Court File No.: CV-16-11549-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF URBANCORP (WOODBINE) INC. URBANCORP (BRIDLEPATH) INC., THE TOWNHOUSES OF HOGG'S HOLLOW INC., KING TOWNS INC., NEWTOWNS AT KING TOWNS INC. AND DEAJA PARTNER (BAY) INC. (COLLECTIVELY, THE "APPLICANTS")

AND IN THE MATTER OF TCC/URBANCORP (BAY) LIMITED PARTNERSHIP

BOOK OF AUTHORITIES OF TERRA FIRMA CAPITAL CORPORATION

February 14, 2019

THORNTON GROUT FINNIGAN LLP
100 Wellington Street West
Suite 3200
P.O. Box 329, TD West Tower
Toronto, Ontario
M5K 1K7

John T. Porter (LSUC# 23844T)
Tel: 416-304-0778
Fax: 416-304-1313
Email: jporter@tgf.ca

Lawyers for Terra Firma Capital Corporation

Court File No.: CV-16-11549-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF URBANCORP (WOODBINE) INC. URBANCORP (BRIDLEPATH) INC., THE TOWNHOUSES OF HOGG'S HOLLOW INC., KING TOWNS INC., NEWTOWNS AT KING TOWNS INC. AND DEAJA PARTNER (BAY) INC. (COLLECTIVELY, THE "APPLICANTS")

AND IN THE MATTER OF TCC/URBANCORP (BAY) LIMITED PARTNERSHIP

BOOK OF AUTHORITIES OF TERRA FIRMA CAPITAL CORPORATION

LIST OF AUTHORITIES

TAB 1

2016 ONSC 569
Ontario Superior Court of Justice

U.S. Steel Canada Inc., Re

2016 CarswellOnt 3816, 2016 ONSC 569, 265 A.C.W.S. (3d) 297, 34 C.B.R. (6th) 226, 5 P.P.S.A.C. (4th) 157

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

In the Matter of a Proposed Plan of Compromise or Arrangement with Respect to U.S. Steel Canada Inc.

H. Wilton-Siegel J.

Heard: January 14-15, 20-22, 25-27, 2016
Judgment: February 29, 2016
Docket: CV-14-10695-00CL

Counsel: Michael E. Barrack, Robert Thornton, Jeff Galway, Kiran Patel, Max Shapiro, for United States Steel Corporation
Alan Mark, Peter Ruby, Tamryn Jacobson, Logan Willis, Jesse-Ross Cohen, for Province of Ontario
Gordon Capern, Kris Borg-Olivier, Denise Cooney, for USW and Locals 1005 and 8782
Andrew Hatnay, Barbara Walancik, Adrian Scotchmer, for Non-unionized Active Employees and Retirees
Sharon Kour, for Applicant, U.S. Steel Canada Inc.
Robert Staley, Jonathan Bell, William Bortolin, for Monitor Ernst & Young Inc.

Subject: Contracts; Corporate and Commercial; Evidence; Insolvency; International; Torts

Headnote

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

Proof of claims — USSC Inc. was indirect wholly-owned subsidiary of USS Inc. — As result of its financial difficulties, USSC Inc. applied for relief under Companies' Creditors Arrangement Act (CCAA) and was granted CCAA protection pursuant to initial order — Pursuant to claims process order, creditors of company were required to file proofs of claim in respect of affected claims with monitor — USS Inc. and its subsidiaries and affiliates filed 14 proofs of claim with monitor including non-contingent secured claims, unsecured claims and contingent secured claims — USS Inc. brought motion to have secured claims and unsecured claims approved by court as proven claims pursuant to claims process order — All claims except one remaining secured claim were confirmed by court as proven claims — Objecting parties had burden of proof that USS Inc.'s debt claims were properly characterized as equity claims under CCAA — To extent any advances from USS Inc. and its subsidiaries and affiliates constituted contribution to capital of USSC Inc., any claim for such amounts as proven claims in CCAA proceedings would constitute equity claim — Determination of whether particular claim was to be treated as debt or equity had to address not just expressed intentions of parties but also manner in which transaction was implemented and economic reality of surrounding circumstances — Outstanding term loan constituted debt claim rather than equity claim for purposes of CCAA proceeding — At time of term loan, USS Inc. expected that USSC Inc. would repay interest on term loan in accordance with terms of term loan agreement and would repay principal on or prior to maturity date of term loan — Objecting parties did not satisfy onus of demonstrating that USS Inc.'s expectation of repayment with interest of principal of term loan was unreasonable — With regards to revolver loan, USS Inc. had reasonable expectation of repayment with interest of advances comprising first and second tranche indebtedness at time such advances were made and claims constituted debt claims rather than equity claims — Security for two remaining secured claims was not unenforceable for lack of consideration or void as fraudulent preference —

Determination of issues pertaining to final secured claim could not be addressed until threshold issue of whether USS Inc.'s subrogation rights at issue qualified as secured obligations.

MOTION by company to have secured and unsecured claims approved by court as proven claims pursuant to claims process order under *Companies' Creditors Arrangement Act*.

***H. Wilton-Siegel J.*:**

1 In this proceeding, United States Steel Corporation ("USS") seeks a determination of 14 Proofs of Claim (the "USS Claims") filed in these proceedings under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "CCAA") regarding U.S. Steel Canada Inc. ("USSC").

2 Objections to the treatment of certain of these Claims as debt rather than as "equity claims" for the purposes of the CCAA, and to the enforceability of the security asserted in respect of certain of these Claims, have been filed by each of: (1) the United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Workers International Union (the "USW") on its own behalf and on behalf of USW Local 1005 and USW Local 8782 (collectively, the "Union"); (2) Her Majesty the Queen in Right of Ontario and the Superintendent of Financial Services (Ontario) in his capacity as administrator of the Pension Benefits Guarantee Fund (collectively, the "Province"); and (3) Representative Counsel to all non-USW active employees and retirees of USSC (collectively, the "Objecting Parties").

