

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

B E T W E E N:

SKYMARK FINANCE CORPORATION

Applicant

- and -

MAHAL VENTURE CAPITAL INC.
and GOLDEN MILES FOOD CORPORATION

Respondents

FACTUM OF SANTOKH MAHAL

January 11, 2023

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PART I - OVERVIEW

1. Santokh Mahal (“**Mahal**”) seeks a declaration that his security interest in the personal property of Golden Miles Food Corporation (“**Golden Miles**”): (a) is valid, enforceable, and ranks in priority to any other security interest registered under the *PPSA*; and (b) secures repayment of principal advances in the amount of \$2,182,914, plus interest, and costs.

2. Although KSV Restructuring Inc., in its capacity as Court–appointed receiver and trustee in bankruptcy of Golden Miles (“**KSV**”) concedes that Mahal’s security is valid, enforceable, and ranks in priority to any other security interest registered under the *PPSA*, it asserts there is only sufficient evidence of \$281,600 in principal secured debt.¹ Regarding the balance, KSV raises four issues: (a) there is no contractual evidence of indebtedness; (b) the advances were made by third parties, rather than Mahal; (c) Golden Miles’ financial statements for certain years prior to the advances call into question whether the balance of the advances claimed is credible; and (d) more generally, Mahal suffers from credibility issues.²

3. Mahal submits that the approach taken by KSV raises concerns regarding KSV’s impartiality as an officer of the Court charged with representing the interests of all creditors. It is overly formalistic in circumstances where the applicable jurisprudence cautions against undue formalism. It is irreconcilable with KSV’s allowance of a secured claim of \$281,600. It is tainted by a transparent attempt to place Mahal’s character in issue in a manner which offends trite rules of evidence, when Mahal’s general credibility has no causal connection whatsoever to the inquiry

¹ Fourth Report of the Receiver, dated November 1, 2022 (“**Fourth Report of the Receiver**”), Appendix “A”: Security Review Opinion, Responding Motion Record of the Receiver (“**RMRR**”), p. 22.

² Fourth Report of the Receiver at s 3.1, paras 1-28, RMRR, pp. 8-14.

regarding the quantum of his secured claim. It is also not clear why KSV has chosen to lead the attack when the attack was originally mounted by Skymark Finance Corporation (“**Skymark**”), who unlike KSV, has no obligation to be even-handed.

PART II - SUMMARY OF FACTS

A. Background

4. Mahal is the sole shareholder, officer and director of Golden Miles. He is also the sole shareholder, officer, and director of JTI International, Inc. (“**JTI**”), and Canada Fresh Corporation (“**Canada Fresh**”).³

B. The Promissory Note and General Security Agreement

5. On or about December 14, 2020, Golden Miles (the “**Borrower**”) executed a promissory note (the “**Promissory Note**”) promising to pay Mahal the principal amount advanced and outstanding from time to time, plus interest on the principal at the rate as is agreed between the Borrower and Mahal, until payment in full.⁴

6. The Promissory Note provides:⁵

The Lender is authorized to endorse on the schedule annexed, or any continuation schedule which may at any time be attached hereto, the date and amount of each advance and each payment of principal on account thereof, together with the unpaid balance of the principal amount outstanding owing by the Borrower to the Lender. Each such endorsement shall be prima facie evidence of the amount so advanced and repaid, and, in the absence of manifest mathematical error, this Promissory Note shall be conclusive evidence of the amount of the Borrower’s liability to the

³ Affidavit of Santokh Mahal sworn December 17, 2021 at paras 1 and 7, Supplementary Motion Record of Santokh Mahal (“**SMR**”), Caselines Current F160 and F162.

⁴ Promissory Note dated December 14, 2020, Exhibit A, Responding Affidavit of Santokh Mahal sworn November 21, 2021 (“**Responding Mahal Affidavit**”), Responding and Cross-Motion Record of Santokh Mahal (“**RCMR**”), Caselines Current F17.

⁵ Promissory Note dated December 14, 2020, Exhibit A, Responding Mahal Affidavit, RCMR, Caselines Current F17.

