 B.C.L.R. (2d) 257 (B.C. S.C.).

29 Ultimately, he concluded that the Lockbox Funds were to be allocated on a *pro rata* basis in accordance with certain governing principles, which are outlined below.

30 After his reasons were released, the U.S. Debtors supported by the Official Committee, the Ad Hoc Group of Bondholders and the Law Debenture Trust Company of New York filed motions for clarification, reconsideration or amendment in Canada and the U.S. and a number of points were clarified.

31 In the end result, the judgment that was signed, issued and entered on April 26, 2016 provided that the allocation proceed on a *pro rata* basis in accordance with the following principles:

> (a) Each Debtor Estate [10] is to be allocated that percentage of the Lockbox Funds that the total allowed pre-filing claims against that Debtor Estate bear to the total allowed pre-filing claims against all Debtor Estates.
>
> (b) In determining what the claims are against the Debtor Estates, pre-filing claims of the kind provable under the *Companies' Creditors Arrangement Act* that have received court approval and which have been paid may be taken into account to the extent that they have been paid under the settlement.
>
> (c) In determining what the pre-filing claims are against each Debtor Estate, a claim that can be made against more than one Debtor Estate can only be calculated and recognized once.

i. Claims on bonds are to be made on the Debtor Estate of the issuer and shall be included in that Debtor Estate's total allowed claims for the purpose of determining its allocation. A claim can be recognized by the Debtor Estate that guaranteed the bond, but those claims will not be taken into account in determining the claims against the Debtor Estates for allocation purposes.

ii. If the UK Pension Claimants make a claim for the approximately £2.2 billion deficit in the NNUK pension plan against NNUK and also against other EMEA Debtors or the EMEA Non-Filed Entities, the claim against NNUK will be taken into account in determining claims against the Debtor Estates for allocation purposes but the additional claims against the EMEA Debtors or the EMEA Non-Filed Entities will not be taken into account in determining the claims against the Debtor Estates for allocation purposes.

(d) Subject to the general proviso in (c), above, in respect of claims that can be made against more than one Debtor Estate, pre-filing intercompany claims against a Debtor Estate shall be included in the determination of the claims against that Debtor Estate for purposes of its allocation.

(e) The following specific pre-filing claims shall be included in the determination of the allowed claims against NNL for purposes of determining its allocation:

i. the US$2.0627 billion claim of NNI against NNL that was approved by this Court and the U.S. Court;

ii. the claims of NNUK and Nortel Networks SpA against NNL pursuant to the Agreement Settling EMEA Canadian Claims and Related Claims dated July 9, 2014; and

iii. the claim of the UK Pension Claimants against NNL recognized in this Court's judgment of December 9, 2014, as such claim is finally determined.

(f) Cash on hand in any Debtor Estate will not be taken into account in determining its allocation. Each Debtor Estate with cash on hand will continue to hold that cash and deal with it in accordance with its administration.

D. Analysis

32 Six moving parties now seek leave to appeal from the trial judge's allocation decision: the U.S. Debtors, the Ad Hoc Group of Bondholders, the Conflicts Administrator of Nortel Networks S.A., the Official Committee of Unsecured Creditors of NNI and others, the Bank of New York Mellon as Indenture Trustee, and the Nortel Trade Claims Consortium.

33 We will commence our analysis by discussing the test for leave to appeal under the *CCAA* and then address the moving parties' positions in relation to that test.

(1) Test for Leave to Appeal

34 Section 13 of the *CCAA* provides that any person dissatisfied with an order or a decision made under the Act may appeal from the order or decision with leave. Leave to appeal is granted sparingly in *CCAA* proceedings and only where there are serious and arguable grounds that are of real and significant interest to the parties. In addressing whether leave should be granted, the court will consider whether:

(a) the proposed appeal is *prima facie* meritorious or frivolous;

(b) the points on the proposed appeal are of significance to the practice;

(c) the points on the proposed appeal are of significance to the action; and

(d) whether the proposed appeal will unduly hinder the progress of the action.

See, for e.g.: *Stelco Inc., Re* (2005), 75 O.R. (3d) 5 (Ont. C.A.), at para. 24; *Timminco Ltd., Re*, 2012 ONCA 552, 2 C.B.R. (6th) 332 (Ont. C.A.), at para. 2; and *Nortel Networks Corp., Re*, 2013 ONCA 427, 5 C.B.R. (6th) 254 (Ont. C.A.), at para. 3.

(a) Whether Appeal is Prima Facie Meritorious

35 The moving parties take the position that leave should be granted because the appeal is *prima facie* meritorious. In making that argument, they raise three main issues — substantive consolidation, the interpretation of the MRDA, and questions of fairness. We will deal with each issue in turn.

(i) Substantive consolidation

Position of the Moving Parties

36 First, the moving parties submit that the trial judge erred in not recognizing that the allocation ordered departed from "corporate separateness" and was a form of substantive consolidation.

37 Secondly, it is alleged that the trial judge erred by applying an inappropriately low threshold for the application of substantive consolidation.

38 In its supplementary factum, the Bank of New York Mellon, as Indenture Trustee, makes a related argument. It submits that since the Nortel proceeding no longer involves a restructuring, the *CCAA*'s purpose is spent and the proceeds should thereafter be distributed under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*"), or at least in a manner consistent with the *BIA* scheme. It says the *BIA* does not contemplate consolidation but rather distribution on an entity-by-entity basis.

39 Finally, the Ad Hoc Group of Bondholders makes a related argument. It submits that the allocation decision takes property interests that belong to certain debtor estates and gives them to others. They argue that, even though the authority provided under s. 11 is broad, the *CCAA* does not permit a court to redistribute property in this way.

Analysis

40 The moving parties' arguments on substantive consolidation are not *prima facie* meritorious.

41 Professor Janis Sarra, a leading expert on insolvency law in Canada, describes substantive consolidation in her article "Corporate Group Insolvencies: Seeing the Forest and the Trees" (2008) 24 B.F.L.R. 63, at pp. 80 - 81:

> Substantive consolidation essentially treats member entities of a corporate group as one entity. In the context of liquidation, it creates a common pool of assets to meet creditors' claims. In the context of restructuring, it may create the opportunity f or creditors to share in the future upside potential of a restructured entity or entities by centralizing and negotiating an arrangement in respect of their claims. Canadian courts have recognized substantive consolidation under both the *BIA* and the *CCAA* where there is evidence of intertwined assets and liabilities; integrated administrative functioning and operations; a perception by creditors that they are dealing with an integrated entity; common control and governance structures; where it would be impracticable to separate the affairs of related entities; where it is more cost effective and beneficial to creditors to have the proceedings administered as a single estate; and where it would result in an expeditious and administratively efficient administration of the proceeding.

42 As we have noted, the trial judge concluded that *pro rata* allocation was appropriate, that it did not amount to substantive consolidation, and that even if it could be said that a *pro rata* allocation involved substantive consolidation, it was not precluded by law in the unique circumstances of the case.

43 In reaching those conclusions, he made numerous factual findings, in addition to those already mentioned, including the following:

- "Nortel (a) had fully integrated and interdependent operations; (b) had intercompany guarantees for its primary indebtedness; (c) operated a consolidated treasury system in which generated cash was used throughout the Nortel Group as required; (d) disseminated consolidated financial information throughout its entire history, save for the year before its bankruptcy; and (e) created IP through integrated R&D activities that were global in scope": para. 223.

- "[N]o one entity or region was able to provide the full line of Nortel products and services": para. 202.

- "Nortel's matrix structure also allowed Nortel to draw on employees from different functional disciplines worldwide ... regardless of region or country according to need": para. 203.

- "R&D was organized around a particular project, not particular geographical locations or legal entities, and was managed on a global basis": para. 202.

- "The fact that Nortel ensured that legal entities were properly created and advised in the various countries in which it operated in order to meet local legal requirements [did] not mean that Nortel operated a separate business in each country. It did not": para. 202.

- "The intangible assets that were sold, being by far the largest type of asset sold, were not separately located in any one jurisdiction or owned separately in different jurisdictions": para. 202.

- The assets are "so intertwined that it is difficult to separate them for purposes of dealing with different entities": para. 222.

- There is "no recognized measurable right in any one of the selling Debtor Estates to all or a fixed portion of the proceeds of sale": para 224.

- "Nortel has had significant difficulty in determining the ownership of its princip[al] assets, namely the $7.3 billion representing the proceeds of the sales of the lines of business and the residual patent portfolio", which "constitutes more than 80 per cent of the total assets of all Nortel entities": para. 222.

44 In addition to his factual findings supporting the *pro rata* order, the trial judge explained why the allocation in this case did not constitute substantive consolidation, either actual or deemed:

- The Lockbox Funds were largely due to the sale of IP and no one Debtor Estate had any right to the funds. They did not belong in whole or in part to any one Estate or combination of Estates.

- The various entities and the various Estates were not being treated as one entity and the creditors of each entity would not become creditors of a single entity. Each entity remained separate and with its own creditors.

- Each entity would maintain its own cash on hand and would be administered separately.

- The inter-company claims would not be eliminated.

45 Similarly, Judge Gross explained at p. 554 of his reasons that the *pro rata* allocation, which was not a distribution, "both recognizes the integrity of the corporate separateness and the integrated synergistic operations of Nortel." Furthermore, he noted that a "pro rata allocation does not merge the Nortel Debtors into a single survivor and does not erase intercompany claims": p. 554.

46 In our view, there is no *prima facie* merit to the argument that we should interfere with the trial judge's conclusion that the allocation decision did not amount to substantive consolidation. His conclusion was based on the nature and effect of his allocation decision and his factual findings. He made the findings having heard from 36 witnesses and having received and reviewed thousands of exhibits and dozens of deposition transcripts over the course of a six-week trial. Those factual findings were central to the result. Absent palpable and overriding error, those factual findings are afforded deference by this court: *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235 (S.C.C.), at para. 10.

47 The moving parties also allege that the trial judge erred by applying an inappropriately low threshold for the application of substantive consolidation in finding that, even if the allocation did constitute substantive consolidation, it was permissible. They point to *Northland* as the leading authority on substantive consolidation but say that it is time to revisit that decision in Canada.

48 The trial judge correctly observed that while the *CCAA* does not expressly address the issue of substantive consolidation, jurisprudence in Canada has recognized substantive consolidation as being appropriate in certain exceptional circumstances: see, for e.g., *Lehndorff General Partner Ltd.*, *PSINet Ltd.*, and *Northland Properties Ltd.*

49 He also correctly observed that the court has jurisdiction to make any order that it considers appropriate in the circumstances under s. 11 of the *CCAA*. Although that section came into effect after the Nortel filing under the *CCAA*, it reflects past jurisprudence: *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60, [2010] 3 S.C.R. 379 (S.C.C.), at para. 68. Specifically, s. 11 states:

> Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.

50 That said, since there is no *prima facie* merit to the argument that the *pro rata* allocation constitutes substantive consolidation, there is no need to re-visit the jurisprudence governing substantive consolidation in Canada or to consider whether the threshold for substantive consolidation should be changed.

51 Furthermore, we see no merit in the argument raised by the Bank of New York Mellon that the trial judge erred by failing to allocate the Lockbox Funds in a manner consistent with the *BIA* scheme, which contemplates distribution on an entity-by-entity basis. Under the *CCAA* allocation decision, distribution to creditors will be done on an entity-by-entity basis.

52 Finally, the argument raised by the Ad Hoc Group of Bondholders and the Official Committee also lacks merit. It presumes that the various Nortel companies had distinct and separable property rights in Nortel's IP. The trial judge repeatedly rejected that proposition. As we explain in the following sections, we see no merit in the argument that the trial judge erred in failing to recognize such distinct property rights. As such, we see no merit in the argument that he exercised his authority in a way that ignored such rights.

53 This ground of appeal is not *prima facie* meritorious.

(ii) The Interpretation of the MRDA

Position of Moving Parties

54 The moving parties take the position that the trial judge erred in concluding that the MRDA has no application to the allocation of the Lockbox Funds. On their reading, the MRDA provides NNI and other "Integrated Entities" with valuable rights to Nortel's IP in their respective exclusive jurisdictions. They note that the trial judge and Judge Gross diverged on the issue of IP rights under the MRDA.

55 The thrust of their contractual argument is two-fold: (1) the trial judge misinterpreted the MRDA by disregarding the words of the agreement; and (2) he failed to apply the Supreme Court of Canada's decision in *Sattva Capital Corp.* by taking an impermissibly narrow view of the scope of factual matrix evidence. In particular, they submit that the trial judge failed to take into account evidence relating to, and explaining, the tax-driven nature of the MRDA and the purposes the parties were trying to achieve through the agreement.

Analysis

56 We reject the moving parties' submissions on the interpretation of the MRDA.

57 On August 1, 2014, the Supreme Court of Canada released *Sattva Capital Corp.* The essence of that decision is best captured by excerpts from the reasons of the court written by Rothstein J.:

- "Historically, determining the legal rights and obligations of the parties under a written contract was considered a question of law": para. 43.

- "[T]he historical approach should be abandoned. Contractual interpretation involves issues of mixed fact and law as it is an exercise in which the principles of contractual interpretation are applied to the words of the written contract, considered in light of the factual matrix": para. 50.

- "[T]his Court in *Housen [v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235] found that deference to fact-finders promoted the goals of limiting the number, length, and cost of appeals, and of promoting the autonomy and integrity of trial proceedings .... These principles also weigh in favour of deference to first instance decision-makers on points of contractual interpretation. The legal obligations arising from a contract are, in most cases, limited to the interest of the particular parties. Given that our legal system leaves broad scope to tribunals of first instance to resolve issues of limited application, this supports treating contractual interpretation as a question of mixed fact and law": para. 52.

- "[I]t may be possible to identify an extricable question of law from within what was initially characterized as a question of mixed fact and law .... Legal errors made in the course of contractual interpretation include 'the application of an incorrect principle, the failure to consider a required element of a legal test, or the failure to consider a relevant factor'": para. 53.

- "However, courts should be cautious in identifying extricable questions of law in disputes over contractual interpretation": para. 54.

- "The close relationship between the selection and application of principles of contractual interpretation and the construction ultimately given to the instrument means that the circumstances in which a question of law can be extricated from the interpretation process will be rare": para. 55.

58 Justice Rothstein also discussed the need to consider the surrounding circumstances, or factual matrix of a contract, when interpreting a written agreement. The goal of contractual interpretation is to ascertain the objective intentions of the parties. In doing so, "a decision-maker must read the contract as a whole, giving the words used their ordinary and grammatical meaning, consistent with the surrounding circumstances known to the parties at the time of formation of the contract": para. 47. Recognizing that words do not have an immutable meaning, the court should consider the contract's commercial purpose, taking into account its genesis, background, context, and the market in which the parties are operating.

59 In this case, the moving parties suggest that the trial judge erred in his interpretation of the MRDA and failed to pay heed to *Sattva Capital Corp.* In our view, the moving parties' arguments are not *prima facie* meritorious.

60 We are not persuaded that there is any reason to interfere with the trial judge's interpretation of the agreement on the basis of palpable and overriding error. Nor, in our view, have the moving parties pointed to any extricable legal error warranting intervention by this court.

61 As mentioned, although *Sattva Capital Corp.* was released during the course of the allocation trial, the trial judge nonetheless considered and applied *Sattva Capital Corp.* in interpreting the MRDA. In over 40 paragraphs, he addressed the relevant law on, and evidence of, factual matrix: see paras. 55 - 57, 117 - 157. He properly rejected evidence of subjective intention as being inadmissible.

62 We would also observe that, as noted by the Monitor and the Canadian Debtors, to be fully successful on their appeal, the U.S. Debtors would have to persuade the court that the trial judge should have: (i) concluded that the MRDA controlled allocation of Nortel's assets in the event of insolvency; (ii) adopted the interpretation of the MRDA advanced by the U.S. Debtors; and (iii) accepted the expert valuation evidence tendered by the U.S. Debtors.

63 The trial judge did none of these things. All of his conclusions to the contrary engage questions of fact or mixed fact and law that are well within his province.

64 For instance, the trial judge rejected the U.S. Debtors' valuation evidence as unreliable and the moving parties' factums are silent on how this finding could be overcome. The acceptance or rejection of the evidence of a witness is squarely within the fact-finding arena of the trial judge. The moving parties have suggested no reason why the trial judge's findings on valuation would be reversed.

65 In conclusion, this ground of appeal does not warrant granting leave to appeal.

(iii) Fairness to the Parties and Related Arguments

Position of Moving Parties

66 Next, the moving parties submit that they were denied procedural fairness in various respects and that the allocation decision is, among other things, arbitrary, and inequitable. In this regard, we do not propose to address every argument in the multitude of factums filed. The principal submissions on fairness and related arguments that merit comment are as follows.

67 The moving parties say they were given no notice or opportunity to make submissions on the remedy granted. Moreover, there was no record before the court on the full spectrum of claims asserted against the Selling Debtors and no one proposed the specific remedy granted.

68 The U.S. Debtors also submit that the remedy did not respond to the question before the court, which they say was the allocation of the Sale Proceeds (i.e. the proceeds from a particular Sale Transaction) among the Selling Debtors (i.e. the Nortel parties to a particular Sale Transaction). In their view, the trial judge did not answer that question but instead allocated the Sale Proceeds to Nortel entities that did not transfer assets in a particular Sale Transaction and were, thus, not entitled to any Sale Proceeds.

69 The Ad Hoc Group of Bondholders similarly submits that the trial judge answered the wrong question. For instance, it says that the only question properly before the court was to determine the relative value of the assets, rights and interests that each Selling Debtor sold or relinquished, which generated the Sale Proceeds. Moreover, they say that the decision disregards their legitimate expectations.

70 The U.S. Debtors further submit that the allocation is arbitrary since there is no logical connection between what will be or will not be counted for allocation purposes. In particular, they point to the fact the allocation excludes $4 billion in bondholder guarantee claims from the U.S. Debtors' allocation. They say that, as a result, the U.S. Debtors will receive no allocation of funds on account of approximately two-thirds of their claims.

71 Similarly, the Ad Hoc Group of Bondholders submits the allocation is arbitrary as it produces a redistribution of assets among debtors that violates the rule that equity holders get paid after creditors.

72 The Conflicts Administrator of NNSA also takes issue with the fairness of the allocation decision. It says that NNSA is prejudiced by the decision because of the relatively small quantum of its creditors' claims in comparison with those of other debtor estates.

73 Finally, the Official Committee, which represents all general unsecured creditors of the U.S. Debtors, complains that the trial judge exercised his discretion in an unprincipled way and strayed into improper "commercial judicial moralism".

Analysis

74 We are not satisfied that there is *prima facie* merit to the moving parties' submissions.

75 As explained, the trial judge was required to "determine the allocation of the Sale Proceeds among the Selling Debtors" under the Allocation Protocol.

76 Given the trial judge's conclusion that the MRDA did not govern allocation and his rejection of the EMEA Debtors' joint ownership theory, the trial judge had to determine what other metric should be used to allocate the Lockbox Funds among the U.S., Canadian and EMEA Debtor Estates.

77 The Allocation Protocol permitted submissions on "any theory of allocation". At trial, the UKPC and the CCC, in the alternative, sought a *pro rata* distribution of the funds held in escrow and each submitted expert reports that supported a *pro rata* result. Moreover, the U.S. Debtors, the Official Committee and the Ad Hoc Group of Bondholders all made submissions before the trial judge opposing a *pro rata* allocation and had an opportunity to test the evidence. They submitted a motion to strike the *pro rata* allocation evidence, attacked the reliability of the expert reports and cross-examined the experts.

78 Thus, all parties knew that a *pro rata* allocation was in play. The fact that the specifics of the allocation ordered by the trial judge were not identical to those advanced by any of the parties does not, in our view, create unfairness to the parties. This is not a situation where the trial judge addressed an issue that was not before him, failed to grapple with the arguments or evidence, or came up with a new theory of the case.

79 The two judges were not required to determine value but allocation. The IFSA provided for a right to receive an allocation of the Sale Proceeds without restricting the basis upon which that allocation might be determined by the two courts. In particular, we note that the trial judges were given authority to decide the issue of allocation. In addition to the terms of the Allocation Protocol, we note s.10(a) of the IFSA:

> [T]his Agreement is not, and shall not be deemed to be, an acknowledgement by any Party of the assumption, ratification, adoption or rejection of the Transfer Pricing Agreements or any other Transfer Pricing methodology employed by the Nortel Group or its individual members for any purpose nor shall it be determinative of, or have any impact whatsoever on, the allocation of proceeds to any Debtor from any sale of assets of the Nortel Group;
>
> [Emphasis added.]

80 We also observe that the trial judge turned his mind to expectations and found that there was no evidence to support the Bondholders' argument that their legitimate expectations would be disregarded by a *pro rata* allocation.

81 Furthermore, we see no basis for the assertion that the allocation framework is arbitrary and unfair since it excludes $4 billion in Bondholder guarantee claims from the U.S. Debtors' allocation. Under the allocation decision, a claim that can be made against more than one Debtor Estate can only be calculated and recognized once for allocation purposes. This principle is applicable to all claims. The allocation decision also specifies that claims on bonds are to be made on the Debtor Estate of the issuer. Claims on those bonds may also be made on the Debtor Estate of the guarantor but those claims will not be taken into account in determining the claims against the Debtor Estates for allocation purposes.

82 On the reconsideration motion, it was argued that the trial judge's decision should be changed to provide that the claims by the bondholders on the guaranteed bonds against the issuer and guarantor Debtor Estates should be included in the claims for allocation purposes. It was contended that, without such a change, there would be a manifest injustice, especially to the creditors of the U.S. Debtors other than the bondholders.

83 The trial judge rejected that argument, noting that the $2 billion admitted claim against NNL endures. Further, cash on hand in the U.S. Debtors' Estates would be available to their creditors. He also noted that the issue of the treatment of the guaranteed bonds, and whether they should be counted once or twice in a *pro rata* allocation, was a live issue in evidence at trial, which was open to the U.S. Debtors to explore. He found, at para. 16, that "any lack of briefing by the U.S. Debtors and the [Official Committee] was a deliberate tactic taken by them in attacking the pro rata allocation method proposed at trial". He concluded that, even if he were to reconsider the double-counting issue, he would not change his mind:

> I see no injustice in the result.... There must also be considered other claims that could be made against more than one Debtor Estate, including the pension claim by the UKPC against NNUK that could be made against other EMEA Debtors and claims that could be made on bonds issued by NNL and guaranteed by NNC. The allocation decision precludes the double counting of any such claims for allocation purposes. The U.S. Debtors and [Official Committee] do not suggest that any of these other claims should be permitted to be claimed twice for allocation purposes. I see no basis to treat the guaranteed bonds any differently for allocation purposes. The principles that govern allocation should be applied consistently to each debtor.

84 We are not persuaded that there is *prima facie* merit to the argument that the allocation is arbitrary. The trial judge was clearly alive to the fairness concerns and gave reasons for adopting the approach he did after careful consideration of the evidence and argument at trial.

85 We would also observe that there was no other clear answer to the question of who was entitled to receive the sale proceeds. As Judge Gross noted at p. 500 of his reasons, the parties "submitted widely varying approaches for deciding the issue leaving virtually no middle ground." The U.S. Debtors and Bondholders argued that in excess of $5 billion belonged to the U.S. Estate and that the Canadian Estate should receive only $0.77 billion. The Canadian Debtors and the Monitor, in sharp contrast, argued that in excess of $6 billion belonged to the Canadian Estate and that the U.S. Estate should receive just over $1 billion. The highly integrated nature of the Nortel business operations and the nature of the assets sold defied either outcome.

86 Judge Gross's comments in his reasons on the allocation trial, at pp. 532-533, accurately sum up the context in which the two courts came to adopt the *pro rata* allocation approach:

> The Court is convinced that where, as here, operating entities in an integrated, multi-national enterprise developed assets in common and there is nothing in the law or facts giving any of those entities certain and calculable claims to the proceeds from the liquidation of those assets in an enterprise-wide insolvency, adopting a prorata allocation approach, which recognizes inter-company and settlement related claims and cash in hand, yields the most acceptable result.
>
> There is nothing in the law or facts of this case which weighs in favour of adopting one of the wide ranging approaches of the Debtors. There is no uniform code or international treaty or binding agreement which governs how Nortel is to allocate the Sales Proceeds between the various insolvency estates or subsidiaries spread across the globe.

87 Nor are we satisfied that there is *prima facie* merit to the Official Committee's argument that the trial judge exercised his discretion in an unprincipled way by straying into improper "commercial judicial moralism". To the extent the Official Committee is suggesting that it amounts to judicial moralism when a judge takes into account fairness concerns, we reject that argument. The trial judge considered the evidence before him in considerable detail and worked with the facts presented to him. Based on those facts, he concluded that a *pro rata* order constituted the answer to the allocation issue. The fact that the answer is also fair should not detract from the force of his conclusion.

88 Finally, we are not persuaded that there is any merit to the argument that the allocation violates the rule that equity holders get paid after creditors. The Ad Hoc Group of Bondholders submits that the trial judge's decision results in NNL (NNI's parent company) receiving allocation proceeds from the sale of NNI's assets and rights that ought to have been allocated to the NNI estate for the benefit of NNI's creditors. This argument is premised on NNI having a right to the particular proceeds as a result of the MRDA interpretation advanced by the U.S. Debtors and Bondholders. As we have discussed above, the trial judge rejected that argument.

89 For these reasons, we conclude that none of the fairness and related arguments put forward by the moving parties are *prima facie* meritorious.

(b) Significance of Issues to the Practice

Position of Moving Parties

90 The moving parties submit that the trial judge's decision presents important issues of first impression in the cross-border insolvency context. They submit that, without appellate intervention, there is a risk substantive consolidation will become far more widely available. In addition, they say that it creates significant uncertainty on the separation of subsidiaries within a corporate group and on the consequences of an insolvency proceeding on the rights of stakeholders, including creditors. In their submission, an appeal would permit this court to clarify these issues. Furthermore, the appeal would allow this court to clarify the proper interpretation and effect of *Sattva Capital Corp.* on commercial agreements.

Analysis

91 As discussed above, the moving parties have raised three main issues they say warrant leave — namely, substantive consolidation, the interpretation of the MRDA, and fairness. Of the three issues, the moving parties submit that the first two raise issues of significant interest to the practice.

92 We disagree.

93 The facts of this case are unique and exceptional. As we have already discussed, substantive consolidation is not engaged and so this case would not provide an opportunity for this court to provide guidance on that question. Nor does this case engage any issues that require any clarification on the application of *Sattva Capital Corp.* . In short, granting leave would not provide an opportunity for this court to provide guidance on legal issues of significance to the practice.

(c) Significance of Issues to the Action

Position of Moving Parties

94 The moving parties state that the allocation of the Lockbox Funds is the overriding issue in the *CCAA* proceedings.

Analysis

95 We accept that the allocation of the Lockbox Funds is a significant issue in this *CCAA* proceeding. That said, we are of the view that, standing alone, this factor is insufficient to warrant granting leave to appeal. To perhaps state the obvious, typically parties tend to seek leave to appeal a decision that is of significance to an action.

(d) Progress of Proceedings

Position of Moving Parties

96 The moving parties submit that the proposed appeal will not unduly hinder the progress of Nortel's *CCAA* proceeding. They state that many steps and issues remain before creditor distributions can be made, including the determination of claims. In addition, the allocation decisions of the Canadian court and the U.S. court must both be final orders in their respective jurisdictions before funds can be released from escrow. It is argued that this court should grant leave to ensure that it maintains the ability to address any issues should Judge Gross's decision be varied or overturned on appeal.

97 The moving parties also make the point that there are no operating businesses that are in the process of restructuring because the Nortel businesses and assets have been liquidated and the joint trial was a "stand-alone component" of the *CCAA* proceeding. Thus, it is argued that the traditional concerns leading courts to "sparingly" grant leave to appeal in *CCAA* proceedings are not applicable here. In fact, the Official Committee submits that where an appeal would have existed as of right under the *BIA*, it is nonsensical to deny leave here simply because Nortel's liquidation proceeded under the *CCAA*.

Analysis

98 This brings us to the final consideration: progress. Repeatedly, the parties have been encouraged to resolve their differences, but without success. For instance, in a 2011 decision, *Nortel Networks Inc., Re*, 669 F.3d 128 (U.S. C.A. 3rd Cir. 2011), the Third Circuit Court of Appeals admonished the parties at p. 143:

> We are concerned that the attorneys representing the respective sparring parties may be focusing on some of the technical differences governing bankruptcy in the various jurisdictions without considering that there are real live individuals who will ultimately be affected by the decisions being made in the courtrooms. It appears that the largest claimants are pension funds in the U.K. and the United States, representing pensioners who are undoubtedly dependent, or who will become dependent, on their pensions. They are the Pawns in the moves being made by the Knights and the Rooks.
>
> Mediation, or continuation of whatever mediation is ongoing, by the parties in good faith is needed to resolve the differences. [Footnote omitted.]

99 Former Chief Justice Winkler also encouraged the parties to find a way to resolve this matter. In April 2012, he warned about the "prospect of additional delays and the potential for conflicting decisions" if the parties failed to reach a negotiated settlement.

100 Numerous mediations have been ordered but have failed.

101 In the Annual Review of Insolvency, Kevin P. McElcheran described *Nortel* as a case that has become "an emblem of waste and dysfunction in a system intended to foster consensus based solutions to commercial insolvency", noting that it has "eclipsed all previous Canadian cases in both duration and expense": 2014 Ann. Rev. Insolv. L. 24 at p. 24. And that was in 2014.

102 Consistent allocation decisions have been issued by the Canadian and U.S. courts. A further appeal proceeding in Canada would achieve nothing but more delay, greater expense, and an erosion of creditor recoveries. There are asymmetric appeal routes in Canada and the U.S. However, we do not accept that the separate appeal proceedings in the U.S. somehow diminish the need to bring these proceedings in Canada to a conclusion. In our view, any additional step is a barrier to progress.

103 Furthermore, the fact that this case is a liquidation and not a restructuring does not render delay immaterial, where so many individuals and businesses continue to await a resolution of this proceeding. The potential of an interim distribution, remote or otherwise, does not alter this reality. In addition, the parties acceded to a liquidation under the *CCAA*. They cannot now reject the parameters of that statute, which requires leave to appeal, and where the jurisprudence on the applicable test is settled and long-standing.

E. Standing Issue

104 There is the additional issue of the standing of the Nortel Trade Claims Consortium that needs to be addressed. It represents a group of creditors that collectively holds over $130 million in unsecured claims against NNI and certain of its U.S. affiliates. It includes institutional investors and former Nortel employees. Unlike other U.S. creditors, the Consortium's sole recourse is against the U.S. Debtors' estates.

105 At trial, the Consortium was represented by the Official Committee. It says that, given the trial decision, its interests may diverge from those of the rest of the Official Committee. It submits that the Consortium should have standing to seek leave to appeal. It relies on the court's jurisdiction to grant leave to appeal, pursuant to s. 13 of the *CCAA*, to "any person dissatisfied with an order or a decision made under [the] Act". It argues that the trial judge exceeded his jurisdiction by deciding matters that are properly for the U.S. court to decide.

106 It is unnecessary to decide the standing issue. Even if the Consortium had standing, we would dismiss its leave motion for the same reasons we have dismissed the other leave motions. In any event, we see no merit in its argument that the trial judge exceeded his jurisdiction.

F. Disposition

107 In conclusion, we are not persuaded that the test for leave to appeal has been met. For these reasons, we dismiss all of the motions for leave to appeal.

Motions dismissed.

Footnotes

1 All references to dollars are to U.S. dollars, unless otherwise specified.

2 Judge Gross's reasons are reported at 532 B.R. 494 (U.S. Bankr. D. Del. 2015).

3 In accordance with the directions of the Court of Appeal case management judge, there was one main factum filed on behalf of the moving parties by the U.S. Debtors and one main factum filed on behalf of the responding parties by the UKPC. Six supplementary factums and one reply factum were also filed.

4 With the exception of Nortel Networks (CALA) Inc.

5 The Joint Administrators were also party to the IFSA but only for the purposes of Section 17 (No Personal Liability of the Joint Administrators).

6 A description of "Selling Debtor" is found in s.12 (a) of the IFSA: "Each Debtor hereby agrees that its execution of definitive documentation with a purchaser (or, in the case of any auction, the successful bidder in any such auction) of, or closing of any sale of, material assets of any of the Debtors to which such Debtor (a "Selling Debtor") is proposed to be a party..."

7 Selling Debtors was defined in the Allocation Protocol as the "Canadian Debtors, U.S. Debtors, EMEA Debtors and Nortel Networks Optical Components Ltd., Nortel Networks AS, Nortel Networks AG, Nortel Networks South Africa (Pty) Limited, and Nortel Networks (Northern Ireland) Limited."

8 The EMEA Debtors were held to have attorned to the jurisdiction of the Canadian court and the U.S. bankruptcy court.

9 Nortel Networks Australia was also a party to the agreement. It ceased being a Residual Profit Entity on December 31, 2007.

10 The order defines "Debtor Estate" as "each of the individual legal entities" set out in Schedule B. Schedule B lists the 45 entities, including the Canadian Debtors, the U.S. Debtors, the EMEA Debtors and five "EMEA Non-Filed Entities" who have not commenced insolvency proceedings. See also the similar definition given to Selling Debtors under the Allocation Protocol.

3

2016 CarswellOnt 14117
Supreme Court of Canada / Cour suprême du Canada

Nortel Networks Inc. v. Pension Protection Fund [Application / Notice of Appeal]

2016 CarswellOnt 14117

Nortel Networks Inc. and Nortel Networks Inc. (formerly Northern Telecom International) et al. v. Board of the Pension Protection Fund and Nortel Networks U.K. Penstion Trust Ltd. et al. Official Committee of Unsecured Creditors of Nortel Networks Inc. et al. v. Board of the Pension Protection Fund and Nortel Networks U.K. Pension Trust Ltd. et al.

Bank of New York Mellon as Indenture Trustee v. Official Committee of Unsecured Creditors of Nortel Networks Inc. et al

Conflicts Administrator of Nortel Networks S.A. v. Board of the Pension Protection Fund and Nortel Networks U.K. Pension Trust Ltd.

AD Hoc Group of Bondholders v. Board of the Pension Protection Fund and Nortel Networks U.K. Pension Trust Ltd. et al.

Nortel Trade Claims Consortium v. Board of the Pension Protection Fund and Nortel Networks U.K. Pension Trust Ltd. et al.

—

Filing Date / Date de production: July 29, 2016
Docket / No. de cause: 37117

Proceedings: Application/Notice of Appeal, 2016 ONCA 332, 2016 CarswellOnt 6785, 265 A.C.W.S. (3d) 834, 36 C.B.R. (6th) 1, 130 O.R. (3d) 481, 348 O.A.C. 131 (Ont. C.A.); Leave to appeal refused, 2015 ONSC 2987, 2015 CarswellOnt 7072, 254 A.C.W.S. (3d) 522, 27 C.B.R. (6th) 175 (Ont. S.C.J. [Commercial List]); Leave to appeal refused, 2015 ONSC 4170, 2015 CarswellOnt 10304, 27 C.B.R. (6th) 51, 256 A.C.W.S. (3d) 688 (Ont. S.C.J. [Commercial List])

Counsel at Court of Appeal / Conseil à la cour de l'appel: Sheila R. Block, for / pour Nortel Networks Inc. and Nortel Networks Inc. (formerly Northern Telecom International) et al.
Michael E. Barrack, for / pour Board of the Pension Protection Fund and Nortel Networks U.K. Penstion Trust Ltd. et al.
Shayne Kukulowicz, for / pour Official Committee of Unsecured Creditors of Nortel Networks Inc. et al.
Andrew J.F. Kent, for / pour Bank of New York Mellon as Indenture Trustee
David R. Byers, for / pour Conflicts Administrator of Nortel Networks S.A.
Kevin Zych, for / pour AD Hoc Group of Bondholders
Steven Graff, for / pour Nortel Trade Claims Consortium

Subject: Contracts; Estates and Trusts; Evidence; Insolvency; Intellectual Property; International; Property

Headnote

Bankruptcy and insolvency
Conflict of laws
Contracts
Evidence

Application for leave to appeal filed / Demande d'autorisation d'appel déposées from *Nortel Networks Corp., Re* (2016), 2016 CarswellOnt 6785, 348 O.A.C. 131, 130 O.R. (3d) 481, 36 C.B.R. (6th) 1, 2016 ONCA 332 (Ont. C.A.)

Filed / Déposée July 29, 2016

Motion to extend time / Requête en prorogation de délai.

GRANTED / ACCORDÉE November 18, 2016

UPON APPLICATION on behalf of all the Applicants, the Respondents and the Interveners, for an order extending the time to serve and file any responses to the six (6) applications for leave to appeal in Court file No. 37117, to a date that is 30 days after the earlier of: (i) August 31, 2017; or (ii) the date on which the Settlement and Plans Support Agreement is terminated in accordance with its terms;

AND UPON REVIEW of the affidavit of Molly Reynolds and other material filed, including the Applicants', Respondents' and Interveners' consent to the motion and the undertaking by counsel for the Applicants to notify the Court of any developments that would affect the continuation of or a joint request for dismissal of the proceeding;

IT IS HEREBY ORDERED THAT:

The motion is granted.

À LA SUITE DE LA DEMANDE présentée au nom des demanderesses, des intimés et des intervenants en prorogations du délai pour signifier et déposer toute réponse aux six (6) demandes d'autorisation d'appel dans le dossier portant le no de greffe 37117 à une date qui soit postérieure de trente jours à celles des deux dates suivantes qui survient en premier : (i) le 31 août 2017 ou (ii) la date à laquelle l'Entente globale de règlement et de soutien prendra fin suivant les clauses qui s'y trouvent;

ET APRÈS EXAMEN de l'affidavit de Molly Reynolds et d'autres documents déposés, y compris le consentement des demanderesses, des intimés et des intervenants à la requête et l'engagement par les avocats des demanderesses d'aviser la Cour de tout événement qui pourrait avoir une incidence sur la poursuite de la présente instance ou de l'existence d'une demande conjointe pour rejet de la présente instance;

IL EST ORDONNÉ CE QUI SUIT :

La requête est accueillie.

Notice of Discontinuance Filed / Avis de désistement déposés

FILED / DÉPOSÉ May 8, 2017

End of Document

(4)

MANITOBA

THE MERCANTILE LAW AMENDMENT ACT

C.C.S.M. c. M120

LOI MODIFIANT LE DROIT COMMERCIAL

c. M120 de la *C.P.L.M.*

As of 29 Oct 2021, this is the most current version available. It is current for the period set out in the footer below.

Le texte figurant ci-dessous constitue la codification la plus récente en date du 29 oct. 2021. Son contenu était à jour pendant la période indiquée en bas de page.

LEGISLATIVE HISTORY

The Mercantile Law Amendment Act, C.C.S.M. c. M120

Enacted by
RSM 1987, c. M120

Amended by
SM 1992, c. 32, s. 10

Proclamation status (for provisions in force by proclamation)
whole Act: in force on 1 Feb 1988 (Man. Gaz. 6 Feb 1988)

HISTORIQUE

Loi modifiant le droit commercial, c. M120 de la C.P.L.M.

Édictée par
L.R.M. 1987, c. M120

Modifiée par
L.M. 1992, c. 32, art. 10

État des dispositions qui entrent en vigueur par proclamation
l'ensemble de la Loi : en vigueur le 1er fèvr. 1988 (Gaz. du Man. : 6 fèvr. 1988)

CHAPTER M120

THE MERCANTILE LAW AMENDMENT ACT

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LOI MODIFIANT LE DROIT COMMERCIAL

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CHAPTER M120

THE MERCANTILE LAW AMENDMENT ACT

HER MAJESTY, by and with the advice and consent of the Legislative Assembly of Manitoba, enacts as follows:

Guarantee not invalid though consideration does not appear

1 No special promise made by any person to answer for the debt, default, or miscarriage of another person, being in writing, and signed by the party to be charged therewith, or some other person by him thereunto lawfully authorized, shall be deemed invalid to support an action, suit, or other proceeding to charge the person by whom the promise was made, by reason only that the consideration for the promise does not appear in writing, or by necessary inference from the written document.

Surety entitled to assignment

2 Every person who, being surety for the debt or duty of another, or being liable with another for any debt or duty, pays the debt or performs the duty, is entitled to have assigned to him, or to a trustee for him, every judgment, specialty, or other security that is held by the creditor in respect of the debt or duty, whether the judgment, specialty, or other security is or is not deemed at law to have been satisfied by the payment of the debt or performance of the duty; and that person is entitled to stand in the place of the creditor, and to use all the remedies, and, if need be, and upon a proper indemnity, to use the name of the creditor, in any action

CHAPITRE M120

LOI MODIFIANT LE DROIT COMMERCIAL

SA MAJESTÉ, sur l'avis et du consentement de l'Assemblée législative du Manitoba, édicte :

Promesse valable

1 Aucune promesse spéciale faite par une personne de répondre des dettes, du défaut ou des actes dommageables d'une autre personne, constatée par écrit et signée par la partie qui fera l'objet de poursuites à cet égard ou par toute autre personne qu'elle a légalement autorisée à cet effet, n'est réputée sans effet pour soutenir une action, un procès ou autre procédure contre la personne qui a fait la promesse pour la seule raison que la contrepartie de la promesse n'est pas indiquée par écrit ni ne s'infère nécessairement du document écrit.

Cession à la caution

2 Toute personne qui s'est portée caution de la dette ou de l'obligation d'une autre personne ou répond avec une autre personne d'une dette ou d'une obligation et rembourse la dette ou exécute l'obligation est en droit de se faire céder ou de faire céder à un fiduciaire à son profit, tout jugement, contrat scellé ou autre sûreté détenu par le créancier relativement à cette dette ou obligation, que le remboursement de la dette ou l'exécution de l'obligation soit ou non réputé en droit avoir satisfait au jugement, au contrat scellé ou autre sûreté. Cette personne a le droit d'être subrogée au créancier et d'utiliser tous les recours et, au besoin et en

or other proceeding, at law or in equity, in order to obtain from the principal debtor, or any co-surety, co-contractor, or co-debtor, as in the case may be, indemnification for the advances made and loss sustained by the person who has so paid the debt or performed the duty, and the payment or performance so made by the surety is not pleadable in bar of any such action or other proceeding by him.

fournissant une indemnisation appropriée, d'utiliser le nom du créancier dans toute action ou autre procédure fondée en common law ou en Équité, en vue d'obtenir du débiteur principal ou de toute cocaution, de tout cocontractant ou de tout codébiteur, selon le cas, une indemnisation pour les avances faites et les pertes subies par la personne qui a ainsi remboursé la dette ou exécuté l'obligation. L'exécution ou le paiement ainsi fait par la caution ne constitue pas une défense au fond opposable à une telle action ou procédure.

Right to recover

3 No co-surety, co-contractor or co-debtor is entitled to recover from any other co-surety, co-contractor or co-debtor by the means aforesaid, more than the just proportion to which, as between those parties themselves, the last mentioned person is justly liable.

Recouvrement

3 Une cocaution, un cocontractant ou un codébiteur n'a le droit de recouvrer d'une autre cocaution, d'un autre cocontractant ou d'un autre codébiteur par les moyens mentionnés ci-dessus que la juste part dont cette dernière personne est, dans les rapports qui unissent ces parties entre elles, justement redevable.

Effect of giving time to a principal debtor

4 Giving time to a principal debtor, or dealing with or altering the security held by the principal creditor, does not of itself discharge a surety or guarantor; in such cases a surety or guarantor is entitled to set up the giving of time or dealing with or alteration of the security as a defence, but the defence shall be allowed in so far only as it is shown that the surety has thereby been prejudiced.

Délai accordé au débiteur principal

4 Le fait d'accorder un délai au débiteur principal ou d'effectuer une opération portant sur la sûreté détenue par le créancier principal n'a pas pour effet de libérer une caution ou un garant; dans un tel cas, la caution ou le garant a droit d'opposer l'octroi du délai ou la négociation ou modification de la sûreté comme défense, mais celle-ci ne peut être admise que dans la mesure où il est prouvé que la caution a ainsi subi un préjudice.

Stipulations as to time

5 Stipulations in contracts as to time or otherwise which would not, before the passing of *The Queen's Bench Act, 1895*, have been deemed to be, or to have become, of the essence of such contracts in a court of equity shall receive in all courts the same construction and effect as they would, prior to the passing of *The Queen's Bench Act, 1895*, have received in equity.

Stipulations relatives au terme

5 Les stipulations contractuelles relatives au terme ou autrement qui n'auraient pas, avant l'adoption de la Loi intitulée « *The Queen's Bench Act, 1895* », été réputées être ou être devenues des conditions essentielles de tels contrats devant un tribunal d'Équité doivent recevoir de tous les tribunaux la même interprétation et le même effet qu'elles auraient reçus en Équité avant l'adoption de la Loi intitulée « *The Queen's Bench Act, 1895* ».

Part performance of obligation

6(1) Part performance of an obligation either before or after a breach of the obligation extinguishes the obligation

Exécution partielle de l'obligation

6(1) L'exécution partielle d'une obligation, soit avant, soit après une violation de l'obligation éteint celle-ci dans les cas suivants, même en l'absence d'une nouvelle contrepartie :

(a) when expressly accepted by a creditor in satisfaction; or

(b) when rendered pursuant to an agreement for that purpose;

though without any new consideration.

a) elle est acceptée expressément par un créancier en paiement;

b) elle a lieu conformément à un accord conclu à cette fin.

Unconscionability
6(2) Notwithstanding subsection (1), an obligation is not extinguished by part performance where a court of competent jurisdiction finds that it is unconscionable to so allow.

Exception
6(2) Malgré le paragraphe (1), une obligation n'est pas éteinte par son exécution partielle si un tribunal compétent estime qu'il est abusif de permettre qu'elle le soit.

Agreement under clause 6(1)(a)
6(3) Subject to any agreement to the contrary, an acceptance by a creditor under clause 6(1)(a) need not be in writing.

Acceptation écrite
6(3) Sous réserve de tout accord contraire, il n'est pas nécessaire que l'acceptation visée à l'alinéa 6(1)a) soit écrite.

Right of revocation
6(4) A creditor may revoke an agreement under clause 6(1)(b) where

(a) the debtor has not commenced performance of the agreement; or

(b) the debtor has commenced performance of the agreement, but fails to continue performance on a date or within a time provided for in the agreement, and it would be unreasonable in the circumstances for the creditor to give the debtor more time to remedy the default.

Droit de révocation
6(4) Le créancier peut révoquer l'accord visé à l'alinéa 6(1)b) dans les cas suivants :

a) le débiteur n'a pas commencé à l'exécuter;

b) le débiteur a commencé à l'exécuter mais omet de continuer à le faire à la date ou dans le délai qui y est prévu et, dans les circonstances, il serait déraisonnable pour le créancier de donner au débiteur plus de temps pour remédier à son défaut.

Transitional
6(5) This section does not affect an obligation arising before the day on which this section comes into force.

S.M. 1992, c. 32, s. 10.

Disposition transitoire
6(5) Le présent article ne modifie en rien les obligations qui prennent naissance avant son entrée en vigueur.

L.M. 1992, c. 32, art. 10.

Deceased joint debtors
7 Where any one or more joint contractors, obligors, or partners die, the person interested in the contract, obligation or promise entered into by the joint contractors, obligors, or partners may proceed by action against the representatives of the deceased contractor, obligor, or partner in the same manner as if the contract, obligation, or promise had been joint and several, and this notwithstanding there is another person liable under

Décès de débiteurs conjoints
7 Lorsqu'un ou plusieurs cocontractants, codébiteurs ou associés décèdent, la personne intéressée au contrat conclu, à l'obligation contractée ou à la promesse faite par les cocontractants, codébiteurs ou associés, peut procéder par voie d'action contre les représentants du défunt de la même manière que si le contrat, l'obligation ou la promesse avait été conjoint et solidaire, en dépit du fait qu'une autre personne

the contract, obligation, or promise still living, and an action pending against that person; but the property and effects of shareholders in chartered banks or members of other incorporated companies is not liable to a greater extent than they would have been if this section had not been passed.

responsable aux termes du contrat, de l'obligation ou de la promesse soit encore vivante et qu'une action soit en cours contre cette personne; toutefois, les biens et effets des actionnaires de banques ou de membres d'autres entreprises constituées en corporations ne sont pas sujets à saisie dans une plus grande mesure qu'ils l'auraient été si le présent article n'avait pas été adopté.

THE LAW OF GUARANTEE

THIRD EDITION

Kevin McGuinness

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> respect, the sureties cannot have any well-grounded complaint. If, on the other hand, the creditor fails so to do, I take it to be inequitable on his part to sue for the amount of the deficiency which is the result of his own conduct.[121]

§10.39 Clearly a privately appointed receiver and manager can be in no better position *vis-à-vis* the surety than is the creditor who appointed him. If the creditor is liable to the surety for his dealing with the security, then so too should be the receiver.[122] In *Standard Chartered Bank Ltd. v. Walker*,[123] the Court of Appeal rejected the *Latchford* decision, and stated that the creditor and a receiver owed a duty of care toward the surety in respect of the realization of security:

> Clearly the guarantors' liability is dependent upon the company's ... the amount of his liability depends entirely on the amount that the stock realizes when sold with proper care. To my mind he is well within the text of proximity. The receiver owes a duty not only to the company but to the guarantor, to exercise reasonable care in the disposal of the assets.[124]

(1) Assignment of Security

§10.40 The common law recognized the right of a surety to an indemnity from the principal, but that right was in the nature of a right *in personam*. Formerly, where a surety paid off the bond debt of his principal, for which he was bound, he could not require the creditor to assign to him that bond debt, because it was satisfied and extinguished by the very act of payment by the surety.[125] This rule was reversed by statute in England in 1856 section 5 of the *Mercantile Law Amendment Act*.[126] Under the present rule not only is a surety who pays off his principal's debt entitled to a transfer of securities held by the creditor, but he or she is also in all respects entitled to all the equities which the creditor could have enforced.

§10.41 It follows that every person who, being surety for the debt or default of another or being liable with another for any debt or duty, pays the debt or performs the duty is entitled to have assigned to him (or her), or to a trustee for him, every judgment, specialty or other security that is held by the creditor in respect of the debt or duty, whether the judgment, specialty or other security is or is not deemed at law to have been satisfied by the payment of the debt or the performance of the duty.[127] Unless such an assignment is obtained, a surety

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121 See also *Hoskin v. Price Waterhouse Ltd.*, [1982] O.J. No. 3135, 35 O.R. (2d) 350 (Ont. H.C.J.).