3 This motion principally addresses the objections filed by the Objecting Parties (the "Objections"). The following are the USS Claims in respect of which Objections have been made:

Claim Reference #	*Description of Claim*	*Amount of Claim*
9	Unsecured Term Loan	$1,847,169,934
10	Unsecured Revolver Loan	U.S. $120,150,928
11	Secured Revolver Loan	U.S. $72,938,390
11(a)	Secured Cliffs LRD Transaction	U.S. $14,538,463
11(b)	Secured Credit Support Payments	U.S. $3,742,479
11(c)	Secured Intercompany Trade	U.S. $31,252,193

The Claim numbers above, and amounts reflected in this table, are taken from the Third Supplementary Seventh Report of the Monitor dated July 29, 2015 (the "Third Supplementary Monitor's Report") at para. 11.

4 In these Reasons, Claims #9 and #10 are referred to as the "USS Unsecured Claims" and Claims #9, #10 and #11 are referred to collectively as the "USS Debt Claims". In addition, Claims #11, #11(a), #11(b) and #11(c) are referred to as the "USS Secured Claims", and Claims #11(a), #11(b) and #11(c) are referred to as the "USS Remaining Secured Claims".

Background

5 The following is a brief summary of the background to this proceeding. Further detail regarding the relationship between USS and USSC and the USS Claims that have given rise to the Objections is set out below.

USSC

6 USSC is an integrated steel manufacturer that conducts most of its business from two large steel plants located in Ontario: the Hamilton Works located in Hamilton, Ontario and the Lake Erie Works located in Nanticoke, Ontario.

7 USSC is an indirect wholly-owned subsidiary of USS. Prior to its acquisition by USS in 2007, USSC was known as Stelco Inc. ("Stelco").

8 As a result of its financial difficulties, USSC applied for relief under the CCAA and was granted CCAA protection pursuant to an Initial Order dated September 16, 2014 (the "Filing Date") (as amended and restated from time to time, the "Initial Order").

The USS Parties

9 USS is an integrated steel producer with major operations in North America and Central Europe. USS is a publicly-traded, Delaware corporation and its shares are listed for trading on the New York Stock Exchange.

10 1344973 Alberta ULC ("ABULC") was an Alberta corporation incorporated on August 22, 2007 to be the acquisition vehicle for the purposes of the USS acquisition of Stelco.

11 U.S. Steel Canada Limited Partnership ("Canada LP") is a limited partnership formed under the laws of Alberta. Canada LP is an indirect wholly-owned subsidiary of USS. At the time of the USS acquisition of Stelco, Canada LP owned all the outstanding shares of ABULC and was, therefore, ABULC's direct parent. As a result of the amalgamation of ABULC and USSC on December 31, 2007 described below, Canada LP has become the direct parent of USSC.

12 United States Steel Credit Corporation ("Credit Corp") was a Delaware corporation that was a wholly-owned subsidiary of USS. Credit Corp was merged into another wholly-owned subsidiary of USS on December 20, 2013.

13 U.S. Steel Kosice s.r.o. ("USS Kosice") is a Slovakian corporation that is an indirect wholly-owned subsidiary of USS.

The USS Acquisition of Stelco Inc. in 2007

14 On August 26, 2007, the USS board of directors approved the USS acquisition of Stelco, and USS, Stelco and ABULC entered into an arrangement agreement giving effect to the proposed transaction. The plan of arrangement by which the acquisition was implemented was subsequently approved by the Ontario Superior Court of Justice on October 30, 2007, and the acquisition transaction closed on October 31, 2007 (the "Acquisition").

Financing the Acquisition and the Flow of Funds

15 The total amount spent by USS in connection with the Stelco acquisition was approximately $1.939 billion, or U.S. $2.056 billion at then prevailing exchange rates. The relevant corporate structure and the flow of funds are shown on the Funds Flow Chart attached as Schedule A to these Reasons. In these Reasons, all dollar amounts are denominated in Canadian dollars unless otherwise specifically indicated.

16 ABULC was the acquisition vehicle that directly acquired Stelco. ABULC was financed by the following loans and capital contributions:

(a) Canada LP loaned ABULC $700 million pursuant to a loan agreement dated October 29, 2007 described below (the "Term Loan");

(b) Canada LP provided ABULC with equity in the amount of $600 million; and

(c) Credit Corp loaned ABULC approximately U.S. $744 million pursuant to a loan agreement dated October 29, 2007 described below (the "Credit Corp Loan").

17 ABULC used the funds received from Canada LP and Credit Corp as follows: (1) ABULC used $1.046 billion to purchase the outstanding shares of Stelco; (2) ABULC loaned Stelco approximately $741 million, which Stelco used to pay out its third party debt (other than a loan from the Province of Ontario); (3) ABULC loaned Stelco approximately $59 million, which Stelco used to pay out its option holders; (4) ABULC loaned Stelco approximately $61 million, which

Stelco used to pay out its warrant holders; (5) ABULC loaned Stelco $32.5 million, which Stelco used to make a payment to its four main pension plans; and (6) ABULC loaned Stelco $40 million to fund Stelco's working capital.

18 The funds used to acquire Stelco were derived from multiple sources. First, USS obtained new debt financing in the principal amount of U.S. $900 million in the form of facilities provided by a banking syndicate led by J.P. Morgan Chase Bank, N.A. These facilities comprised an unsecured three-year term loan in the principal amount of U.S. $500 million and an unsecured one-year term loan in the amount of U.S. $400 million. The one-year term loan was subsequently refinanced by USS as part of a larger offering of ten-year bonds in the public market. Second, USS obtained approximately U.S. $400 million by drawing on an existing receivables purchase facility. Third, USS utilized approximately U.S. $153 million of cash on hand at the USS level and 434,415,519.56, or $597,860,287.50, of cash on hand in USS Kosice.

19 The source of the financing for the Acquisition, the structure of the Acquisition and the flow of funds to ABULC for such purposes was developed by USS between the date of the Arrangement Agreement and the date of the Acquisition. The principal consideration in the development of this structure was tax-efficiency from the perspective of USS. With respect to ABULC, the amounts received by it as debt and equity were driven by the "thin capitalization" rules under the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.). In addition, the amount of the funding reflected a USS policy of avoiding any secured third party indebtedness at the level of any subsidiary. As a result, it was necessary to fund Stelco with the amount necessary to repay all outstanding third party debt at the date of the Acquisition, other than a loan from the Province.

Post-Acquisition Corporate Reorganization & Refinancing

20 On November 1, 2007, immediately following the Acquisition, Stelco was renamed U.S. Steel Canada Inc.

21 Between October 31, 2007 and the year-end, the Credit Corp Loan was repaid in full. Certain of the repayments were made from additional advances under the Term Loan which are described in greater detail below.