Lender for the unpaid balance of the principal amount outstanding owing by the Borrower to the Lender. (emphasis added)

7. On December 14, 2020, Mahal recorded the advances he made to Golden Miles prior to December 14, 2020, on a schedule attached to the Promissory Note.⁶

8. On December 14, 2020, Golden Miles also executed a General Security Agreement (the “GSA”) pursuant to which it granted Mahal a general and continuing security interest in the undertaking of Golden Miles and in all of its personal property and in all proceeds thereof, as security for the payment of:

“all obligations, indebtedness and liabilities, direct or indirect, at any time owing by Golden Miles to Mahal, direct or indirect, absolute or contingent, wheresoever and howsoever incurred, (the “**Indebtedness**”) (emphasis added)”⁷

9. Mahal’s security under the GSA was registered under the *PPSA* on December 16, 2020.⁸

C. The Secured Advances

10. Mahal has narrowed his secured claim to principal advances of \$2,182,914.00 made after the execution of the Promissory Note and GSA and the registration under the *PPSA* in December 2020 (collectively, the “**Advances**”). It is Mahal’s uncontroverted evidence, in respect of which he was not cross-examined, that the Advances to Golden Miles were made directly by him, as

⁶ Promissory Note dated December 14, 2020, Exhibit A, Responding Mahal Affidavit, RCMR, Caselines Current F18.

⁷ General Security Agreement dated December 14, 2020, Exhibit B, Responding Mahal Affidavit, RCMR, Caselines Current F20.

⁸ PPSA search report in respect of Golden Miles, Exhibit G, Responding Mahal Affidavit, RCMR, Caselines Current F134.

evidenced by his personal bank account statements, and indirectly, at his direction, and for his benefit, from the accounts of his wholly-owned companies, JTI and Canada Fresh.⁹

11. In certain foreign jurisdictions where Canada Fresh operates, foreign currency regulations prohibit payment to Canada Fresh in US or Canadian dollars. Canada Fresh, therefore, uses King MSP to provide international money transfer services to facilitate payment to it from overseas customers. The funds deposited to the bank account of Golden Miles from King MSP represent loans which Mahal caused to be made to Golden Miles on his behalf.¹⁰

12. The banking records produced by Mahal on this motion show that Golden Miles received the Advances from the following sources:¹¹

Advancing Party	Aggregate Advances
Mr. Mahal, personally	\$281,600
CanadaFresh Corporation	\$1,493,310
J.T. International Inc.	\$395,000
King MSP	\$13,004
Total	\$2,182,914

D. Financial Statements of Golden Miles

13. In the fall of 2020, Golden Miles had not yet commenced operations at the flour mill. At the request of and in conjunction with Paul Millar and Michael Slattery of Skymark, Golden Miles arranged for its accountant, Perry Singh, to prepare a projected income statement of Golden Miles

⁹ Spreadsheet summarizing the transactions deposited into Golden Miles' bank account, 0646-5325309, Exhibit C1, Responding Mahal Affidavit, RCMR, Caselines Current F33; Advances made from December 2020 to September 2021, Exhibits D1-D10, Responding Mahal Affidavit, RCMR, Caselines Current F38-F107.

¹⁰ Spreadsheet summarizing the transactions deposited into Golden Miles' bank account, 0646-5325309, Exhibit C1, Responding Mahal Affidavit, RCMR, Caselines Current F33; Spreadsheet summarizing USD transactions deposited into Golden Miles' bank account, 7339061 USC, Exhibit C2, Responding Mahal Affidavit, RCMR, Caselines Current F36.

¹¹ Fourth Report of the Receiver at s 3.0, para 6, RMRR, p. 8.

during the first two years following commencement of the flour mill operations. The projections forecast that Golden Miles would earn significant revenues within those two years.¹²

14. Mahal is a director of 12175622 Canada Inc. (“**121**”), which as the successful and highest bidder in the Court-approved SISP, purchased substantially all of the Debtors’ assets from KSV pursuant to an Asset Purchase Agreement dated March 18, 2022 (the “**APA**”). Pursuant to the APA, 121 acquired all tax refunds owing to Golden Miles in respect of the period ending prior to September 30, 2021 (the “**Purchased Tax Refunds**”). In order to collect the Purchased Tax Refunds, 121 had to file Golden Miles’ tax returns for the period ending September 30, 2021. In connection therewith, Mahal engaged Gill & Co. Chartered Accountants to prepare Golden Miles’ financial statements and tax returns before the filing deadline.¹³

15. The financial statements for the fiscal year ended June 30, 2021, and the three-month period ending September 30, 2021 were prepared and released by Gill & Co. on October 24, 2022. The financial statements record the amount “due to shareholder” as \$11,384,952 as at June 30, 2021 and \$11,694,471 as at September 30, 2021. Each of the Advances claimed by Mahal on this motion is included in the amount recorded as “due to shareholder” in the financial statements and was recorded by the company’s accountant as a loan in the accounting journals of Golden Miles, for the period in which the Advance was made.¹⁴

¹² Letter dated November 24, 2022 from Dickinson Wright LLP to Blakes LLP; Letter dated December 1, 2022 from Dickinson Wright LLP to Blakes LLP.