122 *Bank of Montreal v. Western Store Supplies Ltd.*, [1983] N.S.J. No. 381, 57 N.S.R. (2d) 118 (N.S.T.D.).

123 [1982] 3 All E.R. 938 at 942 (C.A.), *per* Lord Denning M.R. See also *MacManus v. Royal Bank*, [1985] N.B.J. No. 44, 55 C.B.R. (N.S.) 238 (N.B.C.A.)

124 *Standard Chartered Bank Ltd. v. Walker*, [1982] 3 All E.R. 938 (C.A.), *per* Lord Denning M.R.

125 H.A. de Colyar, *Law of Guarantees and of Principal & Surety*, 3d ed. (London: Butterworths, 1897) at 326-27.

126 19 & 20 Vict., c. 97.

127 Subsection 2(1) of the *Mercantile Law Amendment Act*. Note that this provision does not refer to liability in respect of the "miscarriage" of another, *cf. Statute of Frauds*, section 4. The English equivalent to this provision is the *Mercantile Law Amendment Act, 1856*, s. 5. In Manitoba, see *Mercantile Law Amendment Act*. R.S.M. 1987. c. M-120. s. 2.

is not purely personal, but is a right in the security, judgment or deed itself.[137] The surety may step into the place of the creditor and enforce the judgment[138] or security[139] even if no actual assignment of those rights has been made, but the surety must obtain leave from the court before he can issue execution.[140] The rights of a surety under section 2 are not affected by the insolvency of the principal. The precise scope of the term "security" is not clear, but given the width of the concept of security in cases dealing with the common law and equitable rights of sureties it is likely that the term would be widely construed by a court.[141]

§10.42 A surety is entitled to stand in the place of the creditor, and to use all the remedies and, on proper indemnity, to sue in the name of the creditor in any action or other proceeding in order to obtain from the principal debtor, or any co-surety, co-contractor or co-debtor, indemnification for the advances made or loss sustained by such person, and the payment or performance made by him is not a defence to such action or other proceeding by him.[142] However, no co-surety, co-contractor or co-debtor is entitled to recover from any other co-surety, co-contractor or co-debtor more than the just proportion to which, as between themselves, the last mentioned person is justly liable.[143] There is no statutory limitation on recovery against the principal, since the principal is obliged to indemnify his sureties in full.

§10.43 The assignment of a security held by the creditor to the surety gives the surety no greater rights than the assignee.[144] An assigned security only stands as security for payments made by the assignee if the payments were made for the purpose of purchasing the assignment.[145]

(2) Benefit of Securities in Favour of the Creditor

§10.44 The surety is also entitled to the benefit of a security as well as to an assignment on payment. Since the release of any security existing at the time when the surety entered into the guarantee will affect the surety's liability under

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137 *Batchellor v. Lawrence* (1861), 9 C.B.N.S. 543, 142 E.R. 214, *per* Erle C.J.

138 *Re M'Myn* (1886), 33 Ch. D. 575.

139 *Re Windham Sales Ltd.*, [1979] O.J. No. 4387, 26 O.R. (2d) 246 (Ont. H.C.J.); *Jamieson v. Hotel Renfrew Ltd. (Trustees of)*, [1941] O.J. No. 232, [1941] 4 D.L.R. 470 (Ont. H.C.J.).

140 *Kayley v. Hothersall et al.*, [1925] 1 K.B. 607 (C.A.).

141 *In Re Earle Pullan Co.* (1968), 12 C.B.R. (N.S.) 136 (O.S.C. in Bank.); *Re Major-Way Trailers* (1964), 7 C.B.R. (N.S.) 198 (B.C.S.C.); *In Re Burnstein* (1964), 6 C.B.R. (N.S.) 298 (O.S.C., in Bank.), in which it was held that the section entitled a surety paying a debtor to the Crown as a creditor to stand in the place of the Crown as a preferred creditor in a bankruptcy.

142 *Mercantile Law Amendment Act*, R.S.O. 1990, c. M.10, s. 2(2); in England, the corresponding provision is found in the *Mercantile Law Reform Act*, s. 5. This statute is part of the received law of some Provinces.

143 *Ibid.*, s. 2(3).

144 *715486 Ontario Ltd. v. Hristovski*, [1998] O.J. No. 4759 at para. 22 (Ont. Gen. Div.), *per* Ferguson J.

145 *715486 Ontario Ltd. v. Hristovski*, [1998] O.J. No. 4759 at para. 33 (Ont. Gen. Div.), *per* Ferguson J.

it (whether the release occurs before or after default) to at least some extent. The right to the benefit of a security arises immediately, rather than on payment. The sureties rights of subrogation are not limited to the rights *in personam* to which the creditor is entitled. It is an ancient principle,[146] founded upon the equitable doctrine of marshaling,[147] that unless otherwise agreed[148] on payment or performance by the surety of the guaranteed obligation,[149] the surety has the right to the benefit of all securities that the creditor has received from the principal debtor in respect of the debt in order to enable the surety to obtain satisfaction for what he has paid.[150] The surety will be released to the extent of any prejudice suffered if the creditor cannot, by reason of what he has done, give the surety the securities in the same condition as they were formerly held by the creditor in respect of the guaranteed debt.[151] If the creditor diminishes or destroys through laches (unreasonable delay) or neglect a security to which the surety would otherwise have been entitled, the creditor is bound to credit the surety with the fair value of the security so prejudiced.[152] The surety's right to receive the benefit of these securities applies irrespective of whether the surety had knowledge of their existence at the time when he became a surety.[153] A surety for a limited

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146 *Morgan v. Seymour* (1638), 1 Rep. Ch. 120, 21 E.R. 525 (Ch.); *Swain v. Wall* (1641), 1 Rep. Ch. 149, 21 E.R. 534 (Ch.), *per* Hutton J.

147 The term "marshaling" refers to the practice in equity of ranking or arranging classes of creditors with respect to the assets of a common debtor so as to provide for the satisfaction of the greatest number of claims. In *Fitallis North America Inc. v. Pigot Construction Ltd.* (1992), 3 P.P.S.A.C. (2d) 30 at 34 (O.G.D.), Austin, J. explained the operation of the doctrine in the following terms:

> Marshaling is an equitable doctrine which applies to protect a creditor who has recourse to one fund of a debtor from the actions of another creditor who has access to more than one fund of the same debtor. ... The court will not interfere with the rights of creditor X against any or all of the funds, but if X resorts to the one funds against which Y has rights, then in appropriate circumstances the court will subrogate Y to the rights of X in the other funds. ... Three conditions must prevail in order for the doctrine to apply: (a) the claim must be against a single debtor; (b) the two funds must be at the debtor's disposal; (c) the two funds must be in existence when the question of marshaling arises.

148 *Bauer v. Bank of Montreal*, [1980] S.C.J. No. 46, [1980] 2 S.C.R. 102 (S.C.C.); but *cf. Pioneer Trust Co. v. 220263 Alberta Ltd.*, [1989] A.J. No. 56, [1989] 4 W.W.R. 154, 94 A.R. 86 at 94 (Alta. Q.B.), *per* Virtue J.; *Canadian Imperial Bank of Commerce v. Morrison*, [1986] N.S.J. No. 378, 33 D.L.R. (4th) 132 (N.S.C.A.).

149 In *Dixon v. Steel*, [1901] 2 Ch. 602 at 607, *per* Cozens-Hardy J. made it clear that while the right of the surety to take an assignment does not arise till payment, the right to the benefit of a security arises at the time when the surety assumes his obligations as such.

150 See, for instance, *Ex p. Crisp* (1744), 1 Atk. 133, 26 E.R. 87 at 135 (L.C.); *Pledge v. Buss* (1860), John 663, 70 E.R. 585 (V.C.); *Duncan, Fox & Co. v. N. & S. Wales Bank* (1880), 6 App. Cas. 1 (H.L.).

151 *Wulf v. Jay* (1872), 7 Q.B. 765 at 764, *per* Hannen J.

152 *Taylor v. Bank of New South Wales* (1886), 11 App. Cas. 596 at 602-03 (P.C.), *per* Lord Watson; *Traders Finance Corp. v. Ross*, [1942] O.J. No. 469, [1942] O.R. 618 (Ont. H.C.J.) *McKay v. O'Hanley* (1910), 8 E.L.R. 115 at 118 (P.E.I.S.C.), *per* Fitzgerald J.; *MacDonald v. Hirsch*, [1932] N.S.J. No. 9, 5 M.P.R. 469 (N.S.S.C.).

153 See, for instance, *Leicestershire Banking Co. v. Hawkins* (1900), 16 T.L.R. 317 (Q.B.); *Duncan, Fox & Co. v. N. & S. Wales Bank* (1880), 6 App. Cas. 1 (H.L.); *Nicholas v. Ridley*, [1904] 1 Ch. 192 (C.A.); *Merchants Bank of London v. Maud* (1871), 16 W.R. 657; *Forbes v. Jackson* (1882), 19 Ch. D. 615.

amount has in respect of that amount the same rights as the creditor. To the extent of his liability, therefore, the surety is entitled to the benefit of any security held by the creditor in respect of the whole debt.[154]

§10.45 The surety's rights with respect to securities existing in respect of the guaranteed obligation are derived from the equitable doctrine imposed upon the principal debtor to indemnify the surety.[155] In addition, it is felt to be inequitable for a creditor to fail to realize against a security which is available to him in respect of the guaranteed debt, and instead to throw the whole liability upon the surety.[156] To compensate the surety for the payment that he has made on the principal's behalf in respect of the guaranteed debt, he is given a right to look to the security held by the creditor in respect of that debt.[157] As mentioned above, this right is based upon general principles of equity that are similar to those which govern the marshaling of funds and securities.[158] The marshaling concept is a requirement imposed upon creditors by equity in those cases where one creditor of a debtor is able to draw upon two or more sources of payment, while a second creditor of that debtor may resort to a lesser number of sources.[159] The goal of the doctrine of marshaling is to ensure that one creditor does not act so as to deprive another creditor of his due proportion of the debtor's estate.[160]

§10.46 The surety is entitled to the benefit of all securities held in respect of the guaranteed debt or obligation, including both those that existed at the time when the guarantee was given,[161] and those that came into existence after the assumption of liability by the surety.[162] The right of the surety to be subrogated to the rights of a secured creditor in respect of collateral securities deposited by the principal will in certain cases enable the surety to step ahead of subsequent

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154 *Goodwin v. Gray* (1874), 22 W.R. 312; see also *Re Hamilton* (1895), 10 Man. R. 573 (C.A.); *Rigney v. Vanzandt* (1856), 5 Gr. 494.

155 *Nicholas v. Ridley*, [1904] 1 Ch. 192 (C.A.); *Yonge v. Reynell* (1852), 9 Hare 809, 122 E.R. 951; *Lord Harberton v. Benntee* (1829), Beat 386.

156 *Aldrich v. Cooper* (1803), 8 Ves. 382, 32 E.R. 402 at 389, *per* Lord Eldon V.C.

157 *First City Capital Ltd. v. Hall*, [1993] O.J. No. 135, 11 O.R. (3d) 792 (Ont. C.A.).

158 *Duncan Fox & Co. v. N. & S. Wales Bank* (1880), 6 App. Cas. 1 at 12 (H.L.), *per* Lord Selborne; *Heyman v. Dubois* (1871), L.R. 13 Eq. 158.

159 Discussed in R.P. Meagher, W.M.C. Gummow & J.R.F. Lehane, *Equity: Doctrines and Remedies* (Sydney: Butterworths, 1975) at 271.

160 See, generally, *Re Cohen, National Prov. Bank v. Katz*, [1960] 1 Ch. 179 at 190 (Ch.), *per* Dankwerts J.

161 *Forbes v. Jackson* (1882), 19 Ch. D. 615 at 621, *per* Hall V.C.; *Campbell v. Rothwell* (1877), 47 L.J.Q.B. 144 at 146, *per* Denman J; *Re Davidson's Estate* (1893), 31 L.R. Ir. 249 (L.J.C.), affd [1894] 1 Ir. 56 (C.A.). In PPSA jurisdictions, there is no obligation to register a financing change statement under the *Personal Property Security Act* in order to protect the surety's rights against a trustee in bankruptcy: *Re Windham Sales Ltd.* (1979), 1 P.P.S.A.C. 73 (Ont. S.C. in bank.).

162 *Mahew v. Crickett* (1818), 2 Swans 185, 36 E.R. 585 at 191 (Ch.), *per* Lord Eldon L.C.; *Pledge v. Buss* (1860), John 663, 70 E.R. 585 (V.C.); *Lake v. Brutton* (1856), 8 De G. M. & G. 440; *Scott v. Knox* (1838), 2 Jo. Ex. Ir. 778; *Campbell v. Rothwell* (1877), 47 L.J.Q.B. 144 at 146, *per* Denman J; *Traders Finance Corp. v. Ross*, [1942] O.J. No. 469, [1942] O.R. 618 (Ont. H.C.J.); *Leicestershire Banking Co. v. Hawkins* (1900), 16 T.L.R. 317 (Q.B.), *per* Mathew J.; but compare *Newton v. Chorlton* (1853), 10 Hare 646, 68 E.R. 1087 (V.C.).

encumbrancers and the general creditors of the principal.[163] This right may be viewed in some respects as being unfair to subsequent encumbrancers and other creditors.

§10.47 The term "security" is given a wide meaning by the courts.[164] It has been held that a guarantee by one partner of a firm under which the creditor has a right of proof against the separate estate of that partner (in addition to the creditor's right of proof against the partnership property) is a security to which a surety may resort.[165] An insurance policy on the life of the principal,[166] or upon his assets,[167] has also been held to be a security of which the surety is entitled to enjoy the benefit. Likewise, a sum of money standing to the credit of the principal, but which is appropriated to a particular purpose under the terms of a contract is considered to be comparable to a security, and the surety has similar rights in respect of that sum as he would have in the case of a genuine security.[168] A right of distress is not a security in the nature of a lien, but a lien arises once that right is exercised against the property concerned.[169]

§10.48 The right of a surety to the benefit of the security interests held by the creditor must be properly understood.[170] If the secured creditor realizes on the security and applies the proceeds so obtained to the payment of the guaranteed debt, then the surety obtains that benefit.[171] If the secured creditor realizes on its

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163 *Badeley v. Consolidated Bank* (1888), 38 Ch.D. 238 (C.A.).

164 *Re Holland, ex p. Alston* (1868), 4 Ch. App. 168; but *cf. Royal Bank of Canada v. Canadian Rocky Mountain Resorts Ltd.*, [1994] A.J. No. 274, 114 D.L.R. (4th) 537 (Alta. C.A.); *Child & Gower Piano Co. v. Gambrel*, [1933] S.J. No. 23, [1933] 2 W.W.R. 273 at 281-282 (Sask. C.A.); see also *Alberta Opportunity Co. v. Schinnour*, [1990] A.J. No. 1125, 78 Alta. L.R. (2d) 48 (Alta. C.A.).

165 *Re Stratton* (1883), 25 Ch. D. 148 at 153 (C.A.), *per* Fry L.J.

166 *Lake v. Brutton* (1856), 8 De G. M. & G. 440; *Heyman v. Dubois* (1871), L.R. 13 Eq. 158 (V.C.); but compare *Dalby v. India & London Life Assurance Co.* (1854), 15 C.B. 365, 139 E.R. 465 (C.P.).

167 *Watts v. Shuttleworth* (1861), 7 H. & N. 353, 158 E.R. 510 (Ex. Ch.). Note, however, that there is no general obligation on the creditor to keep the assets insured: *Bank of Montreal v. Kodiak Log Services Ltd.*, [1984] B.C.J. No. 1317, 6 C.C.L.I. 14 (B.C.S.C.), revd [1984] B.C.J. No. 1955, 8 C.C.L.I. 9 (B.C.C.A.).

168 *Re Sherry, London & County Banking Co. v. Terry* (1884), 25 Ch. D. 692 at 702 (C.A.), *per* Lord Selbourne L.C.; but *cf. Royal Bank of Canada v. Canadian Rocky Resorts Ltd.*, [1994] A.J. No. 274, 114 D.L.R. (4th) 537 at 540 (Alta. C.A.), where such a conclusion was rejected given the tenor of correspondence that had passed between the parties.

169 *Commercial Credit Corp. v. Harry D. Shields Ltd.*, [1980] O.J. No. 3639, 29 O.R. (2d) 106 (Ont. H.C.J.), affd [1981] O.J. No. 2999, 32 O.R. (2d) 703 (Ont. C.A.), *per* R.E. Holland J. and *per* Weatherstone J.A.; *Leavere v. Port Colborne*, [1995] O.J. No. 217, 79 O.A.C. 16 at 19 (Ont. C.A.), *per* Galligan J.A.

170 See, for instance, *Manufacturers Life Insurance Co. v. Zellagate Holdings Inc.*, [1999] O.J. No. 800 at paras. 15, 17, 20 (Ont. Gen. Div.), *per* Whitten J.

171 *Regina Brokerage and Investment Co. v. Waddell*, [1916] S.J. No. 41, 27 D.L.R. 533 at 535 (Sask. S.C.): "... a creditor has securities in his hands for the debt guaranteed, he is entitled to realize upon those securities without releasing the surety. A surety, it is true, is entitled to all the securities in the hands of the creditor if he pays the guaranteed debt. This is to enable him to proceed against the principal debtor and reimburse himself for the monies paid out under his guarantee on behalf of such debts, but where the creditor himself has realized on these securities

security interests in an imprudent (or improvident) manner,[172] then the surety is entitled to be credited with what ought to have been realized had the creditor followed a more prudent course.[173] If the secured creditor calls upon the surety to pay the guaranteed debt, and the surety does so pay, then the secured creditor must deliver its security interest to the surety upon payment. This right arises by virtue of subrogation.

§10.49 The rights of a surety with respect to the security held by the creditor qualifies the general rule that payment of a secured debt by the debtor who granted the security interest will normally[174] discharge the security interest that has been granted. This result grows out of the principle that a mortgage (or other security interest) is granted for a specific purpose, and upon the satisfaction of that purpose, the rights conferred under the mortgage are spent. However, it does not follow that the payment of the amount owing by some third party results in a corresponding evaporation of the security interest. Such a contractual right is granted to secure the performance of the principal debtor. The payment by the surety to the creditor no more constitutes the performance of the principal debtor than the purchase of the security agreement by a third party would constitute such performance. The principal remains obliged to perform, and therefore the security interest continues in respect of such performance.[175] The arrangements as between the surety and the creditor are immaterial to the relationship between the creditor and principal, and to any security interest that the creditor has granted.

(3) Realization of Security and Improvident Realization

§10.50 A secured creditor owes a duty to the principal and any guarantors to take reasonable precautions to obtain the true market value of the charged property on the date the creditor decides to sell the property.[176] There is also a duty to

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and has credited the full value thereof on the guaranteed debt, the surety is in no way prejudiced."

172 *Duca Financial Services Credit Union Ltd. v. Bozzo*, [2006] O.J. No. 4339 at para. 14 (Ont. C.A.), *per* Blair J.A.: "... a guarantor is entitled, from the moment of his or her guarantee, to call for the benefit of all securities held in respect of the guaranteed debt, if needed, and that a creditor has a general obligation to protect and preserve the security and to be in a position to return or reassign the security to the debtor or surety on repayment of the debt. ... Should the mortgaged property be disposed of by power of sale, the mortgagee's obligation is to account for the proceeds of sale."

173 A defence based upon this line of attack is rarely successful. See, generally, on this point: *Royal Bank of Canada v. 2021847 Ontario Ltd.*, [2007] O.J. No. 4994 (Ont. S.C.J.), affd [2008] O.J. No. 3511 (Ont. C.A.); contrast however *Crawford v. New Brunswick (Agricultural Development Board)*, [1997] N.B.J. No. 368, 192 N.B.R. (2d) 68 (N.B.C.A.), *per* Bastarache J.A.

174 There are exceptions, as for instance, in the case of a security interest securing a revolving line of credit.

175 Compare *Standard Trust Co. v. Bank of Nova Scotia*, [2006] N.J. No. 345, 262 Nfld. & P.E.I.R. 319 (Nfld. C.A.).

176 *Bank of Nova Scotia v. Barnard*, [1984] O.J. No. 3218, 46 O.R. (2d) 409 (Ont. H.C.J.); *Royal Bank of Canada v. Cramer*, [1990] O.J. No. 827, 73 O.R. (2d) 677 (Ont. H.C.J.).

HMANALY G§59
Houlden & Morawetz Analysis G§59

Bankruptcy and Insolvency Law of Canada, 4th Edition

THE BANKRUPTCY AND INSOLVENCY ACT

Part V (ss. 127-134)
L.W. Houlden and Geoffrey B. Morawetz

G§59 — Who is a Secured Creditor?

G§59 — Who is a Secured Creditor?

See ss. 127, 128, 129, 130, 131, 132, 133, 134

Section 2(1) defines a secured creditor as follows:

> "secured creditor" means a person holding a mortgage, hypothec, pledge, charge or lien on or against the property of the debtor or any part of that property as security for a debt due or accruing due to the person from the debtor, or a person whose claim is based on, or secured by, a negotiable instrument held as collateral security and on which the debtor is only indirectly or secondarily liable, and includes
>
> (a) a person who has a right of retention or a prior claim constituting a real right, within the meaning of the *Civil Code of Québec* or any other statute of the Province of Quebec, on or against the property of the debtor or any part of that property, or
>
> (b) any of
>
> (i) the vendor of any property sold to the debtor under a conditional or instalment sale,

> (ii) the purchaser of any property from the debtor subject to a right of redemption, or
>
> (iii) the trustee of a trust constituted by the debtor to secure the performance of an obligation,
>
> if the exercise of the person's rights is subject to the provisions of Book Six of the *Civil Code of Québec* entitled *Prior Claims and Hypothecs* that deal with the exercise of hypothecary rights.

In Québec, there are legal hypothecs, in particular the construction legal hypothec. Québec does not have construction liens or trusts; rather, prior rights that create a real right and rights of retention, all of which are a secured claim under s. 2 of the *BIA*.

The *Bankruptcy and Insolvency Act* defines "secured creditor" in s. 2(1) but defers to provincial law for the creation of secured claims. However, provincial legislation that has the effect of re-ordering priorities created by the *Bankruptcy and Insolvency Act* is of no effect: *Husky Oil Operations Ltd. v. Minister of National Revenue* (1993), [1994] 1 W.W.R. 629, 22 C.B.R. (3d) 153, 1993 CarswellSask 27, 11 C.L.R. (2d) 1, 108 D.L.R. (4th) 681, 116 Sask. R. 46, 59 W.A.C. 46 (C.A.), affirmed [1995] 10 W.W.R. 161, 35 C.B.R. (3d) 1, 24 C.L.R. (2d) 131, 128 D.L.R. (4th) 1, 188 N.R. 1, 137 Sask. R. 81, 107 W.A.C. 81, 1995 CarswellSask 739, 1995 CarswellSask 740 (S.C.C.). "Secured creditor" is to be interpreted in accordance with the definition in s. 2(1); provincial legislation cannot affect the interpretation of the term: *Dartmouth (City) v. Barclays Bank of Canada* (1996), 40 C.B.R. (3d) 1, 151 N.S.R. (2d) 264, 440 A.P.R. 264, 1996 CarswellNS 210 (C.A.).

To be a secured creditor, the claim of a creditor must be secured against some asset of the bankrupt. Something has to be identifiable as the subject of the security, either a specific asset or assets or all assets generally: *A.A. Electric Ltd. v. Bank of British Columbia* (1978), 27 C.B.R. (N.S.) 298, 7 Alta. L.R. (2d) 92, 89 D.L.R. (3d) 157 (*sub nom. Re A.A. Elec. Ltd. and Swan Elec. Ltd.*), 21 A.R. 248 (T.D.); *Protz v. Protz* (1997), 49 C.B.R. (3d) 63, 1997 CarswellSask 477 (Sask. Q.B.). The only security contemplated by the *Act* is that which is "on or against the property of the debtor": *Campbell Sharp Ltd. v. Bank of Montreal* (1984), 53 C.B.R. (N.S.) 225, 30 Man. R. (2d) 73 (Q.B.). See also *Re Stenan Const. Ltd.* (1977), 25 C.B.R. (N.S.) 7 (Ont. S.C.); *Asselford Martin Shopping Centers Ltd. v. Ross* (1994), 28 C.B.R. (3d) 130, 1994 CarswellOnt 304 (Ont. Gen. Div.). A creditor holding security on property not belonging to the bankrupt is not a secured creditor: *Re Reeve-Dobie Mines Ltd. (No. 2)* (1921), 1 C.B.R. 540, 64 D.L.R. 534, 50 O.L.R. 499, 1921 CarswellOnt 11 (S.C.).

To be a secured creditor, a person holding a mortgage, hypothec, etc., must be a creditor of the bankrupt: *New Brunswick v. Peat Marwick Thorne Inc.* (1995), 37 C.B.R. (3d) 268, 170 N.B.R. (2d) 373, 435 A.P.R. 373, 1995 CarswellNB 114 (C.A.). A loan agreement that would otherwise

create a secured interest does not fail simply because it contemplates payments to be made from sources that will produce revenue in the future: *Re Bearcat Explorations Ltd.* (2004), 2004 CarswellAlta 1052, 3 C.B.R. (5th) 173, 2004 ABQB 601 (Alta. Q.B.).

Many of the claims of creditors that have or have not been recognized as secured creditors are dealt with in other parts of the book. In the notes to ss. 67-68.1, most of the important secured claims are discussed in detail, see, for example, F§63 "*Personal Property Security Act*", which deals with secured claims under provincial personal property security legislation. In the notes to ss. 70-84, claims, such as judgment creditors and landlords, which have not been recognized as secured claims are reviewed in detail. To avoid repetition, in this section of Houlden and Morawetz only secured claims that are not covered in other parts of the book are discussed. To find where a claim that is not covered in this section is dealt with in the book, reference should be made to the Index.

The registrar of the Alberta Court of Queen's Bench disallowed the appeal of a bank with respect to the claim of the bank that its Homeline Plan secured prior debts owed to the bank. The trustee had disallowed a portion of the secured claims on the ground that the Homeline Plan did not secure prior unsecured debts of the bankrupts, but only the advances made under the Homeline Plan. The issue was whether the terms of the RBC Homeline Plan captured past indebtedness. While there was some merit to the suggestion that the definition of "mortgage" standing alone appeared to capture prior debts, the RBC Homeline Plan had another provision that addressed the indebtedness covered by the security that was inconsistent with this feature of the definition of "mortgage". Registrar Mason was of the view that the definition of "total debt" in the Homeline Plan did not contemplate and made no reference to prior debts, creating an ambiguity which in the circumstances had to be resolved in favour of the bankrupts: *Re Czerwinski* (2009), 2009 CarswellAlta 1366, 2009 ABQB 510 (Alta. Q.B.).

Editor's note: The interpretation of the same creditor's Homeline Plan came before the Ontario Superior Court of Justice in *Dale & Lessmann LLP v. Royal Bank* (2009), 2009 CarswellOnt 5273 (Ont. S.C.J.). Spiegel J. found that the words "and all present and future amounts at any time owing by you as described in the Mortgage" in the definition of "Mortgage" under the Homeline Plan agreement read together with the standard charge terms were at best ambiguous and that on the proper interpretation of the terms that the credit card debt was not secured by the charge.

The Ontario Court of Appeal dismissed an appeal in which the appellant had a writ of seizure and sale against a party that owned an undivided 35% beneficial interest in lands registered under the *Land Titles Act*. The registered owner of the lands holds the land for the debtor and two other corporations under an unregistered trust agreement. Under s. 62(1) of the *Land Titles Act*, notice of an express, implied, or constructive trust "shall not be entered on the register or received for registration." The Court of Appeal concluded that the appellant was not entitled to enforce its writ against the registered owner or over the mortgagees who had provided

construction financing. The Court held that neither the statutory authorities nor the case law support the appellant's entitlement to the relief it sought. Beyond stipulating that a writ of seizure and sale binds the lands of the party named in the writ and authorizing the sheriff to sell those lands even if they are held in the name of a trustee, the *Execution Act* provides no further remedy to a judgment creditor in relation to a writ of seizure and sale. The Court held that the *Execution Act* is a procedural statute that facilitates the collection of debts through the mechanisms contained in it. It does not purport to grant substantive rights to judgment creditors. The *Execution Act* does not authorize effectively adding the legal owner of a property in which a judgment debtor has an unregistered beneficial interest to a writ of seizure and sale against the judgment debtor. The Court held that the execution creditor stands in no better position than the debtor. Accordingly, lands to be sold at the request of an execution creditor are sold subject to the charges, liens, and equities to which they were subject in the hands of the debtor. As the appellant stands in no better position than the debtor, the appellant's entitlement is limited to having the sheriff seize and sell whatever the debtor's interest in the land may be and to share in the proceeds of sale of that interest in accordance with the priorities set out in the *Creditors' Relief Act*. The sheriff steps into the shoes of the execution debtor and can have no higher rights than the execution debtor. The Court also noted that s. 14 of the *Creditors' Relief Act, 2010* does not give an execution creditor priority over subsequent advances made under a charge registered prior to the execution being filed. The Court also held that s. 93(4) of *Land Titles Act* does not create any priorities over a prior registered charge for an execution creditor. Rather, s. 93(4) speaks to the priority of advances made under a previously registered charge following registration of a further transfer, charge, or other instrument executed by the chargor. The appellant as the holder of a writ of seizure and sale does not fall within that section. The Court of Appeal noted that its decision should not be taken as expressing any opinion on if or how an execution creditor seeking to have a sheriff sell a beneficial interest under the *Land Titles Act* might protect its remedies under that Act. The appeal was dismissed: *1842752 Ontario Inc. v. Fortress Wismer 3-2011 Ltd.*, 2020 CarswellOnt 4915, 77 C.B.R. (6th) 165, 2020 ONCA 250 (Ont. C.A.).

(1) — *Guarantors*

To be a secured creditor within the definition in s. 2(1), a person must hold a mortgage, hypothec, etc., "on or against the property of the debtor". Hence, a creditor who holds the guarantee of a third party for the indebtedness of the bankrupt is not a secured creditor: *Re Coughlin & Co.*, 4 C.B.R. 294, [1923] 3 W.W.R. 1177, [1923] 4 D.L.R. 971 , 33 Man. R. 499 (C.A.); *Banque canadienne nationale v. Dufour* (1979), 31 C.B.R. (N.S.) 300 (Que. S.C.); *Campbell Sharp Ltd. v. Bank of Montreal* (1984), 53 C.B.R. (N.S.) 225, 30 Man. R. (2d) 73 (Q.B.).

If a guarantor pays in full the indebtedness of the principal debtor, the guarantor is entitled to any security held by the principal creditor and becomes a secured creditor. There is no necessity

for any formal transfer of the security to the guarantor; the guarantor stands in the place of the creditor: *Re Windham Sales Ltd.* (1979), 31 C.B.R. (N.S.) 130, 26 O.R. (2d) 246, 1 P.P.S.A.C. 73, 8 B.L.R. 317, 102 D.L.R. (3d) 459, 1979 CarswellOnt 227 (S.C.). However, a guarantor who makes partial payment of the amount owing by the principal debtor is not entitled to security held by the principal creditor: *Matticks v. B & M Construction Inc. (Trustee of)* (1992), 15 C.B.R. (3d) 224, 11 O.R. (3d) 156, 1992 CarswellOnt 193 (Gen. Div.); *Ferguson v. Gibson* (1872), L.R. 14 Eq. 379; *Re Howe; Ex parte Brett* (1871), 6 Ch. App. 838, 40 L.J. Bank. 54; it is difficult to see why, if the principal creditor realizes a surplus from the realization of its security, the guarantor is not entitled to reimbursement for the payments made by it.

If the bankrupt has guaranteed payment of a debt, the principal creditor is not a secured creditor in the bankruptcy of the guarantor because it holds security of the principal debtor. The creditor can prove in the bankruptcy of the guarantor for the full amount owing to it, and the trustee in bankruptcy of the guarantor can only demand the security held by the creditor if it pays the debt of the principal debtor in full: *Mather v. C.C.M.T.A. Ltd.,* 14 C.B.R. 292, [1933] 1 W.W.R. 526, [1933] 2 D.L.R. 790 (Sask. K.B.); *Re Crown Royal Clothing Co.* (1969), 15 C.B.R. (N.S.) 203 (Que. S.C.).

A creditor who holds an unsecured guarantee of the bankrupt in support of a secured claim against a subsidiary of the bankrupt can prove a claim against the bankrupt estate as an unsecured creditor without giving credit for the security given by the subsidiary. The creditor must, however, give credit for any payments received on the debt from the subsidiary prior to the date of bankruptcy but not for payments received after that date: *Re Olympia & York Developments Ltd.* (1997), 45 C.B.R. (3d) 85, 143 D.L.R. (4th) 536, 1997 CarswellOnt 657 (Ont. Gen. Div.).

The Ontario Court of Appeal allowed the appeal of a decision of the motion judge and reduced summary judgment against the guarantor of a corporate debt from US$3 million to US$250,000. The motion judge had erred in law by failing to take into account that the amended guarantee limited the exposure of the guarantor to US$3 million less facility and forbearance fees. Pepall J.A. observed that a personal guarantee of corporate indebtedness should only be given after serious deliberation. In this case, the guarantor turned his mind to the language of the guarantee in the expectation that his exposure would be limited. That expectation was not met. The debtor company carried on business as a supplier of information technology products. It defaulted on its obligations to a creditor, which had previously purchased the company's debt from the bank, increasing interest rates and charging a facility fee. The CEO of the debtor company blamed the creditor for the company's increased difficulty in servicing its debt, alleging that its "loan to own" strategy was consuming the equity value of the company's business through debt and fees. There were several negotiated forbearance agreements. The parties negotiated amendments to the guarantee so that the CEO would not be responsible for any portion of the company debt that arose from the creditor's fees, past or future. The creditor subsequently commenced proceedings for appointment of a receiver, approval of a stalking horse asset purchase credit bid agreement

and a sale process, and an order declaring that its nominee company would the successful bidder absent a better offer. The sale was approved and the creditor then sued the former CEO on the guarantee. The Court of Appeal held that the motion judge had erred in law by failing to consider that the amended guarantee served to reduce the company's obligations that were guaranteed; and the judge made a further palpable and overriding factual and mathematical error in calculating the amount owing under the guarantee: *Callidus Capital Corporation v. McFarlane*, 2017 CarswellOnt 11537, 51 C.B.R. (6th) 1, 2017 ONCA 626 (Ont. C.A.).

(2) — *Joint Debt*

To come within the definition of "secured creditor" in s. 2(1), there must be a debt due or accruing due to the secured creditor "from the debtor". Although there was some doubt about whether a person who holds security for a joint and several obligation due by the bankrupt and another is a secured creditor (see *Thomson v. Toronto Dominion Bank* (1970), 15 C.B.R. (N.S.) 177 (Alta. T.D.); *HSBC Bank Canada v. Expressway Concrete Supply Ltd.* (1999), 14 C.B.R. (4th) 1, 1999 CarswellOnt 3582, 1 B.L.R. (3d) 147, 15 P.P.S.A.C. (2d) 128 (Ont. S.C.J.)), it now appears to be settled that such a person is a secured creditor: *Pike v. Bel-Tronics Co.* (2000), 19 C.B.R. (4th) 262, 2000 CarswellOnt 3540 (Ont. S.C.J.); *Re Darwest Oil Services Ltd.* (2001), 25 C.B.R. (4th) 234, 2001 ABQB 416, 2001 CarswellAlta 665 (Alta. Master). See Frederick L. Myers and Monica Creery, *"Pike v. Bel-Tronics:* Secured Creditors Status Restored: Trade Creditors Warned to Protect Their Own Interests", 13 Comm. Insol. R. 1; Case Comment by Jacob Ziegel, 14 C.B.R. (4th) 9; and David E. Baird Q.C., "An Insolvency Update", 18 Nat. Insol. Rev. 33.

Where partners gave securities that they owned individually for a debt due, not from the partners, but from the firm of which they were partners, the creditor was allowed to prove against the separate estate of the partners without showing the security . The partnership and the individual partners are regarded as separate entities: *Re Dutton, Massey & Co.; Ex parte Manchester & Liverpool District Banking Co.,* [1924] 2 Ch. 199, 93 L.J.Ch. 547, 131 L.T. 622, [1924] B. & C.R. 129 (C.A.).

(3) — *Letter of Credit*

See *ante* F§109 "Letters of Credit".

In *Ontario v. Canadian Airlines Corp.* (2001), 29 C.B.R. (4th) 236, 2001 CarswellAlta 1488, 2001 ABQB 983, [2002] 3 W.W.R. 373 (Alta. Q.B.), Romaine J. of the Alberta Court of Queen's Bench was of the opinion that a creditor who had received a stand-by letter of credit from a debtor was a secured creditor but *quaere.*

(4) — *Lienholders*

See *infra* (9) "Mechanics' and Construction Lien Holders".

Section 2(1) defines "secured creditor" to include a person holding a lien on or against the property of the debtor or any part thereof. A lien is any charge of a payment of debt or duty upon either real or personal property: *Chassey v. May,* 35 B.C.R. 113, [1925] 2 W.W.R. 199 (C.A.).

A provincial statute that gives a credit union a lien on any amount standing to the credit of a member for a debt owing by the member makes the credit union a secured creditor: *Ecarnot (Trustee of) v. Western Credit Union Ltd.* (1990), 2 C.B.R. (3d) 286, [1990] 6 W.W.R. 550, 1990 CarswellSask 35, (*sub nom. Ecarnot, Re*) 87 Sask. R. 9 (Q.B.), affirmed, 7 C.B.R. (3d) 207, [1991] 5 W.W.R. 268, (*sub nom. Ecarnot, Re*) 93 Sask. R. 179, 4 W.A.C. 179, 1991 CarswellSask 41 (C.A.).

While a provincial legislature may create a valid statutory lien in favour of a credit union in respect of monies deposited into a joint bank account in the name of the bankrupts, if the account was in an overdraft position at the date of bankruptcy, the credit union would not be entitled to the lien since there would be no property of the bankrupts on which the lien could have attached. A statutory lien arising after the date of bankruptcy on after-acquired property is not valid against a trustee in bankruptcy: *Re Demare* (2004), 49 C.B.R. (4th) 77, 2004 CarswellMan 32, 2004 MBQB 36, 182 Man. R. (2d) 74 (Man. Q.B.).

The *Legal Aid Act* of Ontario creates a lien in favour of the Law Society on the lands of a person who had agreed to contribute to the cost of legal aid received by him or her. If the person receiving the legal aid goes into bankruptcy, the Law Society, by virtue of its lien, is a secured creditor: *Re Calla* (1975), 20 C.B.R. (N.S.) 234, 9 O.R. (2d) 755, 61 D.L.R. (3d) 627, 1975 CarswellOnt 92 (S.C.).

Where a debtor has paid money into court to remove a lien and the debtor then goes into bankruptcy, the money in court is not the property of the bankrupt. The lien attaches to the money in court and, if the lien is valid, is the property of the lienholder: *Van Den Bogerd (Trustee of) v. Paulsen* (2002), 36 C.B.R. (4th) 307, 2002 CarswellSask 541, 2002 SKQB 356 (Sask. Q.B.).

A claim pursuant to the *Forestry Workers Lien for Wages Act* (Ontario) should describe the form of logs or timber on which the lien is claimed, and the nature and location of services provided to support the lien at the time the work was undertaken. However, the standard of identification does not require marking of each log, timber or wood chip; and intermingling of wood at a mill does not defeat a lien claim on the grounds that logs cannot be identified, but it may prevent seizure of specific logs. A large and liberal interpretation of the statute is consistent with the objectives of lien legislation to protect vulnerable forest workers: *Re Buchanan Forest Products Ltd.* (2009), 2009 CarswellOnt 5733, 58 C.B.R. (5th) 184 (Ont. S.C.J.).

The Federal Crown had priority over provincial legislation granting woodworkers lien claims, the *Woodworker Lien Act,* R.S.B.C. 1996, c. 491; as s. 224(1.2) of the *Income Tax Act* applies notwithstanding provincial enactments. The security interest in s. 224(1.2) of the *Income Tax Act* is not required to be in the possession of the tax debtor and the claim of interest as *in rem* interest did not affect the priority: *W. Mullner Trucking Ltd. v. Baer Enterprises Ltd.* (2010), 2010 CarswellBC 371, 61 C.B.R. (5th) 1 (B.C. C.A.).

The Yukon Territory Supreme Court dismissed the application of a lien claimant who wanted to pursue its claim against the bankrupt contractor. Money had been paid into court to vacate the lien. The claimant argued, unsuccessfully, that it was a secured creditor for the portion of its claim relating to the builders' liens or, alternatively, that the funds held in trust did not form part of the bankrupt's estate: *Nelson Drywall Interiors Alberta Inc. v. Dowland Contracting Ltd.*, 2016 CarswellYukon 70, 37 C.B.R. (6th) 265, 2016 YKSC 25 (Y.T. S.C.).

(5) — *Maintenance and Support*

The Manitoba *Judgments Act* provides for the registration of an order or judgment for maintenance against real property of the defendant, and the judgment or order, if so registered, will bind the property while the judgment is in force. The registration of an order for maintenance pursuant to the Act does not give the plaintiff the status of a secured creditor in the bankruptcy of the defendant: *Can. Imperial Bank of Commerce v. McFadzean,* 28 C.B.R. (N.S.) 87, [1978] 5 W.W.R. 750, 90 D.L.R. (3d) 84 (Man. Q.B.).

Where a spouse was granted an equalization payment under the *Matrimonial Property Act,* R.S.A. 2000, c. M-8, and the judgment was registered against the lands jointly owned by the parties, the court concluded that the matrimonial order gave the wife security in the interest of the husband in the lands after the husband made an assignment in bankruptcy. The wife was free to pursue her claim as a secured creditor outside the bankruptcy: *Re Coulthard* (2003), 2003 CarswellAlta 1712, 2003 ABQB 976, 48 C.B.R. (4th) 59, 25 Alta. L.R. (4th) 101 (Alta. Q.B.).

(6) — *Cattle Breeder's Lien*

A creditor who has possession of cattle and who has supplied food, care, etc., to the cattle has a lien on the cattle under the *Cattle Lien Act* of British Columbia and is a secured creditor: *Re Can. Exotic Cattle Breeders' Co-Op.* (1979), 14 B.C.L.R. 183, 31 C.B.R. (N.S.) 217, 103 D.L.R. (3d) 112 (S.C.).

(7) — *Livery Stable Keeper's Lien*

The *Innkeeper's Act* of Ontario confers a lien on the keeper of a livery stable or boarding stable

on every horse or other animal for charges for boarding and caring for the horse or animal. The holder of such a lien is a secured creditor: *Re Rauf* (1974), 20 C.B.R. (N.S.) 143, 5 O.R. (2d) 31, 49 D.L.R. (3d) 345 (S.C.).

(8) — *Maritime Liens*

A maritime lien created by foreign law is a secured claim and will be given effect by Canadian courts: *Ultramar Canada Inc. v. Pierson Steamships Ltd.* (1982), 43 C.B.R. (N.S.) 9 (Fed. T.D.); *Holt Cargo Systems Ltd. v. ABC Containerline N.V. (Trustees of),* 1997 CarswellNat 508, [1997] F.C.J. No. 409, 1997 CarswellNat 2144, 146 D.L.R. (4th) 736, 46 C.B.R. (3d) 169, (*sub nom. Holt Cargo Systems Inc. v. ABC Containerline N.V. (Bankruptcy)*) 127 F.T.R. 244, [1997] 3 F.C. 187 (Fed. T.D.), affirmed [1999] F.C.J. No. 337, 1999 CarswellNat 381, 1999 A.M.C. 1486, 239 N.R. 114, 173 D.L.R. (4th) 493, [1999] I.L.Pr. 634 (Fed. C.A.), affirmed 2001 CarswellNat 2816, 2001 CarswellNat 2817, 2001 SCC 90, 30 C.B.R. (4th) 6, 207 D.L.R. (4th) 577, 280 N.R. 1 (S.C.C.). The fact that provincial law creates a lien for dockage fees will not create a maritime lien enforceable by an action *in rem* in the Federal Court: *Holt Cargo Systems Inc. v. ABC Containers N.V. (Trustees of), supra.*

A master of a ship is entitled to be reimbursed by the owners of the ship for necessaries ordered by the master and is entitled to a maritime lien for the disbursements. In order to be entitled to such disbursements, the master must be unable to communicate with the owners. Principal and interest on loans obtained by the master for the owners and interest charges on personal lines of credit are not master's disbursements: *Doris v. Ferdinand (The)* (1998), 5 C.B.R. (4th) 182, 155 F.T.R. 236, 1998 CarswellNat 1861 (T.D.).

For a maritime lien, the wages of an employee must be referable to a particular ship. If the source of severance pay is not a contract specific to a ship but to a company service agreement, there is no maritime lien. Company service agreements provide continuous employment notwithstanding the particular voyages or ships on which the employee may from time to time be involved: *Canadian Imperial Bank of Commerce v. "Chene No. 1" (Le)* (2003), 41 C.B.R. (4th) 13, 2003 CarswellNat 619, 2003 CarswellNat 1581, 2003 FCT 292, 2003 CFPI 292, 2003 A.M.C. 1162, 229 F.T.R. 181 (Fed. T.D.).

A company operated a passenger ferry running between two coastal cities and had hired contractors to complete extensive repairs on the vessel. The vessel returned to service, and the company encountered problems with the motor unrelated to the repairs and subsequently declared bankruptcy. The contractors brought an application for an order that the bankruptcy stay of proceedings did not apply to their actions against the company for monies allegedly owed in relation to the repairs and the court granted the order. The court held that the contractors' claims were integrally connected to the operation and navigation of the vessel, and the fact that the ship at the time of the repairs only plied in intra-provincial waters did not change the character of those services to debt claims solely within provincial jurisdiction. The

contractors' repairs enhanced the value of the vessel and their maritime lien claims were secured within the meaning of bankruptcy legislation and the ranking of priorities of various marine claims was a matter for the court to determine pursuant to the principles of federal maritime law. The court further held that claims of the seamen also in pith and substance related to the operation and navigation of the ship and if proven, their wage claims would constitute a maritime lien and they should have the opportunity to argue that their claims were elevated to rank *pari passu* with the other maritime liens; the court therefore granted an order that the statutory stay under s. 69.4 did not apply to their claims under the admiralty action before the federal court: *Nanaimo Harbour Link Corp. v. Abakhan & Associates Inc.* (2007), 2007 CarswellBC 177, 2007 BCSC 109, 31 C.B.R. (5th) 298, 2007 A.M.C. 631 (B.C. S.C.).

The British Columbia Supreme Court granted initial *CCAA* protection to a group of entities involved in the business of designing, manufacturing, and selling custom super yachts. The initial application was opposed by certain creditors on the basis that the B.C. court had no jurisdiction to stay *in rem* maritime law proceedings in the Federal Court. The initial order granted by the B.C. court included, as a matter of comity, a request for recognition and aid of the Federal Court with respect to the initial order. The court was of the view that priority issues as they related to claims of maritime lien holders did not have to be addressed on the initial application: *Sargeant III v. Worldspan Marine Inc.* (2011), 2011 CarswellBC 1444, 2011 BCSC 767 (B.C.S.C. [In Chambers]). For further discussion of this case, see N§59 "Jurisdiction of Courts".

In related decisions, *BBC Chartering Carriers GMBH & CO. KG v. Openhydro Technology Canada Limited*, 2018 CarswellNat 6194, 2018 FC 1098 (F.C.) and *Re OpenHydro Technology Canada Ltd.*, 2018 CarswellNS 861, 2018 NSSC 283 (N.S. S.C.), the Federal Court held that a *BIA* stay of proceedings did not stay *in rem* proceedings in the Federal Court. The Nova Scotia Supreme Court declined to issue an order to stay the Federal Court *in rem* proceedings. If there is to be such a stay, it should be decided by the Federal Court on motion of the debtor and not the Nova Scotia Supreme Court.

In *BBC Chartering Carriers GMBH & CO. KG v. Openhydro Technology Canada Limited*, the plaintiff BBC Chartering Carriers ("BBC") sought default judgment against the defendant being a turbine control centre *in rem* ("TCC" or "*in rem* defendant"). The plaintiff also sought an order for commission or sale of TCC. The defendants did not file a statement of defence and no one appeared on their behalf at the hearing of the motion. In advance of the motion, the court received communications from legal counsel on behalf of the *in personam* defendant, OpenHydro Technology Canada Limited ("OpenHydro"), requesting that the court decline to consider the motion as it had filed a notice of intention to make a proposal pursuant to s. 50.4(1) of the *BIA*. OpenHydro had entered into a charterparty agreement in 2018 for offshore service vessels with BBC, OpenHydro chartering a vessel from BBC for the carriage of the cargo, TCC, which is the *in rem* defendant that was loaded aboard the vessel and transported from Ireland to New Brunswick. BBC invoiced OpenHydro for the agreed upon amount of $871,339. No

payments were made by OpenHydro. Pursuant to the terms of the charterparty agreement, upon default, BBC was entitled to assert a lien on the cargo. This right of lien was the basis of the *in rem* claim against the cargo. The only issue for determination was if default judgment should be granted against the *in rem* defendant, TCC. Justice McDonald noted that pursuant to s. 22(1) of the *Federal Courts Act* (*FCA*), the Federal Court has concurrent original jurisdiction over matters of navigation and shipping; s. 22(2)(1) states that the Federal Court has jurisdiction with respect to "any claim arising out of any agreement relating to the carriage of goods in or on a ship or to the use or hire of a ship whether by charter party or otherwise" and s. 43(2) of the *FCA* states that: 43(2) Subject to subsection (3), the jurisdiction conferred on the Federal Court by s. 22 may be exercised *in rem* against the ship, aircraft or other property that is the subject of the action, or against any proceeds from its sale that have been paid into court. Justice McDonald noted that s. 43(2) of the *FCA* was addressed by the Supreme Court of Canada in *Phoenix Bulk Carriers Ltd. v. "M/V Swift Fortune" (The)*, 2007 CarswellNat 531, (*sub nom.* Phoenix Bulk Carriers Ltd. v. Kremikovtzi Trade) [2007] 1 S.C.R. 588, 2007 SCC 13, which held that s. 43(2) does not require a physical nexus between the cargo and the vessel in order to give rise to *in rem* rights. Rather, s. 43(2) proposes identifiability of the property as the controlling factor so as to ensure that the scope of the *in rem* proceedings is not unduly enlarged: the action *in rem* must relate to the specific property contemplated in the contract at issue. Justice McDonald noted that although the cargo was no longer on the charter vessel and was in fact located on the seafloor, there was a clear nexus between the cargo and the vessel and therefore it was within the court's maritime law jurisdiction. In this case, the arrest of the *in rem* defendant took place in August 2018. OpenHydro's notice of intention under the *BIA* was filed in September 2018. Therefore, the maritime jurisdiction of the federal court was engaged in advance of the *BIA* proceedings. Justice McDonald was satisfied on the facts that the plaintiff was entitled to default judgment against the *in rem* defendant in the amounts invoiced together with interest and ordered accordingly: *BBC Chartering Carriers GMBH & CO. KG v. Openhydro Technology Canada Limited*, 2018 CarswellNat 6194, 2018 FC 1098 (F.C.).