22 Following such additional advances by Canada LP to ABULC under the Term Loan in 2007, the outstanding principal amount outstanding under the Term Loan on December 31, 2007 was $1,227,363,149.82. The total amount outstanding on that date including accrued interest was $1,240,009,143.

23 ABULC and USSC amalgamated on December 31, 2007 to continue as USSC (the "Amalgamation"). As a result of the Amalgamation, the obligations of ABULC under the Term Loan became obligations of the amalgamated entity, USSC.

The History of the Credit Corp Loan

24 As described above, pursuant to the Credit Corp Loan, Credit Corp advanced U.S. $744,463,605 to ABULC on or about October 31, 2007. The funds provided by the Credit Corp Loan were notionally intended to fund Stelco's third party debt at the date of acquisition that was denominated in U.S. dollars. USS intended the facility to be a short-term facility that would be repaid within two months. Larry Brockway, the Senior Vice-President, Chief Financial Officer and Chief Risk Officer of USS ("Brockway"), testified that the "purpose of the agreement was to help stair-step the structure into a more permanent structure as part of the ultimate steps between the acquisition and year end".

25 Consistent with this objective, the Credit Corp Loan was repaid by means of: (1) a repayment of approximately U.S. $26 million in November 2007; (2) a repayment of approximately U.S. $41 million on December 4, 2007, which was funded by an advance to ABULC under the Term Loan on the same day described below; (3) a U.S. $87 million repayment by ABULC on December 21, 2007, comprised of U.S. $10 million presumably funded out of a U.S. $20 million equity injection from Credit Corp to ABULC on the same day and application of U.S. $77 million out of the $470 Million Advance described below; and (4) a reduction in the amount of approximately U.S. $595 million pursuant to the SHC Transaction described below.

The SHC Transaction

26 The following summarizes the description of the SHC Transaction set out in the Third Supplementary Monitor's Report.

27 At the time of the Acquisition, Stelco indirectly owned all of the outstanding shares of Stelco Holding Company ("SHC"), a corporation incorporated under the laws of Delaware. SHC's principal assets were interests in two mining joint ventures — Hibbing Taconite Company ("Hibbing") and Tilden Mining Company ("Tilden").

28 At the time of the Acquisition, SHC had a liability to Stelco in the amount of approximately U.S. $393 million. This amount principally represented the excess of the amount owing by Stelco to SHC for iron-ore pellets produced by Hibbing and Tilden and shipped to Stelco, representing SHC's *pro rata* share of such production, less the amount of annual cash calls on SHC in respect of Hibbing and Tilden, which were paid by Stelco on behalf of SHC. This liability was booked as an advance from SHC to Stelco, and had increased in each year prior to 2007. The liability also included legacy liabilities of Stelco to certain other subsidiaries of SHC that were dormant. Stelco had not repaid any amount on account of these advances, and had no intention of doing so prior to the Acquisition, due to the adverse tax consequences of dividending the amount of any such payment back to Canada.

29 The Acquisition presented an issue of tax inefficiency for USS, referred to as a "tax sandwich", that would result if distributions from SHC (as dividends or interest) were made to USSC in Canada and, in turn, distributed to USS in the United States. To address this issue, USS caused ABULC, USSC and SHC to enter into certain transactions which were effected by book entries in the financial accounts of the relevant corporations pursuant to a payment direction agreement dated December 21, 2007 (the "Payment Direction") (collectively, the "SHC Transaction").

30 The SHC Transaction involved the following steps:

(1) ABULC loaned USSC the amount of U.S. $393 million out of the $470 Million Advance (defined below);

(2) USSC repaid the outstanding advance to SHC in the same amount;

(3) USSC sold its equity interest in SHC to USS for consideration in the form of a promissory note dated December 31, 2007 in the principal amount of U.S. $595 million payable to the wholly-owned subsidiary of USSC that owned the shares of SHC. The face amount of the promissory note of U.S. $595 million represented USS' estimation of the fair market value of SHC at the time of the sale; and

(4) The promissory note was distributed by such wholly-owned subsidiary to USSC on December 31, 2007 which, in turn, assigned the note to Credit Corp in reduction of the remaining principal amount outstanding under the Credit Corp Loan, which was slightly less than U.S. $593 million.

31 The effect of the SHC Transaction was to transfer ownership of SHC from USSC to USS by way of satisfaction of the remaining amount outstanding under the Credit Corp Loan as of December 31, 2007.

The Term Loan

32 The following summarizes the provisions of the Term Loan that are relevant for the issues in this proceeding and the history of draws and accrued interest under the Term Loan resulting in the USS claim in respect of the Term Loan.

The Relevant Provisions of the Term Loan

33 The Term Loan is an unsecured loan facility having a term of 30 years repayable by USSC at any time without premium or penalty. The full amount of the outstanding principal is therefore due on October 31, 2037, to the extent it is

not repaid before that date. USS says that it selected a 30-year term for the Term Loan because it viewed its investment in Stelco as a long-term one. The 30-year term was also the maximum term countenanced for U.S. tax purposes.

34 Interest on the Term Loan accrued daily and compounded semi-annually at an interest rate of 9.03% per annum. USS obtained and relied upon advice from an independent, third-party consultant regarding an acceptable interest rate for a company with a similarly rated risk for 30-year debt. Interest is payable on the last business day of the year on the second anniversary after the year in which it accrues. As a result, interest under the Term Loan was payable from 24 to 36 months after the date it began to accrue.

35 The Term Loan was denominated in Canadian dollars. The Term Loan originally allowed for a maximum borrowing of $1 billion. The maximum availability under the Term Loan was increased from $1 billion to $1.5 billion on December 21, 2007. As mentioned, the amount of $700 million was initially advanced on October 31, 2007. The Term Loan provided that further advances could be obtained "with prior written notice ... pursuant to a request for advance" set out in a form similar to a scheduled document to the Term Loan.

36 The loan agreement contains certain representations and covenants of ABULC/USSC and events of default. The events of default include an event of default if the borrower is "unable to meet debts". Upon the occurrence of an event of default, the maturity date is accelerated and Canada LP has the right to demand repayment.