¹³ Letter dated November 24, 2022 from Dickinson Wright LLP to Blakes LLP.

¹⁴ Financial Statements of Golden Miles Food Corporation, Exhibit B, Supplementary Reply Affidavit of Santokh Mahal sworn October 26, 2022, Reply Motion Record of Santokh Mahal, Caselines Current F438.

16. The financial statements for the periods before 2020 predate the Advances in issue on this Motion and are not relevant.

E. Credibility

17. KSV raises four sources of concern in relation to Mahal's credibility.

(a) **Skymark's pre-appointment debt claim.** Prior to KSV's appointment, Skymark claimed a total indebtedness due to it of approximately \$29M. Mahal swore an Affidavit challenging that amount and asserting that the aggregate indebtedness was approximately \$19M. Following an analysis of the Debtors' books and records, KSV concluded that Skymark's number was correct. However, KSV never suggested that Mahal's evidence was dishonest or that he acted in bad faith. Rather, it was apparent in KSV's report regarding the quantum of Skymark's indebtedness that there were a number of legitimate questions raised by Mahal, including the reasonableness of certain fees, bonuses, default interest and entitlement to monthly compound interest claimed by Skymark. The fact that KSV did not agree with Mahal's challenges to certain amounts claimed by Skymark is of no relevance to this motion.

(b) **Failure to cooperate with KSV.** Mahal denies that he did not cooperate in responding to KSV's requests for information and documents. In fact, he consented to the Order dated October 21, 2021 obtained by KSV for disclosure of all

information and documents and agreed to pay and did in fact pay KSV's costs of that motion.¹⁵

- (c) **False or misleading statements to KSV.** Mahal denied that he removed equipment from the Debtors' premises, tampered with the access gates, and provided inconsistent information regarding tobacco on the premises.
- (d) **Condominium motion.** Mahal sought a declaration that a contract to purchase a residential condominium entered into in the name of Mahal Venture Capital Inc. with funds he advanced was held in trust for him. Upon receipt of KSV's report relating to the Condominium motion, Mahal promptly withdrew his motion, and subsequently offered to purchase an assignment of the contract from KSV.¹⁶

18. None of the above-noted sources of purported concern regarding Mahal's credibility have any connection whatsoever to the quantum of his secured claim. Moreover, there has never been any judicial or administrative finding of dishonesty or bad faith by Mahal in these proceedings. Mahal was also not cross-examined in relation to any of these purported concerns.

PART III - ISSUE, LAW & AUTHORITIES

19. The issue on this motion is whether there is sufficient evidence of secured indebtedness owing to Mahal by Golden Miles, in excess of the \$281,600.00 accepted by KSV.

¹⁵ Affidavit of Santokh Mahal sworn October 24, 2022 at para 15, Reply Motion Record of Santokh Mahal ("RMR"), Caselines Current F395.

¹⁶ Affidavit of Santokh Mahal sworn October 24, 2022 at para 16, RMR, Caselines Current F396.

A. KSV Bears the Onus of Proof

20. A party asserting that a purported loan is in substance a capital contribution and not a loan bears the onus of proving that the debt ought to be characterized as equity.¹⁷

21. In *U.S. Steel*, Justice Wilton-Siegel stated:

“...a creditor bears the onus of proving the validity and amount of its debt claim. It is not required to go further and prove the negative. In other words, it does not have to demonstrate that a claim is not an equity claim. A creditor who chooses to assert such an argument, must bear the onus of proving that an otherwise proven debt claim is more properly characterized in substance as an “equity claim”.¹⁸

B. KSV’s Challenge to Mahal’s Secured Debt Claim

22. In its Fourth Report filed in response to this motion, KSV acknowledges that Mahal’s security is valid, enforceable and properly perfected to the extent it secures advances after December 14, 2020. KSV argues, however, that the evidence only justifies a distribution to Mahal in the principal sum of \$281,600.¹⁹

23. KSV asserts that Mahal is not entitled to the balance claimed because: (a) there was no schedule attached to the Promissory Note evidencing the amounts advanced; (b) the advances were made by third parties “at the undocumented direction of a related secured party” and do not constitute secured debt; (c) there are inconsistencies in Golden Miles financial statements; and (d) Mahal has credibility issues.

¹⁷ *U.S. Steel Canada Inc., (Re)*, 2016 ONSC 569 at [para 140](#).