In the related judgment, *Re OpenHydro Technology Canada Ltd.*, the debtor OpenHydro filed a notice of intention to make a proposal pursuant to the *BIA* in September 2018 and a month later, filed a motion requesting that the proceeding be converted to an application pursuant to the *CCAA*. The debtor is a Canadian subsidiary of an Irish energy technology company involved in the business of design and manufacture of marine turbines for electrical generation. The debtor deployed two turbines in Nova Scotia, as part of a demonstration project exploring the generation of electricity through tidal energy. By September 2018, the turbines had been damaged beyond repair and were incapable of generating electricity. In August 2018, a number of creditors of the debtor commenced proceedings in the Federal Court against the "Scotia Tide", a vessel owned by the company. In August 2018, the vessel was arrested pursuant to a Federal Court warrant. Seven creditors advanced *in rem* claims against the vessel. Also in August 2018, another creditor of the debtor, "BBC", commenced *in rem* proceedings in the Federal Court asserting a claim against the Turbine Control Centre ("TCC"), which was associated with the submerged turbines. That equipment was also arrested pursuant to a Federal

Court warrant. On November 1, 2018, the Federal Court granted default judgment in favour of BBC and ordered the sale of the TCC (see case summary immediately above). Justice Wood was prepared to grant the initial order and charging order on the terms proposed, subject to his decision on the scope of the temporary stay. Justice Wood noted that cases that dealt with the relationship between superior courts exercising bankruptcy jurisdiction and the Federal Court's maritime law jurisdiction, also applied to some extent in proceedings under the *CCAA*. Wood J. held that the Federal Court continued to have jurisdiction over the *in rem* claims advanced by the respondents and that the Nova Scotia Supreme Court should not issue the equivalent of an anti-suit injunction preventing the Federal Court from dealing with those claims. Justice Wood held that the *in rem* claims of the respondents being advanced in the Federal Court were exempt from the stay created by the initial order with a request to the Federal Court for aid and recognition. It would then be up to the Federal Court to determine whether it should stay the *in rem* claims and, if so, on what terms: *Re OpenHydro Technology Canada Ltd.*, 2018 CarswellNS 861, 2018 NSSC 283 (N.S. S.C.).

(9) — *Mechanics' and Construction Lien Holders*

A mechanic or construction lien holder who holds a lien against the property of an owner who has become bankrupt is a secured creditor: *Re Rockland Chocolate & Cocoa Co.* (1921), 1 C.B.R. 452, 61 D.L.R. 363, 50 O.L.R. 66 (S.C.); *Re Victoria Bed & Mattress Co.* (1960), 1 C.B.R. (N.S.) 175, 24 D.L.R. (2d) 414 (B.C. S.C.); *Re Panver Const. Ltd.* (1987), 62 C.B.R. (N.S.) 222, 57 O.R. (2d) 758, 23 C.L.R. 233, 34 D.L.R. (4th) 316 (S.C.); *Pisiak v. Dyck* (1986), 63 C.B.R. (N.S.) 151, 32 D.L.R. (4th) 287, 56 Sask. R. 107 (Q.B.); *Dufferin-Custom Concrete v. Carting / Maplehurst Developments Inc.* (1993), 22 C.B.R. (3d) 67, 1993 CarswellOnt 239 (Ont. Gen. Div.); *561861 Ontario Ltd. v. 1085043 Ontario Inc.* (1999), 15 C.B.R. (4th) 146, 49 C.L.R. (2d) 143, 1999 CarswellOnt 2227 (Ont. Gen. Div.). Similarly, a sub-contractor who has a mechanic's or construction lien on the property of the bankrupt is a secured creditor: *Re NsC Diesel Power Inc.* (1990), 79 C.B.R. (N.S.) 1, 97 N.S.R. (2d) 295, 258 A.P.R. 295, 1990 CarswellNS 33 (T.D.).

A mechanics' or construction lien holder who has a lien on the property of an owner from whom the bankrupt is purchasing property but which has reverted to the owner is not a secured creditor. To be a secured claim, a lien must be a lien upon the property of the bankrupt: *Re Reeve-Dobie Mines Ltd. (No. 2)* (1921), 1 C.B.R. 540, 64 D.L.R. 534, 50 O.L.R. 499 (S.C.).

A mechanics' lien on oil and gas wells attaches only to the property on which the oil and gas wells are situate; it does not extend to the proceeds of the sale of the gas and oil from the wells. Accordingly, mechanics' lien holders with this kind of lien are not secured creditors with respect to proceeds of sale that have been paid into court prior to bankruptcy as a result of garnishees: *Halliburton Services Ltd. v. Snowhawk Energy Inc.* (1988), 70 C.B.R. (N.S.) 155, 57 Alta. L.R. (2d) 258, 89 A.R. 32 (Q.B.).

In *Roscoe Enterprises Ltd. v. Wasscon Construction Inc.* (1998), 161 D.L.R. (4th) 725, 1998 CarswellSask 463 (Sask Q.B.), prior to bankruptcy, the debtor paid money into court to remove a mechanic's lien. The lien was satisfied, leaving a substantial sum of money in court. The court held that unpaid mechanics' lienholders were not secured creditors with respect to the money paid into court but that the money was the property of the bankrupt and hence should be paid to the trustee in bankruptcy.

Where a bankrupt is a contractor, the owner of the property on which the work is being performed must retain the statutory holdback for mechanics' lienholders. Although the lienholders are not secured creditors of the bankrupt estate, they have a charge on the holdback, and the trustee in bankruptcy of the contractor is only entitled to the balance (if any) after the liens are discharged. The legal position is not changed by the fact that the holdback has been paid into court: *Forsythe Estate (Trustee of) v. Southport Home Centre Ltd.* (2000), 22 C.B.R. (4th) 71, 2000 PESCTD 104, 197 Nfld. & P.E.I.R. 183, 591 A.P.R. 183, 2000 CarswellPEI 112 (P.E.I. T.D.).

Where the bankrupt is a contractor and liens have been registered by subcontractors and the owner has paid money into court to remove the liens, the money paid into court is not the property of the bankrupt. When the money is paid into court, the liens are not discharged. They cease to attach to the land and holdback but attach instead to the money paid into court: *D & K Horizontal Drilling (1998) Ltd. (Trustee of) v. Alliance Pipeline Ltd.* (2002), 33 C.B.R. (4th) 217, 2002 CarswellSask 168, 216 Sask. R. 199, 2002 SKQB 86, [2002] 6 W.W.R. 497 (Sask. Q.B.), affirmed (2002), 39 C.B.R. (4th) 201, 2002 CarswellSask 825, 2002 SKCA 145, [2003] 4 W.W.R. 29, 227 Sask. R. 250, 287 W.A.C. 250 (Sask. C.A.). If, after the liens are paid in full, there is a surplus, the surplus will be subject to the claims of unpaid creditors who supplied labour and materials to the project: see *ante* F§17 "Trust Fund Provisions of the Mechanics' and Construction Lien Acts".

A receiver manager, in administering a receivership, became aware of builders' lien claims against the interests of the debtor companies. The Court held that while the bank had properly registered its security, s. 22(2) of the Saskatchewan *Builders' Lien Act* gave the lienholders priority over the bank security. The Court noted that the receiver's failure to make an accounting of inventory at the time of its appointment did not extinguish or nullify the lienholders' priority: *KNC Holdings Ltd. v. FTI Consulting Canada Inc.*, 2016 CarswellSask 714, 41 C.B.R. (6th) 267, 2016 SKQB 349 (Sask. Q.B.).

The Ontario Court of Appeal considered the issue of whether the funds owing to or received by a bankrupt contractor and impressed with a statutory trust created by s. 8(1) of the *Construction Lien Act*, R.S.O. 1990, c. C.30 (*CLA*) [now the *Construction Act*, effective 2017] were excluded from distribution to the contractor's creditors, pursuant to s. 67(1)(a) *BIA*. The debtor was deemed bankrupt in 2014. The bankruptcy judge directed the receiver to establish a "paving projects account" and a general post-receivership account, without prejudice to the existing

rights of any party. While the receiver commingled the trust funds received from four projects, the allocation of the funds to each specific project was identifiable because of the receiver's careful accounting. The Court of Appeal cited *British Columbia v. Henfrey Samson Belair Ltd.*, 1989 CarswellBC 711, [1989] 2 S.C.R. 24, [1989] S.C.J. No. 78 (S.C.C.), which held that Parliament only intended s. 67(1)(a) *BIA* to apply to trusts arising under general principles of law, namely trusts that meet the three certainties: certainty of intention, certainty of subject matter, and certainty of object. Section 8(1) *CLA* provides that the amounts in ss. 8(1)(a) and (b) "constitute a trust fund" and s. 8(2) establishes that the contractor or subcontractor "is the trustee of the trust fund created by subsection (1)." Section 8(2) also imposes a statutory trust obligation on the contractor or subcontractor not to appropriate or convert any part of the trust fund until all subcontractors and suppliers have been fully paid for their work. The *CLA* scheme protects subcontractors who are vulnerable due to their lack of privity of contract with the owner who benefits from the improvements they perform. Holdbacks require the owner and other contractors to withhold payments in order to ensure that funds are available to pay subcontractors and suppliers. Liens give subcontractors and suppliers the right to assert a claim directly against the property they have improved. The purpose of s. 8 is to impress money owing to or received by contractors or subcontractors with a statutory trust, a form of security, to ensure payment of suppliers to the construction industry. The trust must be seen as an integral part of the scheme of holdbacks, liens and trusts, designed to protect the rights and interests of those engaged in the construction industry and to avoid the unjust enrichment of those higher up the construction pyramid. That purpose exists outside the bankruptcy context. As valid provincial legislation, the *CLA* benefits from a presumption of constitutionality and should be interpreted to avoid conflict with federal legislation where possible. The Court held that it is appropriate to look to provincial statutory law to determine whether a trust satisfies the three certainties. Section 72 of the *BIA* contemplates the integration of the *BIA* with provincial legislation by providing that the *BIA* "shall not be deemed to abrogate or supersede the substantive provisions of any other law or statute relating to property or civil rights that are not in conflict" demonstrates that Parliament intends provincial law to continue to operate in the bankruptcy and insolvency context unless it is inconsistent with the *BIA*. The *CLA* trust does not frustrate the purpose of the *BIA*. To allow s. 8(1) *CLA* trust funds to be distributed to creditors of a bankrupt contractor would provide an "unexpected and unfair windfall" to those creditors. Section 8(1) imposes a deemed statutory trust rather than merely create a statutory trust obligation on the contractor to hold money on trust in a separate account. The s. 8(1) trust is imposed from the time the moneys are owed to the contractor, not just after they are received. Accordingly, the fact that ss. 8(1) and (2) did not require the segregation of amounts received is not determinative because the statute itself, not the act of complying with a statutory obligation to segregate funds, created the trust. The commingling of *CLA* funds from various projects does not mean that the required certainty of subject matter was not present because the funds remained identifiable and traceable. The Court allowed the appeal, set aside the order below and made an order that the funds at issue satisfy the requirements for a trust at law and so were not property of the debtor available for to creditors: *The Guarantee Company of North America v. Royal Bank of Canada*, 2019 CarswellOnt 300, 2019 ONCA 9 (Ont. C.A.).

(10) — *Municipality's Lien for Unpaid Taxes*

A municipality that has a lien for overdue taxes on real property is a secured creditor and does not have to obtain leave under s. 69.4 to enforce its lien. It may proceed to follow the steps set out in provincial legislation for enforcement of the lien and, if the taxpayer does not pay the arrears, to have the property transferred into its name as owner: *Condominium Plan No. 762 0380 v. Edmonton (City)* (2001), 24 C.B.R. (4th) 9, 2001 CarswellAlta 155, 2001 ABQB 97, [2001] 6 W.W.R. 316, 90 Alta. L.R. (3d) 229, 284 A.P.R. 62 (Alta. Q.B.); *Re Perrette Inc., (sub nom. Perrette Inc. (Proposition concordataire de))*, 2000 CarswellQue 610, 24 C.B.R. (4th) 268, [2000] R.J.Q. 1300, [2000] R.D.F.Q. 61, [2001] G.S.T.C. 99 (Que. S.C.).

Insolvent debtor energy companies were placed into receivership, and, subsequently, bankruptcy. Three municipalities sought a priority for tax arrears under the *BIA*. The municipalities were three of six municipalities through which a pipeline operated by the debtor passes. The municipalities did not advance claims as secured creditors, although served with notice. The receiver distributed all the recovered funds to the secured creditors, with no funds remaining. The Alberta Court of Appeal held that the mere fact that the funds have been distributed by the receiver does not render moot an appeal of the order authorizing the distribution. The taxation provisions of the *Municipal Government Act*, R.S.A. 2000, c. M-26 (*MGA*) are tax arrears and the issue was whether the special lien for linear property tax arrears is a secured claim for purposes of the *BIA*. The *MGA* defines linear property as electric power systems, street light systems, telecommunication systems, pipelines, railway property, and wells. The Court held that when the *MGA* provisions are read in their ordinary and grammatical sense and in the context of the scheme of the *Act*, it is apparent that the lien provision does not encompass linear property. The appeal was dismissed: *Northern Sunrise County v. Virginia Hills Oil Corp* (2019) 2019 CarswellAlta 236, 2019 ABCA 61, 67 C.B.R. (6th) 8 (Alta C.A.).

(11) — *Negotiable Instrument Holder*

For voting by a holder of a negotiable instrument, see *ante* G§10 "Creditor with a Claim on a Bill or Promissory Note on Which the Bankrupt is Secondarily Liable".

Section 2(1) provides that "secured creditor" includes a person whose claim is based upon or secured by a negotiable instrument held as collateral security and on which the debtor is only secondarily liable. Where a debtor has endorsed customers' notes and discounted them to its bank as security for the amount owing by the debtor to the bank, the bank is a secured creditor: *Re Hayes* (1934), 16 C.B.R. 10, 7 M.P.R. 535 (P.E.I. S.C.).

(12) — *Real Estate Agent*

A real estate agent who has arranged a sale of the bankrupt's house prior to bankruptcy is not a secured creditor for the amount owing to him or her, even though the sale of the property is completed by the trustee in bankruptcy: *Re Bertrand* (1981), 40 C.B.R. (N.S.) 64 (Que. S.C.). See *ante* F§5 "Trust Property — (5) Express Trusts" for trust claims with respect to real estate agents.

(13) — *Ship Owner's Lien*

If the owner of a vessel charters a vessel to a debtor and the charter provides that the owner will have a lien against cargoes if the hire is not paid, in the bankruptcy of the debtor the owner is a secured creditor for the amount owing for the hire of the vessel with respect to the property of the bankrupt stowed on board the vessel. The term "cargo" as used in the charter contract was held not to be restricted to goods that were carried for hire but included goods of the bankrupt stowed on board the vessel and carried for the bankrupt's own use: *Cooper & Lybrand Ltd. v. Centennial Towing Ltd.* (1980), 35 C.B.R. (N.S.) 211, 22 B.C.L.R. 96 (S.C.).

(14) — *Airport Authorities and Air Navigation Services*

In *Re Canada 3000 Inc.* (2004), 2004 CarswellOnt 149, 3 C.B.R. (5th) 207, (*sub nom. Greater Toronto Airports Authority v. International Lease Finance Corp.*) 69 O.R. (3d) 1, 183 O.A.C. 201, 235 D.L.R. (4th) 618 (Ont. C.A.), additional reasons at (2004), 2004 CarswellOnt 1915, 3 C.B.R. (5th) 288, (*sub nom. Canada 3000 Inc. (Bankrupt), Re*) 186 O.A.C. 116 (Ont. C.A.), the court considered whether the seizure and detention rights of the airport authorities and the operator of Canada's Civil Air Navigation System (NAV Canada) gave them priority over lessors of aircraft to the bankrupt airlines. Under the *Civil Air Navigation Services Commercialization Act* (*CANSCA*), the owners and operators of aircraft are jointly and severally liable for payment of air navigation services, and `owner' includes a person in whose name an aircraft is registered. It was held that the word 'owner' does not include the holder of the legal title where the aircraft has been leased under a true lease. The bankrupt was the registered owner of the aircraft, and the responsibility for the unpaid charges did not lie with the lessors.

Based on the plain meaning of s. 9 of the *Airports Act,* it was not possible to say that Parliament intended to create a lien in favour of the airport authorities in priority to the rights of the lessors as it was not so provided in clear in an unambiguous language.

The remedies created under the detention provisions of both statutes do not create rights in the aircraft that ranked in priority to the interests of the lessors or precluded the exercise by the lessors of their contractual rights to repossession.

The Supreme Court of Canada held that in dealing with aircraft flown in and out of jurisdictions under complex lease arrangements, the only effective collection scheme is to render the aircraft

themselves available for seizure, and thereafter to let those interested in them, including legal titleholders, registered owners, sublessors and operators, to resolve their dispute about where the money is to come from to pay the debts due to the service providers. The detention remedy is against aircraft and their parts, irrespective of who is the ultimate owner of the aircraft and irrespective of any security interests in the aircraft and it is only a right of detention without a right to sell or dispose of the aircraft. No insolvency stay is applicable to the detention remedy where the bankruptcy trustee of the airline or the airline under restructuring claims no economic interest in the aircraft. A judge has wide discretion to grant the remedy and to alleviate the burden and potential unfairness of a detention amongst various owners of aircraft, subject only to the right of the authorities and NAV Canada to be paid in full. Parliament has left the door open for the motions judge to work out an arrangement that is fair and reasonable to all concerned, provided that the object and purpose of the remedy, to ensure the unpaid user fees are paid, is fulfilled: *NAV Canada c. Wilmington Trust Co.* (2006), 2006 CarswellQue 4890, 2006 CarswellQue 4891, (*sub nom. Canada 3000 Inc., Re*), 2006 SCC 24, [2006] S.C.J. No. 24 (*sub nom. Greater Toronto Airports Authority v. International Lease Finance Corp.*) 80 O.R. (3d) 558 (note), (*sub nom. Canada 3000 Inc., (Bankrupt), Re*),, 20 C.B.R. (5th) 1, 349 N.R. 1, [2006] 1 S.C.R. 865, 10 P.P.S.A.C. (3d) 66, 212 O.A.C. 338 (S.C.C.).

End of Document

(1)

1979 CarswellOnt 227
Ontario Supreme Court, In Bankruptcy

Windham Sales Ltd., Re

1979 CarswellOnt 227, [1979] 3 A.C.W.S. 487, 102 D.L.R. (3d) 459,
1 P.P.S.A.C. 73, 26 O.R. (2d) 246, 31 C.B.R. (N.S.) 130, 8 B.L.R. 317

RE WINDHAM SALES LIMITED

Henry J.

Heard: September 6, 1979
Judgment: September 6, 1979
Docket: No. 07939

Counsel: *K. R. Dore*, for trustee.
M. Slan, for respondent creditor G. McConnell.

Subject: Corporate and Commercial; Insolvency; Property
Related Abridgment Classifications
Personal property security
I Nature and scope of legislation
I.3 Guarantees
Personal property security
IV Priority of security interest
IV.6 Security interests versus other interests
IV.6.a Under federal law
IV.6.a.ii Trustee in bankruptcy
Headnote
Bankruptcy --- Priorities of claims — Secured claims — Loss of secured status — Effect of P.P.S.A
Personal Property Security --- Perfection of security interest — Registration
Personal Property Security --- Priority of security interest — Security interests versus other interests — Under federal law — Trustee in bankruptcy
Secured creditors — Kinds of security — Chattel mortgages — Chattel mortgage in favour of bank securing loan — Security properly registered — Loan paid off by guarantor — Subsequent bankruptcy of borrower — Guarantor standing in place of original creditor — The Personal Property Security Act.
The debtor borrowed money from the bank which was secured by a chattel mortgage, given by the debtor in November 1977, in respect of which a financing statement was properly registered under the Personal Property Security Act. The loan was guaranteed by M. The debtor defaulted on his obligation to the bank in September 1978, and the guarantor paid off the loan. In December 1978 the debtor filed an assignment in bankruptcy. On the following day a financing change statement was filed reflecting the interest of the guarantor in the security agreement by way of assignment from the bank.
Held:
The security by way of chattel mortgage of the personal property in question had priority over the trustee's interest, and M. was a secured creditor to the extent of the amount of the payments he had made pursuant to the guarantee. Upon implementation of the guarantee, the guarantor stood in the place of the original creditor without the necessity of any formal transfer of any security interest to the guarantor. The guarantor, prior to the bankruptcy, had acquired by payment under the guarantee the same interest as the bank had in the security. The security interest having been properly protected by due registration of the original financing statement under the Personal Property Security Act, the guarantor was therefore protected in respect of this interest by that registration, his payment under the guarantee and the effect of the Mercantile Law Amendment Act. He was not obliged

to register the financing change statement (which is optional and not mandatory), since the perfected security interest at no time ceased to be perfected.

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Cases considered:

Jamieson v. Hotel Renfrew Trustees, [1941] 4 D.L.R. 470 (Ont.) — *applied*

Re Pathe Frères Phonograph Co. of Can.; Ex parte U.S. Fidelity & Guar. Co. (1921), 50 O.L.R. 644, 2 C.B.R 21, 64 D.L.R. 628 — *applied*

Statutes considered:

Personal Property Security Act, R.S.O. 1970, c. 344, s. 48(1) [re-en. 1973, c. 102, s. 9].

Mercantile Law Amendment Act, R.S.O. 1970, c. 272, s. 2.

Application by trustee for advice and directions relative to question of priorities between guarantor paying off chattel mortgage and trustee.

***Henry J.* (orally):**

1 The trustee applies in effect for advice and directions as to whether a security agreement duly registered under the Personal Property Security Act, R.S.O. 1970, c. 344, takes priority over the interest of the trustee.

2 The facts are not in dispute. The debtor, now the bankrupt, borrowed money from the Royal Bank of Canada which was secured by chattel mortgage, given by the debtor on 4th November 1977, in respect of which a financing statement was properly registered under the Personal Property Security Act. The loan was guaranteed by the respondents herein, Glenn McConnell and Isabel McConnell. The debtor defaulted on his obligation to the bank on 11th September 1978, and the guarantors paid off the loan. On 6th December 1978 the debtor made an assignment in bankruptcy. On the following day a financing change statement was filed, as is permitted by s. 48 (1) [re-en. 1973, c. 102, s. 9] of the Personal Property Security Act, reflecting the interest of the guarantors in the security agreement by way of assignment from the bank. I say, at once, that this registration, which is optional and not mandatory, does not affect the issue before me.

3 The real issue, as Mr. Dore acknowledges, is whether the bank's interest devolved upon the guarantors when payment was made. If it did, that event occurred before the bankruptcy and would be binding on the trustee. The trustee has brought the application mainly, as I understand it, because of uncertainty as to whether it was necessary for the McConnells, upon implementing the guarantee, to call for a formal assignment in writing of the chattel mortgage by the bank to themselves. There was in fact no such assignment.

4 Section 2 of the Mercantile Law Amendment Act, R.S.O. 1970, c. 272, provides as follows:

> 2. — (1) Every person who, being surety for the debt or duty of another or being liable with another for any debt or duty, pays the debt or performs the duty is entitled to have assigned to him, or to a trustee for him, every judgment, specialty or other security that is held by the creditor in respect of the debt or duty, whether the judgment, specialty or other security is or is not deemed at law to have been satisfied by the payment of the debt or the performance of the duty.
>
> (2) Such person is entitled to stand in the place of the creditor, and to use all the remedies and, on proper indemnity, to use the name of the creditor in any action or other proceeding in order to obtain from the principal debtor, or any co-surety, co-contractor or co-debtor, indemnification for the advances made and loss sustained by such person, and the payment or performance made by him is not a defence to such action or other proceeding by him.

5 The law appears to be well settled that upon implementation of the guarantee in a situation such as that before me the guarantor stands in the place of the original creditor without the necessity of any formal transfer of any security interest to the guarantor. It appears to me that this must be the effect of subs. (2): see *Re Pathe Frères Phonograph Co. of Can.; Ex parte U.S. Fidelity & Guar. Co.* (1921), 50 O.L.R. 644, 2 C.B.R. 21, 64 D.L.R. 628, and *Jamieson v. Hotel Renfrew Trustees*, [1941] 4 D.L.R. 470 (Ont.).

6 In the circumstances I am of the opinion that prior to the bankruptcy the guarantors, Mr. and Mrs. McConnell, acquired by payment under the guarantee the same interest as the bank had in the security. That security interest had been properly perfected by due registration of the original financing statement under the Personal Property Security Act. The guarantors were therefore protected in respect of this interest by that registration, their payment under the guarantee, and the effect of the Mercantile Law Amendment Act. While they might have done so, they were not obliged to register the financing change statement, since the perfected security interest at no time ceased to be perfected.

7 The trustee is therefore directed to regard the security by way of chattel mortgage of the personal property in question as having priority over the trustee's interest and Mr. and Mrs. McConnell as secured creditors to the extent of the amount of the payment they have made pursuant to the guarantee.

8 Prior to this application coming before me the trustee and the McConnells very properly agreed that the trustee should sell the chattels constituting the security, and the trustee at present holds the proceeds of the sale pending the direction of the court as to their disposition. They will, of course, be paid over to Mr. and Mrs. McConnell after the trustee has deducted the costs and expenses he has incurred in liquidating the chattels. Counsel have indicated that they do not see any difficulty in agreeing on the amount of these costs and expenses.

9 The respondents will have their costs of this application to be paid by the trustee out of the estate, which are hereby fixed at the amount of $150. The trustee also is entitled to his costs to be paid out of the assets of the estate.

Chattel mortgage securing loan properly registered. Guarantor paying off loan entitled to protection of security.

(8)

2011 ABCA 314
Alberta Court of Appeal

Alberta Treasury Branches v. Weatherlok Canada Ltd.

2011 CarswellAlta 1883, 2011 ABCA 314, [2012] A.W.L.D. 1735, [2012] A.W.L.D. 1737, [2012] A.W.L.D. 1738, [2012] A.W.L.D. 1739, [2012] A.W.L.D. 1775, 210 A.C.W.S. (3d) 52, 343 D.L.R. (4th) 304, 515 A.R. 148, 532 W.A.C. 148, 68 Alta. L.R. (5th) 400

Mark Wesley Trinier also known as Mark Trinier and Deborah Ellen Trinier also known as Debbie Trinier, Appellants (Defendants) and Donald Shurnaik and Debbie Shurnaik, Respondents (Defendants) and Alberta Treasury Branches, Not a Party to the Appeal (Plaintiff) and Weatherlok Canada Inc., Not a Party to the Appeal (Defendant)

Jean Côté, Marina Paperny, R. Paul Belzil JJ.A.

Heard: September 7, 2011
Judgment: November 4, 2011 *
Docket: Edmonton Appeal 1103-0033-AC

Proceedings: reversing *Alberta Treasury Branches v. Weatherlok Canada Ltd.* (2011), 2011 ABQB 15, 2011 CarswellAlta 17 (Alta. Q.B.); additional reasons at *Alberta Treasury Branches v. Weatherlok Canada Ltd.* (2011), 2011 ABCA 360, 2011 CarswellAlta 2473 (Alta. C.A.)

Counsel: N.D. Anderson for Appellants
G.J. Lintz for Respondents

Subject: Civil Practice and Procedure; Corporate and Commercial
Related Abridgment Classifications
Civil practice and procedure
XVII Default proceedings
XVII.2 Judgment following default
XVII.2.a By signing default judgment
Civil practice and procedure
XXIV Costs
XXIV.7 Particular orders as to costs
XXIV.7.e Costs on solicitor and client basis
XXIV.7.e.i General principles
Civil practice and procedure
XXIV Costs
XXIV.10 Costs of particular proceedings
XXIV.10.t Miscellaneous
Guarantee and indemnity
IV Practice and procedure
IV.1 Guarantee
IV.1.h Costs
Headnote
Civil practice and procedure --- Costs — Particular orders as to costs — Costs on solicitor and client basis — General principles

Plaintiff creditor brought action against T defendants and S defendants on their personal guarantees of company debt — T defendants paid full debt and took assignment of plaintiff's default judgment against S defendants — Guarantee included provision for payment of solicitor-client costs, which were part of assigned judgment debt — Taxing officer awarded solicitor-client costs of proceedings to enforce judgment debt — Appeal by S defendants was allowed on basis that assignment of default judgment and debt did not include right to solicitor-client costs — Costs award was overturned — T defendants appealed — Appeal allowed — There was contractual right to solicitor-client costs — Guarantee, loan agreements and assignment were drafted in wide terms, and provided for solicitor-client costs — Assignment contained power of attorney clause which empowered T defendants to do all matters in relation to judgment that plaintiff could do — Court proceedings were against guarantors — Statement of claim recited terms of note and loan agreements which provided for solicitor-client costs — Costs incurred by T defendants in trying to collect from S defendants were incurred under all financial documents — Default judgment taxed solicitor-client costs against S defendants — Since T defendants were paying guarantors, they had every remedy which creditor had against other guarantors — Decision of previous judge clearly stated that costs were to be on solicitor-client basis — Solicitor-client costs were available on default judgment.

Guarantee and indemnity --- Practice and procedure — Guarantee — Liability for costs

Plaintiff creditor brought action against T defendants and S defendants on their personal guarantees of company debt — T defendants paid full debt and took assignment of plaintiff's default judgment against S defendants — Guarantee included provision for payment of solicitor-client costs, which were part of assigned judgment debt — Taxing officer awarded solicitor-client costs of proceedings to enforce judgment debt — Appeal by S defendants was allowed on basis that assignment of default judgment and debt did not include right to solicitor-client costs — Costs award was overturned — T defendants appealed — Appeal allowed — There was contractual right to solicitor-client costs — Guarantee provided for solicitor-client costs, and was assigned — Assignment contained power of attorney clause which empowered T defendants to do all matters in relation to judgment that plaintiff could do — Court proceedings were against guarantor — Statement of claim recited terms of note and loan agreements which provided for solicitor client costs — Default judgment taxed solicitor-client costs against S defendants — Since T defendants were paying guarantors, they had every remedy which creditor had against other guarantors — Costs incurred by T defendants in trying to collect from S defendants were incurred under loan documents, guarantee and assignment.

Civil practice and procedure --- Default proceedings — Judgment following default — By signing default judgment — General principles

Costs — Plaintiff creditor brought action against T defendants and S defendants on their personal guarantees of company debt — T defendants paid full debt and took assignment of plaintiff's default judgment against S defendants — Guarantee included provision for payment of solicitor-client costs, which were part of assigned judgment debt — Taxing officer awarded solicitor-client costs of proceedings to enforce judgment debt — Appeal by S defendants was allowed on basis that assignment of default judgment and debt did not include right to solicitor-client costs — Costs award was overturned — T defendants appealed — Appeal allowed — There was contractual right to solicitor-client costs — Guarantee provided for solicitor-client costs — Costs incurred by T defendants in trying to collect from S defendants were incurred under loan documents, guarantee and assignment — Decision of previous judge clearly stated that costs were to be on solicitor-client basis — Previous proceedings were proper — Solicitor-client costs were available on default judgment — Default judgment taxed solicitor-client costs against S defendants — Clerk of court had clear power to grant judgment for any liquidated claim pleaded after default.

Civil practice and procedure --- Costs — Costs of particular proceedings — Miscellaneous

Default judgment — Plaintiff creditor brought action against T defendants and S defendants on their personal guarantees of company debt — T defendants paid full debt and took assignment of plaintiff's default judgment against S defendants — Guarantee included provision for payment of solicitor-client costs, which were part of assigned judgment debt — Taxing officer awarded solicitor-client costs of proceedings to enforce judgment debt — Appeal by S defendants was allowed on basis that assignment of default judgment and debt did not include right to solicitor-client costs — Costs award was overturned — T defendants appealed — Appeal allowed — There was contractual right to solicitor-client costs — Guarantee provided for solicitor-client costs — Costs incurred by T defendants in trying to collect from S defendants were incurred under loan documents, guarantee and assignment — Decision of previous judge clearly stated that costs were to be on solicitor-client basis — Previous proceedings were proper — Solicitor-client costs were available on default judgment — Default judgment taxed solicitor-client costs against S defendants — Clerk of court had clear power to grant judgment for any liquidated claim pleaded after default.

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British American Co. v. Law & Co. (1892), 21 S.C.R. 325, 1892 CarswellNS 84 (S.C.C.) — referred to

Brown v. Coughlin (1914), 28 D.L.R. 437, 50 S.C.R. 100, 1914 CarswellOnt 423 (S.C.C.) — referred to

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Dykes v. Goczan (1996), 38 Alta. L.R. (3d) 425, 49 C.P.C. (3d) 306, 188 A.R. 352, 1996 CarswellAlta 279 (Alta. Q.B.) — considered

Elliott v. Hill Bros. Expressways Ltd. (1999), 1999 CarswellAlta 138, 41 M.V.R. (3d) 142, 232 A.R. 258, 195 W.A.C. 258 (Alta. C.A.) — referred to

Hill v. Stephen Motor & Aero Co. (1929), 1929 CarswellSask 47, 23 Sask. L.R. 552, [1929] 3 D.L.R. 676, [1929] 2 W.W.R. 97 (Sask. C.A.) — referred to

Hillas & Co. v. Arcos Ltd. (1932), 43 Ll. L. Rep. 359, [1932] UKHL 2, [1932] All E.R. Rep. 494, 147 L.T. 503, 38 Com. Cas. 23 (U.K. H.L.) — referred to

Johnson, Re (1957), 8 D.L.R. (2d) 221, 1957 CarswellSask 16, 21 W.W.R. 289 (Sask. C.A.) — referred to

Klinck v. Drinnan (1985), 1985 CarswellAlta 246, 41 Alta. L.R. (2d) 299, 66 A.R. 321 (Alta. Q.B.) — referred to

McElroy v. Cowper-Smith (1967), [1967] S.C.R. 425, 60 W.W.R. 85, 1967 CarswellAlta 36, 62 D.L.R. (2d) 65 (S.C.C.) — followed

Mills v. Dunham (1891), [1891] 1 Ch. 576, 39 W.R. 289, 7 T.L.R. 238, 60 L.J. Ch. 362 (Eng. C.A.) — referred to

R. v. Frontenac Gas Co. (1915), 1915 CarswellNat 46, (sub nom. *Quebec, Jacques Cartier Electric Co. v. R.)* 51 S.C.R. 594, 24 D.L.R. 424 (S.C.C.) — considered

Robinson v. Fiesta Hotel Group Resorts (2008), 2008 ABQB 311, 2008 CarswellAlta 732, 91 Alta. L.R. (4th) 158, 450 A.R. 167, [2008] 12 W.W.R. 152 (Alta. Q.B. [In Chambers]) — referred to

Royal Bank v. Fox (1975), (sub nom. *Standard Brands Ltd. v. Fox)* [1976] 2 S.C.R. 2, 6 N.R. 382, 59 D.L.R. (3d) 258, (sub nom. *Fox v. Royal Bank)* 13 N.S.R. (2d) 176, 1975 CarswellNS 34, 1975 CarswellNS 34F (S.C.C.) — referred to

Royal Trust Corp. of Canada v. Rick Holdings Ltd. (1999), 250 A.R. 156, 213 W.A.C. 156, 1999 CarswellAlta 591, 1999 ABCA 187 (Alta. C.A.) — referred to

Schwartz v. Longview Motel & Saloon Corp. (1994), 1994 CarswellAlta 80, 18 Alta. L.R. (3d) 358, (sub nom. *Schwartz v. Stinchcombe)* 152 A.R. 241 (Alta. Q.B.) — referred to

Smith v. McPherson (1921), 51 O.L.R. 457, 69 D.L.R. 477 (Ont. C.A.) — referred to

Spiller v. Brown (1973), [1973] 6 W.W.R. 663, 43 D.L.R. (3d) 140, 1973 CarswellAlta 99 (Alta. C.A.) — followed

Standish Hall Hotel Inc. v. R. (1962), 35 D.L.R. (2d) 140, 1962 CarswellNat 298, [1963] S.C.R. 64 (S.C.C.) — referred to

Sulef v. Parkin (1966), 1966 CarswellAlta 49, 57 W.W.R. 236 (Alta. C.A.) — followed

Syncrude Canada Ltd. v. Tibo Steel Products Ltd. (2001), 2001 ABQB 478, 2001 CarswellAlta 741, 292 A.R. 368 (Alta. Q.B.) — referred to

Thimer v. Alberta (Workers' Compensation Board Appeals Commission) (2000), 2000 CarswellAlta 1111, 2000 ABQB 706, 89 Alta. L.R. (3d) 353, 31 Admin. L.R. (3d) 281, 276 A.R. 236 (Alta. Q.B.) — referred to

Wright v. Murray Rosen Professional Corp. (2005), 2005 ABCA 116, 2005 CarswellAlta 332 (Alta. C.A.) — referred to

Yaremchuk v. Haight (2001), 8 M.V.R. (4th) 12, 6 C.P.C. (5th) 112, 89 Alta. L.R. (3d) 311, 2001 ABCA 7, 2001 CarswellAlta 28, 277 A.R. 160, 242 W.A.C. 160 (Alta. C.A.) — referred to

Statutes considered:

Vendors' and Mortgagees' Costs Exaction Act, R.S.A. 1955, c. 357

Generally — referred to

Rules considered:

Alberta Rules of Court, Alta. Reg. 390/68

Generally — referred to

R. 142(1)(a) — referred to

R. 149(1) — referred to

R. 318 — referred to

R. 319 — referred to

R. 321(2) — referred to

R. 321(3) — referred to

R. 327 — referred to

R. 548 — referred to

R. 605(1) — referred to

APPEAL by paying co-guarantors from judgment reported at *Alberta Treasury Branches v. Weatherlok Canada Ltd.* (2011), 2011 ABQB 15, 2011 CarswellAlta 17 (Alta. Q.B.), setting aside order for solicitor-client costs.

***Jean Côté J.A.*:**

A. Introduction

1 The issues here revolve about entitlement to solicitor-client costs after default judgment, and settling and entering formal orders. The respondents and the chambers judge under appeal have raised a number of procedural grounds for objecting to such costs and those orders.

2 The biggest surprise of civil litigation befalls lay people who learn that their real troubles often begin after they win. Collecting on a judgment is often frustrating, even if the debtor has assets. Soon this suit will be eight years old, yet the successful appellants still have achieved limited progress.

B. Facts

3 The appellants and the respondents are two couples who guaranteed the Treasury Branches' loan to a private company. The company did not pay, so the creditor Treasury Branches sued all of them. The respondents neither paid nor defended. So the Treasury Branches signed default judgment against the respondents.

4 Over seven years ago, the appellants paid off the Treasury Branches and got an assignment from it. In the document, the Treasury Branches expressly assigned both its default judgment against the respondents, and also the costs (present or future), and the moneys recoverable. Since the appellants had paid the whole debt and not merely their proportionate share, they moved for contribution from the respondents; i.e. reimbursement of the excess.

5 That post-judgment litigation has limped since. The appellants appeal the latest order (with leave of the Queen's Bench chambers judge who made it).

C. The Latest Proceedings

6 The appeal is from an order whose formal portion reverses a decision of the taxing officer and reduces "costs" from solicitor-client to party-party. The formal order does not confine that costs reduction to any particular stage, nor to any particular issues. The chambers judge even gave some costs to the respondents (judgment debtors).

7 The underlying motion to the chambers judge was an appeal from the Clerk and Taxing Officer's decision of late 2009. The chambers judge heard argument in January and April 2010. His formal order is based on his written Reasons issued on January 10, 2011. They are cited as 2011 ABQB 15 (Alta. Q.B.). They conclude that the appellants were not entitled to solicitor-client costs, and set aside intermediate orders of another Queen's Bench judge giving solicitor-client costs. The Reasons do not purport to disturb the default judgment.

D. Benefit of the Contracts for Solicitor-Client Costs

8 The guarantee to the Treasury Branches is in evidence and calls for solicitor-client costs. That part is quoted toward the end of Part F below.

9 One part of the Reasons of the chambers judge finds no contractual right to solicitor-client costs. It so concludes on the basis that only the default judgment and the debt were assigned. The assignment does include costs present or future.

10 I respectfully disagree with that reasoning.

11 First, the assignment here contains a power of attorney clause. It expressly empowers the appellants to "do all acts matters and things in relation to the judgment as the [Treasury Branches] could do." That widens the assignment and fully links it to the loan documents and to the guarantee.

12 The guarantee is in evidence (Ex C to December 12, 2009 affidavit). It expressly calls for solicitor-and-own-client costs (para 17). The guarantee is signed by both the appellants and the respondents, so the respondents cannot dispute the correctness or justness of solicitor-client costs. Nor is this a contract with strangers, so no assignment of it is necessary. (It is quoted below in Part F.)

13 The debtor company had no money, and the costs were incurred in the suit. That suit, the payment, the default judgment, and steps since, were all on the guarantee. The judgment and later steps were not against the company; the part of the suit against the company went nowhere, and incurred none of the costs. The court proceedings were against the guarantors. I respectfully suggest that that alone suffices to found all the solicitor-client costs in question here.

14 The statement of claim does recite the terms of the note and loan agreements between the plaintiff Treasury Branches and the company borrower (pp P1-P2). The statement of claim (p P2, para 8) recites that the borrower covenanted to pay "legal costs as between a solicitor and his own client on a full indemnity basis".

15 The statement of claim also recites (paras 9-10) that the appellants contracted to guarantee all that, and (paras 15-16, pp P3-P4) that the respondents also guaranteed the whole indebtedness including "all costs, charges and expenses which may be incurred by the plaintiff in recovering any indebtedness ...". And the statement of claim's prayer expressly calls for solicitor-and-own-client costs (para (g), p P5). The defendants are the company, the appellants and the respondents.

16 So which document was assigned does not matter here, because all three documents give these higher costs.

17 The chambers judge's Reasons are critical of a statement to him by the appellants' counsel, that the underlying contracts ("financial documents") called for solicitor-client costs. Indeed the Reasons purport to upset an earlier order of the same judge because of that statement. But all the above shows that that statement by counsel was accurate.

E. Default Binds Respondents

18 Indeed the various covenants for solicitor-client costs are incontestible. The respondents did not defend, and default judgment was signed against them on April 21, 2004 (7-1/2 years ago). On its face, the default judgment taxes solicitor-client costs against the respondents.

19 In July 2005, the respondents applied to open up that judgment (AR pp P7-8) (and on September 21, 2006, says the appellants' factum, para 7). Argument (written and oral) concedes that the court never did open up the judgment, and it was never appealed. The respondents say that the opening up question was heard in October 2007. In any event, opening up has never happened, and no one suggests that it is going to happen or is still pending.

20 The body of the statement of claim recites what the loan documents say. The recitals are not evidence, but they became stronger than evidence after default judgment. A long line of authority holds that not filing a statement of defence constitutes an admission of the facts alleged in the statement of claim. Older English authority is cited in *Hill v. Stephen Motor & Aero Co.*, [1929] 2 W.W.R. 97 (Sask. C.A.), 98-99, which also adopts the proposition. Though at times some jurisdictions have had express Rules of Court on the topic, that is not necessary. See *Sulef v. Parkin* (1966), 57 W.W.R. 236 (Alta. C.A.), 239. And most cases cite no Rule saying that.

21 Supreme Court authority for the deemed admission is *McElroy v. Cowper-Smith*, [1967] S.C.R. 425 (S.C.C.), 428, (1967), 60 W.W.R. 85 (S.C.C.), 88. Its majority adopt statements to that effect by Spence J., dissenting on other grounds, who follows the Alberta Court of Appeal.

22 Alberta Court of Appeal authority for the deemed admission is *Brennan v. Arcadia Coal Co.*, [1929] 3 W.W.R. 446 (Alta. C.A.), 448, (1929), 24 Alta. L.R. 236 (Alta. C.A.); *Sulef v. Parkin*, *supra* (citing a 19th Century English textbook); and *Spiller v. Brown*, [1973] 6 W.W.R. 663 (Alta. C.A.), 666. There are similar *dicta* in *Yaremchuk v. Haight*, 2001 ABCA 7, 277 A.R. 160, 6 C.P.C. (5th) 112 (Alta. C.A.).

23 Alberta's Court of Queen's Bench has also held the same, adopting the defaulting defendant's deemed admission of the plaintiff's pleading: *Klinck v. Drinnan* (1985), 66 A.R. 321 (Alta. Q.B.), 325-36, (1985), 41 Alta. L.R. (2d) 299 (Alta. Q.B.) (paras 22-24) (citing much authority); *Schwartz v. Longview Motel & Saloon Corp.* (1994), 18 Alta. L.R. (3d) 358 (Alta. Q.B.), 385 (para 90); *Syncrude Canada Ltd. v. Tibo Steel Products Ltd.*, 2001 ABQB 478, 292 A.R. 368 (Alta. Q.B.), (citing much law); *Dykes v. Goczan* (1996), 188 A.R. 352 (Alta. Q.B.); *Robinson v. Fiesta Hotel Group Resorts*, 2008 ABQB 311, [2008] 12 W.W.R. 152, 450 A.R. 167 (Alta. Q.B. [In Chambers]), 172-73, (2008), 91 Alta. L.R. (4th) 158 (Alta. Q.B. [In Chambers]) (paras 10-12) (citing authority); *Dyck v. Wilkinson*, 2004 ABQB 731 (Alta. Q.B.), [2004] A.R. Uned 657, JDE 0103-01520 (para 9). A Master has held the same, in *AMHC v. Keith Empy Homes* (M July 22 '86) JDE 8603-07910, AUD (M) 109.

24 *Dykes v. Goczan*, *supra*, holds that contrary evidence by the defendant is inadmissible. The same thing is said in 16 *Hals. Laws of Eng.* § 1172-73 and 1559-1561 (4th ed), but in somewhat narrower circumstances than apply to the deemed admission.

25 I have not found any exceptions to the rule which are relevant here. I see no need to discuss here the exceptions, nor their scope, whether based on type of claim, relief sought, relevance of the pleading, or otherwise.

26 Furthermore, this default judgment does not say "costs to be taxed." An integral part of the judgment is an itemized and taxed bill of costs, and the judgment itself awards the bill's total amount. That amount is patently solicitor-client costs. The costs taxed and awarded there are far beyond Schedule C (i.e. beyond party-party costs). The services listed are lengthy and most bear no relation to the few services listed in Schedule C. Nor are any individual amounts from Schedule C (or for individual services) given. This is a solicitor-client bill of costs.

27 The chambers judge relied on *Arbitus Leasing Ltd. v. X-Zibit A Inc.*, 2006 ABQB 764, 405 A.R. 288 (Alta. Q.B.). Even if it were correct, it would be distinguishable here for two reasons. First, the face of the default judgment here awards solicitor-client costs. Second, where the statement of claim leading to the default judgment recites a covenant for solicitor-client costs, there is no room for any presumption that "costs" mean party-party costs, as explained above.

28 If a formal judgment is ambiguous, the taxing officer may look at the trial judge's Reasons for decision, in order to tax costs: *R. v. Frontenac Gas Co.* (1915), 51 S.C.R. 594 (S.C.C.), 598, 600. (That was a case about solicitor-client expenses.) Cf *Standish Hall Hotel Inc. v. R.* (1962), [1963] S.C.R. 64, 35 D.L.R. (2d) 140 (S.C.C.), 153. If a judgment gives a thing, that thing is not to be presumed then to be taken away by other words in the same judgment: Re *Smith*, *supra*, at p 480 (DLR). One cannot go back further behind the reasons: *Johnson, Re* (1957), 21 W.W.R. 289 (Sask. C.A.), 201.

29 Reasons for decision are to be read reasonably, generously, and not *contra proferentem*: *Elliott v. Hill Bros. Expressways Ltd.* (1999), 232 A.R. 258 (Alta. C.A.), 261 (para 18). Cf. 2 Williston and Rolls, *Law of Civil Procedure* 1046 (1970); Re *Smith v. McPherson* (1921), 51 O.L.R. 457 (Ont. C.A.) , 463, (1921), 69 D.L.R. 477 (Ont. C.A.), 480. That should apply to oral reasons too. Reasons are to be read as a whole, not in little isolated pieces: *Elliott v. Hill Bros. Expressways Ltd.*, *supra* at para 22 (and cf paras 23-27).

30 When there is an express covenant for solicitor-client costs, there is no reason to presume that a judgment does not speak of them.

F. Contribution Among Guarantors

31 Next, I will go beyond the particular technical objections recited above. I turn to substance, and to the general rules about contribution among co-guarantors. The assignment of judgment and debt here is not the only cause of action which the appellants had against the respondents (despite what the Reasons seem to imply).

32 If a guarantor pays the creditor the debt guaranteed (not merely the payor's proportionate share of it), the paying guarantor becomes subrogated to the rights of the creditor so paid: Goff & Jones, *The Law of Restitution*, paras 3-009, 3-025 (7th ed 2007); Maddaugh & McCamus, *The Law of Restitution*, 8-1, 8-2 (2d ed 2004); Fridman, *Restitution*, 403 (2d ed, 1992); *Royal Bank v. Fox* (1975), [1976] 2 S.C.R. 2 (S.C.C.), 7, (1975), 6 N.R. 382, 59 D.L.R. (3d) 258 (S.C.C.) .