History of Advances and Repayments under the Term Loan

37 As mentioned above, Canada LP advanced $700 million to ABULC on October 31, 2007 in connection with the Acquisition. This amount became a direct obligation of USSC after the Amalgamation. In addition, during the period from the Acquisition to the Amalgamation, ABULC recorded three additional advances. On December 4, 2007, ABULC recorded two advances totaling approximately U.S. $61 million, of which U.S. $41 million was applied to reduce the Credit Corp Loan and the balance was advanced to USSC for working capital purposes. On December 22, 2007, ABULC recorded an advance of U.S. $470 million under the Term Loan pursuant to the Payment Direction (the "$470 Million Advance"). The foregoing advances under the Term Loan are collectively referred to as the "initial advances".

38 During 2008, USSC made interest payments to Canada LP under the Term Loan totalling approximately $113 million. Of this amount, $99,940,908 was paid in October and November 2008. Such payments were made in advance of their due date under the Term Loan Agreement, which provided that such interest was not payable until December 31, 2010. In addition, USSC made a principal repayment of $19 million in January 2008. The only additional funding provided to USSC by USS or any of its affiliates in 2008 was an equity injection of approximately $55 million in October 2008.

39 In 2009, USSC received additional advances from Canada LP under the Term Loan totalling $211.2 million. These advances were made during the months of February, June, September, November and December 2009. No interest or principal was paid during 2009. In addition, as set out in the table above, USS provided equity injections totalling $61 million during 2009. These capital contributions were made in February, July and October 2009.

40 There were no further advances under the Term Loan after 2009. At the end of 2010, USS decided to waive the remaining interest that was due under the Term Loan in respect of interest accrued during 2008. Since there had been substantial interest payments made in 2008, the accrued interest that was waived in December 2010 was only $10.5 million. USS says that, given USSC's other funding needs at the time, the interest payment could only have been made if USSC received additional funding. Further, due to taxation on interest payments, it did not make economic sense to fund USSC with additional debt or equity in order to enable USSC to repay interest on the Term Loan. USS says that this was the first time that USS considered waiving interest due under the Term Loan. In other words, it asserts that it did not have such expectation at the time that it entered into the Term Loan.

41 USS continued the practice of waiving interest in each year after 2010. Accordingly, in each of the years 2010 to 2013, USS waived approximately one-half of the accrued and unpaid interest due in that year. In total, USS has

waived interest obligations of USSC totaling approximately $428 million and has accrued interest under the Term Loan in approximately the same amount.

42 As of the Filing Date, the total amount outstanding under the Term Loan, including accrued interest, was $1,847,169,934.

The Revolver Loan

43 Pursuant to an agreement dated May 11, 2010 between USSC and Credit Corp (as amended from time to time, the "Revolver Loan Agreement"), Credit Corp established a Revolver Loan to provide working capital to USSC to support its operating activities. The Revolver Loan Agreement was subsequently amended successively by an agreement dated July 31, 2012 (the "First Revolver Amendment"), an agreement dated January 28, 2013 (the "Second Revolver Amendment") and an agreement dated October 30, 2013 (the "Third Revolver Amendment") in the circumstances described below. In these Reasons, the loan outstanding under the Revolver Loan Agreement, as so amended from time to time, is herein referred to as the "Revolver Loan" and the Term Loan and the Revolver Loan are collectively referred to as the "Loans" and individually are referred to as a "Loan".

44 USS has filed two proofs of claim in respected of the Revolver Loan. The first claim is an unsecured claim (being Claim #10) in the amount of U.S. $120,150,928, representing the outstanding loan on October 30, 2013, together with accrued interest since that date. The second claim is a secured claim (being Claim #11) in the amount of U.S. $72,938,390, representing the loan advances since October 30, 2013 plus accrued interest. The following sets out the principal terms of the Revolver Loan, including the related security, and the history of advances and payments in respect of the Revolver Loan.

Terms of the Revolver Loan

45 The Revolver Loan was originally an unsecured loan having a fifteen-year term. Accordingly, all outstanding advances are due on May 11, 2025. As mentioned, the Revolver Loan originally provided for a maximum availability of U.S. $350 million.

46 Advances under the Revolver Loan accrued interest at the applicable federal interest rate for the month in which the advance was drawn and compounded interest semi-annually. The applicable interest rate as of the date of the Revolver Loan was 4.42% per annum.

47 The loan agreement contains certain representations and covenants of USSC, including originally, a solvency representation, and events of default. The events of default include an event of default in the event that the borrower is "unable to meet debts". Upon the occurrence of an event of default, the maturity date is accelerated and Credit Corp had the right to demand repayment. The loan agreement is governed by the laws of the Commonwealth of Pennsylvania.

The History of Advances and Repayments Under the Revolver Loan

48 Credit Corp advanced a total of U.S. $120 million under the Revolver Loan from its establishment in May 2010 through the third quarter of 2011. Of this amount, U.S. $75 million was advanced in May 2010, U.S. $25 million was provided in two advances in August 2010, and a further U.S. $20 million was advanced in June 2011.

49 In the period from November 2011 to April 2012, USSC had somewhat more stable cash flows. Credit Corp advanced approximately U.S. $136 million under the Revolver Loan during this period. During the same period, USSC made interest payments totaling almost U.S. $9 million and principal repayments of approximately U.S. $61.8 million under the Revolver Loan. Thereafter, the outstanding balance began to grow with additional advances in each month in 2012, other than October.

50 By July 31, 2012, the outstanding principal balance of the Revolver Loan was, however, approaching the cap of U.S. $350 million. On that date, Credit Corp and USSC executed the First Revolver Amendment, which increased the

maximum availability under the Revolver Loan to U.S. $500 million. Apart from removal of the solvency representation of USSC, the First Revolver Amendment did not otherwise amend the provisions of the Revolver Loan Agreement, including the events of default. The solvency representation of USSC was removed at the request of USSC's management, which had a concern about USSC's solvency given its recent losses and the level of its debt. The circumstances pertaining to this action are addressed further below.

51 By January 28, 2013, however, after additional advances to USSC under the Revolver Loan, the outstanding principal balance of the Revolver Loan had again reached the maximum availability. USSC's business plan for 2013 indicated that it would need substantial additional financing during that year in order to finance its operations. Accordingly, on that date Credit Corp and USSC executed the Second Revolver Amendment, which increased the maximum availability under the Revolver Loan from U.S. $500 million to U.S. $600 million, on the condition that USSC grant a security interest in favour of USS in respect of its inventory of iron ore pellets sold to it by SHC. The Second Revolver Amendment did not otherwise amend the provisions of the Revolver Loan Agreement as it existed on January 28, 2013, including the events of default and consequences of a default.