¹⁸ *U.S. Steel Canada Inc., (Re)*, 2016 ONSC 569 at [para 141](#).

¹⁹ Fourth Report of the Receiver at s 1.1, para 2, RMRR, p. 4.

C. Contractual Evidence of Indebtedness

i. KSV's Position is Inconsistent

24. KSV's challenge to Mahal's claim on the basis that the Promissory Note failed to contain a schedule evidencing the Advances cannot be taken seriously. KSV acknowledges that Mahal has a valid and enforceable secured claim to \$281,600 of the Advances notwithstanding that there was no schedule attached to the Promissory Note listing those advances. In other words, KSV acknowledges that the Advances, or at least some of them, constituted debt. KSV nonetheless argues that the other Advances cannot be characterized as debt because they were not set out in a schedule attached to the Promissory Note. This is inconsistent. Given its admission that some advances constituted debt, KSV cannot seriously argue that the other advances do not constitute debt on the basis that there was no schedule attached to the Promissory Note.

25. KSV's position that there is no contractual evidence of debt to support a distribution is similarly undermined by its assertion in its Fourth Report that Mahal would share in the pool of claims of unsecured creditors of Golden Miles' bankrupt estate.²⁰ If, as KSV argues, Mahal has not proven that the advances constituted debt, then Mahal would not be entitled to share in the distributions to unsecured creditors of Golden Miles' bankrupt estate because his claim would not be a debt claim.

²⁰ Fourth Report of the Receiver at s 3.2, para 4, RMRR, p. 15.

ii. *Contractual Evidence of Indebtedness is Not a Necessary Condition to Proving Debt*

26. In *U.S. Steel*, Justice Wilton-Siegel emphasized the importance of considering the “underlying substantive reality” of the transactions, which are factual matters rather than matters based on allegations of inequitable behavior on the part of a lender.²¹

27. Justice Wilton-Siegel went on to state:

“In addition, in a wholly-owned subsidiary relationship, there is no need for extensive documentation, nor is there a need for types of contractual protections typically found in commercial loan agreements. Given the parent’s ability to control the subsidiary’s actions as its sole shareholder, there is also no need for a strict schedule of repayment of principal. Further, there is no reason why a parent corporation would enforce any rights on default that may arise in the course of a loan so long as the parent corporation believes that the subsidiary has value. Such rights are asserted only as required to protect the parent corporation in the event that a third party asserts its rights as a creditor against the subsidiary or to terminate the parent corporation’s support of the subsidiary.”²²

28. More recently, in *Maisonneuve et al. v. Langlois et al.*,²³ the plaintiffs alleged that a solicitor was negligent in failing to prepare a promissory note to evidence their advances of a loan to a company, which invalidated their security over the company’s assets. In dismissing the action against the solicitor, R.S.J. McLeod observed that the validity of security is not necessarily conditional on the existence of a promissory note evidencing the advances:

“I have not been provided with any authority that a Promissory Note as such is a precondition to the validity of a floating charge such as a GSA or to the priority given to security registered under the PPSA....

All creditors, secured or not, will have to prove the amount owing and the terms of the loan such as interest rate, due date, acceleration provisions or any other terms and conditions. A new Promissory Note might have been a useful document for

²¹ *U.S. Steel Canada Inc., (Re)*, 2016 ONSC 569 at paras [143](#), [168](#) and [181](#).

²² *U.S. Steel Canada Inc., (Re)*, 2016 ONSC 569 at [para 217](#).

²³ *Maisonneuve et al. v. Langlois et al.*, [2021 ONSC 3587](#).

that purpose, but it would not be the only acceptable proof of the debt. Shareholder loans would normally be recorded in the corporate books and records (which would presumably have been in the control of the plaintiff as the CFO) ...

It is not self-evident that a Promissory Note would have been essential for the validity of the security and even if it was, it could have been simply remedied by a subsequent Note.”²⁴

29. In the case at bar, the Promissory Note and the GSA, as well as the accounting records and financial statements of Golden Miles evidence the parties’ intention to treat the Advances made by and on behalf of Mahal as debt. The failure to complete a schedule to the Promissory Note to record advances made after December 2020, is a technicality which, in any event, was cured when Mahal attached a continuation of the schedule of the Advances in 2022.