33 That subrogation gives the paying guarantor every remedy, every security, and every means of payment which the creditor had against the other guarantors. That subrogation is automatic, and does not depend in any way on contracts, such as an assignment. See Fridman, *op cit. supra* at 402-03; Goff and Jones, *op cit. supra* at paras 3-025 and 3-027; *Brown v. Coughlin* (1914), 50 S.C.R. 100 (S.C.C.), 104; cf *Royal Trust Corp. of Canada v. Rick Holdings Ltd.*, 1999 ABCA 187, 250 A.R. 156 (Alta. C.A.), (para 2).

34 Besides, it is very doubtful that there is any gap or discrepancy here between the guarantee, the loan agreements, and the assignment. All are drafted in wide terms. Obviously the assignment is designed to give to the appellants the Treasury Branches' rights. And the guarantee is designed to enforce all the rights of the Treasury Branches under the loan. A contract should be interpreted to make it workable; it is not a penal statute for courts to construe narrowly and technically. See Burrows, *Interpretation of Documents* 92-94 (2d ed 1946); Broom, *Legal Maxims* 361-69 (10th ed 1939); *Hillas & Co. v. Arcos Ltd.* (1932), 147 L.T. 503 (U.K. H.L.), 514, [1932] UKHL 2 (U.K. H.L.); *British American Co. v. Law & Co.* (1892), 21 S.C.R. 325 (S.C.C.); *Mills v. Dunham*, [1891] 1 Ch. 576 (Eng. C.A.), esp. at 590, (1891), 60 L.J. Ch. 362 (Eng. C.A.).

35 What does the subrogation give here? To answer that, it is useful to look at the precise covenants to pay solicitor-client costs. One covenant in one loan and agreement (the General Security Agreement) was to pay

> all costs and expenses incurred ... **in connection with** any recovery action commenced ... including, without limitation, legal costs as between a solicitor and his own client on a full indemnity basis.
>
> (Statement of Claim, para 8, emphasis added)

The equivalent covenant in another loan agreement (the mortgage) called for:

> ... all costs and expenses incurred by the Plaintiff in respect of exercising or enforcing or attempting to enforce or in pursuance of any right, power, remedy or purpose thereunder, including, without limitation, legal costs as between a

> solicitor and his own client on a full indemnity basis and an allowance for the time, work and expenses of the Plaintiff or of any agent, solicitor, or servant of the Plaintiff.
>
> (Statement of Claim, para 14)

The guarantee contained the respondents' covenant to pay

> ... all costs, charges, and expenses (including, without limitation, lawyers' fees as between solicitor and his own client on a full indemnity basis) incurred by [the plaintiff] for the ... enforcement of this guarantee ...
>
> (December 12, 2009 affidavit, Ex C)

The appellants and the respondents are all direct original parties to the guarantee. They are bound by it, and can sue and benefit under it. It sets the extent of the obligations, and that expressly includes solicitor-client costs.

36 These covenants about costs are not against public policy. The *Vendors' and Mortgagees' Costs Exaction Act* was repealed by 1965 c 98.

37 The efforts and expenses of the appellants were expended to collect from guarantors on the guarantee. They were not incurred exclusively under the loan; the company (the principal debtor) obviously could not pay, and the steps in question here involved no futile attempts to get money from the company.

38 The topic is costs. The guarantee is to enforce the loan agreements, which were assigned. Given all that, it appears to me beyond doubt that costs incurred by the appellants in trying to collect from the respondents were incurred under all the documents (loan agreements, guarantee, and assignment).

G. Any Discretion?

39 It was argued before us that the chambers judge now appealed from had a "discretion" to deny solicitor-client costs. Given the covenants here, it is doubtful.

40 But even if a discretion existed as to certain items, there is no proper legal ground to exercise such a discretion here. No misconduct or sharp practice by the appellants is even alleged. They ultimately lost no step, in my view. They did not churn, and did not pursue trivia in order to incur huge solicitor-client costs. And most of the steps whose costs were in issue had already been the subject of previous costs decisions.

41 If there was any discretion as to costs, at best it was as to the costs of the "side issue" about contribution for the first $100,000 paid by the appellants before the suit. But any such discretion was that of the first judge (Lewis J.), not the (second) chambers judge now under appeal. So the second judge was not entitled to revisit that. And so even if he was, the Court of Appeal owes him no deference on further appeal on that topic. He purported to sit on appeal from the taxing officer who taxed solicitor-client costs.

42 Besides, the covenants here are for solicitor-and-*own*-client costs, so a mere immoderate amount of costs or of the appellants' steps would likely not remove the right to such costs.

H. Previous Orders

43 The chambers judge's Reasons offered another ground for denying solicitor-client costs. They concluded that there was no order providing for solicitor-client costs. This proposition was not argued earlier.

44 In fact, however, in August and October 2007, Lewis J. had ordered solicitor-client costs. And in January 2008, the very chambers judge now appealed had done the same. Only one of those three previous orders was appealed, and then that appeal was abandoned.

45 The Reasons now under appeal hypothesized that all three of those earlier orders lacked legal effect.

46 First, the Reasons said that this same chambers judge's own previous order of 2008 should somehow be upset because the then-counsel for the appellants had stated that both the guarantee and the loan agreement called for solicitor-client costs. Counsel's statement was accurate; both contracts did (and in any event, one alone would suffice). There was no misrepresentation at all of any sort. Counsel was not required to foresee the narrow and strained interpretation later imposed by the judge's Reasons. Such reasoning would be virtually circular. (And even the *Arbitus* case there relied upon, was not decided until late 2006.)

47 The previous order by the same chambers judge in question was not *ex parte*, and it is not clear how or why it could be upset. There was no suit to upset it for fraud, and such a suit could not possibly succeed. No law on upsetting orders was cited.

48 In my view, the transcript of the decision of the previous judge (pp F19-20) clearly says that costs are to be on a solicitor-client basis.

49 In any event, there is an entered order on the topic, by the former judge, Lewis J. (AR pp F27-28). It clearly states that costs are to be on a solicitor-client basis (para 4). There was no ground for a different judge to revisit that question later.

50 The explanation for that attempt to revisit is found in the "Background Facts" part of the Reasons now under appeal (para 20). It reads as follows:

> Mr. Moroz drafted forms of orders in relation to the appearances before Lewis, J. in October, 2007. Those orders have never been signed by any Judge of the Court, nor have they been filed with the Clerk. Therefore, to this date there are no formal filed orders of Lewis, J. in respect to the two October 2007 hearings.

However, the end of the recital is incomplete. As noted, there *were* settled formal orders of the previous judge filed with the clerk's office (i.e. entered).

51 The chambers judge's Reasons and the respondents argue that the entered orders were nullities or had to be upset by the judge appealed from. They offer two grounds.

52 The first ground suggested for invalidity is that the orders were never signed by a judge. However, the Rules then in force directed that the *Clerk* sign orders: see Rr 321(2), (3). This was not a case where the opposite party neglected to approve the draft. The parties disagreed as to what the formal order should say. In such circumstances, the Rules called on the *Clerk* to settle the wording: Rr 318, 319. Often judges used to do that, but no Rule called for that, and that practice could not detract from that Rule.

53 The transcript of the sessions before Mr. Christensen shows no objection by anyone to his jurisdiction to settle the wording of these previous orders by Lewis J. pronounced on October 16, 2007 and October 30, 2007. (See transcripts of argument on September 17, 2009, October 27, 2009 and November 5, 2009.) Yet the proper wording was expressly decided at the last session (November 5).

54 Mr. Christensen settled this wording for the formal order, after a formal appointment to do so (AB p P17), and after a contested hearing (transcript, pp F106-F122). He is a Deputy Clerk and so had the power to do so. The formal Appointment refers to him as Clerk, not as Taxing Officer. In practice the Clerk himself almost never acts, and such tasks are performed by Deputy Clerks.

55 The statement in the Reasons under appeal that the "Taxing Officer attempted to settle the terms" is puzzling. Mr. Christensen did so in his capacity as a Deputy Clerk.

56 In my view, the formal order of Lewis J. reflects the transcript of the hearing before him, and the minutes of the order as settled by the Deputy Clerk are correct.

57 The chambers judge now being appealed was not the trier of fact, nor the one to settle the minutes. All that had occurred beforehand. The chambers judge sat in an appellate capacity. The standard of review on appeal from him to the Court of Appeal is therefore correctness.

58 Now I turn to another argument made by the respondents (AR p 200).

59 The respondents rely upon a letter of Wachowich J. responding to an inquiry about an unanswered letter to the previous judge (Lewis J.) who had since retired. Wachowich J. said to go to a judge. His letter did not refer to any specific judge, and even then said to get advice from "a chambers judge ... as to how to deal with the matter, taking into account the Rules of Court that are to be considered ...". In no sense was this letter an order, still less one removing jurisdiction. It did not remove the authority of the Clerk to settle minutes of previous orders, still less make such settlement a nullity. A letter from a judge could not repeal a Rule of Court.

I. Time Limit for Entry

60 The second possible ground to upset the entered order of the previous judge, Lewis J., seems not to be a foundation for the Reasons now under appeal (though they recite that the argument was then made: para 28). Nor is this point mentioned in the respondents' "Notice of Appeal from Taxation", which is what was before the chambers judge. The respondents argue that a year having expired, the Clerk had no power to enter the order (old R 327).

61 That Rule gave a time limit for entry, not for settling the contents of an order. It is impossible to enter an order until its wording is either approved or settled.

62 And any breach of R 327 would not produce nullity. The grounds for extending the year are many, and the tests are lax. An unentered order exists and has force, and where parties have relied on it, a later judge should not upset it just because he or she thinks that it is wrong, or because one year has gone by without it being entered.

63 There is full discretion for the court to allow entry of an order despite expiry of a year: *Wright v. Murray Rosen Professional Corp.*, 2005 ABCA 116 (Alta. C.A.), [2005] AR Uned 44, [2005] AJ #274, Calg 0301-0355 AC (March 10/16). Indeed, an extension of time to do so should not be refused unless it would cause real prejudice to the other side: *Csepregi v. Bygrove*, 2001 ABCA 108 (Alta. C.A.), [2001] AR Uned 31, [2001] AUD 1051 (April 17/May 3). At times, fairness requires entering an order late: *Thimer v. Alberta (Workers' Compensation Board Appeals Commission)*, 2000 ABQB 706, 276 A.R. 236 (Alta. Q.B.), 252-53 (paras 53-59).

64 If R 327 was operative before this chambers judge (which is far from clear), his Reasons did not consider the mandatory topic of a time extension. The appellants' factum argues it and calls it "a fiat" (paras 12-14, 27, 37). The appellants' factum also suggests (para 37) that the respondents lay in the weeds for years, and then raised technical objections after it seemed too late to fix them. The respondents' factum does not answer that.

65 The fact that counsel for the respondents refused to sign the draft of the formal order of Lewis J. certainly explains some time gap. The minutes of the proposed order were correct. Why was it not entered promptly? Simply because counsel for the respondents would not approve it as to form, as admitted in the respondents' factum (p 5, para (3)). So it ill lies in the respondents' mouths to complain of the delay in entry.

66 There is no suggestion (let alone evidence) that the appellants caused the delays. Both Lewis J. and Mr. Christensen lost some time over their health issues. Ordinary time hazards of litigation must not destroy an order.

67 For a century, R 548 and similar Rules on extensions of time set by Rules or orders were always generously interpreted. It would be a rare case where someone would lose his rights through a few months' delay which were not wilful, and caused no significant irreparable prejudice. See the cases collected in 1 Stevenson & Côté, *Civil Procedure Encyclopedia*, pp 18-19 and 18-20 (Chapter 18, Part N) (2003).

68 Maybe the factum of the respondents suggests that leave had to occur before entry (p 6, replying to ground 3). If so, that is wrong, because it is expressly contrary to old R 548(2).

69 Rarely, an order can be abandoned by the party getting it; but what happened here was the opposite. The appellants kept trying to enforce the orders which they had obtained and entered, but were thwarted by the respondents' objections and motions.

70 Therefore, solicitor-client costs were the proper basis for the costs of all these proceedings, the previous proceedings were proper, and there was no reason to question, to attack collaterally, nor to reverse, any order to that effect.

J. Can Default Judgments Give Solicitor-Client Costs?

71 The respondents' factum relies on the entire *Arbitus* decision (factum, paras 16(1) and 18), and so do the Reasons under appeal. That decision suggests that a default judgment cannot give solicitor-client costs.

72 The decision in *Arbitus* gave three grounds for not allowing solicitor-client costs on one particular default judgment there. The first and probably biggest point was as follows: default judgments supersede the covenant for solicitor-client costs (405 AR. p 293, at the end of para 19). The Reasons cite only two bits of authority: *Black's Law Dictionary* (no page cited, but maybe the definition of "merger"), and an 1844 decision. The latter decision merely says that one cannot sue a second time on a cause of action after one has got judgment on it. Of course that is not what happened here. And it would create a Catch 22: you cannot sue now because you sued before, and you cannot rely on the judgment because the part of it in your favour is invalid. That would be both unfair and self-contradictory.

73 The second ground stated in the *Arbitus* case was just that the particular default judgment in that case merely said "costs" or maybe "costs to be taxed" with no further detail (p 294 AR, para 22). Of course that is not the situation here, where the default judgment itself awarded solicitor-client costs as described above in Part E.

74 Finally, the *Arbitus* judgment came at the matter a third way. It suggested that a default judgment could not go above party-party costs because R 605(1) did not let a taxing officer go higher than party-party costs "unless ordered". It cited some decisions by taxing officers.

75 With respect, that is another *non sequitur*. Default judgments are not given by taxing officers. These are given by the Clerk of the Court. And the Clerk of the Court had very clear power to grant judgment for any liquidated claim pleaded (or for recovery of a specific asset) after default: old Rr 142 (1)(a), 148(1); cf R 149(1). It is quite common for such default judgments to compute interest or unit prices in debt, and similar matters. Often the default judgment is for a whole set of accounts with amounts in both directions (e.g. new invoices and then partial payments).

76 To support this third ground, the *Arbitus* judgment took out of context a statement that pleadings and admissions cannot confer on the court a new jurisdiction (pp 294-95). But there is no question about the jurisdiction of the court in the *Arbitus* case, nor the present case. Moreover, there is no doubt about the jurisdiction of the Clerk (or Deputy Clerk) to give default judgment, as noted.

77 There is a somewhat similar brief argument in the respondents' factum in the Court of Appeal (reply to ground of appeal number 2, on p 6). It suggests that only a judge can award costs, and so the Clerk cannot even settle minutes of judgment or sign them, if their subject is entitlement to costs where what the judge pronounced was ambiguous. This proposition seems wrong in principle, and at the very best is circular reasoning. It is clear that pronouncing a decision (or reconsidering it) are totally different from settling the wording of the formal order recording that. Settling asks what was decided, not whether it was correct. See *Davidson v. Patten*, 2006 ABQB 370 (Alta. Q.B.), JDC 0101-00193, [2006] AR Uned 318 (May 18); *Collings, Re* (1937), [1936] S.C.R. 613 (S.C.C.), 614-15, [1937] 1 D.L.R. 409 (S.C.C.) (one judge). Whoever settles the minutes cannot go off on a voyage of discovery of his or her own, and is the servant not the master.

78 The reply by the respondents' factum (to point number 1) implies that the minutes of the orders were settled by a taxing officer who cannot award solicitor-client costs. But the same person (here Mr. Christensen) has two hats. One is Deputy Clerk and the other is Taxing Officer. As noted, he settled the orders in the former capacity.

K. Side Issue?

79 That leaves another argument of the respondents. Their counsel firmly suggested in oral argument to us that even if solicitor-client costs are proper for true collection procedure, they should not extend to (or not yet extend to) another substantive issue. It attempts to see whether the 45% contribution owed by the respondents should include a sum said to have been paid by the appellants to the Treasury Branches on the loan, before the suit and before its default judgment.

80 The first answer to that argument is that the loan contracts and the guarantee antedate the past payment by the appellants which is now in question. That the evidence of the guarantee was filed later, or that the admission of the facts about the loan agreement came later, is irrelevant. In any event, the motions about that payment came after the default judgment. So there is nothing retroactive about this part of the claim for solicitor-client costs.

81 The second answer is that the covenants for solicitor-client costs in all contracts (loan and guarantee) are very broad. (They are quoted above in Part F.) Those extend to indirect or ancillary proceedings.

82 The appellants were only responsible for 55% of the obligations guaranteed, but actually paid the whole thing, and the Treasury Branches' default judgment and security assigned and subrogated to the appellants are for more than the amount the appellants seek from the respondents. Therefore, this one motion to fix the amount (of which the respondents must pay 45%) is connected to the respondents' covenants to pay solicitor-client costs, and connected to the security.

83 The respondents next argue that the question of whether the respondents must pay 45% of the sum paid by the appellants before suit has not yet been decided and is to be tried. They say that it could even be decided against the appellants. That may be true, but the question at the moment is not the costs of some future trial of an issue. The question now is costs of motions on preliminary procedure decided some years ago. In no sense did the appellants lose these motions, and they had to bring them.

84 Sometimes it may be sensible to defer costs awards of interim steps; but given the long gap, and the various contests with the respondents which intervened, such deferral is inappropriate here. The previous judge (Lewis J.) exercised his discretion and decided not to defer them. That costs question was no longer open. Settling terms of a formal order is not an appeal from it on the merits. It is not a reopening of the merits. Counsel who attempt that produce serious delay. Costs now and not years later involve no error in principle. This case has seen too much delay.

85 The appellants should get solicitor-client costs of that issue too.

L. Conclusion

86 I would allow the appeal, reinstate the formal orders of Lewis J. as settled by the Deputy Clerk, reinstate the former costs order dated August 27, 2007 which this chambers judge set aside, and would award the appellants solicitor-client costs (full indemnity) for all steps to date, with no deduction for unreasonableness or overcaution. The order for costs against the appellants should be set aside.

87 If the parties cannot agree on costs, then within 10 days of the date of these Reasons they may each file and serve a submission on costs. These should be double spaced and not exceed 10 pages each.

88 Court of Queen's Bench written Reasons are easily obtained on the Alberta Courts' website. The appeal record should not have used a faxed copy of the Reasons under appeal (with the faxing line and page numbers superimposed and scribbled marginal notes). The appeal record does not state who prepared it. I would deduct $200 from the appellants' disbursements on appeal for those flaws.

Marina Paperny J.A.:

I concur:

R. Paul Belzil J.A.:

I concur:

Appeal allowed.

Footnotes

* Additional reasons at *Alberta Treasury Branches v. Weatherlok Canada Ltd.* (2011), 2011 ABCA 360, 2011 CarswellAlta 2473 (Alta. C.A.).

2019 ABQB 985
Alberta Court of Queen's Bench

Bank of Montreal v. Ladacor AMS Ltd

2019 CarswellAlta 2801, 2019 ABQB 985, [2020] A.W.L.D. 274, 313 A.C.W.S. (3d) 556

Bank of Montreal (Plaintiff) and Ladacor AMS Ltd, Nomads Pipeline Consulting Ltd, 2367147 Ontario Inc, and Donald Klisowsky (Defendants)

Robert A. Graesser J.

Heard: November 26, 2019
Judgment: December 19, 2019
Docket: Edmonton 1803-09581

Counsel: Andrew Wilkinson for Liberty Mutual Insurance Company
James Reid, Keith D. Marlowe for Receiver
Shaun D. Wetmore for Steenhof Entities
Norman D. Anderson for Donald Klisowsky

Subject: Corporate and Commercial; Insolvency; Public

Related Abridgment Classifications

Debtors and creditors
VII Receivers
VII.6 Conduct and liability of receiver
VII.6.a General conduct of receiver

Headnote

Debtors and creditors --- Receivers — Conduct and liability of receiver — General conduct of receiver

Debtors were three related companies, two of which were involved in production of modular structures while third operated hotel — Debtors were placed into receivership, with receiver being appointed by court as receiver/manager — Significant debts were paid off, and receiver proposed that debtors be placed into bankruptcy — Debtors' principal believed one debtor was still solvent — Receiver brought application for order essentially approving receiver's conduct and accounts and proposed assignment of debtors into bankruptcy, and discharging and releasing receiver from any further obligations and any liability — Application granted in part — Anticipated accounts, fees, and disbursements in connection with completion of receivership proceedings were not to be approved until incurred, and discharging and releasing receiver was not appropriate until its work was actually completed, but requested relief was otherwise granted — Since two debtors had paid off secured debts of other debtor as guarantors, they essentially stood in shoes of secured creditor by way of subrogation — Net result was that remaining assets of debtors were to be transferred to one debtor who paid off most debt, to be followed by assignments into bankruptcy — It was unlikely that debtor with remaining assets would have enough to satisfy unsecured claims, and suggestion that other debtor was solvent was fanciful — Principal's criticisms of receiver's conduct were rejected — Sole effective way of dealing with numerous claims was through statutory process such as bankruptcy.

Table of Authorities

Cases considered by *Robert A. Graesser J.*:

Abakhan v. Halpen (2006), 2006 BCSC 1979, 2006 CarswellBC 3323, 29 C.B.R. (5th) 50, 26 B.L.R. (4th) 1 (B.C. S.C.) — referred to

Abakhan v. Halpen (2008), 2008 BCCA 29, 2008 CarswellBC 110, 39 B.L.R. (4th) 1, 76 B.C.L.R. (4th) 267, 40 C.B.R. (5th) 159, 250 B.C.A.C. 277, 416 W.A.C. 277, [2008] 7 W.W.R. 510 (B.C. C.A.) — referred to

Bank of Montreal v. Tolo-Pacific Consolidated Industries Corp. (2012), 2012 BCSC 1785, 2012 CarswellBC 3719, 97 C.B.R. (5th) 56 (B.C. S.C.) — referred to

EC & M Electric Ltd. v. Medicine Hat General & Auxiliary Hospital & Nursing Home (District No. 69) (1987), 50 Alta. L.R. (2d) 48, (sub nom. *E C & M Electric Ltd. v. Medicine Hat General & Auxiliary Hospital & Nursing Home, District No. 69)* 35 D.L.R. (4th) 80, 76 A.R. 281, 25 C.L.R. 110, 1987 CarswellAlta 25 (Alta. Q.B.) — referred to

Gerrow v. Dorais (2010), 2010 ABQB 560, 2010 CarswellAlta 1752, 324 D.L.R. (4th) 332, 34 Alta. L.R. (5th) 112, [2011] 3 W.W.R. 320, 96 C.L.R. (3d) 215, 503 A.R. 65 (Alta. Q.B.) — referred to

Jaycap Financial Ltd v. Snowdon Block Inc (2019), 2019 ABCA 47, 2019 CarswellAlta 160, 68 C.B.R. (6th) 7 (Alta. C.A.) — considered

Matticks v. B. & M Construction Inc. (Trustee of) (1992), 15 C.B.R. (3d) 224, (sub nom. *B & M Construction Inc., Re)* 11 O.R. (3d) 156, 1992 CarswellOnt 193 (Ont. Bktcy.) — referred to

Royal Bank v. Melvax Properties Inc. (2011), 2011 ABQB 167, 2011 CarswellAlta 401, 75 C.B.R. (5th) 294 (Alta. Q.B.) — considered

Western Union Petro International Co Ltd v. Anterra Energy Inc (2019), 2019 ABQB 165, 2019 CarswellAlta 418 (Alta. Q.B.) — considered

Windham Sales Ltd., Re (1979), 26 O.R. (2d) 246, 31 C.B.R. (N.S.) 130, 1 P.P.S.A.C. 73, 8 B.L.R. 317, 102 D.L.R. (3d) 459, 1979 CarswellOnt 227 (Ont. S.C.) — referred to

Wong v. Field (2012), 2012 BCSC 1141, 2012 CarswellBC 2720 (B.C. S.C. [In Chambers]) — referred to

Statutes considered:

Business Corporations Act, S.B.C. 2002, c. 57

Generally — referred to

Guarantees Acknowledgment Act, R.S.A. 2000, c. G-11

Generally — referred to

Personal Property Security Act, R.S.A. 2000, c. P-7

s. 66(1) — referred to

APPLICATION by receiver for order essentially approving receiver's conduct and accounts and proposed assignment of debtors into bankruptcy, and discharging and releasing receiver from any further obligations and any liability.

***Robert A. Graesser J.*:**

Introduction

1 Alvarez & Marsal Canada Inc. LIT (the "Receiver") is the Receiver and Manager of Ladacor AMS Ltd. ("Ladacor"), Nomads Pipeline Consulting Ltd. ("Nomads") and 2367147 Ontario Inc. ("236"). It was appointed receiver and manager of these entities by Court order dated May 18, 2018 (the "Receivership Order"). It now applies for a number of orders:

1. Approving the actions, conduct and activities of the Receiver and its legal counsel outlined in the Receiver's Fourth Report to the Court dated September 3, 2019 and all other reports filed by the Receiver in these receivership proceedings;

2. Approving the Receiver's final statement of receipts and disbursements for the period for May 18, 2018 to August 31, 2019 as set out in the Fourth Report;

3. Approving the accounts, fees and disbursements of the Receiver and its independent legal counsel in connection with the completion of these receivership proceedings, including the costs of this application;

4. Approving the proposed allocation of cash held by the Receiver for Ladacor and Nomads to 236, as set out in the Fourth Report;

5. Approving the Receiver's proposal to assign the Debtors into bankruptcy in accordance with the Receivership Order;

6. Approving the transfer of all funds and property held by or collected by the Receiver, net of costs required to complete the administration of these receivership proceedings, into the bankrupt estates of the Debtors;

7. Declaring that the Receiver has duly and properly discharged its duties, responsibilities and obligations as Receiver;

8. Discharging and releasing the Receiver from any and all further obligations as Receiver and any and all liability in respect of any act done by the Receiver in these receivership proceedings, and its conduct as Receiver pursuant to its appointment in accordance with the Receivership Order, or otherwise; and

9. Authorizing the Receiver to transfer the books and records of the Debtors to the bankruptcy trustee, subject to preserving such records as required by statute.

2 The application was initially heard by Topolniski J on September 13. She approved the Receiver's accounts as set out in the Fourth Report and the Affidavit of Fees, a well as the accounts of the Receiver's counsel, Blake, Cassels & Graydon LLP.

3 Mr. Klisowsky was directed to provide the Receiver's counsel with a list of issues or questions pertaining to the Receiver's findings as reported in the Fourth Report and the Supplemental Report dated September 12, 2019.

4 An application by Hythe & District Pioneer Homes (Advisory Committee) ("Hythe") seeking to lift the stay of proceedings against Ladacor was adjourned to a later date. Hythe was attempting to file an amended statement of defence and counterclaim. It alleges that the work by Nomads was so deficient and defective that the entire project has to be demolished and Hythe will have to start again with a new contractor.

5 Mr. Klisowsky's application in relation to Nomad's potential liability on performance bonds with Liberty Mutual Insurance Company, and Mr. Klisowsky's concerns about Nomad's potential liability to the Government of Canada under the Employment and Social Development Canada Wage Earner Protection Program ("WEPP"), were also adjourned to a later date. The Receiver's discharge application was adjourned as well.

6 The adjourned applications were set down before me on November 27. The Hythe matter had been resolved directly between its counsel and counsel for the Receiver. That still left a number of issues that required resolution. Following submissions and argument, I reserved on all of the issues left to me to decide.

7 I received written submissions from counsel for the Receiver (3 in total), from counsel for Mr. Klisowsky, and from counsel for J. Steenhof & Associates Ltd and 1459428 Ontario Inc. I heard submissions from those counsel as well as from counsel for Liberty Mutual Insurance Company ("Liberty Mutual").

8 There was a significant volume of material put before me. The Receiver had prepared four reports over the course of the receivership, and added a supplement to the Fourth Report and provided a Fifth Report filed October 25, 2019 for the purposes of this application. The Supplement and Fifth Report mainly responded to the issues raised by Mr. Klisowsky.

9 There was an affidavit of fees from Orest Konowalchuk, a senior vice president of the Receiver. There were also were affidavits from John Hermann, from the Bank of Montreal ("BMO"), sworn May 18, 2018, from Mr. Klisowsky sworn September 7, 2019, September 11, 2019, and October 5, 2019, from Larry Slywka, a former employee of Ladacor, sworn October 13, 2019, from Bonnie Erin Richard, another former employee of Ladacor, filed October 25, 2019, and a "secretarial affidavit" from Lindsay Farr, sworn November 20, 2019. There was also an affidavit from Jacob Steenhof, from J. Steenhof & Associates Ltd ("J. Steenhof") and 1459428 Ontario Inc ("145"), sworn October 25, 2019.

10 Each of Mr. Klisowsky, Mr. Slywka, Ms. Richard and Mr. Steenhof were cross-examined on their affidavits and I have the transcripts from their cross-examinations.

Background

11 Most of the background facts are not in dispute. Mr. Klisowsky is the majority shareholder in Nomads (97.28%). His son owns the remaining 2.72% of the shares. Nomads was a Calgary based company whose principal business was the manufacture and production of advanced modular buildings and structures. These structures were generally constructed of sea cans. Part of

Nomads' business was investing in other assets. One of those investments is its 90% interest in 236. 236 is an Ontario corporation whose business was the ownership and operation of a Days Inn hotel in Sioux Lookout, Ontario. The remaining 10% of the shares in 236 are owned by J. Steenhof, an Ontario corporation.

12 Ladacor is a wholly owned subsidiary of Nomads. Ladacor came into existence in 2017 and carried on the same advanced modular home business as did Nomads. It appears that the incorporation of Ladacor coincided with a banking change by Nomads.

13 In the latter part of 2017, Nomads began a banking relationship with BMO. Mr. Klisowsky injected some $4,000,000 of capital into Nomads/Ladacor. BMO loaned approximately $4,000,000 to Nomads/Ladacor. Ladacor was the principal debtor. BMO took typical security from Ladacor. Guarantees of the Ladacor debt to BMO were provided by Nomads, 236 and Mr. Klisowsky.

14 After Ladacor was incorporated, all new work was directed to it, while Nomads completed the work it already had under contract. The work contracted by Nomads was, however, performed for it by Ladacor. Payments, whether from Nomads customers or Ladacor customers, were deposited into Ladacor's bank account with BMO

15 The accounting records and the evidence of Mr. Klisowsky, Mr. Slywka and Ms. Richard show that Nomads and Ladacor essentially operated as one entity. All bills were paid from the Ladacor bank account with BMO, and all of the enterprise employees (but for Mr. Klisowsky, his wife, and his son, were paid by Ladacor.

16 Ladacor entered into a bonding relationship with Liberty Mutual. Ladacor's indemnification obligations to Liberty Mutual were guaranteed by Nomads, 236, and by Mr. Klisowsky.

17 The months following the incorporation of Ladacor were not financially successful. Nomads had a major contract with Hythe that was ongoing and far from completion. Nomads had a large receivable ($2,700,000) owed to it by 1507811 Alberta Ltd on a project in Edmonton known as "Westgate". That project had been completed, but there were ongoing discussions about the outstanding payment.

18 Ladacor was performing the work on ongoing projects that were in various stages of completion, including a project in Banff. The Receiver completed these obligations over the course of the receivership.

19 In May 2018, shortly before the Receivership Order, Ladacor was awarded a sub-contract for work on the new court house in Chateh, Alberta. From the information before me, it is likely that Liberty Mutual had previously provided a bid bond, and subsequently provided a surety bond in favour of the general contractor, Kor Alta Construction Ltd ("Kor Alta"). Physical work on the project had not begun at the time of the Receivership Order, and the Receiver disclaimed the contract. That led to a bond claim by Kor Alta against Liberty Mutual. The claim in favour of Kor Alta is tentatively valued at over $1,000,000. Liberty Mutual seeks indemnification for that amount from each of Ladacor, Nomads, 236, and Mr. Klisowsky.

20 Following the Receivership Order, Hawke Electric, a subcontractor to Nomads, made a bond claim on a labour and material payment bond on the Westgate project against Liberty Mutual. Kor-Alta, the general contractor on the Chateh courthouse project, claimed in excess of $1,000,000 as a result of the termination of the subcontract by the Receiver. Liberty Mutual seeks indemnification for those amounts from each of Ladacor, Nomads, 236 and Mr. Klisowsky.

21 Liberty Mutual values these claims at a total of approximately $1,100,000.

22 The Receiver has reported throughout the receivership on its activities and realizations. A sale of the physical assets of Nomads and Ladacor was conducted in the late fall of 2018. The auction sale netted $606,000. Further physical assets (miscellaneous inventory) netted a further $76,000.

23 The Receiver was successful in collecting most if not all of the $2,700,000 receivable owed to Nomads on the Westgate project. The Receiver collected $1,568,609 owed to Ladacor on the Banff project.

24 Since 236 was also put into receivership, the Receiver took steps to sell 236's main asset, the Days Inn Hotel in Sioux Lookout. Of the roughly $5,000,000 sale proceeds, $4,000,000 were paid by the Receiver to BMO.

25 Ultimately, the time of the Fourth Report, the Receiver had paid off the secured debt to BMO, the Receiver's borrowings from BMO to enable it to carry on the Receivership, the WEPP claims, CRA and Service Canada trust/priority claims, along with its and its lawyer's fees and disbursements.

26 The supplemental report and Fifth Report update the figures. As at the time of that report, October 25, the Receiver was holding $10,398 for Nomads, $722,661 for Ladacor, and $637,241 for 236. The Receiver proposes to allocate all of the available proceeds currently in Ladacor's and Nomads' accounts to 236.

27 All three corporations would then be placed in bankruptcy.

28 Because Nomads and Ladacor had intermingled their physical assets, it was not possible for the Receiver to determine with any degree of certainty what assets belonged to Nomads and what assets belonged to Ladacor. For BMO, the secured creditor, it did not matter. It had reportedly good security against all of the assets regardless of which corporation owned them. For the purposes of the Fourth Report, which was from the date of the Receivership Order to August 31, 2019, the Receiver apportioned the auction proceeds $451,450 to Nomads and $154,407 to Ladacor. Ongoing expenses were apportioned between the two corporations based on the contracting party for the contract being worked on. Employee withholding claims by CRA and WEPP claims were broken down between the two corporations as well.

29 Following receipt of Mr. Klisowsky's cross application and the concerns he expressed over the apportionments in the Fourth Report, the Receiver retained Erin Richard to explain the financial situation and accounting of Nomads and Ladacor while she was comptroller for the final year of their operations. She had worked with the Receiver during the course of the receivership. Ms. Richard outlined in her affidavit how employees and assets had been apportioned between the two entities. She attempted to determine from the available records what assets had been owned before Ladacor was incorporated. Those would have been Nomads. Because Ladacor had become the main operating entity after the fall of 2017, anything acquired since then was attributed to Ladacor.

30 The same analysis was performed with respect to employees. For the purposes of payroll, withholdings and other employment related issues, the Receiver treated employees who had been employed with Nomads and who stayed on after Ladacor began operating as Nomads employees. Employees hired after Ladacor began operating were treated as Ladacor employees, even though they may have been working on Nomads projects.

31 For accounts payable and monies owed to trade creditors, the Receiver looked at which entity an invoice was addressed to, or which project it related to. If it was addressed to Nomads, or was in relation to a Nomads project, it was attributed to Nomads. And vice versa for Ladacor.

32 There does not appear to be any dispute that the Nomads/Ladacor records did not provide the Receiver with much guidance. There was no written agreement between Nomads and Ladacor when Ladacor assumed all of the operations of the two corporations. There was no asset transfer agreement. There was no agreement transferring Nomads' rights under any of its ongoing contracts to Ladacor. There was no agreement relating to employees.

33 According to Mr. Slywka, when Ladacor assumed the operations, employees at the time were simply told they were now working for Ladacor. It is unclear whether any of the parties Nomads had contracted with were ever told that Ladacor had taken over Nomads' operations, or that Nomads had assigned any rights to Ladacor.

34 Mr. Klisowsky takes issue with the amount of the asset sale proceeds attributed to Ladacor versus Nomads. He challenges Ms. Richard's assessment, noting that she was a relatively new employee at Ladacor. He also takes issue with the allocation of employees between the companies, and says that only his wife and son were Nomads employees, as all other workers worked

for Ladacor. That impacts wages paid to the employees (their WEPP claims) as well as claims by the government for employee deductions and other trust claims made by the Government of Canada.

35 Mr. Klisowsky's view is that as at the beginning of 2018, Nomads was essentially a holding company. All of its projects, employees and assets had been transferred to Ladacor. Ladacor performed all of the work on all of the projects contracted to either Nomads or Ladacor. Ladacor paid all of the employee wages, regardless of what project they were working on. Ladacor paid all of the bills whether they were invoiced to Ladacor or to Nomads, as Ladacor had taken over all of the work on all of the ongoing projects.

36 Whatever the arrangement between Nomads and Ladacor was, it was not reduced to writing. There is some suggestion that the merging of operations and the creation of Ladacor was linked to collection activities undertaken against Nomads by Alberta Treasury Board and Finance in relation to a reassessment of tax credits Nomads had been given under a government tax incentive program. A review by the Tax and Revenue Administration revisited the credits given to Nomads for 2012, 2013 and 2014 and assessed Nomads some $769,000. The Provincial government had apparently garnisheed Nomads' former bank, leading to Nomads setting up a new banking relationship with BMO.

37 The best that can be said of the operations of Nomads and Ladacor once Ladacor came into existence is that they operated under Mr. Klisowsky's control as "owner" of both entities. Daryl Nimchuk was the chief operating officer for some time. Ms. Richard was comptroller, and Larry Slywka was Ladacor's production manager. The operations of both Nomads and Ladacor were merged so that all receipts went into the Ladacor bank account and all bills were paid out of that account. There was no internal attempt to separate assets, projects, employee functions, bills or receivables. The reporting to BMO and any financial statements produced were "consolidated", although the two corporations were never consolidated under the *Business Corporations Act*. The joint operation is frequently described internally and on contracts as "Nomads Pipelines Consulting Ltd o/a Ladacor". The internal treatment of the two entities' operations does not reflect either entity's legal rights or obligations.

38 According to the brief filed on behalf of Mr. Klisowsky, and his affidavit evidence, he believes that despite all of the various claims being advanced against it, Nomads remains a solvent entity and that Nomads should not be put into bankruptcy. He points to the large receivable of $2,800,000 secured by a builder's lien against the Hythe project. He claims that there is a good defence to Liberty Mutual's claim against Nomads on the indemnity and guarantee agreement on the bond issued in favour of Kor Alta.

39 Mr. Klisowsky points to the wording of the indemnity agreement and argues that the agreement gave Nomads (or the Receiver when it took over control of Nomads following the Receivership Order) their right to cancel the bond in favour of Kor Alta. The Receiver failed to do so. The Receiver's failure should not be visited on Nomads, such that Nomads should not ultimately have to pay anything to the bonding company.

40 He refers to paragraph 45 of the Indemnity agreement that provides:

> 45. *Termination of the present agreement and its effect upon outstanding Bonds* — The present agreement shall only be terminated by any Indemnitor, upon prior written notice to the Surety by registered mail and at its head office, at least thirty days prior to its effective date; however, the said prior notice of termination will not modify, nor exclude, nor discharge the Indemnitors' obligations relating to Bonds issued prior to the effective date of termination or Bonds issued after the effective date of termination by reason of undertakings by the Surety prior to such date, the present agreement will remain in full force and effect as regards the other Indemnitors without any obligation on the part of the Surety to advise such other Indemnitors of such termination.

41 This argument affects Ladacor as well, as it is the primary obligee on the bond and it is required to indemnify Liberty Mutual. The Indemnity Agreement in favour of Liberty Mutual executed by Ladacor, Nomads and 236 by Mr. Klisowsky signing the same. Mr. Klisowsky signed a personal indemnification in favour of Liberty Mutual and there is a *Guarantees Acknowledgement Act* certificate dated January 4, 2018.

Issues

42 The Receiver raises a number of issues and seeks the Court's direction on the following:

1. Should the Receiver's apportionment of funds be approved, including its treatment of the contribution and subrogation obligations and rights of the guarantors?

2. Is there a valid defence on Liberty Mutual's indemnification claims on the bond claims against it?

3. Has the Receiver erred in apportioning employees, assets and debts?

4. Should all or any of the entities be put into bankruptcy? and

5. Should the Receiver's actions be approved?

43 Mr. Klisowky's application challenges a number of the Receiver's recommendations and conclusions and raises a number of issues:

1. The validity of the Liberty Mutual claims under the Indemnity Agreement;

2. The identification and allocation of unsecured debt as between Ladacor and Nomads;

3. The identification and allocation of the auction proceeds between Ladacor and Nomads;

4. The identification of employees of Nomads and any claims (CRA and WEPP);

5. The validity of the Alberta Treasury Board and Finance claim against Nomads;

6. The proposed subrogation from Nomads and Ladacor to 236;

7. The claim of J. Steenhof against 236; and

8. The conduct of the Receiver.

44 I will deal with subrogation first as my decision on it will impact a number of the other issues. I will then deal with Mr. Klisowsky's concerns and claims, before dealing with the relief sought by the Receiver.

Subrogation

45 BMO has been paid in full. It received $5,834,882. That included repayment of amounts loaned by BMO to fund the receivership. Most if not all of the funds that were paid to BMO resulted from the sale of 236's hotel in Sioux Lookout and the collection of the $2,600,000 receivable on the Westgate contract owed to Nomads. The principal debtor to BMO was Ladacor. It was the entity that borrowed and received the funds from BMO. The funds that resulted from collections on other Nomads and Ladacor projects and the sale of Nomads' and Ladacor's physical assets were mainly used to pay the ongoing costs of the receivership, including completion of some of the project work, and the Receiver's fees and disbursements.

46 BMO was a secured creditor, subject only to the superior WEPP claims and CRA source deduction claims, and the costs of the receivership. The Receiver argues on this application that guarantors (such as Nomads and 236) are entitled to be subrogated to the claims they have paid out on behalf of the principal debtor, Ladacor.

47 In this case, Nomads and 236 have paid off BMO's claims against Ladacor. Nomads and 236 are entitled to be subrogated to BMO's claim, and to stand in BMO's shoes with respect to any security BMO held against Ladacor. That means, according to the Receiver, that Nomads and 236 are now the primary secured creditors on any of Ladacor's remaining assets.

48 Additionally, as between guarantors who have paid out on their guarantees, Nomads and 236 are entitled to be treated proportionately, so the debt paid off should be apportioned between them. Where guarantors are equally liable to the obligee, the guarantors are considered to be responsible for equal shares of the debt.

49 Here, that would mean that each of Nomads and 236 should have paid off half of the debt owed to BMO. Since 236 paid more than half of the BMO debt, there should be an adjustment as between Nomads and 236, in 236's favor.

50 The way the Receiver has accounted for this is that the excess of collections over required payments has left a surplus, some of which now stands to the credit of Ladacor. Because 236 paid more than its half of the obligation, 236 is entitled to recover that excess from Ladacor.

51 Of the $5,834,882 paid to satisfy BMO's claims, $4,000,000 came from 236. The remainder came from Nomads. Because of contribution principles between guarantors, each of the guarantors should have paid $2,917,441. 266 overcontributed by $1,082,559. That amount is owed to it by Nomads.

52 The Receiver proposes to pay the funds remaining in the Nomads account and the Ladacor account (after holdbacks for further administration costs) in the approximate amount of $465,000 (Receiver's Fifth Report). 236 is expected to have approximately $517,000 in its account, so it will recover $982,001. It will be short by approximately $100,559. Because of it standing into BMO's security, it will be Nomads' only secured creditor to that extent.

53 This analysis and position is well supported by the Receiver's first brief for this application. The Receiver cites:

Gerrow v. Dorais, 2010 ABQB 560 (Alta. Q.B.);

Mercantile Law Amendment Act 1856, 19 & 20 Vict, c 97;

Matticks v. B. & M Construction Inc. (Trustee of), 1992 CarswellOnt 193 (Ont. Bktcy.);

Andrews & Millett, *Law of Guarantees*, 7th Ed (London: Sweet & Maxwell, 2015) at para 11-017;

Windham Sales Ltd., Re, 1979 CarswellOnt 227 (Ont. S.C.);

Wong v. Field, 2012 BCSC 1141 (B.C. S.C. [In Chambers]);

EC & M Electric Ltd. v. Medicine Hat General & Auxiliary Hospital & Nursing Home (District No. 69), 1987 CarswellAlta 25 (Alta. Q.B.); and

Abakhan v. Halpen, 2006 BCSC 1979 (B.C. S.C.) aff'd 2008 BCCA 29 (B.C. C.A.).

54 J. Steenhof, as an unsecured creditor of 236, and 145 as an unsecured creditor of Nomads on the Hythe project, agree with this analysis, as does Liberty Mutual. Mr. Klisowsky raises no specific objection to this proposal on the part of the Receiver, but suggests that it is premature. He says that the proper contribution between Nomads and 236 can only be calculated once the assets and liabilities of Nomads and Ladacor (as between those entities) have been properly allocated.

55 I am satisfied that for the purposes of finalizing the Receivership accounts, the monies the Receiver holds to the account of Ladacor and Nomads should be transferred to 236's account as a function of a guarantor's right to subrogation and to contribution rights and obligations as between co-guarantors.

Assets and Liabilities of the Debtors

Ladacor

56 There is no doubt that Ladacor is insolvent under any interpretation of "insolvency". It has no remaining assets, other than a contingent interest in the funds proposed to be held back by the Receiver to deal with CRA's post-receivership withholdings claims (discussed below), and a $57,000 GST refund apparently owed to it by CRA. All physical assets have been disposed of. All of Ladacor's projects have been abandoned, completed or wound down. Its receivables have been collected. There are still claims by CRA relating to pre-receivership GST. These claims total $33,446. While these claims presently enjoy priority status, they will drop down to unsecured status in the event of Ladacor's bankruptcy.

57 There is a post-receivership claim relating to source deductions assessed against the Receiver's independent contractors used to complete project work and for other receivership purposes. CRA's position is that these contractors should be treated as employees subject to employment insurance and Canada Pension Plan deductions. While the presently-advanced claim is approximately $10,000, the Receiver anticipates that there are a number of other claims that CRA will advance, depending on its success on the claims already made. The Receiver proposes to withhold $125,000 as a contingency to deal with those funds. It is possible that not all of those funds will be required, and some might ultimately be released back to Ladacor. Conversely, it is possible that the claims and costs of defending Ladacor against them will use up most or all of the contingency amount.

58 The Receiver's records list Ladacor's unsecured creditors. The present list totals approximately $3,500,000 in unsecured claims. That does not include over $1,100,000 from Liberty Mutual under the Indemnity Agreement in favour of Liberty Mutual.

59 The priority claims of CRA have been accounted for in the holdback of $125,000 discussed above. Ladacor's only remaining secured creditors are 236 and Nomads, because they are able to step into BMO's secured position because of their subrogation rights. Since 236's and Nomads' assets were used to pay off BMO, 236 and Nomads have a secured claim against Ladacor for up to $5,834,882, less the approximately $465,000 that will be paid to 236 as a result of this application.

60 It appears from this analysis that Ladacor's unsecured creditors are unlikely to make any recovery at all, as any remaining funds will go to or be attributed to 236 and Nomads, with 236 being able to recover all of any anticipated or hoped-for funds because of its contribution rights against Nomads.

61 It is obvious that Ladacor should be placed into bankruptcy, although it is difficult to see any advantage to that for Ladacor's unsecured creditors. The bankruptcy would appear to benefit only the creditors of 236, as discussed below.

62 In any event, there needs to be an orderly resolution to the massive amount of unsecured debt owed to Ladacor's creditors and the only way of achieving that is through bankruptcy

236

63 236 has no remaining assets, other than its subrogated claim against Ladacor and its claim against Nomads for contribution so that its and Nomads' contributions to BMO will be equalized. 236's creditors are all unsecured. The major claims are Liberty Mutual's claim for indemnity for bond claims against Ladacor ($1,100,000) and a claim from J. Steenhof for approximately $444,000. It too has a GST claim by CRA ($33,000), which is presently a priority claim but which will become unsecured on bankruptcy. There are only a few other unsecured claims totaling about $40,000.

64 Through its subrogation rights and contribution rights arising out of 236's payments to BMO, 236 will receive all of the remaining cash in the three debtor accounts. There is the possibility that some further funds might come to 236 from Ladacor (any surplus from the CRA holdback discussed above and the GST refund). Any such funds may be available for 236's creditors.

65 It is unlikely that 236 will receive any more than the amount presently suggested by the Receiver. That will not satisfy Liberty Mutual's claim, if the claim is valid and anywhere close to the current amount claimed. If J. Steenhof's claim has any validity, it and Liberty Mutual will recover only a fraction of their claims.

Nomads

66 In his submissions, Mr. Klisowsky emphasizes the $2,800,000 receivable and builder's lien claim Nomads has against Hythe. As discussed below, that claim is hotly disputed by Hythe. Hythe is attempting to amend its statement of defence and counterclaim to advance a claim against Nomads for damages significantly higher than the Nomads claim against Hythe.

67 There are two investments owned by Nomads. The first is 27.5% of the common shares in a private corporation, Testalta Corporation Ltd. Nomads is also owed a shareholder's loan of $220,500. The Receiver has no information on the value of this investment. It says that Mr. Klisowsky has not provided any relevant information that would assist it in valuing this asset. As a result, the Receiver places no value on Nomads' investment in Testalta and the Receiver has no information as to whether the shareholders' loan is recoverable.

68 The second of these investments is a 50% interest in 1878826 Alberta Ltd. This private corporation owns a Studio 6 Hotel in Bruderheim, Alberta. The Receiver's information is that the hotel is presently producing "minimal positive cash flow" and is subject to a mortgage of approximately $3,000,000. Because of the lack of information, the Receiver is unable to place any value on this investment.

69 Nomads has a contingent claim to the $54,236 the Receiver paid into Court to discharge a builder's lien in favour of Hawk Electric, filed against the Westgate project. Those funds are in Court as security for the lien and will remain there until further Court order. It is possible that some of those funds might come back to Nomads.

70 Nomads owns 23 modular storage units which were earmarked for the Hythe project. They remain in storage. Unless the Hythe project can use them, they have little residual value. No information was put before me as to the potential value of these storage units. The main value appears to be the ability to use them for completion of the Hythe project. It seems highly unlikely Nomads or the Receiver will have any further involvement with Hythe, other than in the litigation that has ensued.