52 In furtherance of the provisions of the Second Revolver Amendment, USSC granted a security interest in favour of Credit Corp over all of its inventory of iron ore pellets sold to USSC by SHC, and related proceeds, pursuant to a security agreement dated January 28, 2013 executed by USSC and USS (the "Security Agreement").

53 In February 2013, USS determined that the foreign currency exchange fluctuations on the Revolver Loan, which was a U.S. dollar-denominated loan, had become unacceptable as a result of the volatility of USSC's revenues, and accordingly of its quarterly earnings, due to fluctuations in the Canadian dollar. Over a period of several months thereafter, Canada LP injected significant amounts of equity into USSC to provide for USSC's working capital funding needs and to allow USSC to pay down the Revolver Loan.

54 Between February and September 2013, as set out above, equity injections provided to USSC totaled over $680 million. Payments of principal and interest on the Revolver Loan over the same period totaled over U.S. $390 million. As of October 30, 2013, the amount outstanding under the Revolver Loan had been reduced to $116,969,996.

55 On October 30, 2013, Credit Corp and USSC executed the Third Revolver Amendment. The Third Revolver Amendment contains a recital to the effect that the parties wish to amend and restate the Revolver Loan "in order to permit the Borrower to access the remainder of the [Revolver] Loan." The Third Revolver Amendment continued the availability under the Revolver Loan in the amount of U.S. $600 million. However, it divided borrowings under the facility into two tranches: (1) the "First Tranche Indebtedness", being the outstanding amount of $116,969,996, which was entitled to the security interest over iron-ore pellets constituted by the Security Agreement; and (2) the "Second Tranche Indebtedness", being any advances after October 30, 2013, which were entitled to the general security interest constituted by the October Security Agreement (as defined below). The Third Revolver Amendment did not otherwise amend the provisions of the Revolver Loan as it existed on October 30, 2013, including the events of default and consequences of a default.

56 Concurrently with the execution of the Third Revolver Amendment, USSC and Credit Corp executed an amendment and restatement of the Security Agreement pursuant to an agreement also dated October 30, 2013 (the "October Amendment"). Pursuant to the October Amendment, USSC granted a general security interest over all of its personal property in favour of Credit Corp. The October Amendment contained a recital to the effect that Credit Corp "is willing to continue to provide Loans pursuant to [the Revolver Loan], only if [USSC] enters into this Amendment". The General Security Agreement, as amended by the October Amendment, is herein referred to as the "October Security Agreement". Apart from broadening the security interest granted in favour of Credit Corp, the October Amendment did not otherwise amend the provisions of the Security Agreement as it existed as of October 30, 2013.

57 USS has acknowledged that, as of October 30, 2013, although USSC was meeting its obligations as they fell due, the total liabilities of USSC exceeded the market value of its assets and, accordingly, USSC was otherwise "insolvent", including for the purposes of section 95 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the "BIA").

58 After the execution of the Third Revolver Amendment and the October Security Agreement, Credit Corp advanced loans to USSC under the Revolver Loan totaling U.S. $71 million. These loans were outstanding at the Filing Date. USSC did not make any payments of either principal or interest after October 30, 2013 in respect of the First Tranche Indebtedness under the Revolver Loan outstanding as of October 30, 2013.

59 Accordingly, at the Filing Date, the total amount outstanding under the Revolver Loan, including accrued interest, was U.S. $193,089,318. The portion of this balance attributable to advances made prior to October 30, 2013, i.e., to the First Tranche Indebtedness plus accrued and unpaid interest thereon since that date, was U.S. $120,150,928. This is the amount of the USS unsecured claim in respect of the Revolver Loan. The portion attributable to advances made after October 30, 2013, i.e., to the Second Tranche Indebtedness, was U.S. $72,938,390, representing U.S. $71 million of advances plus interest. This is the amount of the USS secured claim in respect of the Revolver Loan.

Internal Procedure for Additional Draws and Equity Capital Contributions

60 In order to request funding under the Term Loan after December 31, 2007 and under the Revolver Loan, USSC would prepare and submit to USS a cash flow forecast setting out its anticipated cash requirements for the following 13-week period. The submission of these weekly cash flow forecasts, and the related correspondence and discussions between USS and USSC, constituted USSC's formal request for funding.

61 USS would review the forecast and determine whether funds would be advanced, and if so whether they would be advanced as debt under the Loans or as an equity injection. Typically the funds would be advanced as debt unless additional debt would cause USSC to go offside the "thin capitalization" tax rules under the *Income Tax Act*.

62 There is no dispute that all advances made under the Term Loan were documented and recorded by both Canada LP and USSC as debt and that all advances made under the Revolver Loan were similarly documented and recorded by both Credit Corp and USSC as debt. It is also not disputed that all contributions to equity by Canada LP were recorded by both Canada LP and USSC as equity. In this regard, the Monitor has noted that USSC's books and records relating to these intercompany transactions are well organized and documented, including with respect to each specific advance of cash in the form of equity or debt.

63 The following table summarizes the equity capital injections by USS into USSC between October 31, 2007 and the Filing Date:

Equity Contributions (CAD $Millions)

Period	Original Contribution	Equity Advances	Total
Oct 31, 2007	600		600
Nov 30, 2007	-	-	600
Dec 31, 2007	-	20	620
2008	-	55	675
2009	-	61	736
2010	-	612	1,347
2011	-	213	1,561
2012	-	-	1,561
2013	-	764	2,325
Sept 15, 2014	-	-	2,325
Total	**600**	**1,725**	**2,325**

Source: USSC Share Consideration Registry

64 The Remaining USS Secured Claims USS has asserted the following three Claims, which it says are secured pursuant to the November Security Agreement (as defined below):

Claim	***Amount (USD)***	***Claim Reference #***
Secured Cliffs Transaction	$14,538,462.95	11(a)
Secured Credit Support Payments	$3,742,478.78	11(b)
Secured Intercompany Goods & Services	$31,252,193.05	11(c)

As mentioned, these Claims are collectively referred to as the "USS Remaining Secured Claims". It is my understanding that the Objecting Parties do not challenge the quantum of these Claims but assert that the security for these Claims is unenforceable on the grounds described later in these Reasons.