30. In the context of a shareholder loan, the fundamental consideration in assessing whether a transaction is a loan is whether the lender expects at the outset to be repaid the principal amount of the loan with interest out of cash flows of the company. This implies a belief on the part of a lender that its debtor will have the financial capacity to generate cash flow sufficient to pay interest and repay principal over the term of the loan, regardless of the profitability of the debtor from time to time in the course of that term.²⁵

31. In order to find that alleged debt claims are “equity claims,” the court must be satisfied that either:

(1) at the time of making an advance under the loan, the lender did not believe that the borrower would be able to repay the advance with interest out of its cash flows over the term of the loan, or

²⁴ *Maisonneuve et al. v. Langlois et al.*, 2021 ONSC 3587 at [paras 26 – 28](#).

²⁵ *U.S. Steel Canada Inc., (Re)*, 2016 ONSC 569 at [para 185](#).

(2) at the time of the advance, there was no reasonable basis on which the lender could have expected the borrower to generate cash flow sufficient to pay interest on and repay the principal of the advances over the term of the loan.²⁶

32. The first inquiry is a subjective inquiry, and the second question is an objective inquiry as to what a reasonable person would expect in the circumstances.²⁷ A party seeking to characterize the debt as equity again bears the onus of proving that the lender's expectation of repayment with interest was unreasonable.²⁸

33. In the facts at bar, the uncontroverted evidence of Mahal is that the funds in issue were advanced as loans, and intended to be repaid in accordance with the Promissory Note. When the GSA was obtained and registered in December 2020, the projected statement of income for Golden Miles, which the evidence shows was prepared at the request of and in conjunction with Skymark (the very creditor for whose benefit KSV is leading the attack on the quantum of Mahal's secured claim), forecast that it would generate significant revenue during the first 2 years of the flour mill's operations. In those circumstances, it is submitted that it was reasonable for Mahal to expect repayment of his loans with interest. The fact that Golden Miles had not yet commenced operations and was in start-up mode is further evidence to support the fact that it was reasonable for Mahal to require that Golden Miles execute a promissory note and grant a general security interest to secure repayment of any future advances.

34. In *U.S. Steel*, Justice Wilton-Siegel found that a provision in a loan agreement providing flexibility in the timing of payment of interest and repayment of principal is not a basis for inferring

²⁶ *U.S. Steel Canada Inc., (Re)*, 2016 ONSC 569 at [para 191](#).

²⁷ *U.S. Steel Canada Inc., (Re)*, 2016 ONSC 569 at [para 187](#).

²⁸ *U.S. Steel Canada Inc., (Re)*, 2016 ONSC 569 at [para 189](#).

that the lender did not expect to receive payment at the time of the initial advances.²⁹ Similarly, the absence of a maturity date or scheduled repayment dates under the Promissory Note is not a basis for concluding that Mahal did not expect to receive payment of his Advances.³⁰

35. In addition, any uncertainty arising from the reference in the Promissory Note to interest on the indebtedness “as agreed between the Borrower and the Lender” is resolved by Section 3 of *Interest Act* (R.S.C. , 1985, c. I-15), which provides as follows:

Interest rate when none provided

Whenever any interest is payable by the agreement of parties or by law, and no rate is fixed by the agreement or by law, the rate of interest shall be five per cent per annum.

E. Third Party Advances

36. The GSA expressly provides that the security interest created by the GSA secures both direct and “**indirect**” indebtedness owing by Golden Miles to Mahal.

37. The plain meaning of the word indirect, as defined in the Oxford Learner’s Dictionary and Collins Dictionary is:

Indirect, adj. An indirect result or effect is not caused immediately and obviously by a thing or person, but happens because of something else that they have done.³¹

Indirect, adj.

1. Happening not as the main aim, cause or result of a particular action, but in addition to it
2. Not done directly; done through somebody/something else
3. Avoiding saying something in a clear and obvious way
4. Not going in a straight line

²⁹ *U.S. Steel Canada Inc., (Re)*, 2016 ONSC 569 at [para 288](#).

³⁰ *U.S. Steel Canada Inc., (Re)*, 2016 ONSC 569 at para [215](#) and [217](#).

³¹ *Collins English Dictionary* (Harper Collins), online: < www.collinsdictionary.com/dictionary/english/indirect > sub verbo “indirect”.

a. OPPOSITE direct³²

38. Similarly, Black's Law Dictionary defines indirect as the opposite of direct i.e., through an agent or medium.³³

39. The indebtedness arising from funds advanced to Golden Miles by third parties controlled by Mahal, at the direction of and on behalf of Mahal, fits squarely within the meaning of indirect indebtedness expressly secured by the language of the GSA.