71 Nomads is entitled to be indemnified for its payments to BMO by Ladacor and in that regard is a secured creditor, being entitled to step into BMO's security position. There is a possibility that Ladacor may not need all of the CRA contingency it has set up, and that it might recover a pre-receivership GST refund. However, since 236 is entitled to contribution from Nomads to equalize their payments to BMO to pay off Ladacor's debts to BMO, 236 will be entitled to recover any of the required contribution from Nomads as a secured creditor.

72 Having regard to the roughly $100,000 contribution owed to 236 and 236's security position, it appears highly unlikely that any funds will remain for the benefit of any of Nomads' unsecured creditors.

73 By way of liabilities, CRA is a priority creditor in the amount of $152,742 in pre-receivership GST. As with Ladacor, this claim will drop down to unsecured status in the event of Nomads' bankruptcy.

74 Nomads is liable to indemnify Liberty Mutual for both of the bond claims Liberty Mutual is liable for. Those claims total approximately $1,100,000.

75 Alberta Treasury Board and Finance Tax and Revenue Administration has a claim (presumably unsecured) against Nomads following a reassessment of tax credits for 2012, 2013 and 2014 totaling $769,245.68. This claim has been outstanding since some time in 2017. Mr. Klisowsky professes to know nothing about this claim.

76 236 has a claim against Nomads to equalize what the two entities paid out to satisfy Ladacor's debts to BMO in the approximate amount of $100,000, assuming all available funds from Ladacor and Nomads are paid over to 236 as a result of this application.

77 Hythe has recently provided information to the Receiver that the work done by Nomads should be demolished because of defects and mold infestation. The expert report provided states that the cost of repairing the existing work and completing it is likely to be significantly more expensive than demolishing the existing work and starting over again. The intended counterclaim will greatly exceed the amount of Nomads' builder's lien and claim for the value of work it claims to have done. While the relative merits of the positions of Nomads and Hythe are unknown, it seems clear that it will be a long and difficult fight for

Nomads to collect anything from Hythe. It is not known what was agreed between the Receiver and Hythe with respect to this application such that Hythe's application to lift the stay of proceedings to allow it to file an amended statement of defence and counterclaim. However, the information presented by the Receiver casts doubt on the recoverability of the claimed receivable.

78 Nomads also has approximately $1,900,000 in debts to creditors, after deducting the Liberty Mutual and Alberta Treasury Board claims. One of the J. Steenhof companies, 145, has a claim against Nomads for work done on the Hythe project, but its hopes of collection are likely tied to its builder's lien.

79 It appears, following this analysis, that anything that Nomads may be able to recover from its few debtors will ultimately go to 236 until its and 236's payments to BMO have been equalized. The absence of information as to the potential value of Nomads' investments in Testalta and 1878826 Alberta Ltd makes it impossible to determine if there is any chance of recovery on either of those investments, or in what amount. The first $100,000 is likely to go to 236 and there are $4,700,000 in other creditors, so even if Nomads' present claim against Hythe were given full value (ignoring Hythe's counterclaim), Nomads would be unable to pay off its unsecured creditors. In my view, the suggestion that Nomads is solvent and should be able to resolve outstanding issues with its creditors is fanciful.

80 Any remaining assets of Ladacor and Nomads will likely end up with 236 and be distributed to its creditors and not to any other creditors of Nomads or Ladacor. The resulting beneficiaries of that scenario are Liberty Mutual and J. Steenhof.

81 236 has no remaining assets other than its subrogated claim against Ladacor and the contribution claim against Nomads. The Receiver proposes to pay Ladacor's remaining funds in the amount of $799,000 less holdbacks and estimated administration costs to 236. Its claim against Ladacor is secured because of its rights to subrogation. However, claims will not satisfy the $4,000,000 236 paid to BMO.

Positions of Liberty Mutual, J. Steenhof and 145

82 Both Liberty Mutual and the Steenhof parties support the Receiver's application. They support the proposal to put all three of the debtor corporations into bankruptcy. They do not oppose any of the other relief sought by the Receiver.

Position of Mr. Klisowsky

83 The foundation of Mr. Klisowsky's disputes with the Receiver's reports and recommendations is that Mr. Klisowsky believes that Nomads remains solvent. Because of its assets, and in particular the Hythe receivable and builder's lien claim, the mis-allocation of debt between Nomads and Ladacor, the invalidity of the Alberta Treasury Board claim and the invalidity of the Liberty Mutual indemnification claims, there is no need to put Nomads into bankruptcy. He argues that Nomads essentially shut down and transferred all of its business to Ladacor. After late 2017, when the transfer took place, all rights and all obligations under existing contracts were assumed by Ladacor. As a result, almost all of the claims against Nomads and Ladacor should be Ladacor's responsibility. Mr. Klisowsky challenges the commercial reasonableness of the Receiver's decision to attribute a significant portion of the creditors to Nomads.

84 Mr. Klisowsky makes the same argument with respect to the physical assets of the enterprise. Effective late 2017, the assets that were eventually auctioned off by the Receiver were mainly assets of Ladacor and not Nomads. Mr. Klisowsky claims that the Receiver did not accurately identify equipment owned by Nomads such that it should be given credit for more of the proceeds of the physical asset sale than it was. The total proceeds of sale were $605,858, of which $451,450 was allocated to Nomads and $154,407 was allocated to Ladacor. Mr. Klisowsky says that most of this should have been allocated to Ladacor.

85 The same holds true for employee claims and the Receiver's treatment of WEPP claims and CRA withholding claims. After the assignment of the business to Ladacor, all employees (but for Mr. Klisowsky's wife and son) became Ladacor employees. Thus none, or almost none, of Nomads' real assets should have been used to pay off the BMO claims. Any remaining claims should be to Ladacor's account. and all the allocation of debt as between Nomads and Ladacor should be attributed to Ladacor.

86 According to Mr. Klisowsky, the Receiver overpaid the WEPP claims and CRA preferred/secured claims because of failing to properly identify what employees worked for Nomads and for Ladacor. From the Receiver's accounting, CRA source deductions for Nomads and Ladacor totaled $322,652. These do not appear to have been broken down between Nomads and Ladacor by the Receiver. The WEPP claims totaled $25,005 (attributed $18,056 to Nomads and $8949 to Ladacor.

87 Mr. Klisowsky says the manner of apportionment of employees was not commercially reasonable.

88 Ultimately, Mr. Klisowsky says that more work needs to be done by the Receiver to properly analyzed and the results amended.

89 Mr. Klisowsky's position with respect to the Liberty Mutual indemnification claims is that if Ladacor had any outstanding bonds, and if there are any valid bond claims, the indemnity agreement should have been terminated by the Receiver immediately on their appointment thus avoiding liability on the bonds. Mr. Klisowsky also takes the position that the Receiver should not have terminated the subcontract with Kor-Alta because that triggered the performance bond claims. Mr. Klisowsky challenges the commercial reasonableness of the Receiver's decision to cancel the contract.

90 Mr. Klisowsky argues that the work done by the Receiver to analyze and quantify the Alberta Finance claim relating to the reversed tax credits is deficient and needs further investigation as to whether the amount claimed is legitimate, whether it can be negotiated, and whether there is a process to appeal the reassessment. Mr. Klisowsky notes that the Alberta Finance claim is the most significant claim against Nomads other than the Liberty Mutual claim and suggests that the Receiver has not yet reached the point of commercial reasonableness in its work on this claim.

91 Mr. Klisowsky also argues that the 145 claim against Nomads on the Hythe project is not valid. It is a claim for $603,000. Additionally, he disputes J. Steenhof's claim for $444,000 against 236. He says there is an issue for trial regarding that claim, as he says that amount represents part of J. Steenhof's investment in 236 and not a debt owed by 236 to J. Steenhof.

92 Mr. Klisowsky argues that assigning any of the debtors into bankruptcy should only be done after the Receiver has completed a proper investigation and analysis of the assets and debts of the debtor corporations. Such a step should only occur when it is commercially reasonable to do so and that point has not been reached.

93 Other issues raised include the reasonableness of the Receiver's actions when heavy rains damaged the roof and other parts of the under-construction Hythe project and its response to the theft of some property from that site.

94 Mr. Klisowsky cites *Royal Bank v. Melvax Properties Inc.*, 2011 ABQB 167 (Alta. Q.B.) in support of his submissions. At the hearing, his counsel also referred to section 66(1) of the *Personal Property Security Act*, RSA 2000 c P-7, and *Bank of Montreal v. Tolo-Pacific Consolidated Industries Corp.*, 2012 BCSC 1785 (B.C. S.C.).

Analysis

1. The validity of the Liberty Mutual claims under the Indemnity Agreement

95 I cannot make any determination as to the validity of the Liberty Mutual claims as I have no documentation supporting the claims against the various bonds. In particular, none of the underlying contracts or subcontracts by Ladacor are in evidence. Mr. Klisowsky suggests that there was no signed contract between Ladacor and Kor-Alta. That may be so. However, that does not answer the matter, as there may well have been a bid bond issued in favour of Kor-Alta during the tendering process. A bid bond secures the successful tenderer's obligation to enter into a contract to perform the work and to provide a performance bond.

96 Mr. Klisowsky's brief seems to suggest that a performance bond and labour and material payment bond were issued, which suggest that there were underlying contracts in existence. But it is premature to try to assess these issues. Liberty Mutual has indemnification agreements from each of Ladacor, Nomads, 236 and Mr. Klisowsky. It does not appear that any of the bond claims have been finalized.

97 Liberty Mutual claims that it is or will be owed approximately $1,100,000 on account of the labour and material payment bond claim by Hawke Electric and the performance bond claim by Kor-Alta. Those claims may be valid and if they are valid, the indemnification agreements appear valid on their face.

98 The defence raised by Mr. Klisowsky: that the Receiver should have terminated the indemnity agreements thereby avoiding liability for the indemnitors, is entirely without merit. His reference to paragraph 45 of the Indemnity Agreement might provide an argument in his favour, it the paragraph ended after the first part of the first sentence. The sentence continues:

> . . . however, the said prior notice of termination will not modify, nor exclude, nor discharge the Indemnitors' obligations relating to Bonds issued prior to the effective date of termination or Bonds issued after the effective date of termination by reason of undertakings by the Surety prior to such date . . .

99 It would make no sense at all for the indemnitors to be able to avoid their liability to indemnify the bonding company for bonds issued before the termination becomes effective. The essence of paragraph 45 is that the indemnitors can avoid liability for future bonds or bonding obligations by giving a 30-day notice. Existing arrangements are not affected.

100 Standard form performance bonds, labour and material payment bonds and bid bonds do not have unilateral termination provisions or cancellation provisions on the part of either party. Once the bonding company is on the hook for a bonded obligation, the indemnitors are likewise on the same risk.

101 This is so elementary in the bonding world that no authorities need be cited. Mr. Klisowsky's argument here is without merit. If Liberty Mutual is liable on any of the bonds it issued for Ladacor, the indemnitors are almost certainly liable to indemnify Liberty Mutual (subject to the usual types of defences available to guarantors.

102 There is no basis to reject the Liberty Mutual claims from consideration of the merits of putting the debtor corporations into bankruptcy. Undoubtedly there may be litigation as to whether Liberty Mutual has properly paid out any of the claims against it and whether they have acted reasonably. But someone will have to carefully monitor the claims and Liberty Mutual's responses, and in doing so will be a costly venture for whomever is tasked with that.

2. The identification and allocation of unsecured debt as between Ladacor and Nomads

103 This is another area where Mr. Klisowsky's arguments are without merit. A debtor cannot unilaterally pass its debts on to someone else and avoid further liability. Subject to the terms of the contract between the creditor and the debtor, a creditor can assign its rights (like its receivables or benefits accruing under a contract) to a third party. Sometimes that requires the consent or agreement of the debtor or other contracting party, and sometimes not. Nomads might have been able to assign its rights under the contract with Hythe and others to Ladacor, and it might not have been.

104 While Nomads could by contract require another party to satisfy its obligations (such as Ladacor) that is not binding on the creditor. Someone cannot simply go to a creditor and say "I don't owe that to you any more, I assigned my obligations to someone else". If that were possible, every debtor would rush to assign its obligations to a shell company or insolvent entity. Creditors are entitled to look to their debtor for payment or performance and they do not have to try to collect from someone else, unless they have specifically agreed to do that through some valid contractual mechanism.

105 There is no evidence here that any of the Nomads creditors ever agreed to release Nomads and substitute Ladacor is its debtor. As a result, the method used by the Receiver with the assistance of Ms. Richard and others, was commercially reasonable. There were no written agreements between Nomads and Ladacor. Claims on contracts Nomads entered into are likely still Nomads' responsibility. Suppliers who supplied things on Nomads projects are likely still Nomads' creditors.

106 I see no error in principle as to how the Receiver characterized the creditors. The Receiver has made no binding determinations; that would result from a claims process in the receivership, or the normal claims processes in bankruptcy. No one has suggested that it would be more efficient or effective to have a claims process within the existing Receivership.

107 I do not see that the Receiver's actions in this area have been unreasonable in any way. It was faced with an undocumented mess and the Receiver has done its best to make sense of the disorganization created by the do-it-yourself creation of Ladacor by Mr. Klisowsky.

3. The identification and allocation of the auction proceeds between Ladacor and Nomads

108 There were no transfer documents in evidence as to any transfers of assets between Nomads and Ladacor. No purchase documents were in evidence showing which entity actually purchased an asset in the first place. In the absence of documentation, the approach taken by the Receiver appears to be reasonable. Where an asset appears to have been in Nomads' possession at the time Ladacor came into existence, it remained Nomads'. Anything acquired after Ladacor began operations was attributed to Ladacor.

109 I see nothing in this approach that is unreasonable. Again, any potential errors on the part of the Receiver were caused by the absence of appropriate documentation at the commencement of the receivership.

110 In any event, arguments of this nature do not get Nomads anywhere. The fewer assets Nomads had, the less it contributed to paying off the BMO debt, and the more it would owe to 236's contribution claim.

4. The identification of employees of Nomads and any claims (CRA and WEPP)

111 It does not appear that existing Nomads employees were properly transferred over to Ladacor's employment. Ladacor may well have been making all of the payroll payments once it took over as the operating company. For employment insurance, Canada Pension purposes, and employment standards purposes, the existing employees should have been terminated from Nomads and hired by Ladacor. Records of Employment should have been prepared and filed; accrued vacation pay should have been paid out.

112 The failure to take those steps, however, does not invalidate a successor employer's employment or liability to the workers it has taken on. It creates liabilities for the former employer (in this case Nomads).

113 This is one area where the Receiver may have been incorrect in its treatment of employees and liability for wages and withholdings. I only say "may", as in the circumstances the Receiver faced, it is possible that any unpaid employee (and CRA) could have chosen which entity to pursue. It would have been possible for Ladacor employees to work on Nomads projects. Nomads could have subcontracted its obligations to Ladacor such that as between Nomads and Ladacor, Ladacor would have all future responsibilities.

114 The absence of any agreement between Nomads and Ladacor makes it virtually impossible to determine what enforceable arrangements between Nomads and Ladacor were made. Consolidated financial statements were prepared. There is no evidence that Nomads and Ladacor had their own financial statements or books once Ladacor came into the picture.

115 There is no evidence that Nomads was ever paid anything by Ladacor for Nomads assets or its ongoing contracts. There is no evidence that Ladacor ever indemnified Nomads against claims from any of Nomads' creditors or contracting parties. Nevertheless, it is possible that most of the employee claims were Ladacor obligations.

116 That being said, the amounts of the claims really makes this a *de minimus* area of concern. Mr. Klisowsky complains of $18,056 of WEPP claims already paid out by the Receiver from Nomads, and disputes the estimated $84,300 in unsecured WEPP claims remaining against Nomads. Charging $18,056 to Ladacor instead of Nomads changes nothing of significance with respect to the results of the receivership and indeed would increase the amount of contribution Nomads would owe to 236. The less attributed to Nomads means the more attributed to 236 such that 236 would itself be a larger creditor of Nomads. That takes on even more significance when 236's status as a secured creditor is factored in, along with the unlikelihood of recovery for any of Nomads' unsecured creditors.

117 While Mr. Klisowsky makes a valid theoretical point, there is no merit to it in substance, as the amounts are too small to make any difference in the overall results.

5. The validity of the Alberta Treasury Board and Finance claim against Nomads

118 The Alberta Finance claim will have to be dealt with whether in the receivership or in a bankruptcy. This is not a claim that was made after the receivership began; it was made against Nomads sometime in 2017. If an appeal period with respect to the reassessment of taxes was missed, it was likely missed long before the Receivership. The Receiver can hardly be faulted for not spending a lot of time investigating an unsecured claim that Nomads appeared to be ignoring and restructuring its affairs to avoid paying.

119 There is nothing unreasonable in the Receiver's approach to this claim. The Receiver did nothing with respect to investigating the validity of any of the unsecured claims, let alone trying to negotiate settlements on them. The main task of the Receiver was to identify secured and preferred claims, and pay out BMO, CRA, Service Canada, and WEPP, so that anything remaining could be properly divided amongst the unsecured creditors.

120 The latter process has yet to occur, and is one of the reasons bankruptcy is a necessary process.

121 I find no fault on the part of the Receiver in this area, and certainly no lack of commercial reasonableness.

6. The claim of J. Steenhof against 236

122 There is little information about the validity of J. Steenhof's claims against 236. Mr. Klisowsky acknowledges that there is a triable issue between 236 and J. Steenhof as to whether the claim is a debt owed to a shareholder or whether the claim relates to the shareholder's investment in the corporation for the purchase of its shares. That needs to be decided in some binding manner. Absent a claims process, the Receiver is not in a position to make any determination. At the end of the day, however, that is really a question for the unsecured creditors of 236. Mr. Klisowsky does not claim to be a creditor of 236, let alone a secured creditor. He claims to be a shareholder. The information suggests that the shareholders of 236 are likely to receive nothing for any shareholders' loans, let alone any equity they may have in that corporation.

123 It is certainly not an issue that can be decided summarily and will likely be a time consuming and expensive exercise.

124 The Receiver cannot be criticized for its approach to this claim and there is nothing commercially unreasonable about maintaining the J. Steenhof claims in the list of unsecured creditors.

Relief sought by Receiver

125 This takes us to the Receiver's requested relief, which I can now deal with having regard to the facts as I have found them.

1. Approving the actions, conduct and activities of the Receiver and its legal counsel outlined in the Receiver's Fourth Report to the Court dated September 3, 2019 and all other reports filed by the Receiver in these receivership proceedings

126 Whether the Receiver should have taken different action after the rain damage to the Hythe project, and whether the Receiver should have taken different action after thefts of equipment or tools from that project, are arguable issues.

127 However, Mr. Klisowsky has not raised any issues or arguments that require further evidence or a trial.

128 In response to Mr. Klisowsky's criticisms of the Receiver, counsel says that it is too late for Mr. Klisowsky to raise these arguments. The Receiver has been transparent throughout; Mr. Klisowsky has been represented throughout and has been present at most if not all of the court appearances. The allocations of assets and employees and payment of secured and preferred claims have been dealt with in the Receiver's various reports and on the court applications approving payments and transactions. Mr. Klisowsky has been silent throughout the proceedings and took no appeals from any of the orders made. Counsel argues that any suggestion that the Receiver has not acted in a commercially reasonable manner is without foundation.

129 Additionally, counsel for the Receiver points out that no expert evidence has been put forward as to what should have been done regarding any of these issues to achieve commercial reasonableness.

130 The Receiver cites *Jaycap Financial Ltd v. Snowdon Block Inc*, 2019 ABCA 47 (Alta. C.A.) on the subject of commercial reasonableness and a receiver's obligation to:

> . . . exercise such reasonable care, supervision and control of the debtor's property as an ordinary person would give to his or her own. A receiver's duty is to discharge the receiver's powers honestly and in good faith. A receiver's duty is that of a fiduciary to all interested stakeholders involving the debtor's assets, property and undertaking (at paragraph 28).

131 The Receiver says that here, it satisfied those obligations and acted in a fully transparent manner having regard to its various reports and court applications.

132 The Receiver cites *Western Union Petro International Co Ltd v. Anterra Energy Inc*, 2019 ABQB 165 (Alta. Q.B.) and argues that the record before me is sufficient to enable me to make a fair and just determination of the issues without requiring more evidence, or a trial.

133 Counsel also refers to the decision in *Royal Bank v. Melvax Properties Inc.*, 2011 ABQB 167 (Alta. Q.B.) where Veit J referred to the weight to be given to the business judgments of others involved in the matter. Here, counsel points to the support the receiver has from Nomads', Ladacor's and 236's largest creditors, Liberty Mutual and the Steenhof parties. The other large creditor, Alberta Finance, has taken no position.

134 The value of the theft was not significant in the overall scheme of things, and the Receiver's actions following the rain damage were aimed towards having Hythe continue on with some aspects of the construction contract. The objective there was to recover the amounts owed to date, and be able to make valuable use of the containers that still remain in storage. While those efforts ultimately proved unsuccessful, and the benefit of hindsight gives rise to the efficacy of those actions, the Receiver's actions do not appear to be outside the scope of commercial reasonableness. Nor do they approach the gross negligence or willful misconduct level required to have the Receiver liable for any loss resulting from those actions.

135 To the extent that the Receiver's actions have not otherwise been approved in previous orders, I am satisfied that relief should be granted to the Receiver

2. Approving the Receiver's final statement of receipts and disbursements for the period for May 18, 2018 to August 31, 2019 as set out in the Fourth Report

136 With the exception of Mr. Klisowsky's concerns addressed above, no one challenged the appropriateness of the Receiver's final statement of receipts and disbursements for this period. Mr. Klisowsky took no objection to the time spent or the hourly rates, but objected to the completeness of the Receiver's work.

137 I am satisfied that it is appropriate to approve these accounts, and do so (to the extent not already covered by Topolniski J's Order of September 13).

3. Approving the accounts, fees and disbursements of the Receiver and its independent legal counsel in connection with the completion of these receivership proceedings, including the costs of this application

138 While I do not see any problem with the anticipated accounts, fees and disbursements in connection with the completion of the receivership proceedings, I think it is more appropriate to approve these accounts, fees and disbursements when they have been incurred. Hopefully they can be completed within the budgeted amounts.

4. Approving the proposed allocation of cash held by the Receiver for Ladacor and Nomads to 236, as set out in the Fourth Report

139 I acknowledge that the Receiver's work in allocating assets and employees between Ladacor and Nomads may not have resulted in a perfect allocation. That is not because the Receiver's work was deficient or flawed. Rather, it was because of the corporate mess that existed at the time of the Receivership Order. The Receiver had to try to make sense of an undocumented and ill-conceived "takeover" of Nomads by Ladacor. The proposed method of allocation by Mr. Klisowsky is unworkable, especially as it is founded on the incorrect assumption that Nomads could assign its obligations to Ladacor in a manner that would be binding on its creditors.

140 The reality is that any reallocation of assets would be moot. Putting more assets and liabilities into Ladacor would result in Nomads making a smaller contribution to paying off the BMO debt. That would simply increase the amount of 236's secured claim for contribution from Nomads. While it might leave fewer unsecured creditors for Nomads to have to deal with, the above analysis indicates that Nomads' unsecured creditors are unlikely to make any recovery at all.

141 As such, my conclusion is that no creditor is prejudiced by the allocations that were made by the Receiver between Nomads and Ladacor.

142 The Receiver has, in my view, correctly applied the applicable principles of subrogation and contribution, such that it is appropriate to allocate all of the remaining cash of Ladacor and Nomads to 236.

5. Approving the Receiver's proposal to assign the Debtors into bankruptcy in accordance with the Receivership Order

143 What is left with the three debtor corporations is a paucity of assets and a mountain of claims against them. Only the Liberty Mutual claim involves all three corporations. Total claims (counting Liberty Mutual only once) exceed $7,000,000. None of the claims have been proven. There may be defences to some or many of the claims, and some of the claims may be excessive in amount.

144 Getting to the bottom of all of this will be time consuming and very expensive. Litigation with Hythe has already commenced. Its result is uncertain. Success on that litigation would appear to be the only real chance of any collection for Nomads' unsecured creditors. The only effective way of dealing with the numerous claims is through a statutory process such as bankruptcy. While there are possible ways of dealing with claims in a receivership, no one other than Mr. Klisowsky is recommending that the receivership continue. The Receiver's recommendation is to use the bankruptcy process to deal with the few remaining assets and myriad of claims.

145 I agree with the Receiver's recommendation and accordingly approve its proposal to assign the three debtor corporations into bankruptcy.

6. Approving the transfer of all funds and property held by or collected by the Receiver, net of costs required to complete the administration of these receivership proceedings, into the bankrupt estates of the Debtors

146 Having approved the assignments into bankruptcy, it flows that any funds and property remaining after the administration of the receivership has been completed should be transferred into the respective bankruptcy proceedings.

7. Declaring that the Receiver has duly and properly discharged its duties, responsibilities and obligations as Receiver

147 There is no valid objection to this relief being granted, to the date of this decision and insofar is the Receiver carries out the orders herein.

8. Discharging and releasing the Receiver from any and all further obligations as Receiver and any and all liability in respect of any act done by the Receiver in these receivership proceedings, and its conduct as Receiver pursuant to its appointment in accordance with the Receivership Order, or otherwise

148 This order appears to be premature, as there is still work to be done to carry out the terms of this order. To date, this relief appears appropriate but this relief should be applied for after the Receiver has completed its work and not in advance.

9. Authorizing the Receiver to transfer the books and records of the Debtors to the bankruptcy trustee, subject to preserving such records as required by statute.

149 Having approved the assignments into bankruptcy, this relief flows from that order and is granted.

Application granted in part.

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2016 ONSC 4453
Ontario Superior Court of Justice

Redstone Investment Corp. (Receiver of), Re

2016 CarswellOnt 15863, 2016 ONSC 4453, 271 A.C.W.S. (3d) 248, 40 C.B.R. (6th) 181

IN THE MATTER OF THE RECEIVER OF REDSTONE INVESTMENT CORPORATION AND REDSTONE CAPITAL COROPRATION

AND IN THE MATTER OF A MOTION PURSUANT TO SECTION 101
OF THE COURTS OF JUSTICE ACT, R.S.O. 1990, c. C.43, AS AMENDED

G.B. Morawetz J.

Judgment: October 5, 2016 *
Docket: CV-14-10495-00CL

Counsel: Ian Aversa, Jeremy Nemers, for Grant Thornton Limited., in its capacity as Receiver and Manager of Redstone Investment Corporation, Redstone Capital Corporation and 1710814 Ontario Inc. o/a Redstone Management Services
Justin Fogarty, Pavle Masic, for RIC Investors
Grant Moffat, Kyla Mahar, for RCC Investors
Harvey Chaiton, Doug Bourassa, for RMS Investors

Subject: Insolvency
Related Abridgment Classifications
Bankruptcy and insolvency
XX Miscellaneous
Headnote
Bankruptcy and insolvency --- Miscellaneous
Substantive consolidation — Court appointed receiver over three corporate entities, RI Co., RC Co. and 171 Inc. — Received assigned RI Co. and RC Co. into bankruptcy — RC Co. Investors had priority for any receivership funds over RI Co. Investors by virtue of agreement under which RC Co. was secured creditor of RI Co. — Receiver brought motion to determine whether estates of three companies should be substantively consolidated — Motion dismissed — Extraordinary remedy of substantive consolidation was not appropriate — Elements of consolidation were not present — Assets were held separately — Audited financial statements existed for RI Co. and RC Co. — Governing loan documents clearly set out that companies were separate and that obligations of RI Co. to RC Co. were subject to general security agreement — There was no unity of interest in ownership — Creditor's motivation for investing is not relevant to considerations set out in test for substantial consolidation — There would be significant financial prejudice to creditors of RC Co. if substantive consolidation were ordered.
Table of Authorities
Cases considered by *G.B. Morawetz J.*:

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Eastgroup Properties v. Southern Motel Assoc., Ltd. (1991), 935 F.2d 245, Bankr. L. Rep. P 74, 055 (U.S. C.A. 11th Cir.) — referred to
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In re Auto-Train Corp., Inc. (1987), 810 F.2d 270, Bankr. L. Rep. P 71, 618 (U.S. Ct. App.) — considered
In re Owens Corning (2005), 419 F.3d 195, Bankr. L. Rep. P 80, 343 (U.S. C.A. 3rd Cir.) — considered
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Snider Brothers Inc., Re (1982), 18 B.R. 230 (U.S. Mass.) — considered
Soviero v. Franklin National Bank of Long Island (1964), 328 F.2d 446 (U.S. C.A. 2nd Cir.) — considered

Statutes considered:

Bankruptcy Code, 11 U.S.C.
s. 105(a) — considered
Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3
s. 183(1) — considered
Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
Generally — referred to
Personal Property Security Act, R.S.O. 1990, c. P.10
Generally — referred to

Words and phrases considered:

substantive consolidation

Under a substantive consolidation, a number of affiliated legal entities, typically corporations, are treated as if they were one entity, resulting in the assets of the various debtors being pooled to create a common fund out of which claims of creditors of all the debtors are jointly satisfied.

MOTION by receiver to determine whether three corporate entities should be substantively consolidated.

***G.B. Morawetz J.*:**

Introduction

1 This motion seeks a determination of whether the estates of three corporate entities — Redstone Investment Corporation ("RIC"), Redstone Capital Corporation ("RCC"), and 1710814 Ontario Inc. o/a Redstone Management Services ("RMS") — should be substantively consolidated.

2 The motion was brought by Grant Thornton Limited in its capacity as court-appointed receiver ("GTL" or the "Receiver") of the property, assets and undertakings of RIC, RCC, and RMS (collectively "Redstone").

3 To facilitate the determination of this issue, Newbould J. granted an order, which, among other things, appointed representative counsel ("RIC Representative Counsel") to represent the interests of parties who hold promissory notes issued by RIC (the "RIC Investors"), representative counsel ("RCC Representative Counsel") to represent the interests of all parties who

hold bonds issued by RCC (the "RCC Investors"), and representative counsel ("RMS Representative Counsel") to represent the interests of all parties who invested money with RMS ("RMS Investors").

4 The order of Newbould J. provides that any RIC Investor, RCC Investor, and RMS Investor who is not represented by their respective Representative Counsel will nonetheless be bound by the decision made in respect of this motion.

5 In the absence of substantive consolidation of RIC, RCC, and RMS, the RCC Investors have priority for any receivership funds over the RIC Investors by virtue of an inter-corporate agreement under which RCC is a secured creditor of RIC.

6 The RIC and RMS Investors argue in favour of substantive consolidation; the RCC Investors oppose substantive consolidation; the Receiver put forward an independent legal opinion that it is unlikely substantive consolidation would be ordered in this case.

What is Substantive Consolidation?

7 Under a substantive consolidation, a number of affiliated legal entities, typically corporations, are treated as if they were one entity, resulting in the assets of the various debtors being pooled to create a common fund out of which claims of creditors of all the debtors are jointly satisfied. See: Janis Sarra, *"Corporate Group Insolvencies: Seeing the Forest and the Trees"* (2008) 24 B.F.L.R. 63, at p. 8.

8 The authority for substantive consolidation of bankrupt estates in Canada lies under the equitable jurisdiction of the Superior Court of Justice granted by s. 183(1) of the *Bankruptcy and Insolvency Act* ("BIA"). See:*A. & F. Baillargeon Express Inc. (Trustee of), Re* [1993] Q.J. No. 884 ("Baillargeon"), at para. 23); *Nortel Networks Corp., Re*, 2015 ONSC 2987 (Ont. S.C.J. [Commercial List]), at para. 216 and *Bacic v. Millennium Educational & Research Charitable Foundation*, 2014 ONSC 5875 (Ont. S.C.J.) .

Background

Procedural History

9 On March 24, 2014, RIC and RCC commenced proceedings under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "CCAA"), with GTL appointed as Monitor.

10 On August 8, 2014, the CCAA proceedings were converted to receivership proceedings and GTL was appointed as Receiver of the property, assets and undertakings of RIC and RCC.

11 On August 12, 2014, the Receiver assigned RIC and RCC into bankruptcy. GTL was appointed trustee in bankruptcy of each estate.

12 On September 17, 2014, the receivership proceedings were expanded, on motion by the Receiver, to include RMS.

13 A *Mareva* injunction has been in place since April 4, 2014, restraining RMS and Mr. Edmond Chin-Ho So, the founder of the Redstone group of companies, from encumbering the assets of RMS (the "Mareva Order").

Redstone Incorporation and Ownership Structure

14 RMS was incorporated on September 19, 2006, and it is wholly-owned by Mr. So. RMS was used to process loans until the establishment of RIC. Starting March 14, 2012, RMS provided administrative services to RIC and RCC through a Management Services Agreement (the "MSA"). The services provided to RIC included seeking out borrowers, reviewing suitability for investment, carrying out due diligence, and maintaining a register of outstanding RIC Notes.

15 RIC was incorporated in Ontario on September 25, 2009, and is also extra-provincially registered in Alberta. RIC was wholly-owned by Mr. So until January 28, 2014, when he transferred 60% of the shares to Mr. Eric Hansen. RIC carried on business as a commercial lender to Canadian small to medium-sized businesses and entrepreneurs seeking capital on a short-

term basis. Loans ranged from $250,000 to $2,000,000 and were payable within 30 days to one year. RIC financed its lending activities by way of a continuous offering of unsecured promissory notes ("RIC Notes") distributed under exemptions from the prospectus requirement.

16 RCC was incorporated on December 15, 2011, for the purpose of raising registered funds that would be transferred to RIC. RCC is owned 40% by Mr. So and 60% by Target Capital Inc. ("TCI"). RCC ownership was set up with TCI in voting control so that investments in RCC would qualify as a "deferred plan investment" under Canadian income tax legislation, making it eligible for registered savings plans.

17 RCC raised capital through a continuous offering of unsecured fixed rate bonds ("RCC Bonds") under the same exemptions from the prospectus requirement as the RIC Notes. RCC would then transfer the capital it obtained from investors to RIC so that RIC could use the amounts to fund new loans to third parties.

Leadership and Business Operations of Redstone

18 Mr. So created the Redstone group of companies with the aim of providing short-term high-interest loans to small and medium-sized Canadian companies. Borrowing clients came to RIC directly, through a referral, or from a bank or accounting firm. After conducting due diligence consisting of an assessment of their financial position and financing needs, loans would be arranged.

19 Mr. So is an experienced and educated participant in securities' markets. His formal education includes completion of three and a half years of a Bachelor of Commerce program at the King's University in Alberta. Upon leaving university, he joined a boutique corporate finance firm, Harris Brown, where he started as a research analyst and ultimately moved into the role of Manager of Finance and Administration. Throughout his employment, he researched target companies, worked in debt lending, and liaised with clients looking for debt or equity financing.

20 Mr. So was the president and chief executive officer ("CEO") of RIC and RCC until January 28, 2014, when he resigned from these roles following his incarceration for unrelated criminal charges. At that time, Mr. Hansen — who had been a consultant providing marketing and investor relations to the Redstone companies since the summer of 2011 — became the sole director and officer of RIC and RCC, until his own resignation on August 8, 2014, when Redstone entered receivership.

21 RIC and RCC shared the same registered office, located at 101 Duncan Mill Road, Suite 400, Toronto, Ontario. Though it had another registered office, RMS used Duncan Mill Road as its principal address.

22 Mr. So had sole signing authority for transfers between the three Redstone entities, though he contends that Mr. Chris Shaule and Mr. Karim Habib, both of whom had acted under him as portfolio analysts for the Redstone companies under contract, did as well. Mr. Shaule was responsible for maintaining the books and records of RIC and RCC. Mr. So himself maintained the books and records of RMS.

23 Mr. Hansen, together with Mr. Shaule and Mr. Habib, engaged in a review of the Redstone companies' financial position starting January 2014. Various financial irregularities came to light, so the Redstone companies and GTL on March 17, 2014, with a view to potentially acting as a court-appointed monitor in a CCAA filing.

The RCC — RIC Loan Agreement and General Security Agreement

24 To facilitate the transfer of funds, RCC and RIC entered into a loan agreement dated January 23, 2012 (the "Loan Agreement"), which provided for a loan between $250,000 and $25,000,000 that would be drawn upon with RCC's pre-approval. The agreement was signed by Mr. So on behalf of both companies. RCC lent RIC approximately $14.5 million under the agreement.

25 As part of this lending arrangement, RIC granted RCC a security interest over all of its property via a General Security Agreement (the "GSA").

26 Mr. So explained on cross-examination that, though he now understands that RCC is the first-ranking secured creditor of RIC due to the GSA, he did not appreciate that the GSA would have this effect until Redstone commenced proceedings under the CCAA in March 2014. This is a point to which I will return later in these reasons.

27 On March 14, 2014, in anticipation of the CCAA proceedings, Mr. Hansen performed a search under the *Personal Property Security Act*, R.S.O. 1990, c. P.10 (the "PPSA") over each of RIC and RCC. The RIC search revealed that RIC had no secured creditors other than TD Bank. The RCC search showed a registration in favour of RIC. Mr. Hansen caused the discharge of the RIC entry against RCC and filed a registration against RIC in RCC's favour. This registration was made prior to the CCAA proceedings.

Redstone Offerings

The Subscription Process

28 RIC Notes and RCC Bonds were issued under a continuous offering made pursuant to exemptions from the prospectus requirement of securities legislation in British Columbia, Alberta, and Ontario. Both RIC and RCC obtained investors under Offering Memoranda ("OM") — documents provided to investors in exempt distributions that set out the business of the company, including liabilities and risk factors. Neither RIC nor RCC are registered in any capacity with securities regulatory authorities.

29 As part of the subscription process, investors acknowledged receipt of the OM and were advised of the risky nature of the investment in the form of a Subscription Agreement delivered to RIC [1] or RCC, [2] depending on the product to which the investors subscribed (i.e., RIC Notes or RCC Bonds). The investors also provided a Representation Letter, in which the investor set out how they qualified for the exemption used to make the purchase. In addition, RCC Investors provided a specific release for TCI. The Subscription Agreement provides, among other information, that "the Subscriber has received and reviewed the Offering Memorandum" in connection with the purchase of the notes.

30 Each one of the RIC and RCC OM contain a section describing risk factors — "ITEM 8 — RISK FACTORS" — that includes the following statements, respectively:

> The purchase of the [RIC Notes] offered hereby is suitable only for sophisticated investors of adequate financial means who can bear the risk of loss associated with an investment in the Company and who have no need for liquidity in this investment. Prospective investors should give careful consideration to the following risk factors in evaluating the merits and suitability of an investment in the Company. The following does not purport to be a comprehensive summary of all the risks associated with an investment in the Company. Rather, the following are only certain particular risks to which the Company is subject. Management urges prospective investors to discuss such risks and other potential risks in detail with their professional advisors prior to making an investment decision.

> The purchase of [RCC Bonds] pursuant to this Offering should only be made after consulting with independent and qualified sources of investment and tax advice. Investment in the Bonds at this time is highly speculative. The Corporation's business involves a high degree of risk, which even a combination of experience, knowledge and careful evaluation may not be able to overcome. Purchasers of Bonds must rely on the ability, expertise, judgement [sic], discretion, integrity and good faith of the management of the Corporation. This Offering is suitable for investors who are willing to rely solely upon the management of the Corporation and who could afford a total loss of their investment.

The RIC Offerings

31 RIC issued seven OMs between 2010 and 2013 for the purpose of obtaining investments and one non-offering OM to amend a prior memorandum for deficient disclosure of the Loan Agreement.

32 The four OMs issued prior to the Loan Agreement advised that RIC may subsequently enter loans that could supersede the RIC Notes. These OMs state, "The [Notes] are unsecured, and as a result (i) are subordinate to any secured debt which

the Company now has or may hereafter incur, and (ii) purchasers will have no direct recourse to the assets of the Company or any other collateral."

33 However, the April 2012 OM failed to disclose the Loan Agreement entered earlier that year as a material contract. The non-disclosure contravened the requirements for a distribution under the s. 2.9 OM exemption that had been used to make distributions in Alberta and British Columbia. This led the securities regulators of those two provinces to issue deficiency letters to RIC with respect to the April 2012 OM, as well as make cease trade orders.

34 RIC settled with the securities regulators by issuing a non-offering OM on August 30, 2012 (the "Rescission OM"), which included and disclosed the RCC Loan and gave RIC Investors who subscribed under distributions based on the April 2012 OM the opportunity to rescind their investments. One investor accepted the rescission offer and the investment was repaid. The correction brought RIC in compliance with the s. 2.9 requirements. The cease trade orders were revoked by both the Alberta and British Columbia securities commissions in October 2012. [3]

35 The amended April 2012 OM and the two subsequent OMs disclose the Loan Agreement and the GSA under material contracts. They also outlined risks related to the notes, including that "[t]he present and after acquired personal property of the Company is secured in favour of RCC pursuant to the terms of the RCC Loan Agreement."

36 Since its inception, RIC has issued 925 notes raising $65,474,000. As of February 28, 2014, approximately $23,340,145 of this is outstanding to RIC Investors.

The RCC Offerings

37 RCC issued two OMs, one in 2012 and the other in 2013. [4] The Loan Agreement is discussed in both OMs: the 2012 OM indicates that RCC intends to enter a loan agreement with RIC and the 2013 OM indicates the agreement has been executed.

38 Both OMs include a summary of loan terms and advise of the risks pertaining to the loan. They indicate that the loan would "be secured by way of a General Security Agreement securing all present and after acquired personal property of RIC in favour of [RCC]." In terms of investment risk with respect to RIC, the OMs indicate that "[a] return on investment for a Subscriber under this Offering is dependent upon RIC's ability to meet its obligations of principal and interest pursuant to the RIC Loan." Further, the risks section explains that "[t]here is no assurance or guarantee that [RCC] will be repaid the RIC Loan in accordance with its terms, if at all, and any failure of RIC pursuant to its payment obligations will directly affect the ability of [RCC] to pay interest and redeem the Bonds."

39 The 2013 RCC OM appends the RIC OM issued March 1, 2013, and advises RCC Investors to review it as it details the risk factors that pertain to RIC's business.

40 Since its inception, RCC has issued 710 bonds raising $16,486,000. All of the bonds were issued after the Loan Agreement was executed. As of February 28, 2014, approximately $16,317,602 of this is outstanding to RCC Investors.

41 It is of note, though perhaps not of consequence, that the RIC and RCC OMs which reference the Loan Agreement misstate the minimum loan amount as $150,000, when the agreement actually provides that the minimum loan amount is $250,000.

Receivership: Redstone Assets and Claims

42 Each of RIC, RCC, and RMS maintained separate financial records and bank accounts. Transfers between the companies have been consistently recorded in their respective books. The Receiver undertook an examination of each company's assets.

43 The assets of RIC as of February 28, 2014, consist of its lending portfolio, which includes 35 accounts with loans totaling approximately $24,648,000. The loans are generally secured against the assets of the borrowers and personal guarantees from their respective shareholders. The sole material asset of RCC is its loan to RIC, which totals $14,260,116. According to the Receiver's investigation, RIC and RCC are owed $8,344,714 by RMS. [5]

44 The claims against each corporation and the Receiver's realizations for each estate as of June 2015 are as follows:

Entity	Claims accepted	Total claim amount	Estate amount
RIC	501	$23,434,146	$16,886,899
RCC	683	$15,849,360	$273,129
RMS	9	$9,854,219	$169,279

45 After disbursements, the Receiver holds $13,776,924. If the priority of RCC Investors is recognized, they would recover approximately 86% of their claims, and the other investors would obtain minimal, if any, recovery. If the Redstone estates are consolidated and the funds divided equally, each investor would recover approximately 28% of their claim.

Law and Argument

46 The RIC and RMS Investors ask me to exercise my equitable discretion and substantively consolidate the estates. The RCC Investors oppose consolidation. Before turning to the parties' interpretation of the facts and their respective arguments, I provide a brief overview of the law surrounding substantive consolidation in Canada and the United States, followed by a description of each party's characterization of the key facts.

47 In determining the appropriateness of substantive consolidation, all counsel referenced *Northland Properties Ltd., Re*, [1988] B.C.J. No. 1210 (B.C. S.C.), affir'd *Northland Properties Ltd., Re*, [1989] B.C.J. No. 63 (B.C. C.A.), where the court stated that in determining whether to impose substantive consolidation, the court must balance the economic prejudice to the creditors resulting from continuing corporate separateness against the economic prejudice caused by consolidation. To establish that substantive consolidation is warranted, it must be shown that the "elements of consolidation" are present, and that the consolidation would prevent a harm or prejudice or would effect a benefit generally. The "elements of consolidation" adopted in *Northland* from United States case law were as follows:

(i) difficulty in segregating assets;

(ii) presence of consolidated financial statements;

(iii) profitability of consolidation at a single location;

(iv) co-mingling of assets and business functions;

(v) unity of interests in ownership;

(vi) existence of inter-corporate loan guarantees; and

(vii) transfer of assets without observing corporate formalities.

Substantive Consolidation in the United States: Three Approaches to Assessing What is Just and Equitable in the Circumstances

48 A brief overview is included to contextualize the approach Canadian courts have adopted thus far, given the relatively limited treatment of this concept in Canada, before addressing the parties' arguments on the application of substantive consolidation to their dispute.

49 In the United States, the determination is made under the courts' equitable jurisdiction, similar to Canada. American courts have taken divergent approaches that has led to the articulation of several tests, the first regarding retaining flexibility but recently indicating that orders should be limited to very specific circumstances.

50 The power of U.S. courts to order substantive consolidation is derived not from explicit statutory provisions but rather from the Bankruptcy Court's general powers in s. 105(a) of the *Bankruptcy Code* "to issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the *Bankruptcy Code*]". Substantive consolidation has been recognized by the Supreme Court as a power under this section in *Sampsell v. Imperial Paper & Color Corp.* [6] Given its foundation upon an equitable basis, in determining whether to order substantive consolidation courts are guided by what is just and equitable in the circumstances. Three leading approaches led to the evolution of this determination.

First Approach: Three-Part Test

51 In *In re Auto-Train Corp., Inc.*, [7] the Court of Appeals for the District of Columbia Circuit moved away from relying on a list of factors to ascertain whether there has been an abuse of the corporate form and instead adopted a three-part test for determining whether or not to grant a substantive consolidation request:

1. Is there a substantial identity between the entities to be consolidated? [8]

2. Is consolidation necessary to avoid some harm or to realize some benefit?

3. If a creditor objects and demonstrates that it relied on the separate credit of one of the entities and that it will be prejudiced by the consolidation, will the demonstrated benefits of consolidation heavily outweigh the harm to the objecting creditor?

Second Approach: Two-Part Test with a Focus on Reliance

52 In *In re Augie/Restivo Baking Co., Ltd.*, [9] the Court of Appeals for the Second Circuit departed from previous cases where determinations were made without regard for creditor reliance and were only based on corporate veil principles pertaining to respecting corporate separateness, [10] and instead set a two-part approach with a focus on reliance:

1. Have creditors dealt with the entities as a single economic unit rather than relying on their separate identities in extending credit?

2. Are the affairs of the debtors so entangled that consolidation will benefit all creditors?

Third Approach: Stricter Focus on Prepetition and Postpetition Consequences of Consolidation

53 In *In re Owens Corning*, [11] the Third Circuit elected to set out a stricter approach, rejecting *Auto-Train* as creating "a threshold not sufficiently egregious and too imprecise for easy measure" and disapproving of the checklist approach used in assessing corporate separateness, holding instead that substantive consolidation is appropriate only when an applicant proves either that:

1. Prepetition, the entities for whom consolidation is sought disregarded separateness so significantly that their creditors relied on the breakdown of entity borders and treated them as one legal entity, or

2. Postpetition, their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors.

54 Interestingly, all three approaches referenced above focus on the administrative costs of separating the entities with consequent detrimental effect on all creditors. In the case at bar, this is not a factor as the assets are held separately and the books and records, although they may not be pristine, are such that the Receiver can identify the creditors of each entity.

55 I now return to the investors' key positions on this issue in the context of Redstone's receivership.

Credibility, Relevance and Findings of Facts

RIC Investors

56 In support of their submission that consolidation is appropriate, counsel for the RIC Investors contends that the Redstone companies operated as a single entity that shared business functions, resources, personnel, and cash flow, and whose assets are intermingled due to inaccurate recordkeeping. RIC Representative Counsel further highlights the following facts:

- Redstone operates a centralized cash management system, with no protocol of any kind regarding the movement of monies between RCC, RIC or RMS — even though the companies have separate bank accounts, the funds flowed between entities to serve operational needs without having any rules, policies or regulations in place in respect of recording inter-company transfers;

- Evidence by Redstone staff that they saw no distinction between how funds were advanced between RCC and RIC or RMS and RIC, and that they treated the companies interchangeably;

- Redstone personnel discovered millions of dollars of unexplained transactions, bearing the hallmark of fraudulent activity;

- The Receiver discovered an error in the RCC accounting ledger — namely, RCC bond purchases between June and September 2012 totalling $713,722 that were not recorded in the RCC accounting ledger, but the funds from which were paid to RCC and then transferred to RIC — that renders unreliable the Receiver's assertion in its Fourth Report that "transfers between bank accounts were recorded in great detail in the books of records of each of RIC and RCC";

- According to the terms of the MSA, all expenses were to be borne by RMS, but in practice RIC generally held the bulk of cash and covered expenses incurred for the benefit of all three companies, such as fees for any market dealers involved in facilitating the sale of RIC Notes or RCC Bonds, accounting and legal fees or salaries for staff;

- Mr. So's evidence that only in 2013 were attempts made to improve recordkeeping within Redstone. Further, the records before late 2013 are not accurate and make it impossible to know the true inter-company balances;

- The RMS books were never subject to an audit, and though Mr. So employed "auditors" in respect of RIC and RCC, no evidence has been produced as to the quality or assurance level of the audits, nor are any reports or working notes included in the record;

- Mr. So's evidence that he viewed the companies as a single entity, which is how he represented them to investors, and he in fact intended, in late 2013, to amalgamate RIC and RCC and wind down RMS, as a part of which the RIC Notes and RCC Bonds would be exchanged for a new and identical security;

- The representations by Mr. So and Redstone personnel to the Exempt Market Dealers (EMD) who promoted Redstone products were that investments in each company would be treated equally. The marketing materials for RIC and RCC distributed to investors were virtually identical, both describing the same investment terms, interest rates, and risks, and both failing to reference any priority for RCC Investors;

- Evidence of investors that they were led to believe RIC, RCC and RMS were interchangeable, and most investors were never informed of the Loan Agreement and GSA.