Secured Cliffs Transaction (Claim #11(a))

65 USS filed a secured claim for U.S. $14,538,462.95 with respect to the amount of a payment made by USS to Cliffs Natural Resources and Cliffs Sales Company (collectively, "Cliffs") for certain iron ore delivered by Cliffs to USSC, which iron ore was, in turn, resold by USS to USSC under the following circumstances.

66 Cliffs and USS are parties to an agreement dated January 1, 2008 for the supply of iron ore (the "Cliffs Agreement"). The iron ore delivered by Cliffs to USSC was sourced by the USS Procurement Department as part of the raw materials services arrangement between USS and USSC that was provided for in the "Limited Risk Distributor Agreement" referred to below.

67 The Claim relates to four shipments of iron ore, and associated screening charges, totaling U.S. $14.1 million, which were delivered by Cliffs to USSC in August 2014, prior to the Filing Date and outstanding obligations in the amount of U.S. $0.4 million for screening charges incurred in January and May 2014 for which Cliffs had not previously issued invoices.

68 On September 16, 2014, pursuant to an agreement between USS and USSC (the "Iron Ore Agreement"), in order to avoid an interruption of the supply of a critical raw material under the Cliffs Agreement, USS agreed to make the payment to Cliffs and to transfer title of the iron ore pellets to USSC provided that USSC confirmed the corresponding obligation of USSC to USS in payment of such iron ore would be secured under the November Security Agreement.

69 The Monitor has confirmed that USSC received delivery of the iron ore prior to the Filing Date and that USS made the payment of $14.1 million to Cliffs on October 2014. The Monitor has also confirmed that, under the Cliffs Agreement, title to the iron ore did not pass to USS until USS paid for the iron ore after the Filing Date. At that time, USS effectively took title to the iron ore and re-sold it to USSC pursuant to the Limited Risk Distributor Agreement described below.

70 Accordingly, this Claim is a claim of USS for the payment of goods sold by USS to USSC after the Filing Date pursuant to arrangements set out in the Iron Ore Agreement that were entered into prior to the commencement of these proceedings under the CCAA.

Secured Credit Support Payments - Claim #11(b)

71 USS filed a secured Claim for U.S. $3,703,450 for contribution and indemnity as guarantor of certain USSC obligations as follows:

Vendor	*Amount (USD)*
Independent Electricity System Operator ("IESO")	$2,616,156.27
Union Gas Limited ("Union Gas")	$669,109.87
Norfolk Southern Corporation ("Norfolk")	$457,212.64

72 USS received demands subsequent to the Filing Date from IESO, Union Gas and Norfolk pursuant to existing guarantee agreements between USS in favour of each of such parties in respect of goods and services supplied to USSC prior to the Filing Date. USS made payments to these vendors pursuant to these guarantees subsequent to the Filing Date. This Claim is therefore an aggregation of USS' rights of subrogation which arose on payment of these three obligations of USSC after the Filing Date pursuant to the USS guarantees in favour of the third parties.

Secured Intercompany Goods & Services - Claim #11(c)

73 In the ordinary course of business, the USS Affiliates provided raw materials and other goods as well as various services to USSC both informally and under several intercompany agreements. Invoices relating to the intercompany goods and services received by USSC in a calendar month were typically paid on a gross basis on or about the 15th day of the following month as part of a normal reconciliation process between USSC and USS.

74 USS filed a secured claim totaling U.S. $31,252,193.05 in respect of the sale of goods and the provision of services on an intercompany basis after the date of the November Security Agreement.

75 As stated above, the sale of goods and the provision of services by USS to USSC took place both informally and under several intercompany agreements. The relevant intercompany agreements include the following: (1) two Marketing, Distributorship and Supply Agreements, dated March 1, 2009 and December 1, 2008, which governed cross-border sales within the USS group, i.e., the sale of steel produced in the U.S. or Canada and sold to a customer in the other country; (2) a Limited Risk Distributor Agreement, dated February 1, 2008, between USS and USSC under which USSC purchased significant quantities of raw material on an as-needed basis from USS; (3) an ERP Cost Sharing Agreement, amended January 1, 2011, that governed the costs of an enterprise-wide financial and operational software solution known as "Oracle"; (4) a Corporate Services Agreement, dated November 1, 2007, pursuant to which USS provided, among other things, financial and accounting, corporate strategic planning, tax planning and audit services to USSC; and (5) a Business Services Agreement, dated January 1, 2014, among USS, USSC and USS Kosice that related to certain IT and financial transaction processing services.

76 The claims that are aggregated as Claim #11(c) are therefore contractual claims of USS for payment of the goods and services provided pursuant to these agreements prior to the Filing Date.

Procedural History of this Proceeding

77 Pursuant to a claims process order of the Court in these CCAA proceedings dated November 13, 2014 (the "Claims Process Order"), creditors of USSC were required to file Proofs of Claim (as defined in the Claims Process Order) in respect of affected Claims with the Monitor by December 22, 2014.

Actions of the Monitor under the Claims Process Order

78 With respect to any claims filed by USS, U.S. Steel Holdings, Inc., Canada LP or any affiliates of USS (other than USSC or any of USSC's subsidiaries), paragraph 28 of the Claims Process Order ordered:

(a) the Monitor to prepare a report to be served on the Service List and filed with the Court, detailing its review of all USS claims and recommendations it has, if any, with respect to the determination of such claims;

(b) the Monitor to seek a scheduling appointment before the Court, on notice to the Service List, to schedule a hearing of a motion to determine the USS claims; and

(c) that the USS claims shall not be accepted or determined as Proven Claims without approval of this Court.

79 USS and its subsidiaries and affiliates filed 14 Proofs of Claim with the Monitor, being the "USS Claims".

80 On March 10, 2015, the Monitor issued its Seventh Report in these CCAA proceedings dated March 9, 2015 (the "Monitor's Seventh Report").

81 As described at paragraph 8 of Monitor's Seventh Report, the USS Claims may be summarized and aggregated into the following three categories:

(a) non-contingent Secured Claims (as defined in the Claims Process Order), which total U.S. $122,432,496.11 (being the "USS Secured Claims");

(b) unsecured Claims, which total U.S. $127,805,815.36 (being Claims #1 to 8, #10 and an unsecured portion of Claim #11) and $1,847,169,934.04 (being Claim #9); and

(c) contingent Secured Claims, which total $78,761,395.00 (which are not addressed in these Reasons).