F. Credibility

40. The allegations by KSV that Mahal has failed to cooperate with the Receiver or made false or misleading statements in the course of these proceedings have been denied by Mahal, and there has been no judicial finding or determination that he has acted dishonestly, or in bad faith, or caused any damage to any creditors of Golden Miles. In these circumstances, KSV's attempt to portray Mahal as a person of bad character and lacking in credibility is improper, irrelevant, highly prejudicial, and ought to be excluded.

41. As explained by the Supreme Court of Canada in *R. v. Handy*,³⁴ the policy basis for the rule excluding evidence of a person's bad character or general propensity is that, while in some cases propensity inferred from similar facts may be relevant, it may also capture the attention of the trier of fact to an unwarranted degree. Its potential for prejudice, distraction and time

³² *Oxford Learner's Dictionaries* (Oxford University Press, 2020), online: < <https://www.oxfordlearnersdictionaries.com/definition/english/indirect> > sub verbo "indirect".

³³ Henry Campbell Black, *Black's Law Dictionary*, (Saint Paul, MN: West Publishing Co, 1979) sub verbo "direct".

³⁴ *R v. Handy*, 2002 SCC 56 at paras [31](#) and [36](#).

consumption is very great and these disadvantages will almost always outweigh its prohibitive value.³⁵

42. In *Krieser v. Gerber*,³⁶ the Ontario Court of Appeal emphasized that before evidence of bad character is admitted there must be a causal connection between the alleged bad conduct and the issues raised in the proceeding. The Court upheld the trial judge's conclusion that:

“Without the requisite causal connection, the attempt to put the [Krieser's] conduct in issue is just bad character evidence and is extraneous to the issue at hand”

43. In *Deep v. Wood*,³⁷ the Court of Appeal stated the rule as follows:

“Evidence of good character in a civil action is ordinarily inadmissible since it is irrelevant in the determination of most issues arising in those cases. Nevertheless, cross-examination relating to general reputation for untruthfulness or to prior criminal convictions or to findings of professional misconduct involving dishonesty may be used to diminish the credibility of a witness”.

44. In the case at bar, it bears emphasizing that Mahal was not cross-examined on any of the sources of purported concerns raised by KSV regarding his credibility. Therefore, the issue of his general credibility is not properly before the court. It would make a mockery of the receivership process if the Court were to accede to KSV's attempt to turn the within priority context between sophisticated commercial parties into a morality play on the basis that one of the parties is purportedly a “bad guy.”

³⁵ *R v. Handy*, 2002 SCC 56 at [para 37](#).

³⁶ *Krieser v. Gerber*, 2020 ONCA 699, at [para 123](#).

³⁷ *Deep v. Wood*, 1983 CanLII 3101 (ON CA) at [para 10](#).

45. Recently, in *Verbeek v. Verbeek*,³⁸ the court followed the rule in *Wood* and excluded evidence that a lawyer's practice had been restricted by the Law Society of Ontario, so as to prevent him from acting as executor, or having any management or control of estate assets. Dennison, J. stated:³⁹

In civil trials, good and bad character evidence is generally not admissible.....

There is no evidence before me as to why the condition was imposed. While it is likely it was imposed as a result of some misconduct, without further evidence, the court cannot assess, what, if any, probative value should be given to this evidence. The prejudicial effect of introducing this evidence is high because it requires the trier of fact to speculate as to the reason for the condition limiting Mr. Verbeek's practice.

G. Equitable Subordination Does Not Apply

46. The thrust of KSV's attack on Mahal's secured claim appears to be nothing more than an effort to equitably subordinate his rights as a secured creditor.

47. Equitable subordination is an American insolvency doctrine (now enshrined in § 510(c) of the U.S. Bankruptcy Code) that permits a court to subordinate a creditor's claim. The following requirements must be met for equitable subordination to apply:

- (a) The claimant must have engaged in some type of inequitable conduct;
- (b) The misconduct must have resulted in injury to creditors of the bankrupt or conferred an unfair advantage on the claimant; and
- (c) Equitable subordination of the claim must not be inconsistent with the provisions of the bankruptcy statute.

³⁸ *Verbeek v. Kooner*, [2021 ONSC 7863](#).

³⁹ *Verbeek v. Kooner*, 2021 ONSC 7863 at [paras 73-74](#).

48. In *U.S. Steel*,⁴⁰ the Court of Appeal for Ontario held that no jurisdiction exists under the *CCAA* to grant equitable subordination. Strathy C.J.O. was of the view that there is no “gap” in the legislative scheme of the *CCAA* to be filled by equitable subordination through the exercise of discretion, the common law, the court’s inherent jurisdiction or by equitable principles.