RMS Investors

57 Counsel to RMS Investors supports the position of the RIC Investors. In particular, RMS points to evidence by RMS and RIC Investors that they were led to believe there was no distinction between RIC and RMS or RIC and RCC. Further, RMS notes that there is no evidence that the RCC Investors relied on their priority position in making their purchases. Counsel also points to the evidence of various Redstone investors and others, who swore they made investments in Redstone and were led to believe that there was no distinction between RIC and RMS. Additionally, some of these investors swore that they were not told that RCC had a priority position and that they either did not receive an OM or only received one after the investments were made. Further, RMS Representative Counsel highlights the following evidence:

• Mr. Farouk Haji, whose affidavit detailed the process an Exempt Market Dealing Representative is required to follow prior to a client undertaking a new trade in an exempt market product, did not discuss whether he advised any clients of the priority position of RCC over RIC;

• There is no evidence from any RCC Investor that they relied on the priority position in making their investments;

• Ms. Cynthia Lewis' second investment in RIC, made in February 2011 in the amount of $540,000, was not treated in accordance with the OM in place at the time: she was first assigned RIC security against the ultimate borrower that was discharged in 2011 without her knowledge, and when her promissory note from RIC matured and rolled over in the February 16, 2012, after having already rolled over a number of times, the replacement note was issued by RMS rather than RIC but the language of the note nonetheless required interest payments from RIC. Ms. Lewis advises that Mr. So explained the rollover to RMS as due to RMS being for "friends and family";

• Mr. Chad MacDonald received a promissory note from RMS and RMS agreed to assign him a portion of the security it obtained from the ultimate borrower, Green Dot Finance Inc. However, the Green Dot loan, which formed the security for the investment and which appeared to be an asset of RIC, was sold for full face value to Maple Brook.

RCC Investors

58 RCC Representative Counsel contends that consolidation would unduly prejudice the RCC Investors' interests as this is not a case where corporate formalities were not maintained or the liabilities were not readily identifiable. They point to the following in support of this position:

• The creditor pools of RIC and RCC are different, the creditors invested in each entity based on distinct OMs prepared on a single-entity basis, and the creditors of each entity are identifiable;

• RIC, RCC and RMS each maintained separate bank accounts. The evidence available to the Receiver and its consultants indicated that Mr. So did not treat each of these as one bank account. Transfers between bank accounts were recorded with great detail in the books and records of RIC and RCC;

• On cross-examination, Mr. So's evidence was that he assumed inter-company transfers were recorded in the books of the respective corporations as either receivables or payables. In addition, he advised staff to make best efforts to ensure the transactions pertaining to an entity stay within that entity and be processed through the correct account. He also advised them to record inter-company transfers where necessary. It was his belief and/or hope that this was undertaken properly;

• The assets of each Redstone corporation are different and identifiable. RIC's assets as of February 28, 2014, consisted of its lending portfolio which included 35 accounts with loans totaling approximately $24.648 million. The loans were all secured against the assets of the underlying borrower, and typically were supported by personal guarantees from shareholders where the borrower was a corporation. RCC's sole material asset is the loan receivable from RIC, on a secured basis in the amount of $14,260,116. The assets of RMS are identified by Mr. So in his sworn affidavit as several loan receivables, office furniture and the like, which he valued at $4,706,510. The assets and liabilities of RMS have been the subject of a forensic review undertaken by GTL in its capacity as Monitor and Receiver;

• RIC and RCC had separate audited and unaudited financial statements and did not prepare consolidated financial statements. The most recent audited financial statements for RIC and RCC were dated August 31, 2012. RMS also maintained separate financial records;

• Note 6 of the audited and unaudited financial statements of RCC attached to the RCC 2013 OM states that the loan from RCC to RIC is secured by way of a GSA on all present and after-acquired property of RIC.

Mr. So's Evidence on Cross-Examination

59 As articulated above, counsel to RCC relies on the evidence of Mr. So to support its position. I have reviewed the affidavits and the transcript of Mr. So's cross-examination and have come to the conclusion that his evidence is unreliable and should be disregarded.

60 In many cases, the answers provided by Mr. So on cross-examination belie the fact that he is highly educated and very experienced in the financial field. Mr. So was asked about the inter-company transfers between each of RMS, RIC and RCC. Mr. So answered that when such inter-corporate transfers occur, there would be an appropriate entry, whether a receivable or payable, in the relevant books and records of those companies.

61 Mr. So was also asked about the Cease Trade Order that related to RCC and RIC. He was asked how the issue was resolved. Mr. So answered as follows:

> While Craig Betham took . . . you know, reformatted both OMs for us. And one of the things at that time was that . . . the original RCC OM was a separate OM that was created. Then, what the regulators wanted us to do, because these two companies are basically the same company, or related companies, they wanted us to do a wrapper, a wrap-around OM, so that the RIC OM had to be included in the RCC OM. That was done. Then, the second thing was we had to offer rights of rescission to all investors that invested in the previous OM, so that they had the proper information to decide if they were going to rescind or remain in the company. And then once those two things were done, we were restored back into good standing with the regulators.

62 In addition, Mr. So was asked whether he had certain friends and family who are RIC Investors. He answered in the affirmative. He also understood that if the RIC Investors were successful on this substantive consolidation initiative, it would be reflected in the ultimate distribution to the investors.

63 Mr. So was asked questions with respect to the GSA provided by RIC to RCC, executed January 23, 2012.

> Question 518: Can you tell me, in your own words, what you think this document purports to do?
>
> Answer: I remember that this was when we created Redstone Capital. It was what . . . I believe the lawyers, for Craig Skauge . . . I can't remember who at that time had told us that it was to be put in place in order to make RCC RSP eligible or something of that sort, that there had to be a securities agreement in place into RIC. But one of the things that I wanted to add, was that I had always spoken to him about, that this was, is in *pari passu* with all RIC Investors . . .
>
> Question 528: So it's your evidence today that starting from your years at Harris Brown and subsequently your years at Redstone, where your primary function was to lend money to entities to take security for those loans, that you did not understand what this general security agreement did?
>
> Answer: I understood that RCC was taking a GSA at RIC. Yes, I understood that.
>
> Question 529: So we'll start again. When you executed this document in January 2012.
>
> Answer: Yes.
>
> Question 530: [D]id you understand that the effect of this document would be to grant a security interest in and to RCC, with respect to RIC's assets?
>
> Answer: I understood that it would be granting a security interest. Yes I did . . .
>
> Question 531: Okay.
>
> Answer: My understanding . . . and which is why all marketing material, and the way that Redstone has always been presented to all investors and EMDss, was that everything was *pari passu*. The only difference between RCC and RIC was RCC was registered funds and RIC were non-registered.

Question 532: I understand that, but I guess. I just want to make sure I understood what you're saying to me. We have established that you understand what a general security agreement is.

Answer: Yes.

Question 533: And what a general security agreement does? And the effect of a general security agreement.

Answer: Yes.

Question 534: And you agree that this document has the effect of a typical general security agreement?

Answer: Yes.

Question 535: And you agree that you have executed this document.

Answer: Yes.

Question 536: But you're telling me that you always had the impression that RIC and RCC would be treated on a *pari passu* basis. I have a hard time how that holds together.

Answer: Well because that's what I had spoken to the lawyers about when we were creating the RCC OM and everything. That it was . . . everyone was always to be *pari passu*. And we were never told differently and that is. Mr. Hansen was even involved in that, when we were creating RCC. I never once told that RCC has a priority over RIC. . . .

64 The foregoing interchange establishes, in my view, that Mr. So's evidence is completely unreliable. It is inconceivable that an individual with a background education in commerce and finance, followed by a lengthy career in the financial industry, could make the statements that Mr. So did. He understands the effect of a GSA, which is that one party is granted security over its assets in favour of another party (the secured party). This is a fundamental and elementary financing concept. I fail to understand how Mr. So can appreciate the effect of a GSA in situations where a Redstone entity is lending money to a borrower, yet fail to understand the effects of the same type of agreement when granted by RIC in favour of RCC. It is impossible to reconcile these positions.

65 I find that Mr. So's attempt to explain this anomaly arose *ex post facto*. Mr. So arrived at his *pari passu* understanding not at the time of granting the security, but subsequent to the collapse of Redstone and the initiation of these proceedings in an attempt to justify that the three entities in question should be consolidated for distribution purposes. The fact that substantive consolidation, if granted, favours his family and friends, cannot be overlooked.

66 I am satisfied that Mr. So knew that RCC was created in order that it could attract eligible funds for registered investors; that RIC was a separate entity from RCC; that RIC granted a security agreement in favour of RCC; and that the effect of granting such a security agreement resulted in RCC being a secured party holding a security interest in the assets of RIC and, therefore, having priority over RCC.

67 The evidence of Mr. So is replete with contradictions. I find his evidence to be unreliable in all respects, such that I have disregarded it in its entirety. Obviously, this finding is extremely detrimental to the position put forth by counsel on behalf of both RIC Investors and RMS Investors. RMS Investors, to the extent they rely on the evidence of Mr. So.

Investor State of Mind

68 Counsel for the RMS Investors also pointed to evidence of a number of RMS and RIC Investors who claimed they were led to believe that there was no distinction between RIC and RMS or RIC and RCC, and further that there was no evidence that RCC Investors relied on their priority position in making their purchases. In support of this argument, the RMS Investors highlighted the evidence of Cynthia Lewis, Chad MacDonald, Nick DeCesare, Robert Dodd, Dario Mirabella and Ronald Smithers. In my view, the evidence of these individuals carries little weight.

69 Their evidence has to be discounted because it is subjective evidence provided today about their state of mind and knowledge at the time they made the investment a number of years ago. Their evidence is also at odds with the language contained in the loan agreement and OMs. The evidence is suspect as these parties are aware that it is in their best financial interest to take the position that they were led to believe there was no distinction between RIC, RMS and RCC. Indeed, it would be surprising if they did not take such a position. Investors in RIC and RMS stand to receive nominal distribution unless there is substantive consolidation. This is in contrast to a projected distribution of 28% if there is substantive consolidation.

70 A review of the authorities also convinces me that their evidence is of very limited utility and is largely irrelevant. The "elements of consolidation" adopted from U.S. case law were referenced in *Northland*, supra. Absent from this list, and for good reason, is the knowledge or state of mind of the investor or creditor at the time that investments were made or credit was advanced.

71 In my view, a creditor's motivation for investing is not relevant to any of the considerations set out in the test for substantial consolidation. I considered this issue in a preliminary motion, indexed as *Redstone Investment Corp., Re*, 2016 ONSC 513 (Ont. S.C.J.), at paras. 11 — 15:

> [11] RCC Representative Counsel submits that the evidence in the Bach Affidavit is relevant as it shows Mr. Bach's motivation for investing in RCC and the actual prejudice he will suffer in the event of substantive consolidation.
>
> [12] The test for substantive consolidation was recently summarized in *Bacic v. Millennium Educational and Research Charitable Foundation*, 2014 ONSC 5875, 19 C.B.R. (6th) 286 at para 113.
>
> It requires the balancing of interest of the affected parties and an assessment whether creditors will suffer greater prejudice in the absence of consolidation and the debtors or any objecting creditors will suffer from its imposition. Regard must be had to the:
>
> a) Difficulty in segregating assets;
>
> b) Presence of consolidated Financial Statements;
>
> c) Profitability of consolidation at a single location;
>
> d) Commingling of assets and business functions;
>
> e) Unity of interests in ownerships;
>
> f) Existence of intercorporate loan guarantees; and,
>
> g) Transfer of assets without observance of corporate formalities.
>
> in order to assess the overall effect of the consolidation. (*Atlantic Yarns Inc., Re*, 2008 NBQB 144 (N.B. Q.B.); *Northland Properties Ltd., Re*, [1988] B.C.J. No. 1210 (B.C. S.C.), affirmed in *Northland Properties Ltd., Re* (1988), [1989] B.C.J. No. 63 (B.C. S.C.) and *PSINET Ltd., Re* (2002), 33 C.B.R. (4th) 284 (Ont. S.C.J. [Commercial List]).
>
> [13] In *PSINET, supra*, Farley J. held, at para. 11 that consolidation by its very nature will benefit some creditors and prejudice others and, as a result, it is appropriate to look at the overall general effect. This approach was affirmed in *Atlantic Yarns, supra*. In *J.P. Capital Corp.*, Re (1995), 31 CBR (3d) 102 (Ont. S.C.) Chadwick J. expressed concern about the consolidation of actions without knowing the effect it will have on all creditors. Chadwick J. wrote, "Although expediency is an appropriate consideration, it should not be done at the possible prejudice or at the expense of any particular creditor." In considering the relevance of *JP Capital* to this matter, I note that the *J.P. Capital* involved an "extremely complex bankruptcy" touching on a number of companies and assets, the parties were in the midst of cross-examination, and there

were issues raised with respect to the actual corporate structure of the various companies and the tracing of the assets in relationship to the parties (para.17)."

[14] In my view, Mr. Bach's motivation for investing in RCC is not relevant to any of the considerations set out in the test for substantive consolidation. As a result, in determining the overall general prejudice to both sets of creditors, it seems to me that if the evidence is not relevant, refusing leave cannot be prejudicial to Mr. Bach, as an individual creditor. The second part of the Rule 39.02(2) is not applicable as no cross-examination took place and since I have determined that the content of the affidavit is not relevant to the determination of the Substantive Consolidation Hearing, the fourth part of the test need not be considered.

[15] Accordingly, since I have concluded that the Bach Affidavit does not meet the relevance criteria of the Rule 39.02(2) test, the motion seeking leave to deliver the Bach Affidavit as evidence in the Substantive Consolidation Hearing is dismissed.

72 There is a great danger to placing any weight on the state of mind of the investor or creditor in the substantive consolidation analysis. Human nature is such that individuals would be far more likely to recite or recall a fact situation, which, if acceptable, puts them in a better financial position. All that is required would be for the individual to take the position that a number of the RIC Investors and RMS Investors are taking in these proceedings, namely, that they did not know that RCC had priority. This presupposes that the investors did not read the governing documents. It presupposes that the EMDs either did not read the governing documents or did not advise the Investors of the contents of the governing documents.

73 To recognize state of mind would result in an unacceptable level of commercial uncertainty where written contracts could be overridden by parties who voluntarily choose not to read the governing documents.

74 Counsel acknowledges that the consolidation of bankrupt estates was recently authorized in *Bacic*, supra and *D'Addario v. Ernst & Young Inc.*, 2014 ABQB 474 (Alta. Q.B.). In both cases, the assets of the corporations, business functions and financial statements were all co-mingled. However, in deciding to consolidate the estates, the court in each decision explicitly noted that consolidation would not be to the prejudice or expense of a particular creditor. In particular, the court in *D'Addario* found that "no creditor would benefit from consolidation at the expense of any other". That is clearly not so in this case. The projected distribution for RCC Investors would be reduced from 86% to 28%.

Legal Argument

75 Counsel to RMS Investors referenced the text of Dr. Janis Sarra, *Rescue: The Companies' Creditors Arrangement Act*, 2d ed (Toronto: Carswell, 2013), where the author explains the process to be followed in assessing whether to consolidate estates:

Generally, the courts will determine whether to consolidate proceedings by assessing whether the benefits will outweigh the prejudice to particular creditors if the proceedings are to be consolidated. In particular, the court will examine whether the assets and liabilities are so intertwined that it is difficult to separate them for purposes of dealing with different entities. The court will also consider whether consolidation is fair and reasonable in the circumstances of the case.

76 Based on the jurisprudence canvassed above, there are two related streams of case law in Canada on the issue of substantive consolidation in either a restructuring or a bankruptcy situation: First, the *Northland* line of cases involving analysis of: (i) the elements of consolidation; and (ii) whether consolidation would prevent a harm or prejudice or would effect a benefit generally. Second, there is a more ad hoc approach involving fact-based analysis guided by the equities.

77 In this case, the essential effect of consolidation would be to avoid the priority arrangement purportedly created by the loan documents, resulting in moderate recoveries to the investors in each of the Redstone entities. Absent consolidation, RCC Investors will receive a projected 86% recovery. RCC Investors and RMS Investors would receive a nominal recovery at best.

78 The following general principles respecting the doctrine of substantive consolidation represent a summary of Canadian case law:

(i) Are the elements of consolidation present, such as the intertwining of corporate functions and other commonalities across the group?

(ii) Do the benefits of consolidation outweigh the prejudice to particular creditors?

(iii) Is consolidation fair and reasonable in the circumstances?

79 Based on the foregoing — and knowing that the evidence of Mr. So carries no weight and that the evidence of the investors is of very limited import — the analysis of the *Northland* factors supports maintaining the status quo.

(i) Difficulty in Segregating Assets

80 The assets of each of RIC, RCC and RMS are easily identifiable, are not difficult to segregate, and have been segregated as is demonstrated by the Receiver's Statement of Receipts and Disbursements.

(ii) Presence of Consolidated Financial Statements

81 RIC, RCC and RMS did not prepare consolidated financial statements. All financial statements, audited and unaudited, were prepared on an entity-by-entity basis. The financial statements of RIC and RCC were audited. This factor supports maintaining the status quo.

(iii) Co-mingling of Assets and Business Functions

82 The only material asset of RCC is the secured inter-company receivable from RIC, which is not co-mingled with any assets of RIC or RMS. To the extent that any business functions were co-mingled, this can be explained by the MSA between RMS and RIC and the terms of the OMs that confirm that RIC was liable for all costs incurred by RCC relating to RCC's Offering. As such, this factor supports maintaining the status quo.

(iv) Unity of Interests in Ownership

83 There is no unity of interest in ownership. RIC, RCC and RMS have different ownership structures. RIC is owned 60% by Mr. So and 40% by Mr. Hansen. RCC is owned 60% by TCI and 40% by Mr. So. RMS is wholly-owned by Mr. So.

(v) Existence of Inter-Corporate Loan Guarantees

84 There are no inter-corporate loan guarantees of any third party financing. This factor supports maintaining the status quo.

(vi) Transfer of Assets Without Observance of Corporate Formalities

85 While there is evidence of transfers of assets without observance of corporate formalities, the preponderance of evidence relates to transfers from RIC/RCC to RMS. Prior to the CCAA filing, it was determined that RMS received significant unauthorized cash transfers from RIC estimated to be approximately $8.5 million. The Receiver completed an investigation and prepared an analysis relating to the source and uses of funds relating to RMS. As a result of the analysis, the Receiver determined that there is a total of approximately $8.3 million due from RMS to RIC and RCC. As such, in my view, this factor supports maintaining the status quo.

Prejudice to Creditors

86 In addition to a review of the factors set out above, the court will consider the relative prejudice to creditors that will result from substantive consolidation. In this case, substantive consolidation eliminates the secured inter-company receivable, while it is the only material asset of RCC. The result is, therefore, from an objective standpoint, extremely prejudicial to the RCC Investors as their recoveries (based on available information in the Receiver's Fourth Report) would go from 86% in a status quo scenario to 28% in a substantively consolidated estates scenario. Conversely, the RIC Investors and RMS Investors benefit

from the consolidation from effectively no recovery in a status quo scenario to a 28% recovery in a substantively consolidated scenario.

87 Investors in RCC and RIC took calculated risks based upon OMs that disclosed the RCC GSA and RIC loan. The RIC Investors acknowledge that these were risky investments and that they may not recover their investments. Now, facing the very risk they previously acknowledged, the RIC Investors seek to ameliorate the prospect of a negligible recovery against RIC to the prejudice of RCC Investors.

88 As Trainer J. explained in *Northland*, "it would be improper for the court to interfere with or appear to interfere with the rights of the creditors," and that such an appearance would be created if the estates are ordered merged for all purposes. This caution rings true in this case. To order substantive consolidation would require me to ignore written contracts and rely on subjective *ex post facto* evidence.

Conclusion

89 Substantive consolidation is an equitable remedy. The primary aim of this extraordinary remedy is to ensure the equitable treatment of all creditors. It is recognized that as consolidation effectively redistributes wealth among creditors of the related entities, individuals will invariably realize asymmetric losses or gains (see: M. MacNaughton and M. Arzoumanidis, *"Substantive Consolidation in the Insolvency of Corporate Groups: A Comparative Analysis"* (2007), ANNREVINSOLV 16, at p. 3).

90 In this case, I have concluded that it is not appropriate to invoke this extraordinary remedy. The assets are held separately and audited financial statements exist for RIC and RCC. The governing loan documents clearly set out that the corporations are separate and that the obligations of RIC to RCC are subject to a GSA. Referencing *Northland*, the "elements of consolidation" are not present. Furthermore, there would also be significant financial prejudice to creditors of RCC if substantive consolidation were ordered.

91 In the result, an order shall issue that the three corporate entities are not be to substantially consolidated.

Costs

92 The parties have previously provided costs outlines to the court, which should be incorporated into a draft order for my review.

Motion dismissed.

Footnotes

* A corrigendum issued by the court on October 17, 2016 has been incorporated herein.

1 The RIC OMs state that the subscription documents have to be delivered to RIC at its Duncan Mill Road address for all except subscriptions under RIC's first two OMs: the July 8, 2010 OM directs that forms be sent to Harris Brown & Partners Ltd. as RIC's agent, and the January 20, 2011 OM directs that forms be sent to Sterling Grace as RIC's agent. On February 20, 2014, the registration of Sterling Grace was suspended by the Ontario Securities Commission for several failures, including with respect to acting as an exempt market dealer facilitating subscriptions to Redstone Investment Corporation.

2 The RCC OMs state that the subscription documents be sent to RCC at its Duncan Mill Road address.

3 The cease trade orders were issued on June 7, 2012 in BC and June 15, 2012 in Alberta. The orders were fully revoked on October 4, 2012 in BC and October 10, 2012 in Alberta.

4 The RCC OMs are dated April 3, 2012 and March 1, 2013.

5 As a result of the *Mareva* order, the Monitor undertook a forensic review of two of RMS's bank accounts at the TD Bank. RMS also maintains an account with National Bank. The Receiver also completed an investigation and prepared completed an analysis relating to the sources and use of funds relating to RMS. As a result of this analysis, the Receiver determined that there was a total of $8,344,714 due from RMS to RIC and RCC.

6 313 U.S. 215 (U.S. Sup. Ct. 1941).

7 810 F.2d 270, Bankr. L. Rep. P 71, 618 (U.S. Ct. App. 1987). This test has been adopted by the D.C. Circuit and the Eleventh Circuit: see *Eastgroup Properties v. Southern Motel Assoc., Ltd.*, 935 F.2d 245, Bankr. L. Rep. P 74, 055 (U.S. C.A. 11th Cir. 1991). The necessity of consolidation requirement follows from *Snider Brothers Inc., Re*, 18 B.R. 230 (U.S. Mass. 1982) and the balancing of interests element flows from *Baker & Getty Financial Services Inc., Re*, 78 B.R. 139 (U.S. Bankr. N.D. Ohio 1987).

8 This is a typical *alter ego* inquiry made in corporate veil cases and generally involves consideration of the seven factors set out in In re Vecco Construction Industries, Inc., 4 B.R. 407 (Bankr. E.D. Va. 1980): 1. Difficulty in segregating assets; 2. Presence of consolidated financial statements; 3. Profitability of consolidation of a single location; 4. Comingling of assets and business functions; 5. Unity of interests in ownership; 6. Existence of inter-corporate loan guarantees; and 7. Transfers of assets without observance of corporate formalities.

9 860 F.2d 515, Bankr. L. Rep. P 72, 482 (U.S. C.A. 2nd Cir. 1988). This test has been adopted by the Second and Ninth Circuits and followed by the Fourth Circuit.

10 For example, in *Soviero v. Franklin National Bank of Long Island*, 328 F.2d 446 (U.S. C.A. 2nd Cir. 1964), the Second Circuit Court of Appeals focused the inquiry on corporate veil-based principles and specifically looked to whether there was an abuse of the corporate form or structure, including whether the companies at issue operated a single business, had the same directors, shareholders, and staff, or shared accounting records. In *Chemical Bank New York Trust Co. v. Kheel*, 369 F.2d 845 (U.S. C.A. 2nd Cir. 1966), the court found that substantive consolidation can be authorized where the finances of the entities are hopelessly entangled despite a creditor's reliance on the separate credit of the debtor companies.

11 419 F.3d 195, Bankr. L. Rep. P 80, 343 (U.S. C.A. 3rd Cir. 2005).

(11)

CITATION: Bacic v. Millennium Educational & Research Charitable Foundation, 2014 ONSC 5875

Receivership Action

COURT FILE NO.: 13-57904
DATE: 2014/10/17

ONTARIO
SUPERIOR COURT OF JUSTICE

IN THE MATTER OF AN APPLICATION PURSUANT TO SECTION 101 OF THE *COURTS OF JUSTICE ACT,* R.S.O. 1990, c. C.43, AS AMENDED

AND IN THE MATTER OF SECTION 248(3)(b) OF THE *ONTARIO BUSINESS CORPORATIONS ACT*, R.S.O. 1990, CHAPTER B.16

AND IN THE MATTER OF SECTION 241(3)(b) OF THE *CANADA BUSINESS CORPORATIONS ACT*, R.S.C. 1985, c. C-44

AND IN THE MATTER OF SECTION 253(3)(b) OF THE *CANADA NOT-FOR-PROFIT CORPORATIONS ACT*, S.C. 2009, c.23

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

BETWEEN:

LILY BACIC, RONALD AYOUB, SANDRA AYOUB, DONALD HUTCHINSON, GLORIA HUTCHINSON, KIM KRUK, DALE HEIN, PAMELA STONE, CAROLINE LEWANDOWSKY, LIM LEWANDOWSKY, ANNE LEFIER, GARY McGINN, DAVID HAMILTON, JAMES MILLER, HELENE LAMADLEINE, MARY LOU FISHER, ALLAN BRETT, RICHARD MELCER, STEPHEN CALDWELL, WENDY CALDWELL, BARRY DOUCETTE, COLLEEN MOORE, MICHELLE VEZEAU, DAVID KORNELSEN, KEVIN HARSH, LUC MALTAIS, COLLEEN MALTAIS, BOB MECH, A.A.N.T. SOFTWARE CORPORATION, TERRANCE FINNIGAN, JAMES JOSS, DAVID WISKOWSKI, MOE LITWACK, TOMY ISSA and GEORGE BOSZORMENY

Applicants

and

MILLENNIUM EDUCATIONAL & RESEARCH CHARITABLE FOUNDATION (formerly the THOMAS C. ASSALY CHARITABLE FOUNDATION), ASSALY INVESTMENT PROGRAM CORPORATION, ASSALY FINANCIAL CORPORATION, ACT 1 CORP. and MILLENNIUM SPRINGS DEVELOPMENT & CONSTRUCTION CORP. (aka MILLENNIUM SPRINGS PROPERTIES LTD.) THOMAS G. ASSALY, KAREN FLOYD-ASSALY, and FRANK H. FEE, III

Respondents

AND

Bankruptcy Action **COURT FILE NO**: 33-165343

ONTARIO
SUPERIOR COURT OF JUSTICE
IN BANKRUPTCY AND INSOLVENCY

IN THE MATTER OF THE BANKRUPTCY OF MILLENNIUM EDUCATIONAL & RESEARCH CHARITABLE FOUNDATION (formerly the THOMAS C. ASSALY CHARITABLE FOUNDATION) a registered charity carrying on business in the City of Ottawa, in the Province of Ontario (the "Foundation")

COURT FILE NOS.: 33-165372; 33-165369; 33-165370 and 33-165371

ONTARIO
SUPERIOR COURT OF JUSTICE
IN BANKRUPTCY AND INSOLVENCY

IN THE MATTER OF THE BANKRUPTCY OF ASSALY FINANCIAL CORPORATION, OF THE CITY OF OTTAWA, IN THE PROVINCE OF ONTARIO, ASSALY INVESTMENT PROGRAM CORPORATION, OF THE CITY OF OTTAWA, IN THE PROVINCE OF ONTARIO AND ACT 1 CORP., OF THE CITY OF OTTAWA, IN THE PROVINCE OF ONTARIO (collectively the "Bankrupt Respondent Corporations")

BEFORE: Kane J.

Counsel:

Martin Black, counsel for the Estate of Thomas C. Assaly (the "Estate")

Jason Dutrizac, counsel for Doyle Salewski Inc., the court appointed Interim Receiver of the Foundation, the Receiver and Manager of the respondent corporations in the Receivership Action, other than the Millennium Educational & Research Charitable Foundation ("Foundation"), and the Trustee in the Bankruptcy of the Foundation (the "Trustee")

Justin R. Fogarty, counsel for the Applicants in the Receivership Action and the Applicants in the Bankruptcy Action (the "Applicants")

HEARD: June 17 and 18, 2014 (at Ottawa)

ENDORSEMENT

[1] This is a motion by the Estate:

(1) Appealing the Notice of Disallowance by the Trustee dated May 8, 2014 of the Proof of Claim of the Estate dated April 22, 2014 for an unsecured claim in the amount of $3,813,507 (the "Claim").

(2) For an order declaring the Estate has a first priority claim to the assets, funds and receipts of the Foundation, to the extent of its claim of $3,813,507, in priority to the claims of the Applicants and other creditors of the Foundation.

(3) For an order declaring that the Applicants and other creditors of the Bankrupt Respondent Corporations in the Receivership Action and of the Bankrupt Respondent Corporations, are not to share in the assets, funds and receipts of the Foundation, by way of pooling or consolidation of assets, funds or receipts.

[2] The Estate submits that:

(1) Based on s. 135 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended (the "*BIA*"), the gifts and settlements made by the late Thomas C. Assaly to create the Foundation and advance its stated objects have failed and must therefore be returned in first priority to his Estate in priority to the Foundation's creditors and other claimants without allowing any pooling or consolidation of other Respondents' or Bankrupts' estates, assets or liabilities.

(2) As the Settlor of the capital monies of the Foundation, TCA if alive, would have a claim to the assets under receivership on the basis that the purposes of his gift to the Foundation were subject to a condition subsequent that the monies be used for the express purposes of the Foundation.

(3) Gifts of money or property can be made subject to a condition subsequent after the gift has taken effect. Non-fulfillment of the condition subsequent will put an end to the gift whereupon the property reverts to the original owner.

(4) The rights and obligations of the deceased succeed to the Estate Trustee and because the Settlor is entitled to a return of the monies, so is the Estate Trustee.

(5) The position of the Settlor, and therefore his Estate, take priority over claims of any investor in the Bankrupt Respondent Corporations who were defrauded by Thomas G. The Applicants should only have resort to the assets of the corporations in which they invested, not the assets of the Foundation; unless there are funds surplus to the Estate's claim, but only if it can be precisely established what monies, if any, were illegally transferred from the various entities to the Foundation.

(6) The Applicants and other creditors of the Bankrupt Respondent corporations, other than the Foundation, may not share in the assets, funds and receipts of the Foundation, by way of pooling or consolidation of assets, funds or receipts.

(7) In the alternative, the monies held in the Foundation as at the date of the Guardianship Order, namely $3,817,000, are trust property by virtue of the provisions of the *Charities Accounting Act* (the "*CAA*").

(8) In the further alternative, the Estate is entitled to participate in the monies available for distribution in this proceeding.

[3] The Receiver and Trustee submits that the issues in this appeal are:

(1) Whether the Receiver erred in disallowing the Proof of Claim filed by the Estate of TCA.

(2) If the Receiver erred in disallowing the Proof of Claim, whether the monies held by the Foundation are trust properties by virtue of the *Charities Accounting Act*, Reg. 4/01 ("*CAA*").

(3) Whether, by operation of s. 67(1) of the *Bankruptcy and Insolvency Act* (the "*BIA*") and after the *CAA*, the Estate of TCA is entitled to payment to the extent

$3,813,507 in priority over the claims of the Applicants in the within application and other creditors of the Foundation.

(4) Whether the pooling distribution scheme as recommended by the Interim Receiver, should be implemented and form part of the Claims Bar Order yet to be issued and entered.

BACKGROUND

[4] The Claim was submitted by Robert Assaly, trustee on behalf of the Estate of Thomas C. Assaly ("TCA" or the "Estate") pursuant to the Claims Bar Process created pursuant to s. 50.1, subsections 65.2(4), 81.2(1), 81.3(8), 81.4(8), 102(2), 124(2), 128(1) and paras. 51(l)(e) and 66.14(b) of the *BIA* and the order of this Court dated December 23, 2013.

[5] The Estate claims $3,813,507 of assets of the Foundation which were misappropriated by Thomas G. Assaly ("Thomas G.") and his wife Karen Floyd-Assaly ("Karen FA").

[6] Prior to his death, TCA, through corporations, developed and controlled considerable corporate real estate assets.

[7] Robert Assaly and Thomas G. are each sons of the deceased TCA.

[8] Thomas G. worked for his father in one or more of the real estate or development corporations operated by TCA. Theirs was a tumultuous relationship. On occasion, Thomas G. had his employment terminated by his father, or resigned or disappeared from the Assaly corporate activities for periods of time.

1989

[9] On July 6, 1989, TCA caused the incorporation of the Thomas C. Assaly Charitable Foundation. The applicants for incorporation were TCA, his two lawyers and his four children.

[10] The parties agree that TCA was its sole settlor by way of causing a transfer of assets to the Foundation having an estimated value of some $5 million.

[11] There is no evidence whether some or all of that $5 million came from TCA personally or via corporations he controlled. The issue before this Court is whether TCA or his Estate is entitled to assets now in the Foundation.

[12] As incorporated, the objects of the Foundation included the following:

(a) To hold, manage, and administer the property of the Corporation for such charitable purposes as may seem expedient from time to time to the board of directors within the scope of the following more particular objects.

(b) To acquire by way of grant gift or purchase, but without public appeal, real and personal property of every class, and to use and apply the principal and income thereof exclusively for the legally charitable purposes herein after mentioned.

(c) To expend by way of grant or gift and to contribute any kind of property and assistance whether by the erection of buildings or other structures, to all matter of legally charitable organizations in Canada for such of their objects as are legally charitable.

(d) To do and to cause to be done all such acts and things as are necessary or incidental to such purposes and objects.

(e) As authorized by by-law:

(i) To borrow money and issue debentures and securities of the corporation.

(ii) To pledge or sell such debentures and securities.

(iii) To secure such borrowings, debentures and securities by mortgage or charge of the real and personal property of the corporation.

1999

[13] By Supplementary Letters Patent, dated January 13, 1999, the name of the Foundation was changed to Thomas C. Assaly Charitable Foundation. The original objects of the

Foundation continued and included "to hold, manage and administer the property of the Corporation for such charitable purposes as may seem expedient from time to time by the Board of Directors ...".

2000 to 2006

[14] TCA was diagnosed with Parkinson's disease.

[15] TCA and the Foundation at some point after 2000, commenced litigation against his three sons and Karen FA. TCA swore an affidavit in that action indicating that Thomas G. had been problematic in his employment with his father's corporations and that they had had a falling out regarding the affairs of the Foundation resulting in the departure of Thomas G. and his non-involvement in the Foundation, allegedly since 2002.

[16] Guardianship proceedings were commenced as to TCA. The court therein appointed legal counsel to represent TCA. Ultimately, legal guardianship of TCA was ordered.

[17] The court appointed legal counsel of TCA, by letter dated April 7, 2006, states that as of that date, TCA was neither a member nor a director of the Foundation.

[18] Thomas G. continued as a member and Director of the Foundation and in fact controlled it after his father ceased participation in the Foundation. Karen FA replaced TCA in becoming a member and Secretary of the Foundation.

[19] The objects of the Foundation were changed by Supplementary Letters Patent dated August 21, 2006. Object "B" above was amended to state that funds held and/or acquired were to be used to "fund scholarships and/or bursaries and for research into neurological diseases ... substantially directed to Parkinson's Disease, followed, in priority by Alzheimer's, Multiple Sclerosis and Muscular Dystrophy."

[20] As of September 12, 2006, the funds being administered by the Foundation allegedly totalled $3,813,507. This is the amount and the 2006 source of the present claim by the Estate put forward by Robert Assaly.

[21] The court notes that Robert Assaly and Thomas G. are potential beneficiaries of any assets flowing from the Foundation into the Estate of their late father.

[22] The Estate alleges that after September, 2006, all expenditures from the Foundation were made for the personal benefit of Thomas G. and Karen FA and their children. Such expenditures include the Foundation's purchase and renovation of a residence in the State of Florida ("Canada House") in which Thomas G., Karen FA and their children resided at the time of these proceedings.

[23] The Estate acknowledges that the applicants or creditors have been defrauded by Thomas G. but stress that the applicants have never been members of the Foundation.

2007

[24] Further Supplementary Letters Patent were issued on September 20, 2007, changing the name of the Foundation to Millennium Educational and Research Charitable Foundation.

STANDARD OF REVIEW

[25] Section 135(2) of the *BIA* empowers a trustee to disallow any claim in whole or in part. Any such disallowance is final and conclusive unless appealed pursuant to s. 135(4) of the *BIA* as has occurred in the present case.

[26] The Standard of Review on an appeal is correctness where the trustee's decision involves a question of law. (*Business Development Bank of Canada v. Pinder Bueckert & Associates Inc.*, 2009 SKQB 458 at para. 20).

ESTATE'S CLAIM TO THE ASSETS OF THE FOUNDATION

[27] The 2006 Supplementary Letters Patent amending the objects of the corporation directed that the properties of the Foundation be used to fund scholarships and research into specified neurological diseases.

[28] The Estate submits that these amended objects are an implied condition subsequent and because the condition became incapable of being fulfilled due to the misappropriation of funds of the Foundation by Thomas G., the gift fails and must be returned to the Settlor, or his Estate.

[29] There are a number of problems in the argument advanced by the Estate as to this first issue.

[30] Subject to conditions, a gift, once complete, cannot be undone: *Richert v. Stewards' Charitable Foundation*, (2005) BCSC 211, at para 18; *Jardine v. Jardine*, 2002 CanLII 2749 (ONSC), at para 23; and *Singh Estate (Trustee of) v. Shandil*, 2005 BCSC 1448 at para 19; aff'd 2007 BCCA 303.

[31] There is no evidence of TCA imposing any reversionary or residual rights to receive back any portion of any monies he donated directly or caused to be donated to the Foundation, at any point in time.

[32] The Estate advances its claim on the presumption that the $3,813,507 that existed in 2006 is the then residue of the $5,000,000 donation caused to be made in 1989 by TCA.

[33] "[T]he relevant time to assess donative intent is the time of the transfer of property from one party to another" (*Campbell v. MacKenzie*, 2003 ABPC 203, at para 6 ("*Campbell*")). As such, the relevant time to assess TCA's intent with respect to any conditions is when he transferred the funds to the Foundation.

[34] There is no evidence as to the source of the $5,000,000 which TCA caused to be donated or funded into the Foundation in 1989. The present claim by the Estate is on behalf of the deceased TCA and his Estate. It is the claim of the deceased in his personal capacity.

[35] There is no evidence as to any express conditions in 1989.

[36] There is no issue that TCA in 1989 caused that funding to flow into the Foundation. The source and therefore the original ownership thereof however are not in evidence. What is known is that the deceased was a very successful developer and owner of real estate and he caused funding of $5,000,000 to be made to the Foundation in 1989.

[37] The Estate filed as part of its claim, a 2006 Charity Information Return which shows that the Foundation in 2006 had assets in the amount of the Claim, namely, $3,813,507. Those assets include an account receivable of $885,000 as well as long-term investments in the amount of $2,893,382.

[38] Pursuant to line 4,250 of the 2006 return, the $2,893,382 was "not used in the charitable program."

[39] A considerable portion of the original $5,000,000 caused to be donated to the Foundation in 1989, had already been expended according to a full and final release between and executed on September 16, 2005, by TCA, Thomas G. and the Foundation. That release records funding provided to the Foundation in 1998 by TCA in the amount of $2,858,329, which is above the $5,000,000 funding in 1989. Combined, these two donations to $7,858,329. Eight years later, there is a maximum of $3,813,507 in the Foundation.

[40] As to this 1998 funding of 2.8 million dollars, the release records that the Foundation is irrevocable beneficiary thereof. Pursuant to this release, TCA and Thomas G. forever released each other from any claims and agree not to allow the Foundation to pursue any claims against TCA for any dealings on behalf of the Foundation, provided that all loans to TCA have and will be repaid by him. There appears to have been an issue involving TCA and the Foundation.

[41] The objects of the original Foundation in 1989 are broadly stated and provide that the Foundation is to use its principal and income exclusively for legally charitable purposes. The Foundation however is permitted to borrow money, issue debentures, provide security for repayment of such debt and to construct and own real property.

[42] The August 21, 2006 Supplementary Letters Patent creating more specific charitable objectives, namely scholarships and research into neurological diseases but repeat the other above earlier general objects.

[43] TCA was neither a member nor Director of the Foundation at the time of these 2006 Supplementary Letters Patent. These amended subsequent objects are not conditions associated with or imposed by TCA or his Estate. They are amended objects enacted by the Foundation

subsequent to TCA's involvement in the Foundation. These specific neurological objects are not conditions subsequent of TCA.

[44] In its present claim of $3,813,507, being the total assets declared in the Information Return in 2006, the Estate disregards all events involving the Foundation during the next eight years.

[45] The Estate of TCA incorrectly assumes a freeze was or should be imposed on funds of the Foundation in 2006.

[46] The financial records of the Foundation in the years 2006 through 2008, indicate that it continued to distribute some money for charitable purposes.

[47] James Meuse was examined under oath by the Receiver on April 29, 2013. Mr. Meuse was a Director of the Foundation from 2008 until February, 2013. Mr. Meuse resigned because expenditures were being made from the Foundation at the direction of Thomas G., for the benefit of Mr. Thomas G.'s children and/or their education.

[48] Mr. Meuse states that the charitable donations made by the Foundation stopped in approximately October of 2011 and that no charitable donations were made between then and the time that he resigned in February of 2013.

[49] Charitable donations continued to be made by the Foundation after 2006 and it is therefore artificial to state that the Estate has a claim to the extent of the amount of the 2006 listed assets, including the $2.893 million listed as not used for charitable purposes.

[50] The combination of: (a) the final release signed by TCA in 2005 evidencing irrevocable donation to the benefit of the Foundation 2.8 million dollars, some or all of which, must be included in the 2006 statement of assets, (b) the opinion of the court appointed solicitor of TCA in 2006 that TCA had no right or interest in and to the Foundation's assets as of that point in time, and (c) the ongoing charitable donations between 2006 and 2011; directly contradicts the position that TCA or his Estate is entitled to payment of the 2006 value of the Foundation in priority to all other claims.

[51] The claim by the Estate further ignores the fact that Thomas G. undertook a program in which he systematically transferred assets belonging to other respondent corporations, including investment funds from the Applicants advanced to fund real property developments into the Foundation. The Estate now claims title to such investment funds diverted to the Foundation.

[52] Thomas G. operated the respondent corporations as departments of one commercial enterprise.

[53] There are affidavits filed by former employees including accountants within the respondent corporations, which indicate that Thomas G. intentionally inter-mingled monies and paid expenses without respecting the separate corporate identities amongst the respondent corporation.

[54] The 2007 financial statements of the Foundation indicate that the receipts for that year totalled $1,298,292, of which $1,120,163 is listed as the Enduring Properties. The Enduring Properties are defined under the Foundation's Minutes dated June 24, 2008; as the Florida property in the amount of $725,000, the Donnelly mortgage in the amount of $200,000 and the 1003-Whitney Road property outside of Ottawa of some 148 acres.

[55] The Whitney Road property was part of the Nature Walk development set up by Thomas G. under a separate respondent corporation, in which some of the investors were directed to pay their investment funds to the Foundation, which in fact occurred.

[56] The Whitney Road property originally was owned by Thomas G. Through a number of inter-corporate investment-related transactions, he sold the Whitney property for $1,500,000 to the corporation he set up to develop that property. Thomas G. received at least partial payment of this sale by the transfer of investment funds from the Applicants who were investing in his proposed real property developments. The Applicants invested the monies to finance the construction of the condominium units and a golf course in this Ontario development which was not built.

[57] The Florida property, Canada House, is a large residential home in the State of Florida which was purchased by Thomas G. and Karen FA as their residence, using monies obtained

from the Foundation according to the Receiver/Inspector and the examination of Thomas G. and Karen FA.

[58] The Minutes of Settlement between the Applicants, the Receiver and Thomas G. and Karen FA, estimates the realization to the Receiver of a low of $1,851,000 and a high of $2,801,000. Of that amount, Canada House has an estimated low value of $1,200,000 and an estimated high value of $1,400,000.

[59] Thomas G., Karen FA and their children resided continuously in Canada House in Florida since approximately February of 2013. Prior to that date, they transferred title of Canada House to the Foundation and established a tax scheme by which seven individuals invested hundreds of thousand dollars for which they received tax benefits as well as a life interest in Canada House.

[60] The Receiver determined that since the transfer of Canada House to the Foundation, extensive renovations have been carried out on that property at a cost of some $774,000. The Receiver determined that $380,000 of those renovation costs came from the Foundation. $263,000 and $131,000 of those renovation costs however came from the respondent bankrupt corporations, Assaly Financial Corporation and Assaly Investment Property Corporation respectively.

[61] The renovation costs of Canada House have largely been paid by investors who advanced monies intended for development of Ontario projects which never proceeded and then the subsequent transfer of those investment monies from the respondent corporations to the Foundation.

[62] In an attempt to distance the assets of the Foundation from these proceedings, Thomas G. and Karen FA, at that point being the only remaining Directors of the Foundation, transferred title of Canada House from the Foundation to themselves in May of 2013. This couple subsequently quit claimed any interest in Canada House to the Receiver on April 3, 2014.

[63] The Receiver determined that the investment by the Applicants in Nature Walk occurred in 2009 and the investment by the Applicants in Villa Montague occurred in 2010.

[64] The Receiver determined that the residual assets of the Assaly group of companies, including the respondent corporations other than the Foundation, were transferred to the Foundation in the years 2011 and 2012.

[65] The Receiver determined that on December 15, 2009, $159,000 was transferred from the respondent Millennium Springs Development Construction Corp. ("MSDC") and invested on behalf of the Foundation. On January 31, 2011, $80,000 was paid by MSDC for "Florida House office expenses". On May 9, 2009, $54,000 was transferred to the Foundation.

[66] The transfer of assets from the respondent corporations to the Foundation includes the transfer of monies and shares of MSDC and Assaly Financial Corporation, Act 1 Corp. "(AFC"), with a value of approximately $348,000.

[67] The Inspector previously reported to this Court that between September, 2011 and February, 2013, Thomas C. authorized the transfer of substantial assets owned by the Assaly Group of respondent corporations to the United States totalling a minimum of $806,564. The documentation disclosed to the Inspector appears to indicate that assets of an even higher value were transferred to the United States during this period of time. Specifically, all investment accounts of MSDC, AFC and AIPC were transferred to the Foundation in 2011.

[68] Mr. Thomson on behalf of TD acknowledged on his examination that multiple transfers between the respondent corporate accounts, including the Foundation were common practice as directed by Thomas G.

[69] Mr. Thomson acknowledged that at some point by February of 2013 all of the assets of the respondent corporations were consolidated into the Foundation and then moved to Florida.

[70] The purchase and establishment of assets by the Foundation in some of its subsidiary corporations derives at least partially from investment monies paid by the applicants or from transfer of their investment monies in some of the respondent corporations to the Foundation.

[71] This Court on April 18, 2013, determined that:

(a) All investment accounts of MSDC, AFC and Assaly Investment Program Corporation "(AIPC") were transferred to the Foundation in 2011.

(b) That on the instructions of Thomas G., all residual funds in the bank accounts of the Foundation were transferred from Canada to the United States on February 8, 2013.

(c) The Foundation is a body corporate affiliated to and controls MSDC.

(d) The Foundation is one of the Assaly Group of companies.

(e) The Foundation, MSDC and AIPC are affiliated body corporations under s. 22 of the *Canada Not-For-Profit Corporations Act*.

[72] The Receiver has traced the transfer and payment of funds from the respondent corporations as follows:

(a) $463,000 to Thomas G.

(b) $221,000 to Karen FA.

(c) $680,000 to the above couple.

(d) $423,000 for payment against credit cards of the above couple.

[73] MSDC, Assaly Investment Program Corporation, C. Assaly Financial Corporation and Act 1 Corporation made an assignment in bankruptcy on September 11, 2013.

[74] The Foundation, under the direction of Thomas G., was conducting commercial activity. It did so in the form of the life interest it sold in Canada House. It did so in the form of its majority ownership of the shares in several of the respondent development corporations, all of which Thomas G. controlled.

[75] The present assets of the Foundation incorporate the transfer to it of monies and assets belonging to the respondent corporations which were commercial corporations and not charities.

[76] It is now highly artificial to attempt to impose a financial silo around each of the respondent corporations, particularly the Foundation, when the directing mind of those corporations carried on business as if each corporation was only a department of one commercial entity.

TCA AND ESTATE'S CLAIM

[77] The 2006 Supplementary Letters Patent creating objects of research into neurological diseases originated from Thomas G., after the departure of TCA, cannot be relied upon now as conditions by the Estate requiring that the remaining donation revert to the Estate. The Estate is incorrect in this argument.

[78] The Estate is further incorrect as, (a) simple mathematics indicate the vast majority of the original 1989 $5,000,000 donated had been spent by 2006, (b) there is no evidence who specifically donated the $5,000,000, and (c) TCA made an irrevocable donation to the Foundation of $2,858,000 in 1998.

[79] There are no express terms as was contained in the will in the case of *Women's Christian Assn. of London v. McCormick Estate*, 1989 CarswellOnt 533, and relied upon by the Estate in this case.

[80] Case law, for the most part, stands for the principle that powers of revocation must be express: *Child v. Chase*, 1980 CarswellSask 161, at para 5; *Eberwein Estate v. Saleem*, 2012 BCSC 250 ("*Eberwein*") at para 19. As stated in *Young v. Young* (1958), 15 D.L.R. (2d) 138 (BCCA) at 139-40 (cited with approval by the Ontario Court of Appeal in *Berdette v. Berdette*, [1991] 3 O.R. (3d) 513 at p. 518 ("*Berdette*")):

> Nothing is clearer than that a gift thus made cannot be revoked unless an express power of revocation is preserved. None can be implied no matter how natural such an implication might be. Here, no matter what the plaintiff's expectations were, no power to revoke the gift to the defendant was reserved; so that was the end of the matter.