82 The review process undertaken by the Monitor (and in certain cases by the Monitor's counsel) of the USS Claims is described at paragraphs 36-40 of the Monitor's Seventh Report. Based on its review of the USS Claims, the Monitor recommended to the Court that:

(a) USS bring a motion to approve the USS Secured Claims and the USS Unsecured Claims; and

(b) the USS Secured Claims and the USS Unsecured Claims be found to be Proven Claims in their entirety as filed by USS.

83 Based on the Monitor's recommendations to the Court, USS commenced this proceeding by a notice of motion dated March 13, 2015. Pursuant to this motion, USS seeks to have the USS Secured Claims and the USS Unsecured Claims approved by the Court as Proven Claims pursuant to the Claims Process Order.

The Objections of the Province, the Union and Representative Counsel

84 The following briefly summarizes the claims set out in the Objections of the Objecting Parties that have given rise to this trial. In addition, an objection was filed by Robert and Sharon Milbourne (collectively, the "Milbournes"). However, the Milbournes chose not to participate in the hearing of this motion. The Court has therefore treated their objection as withdrawn.

The Objection of the Province of Ontario

85 On April 14, 2015, an Objection was filed on behalf of the Province.

86 The Province submitted that the facts of this case raise significant issues with respect to the validity and enforceability of the security interests underlying the secured portions of the USS Claims as well as the proper characterization of the USS Claims. It argued that, in light of these issues, there was an insufficient basis on which to accept the USS Claims as Proven Claims. It argued that a hearing was required to evaluate these issues, which evaluation should include a consideration of whether the security claimed by USS was valid and enforceable given, among other matters, that the adequacy of consideration received by USSC in exchange for the grant of security has not been established. The Province also submitted that the Court should consider whether the USS Claims constitute *bona fide* indebtedness, or whether they are properly characterized as equity contributions from a controlling parent company.

87 The Objection of the Province was supplemented by a clarification dated August 21, 2015, which set out in greater detail the bases upon which the Province asserts that the Term Loan and the Revolver Loan should be re-characterized as "equity claims" and that the security for the USS Secured Claims should be declared to be a fraudulent preference or otherwise unenforceable. As these arguments are addressed below in the Court's analysis, I do not propose to repeat them in this section.

The Objection of the Union

88 On April 14, 2015, an Objection was filed by the Union. By way of overview, the Union submitted that USS, as the shareholder of USSC, directed the operations of USSC in a manner that has caused USSC to significantly underperform, thereby incurring substantial losses and requiring it to incur significant debt. In addition, the Union submitted that such actions undermined the ability of USSC to meet its on-going funding obligations to the USW pension plans of USSC. The Union argued that, as a result, USS has diluted the potential recoveries of the Union members and the USW pension plan beneficiaries in this CCAA proceeding.

89 The Union broadly categorized its objections as follows:

(a) an objection to the granting of security interests on the assets of USSC;

(b) an objection to the characterization of most of the USS Claims as debt when they are properly characterized as equity; and

(c) an objection grounded in USS' conduct in relation to its Canadian plants, unionized pensioners, pension plan members and beneficiaries, which gives rise to claims of oppression and breaches of fiduciary duty.

90 With respect to the objection in (a), the Union submitted that USS' secured claim is based on security interests effectively granted by USS to itself, at a time when there was no independent board of directors or advisors, for insufficient consideration, and in a manner which amounted to an improper preference and/or fraudulent conveyance. With respect to the objection in (b), the Union submitted that a significant portion of USS' debt is really in the nature of equity and should be re-characterized as such based on, among other factors, the fact that (i) much of the debt was incurred to acquire Stelco; (ii) USS completely controlled USSC; (iii) USS was the sole source of USSC's financing; (iv) USS provided commercially unreasonable interest and repayment terms; (v) USS had no reasonable expectation of repayment on the purported loans; and (vi) USSC was significantly undercapitalized throughout the years following its acquisition by USS.

91 The first two claims of the Union overlap significantly, if not completely, with the arguments raised by the Province in its Objection. The remaining claims are not being addressed on this motion. The process for addressing such claims was the subject of an earlier hearing and the Court's endorsement that was released as *U.S. Steel Canada Inc., Re*, 2015 ONSC 5990 (Ont. S.C.J.).

The Objection of Representative Counsel

92 On April 14, 2015, an Objection was filed also filed by Representative Counsel for all non-USW active employees and retirees of USSC. In its Objection and at the trial in this proceeding, Representative Counsel adopted the particulars of the Objections filed by the Province and the Union as applicable to the non-USW active employees and retirees of USSC.

The Disputed USS Claims

93 For completeness, the Objections that were made in respect of Claims #1-5 in the Monitor's Seventh Report, which are unsecured claims in the aggregate amount of U.S. $3,085,746, have now been withdrawn by the Objecting Parties. Further, no Objections have been made in respect of Claims #6-8 in such Report, which are unsecured claims

in the aggregate amount of U.S. $338,169. Therefore, based on the Monitor's Seventh Report, Claims #1-8 inclusive should be confirmed as Proven Claims. The USS Claims which are the subject of this motion, and in respect of which the Objections are maintained, are the following:

Claim Reference #	***Description of Claim***	***Amount of Claim***
9	Unsecured Term Loan	$1,847,169,934
10	Unsecured Revolver Loan	U.S. $120,150,928
11	Secured Revolver Loan	U.S. $72,938,390
11(a)	Secured Cliffs LRD Transaction	U.S. $14,538,463
11(b)	Secured Credit Support Payments	U.S. $3,742,479
11(c)	Secured Intercompany Trade	U.S. $31,252,193

94 For clarity, none of the parties object to the quantum of the USS Claims which are the subject of the present motion.

95 The USS motion and the Objections were addressed collectively at a trial conducted over eight days. The evidence adduced at the trial consisted of affidavit evidence and oral testimony, the relevant portions of which are described below.