49. In the case at bar, the priority of Mahal’s secured creditor claim over unsecured claims in any distribution of proceeds from the realization of the assets of a bankrupt company is governed by section 136 of the *BIA*, which provide as follows:

Priority of claims

136 (1) Subject to the rights of secured creditors, the proceeds realized from the property of a bankrupt shall be applied in priority of payment as follows...⁴¹

50. In addition, the priority of Mahal’s perfected secured claim over the claims of unsecured creditors and a trustee in bankruptcy is governed by section 20(1)(a) and (b) of the *PPSA* which provide as follows:

Unperfected security interests

20 (1) Except as provided in subsection (3), until perfected, a security interest,

(a) in collateral is subordinate to the interest of,

(i) a person who has a perfected security interest in the same collateral or who has a lien given under any other Act or by a rule of law or who has a priority under any other Act, or

(ii) a person who causes the collateral to be seized through execution, attachment, garnishment, charging order, equitable execution or other legal process, or

⁴⁰ *U.S. Steel Canada, Inc. (Re)*, 2016 ONCA 662 at [para 103](#).

⁴¹ *Bankruptcy and Insolvency Act*, R.S.C., 1985. C. B-3 at [s 136](#).

(iii) all persons entitled by the *Creditors' Relief Act, 2010* or otherwise to participate in the distribution of the property over which a person described in subclause (ii) has caused seizure of the collateral, or the proceeds of such property;

(b) in collateral is not effective against a person who represents the creditors of the debtor, including an assignee for the benefit of creditors and a trustee in bankruptcy;⁴²

51. In addition, section 72 of the *PPSA* expressly provides that the principles of equity do not apply to the extent that they are inconsistent with the provisions of the statute:

Application of principles of law and equity

72 Except in so far as they are inconsistent with the express provisions of this Act, the principles of law and equity, including the law merchant, the law relating to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake and other validating or invalidating rules of law, shall supplement this Act and shall continue to apply.⁴³

52. Mahal, therefore, respectfully submits that it would be contrary to the express provisions of the applicable statutes to subordinate his perfected secured claim to the claims of unsecured creditors.

53. Moreover, even if the doctrine of equitable subordination applies, according to U.S. decisions involving similar facts, it should not be granted in the case at bar.

54. As a first principle, the U.S. 7th Cir. Court of Appeal has warned that equitable subordination should be used sparingly: "Court should hesitate to invoke the doctrine of equitable subordination for two primary reasons:

(1) the upsetting of the claimants legitimate expectations, and

⁴² *Personal Property Security Act*, R.S.O. 1990, c. P.10 at [ss 20\(1\)\(a\) and \(b\)](#).

⁴³ *Personal Property Security Act*, R.S.O. 1990, c. P.10 at [s.72](#).

(2) the spawning of legal uncertainty that courts will refuse to honor otherwise binding agreements on amorphous grounds of equity.”⁴⁴

55. In *re Medical Software Solutions*, the debtor’s largest shareholder made a bridge loan to the debtor, which was secured by GSA. Soon after, the debtor filed for bankruptcy and the lender used its debt to credit bid on the debtor’s assets. A group of shareholders argued that the lender’s claim should be equitably subordinated because the bridge loan itself was evidence of inequitable conduct. The Bankruptcy Court of Utah disagreed, finding that “equitable subordination is remedial, and not penal, and should be used sparingly. Further, a loan by a majority shareholder in itself, is not inequitable ... to equitably subordinate the debt, there must be more than just a loan from an insider to the debtor. Inequitable conduct or bad faith ... must be shown.”⁴⁵

56. The U.S. authorities confirm that even if equitable subordination were to apply in Canada, the facts at bar do not support the equitable subordination of Mahal’s secured claim.

H. Role of a Court-Appointed Officer

57. As a court officer, KSV has a duty of even-handedness and cannot favour the interest of one party over another. It must take into account the interests of all stakeholders affected by the Debtors’ insolvency.⁴⁶

⁴⁴ In *re SGK Ventures, LLC*, 2017 WL 2683686 (NDIII, June 20, 2017) at p. 8.

⁴⁵ In *re Medical Software Solutions*, 286 B.R. 431 (2002) at p. 10.

⁴⁶ Kevin P. McElcheran, *Commercial Insolvency in Canada*, 3rd ed, (Toronto: Nexus Canada Inc., 2015) at 190, 238-239.