[81] The Estate, in terms of the decision in *Victoria Order of Nurses for Canada v. Greater Hamilton Wellness Foundation*, 2011 ONSC 5684, is eight years late in seeking the present

remedy. As acknowledged in that decision, the Court has jurisdiction under s. 4 of the *CAA* to require that the executor or trustee of the charity pay into court any funds in their hands. Any such order now however would involve payment of substantial and non-traceable amounts of money misappropriated from the applicants or derived from their investment in other for-profit corporations which assets Thomas G. later caused to be transferred to the Foundation which is now bankrupt.

[82] The Estate in this argument is attempting to do exactly what it correctly faults Thomas G. for doing, namely ignoring the separate legal entities of these corporations in arguing conditions subsequent entitle the Estate to reimbursement of these 2006 assets.

[83] In the face of the irrevocable release signed by TCA in 2005, the Estate cannot now argue there was a condition subsequent to the 1998 funding by TCA that the deceased or his estate is entitled to a refund of any remaining assets of the Foundation because the general charitable objects of the Foundation were, with exceptions, not complied with since 2006 or 2011.

[84] The Receiver determined that the donations to the Foundation over the years include donations from parties other than TCA. In that way, the Estate is also attempting to establish priority ahead of those other donors.

[85] At one point in time, Robert Assaly was a member of the Foundation's Board of Directors. His involvement in the Foundation and the acrimony, including litigation between Robert, and his brother, Thomas G., must have created knowledge in Robert of the inappropriate manner in which Thomas G. was administering the affairs of the Foundation. It is too late now to apply the stamp of charitable objects to the remaining inter-mingled money and assets within the Foundation which last made a charitable donation in 2011.

[86] The provisions of the *CAA* do not provide specifically for the return of an absolute gift to a donor upon a charity's directors non-adherence to the corporate objects. Such remedy however could be available under sections 4(j) and 10(1), as well as under the Court's inherent jurisdiction to regulate charities.

[87] That jurisdiction should not be exercised on the facts in this case.

[88] The directing mind of a charity cannot improperly divert monies belonging to others into a charity and thereupon use the *CAA* as a shield to defeat creditors who can trace the misappropriation of their investment into a charity. A substantial portion of the assets in the Foundation are monies misappropriated from the Applicant investors or the assets they invested in.

[89] The assets of a charitable corporation are not held by it as trustee for its charitable objects but rather are owned by that corporation beneficially, to be used in a fashion consistent with its objects. It is now generally accepted that unrestricted property of a charitable corporation is not to be construed as trust property held by a charitable corporation. As such, a charity may use an unrestricted gift to the full extent of its charitable objects based upon its corporate authority as a legal entity without the involvement of a charitable purpose trust. (*Christian Brothers*, *supra*, 390-91, 701-702 and *Terrence S. Carter*: "Donor-Restricted Charitable Gifts: A practical overview revisited II" September, 2003, at pp. 7-8).

[90] The Estate is incorrect in asserting that it has a priority to the remaining assets presently located within the Foundation in priority to the claims of the Applicant creditors.

[91] The Appellants are not entitled to money misappropriated from others because the wrongdoer deposited it in a charity.

[92] TCA and the Estate have no claim or priority to the assets in the Foundation.

TRUST

[93] A charity is not immune from liability to those who suffered at its hand. Assets of the charity, owned beneficially or in trust, are available to respond to those liabilities. *Christian Brothers of Ireland in Canada (Re)* (2000), 47 O.R. (3d) 674 Ont. C.A.). The applicants have numerous potential claims against the Foundation which include misappropriation and conversion of their money.

[94] As to the argument that TCA intended by his donations to create a trust, the Receiver has determined that no tax returns were ever filed on behalf of any alleged trust nor are there any documents reflecting the creation or the intention to establish such a trust.

[95] Such misappropriated assets belonging to the Applicants are, within the meaning of s. 67(1)(a) of the *BIA*, held by the bankrupt in trust for the Applicants.

[96] The evidence establishes a lack of certainty of intention and objects as considered in *Christian Brothers of Ireland in Canada (Re)* (1998), 37 O.R. (3d) 367 (Ont. Ct. Gen. Div.).

[97] The Appellants have failed to establish an error by the Receiver based on trust law.

[98] The Estate is not a simple creditor. The deceased caused or donated to the Foundation. The deceased acknowledged the irrevocable nature of the 1998 second donation seven years later in September of 2005.

[99] The Estate is not a creditor of the Foundation or other corporate respondents. It has no equal right to share in the consolidated remaining assets in the Foundation.

CONSOLIDATION OR POOLING

[100] As noted by Justice Farley in *PSINet Ltd. (Re)* (2002), 33 C.B.R. (4th) 284 (Ont. S.C.J.) "... consolidation by its very nature will benefit some creditors and prejudice others ..." The rationale for consolidation of assets between corporations in the present case is justified because the businesses were intertwined, were operated as a single business and the allocation of value and claims between the businesses would be burdensome).

[101] The Foundation's business was not since 2006 separate and distinct from the business activities of the other respondent corporations. As previously determined, the activities of the respondent corporations, including the Foundation, since 2006 was operated as part of one business enterprise. That business enterprise misappropriated investors' money and is indebted to the Applicants in an amount which far exceed the best realizable value of the amalgamated assets of such enterprise.

[102] Extensive professional fees have been incurred to date in the inspection, receivership, and bankruptcy proceedings involving this Assaly group of companies, including the Foundation, in Canada and the United States. The Appellants' argument that further assets should be expended

in an attempt to historically trace funding within the Foundation is inappropriate and financially impractical given the extent to which existing claims far exceed assets.

[103] Even if the monies and assets of the Foundation are trust monies, like the decision in *Re Christian Brothers*, such trust monies in the Foundation are not held in priority to the Foundation, but are available to the claims of creditors.

[104] The 2008 Board of Directors' Minutes of the Foundation demonstrates that the Foundation was carrying on business and was not restricting its activities to charitable purposes.

[105] The Foundation's Board of Directors' Minutes dated June 24, 2008, reflect that the transfer of the majority of the shares of Millennium Springs Properties Ltd. and Assaly Investment Program Corporation are transferred to the Foundation. The ownership of the majority control of these corporations, combined with the 2007 financial statements of the Foundation showing the value of the 1003 Whitney Road property and the Donnelly mortgage, both derived from respondent corporations, confirms the commercial business activities and integration of all the respondent corporations into one combined business enterprise in the Foundation, of which Thomas G. was the directing mind.

[106] A June 24, 2008 Directors' meeting refers to the Foundation's two new corporations being Millennium Springs Properties Ltd. and Assaly Investment Program Corporation. Millennium Springs Properties Ltd. is also known as Millennium Springs Development & Construction Corp. or MSDC.

[107] As to consolidating the bankrupt estates of several parties, the Court has jurisdiction at law and in equity to exercise original, auxiliary and ancillary jurisdiction in bankruptcy pursuant to s. 183(1) of the *BIA*.

[108] Substantive consolidation is appropriate where the directing mind of the bankrupt estates has conducted the affairs of the bankrupt with the total disregard for the niceties of corporate identity and separate juridical personalities.

[109] In *A. & F. Baillargeon Express Inc. (Trustee of) (Re)* (1993), 27 C.B.R. (3d) 36 para. 5, the corporate records were so hopelessly confused or non-existent that it was next to impossible to know which fixed assets belonged to which of the respective bankrupt company.

[110] Notwithstanding the absence of a statutory provision in the *BIA* in empowering the court to consolidate such bankrupt estates, the courts in Canada and the United States have relied upon their inherent jurisdiction to do so, where to do otherwise would be impractical given the intermingling and difficulty in separating access, transactions, and finances between the bankrupt estates. (Re. *Baillargeon Express Inc.*, *supra*, para. 21 as well as *Associated Freezers of Canada Inc. (Re)* (1995), 36 C.B.R. (3d) 227 (Ont. Gen. Div.)).

[111] Intermingling and uncertainty of ownership of assets or supports substantive consolidation. (*Associated Freezers of Canada Inc. (Re)*, *supra*, para. 5.)

[112] Substantive consolidation in this case if permitted, is not to the "prejudice or expense of a particular creditor" namely the Estate, as per *J. P. Capital Corp. (Re)* (1995), 31 C.B.R. (3d) 102 (Ont. Gen. Div.).

[113] The test as to substantive consolidation requires the balancing of interest of the affected parties and an assessment whether creditors will suffer greater prejudice in the absence of consolidation and the debtors or any objecting creditors will suffer from its imposition. Regard must be had to the:

(a) difficulty in segregating assets;

(b) presence of consolidated Financial Statements;

(c) profitability of consolidation at a single location;

(d) commingling of assets and business functions;

(e) unity of interests in ownership;

(f) existence of intercorporate loan guarantees; and

(g) transfer of assets without observance of corporate formalities

in order to assess the overall effect of consolidation.

(*Atlantic Yarns Inc. (Re)*, 2008 NBQB 144, paras. 33-34 and *Northland Properties Ltd. Re* [1988] B.C.J. No. 1210, affirmed in *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada (B.C.C.A.)*, [1989] B.C.J. No. 63 and *PSINet Ltd. (Re)*, *supra*, at para. 11)

[114] The above analysis of the facts establishes the difficulty in segregating the assets, the commingling of assets and business functions and the transfer of assets regardless of corporate identities. The facts establish the presence of consolidated financial statements to the extent that assets consisting of some of the developments are specifically referred to in the financial statements of the Foundation.

[115] This Court must be cognizant of the Receiver's opinion that further tracing efforts will produce uncertain results and involve the expenditure of considerably more money which is to the risk of the creditors of the bankrupt corporations and not the Foundation.

[116] Thomas G. directed and managed the respondent corporations, including the Foundation, as a consolidated commercial entity over eight years. It is artificial and impractical at this point to attempt to disengage and isolate the affairs and finances only of the Foundation.

[117] For the reasons stated, substantive consolidation of the assets of the bankrupt Estate, including the Foundation, are hereby authorized.

CONCLUSION

[118] For the above reasons, the appeal of the Estate from the disallowance of its proof of claim is hereby dismissed.

COSTS

[119] Any party seeking costs shall provide the court with brief written submissions within 30 days. Any reply thereto shall be submitted within 21 days thereafter.

Kane J.

Released: October 17, 2014

CITATION: Bacic v. Millennium Educational & Research Charitable Foundation, 2014 ONSC 5875

ONTARIO

SUPERIOR COURT OF JUSTICE

RE: LILY BACIC et al, Applicants

AND

MILLENNIUM EDUCATIONAL & RESEARCH CHARITABLE FOUNDATION, et al Respondents

BEFORE: Kane J.

COUNSEL: Martin Black, counsel for the Estate of Thomas C. Assaly

Jason Dutrizac, counsel for Doyle Salewski

Justin R. Fogarty, counsel for the Applicants

ENDORSEMENT

Kane J.

Released: October 17, 2014

(12)

COURT FILE NO.: 05-CL-005797
DATE: 2006.01.17

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

B E T W E E N:	
DAVID ASHELY, ALEX CHAPMAN, MICHAEL DePENCIER, ESTATE OF CLIVE BENNETT MORTIMER, BRUCE HEYLAND, DAVID WILLIAMS and XENOLITH	Tanya Pagliaroli, for the Plaintiffs (The "Ashley Group")
Plaintiffs	
- and -	
MARLOW GROUP PRIVATE PORTFOLIO MANAGEMENT INC., MARLOW GROUP SECURITIES INC., MARLOW GROUP INC., MARLOW PRIVATE ESTATE BUILDERS INC. and TERRENCE W. MARLOW	Derek J.Bell and Raj Sanhi, for the Receiver, A. Farber & Partners Inc.
	Terrence J O'Sullivan and M. Paul Michell for John Goudey, Thomas Abel, Shobana Ananth, Shane Anderson, Donald Bayer, Michael Caicco, Charles Cutts, John Coudey, Arnold H. Hochman, Mark Irwin, Gary Levy, Karen Malatest, Hamish McEwan, Pierre Meunier, Paul Oakley, Barry Reiter, Mike Stroud, Michelle Szames, Stephen Szames, James Turner, John Unger, and 2044102 Ontario Inc. (The "Goudey Group")
Defendants	

) Arnie Herschorn for Paul Benson,
) Brenda Benson and 145403 Ontario Inc.
) (The "Benson Group")
)
) O. Pasparakis for Goodman & Company,
) Investment Counsel Ltd.
)
) M. McNaughton and B. Wong for
) Canadian Investor Protection Fund
)
) Roy Lee for The Superintendent In
) Bankruptcy

) Jeff Carhart and Arthi Sambasivan for
) Ron Eden
)
) **HEARD:** January 6, 2006

MESBUR J

REASONS FOR DECISION

Nature of the motion:

[1] There is very little jurisprudence concerning Part XII of the *Bankruptcy and Insolvency Act*. At issue on this motion is the correct interpretation of the term "securities firm" within the meaning of Part XII of *Act,* whether trust claims can be made to cash or securities under Part XII, and whether the court should consider compelling the re-registration of certain securities on the eve of a bankruptcy.

[2] If the defendants or some of them are found to be securities firms, are assigned into bankruptcy, and if Part XII of the *Bankruptcy and Insolvency Act* applies, then the court must also address whether securities held for the Goudey Group[1], are "customer held securities" within the meaning of s.253 of the *Act*, or whether they would fall into the "customer pool fund" for distribution among all customers on a *pro rata* basis. It

[1] John Goudey, Thomas Abel, Shobana Ananth, Shane Anderson, Donald Bayer, Michael Caicco, Charles Cutts, John Coudey, Arnold H. Hochman, Mark Irwin, Gary Levy, Karen Malatest, Hamish McEwan, Pierre Meunier, Paul Oakley, Barry Reiter, Mike Stroud, Michelle Szames, Stephen Szames, James Turner, John Unger, and 2044102 Ontario Inc.

must also decide if certain limited partnership units held for the Benson Group[2] and Mr. Eden should be registered in their names prior to a bankruptcy.

[3] In addition to the analysis of these broad issues, the court must also consider receiving the Receiver's Third Report, the Supplement to it, and the Receiver's Fourth Report and approving the Receiver's activities described in them. It must also determine whether to authorize the Receiver to assign the defendants other than Terrence W. Marlow into bankruptcy, and whether, in doing so, the court should procedurally and substantively consolidate their bankrupt estates into one bankruptcy estate, so that the assets of all would form one pool against which the creditors of all could claim.

General Factual Background and the Various Stakeholders:

[4] The corporate defendants collectively referred to themselves as the "Marlow Group" or the "Marlow Financial Group". The companies making up the group are Marlow Group Private Portfolio Management Inc. ("Management Inc."), Marlow Group Securities Inc. ("Securities Inc."), Marlow Group Inc. ("Group Inc.") and Marlow Private Estate Builders Inc. ("Estate Builders Inc."). I am advised that the proper name of Estate Builders Inc. is "Private Estate Builders Inc.". The title of proceedings will be amended to reflect this correction. The defendant Terrence W. Marlow is the sole shareholder, officer and director of each of these corporate entities.

[5] Mr. Marlow operated the four companies out of one office, with one telephone number, one fax number, one set of staff, one bank account, and one set of poorly kept books. He referred to them collectively as Marlow Group, and used letterhead styled "Marlow Financial Group".

[6] Through the companies, Mr. Marlow provided a number of investor services. Management Inc. is an investment advisor and securities dealer that was registered as an investment counsel, portfolio manager and limited market dealer with the Ontario Securities Commission (the "OSC"). Securities Inc. is a securities dealer and registered investment dealer that was registered with the Investment Dealers Association of Canada (the "IDA"). Securities Inc. was also, until it ceased to be a member of the IDA, a member of the Canadian Investor Protection Fund (the "CIPF"). Estate Builders Inc. is a life insurance agency, and Group Inc. is a management company that provided services to the other three companies.

[7] Mr. Marlow was registered with the OSC as a director and advising and trading officer of Management Inc., as well as its chief compliance officer. Mr. Marlow was also registered with the OSC as a trading officer of both Management Inc. and Securities

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[2] Paul Benson, Brenda Benson and 145403 Ontario Inc.

Inc. Unfortunately, Mr. Marlow apparently suffers from an addiction to crack cocaine, for which he is currently receiving rehabilitative treatment.

[8] Because it was a registered investment counsel and portfolio manager, Management Inc. was required to file annual audited financial statements with the OSC within 90 days of its fiscal year ended December 31. It failed to do so following its 2003 year end. After that, the OSC imposed some conditions on Management Inc. One of these was to file a satisfactory reconciliation of its client accounts.

[9] Management Inc. then hired a chartered accountant, Wally Rudensky, to help meet the OSC's demands. Mr. Rudensky's reconciliation concluded there was a significant deficiency between the actual cash that Management Inc. had in its accounts, and the amount it was supposed to be holding in trust for its clients. Mr. Rudensky concluded there would be a trust cash shortfall of about $3.3 million. As a result, the OSC immediately suspended Management Inc.'s operations until an audit was complete.

[10] Mr. Rudensky worked to complete an audited version of his reconciliation. It disclosed that Management Inc. held a large number of securities for its customers, but very few of these were registered in their clients' names. Management Inc. mostly purchased large blocks of securities, and then allocated them to individual investors, although they did not register them in the clients' names. Some securities were registered in clients' names, but were held in their own personal accounts, unaffiliated with the Marlow Group.

[11] The plaintiffs, who are referred to as the "Ashley Group" comprise a group of customers all of whom were essentially in a cash position at this time. They tried to reach an agreement to have Management Inc. return their securities and cash. When that failed, they moved to have the Receiver appointed. Justice Campbell made a Receivership Order on March 9, 2005, appointing A. Farber & Partners Inc. as Receiver over the corporate defendants' assets.

[12] This motion began as the Receiver's motion to assign each of the corporate defendants into bankruptcy. Ancillary to that relief, the Receiver suggests that Management Inc. is a "securities firm" as defined in section 253 of the *Act,* and, as a result, the special provisions of Part XII of the *Act* would apply to this bankruptcy. The Receiver seeks a declaration that only those securities that were actually registered, or in the process of being registered, in the name of customers are to be considered as "customer name securities". It also wishes the bankruptcies of the corporate defendants to be consolidated both procedurally and substantively, so that the assets of all would be available to the creditors of all, and the estates would be administered as one estate. In this regard, it asks the court to consider all the

corporate defendants as one entity, operating as a securities firm, and subject to Part XII on bankruptcy.

[13] In response to the Receiver's motion, other parties and stakeholders responded, and filed cross motions. The Ashley Group supports the Receiver's position completely.

[14] The other participants on this motion are other stakeholders. The Goudey Group comprises a group of customers where were in a securities position at the time of the receivership. The Benson Group was similarly situated, as was Mr Eden. The Benson and Eden holdings were in two limited partnerships. Management Inc. holds sufficient securities to meet all its obligations to hold securities for its customers. It is only in the trust cash area that there is a significant shortfall. The Goudey and Benson Groups, along with Mr. Eden, have all brought cross-motions and oppose the Receiver's motion.

[15] The Canadian Investor Protection Fund (CIFP) is a fund that covers customers of CIPF members that have suffered or may suffer financial loss solely as a result of the insolvency of a member. CIPF is a "customer compensation body" under Part XII of the *Bankruptcy and Insolvency Act.* Of all the companies making up the Marlow Group, only Securities Inc. was a CIPF member. CIPF has participated on the motion in response to the Receiver's request for a substantive consolidation of the bankruptcies of the corporate defendants.

[16] Finally, the Superintendent in Bankruptcy has intervened pursuant to the provisions of section 5(4)(a) of the *Act.* The guiding principles for the Superintendent's intervention under s 5(4)(a) are set out in subsection 2 of Section VIII of the *Superintendent in Bankruptcy's Programs Effective April 1, 1994.* The guiding principle is stated as:

> The Superintendent may intervene in court under this paragraph where it is a question of national interest or importance concerning the bankruptcy process or where the Superintendent feels it is in the public interest to do so.

[17] The Superintendent intervenes here to make submissions on various questions of law relating to the interpretation of Part XII of the *Bankruptcy and Insolvency Act.* The Superintendent is of the view that the legal issues of what constitutes a securities firm, whether trust claims can be advanced under Part XII of the *Act,* and whether a creditor should be able to require a re-registration of securities in order to circumvent Part XII are issues of national importance.

Positions of the various stakeholders:

[18] In order to understand the motion and cross motions, it is important to understand the positions of the various stakeholders on the various issues.

The Receiver

[19] The Receiver takes the position that the corporate defendants should be assigned into bankruptcy, and that bankruptcy should proceed under the provisions of Part XII of the *Act* because Management Inc. is a securities firm as that term is defined in the *Bankruptcy and Insolvency Act*, and all the companies acted essentially as one entity. The Receiver also says that Part XII prevails in any conflict between it and any other provisions of the *Act.* For that reason, the Receiver suggests that trust claims are not permitted in security firm bankruptcies.

[20] The Receiver says that apart from some shares of Stealth Minerals Ltd. actually registered in individual clients' names, the securities that Management Inc. held for the Goudey Group, the Benson Group, and Mr. Eden are not "customer name securities" as that term is defined in the *Act.* Thus, they say that these securities should, with the remaining cash, be placed in the customer pool fund, to be shared proportionally among all the customers.

[21] The Receiver says that it would be contrary to public policy to permit the Benson Group and Mr. Eden to require that their shares be transferred into their names prior to a bankruptcy, and thus convert them into customer name securities in order to avoid their pooling with those of other customers.

The Superintendent of Bankruptcy

[22] The Superintendent of Bankruptcy has intervened on this motion in order to support the Receiver's interpretation of the definition of "securities firm", the Receiver's position that trust claims cannot be made to cash or securities under Part XII, and the Receiver's position that the court should not order the registration of certain securities in the names of certain investors on the eve of bankruptcy. The Superintendent says these legal issues are of national importance and require adjudication.

The Plaintiffs (the Ashley Group)

[23] The Ashley Group supports the Receiver's position, and that of the Superintendent in Bankruptcy.

The Goudey Group

[24] The Goudey Group puts forward a number of arguments. First, it suggests that Management Inc. is not a securities firm. Second, they say that even if it is, and Part XII applies, their securities are customer name securities, because they can be identified as "theirs". Finally, even if the securities are not customer name securities, the Goudey Group says that they can assert a trust claim to the securities which should be returned to them, and not form part of the customer pool to be shared with other investors.

The Benson Group

[25] The Benson Group wants to have Benson's name and address entered on the Register of the CMP 2003 Resource Limited Partnership and the CMP 2004 Resource Limited Partnership ("CMP"). The Benson group has added Goodman & Company, Investment Counsel Ltd. to the motion. Goodman & Company is the Manager appointed by CMP to provide investment, management, administrative and other services in relation to these two limited partnerships. The Benson Group points to these securities being a particular type of tax shelter/limited partnership investment. They say that pursuant to the Limited Partnership Agreement and the provisions of the Prospectus, Goodman & Company is required to list them as the owners of their respective percentage holdings and has failed to do so. The want the court to make an order compelling this registration, prior to the bankruptcy, in order to become customer name securities, and not fall into the customer pool fund.

Mr. Eden

[26] Mr. Eden wants to be treated similarly to the Benson Group if they have success, or the Goudey Group, if they have success. Simply put, Mr. Eden wants securities to be returned to him, however that may be accomplished.

Goodman & Company

[27] Goodman & Company takes no position on whether it should re-register the CMP partnership units or not. However, it denies that it has acted improperly in failing to register any CMP units in the names of the Benson Group or Mr. Eden. It says that the actual subscriber for the limited partnership units was Management Inc. and that is who is recorded as the subscriber for CMP 2003 and CMP 2004 on the Partnership Register. Goodman & Company wishes to be exonerated of any wrongdoing or impropriety.

Canadian Investor Protection Fund

[28] The Canadian Investor Protection Fund has participated on this motion only to oppose the substantive consolidation of the bankruptcies. A substantive consolidation, it says, could prejudice their position. It also takes the position that there are no compelling reasons to order substantive consolidation.

The Law and analysis:

[29] In order to put the issues into context, it is important to consider Part XII of the *Bankruptcy and Insolvency Act*, and its purpose. It is a relatively new part of the *Act,* having come into force in 1997, in response to what were seen as undue complexities involved in the bankruptcies of securities firms.

[30] Part XII of the *Bankruptcy and Insolvency Act* was enacted to simplify and streamline the administration of a bankrupt securities firm's estate. Before Part XII, administration of these estates was time-consuming, complex, uncertain, and costly to both investors and creditors. Customers of the bankrupt firm would raise trust and tracing concepts, which proved difficult to determine. Often, while waiting for adjudication of these trust claims, the Trustee would have to continue to hold potentially volatile securities, whose value could plummet, while customers battled over their entitlement to them.

[31] What Part XII does is to create a particular class of securities that are to be returned to customers. These are called "customer name securities". All other securities and cash held by the bankrupt firm are to be pooled in a "customer pool fund", and distributed among all the customers of the firm on a *pro rata* basis. It is easy to see why some customers would like to avoid the application of Part XII altogether, or, alternatively, have their securities designated as customer name securities, in order to avoid pooling them with other customers.

[32] It should be noted that the customer pool fund is paid out before any creditors are paid at all. If significant securities are returned to customers and do not fall into the pool, the pool will obviously be smaller. Here, if the Receiver's position prevails, the customer pool fund of securities and cash will give all the customers a return of about 60 cents on the dollar. If the Ashley/Benson/Eden positions prevail, they will have securities returned to them, and realize about 95 cents on the dollar for their claims, while the Ashley Group customers will receive less than 5 cents on the dollar.

Bankruptcy?

[33] Under the terms of the Receivership Order, the Receiver has the power to assign all the corporate defendants, apart from Securities Inc., into bankruptcy. Securities Inc.'s exclusion from this general power was made part of the Receivership Order at CIPF's request, presumably because of CIPF's particular potential obligations on the bankruptcy of one of its members. As a result, an order is required to put Securities Inc. into bankruptcy. As far as the other corporate defendants are concerned, the Receiver seeks approval of its decision to assign them into bankruptcy.

[34] There is no question that all the corporate defendants are insolvent, and that it would be in the interests of all the customers and creditors for them to be assigned into bankruptcy. No one now opposes an assignment. The only issue is whether the bankruptcy should proceed under Part XII of the *Act*, or whether it should be a "regular" bankruptcy. Determination of this issue will depend on whether some or all of the corporate defendants are "securities firms", or indeed, whether the Marlow Group should be considered as a single entity which itself is a securities firm.

[35] The "securities firm" issue has focused primarily on Management Inc., since it is the company that seems to holding the bulk of the securities and cash for the customers. As to the other corporate defendants, there is no question that Securities Inc. is a securities firm. It, however, has virtually no assets. Estate Builders Inc. is clearly not itself a securities firm. This may be relevant on the issue of substantive consolidation, but is essentially moot, since the company apparently has no assets either. Group Inc. simply provided management services to the other companies. It has some assets. This leaves the question of whether Management Inc. is a securities firm. If the bankruptcies are substantively consolidated, and Management Inc. is a securities firm, then presumably a consolidated bankruptcy would proceed under Part XII.

Securities Firm?

[36] Section 258 of the *Bankruptcy and Insolvency Act* defines the term "securities firm" as follows:

> "securities firm" means a person who carries on the business of buying and selling securities from, to or for a customer, whether or not as a member of an exchange, as principal or agent, and includes any person required to be registered to enter into securities transactions with the public, but does not include a corporate entity that is not a corporation within the meaning of section 2.

[37] The French version of the statute contains the following definition:

« courtier en valeurs mobilières » Toute personne, membre ou non d'une bourse de valeurs, qui achète des titres a un client ou pour celui-ci ou vend des titres a un client ou pour celui-ci, pour son compte ou en qualité de mandataire, et notamment celle qui a l'obligation de s'inscrire pour avoir le droit de conclure avec le public des opérations sur les titres, a l'exception des personnes qui sont exclues de la définition de « personne morale » a l'article 2.

[38] The Goudey Group sets much store in the phrase "carries on the business" in the English definition. It takes the position that in order to qualify for treatment under Part XII, a firm's primary business must be the buying and selling of securities. It says that Management Inc. held itself out primarily as an advisor. It was registered as an investment counsel, portfolio manager and limited market dealer with the OSC. Since Management Inc. never carried on business as a limited market dealer, the Goudey Group concludes that this necessarily implies Management Inc. was no more than an investment counsel and portfolio manager, and thus cannot be considered a securities firm. While the Goudey Group concedes that Management Inc. did buy securities on their behalf, they say it was only incidental to their primary business of investment counsellors. Thus, they say Management Inc. cannot be held to be a securities firm.

[39] The Superintendent points to the absence of the phrase "carries on the business" in the French version of the *Act.* Section 18 of the *Charter of Rights and Freedoms* provides in section 18 that both the English and French language versions of a Federal statute are equally authoritative. Therefore, the court must examine both to determine Parliament's intention. Each version "forms part of the context in which the other must be read".[3] The court must therefore find a common interpretation for both equally authoritative versions.

[40] While the English version includes the term "carries on the business", the French version does not. A literal translation of the phrase "*Toute personne, membre ou non d'une bourse de valeurs, qui achète des titres a un client ou pour celui-ci ou vend des titres a un client ou pour celui-ci",* from the French version is "Every person, whether or not a member of an exchange, who buys securities from a customer or for him or sells securities to a customer or for him, ...".

[41] The French version does not contain any language to suggest that buying and selling securities must be the person's *primary* business. This forms part of the context in which one must read the English version.

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[3] *Re Estabrooks Pontiac Buick* (1982), 44 N.B.R. (2d) 201, (C.A) at paragraph 19, and *Aeric Inc. v. Canada Post Corp* (1985), 16 D.L.R. (4th) 686 (F.C.A.) at p. 707

[42] The Superintendent suggests[4] that "[u]nderstanding the definition of "securities firm" to include a corporation that buys and sells securities for its customers in the course of doing business even if it also engages in other commercial activities is both a reasonable interpretation of the English version and one that is consistent with the French version". I agree.

[43] The Goudey Group says that this approach is equivalent to "reading out" the phrase "carries on the business" in the English version, and thus cannot comply with the "shared meaning rule." [5] I disagree. What the Goudey Group really wants the court to do is to read in the word "primarily" into the English definition. There is no need to do this. When one gives the usual meaning to all the words in both English and French versions, there is no inconsistency between them. Part of the firm's business must be the buying and selling of securities; it may be its primary business, or it may simply be a part of its overall business. If it is, it is a "securities firm" within the meaning of Part XII, in both English and French. This interpretation is a reasonable interpretation of the English version, and is also consistent with the French version.

[44] The Goudey Group goes on to suggest that "securities firm" should be interpreted to be consistent with the securities law definition of a securities dealer. In this regard, it points to section 1(1) of the *Securities Act* [6] and the definition there of the term "dealer" as "a person or company who trades in securities in the capacity of principal or agent." They point out that this definition differs from the definition of an "advisor", namely "a person or company engaging in or holding himself, herself or itself out as engaging in the business of advising others as to the investing in or the buying or selling of securities." They suggest that since Management Inc. was registered as an advisor under Ontario legislation, and the Goudey Group retained Management Inc. to provide them with investment advice, Management Inc. must therefore be an advisor, not a dealer, and hence not a securities firm.

[45] It would have been an easy matter for Parliament to define "securities firm" in a parallel fashion to provincial securities legislation. It did not. It has created a broad definition in Part XII. The definition carries no ambiguity.

[46] Management Inc. clearly bought and sold securities for all of its customers, whether it did so as its primary business, or as ancillary to its primary business of providing investment advice. In this regard, I note that some of the customers signed Private Client Account Agreements with Management Inc. These Agreements provided: "Individual Securities, including stocks and bonds may be purchased from time to time." The Agreements authorized the Marlow Group "to place

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[4] Superintendent's factum, paragraph 12
[5] see Ruth Sullivan, *Sullivan and Driedger on the Construction of Statutes,* 4th ed. (Markham, Ont.: Butterworths, 2002) at 80
[6] R.S.O. 1990 c. S.5

orders with brokers, investment dealers, banks or trust companies for the purchase and sale of securities."

[47] It is important to note that the definition of "securities firm" under the *Bankruptcy and Insolvency Act* includes a person "required to be registered to enter into securities transactions with the public". This, no doubt, includes firms the Goudey Group describes as brokerage firms, or stockbrokers, who must, of course be registered as dealers. Such firms are firms defined as "dealers" under Ontario securities law. However, by stating that the definition includes such persons, it must, by implication be taken to mean that the definition is not limited to such persons. Thus, the definition must include persons who need not be registered in this way. This would encompass a firm like Management Inc.

[48] As a result, it is clear that Management Inc. "carried on the business of buying and selling securities from, to or for a customer, whether or not as a member of an exchange, as principal or agent, and includes any person required to be registered to enter into securities transactions with the public". I thus conclude they are a securities firm, and therefore Part XII will apply to their bankruptcy.

Customer Name Securities?

[49] Part XII carves out a very limited class of securities that are to be returned to customers when a securities firm goes bankrupt. These are defined as "customer name securities" in section 253 in the following way:

> "customer name securities" means securities that on the date of bankruptcy of a securities firm are held by or on behalf of the securities firm for the account of a customer and are registered in the name of the customer or are in the process of being so registered.

[50] The Goudey Group points to the fact that the term "registered" is nowhere defined in Part XII. They suggest that as a result, it is enough for the securities to be identifiable as belonging to a customer, in order to be a customer name security. They reason that since Management Inc. made allocations of various securities among its customers, those securities can be identified as belonging to the customers. They say that Mr. Rudensky's Account Balance Reconciliation confirms that all of the customer assets held by the Marlow Group have been identified, and the respective owners of those assets have confirmed their ownership. They conclude their argument by stating that this ability to identify the respective owners is equivalent to registration, as contemplated by section 253. To bolster this position, they rely on the re-wording of

the section proposed in Bill C-55 [7]. There, the definition of customer name securities reads as follows:

> "customer name securities" means securities that on the date of bankruptcy of a securities firm are held by or on behalf of the securities firm for the account of a customer and are registered or recorded in the appropriate manner in the name of the customer or are in the process of being so registered or recorded, but does not include securities registered or recorded in the appropriate manner in the name of the customer that, by endorsement or otherwise, are negotiable by the securities firm. [underlining in the original]

[51] The Goudey Group suggests that this new definition clearly supports their view that it is enough simply to be able to identify the beneficial owner of a security, since this would constitute "recording in the appropriate manner" in the records of the securities firm. As a result, they say that their securities are customer name securities and must be returned to them. I disagree with this analysis.

[52] In my view, the addition of the words "or recorded in the appropriate manner" in the amendments in Bill C-55 are designed to cover situations where there is no actual registration of securities, but there is another specified method of recording ownership. This, for example, would cover limited partnerships for whom the *Limited Partnership Act* requires that general partner to maintain a record of the limited partners. This would be a name "recorded in the appropriate manner."

[53] Here, there is no evidence that any particular securities were recorded in any fashion in the names of the Ashley Group. Bill C-55 offers no assistance. The Ashley Group's securities are not customer name securities. They will form part of the customer pool fund, unless they can be excluded on the basis of a trust claim.

Trust Claims allowed under Part XII?

[54] The provisions of Part XII of the *Act* are paramount if there is a conflict with other parts of the *Act.* Section 255 of Part XII says:

> All the provisions of this Act, in so far as they are applicable, apply in respect of bankruptcies under this Part, but if a conflict arises between the application of the provisions of this Part and the other provisions of this Act, the provisions of this Part prevail.

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[7] *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*

[55] In regular bankruptcies, section 67 of the *Act* applies. It clearly states that assets held in trust by the bankrupt do not form part of the bankrupt estate. In securities firm bankruptcies, Part XII creates a kind of "super-priority" for customers. Section 261(1) vests in the trustee any securities held by the firm itself, as well as any securities and cash held by or for the account of the securities firm for a customer. The trustee is then directed to use these securities and cash to create what is called the "customer pool fund". All other assets form what is called the "general fund".

[56] By virtue of s. 262(1), the customer pool fund is allocated first to the costs of administration, if there are insufficient funds in the general fund to pay the costs, and then to distribute the balance to all the firm's customers (except deferred customers) on a *pro rata* basis. Any funds remaining after that distribution are paid into the general fund, which is disbursed according to s. 262(2.1).

[57] What does the concept of the customer pool fund do to the notion of trust claims in a Part XII bankruptcy? To date, there is only one reported case in Canada dealing with this issue.[8]

[58] In *Vantage,* Brenner J considered a Trustee's position that any trust claim to either cash or securities held by a securities firm at the date of bankruptcy vests in the Trustee. Justice Brenner held that the plain wording of the language of the section supported that view. In coming to this conclusion he considered both the plain language of the section, as well as the underlying policy of Part XII.

[59] In order to discern the policy, Justice Brenner relied on an article by B.D. Turcotte, entitled "Securities Firm Bankruptcies" [9]. That article outlined the historical complexities of securities firm bankruptcies prior to Part XII, particularly the difficulties of sorting out ownership of, or claims to securities that securities firms generally hold in many different ways for their customers. Justice Brenner concluded:

> By passing Part XII, Parliament decided to try to simplify securities firm bankruptcies by doing away with the myriad of competing trust claims and the associated legal costs and time delays in securities firm bankruptcies. Parliament recognized that securities firms deal in principally two assets: cash and securities, and so for those two asset classes, Parliament enacted the new rules in Part XII. Under s. 261, Parliament removed the entire concept of trust law for securities (except where those securities are "customer named securities") and cash.

[60] In the context of the *Vantage* case, Justice Brenner was dealing with the issue of cash. He concluded that by virtue of s. 261, all cash held by a securities firm at

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[8] *Re Vantage Securities* (1998), 9 C.B.R. (4th) 169
[9] (1997) 17:3 *Insolvency Bulletin* 75

the date of bankruptcy vested in the trustee, not just the cash owned beneficially by the securities firm. Section 261 is equally applicable to securities, and I thus agree with Brenner J's analysis, and find that all securities held by a securities firm at the date of bankruptcy vest it the trustee, not just the securities owned beneficially by the firm. The only exclusion from the pool is those securities that fall into the definition of "customer name securities". Surely the plain reading of the section suggests that cash and securities "held ...for a customer" must mean cash and securities held in trust or for the benefit of a customer. If cash and securities held in trust for a customer are to vest in the trustee in a securities firm bankruptcy, then clearly this provision is in conflict with the general provisions of section 67 that exclude trust assets from the estate. Since there is a conflict, Part XII prevails, and trust claims must be prohibited.

[61] Since I have held that Management Inc. is a securities firm, the Goudey Group's securities are not customer name securities, and have also found that they cannot assert a trust claim to them, their securities must vest in the trustee, and form part of the customer pool. This addresses the Goudey Group motion. I turn now to the arguments advanced by the Benson Group and Mr. Eden.

Require registration of the Benson Group and Eden securities?

[62] The Benson Group and Mr. Eden were also Management Inc. customers. They invested in two limited partnerships, CMP 2003 Resource Limited Partnership and CMP 2004 Resource Limited Partnership ("CMP"), as well as earlier CMP Limited Partnerships for prior years. The CMP limited partnership units are not registered in the Benson Group or Mr. Eden's names. They say their units should be registered in their names, and ask the court to require Goodman & Company to effect this registration, before any bankruptcy occurs. This, of course, would make their CMP units customer name securities that would be returned to them, since they would be registered in their names prior to bankruptcy.

[63] Simply put, the Benson Group and Mr. Eden say that both the Limited Partnership Agreement and the *Limited Partnership Act* [10] require that the names and addresses of all limited partners of the Limited Partnership must be registered in the records of the limited partnership. They also say that Prospectuses for these two limited partnerships state that shares will be registered in the name of a partner, if the partner requests it. They say they have a right to demand registration, and they are doing so now. They go further, and say that Goodman & Company has acted improperly in failing to maintain their names as owners in the records, and further, has

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[10] See s. 4(1) of the *Limited Partnership* Act, R.S.O. 1990 c. L.16, and s. 3a of Regulation 713 made under the *Limited Partnership Act*

made a misrepresentation in the prospectus, namely that it would keep a record of the limited partners.

[64] The Benson Group and Mr. Eden say that in the years before 2003, their investments in the CMP limited partnerships for the prior years were registered in their names. They also received their expected tax benefits from the investments, received tax receipts, and were acknowledged by the Limited Partnerships to be limited partners.

[65] In the years since, they also received their expected tax receipts for CMP 2003 and 2004. They say that the Receiver says Marlow's records show Marlow was holding 4500 CMP units on behalf of its customers. They point to these facts to support their view that they must therefore be limited partners of the 2003 and 2004 CMP limited partnerships, and thus are entitled to registration of their interests. This will make the investments customer name securities.

[66] Goodman & Company points out that as far as CMP and its records are concerned, in prior years, the Benson Group and Eden subscribed for the partnership units in their own names. They were recorded as limited partners for these investments. However, it was Management Inc. that subscribed for units in CMP 2003 and 2004. In compliance with its obligations under the *Limited Partnership Act*, and the Limited Partnership Agreement, CMP kept registers for unit subscribers for CMP 2003 and 2004. These register show Management Inc. as the subscriber for these units.

[67] As it did for many other securities, Management Inc. purchased blocks of CMP as subscriber, and was thus registered as the holder in its own name. It later allocated them to clients. In my view, this puts the CMP units in exactly the same position as the other securities, which I have found, are not customer name securities. Although the Benson Group and Eden do not assert a trust claim to the CMP units, it is clear to me, on the basis of who subscribed for the units, that Management Inc. was the registered holder, and held the units in trust for the Benson Group and Eden. I see no basis upon which they can require the register to be altered, since they were not the subscribers for these units. I deny their request on this basis. As a result, I need not address whether there are also public policy grounds upon which to deny it as well.

[68] This leaves the last issue; that is whether there should be both a procedural and substantive consolidation of the bankruptcies of the corporate defendants, essentially treating them as one bankruptcy of one securities firm.

Procedural and Substantive Consolidation?

[69] All the stakeholders support procedural consolidation of the bankruptcy of all the corporate defendants. No one opposes a substantive consolidation apart from

the CIPF. In order to assess its position, it is important to consider what the effect of a substantive consolidation would be.

[70] Essentially, a substantive consolidation would treat all of the corporate defendants as one entity. The assets of each would fall into one common pool, to be shared by all their creditors on a *pari passu* basis.

[71] There is no specific authority in the *Bankruptcy and Insolvency Act* to grant an order for substantive consolidation. It is common ground, however, that the court has the authority to do so under its equitable jurisdiction under section 183 of the *Act.*

[72] Few Canadian cases have dealt with substantive consolidation, although the American courts have written extensively on the subject, setting out various, and disparate, tests to support an order for substantive consolidation. We have no such assistance here.

[73] The Receiver seeks a substantive consolidation for a number of reasons. Just as it said the "Marlow Group" as a whole should be treated as a securities firm, so it says, the four corporate defendants should be treated as one legal entity for the purposes of bankruptcy. They say it is appropriate to consolidate bankrupt estates in order to avoid multiplicity of proceedings, and where the bankrupt companies have shared or pooled resources, assets, and bank accounts. Also, they say where related companies are organized in an intertwined manner, it will be reasonable that the estates be dealt with *en bloc* to realize the greatest value for all interested parties.[11]

[74] The Receiver goes on to say that all four companies operated as an interrelated entity, with shared premises, telephone, fax, bank accounts and accounting records. The Receiver says that they were operated as a single, consolidated enterprise, and should be treated as such for bankruptcy purposes, because to do so would be most expedient and cost-effective.

[75] What emerges from the few Canadian cases, however, is that although expediency is an appropriate consideration in deciding whether to grant consolidation, it should not be done at the expense or possible prejudice of any particular creditor.[12] I take this to include any possible prejudice to someone like the CIPF, which as a customer compensation body under the *Act* has some concerns about possible additional expose to claims if there is substantive consolidation, and all creditors, and perhaps customers, then have potential claims against Securities Inc., and thus against the Fund. While there is no evidence of this actually occurring, it is a concern.

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[11] *Re J.P. Capital Corp.* (1995), 31 C.B.R. (3d) 102 (Ont. Gen. Div.), and *Re Associated Freezers of Canada Inc.,* [1995] O.J. No. 2862 (Ont. Gen. Div. In Bankruptcy)
[12] *Re Associated Freezers,* above, at paragraph 5

[76] CIPF also points out that the Receiver wishes to use the only assets of Securities Inc., some cash, to fund the bankruptcy, and thus there is no practical advantage to any of Securities Inc.'s creditors to having a substantive consolidation of all the estates.

[77] CIPF says that substantive consolidation profoundly affects the substantive rights of debtors and creditors, and thus should be considered an extreme remedy and carefully scrutinized. It involves more than procedural convenience, which of course can be accomplished by the procedural consolidation that everyone supports.

[78] The Receiver has not provided evidence concerning the effect on all the creditors of all the corporate defendants if there is a substantive consolidation, and whether this will adversely affect the rights of any creditor of any individual company. Without that evidence, I cannot determine whether a consolidation would occur at the expense or to the prejudice of any particular creditor. I echo the concerns of Chadwick J in *Re J.P. Capital Corp.*[13] where he stated:

> I am concerned with consolidating the actions which will provide for pari passu distribution without knowing the effect that such an order will have on all creditors. Although expediency is an appropriate consideration it should not be done at the possible prejudice or expense of any particular creditor."

[79] I am also concerned about whether there can be a substantive consolidation where Part XII clearly applies to two of the bankrupt companies (Management Inc. and Securities Inc.), but not to Estate Builders Inc. It is a life insurance agency – there is no suggestion that it is also a securities firm. Because of this, I am not persuaded, on the record I have, that all four companies should be treated as a single securities firm for the purposes of Part XII. This has an impact on the claim for consolidation. Although Estate Builders Inc. may not have any assets, or indeed any creditors, substantive consolidation may have the unintended effect of attempting to deal with Estate Builder's bankruptcy under Part XII. Counsel for the receiver was not able to provide me with sufficient evidence to address either of my concerns.

[80] For these reasons, the motion for substantive consolidation is dismissed, without prejudice to its being renewed on further and better material. The motion for procedural consolidation of all the corporate bankrupt estates is granted.

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[13] Note 10, above, at paragraph 19

Receiver's Third and Fourth Reports

[81] There is no objection to the receipt of the Receiver's Third Report, the Supplement to it, and the Receiver's Fourth Report. There is no objection to approving the actions taken by the receiver to date. Accordingly, an order will go as requested in that regard.

[82] The receiver raised an issue concerning paragraph 28 of the Receivership Order. It is of particular relevance now, given my disposition of the motion for substantive consolidation. That paragraph relates to the Receiver's use of the assets of Securities Inc. The only asset Securities Inc. has is cash of about $120,000. The Receiver needs access to this money in order to fund its fees as the Trustee on the bankruptcies. Without substantive consolidation, this may create some difficulty. No one opposes these funds being used by the Trustee to administer all the estates. An order will therefore go deleting paragraph 28 of the Receivership Order so that the receiver can access all the money in Securities Inc. to cover trustee's fees on the procedurally consolidated bankruptcy of the corporate defendants.

Disposition:

[83] For all these reasons, an order will go as follows:

(a) Receiving the Third Report of the Receiver dated August 15, 2005, the Supplement to the Third report of the Receiver dated August 17, 2005, and the Fourth Report of the Receiver dated September 30, 2005, and approving the activities of the Receiver set out in them;

(b) Authorizing and directing the Receiver to assign all of the corporate defendants into bankruptcy, and that A. Farber & Partners Inc. shall be the trustee in bankruptcy ("Trustee");

(c) The bankruptcy estates of the corporate defendants shall be procedurally consolidated and administered together;

(d) Dismissing the Receiver's motion for substantive consolidation, without prejudice to its being renewed on further and better material;

(e) The bankruptcies of Management Inc. and Securities Inc. will proceed under Part XII of the *Bankruptcy and Insolvency Act*;

(f) The Goudey Group's motion to have certain securities declared to be customer name securities, or alternatively for a trust to be imposed on them and their being returned is dismissed;

(g) The Benson Group's and Eden's motion for the re-registration of CMP 2003 and 2004 Limited Partnership units into their names is dismissed;

(h) Declaring the 3,346,667 shares in the capital of Stealth Minerals Limited described in paragraph 7 of the Third Report are the only "customer name securities" held by Management Inc. and Securities Inc., and that the remainder of the securities they hold are not customer name securities and shall be grouped into either the "customer pool fund" or the "general fund" as appropriate in accordance with Part XII of the *Bankruptcy and Insolvency Act*;

(i) Deleting paragraph 28 of the Receivership Order of Campbell J. dated March 9, 2005;

(j) That the Trustee shall be authorized to sell sufficient securities and any other property from the bankruptcy estates in order to realize up to $250,000 of net proceeds to fund the costs of the bankruptcy, including without limitation the fees and costs of the Trustee and its counsel, and that the Trustee may apply to the Court at any time and from time to time to sell any further securities or other property from the bankruptcy estate as it may deem necessary to fund the ongoing costs of the bankruptcy;

(k) That after the assigning the corporate defendants into bankruptcy, the Receiver is authorized and directed to bring a motion before this Court to terminate the Receivership in respect of the corporate defendants and to seek approval of its final statement of receipts and disbursements as Receiver, including approval of its fees and costs and fees and costs of its counsel and the costs payable from the estate pursuant to the Order of this Court made on March 9, 2005 to counsel for the Plaintiffs and to seek a discharge of the Receiver in respect of the corporate defendants;

(l) That the Receiver and the Trustee, upon its appointment, shall incur no liability or obligation as a result of the carrying out the provisions of this Order, except for any gross negligence or wilful misconduct on its part. Nothing in this Order shall derogate from the protections afforded the Receiver by the Order dated March 9, 2005, or by section 14.06 of the *Bankruptcy and Insolvency Act,* or any other applicable legislation.

(m) Amending the title of proceedings to change the name "Marlow Private Estate Builders Inc." to "Private Estate Builders Inc.".

[84] If the parties are unable to agree on the disposition of costs of the motion and cross motions, they may make brief written submissions to me. The Receiver's are

to be delivered within 15 days of the release of these reasons, with all other parties delivering their responses within 15 days following.

MESBUR J

Released: 20060117

(13)

95 086 081

Court File Nos. 074183, 073885, 073910

ONTARIO COURT (GENERAL DIVISION)
In Bankruptcy

IN THE MATTER OF the Bankruptcy and Insolvency Act

AND IN THE MATTER OF the Bankruptcy of J.P. Capital Corporation (Bankruptcy Court File No. 074183)

AND IN THE MATTER OF the Bankruptcy of Jose Perez (Bankruptcy Court File No. 073885)

AND IN THE MATTER OF the Bankruptcy of J.P. Corporation (Bankruptcy Court File No. 073910)

Appearances:

Denis J. Power, Q.C.
counsel on behalf of the Trustee, Deloitte & Touche Inc.

Martin Z. Black, Esq.
counsel for the bankrupt, Jose Perez

REASONS FOR DECISION

CHADWICK, J.

The trustee in bankruptcy of the above three bankrupt estates seeks and order consolidating the three estates under one title of proceedings. Further they seek an order that any realization of assets in any of the three bankruptcies shall be deemed to be for the credit of

the consolidated proceedings with the intent that all creditors, regardless of which proceeding under which they filed proofs of claim, shall be entitled to share dividends on a pari passu in the division of such assets.

The application is opposed by counsel on behalf of the bankrupt, Jose Perez, and others.

At one time, the two bankrupt companies were controlled by the bankrupt Jose Perez. Shortly before the bankruptcies, there was a restructuring of the corporations and the individual bankrupt Jose Perez distanced himself from the control of these corporations.

Beside the two bankrupt corporation there are a number of other related corporations which are not part of the bankrupt estate, but in some cases, creditors of the bankrupt estates.

Counsel for the trustee acknowledges that there is no authority in the provisions of the Bankruptcy and Insolvency Act to provide for consolidation other than the general provisions of the act.

Section 4 B.I.A. states:

> The practice of the court in civil actions or matters, including the practice in chambers, shall, in cases not provided for by the act or these rules, insofar as it is applicable and not inconsistent with the act or these rules, apply to all proceedings under the act or these rules.

The Courts of Justice Act s.138 and the Rules of Practice R.6.01(1) attempt to avoid multiplicity of proceedings and provide for the consolidation of actions. The rule provides that there must be a common question of fact or law or the relief claim arises out of the same transactions or occurrences or a series of transactions or occurrences.

In Re A. and F. Baillargeon Express Inc. 37 C.B.R. (3d) 36, Greenberg J. of the Quebec Superior Court dealt with a similar application. In that case there were five bankrupt companies, and twenty-one related companies that were not bankrupt but an interim receiver had been appointed. The five bankrupt companies were operated as one company with an intermingling of customer lists, bank accounts and assets without any separate corporate identity. In addition, the twenty-one companies that were not bankrupt also operated in a similar manner; there was a total intermingling of assets, operations, creditors and liabilities of all twenty-six companies.

The trustee brought a motion seeking the consolidation and the administration of five bankrupt estates. The registrar in bankruptcy dismissed the motion and on appeal Greenberg J. allowed the consolidation order to issue.

Greenberg J. acknowledged that there was no provision in the B.I.A. for consolidation of actions, but reviewed the American Authorities and in particular an article in California Law Review, Vol. LXV, p.720 entitled "Flow-of-Assets Approach". The article referred to an American case in Chemical Bank New York Trust Company v. Kheel 369 F. 2d 845 (2d CIR. 1966) where there was a similar situation where the companies paid no attention to the formalities of a corporation and operated by intermingling all the assets and accounts and were controlled by the same board of directors. In allowing the appeal, Greenberg J. stated at p.44:

> There is also the consideration that in Bankruptcy matters the Court exercises an equitable as well as a legal jurisdiction, and that practicality is always the order of the day. It is frequently said in the jurisprudence that the Act is a "businessman's law" and that practical business considerations should not be disregarded, as they sometimes are in other domains where a strict interpretation of the law must be followed and observed.

I am satisfied that the general provisions of s.4 of the B.I.A. and the Rules of Civil Procedure and the Courts of Justice Act in Ontario provide for consolidation of actions in order to avoid multiplicity of

proceedings providing there are common questions of fact and law or the relief claimed arises out of the same transaction or occurrence or series of transactions or occurrences.

This consolidation application goes further than to consolidate for the purpose of avoiding multiplicity of proceedings and actually intermingles the assets of the corporate bankrupt into one common pool to be distributed on a pari passu basis. Rule 6.01(1) and s.138 Courts of Justice Act does not provide for an intermingling of assets and distribution from a common pool of funds.

The situation in this application differs somewhat from the facts in A. & F. Baillargeon Express Inc. in that the two bankrupt corporations maintained distinct and separate bank accounts and have acted as separate legal entities.

The other distinguishing factor is that Jose Perez, as an individual, may be in a different position relating to his discharge and that of the corporate bankrupts.

A number of the major unsecured creditors are creditors in both estates and some claim guarantees over against the bankrupt Jose Perez.

The majority of the creditors although served with this motion have not appeared and in fact have consented to the consolidation.

This consolidation application goes further than to consolidate for the purpose of avoiding multiplicity of proceedings and actually intermingles the assets of the corporate bankrupt into one common pool to be distributed on a pari passu basis. Rule 6.01(1) and s.138 Courts of Justice Act does not provide for an intermingling of assets and distribution from a common pool of funds.

I accept the evidence of Chris St. Germain, senior manager at Deloitte & Touche with reference to the fact that the consolidation of the actions will make the administration easier and no doubt in the long run, will probably save administrative fees.

My concern at this time is we are dealing with an extremely complex bankruptcy involving and touching on a number of companies and assets. Cross-examination of various people have been conducted over the past three or four months and have not yet been concluded. The actual corporate structure of the various companies and the tracing of assets in relationship to the parties is clearly in issue.

I am concerned with consolidating the actions which will provide for pari passu distribution without knowing the effect that such an order will have on all creditors. Although expediency is an appropriate consideration it should not be done at the possible prejudice or expense of any particular creditor.

Under the circumstances the application for consolidation is dismissed without prejudice to the trustee to renew the application once there has been a clearer identification of the corporate structure, the assets, and the effect a pari passu distribution would have on the unsecured creditors.

DELIVERED AT OTTAWA: February 28 , 1995.

Charbonneau J

Court File Nos. 074183, 073885, 073910

ONTARIO COURT (GENERAL DIVISION)
(In Bankruptcy)

IN THE MATTER OF the Bankruptcy and Insolvency Act

AND IN THE MATTER OF the Bankruptcy of J.P. Capital Corporation
(Bankruptcy Court File No. 074183)

AND IN THE MATTER OF the Bankruptcy of Jose Perez
(Bankruptcy Court File No. 073885)

AND IN THE MATTER OF the Bankruptcy of J.P. Corporation
(Bankruptcy Court File No. 073910)

REASONS FOR DECISION

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(14)

Most Negative Treatment: Distinguished
Most Recent Distinguished: Canada (Attorney General) v. Transcona Country Club Ltd. | 2013 MBQB 216, 2013 CarswellMan 493, [2014] 1 C.T.C. 22, [2013] M.J. No. 303, 234 A.C.W.S. (3d) 918, 296 Man. R. (2d) 93 | (Man. Q.B., Sep 10, 2013)

2001 CarswellOnt 1680
Ontario Court of Appeal

Downtown Eatery (1993) Ltd. v. Ontario

2001 CarswellOnt 1680, [2001] O.J. No. 1879, [2001] O.T.C. 257, 105 A.C.W.S. (3d) 434, 147 O.A.C. 275, 14 B.L.R. (3d) 41, 2002 C.L.L.C. 210-008, 200 D.L.R. (4th) 289, 54 O.R. (3d) 161, 8 C.C.E.L. (3d) 186

Downtown Eatery (1993) Ltd. (Respondent/Plaintiff) and Her Majesty the Queen in right of Ontario and Joseph Alouche (Appellant/Defendants)

Joseph Alouche (Appellant/Plaintiff by Counterclaim) and The Landing Strip Inc., The Landing Restaurant Inc., The Landing Restaurant (1993) Limited, Downtown Eatery Limited, Downtown Eatery (1993) Limited, Best Beaver Management Inc. (Ontario Corporation #971712), Best Beaver Management Inc. (Ontario Corporation #1042788), Twin Peaks Inc., Herman Grad and Ben Grossman (Respondents/Defendants by Counterclaim)

McMurtry C.J.O., Borins, MacPherson JJ.A.

Heard: March 6-7, 2001
Judgment: May 22, 2001
Docket: Doc. CA C33989

Proceedings: reversing (March 3, 2000), Doc. 97-CV-129317 (Ont. S.C.J.)

Counsel: *J. Gardner Hodder* , for Appellant
John Conway , for Respondents

Subject: Employment; Public; Torts; Contracts; Corporate and Commercial
Related Abridgment Classifications
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III.3 Shareholders
III.3.e Shareholders' remedies
III.3.e.ii Relief from oppression
III.3.e.ii.C Oppressive conduct
III.3.e.ii.C.5 Miscellaneous
Civil practice and procedure
XXII Judgments and orders
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XXII.23.a.vi Persons subject to
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Debtors and creditors
XII Fraudulent conveyances
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XII.11.f Burden of proof

XII.11.f.i General principles
Labour and employment law
II Employment law
II.1 Nature of employment relationship
II.1.a Elements constituting relationship between employer and employee
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Labour and employment law
II Employment law
II.6 Termination and dismissal
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II.6.c.iv Miscellaneous

Headnote

Employment law --- Termination and dismissal — Practice and procedure — Remedies — General

Employee obtained judgment for damages against B Inc. for wrongful dismissal — Employee had withdrawn motion to add B Inc.'s directors to action prior to obtaining judgment, in order to avoid adjournment — B Inc. and D Ltd. were related companies — Directors of B Inc. were also directors of D Ltd. — B Inc. and D Ltd. amalgamated and then reorganized before employee obtained judgment, making B Inc. non-operating company with no assets — Employee caused sheriff to seize money from D Ltd. in purported execution of judgment against B Inc. — D Ltd. brought action for return of money and employee brought counterclaim for order permitting him to enforce judgment against D Ltd., directors and other related companies — Counterclaim was dismissed on basis that since amalgamation and reorganization were not undertaken for purpose of defeating employee's judgment, employee was not entitled to oppression remedy — Employee appealed — Appeal allowed — Intention of depriving employee of judgment was not prerequisite for oppression remedy — Effect of reorganization was unfairly prejudicial or unfairly disregarded employee's interests — Employee had reasonable expectation that employer's affairs would be conducted with view to protecting his interests — B Inc. was profitable at time of reorganizations and directors should have maintained reserve to satisfy contingency that employee's claim may succeed.

Employment law --- Nature of employment relationship — Elements constituting relationship between employer and employee — Existence of contract of employment — Identity of employer — General

Employee obtained judgment for damages against B Inc. for wrongful dismissal — Employee had withdrawn motion to add B Inc.'s directors to action prior to obtaining judgment, in order to avoid adjournment — B Inc. and D Ltd. were related companies — Directors of B Inc. were also directors of D Ltd. — B Inc. and D Ltd. amalgamated and then reorganized before employee obtained judgment, making B Inc. non-operating company with no assets — Employee caused sheriff to seize money from D Ltd. in purported execution of judgment against B Inc. — D Ltd. brought action for return of money and employee brought counterclaim for order permitting him to enforce judgment against D Ltd., directors and other related companies — Counterclaim was dismissed on basis that employee was estopped from claiming directors or related companies were his employers and that he failed in any case to establish that doctrine of common employer was appropriate — Employee appealed — Appeal allowed — While trial judge's analysis on estoppel issue was plausible, his conclusion was not, in circumstances, correct — Fact that employee withdrew motion to add directors personally as defendants did not mean employee was precluded from alleging related companies were "common employers" — Employee's employer was consortium of companies which together operated B Inc. — While employer is entitled to establish complex corporate structures for various purposes, structures should not be utilized to work injustice in realm of employment law — Appropriate to enforce judgment not only against common employers, but against merged and successor companies which resulted from reorganization of common employers.

Practice --- Judgments and orders — Res judicata and issue estoppel — Res judicata — Persons subject to — Miscellaneous issues

Employee obtained judgment for damages against B Inc. for wrongful dismissal — Employee had withdrawn motion to add B Inc.'s directors to action prior to obtaining judgment, in order to avoid adjournment — B Inc. and D Ltd. were related companies — Directors of B Inc. were also directors of D Ltd. — B Inc. and D Ltd. amalgamated and then reorganized before employee obtained judgment, making B Inc. non-operating company with no assets — Employee caused sheriff to seize money from D Ltd. in purported execution of judgment against B Inc. — D Ltd. brought action for return of money and employee brought counterclaim for order permitting him to enforce judgment against D Ltd., directors and other related companies — Counterclaim was dismissed on basis that employee was estopped from claiming directors or related companies were his employers — Employee appealed — Appeal allowed — While trial judge's analysis on estoppel issue was plausible, his conclusion was not, in circumstances, correct — Fact that employee withdrew motion to add directors personally as defendants did not mean employee was precluded from alleging related companies were "common employers" — Only issue to which doctrine of res judicata applied was that of directors' personal liability as potential common employers.

Corporations --- Shareholders — Shareholders' remedies — Relief from oppression — Miscellaneous issues

Employee obtained judgment for damages against B Inc. for wrongful dismissal — Employee had withdrawn motion to add B Inc.'s directors to action prior to obtaining judgment, in order to avoid adjournment — B Inc. and D Ltd. were related companies — Directors of B Inc. were also directors of D Ltd. — B Inc. and D Ltd. amalgamated and then reorganized before employee obtained judgment, making B Inc. non-operating company with no assets — Employee caused sheriff to seize money from D Ltd. in purported execution of judgment against B Inc. — D Ltd. brought action for return of money and employee brought counterclaim for order permitting him to enforce judgment against D Ltd., directors and other related companies pursuant to oppression remedy — Counterclaim was dismissed on basis that amalgamation and reorganization were not undertaken for purpose of defeating employee's judgment, so that employee was not entitled to oppression remedy — Employee appealed — Appeal allowed — Intention of depriving employee of judgment was not prerequisite for oppression remedy — Effect of reorganization was unfairly prejudicial or unfairly disregarded employee's interests — Directors should have maintained reserve to satisfy contingency that employee's claim may succeed.

Table of Authorities

Cases considered by *Borins and MacPherson JJ.A.* :

Bagby v. Gustavson International Drilling Co. (1980), 24 A.R. 181 (Alta. C.A.) — referred to

First Edmonton Place Ltd. v. 315888 Alberta Ltd. (1988), 60 Alta. L.R. (2d) 122, 40 B.L.R. 28 (Alta. Q.B.) — considered

Gray v. Standard Trustco Ltd. (1994), 29 C.B.R. (3d) 22, 8 C.C.E.L. (2d) 46 (Ont. Bktcy.) — considered

Jacobs v. Harbour Canoe Club Inc., 1999 CarswellBC 2200 (B.C. S.C. [In Chambers]) — considered

Johnston v. Topolinski (1988), 23 C.C.E.L. 285 (Ont. Dist. Ct.) — referred to

Jones v. CAE Industries Ltd. (1991), 40 C.C.E.L. 236 (Ont. Gen. Div.) — considered

MacPhail v. Tackama Forest Products Ltd. (1993), 50 C.C.E.L. 136, 86 B.C.L.R. (2d) 218, [1994] 3 W.W.R. 36, 11 B.L.R. (2d) 19 (B.C. S.C.) — referred to

Minott v. O'Shanter Development Co. (1999), 99 C.L.L.C. 210-013, 40 C.C.E.L. (2d) 1, 168 D.L.R. (4th) 270, 117 O.A.C. 1, 42 O.R. (3d) 321 (Ont. C.A.) — considered

Olson v. Sprung Instant Greenhouses Ltd. (1985), 41 Alta. L.R. (2d) 325, 12 C.C.E.L. 8, 64 A.R. 321 (Alta. Q.B.) — referred to

Sidaplex-Plastic Suppliers Inc. v. Elta Group Inc. (1995), 131 D.L.R. (4th) 399, 25 B.L.R. (2d) 179 (Ont. Gen. Div. [Commercial List]) — considered

Sidaplex-Plastic Suppliers Inc. v. Elta Group Inc. (1998), 162 D.L.R. (4th) 367, 111 O.A.C. 106, 40 O.R. (3d) 563, 43 B.L.R. (2d) 155 (Ont. C.A.) — referred to

Sinclair v. Dover Engineering Services Ltd. (1987), 11 B.C.L.R. (2d) 176 (B.C. S.C.) — considered

Sinclair v. Dover Engineering Services Ltd. (1988), 49 D.L.R. (4th) 297 (B.C. C.A.) — referred to

Statutes considered:

Business Corporations Act, R.S.O. 1990, c. B.16

Generally — referred to

s. 245 "complainant"(c) — considered

s. 248(1) — considered

s. 248(2) — considered

s. 248(2)(c) — considered

Employment Standards Act, R.S.O. 1990, c. E.14

Generally — referred to

s. 12(1) — considered

APPEAL by employee from judgment reported at 2000 CarswellOnt 634, 2 C.C.E.L. (3d) 66 (Ont. S.C.J.) , allowing in part action for damages for wrongful dismissal and for oppression remedy.

The judgment of the court was delivered by *Borins and MacPherson JJ.A.*:

A. INTRODUCTION

1 In his valuable text, *Canadian Employment Law* (Aurora: *Canada Law Book* , 1999), Stacey Ball states, at p. 4-1:

> The courts now recognize that, for purposes of determining the contractual and fiduciary obligations which are owed by employers and employees, an individual can have more than one employer. The courts now regard the employment relationship as more than a matter of form and technical corporate structure. Consequently, the present law states that an individual may be employed by a number of different companies at the same time.

2 The mechanism whereby the law concludes that an employee may be employed by more than one company at the same time is the common employer doctrine. The doctrine has a well-recognized statutory pedigree in most jurisdictions. For example, in Ontario s. 12(1) of the *Employment Standards Act* , R.S.O. 1990, c. E.14, deems associated or related businesses to be "one employer" for the purpose of protecting the benefits to which employees are entitled under the Act.

3 A major issue in this appeal is the definition and application of the common employer doctrine in a common law context. A dismissed employee sued his employer for wrongful dismissal. Following a trial, he was awarded substantial damages. Unfortunately, the employer company had no assets and consequently the employee was unable to enforce his judgment. In a subsequent action, the employee sued related companies and the two main principals of all the companies in an attempt to widen its net of potential sources of recovery. His principal legal submission in support of his attempt was, and is on this appeal, the common employer doctrine. In *Canadian Employment Law* , Mr. Ball states that "[t]he finding that more than one corporation is the employer may be a benefit when parts of the corporate group are more solvent than others . . . ." (p. 4-1). That is precisely the benefit the dismissed employee seeks to achieve in this litigation.

4 A second important issue in this appeal is the availability of an oppression remedy to a dismissed employee in the context of a corporate reorganization shortly before a wrongful dismissal trial which has the effect of denying the employee any recovery on a judgment he obtains at the trial.

B. FACTS

(1) The parties and the events

5 In 1992, the respondents Herman Grad ("Grad") and Ben Grosman ("Grosman") were in the nightclub business in Toronto. They owned and operated two nightclubs, *The Landing Strip* at 191 Carlingview Drive and *For Your Eyes Only* at 557/563 King Street West.

6 The appellant, Joseph Alouche ("Alouche"), was born in Egypt and came to Canada in 1974. He attended the Toronto School of Business, took courses in hotel management and received a diploma. He also took correspondence courses relating to the hospitality industry and computers.

7 In December 1992, Grad offered Alouche a position as manager of the nightclub *For Your Eyes Only* . The only entity specifically identified in the written employment contract was *For Your Eyes Only* . However, the contract also provided that Alouche would receive the health care and insurance benefits available "in our sister organization", which was not identified by name.

8 Alouche commenced work on December 29, 1992. During the next few months, he received his pay cheques from Best Beaver Management Inc. ("Best Beaver"), a company controlled by Grad and Grosman. In May 1993, Alouche was sent a formal Notice of Discipline on the letterhead of *For Your Eyes Only* for committing several infractions, including:

- the employee, while soliciting in excess of $1,000.00 gratuity only generated sales of $250.00 for the employer.

- the employee allowed numerous waitresses to abandon their assigned sections to solicit gratuities in the amount of $2,800.00.

9 On June 15, 1993, Alouche was dismissed. On October 13, 1993, he commenced an action against Best Beaver. In subsequent proceedings which form the basis for this appeal, Alouche explained the choice of Best Beaver as the defendant in the first action: "I sued Best Beaver . . . because the paycheque that they gave me in *For Your Eyes Only* , it says Best Beaver Management Inc."

10 In the spring of 1996, there was a major reorganization of the Grad-Grosman companies. Best Beaver ceased to do business. In July 1996, Grad discharged Best Beaver's counsel. Shortly before the start of the trial in his wrongful dismissal action in August 1996, Alouche, worried about recovery if successful in the action, moved to add Grad and Grosman as co-defendants to his claim against Best Beaver. Faced with a potential adjournment of the trial to permit Grad and Grosman to retain counsel, Alouche withdrew the motion.

11 The trial proceeded with Best Beaver as the only defendant. Grad, a director of Best Beaver, represented it throughout the trial. The trial judge, Festeryga J., found in favour of Alouche. He awarded Alouche damages of $59,906.76, plus pre-judgment interest of $8,608.36 and costs of $15,387.79.

12 Best Beaver paid Alouche nothing pursuant to the judgment. Two sheriffs, in purported execution of the judgment, attended at the premises of *For Your Eyes Only* and seized $1,855 in cash. This provoked Downtown Eatery (1993) Ltd., which claimed that the money belonged to it, to commence an action against Alouche. [1] Alouche defended the action and counterclaimed against all of the companies controlled by Grad and Grosman and against Grad and Grosman personally. In December 1997, Kiteley J. ordered that the $1,855 seized by the sheriffs be paid into court to the credit of the action.

13 There are other facts relevant to the disposition of the appeal, including two reorganizations of the Grad-Grosman companies. However, we find it convenient to describe those facts in the context of the specific issues to which they relate.

(2) The litigation

14 The trial proceeded before C. Campbell J. in February 2000. The essence of the trial was Alouche's counterclaim in which he sought to recover against any or all of the defendants for his unsatisfied judgment against Best Beaver.

15 Alouche advanced several bases for recovery of his earlier judgment against the *new* defendants. The trial judge addressed three of them in his reasons for judgment - the common employer doctrine, oppression relief under the *Ontario Business Corporations Act* , R.S.O. 1990, c. B.16, and a tracing remedy associated with a fraudulent conveyance.

16 The trial judge dismissed Alouche's counterclaim in its entirety. On the common employer issue, the trial judge rejected Alouche's submissions, both on the merits and because of the concept of estoppel. With respect to a potential oppression remedy, the trial judge held that such a remedy would not be appropriate because the reorganization of the Grad-Grosman companies was not undertaken for the purpose of depriving Alouche of recovery of his judgment against Best Beaver. For similar reasons, he held that the defendants had not made any fraudulent conveyance, and, therefore, a tracing order was not appropriate.

17 The appellant appeals from the trial judge's decision on the common employer and oppression remedy issues. At the hearing of the appeal, the appellant abandoned his appeal on the fraudulent conveyance/tracing issue.

C. ISSUES

18 The issues on the appeal are:

> (1) Did the trial judge err in failing to find that some or all of the respondents were a common employer of the appellant? [2]
>
> (2) Did the trial judge err in failing to find that the conduct of the respondents was "oppressive" or "unfairly prejudicial" as those terms are used in the *Ontario Business Corporations Act* ?

D. ANALYSIS

(1) The common employer issue

19 The trial judge decided this issue against Alouche for two reasons: (1) Alouche was estopped from raising the issue in his counterclaim action to enforce his previous judgment because he had not raised it in his original wrongful dismissal action; and (2) Alouche had not established the prerequisites necessary to identify any of the respondents as a common employer, along with Best Beaver.

(a) Res judicata/estoppel

20 It will be recalled that shortly before the wrongful dismissal trial, Alouche brought a motion to add Grad and Grosman as defendants because he was concerned that Best Beaver might not respond to a judgment against it. Because this motion would have resulted in an adjournment of the trial, Alouche decided to abandon it. The respondents submit that these steps precluded Alouche from raising the issue in the subsequent proceedings. The trial judge briefly reviewed the doctrines of *res judicata* , cause of action estoppel and issue estoppel. It is not entirely clear which of these doctrines he applied. However, it is clear that he agreed with the respondent's essential submission on this issue. He concluded:

> I am satisfied on the evidence before me that Alouche was content in his wrongful dismissal action to allege that Best Beaver was his employer and to be bound by that conclusion, notwithstanding the possibility of some responsibility on the part of Messrs. Grad and Grosman.
>
> On that basis, Alouche is now estopped from alleging a different or expanded employment obligation when he is now unable to recover on the first judgment.

21 Let us say candidly that this is a plausible analysis and conclusion. On the eve of the wrongful dismissal trial, Alouche was concerned that the corporate reorganization about which he had recently learned might mean that Best Beaver no longer had assets which could potentially satisfy any judgment he obtained. Alouche's response was to consider, initiate and then abandon adding Grad and Grosman as defendants. In light of these steps, it is plausible to conclude, as the trial judge did, that Alouche considered the general question of whom he should sue and decided to proceed against only Best Beaver.

22 However, in the end we do not think that this conclusion is correct. A particularly valuable discussion of *res judicata* and of issue estoppel is found in this court's decision in *Minott v. O'Shanter Development Co.* (1999), 42 O.R. (3d) 321 (Ont. C.A.) (*"Minott"*). Laskin J.A. articulated the underlying purpose of the concept of issue estoppel in this fashion, at p. 340:

> Issue estoppel is a rule of public policy, and, as a rule of public policy, it seeks to balance the public interest in the finality of litigation with the private interest in achieving justice between litigants. Sometimes these two interests will be in conflict, or, at least there will be tension between them. Judicial discretion is required to achieve practical justice without undermining

> the principles on which issue estoppel is founded. Issue estoppel should be applied flexibly where an unyielding application of it would be unfair to a party who is precluded from relitigating an issue.

23 In our view, the issue Alouche considered on the eve of his wrongful dismissal trial was whether to sue Grad and Grosman in their personal capacities as potential employers because of his concern that Best Beaver, the corporate entity which he regarded as his employer (because it paid him), might have no assets. Alouche considered this option because, as he testified at the second trial, he regarded them as his employer:

> Q. At the time you signed this agreement that appears at Tab 1 [the employment contract], who did you believe to be your employer?
>
> A. It was Herman Grad. I started working at For Your Eyes Only. That's the only place I know there.

However, in the end, Alouche made a conscious decision not to join Grad and Grosman in the wrongful dismissal action because it would have delayed the trial. Taking account of that decision, the trial judge concluded that Alouche was estopped from suing Grad and Grosman personally as potential employers in his subsequent action. We see no reason to interfere with this component of the trial judge's decision.

24 However, the issue of a potential common employer for Best Beaver, drawn from the stable of Grad-Grosman companies that were closely connected with the operation of the *For Your Eyes Only* nightclub, was not considered by Alouche on the eve of the wrongful dismissal trial. He did not think about adding other companies at that juncture because the only entities of which he was aware were the nightclub, *For Your Eyes Only* , with which he had a contract of employment, and Best Beaver, which issued his pay cheques. He decided to sue Best Beaver "because the paycheque that they gave me in *For Your Eyes Only* , it says Best Beaver Management Inc." This was a perfectly sensible reason for suing Best Beaver.

25 Only later, after he had won a substantial judgment at trial and had been unable to collect on it from Best Beaver, did Alouche begin to think of other companies which might have been closely connected with *For Your Eyes Only* and Best Beaver. That inquiry led him, *for the first time* , to the respondent corporations.

26 In summary, we cannot say that the trial judge erred by concluding that Alouche was estopped from pursuing Grad and Grosman personally as potential common employers in the counterclaim relating to the enforcement of the previous judgment in the wrongful dismissal action. However, we do not think that the common employer issue, as it relates to the corporate respondents, constitutes, in the language of *Minott* , "relitigating an issue". In this appeal, the balance between finality of litigation and achieving justice between litigants should be struck in favour of the latter. The common employer issue relating to the corporate respondents should be determined on the merits.

(b) The merits

27 *For Your Eyes Only* was a simple entity, a single site nightclub in downtown Toronto. Yet, beneath the surface of lights, liquor and entertainment, there was a fairly sophisticated group of companies involved in the operation of the nightclub. Twin Peaks Inc. ("Twin Peaks") was the owner and lessor of the nightclub premises. The Landing Strip Inc. ("The Landing Strip") leased the premises from Twin Peaks. It also owned the trademark for *For Your Eyes Only* and held the liquor and adult entertainment licences. Downtown Eatery Limited ("Downtown Eatery") owned the chattels and equipment at the nightclub and operated it under a licence from The Landing Strip. Best Beaver paid the nightclub employees, including Alouche. In June 1993, all of these companies were owned and controlled by Bengro Corp. and Harrad Corp., the holding companies for Grosman and Grad.

28 The trial judge considered Alouche's common employer argument on the merits. He concluded that Downtown Eatery was "the most logical of the companies to be treated as a co-employer", but that this did not help Alouche because Downtown Eatery amalgamated with Best Beaver in September 1993, and there was nothing fraudulent or even suspicious about the amalgamation.

29 The trial judge then considered The Landing Strip:

> Counsel for Alouche suggests that Landing Strip Inc., which held the lounge license and the franchise trademark, would be logical co-employers. There is nothing in the record before me that would suggest that Alouche ever had a contractual relationship with Landing Strip Inc.

Then, speaking more generally, the trial judge observed that "there has been no holding out here by either the employee or the employer of joint and several liability of more than one company".

30 The common employer doctrine, in its common law context, has been considered by several Canadian courts in recent years. The leading case is probably *Sinclair v. Dover Engineering Services Ltd.* (1987), 11 B.C.L.R. (2d) 176 (B.C. S.C.), aff'd (1988), 49 D.L.R. (4th) 297 (B.C. C.A.) (*"Sinclair"*). In that case, Sinclair, a professional engineer, held himself out to the public as an employee of Dover Engineering Services Ltd. ("Dover"). He was paid by Cyril Management Limited ("Cyril"). When Sinclair was dismissed, he sued both corporations. Wood J. held that both companies were jointly and severally liable for damages for wrongful dismissal. In reasoning that we find particularly persuasive, he said, at p. 181:

> The first serious issue raised may be simply stated as one of determining with whom the plaintiff contracted for employment in January of 1973. The defendants argue that an employee can only contract for employment with a single employer and that, in this case, that single entity was obviously Dover.
>
> I see no reason why such an inflexible notion of contract must necessarily be imposed upon the modern employment relationship. Recognizing the situation for what it was, I see no reason, in fact or in law, why both Dover and Cyril should not be regarded jointly as the plaintiff's employer. The old-fashioned notion that no man can serve two masters fails to recognize the realities of modern-day business, accounting and tax considerations.
>
> There is nothing sinister or irregular about the apparently complex intercorporate relationship existing between Cyril and Dover. It is, in fact, a perfectly normal arrangement frequently encountered in the business world in one form or another. Similar arrangements may result from corporate take-overs, from tax planning considerations, or from other legitimate business motives too numerous to catalogue.
>
> As long as there exists a sufficient degree of relationship between the different legal entities who apparently compete for the role of employer, there is no reason in law or in equity why they ought not all to be regarded as one for the purpose of determining liability for obligations owed to those employees who, in effect, have served all without regard for any precise notion of to whom they were bound in contract. What will constitute a sufficient degree of relationship will depend, in each case, on the details of such relationship, including such factors as individual shareholdings, corporate shareholdings, and interlocking directorships. The essence of that relationship will be the element of common control.

See also: *Bagby v. Gustavson International Drilling Co.* (1980), 24 A.R. 181 (Alta. C.A.); *Olson v. Sprung Instant Greenhouses Ltd.* (1985), 64 A.R. 321 (Alta. Q.B.); *Johnston v. Topolinski* (1988), 23 C.C.E.L. 285 (Ont. Dist. Ct.); *MacPhail v. Tackama Forest Products Ltd.* (1993), 50 C.C.E.L. 136 (B.C. S.C.); and *Jacobs v. Harbour Canoe Club Inc.*, [1999] B.C.J. No. 2188 (B.C. S.C. [In Chambers]).

31 In Ontario, the common employer doctrine has been considered in several cases. In *Gray v. Standard Trustco Ltd.* (1994), 8 C.C.E.L. (2d) 46 (Ont. Bktcy.), Ground J. said, at p. 47:

> . . . it seems clear that, for purposes of a wrongful dismissal claim, an individual may be held to be an employee of more than one corporation in a related group of corporations. One must find evidence of an intention to create an employer/employee relationship between the individual and the respective corporations within the group.

32 In *Jones v. CAE Industries Ltd.* (1991), 40 C.C.E.L. 236 (Ont. Gen. Div.) (*"Jones"*), Adams J. reviewed many of the leading authorities and observed, at p. 249:

> The true employer must be ascertained on the basis of where effective control over the employee resides . . . . I stress again that an employment relationship is not simply a matter of form and technical corporate structure.

33 *Sinclair, Jacobs v. Harbour Canoe Club Inc.* and *Jones* were all cases involving a 'paymaster' company closely connected with another corporate entity, with both being controlled by the same principals. In all three cases, the courts found that the other company was a common employer. Similarly, in the present appeal, Best Beaver served only as a paymaster for the employees of the nightclubs owned and operated by other Grad and Grosman companies. Accordingly, the question becomes, in Adams J.'s language in *Jones* , "where effective control over the employee resides".

34 In our view, in June 1993 when Alouche was dismissed, there was a highly integrated or seamless group of companies which together operated all aspects of the *For Your Eyes Only* nightclub. Twin Peaks owned the nightclub premises and leased them to The Landing Strip which owned the trademark for *For Your Eyes Only* and, significantly for a nightclub, held the liquor and entertainment licences. Downtown Eatery operated the nightclub under a licence from The Landing Strip and owned the chattels and equipment at the nightclub. Best Beaver served as paymaster for the nightclub employees. Controlling all of these corporations were Grad and Grosman and their family holding companies, Harrad Corp. and Bengro Corp.

35 Grad and Grosman could easily have operated the nightclub through a single company. They chose not to. There is nothing unlawful or suspicious about their choice. As Wood J. said in *Sinclair* , "it is a perfectly normal arrangement frequently encountered in the business world".

36 However, although an employer is entitled to establish complex corporate structures and relationships, the law should be vigilant to ensure that permissible complexity in corporate arrangements does not work an injustice in the realm of employment law. At the end of the day, Alouche's situation is a simple, common and important one - he is a man who had a job, with a salary, benefits and duties. He was fired - wrongfully. His employer must meet its legal responsibility to compensate him for its unlawful conduct. The definition of "employer" in this simple and common scenario should be one that recognizes the complexity of modern corporate structures, but does not permit that complexity to defeat the legitimate entitlements of wrongfully dismissed employees.

37 The trial judge focussed on the absence of a contract between Alouche and any of the potential common employers. With respect, we think this focus is too narrow. A contract is one factor to consider in the employer-employee relationship. However, it cannot be determinative; if it were, it would be too easy for employers to evade their obligations to dismissed employees by imposing employment contracts with shell companies with no assets.

38 The trial judge also observed that there was no holding out by the employer of joint and several liability of more than one company. Again, with respect, we do not attach much significance to this factor. After all, the contract of employment that Alouche signed was with *For Your Eyes Only* , which was only a name, not a legal entity.

39 In these circumstances, when he was wrongfully dismissed, Alouche did his best - he sued the company which had paid him. Later, it turned out that that company had no assets. Yet the nightclub continued in business, various companies continued to operate it and, presumably, Grad and Grosman continued to make money. In these circumstances, Alouche decided to try to collect the money to which a superior court of justice had determined he was entitled. In our view, the common employer doctrine provides support for his attempt.

40 In conclusion, Alouche's true employer in 1993 was the consortium of Grad and Grosman companies which operated *For Your Eyes Only* . The contract of employment was between Alouche and *For Your Eyes Only* which was not a legal entity. Yet the contract specified that Alouche would be "entitled to the entire package of medical extended health care and insurance benefits as available in our sister organization". The sister organization was not identified. In these circumstances, and bearing in mind the important roles played by several companies in the operation of the nightclub, we conclude that Alouche's employer in June 1993 when he was wrongfully dismissed was all of Twin Peaks, The Landing Strip, Downtown Eatery and Best Beaver. This group of companies functioned as a single, integrated unit in relation to the operation of *For Your Eyes Only* .

41 There is a final matter to be considered on the common employer issue. Alouche was dismissed in June 1993. There was a reorganization of Grad and Grosman companies in September 1993. A second reorganization took place in May 1996, three months before the trial in Alouche's wrongful dismissal action. The trial judge found that there was nothing nefarious about

these reorganizations; they were undertaken for business reasons unrelated to Alouche's action. We see no reason to disagree with this conclusion.

42 The question which the reorganizations pose is whether Alouche's judgment, which we have determined should be enforced against all of the companies involved in June 1993 in the operation of *For Your Eyes Only* , should also be enforced against the successor or merged companies which have been created by the reorganizations.

43 We have no hesitation answering this question in the affirmative. Grad testified at the trial that he was very careful to protect the positions, seniority and benefits of current employees when he and Grosman were accomplishing the reorganizations. He said:

> Everyone had a job . . . Everyone that worked for one had a job in the other . . . No one would lose anything . . . The employees were not to lose anything, were not to be hurt.

44 This was, of course, admirable treatment of the current employees of the Grad and Grosman companies. It commends itself, in our view, as a just basis for consideration of Alouche's position after the reorganizations. If, as Grad explained, his current employees were not to be hurt in any way by the reorganizations, it seems obvious and fair that a similar result should flow for Alouche, a man who might also be a current employee but for the fact of his wrongful dismissal.

45 We conclude, therefore, that the list of the original common employers should be expanded to include the other corporate respondents.

(2) The oppression issue

46 Alouche contends that the conduct of the respondents, specifically the corporate reorganizations which resulted in Best Beaver ceasing to exist, was "oppressive" or "unfairly prejudicial" as those terms are used in the *Ontario Business Corporations Act* (*"OBCA"*). Section 248 of the *OBCA* provides:

> **248(1)** A complainant . . . may apply to the court for an order under this section.
>
> **(2)** Where, upon an application under subsection (1), the court is satisfied that in respect of a corporation or any of its affiliates,
>
> *(a)* any act or omission of the corporation or any of its affiliates effects or threatens to effect a result;
>
> *(b)* the business or affairs of the corporation or any of its affiliates are, have been or are threatened to be carried on or conducted in a manner; or
>
> *(c)* the powers of the directors of the corporation or any of its affiliates are, have been or are threatened to be exercised in a manner,
>
> that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer of the corporation, the court may make an order to rectify the matters complained of.

A "complainant", in addition to being a current or former shareholder, director or officer of the company, is defined in s. 245 to include:

> *(c)* any other person who, in the discretion of the court, is a proper person to make an application under this Part.

Although it appears from the pleadings and the factum that Alouche is advancing the oppression argument against all of the respondents, in oral argument counsel made it clear that the focus of Alouche's claim on this issue is the respondents Grad and Grosman.

47 As a preliminary matter, we note that there is no question of *res judicata* or estoppel with respect to the appellant's oppression claim. There was nothing about this claim in the pleadings in the first action, the trial judge in the second action dealt with the claim on the merits, and the respondents in this appeal do not contend that the oppression claim was barred by these doctrines.

48 Turning to the merits, in the Agreed Statement of Facts, facts pertaining to the oppression remedy are sparse. These facts are: Grad and Grosman were directors and officers of Best Beaver at all material times; in September 1993, there was a corporate reorganization of Best Beaver and several of the other corporate respondents in response to apprehended union activities; and in or about March 1996, Best Beaver ceased operations.

49 In his trial testimony, Grad stated that because the "union threat" had disappeared in 1996 there was no need to retain Best Beaver as a separate company. This resulted in Best Beaver ceasing operations in March 1996, followed by a corporate reorganization in May 1996. He testified that these events were not influenced by the pending litigation involving Alouche. Indeed, it was Grad's belief that Best Beaver would win the lawsuit. He described what occurred as "a business decision". Grad confirmed that he and Grosman were the owners of Best Beaver and all of the corporate respondents. He also confirmed that "the role and function" of Best Beaver were to pay the employees of the corporations that he and Grosman owned and that the company carried out this role "based on advice from [his] accountants".

50 Although Grad testified that Alouche's pending claim did not influence his decision to terminate the operations of Best Beaver in March 1996, he acknowledged that at that time a summer trial date had been fixed for the wrongful dismissal trial. He stated that he discharged Best Beaver's lawyer about two weeks before the trial began "because there was no money in the account and [Best Beaver] could not afford to pay" the lawyer. At the trial, Grad acted as Best Beaver's legal representative.

51 Syd Bojarski ("Bojarski") was a partner in the accounting firm that acted for the corporate respondents and Grad and Grosman. He provided extensive evidence concerning the corporate and financial affairs of these entities. He testified that in each year of its existence, Best Beaver earned a profit. He agreed with counsel for Alouche that Best Beaver's accumulated profits were available to pay "whatever obligations [Best Beaver] had". He further agreed that if that company had continued its operations its accumulated profit could have been applied "to satisfy unexpected claims arising from employment [contracts]".

52 In the following questions and answers Grad was asked to comment on Bojarski's evidence:

> Q. Mr. Bojarski gave evidence that it was the role and function of Best Beaver Management as a corporation to pay employees until, of course, until it ceased to do that. But that was its obligation, correct?
>
> A. Yes.
>
> Q. Do you agree with Mr. Bojarski that its obligation was also to pay any claims that individual employees might have against it as employer?
>
> A. It was responsible for all the employees and the management of those people.

53 In dismissing Alouche's claim for an oppression remedy, the trial judge accepted Grad's reasons for the corporate reorganizations of September 1993 and May 1996 and for Best Beaver's cessation of operations in March 1996. He provided the following reasons for dismissing Alouche's claim for an oppression remedy:

> In the case before me, if I had been satisfied that the amalgamation of 1993 or the reorganization of 1996 had been undertaken with the intention of depriving Mr. Alouche of the opportunity to recover against Best Beaver, then an oppression remedy might have been appropriate. In the circumstances where the amalgamation and reorganization took place before he obtained the status of a judgment creditor and those actions were not undertaken for the purpose of depriving him of recovery of judgment, then it would appear that the oppression remedy is not appropriate.

54 At trial, C. Campbell J. also dismissed a claim by Alouche based on the submission that the May 1996 corporate reorganization constituted a fraudulent conveyance resulting in Best Beaver having no assets in the event that he recovered judgment against it. No appeal was taken from this aspect of the judgment. However, the following findings of fact made by the trial judge in deciding this issue are relevant to the oppression remedy issue:

> As noted previously, I am satisfied on the evidence, the reorganization was not entered into for the purpose or with the intent of depriving Alouche from recovering on an anticipated judgment.
>
> I do recognize, however, that the effect of the reorganization left Best Beaver essentially as a non-operating company and that Grad took advantage of this, when faced with the pending trial (by discharging counsel) and by non-payment of the judgment.

55 In our view, this case is similar to *Sidaplex-Plastic Suppliers Inc. v. Elta Group Inc.* (1995), 131 D.L.R. (4th) 399 (Ont. Gen. Div. [Commercial List]), varied (1998), 40 O.R. (3d) 563 (Ont. C.A.) "*Sidaplex-Plastics*") . As in *Sidaplex-Plastics* , Alouche, as a judgment creditor of a corporate party, seeks an oppression remedy in the absence of bad faith or want of probity on the part of individuals who were the directors and shareholders of the corporation. As in *Sidaplex-Plastics* , the corporation, Best Beaver, is no longer in business, having ceased operations in March 1996, at a time when a trial date of August 1996 had been fixed for the wrongful dismissal action against it. Thus, Alouche seeks to invoke the oppression remedy provisions of the *OBCA* against Grad and Grosman in order to rescue himself from the inability of Best Beaver to pay his judgment which resulted from their decision to terminate its business operations and to render it without assets capable of responding to a possible judgment against it.

56 The application of the principles governing s. 248(2) of the *OBCA* to the trial judge's findings of fact and to the evidence in the trial record leads to the conclusion that the trial judge erred in failing to grant an oppression remedy against Grad and Grosman. In our view, the trial judge failed to appreciate that the "oppressive" conduct that causes harm to a complainant need not be undertaken with the intention of harming the complainant. Provided that it is established that a complainant has a reasonable expectation that a company's affairs will be conducted with a view to protecting his interests, the conduct complained of need not be undertaken with the intention of harming the plaintiff. If the effect of the conduct results in harm to the complainant, recovery under s. 248(2) may follow.

57 In *Sidaplex-Plastics* , Blair J. provided a careful and thorough analysis of the principles governing the award of an oppression remedy that was accepted by this court. At p. 403, he stated that it "is well established . . . that a creditor has status to bring an application as a complainant, pursuant to s. 245(c)." At pp. 403-404, he added:

> Moreover, while some degree of bad faith or lack of probity in the impugned conduct may be the norm in such cases, neither is essential to a finding of "oppression" in the sense of conduct that is unfairly prejudicial to or which unfairly disregards the interests of the complainant, under the OBCA.

Blair J. continued, at p. 404:

> What the OBCA proscribes is "any act *or omission* " on the part of the corporation which "*effects* " a result that is unfairly prejudicial to or that unfairly disregards the interests of a creditor. [Emphasis in original.]

58 At p. 404, Blair J. adopted the following factors to be assessed in considering whether an oppression remedy should lie, as described by McDonald J. in *First Edmonton Place Ltd. v. 315888 Alberta Ltd.* (1988), 40 B.L.R. 28 (Alta. Q.B.) at 57:

> More concretely, the test of unfair prejudice or unfair disregard should encompass the following considerations: the protection of the underlying expectation of a creditor in its arrangement with the corporation, the extent to which the acts complained of were unforeseeable or the creditor could reasonably have protected itself from such acts, and the detriment to the interests of the creditor. The elements of the formula and the list of considerations as I have stated them should not be regarded as exhaustive. Other elements and considerations may be relevant, based upon the facts of a particular case.

59 In s. 248(2)(c) of the *OBCA* , the legislature has included the exercise of the powers of a company's directors in targeting the kinds of conduct encompassed by an oppression remedy. In this regard, Blair J. stated, at pp. 405-406:

> Courts have made orders against directors personally, in oppression cases: see, for example, *Canadian Opera Co. v. Euro-American Motor Cars, supra; Prime Computer of Canada Ltd. v. Jeffrey, supra; Tropxe Investments Inc. v. Ursus Securities Corp* ., [1993] O.J. No. 1736 (QL) (Gen. Div.) [summarized 41 A.C.W.S. (3d) 1140]. These cases, in particular, have involved small, closely held corporations, where the director whose conduct was attacked has been the sole controlling owner of the corporation and its sole and directing mind; and where the conduct in question has redounded directly to the benefit of that person.

60 Although the trial judge found that the cessation of Best Beaver's operations in March 1996 and the subsequent corporate reorganization were not undertaken with the intention of depriving Alouche of the ability to recover against Best Beaver if he were to succeed in his forthcoming action against the company, he went on to find that the effect of this conduct "left Best Beaver essentially as a non-operating company and that Grad took advantage of this, when faced with the pending trial (by discharging counsel) and by non-payment of the judgment". In our view, there is no question that the acts of Grad and Grosman, as the directors of Best Beaver, in causing the company to go out of business and transferring its assets to other companies within the group of companies they owned and operated in the spring of 1996 in the face of a trial scheduled to begin a few months later, effected a result that was unfairly prejudicial to, or that unfairly disregarded the interests of, Alouche as a person who stood to obtain a judgment against Best Beaver. Moreover, there was nothing that Alouche could have done to prevent the effective winding-up of Best Beaver.

61 In our view, the evidence of Bojarski, with which Grad agreed, is relevant to whether an oppression remedy is appropriate. From Bojarski's testimony, it is clear that when Best Beaver went out of business it was profitable and that its accumulated profits were available to satisfy any claims arising from employment contracts. The inference can be drawn from this evidence that even though it was abundantly clear to Grad that Alouche's pending claim might result in a judgment against Best Beaver, he took no steps to ensure that Best Beaver retained a reserve to meet that contingency. Rather, believing that Alouche's action would fail, he discharged the company's lawyer and personally assumed its defence at trial. As in *Sidaplex-Plastics* at p. 405, it was Alouche who was entitled to be protected, and, in our view, it was Grad and Grosman who had the obligation to ensure that such protection continued. See Christopher C. Nicholls, "Liability of Corporate Officers and Directors to Third Parties" (2001), 35 C.B.L.J. 1 at 30 *et seq.*

62 In our view, there are additional inferences that can be drawn from the trial judge's findings of fact and from the evidence at the trial. It was the reasonable expectation of Alouche that Grad and Grosman, in terminating the operations of Best Beaver and leaving it without assets to respond to a possible judgment, should have retained a reserve to meet the very contingency that resulted. In failing to do so, the benefit to Grad and Grosman, as the shareholders and sole controlling owners of this small, closely held company, is clear. By diverting the accumulated profits of Best Beaver to other companies that they owned, they were able to insulate these funds from being available to satisfy Alouche's judgment.

63 For the foregoing reasons, it is our opinion that Alouche has demonstrated his entitlement to an oppression remedy against Grad and Grosman.

E. DISPOSITION

64 We would allow the appeal against all of the respondents. The appellant is entitled to recover from the respondents the amounts he was awarded in the wrongful dismissal action, namely damages of $59,906.76, pre-judgment interest of $8,608.36 and assessed costs of $15,387.79 totalling $83,902.91, together with post-judgment interest thereon from the date of Festeryga J.'s judgment to the date of this order and post-judgment interest thereafter. He is also entitled to recover his costs of the second trial before C. Campbell J. and his costs of the appeal.

Appeal allowed.

Footnotes

1 Downtown Eatery (1993) Ltd. also named Her Majesty the Queen in Right of Ontario as a defendant, presumably on the basis of its alleged responsibility for the sheriffs. This component of the action was subsequently discontinued.

2 In his factum, the appellant identified a separate ground of appeal as the trial judge's failure to permit Alouche to proceed by what he called an 'alter ego' action. In oral argument, the appellant suggested that the common employer doctrine is a sub-species of the alter ego doctrine. Like the trial judge, we do not consider the injection of the nebulous concept of alter ego corporations useful. The common employer doctrine is well-recognized in Canadian law and provides a sound and straightforward foundation on which to assess the corporate relationship issue in this appeal.