58. In *Confederation Treasury*,⁴⁷ Farley J. quoted [at para. 15] with approval the words of McQuaid J. in *Prince Edward Island v. Bank of Nova Scotia*, [1988 CanLII 8825 \(PE SCTD\)](#):

It is the duty of the trustee, who is an officer of the court, to represent impartially the interests of all creditors; he is obligated to hold an even hand as between competing classes of creditors; he must act for the benefit of the general body of creditors; he is not an agent of the creditors, but an administrative official required by law to gather in and realize on the assets of the bankrupt and to divide the proceeds in accordance with the scheme of the Bankruptcy Act among those entitled. And perhaps most importantly, he must conduct himself in such a manner as to avoid any conflict, real or perceived, between his interest and his duty.

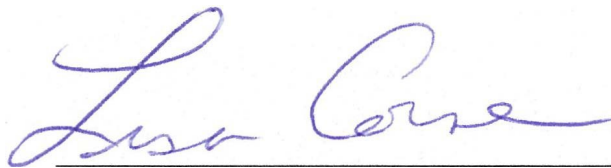
59. On this motion for a declaration of Mahal's priority over other creditors, KSV has regrettably taken a partisan position against Mahal which lacks the impartiality expected of a court-appointed officer.

PART IV - ORDER REQUESTED

60. Mahal requests an order declaring that the principal amount of \$2,182,914.00, plus (ii) interest thereon at the rate of five percent per year, until paid, and (iii) costs, on an actual indemnity basis, is due and owing by Golden Miles to Mahal and secured by a valid and enforceable security interest registered first in priority under the *PPSA* over Golden Miles' personal property (excluding any equipment financed by Skymark).

⁴⁷ *Confederation Treasury Services Ltd., Re*, 1995 CanLII 7386 (ON SC) at [para 15](#); *General Motors v. Trillium Motor World Ltd.*, 2019 ONSC 520 (CanLII) at [paras 31-32](#).

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 11th day of January, 2023.



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SCHEDULE “A”

1. *U.S. Steel Canada Inc., (Re)*, 2016 ONSC 569
2. *Maisonneuve et al. v. Langlois et al.*, 2021 ONSC 3587
3. *Collins English Dictionary* (Harper Collins)
4. *Oxford Learner’s Dictionaries* (Oxford University Press, 2020)
5. *Black’s Law Dictionary*, (Saint Paul, MN: West Publishing Co, 1979)
6. *R v. Handy*, 2002 SCC 56
7. *U.S. Steel Canada, Inc. (Re)*, 2016 ONCA 662
8. *re SGK Ventures, LLC*, 2017 WL 2683686 (NDIll, June 20, 2017)
9. *re Medical Software Solutions*, 286 B.R. 431 (2002)
10. *Krieser v. Gerber*, 2020 ONCA 699
11. *Deep v. Wood*, 1983 Canlii 3101 (ONCA)
12. *Verbeek v. Kooner*, 2021 ONSC 7863
13. *Confederation Treasury Services Ltd., Re*, 1995 CanLII 7386 (ON SC)
14. *General Motors v. Trillium Motor World Ltd.*, 2019 ONSC 520 (CanLII)
15. Kevin P. McElcheran, *Commercial Insolvency in Canada*, 3rd ed, (Toronto: Nexus Canada Inc., 2015)

SCHEDULE “B”

Bankruptcy and Insolvency Act (RSC, 1985, c. B-3) section 136

Priority of claims

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

Personal Property Security Act, R.S.O. 1990, c. P.10 section 20(1)(a)(d)

Unperfected security interests

20 (1) Except as provided in subsection (3), until perfected, a security interest,

(a) in collateral is subordinate to the interest of,

(i) a person who has a perfected security interest in the same collateral or who has a lien given under any other Act or by a rule of law or who has a priority under any other Act, or

(ii) a person who causes the collateral to be seized through execution, attachment, garnishment, charging order, equitable execution or other legal process, or

(iii) all persons entitled by the *Creditors' Relief Act, 2010* or otherwise to participate in the distribution of the property over which a person described in subclause (ii) has caused seizure of the collateral, or the proceeds of such property;

(b) in collateral is not effective against a person who represents the creditors of the debtor, including an assignee for the benefit of creditors and a trustee in bankruptcy;

Application of principles of law and equity

72 Except in so far as they are inconsistent with the express provisions of this Act, the principles of law and equity, including the law merchant, the law relating to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake and other validating or invalidating rules of law, shall supplement this Act and shall continue to apply.

**ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)**

PROCEEDING COMMENCED AT
TORONTO

**FACTUM OF THE MOVING PARTY,
SANTOKH MAHAL**

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