Applicable Statutory Law

96 The following provisions of the CCAA are relevant for the Objections that the USS Claims should be re-characterized as "Equity Claims" for the purposes of these CCAA proceedings:

> 2. In this Act,
>
> "Claim" means any indebtedness, liability or obligation of any kind that would be a claim provable within the meaning of section 2 of the *Bankruptcy and Insolvency Act*;
>
> "Equity Claim" means a claim that is in respect of an equity interest, including a claim for, among others,
>
> > (a) a dividend or similar payment,
> >
> > (b) a return of capital,
> >
> > (c) a redemption or retraction obligation,
> >
> > (d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or
> >
> > (e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d);
>
> "Equity Interest" means
>
> > (a) in the case of a corporation other than an income trust, a share in the corporation — or a warrant or option or another right to acquire a share in the corporation — other than one that is derived from a convertible debt, and
> >
> > (b) in the case of an income trust, a unit in the income trust — or a warrant or option or another right to acquire a unit in the income trust — other than one that is derived from a convertible debt;
>
> 6. (8) No compromise or arrangement that provides for the payment of an equity claim is to be sanctioned by the court unless it provides that all claims that are not equity claims are to be paid in full before the equity claim is to be paid.

> 11. Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.

97 The following provisions of the CCAA are relevant to the Objections that the security for the secured USS Claims, being the general security interest granted by USSC in favour of Credit Corp in the October Security Agreement and in favour of USS, United States Steel International, Inc. and SHC in the November Security Agreement, should be invalidated on the grounds of a fraudulent preference:

> 36.1 (1) Sections 38 and 95 to 101 of the *Bankruptcy and Insolvency Act* apply, with any modifications that the circumstances require, in respect of a compromise or arrangement unless the compromise or arrangement provides otherwise.
>
> (2) For the purposes of subsection (1), a reference in sections 38 and 95 to 101 of the *Bankruptcy and Insolvency Act*
>
> (a) to "*date of the bankruptcy*" is to be read as a reference to "*day on which proceedings commence under this Act*";
>
> (b) to "*trustee*" is to be read as a reference to "*monitor*"; and
>
> (c) to "*bankrupt*", "*insolvent person*" or "*debtor*" is to be read as a reference to "*debtor company*".

98 Section 95 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the "BIA") provides as follows:

> (1) A transfer of property made, a provision of services made, a charge on property made, a payment made, an obligation incurred or a judicial proceeding taken or suffered by an insolvent person
>
> (a) in favour of a creditor who is dealing at arm's length with the insolvent person, or a person in trust for that creditor, with a view to giving that creditor a preference over another creditor is void as against — or, in Quebec, may not be set up against — the trustee if it is made, incurred, taken or suffered, as the case may be, during the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date of the bankruptcy; and
>
> (b) in favour of a creditor who is not dealing at arm's length with the insolvent person, or a person in trust for that creditor, that has the effect of giving that creditor a preference over another creditor is void as against — or, in Quebec, may not be set up against — the trustee if it is made, incurred, taken or suffered, as the case may be, during the period beginning on the day that is 12 months before the date of the initial bankruptcy event and ending on the date of the bankruptcy.
>
> (2) If the transfer, charge, payment, obligation or judicial proceeding referred to in paragraph (1)(a) has the effect of giving the creditor a preference, it is, in the absence of evidence to the contrary, presumed to have been made, incurred, taken or suffered with a view to giving the creditor the preference — even if it was made, incurred, taken or suffered, as the case may be, under pressure — and evidence of pressure is not admissible to support the transaction.

The Issues for Determination in This Proceeding

99 There are two principal categories of Objections addressed in this proceeding: (1) that the USS Debt Claims are, in substance, "equity claims" for the purposes of the CCAA; and (2) that the security for the USS Secured Claims is either unenforceable for lack of consideration or void as a fraudulent preference under section 95 of the BIA, as incorporated into these proceedings by virtue of section 36.1 of the CCAA. These two issues will be addressed in order after first describing certain expert evidence adduced at trial by the parties.

Expert Financial Evidence

100 The Province and USS introduced expert evidence from three financial experts who testified at trial. The following briefly summarizes the principal issues addressed in the reports and testimony of these experts. The significance of such evidence is considered below in the Court's analysis of the characterization of the Term Loan and the Revolver Loan.

The Finnerty Report

101 The Province introduced into evidence a report dated August 21, 2015 of Dr. John Finnerty (the "Finnerty Report"). Dr. Finnerty was qualified as an expert in financial economics. Among other things, the Finnerty Report analyzed the Term Loan and the Revolver Loan against fifteen factors, described later in these Reasons and referred to as the "*AutoStyle* factors", that are used in American courts in debt re-characterization cases. It was Dr. Finnerty's opinion that, from the perspective of financial economics, the terms of the Term Loan and the Revolver Loan, and the manner in which they were implemented, are suggestive of equity rather than debt.

102 The Finnerty Report concluded that, in respect of the Term Loan, eight of the *AutoStyle* factors are more consistent, from a financial economics perspective, with a characterization of equity, one, being the maturity date provisions and the schedule of debt service payments, is more consistent with a characterization of debt, and the remaining six factors are "indeterminate" from a financial economics perspective.

103 The eight factors identified in the Finnerty Report as being more consistent with an equity characterization of the Term Loan are the following: (1) the interest rate provisions and the history of interest payments; (2) the inadequacy of capitalization of ABULC at the date of the acquisition; (3) the absence of security for the advances; (4) the inability of USSC to obtain similar financing from outside institutions, based upon the Hall Report described below; (5) the extent to which advances under the Term Loan were effectively subordinated to claims of outside creditors; (6) the absence of a sinking fund to provide debt repayments; (7) the "hollow" right of USS to enforce principal and interest obligations; and (8) the failure of USSC to repay the Term Loan on the due date or to seek a postponement thereof.

104 The Finnerty Report reached a similar opinion in respect of the Revolver Loan. The Finnerty Report concludes that ten of the *AutoStyle Plastics* factors are more consistent with equity. These are the eight factors enumerated above as being more consistent with equity in respect of the Term Loan, plus: (9) the source of the debt repayments; and (10) the lengthy fixed maturity date and the schedule of debt service payments. The Finnerty Report concludes that the extent to which the advances under the Revolver Loan were used for working capital, rather than to acquire capital assets, is more consistent with a debt characterization and the remaining two factors are "indeterminate".

The Hall Report

105 The Province also introduced into evidence a report dated August 21, 2014 of Brad Hall (the "Hall Report"), a director of Alix Partners LLC, who was qualified as an expert in institutional lending.

106 The Hall Report concludes that a third-party lender in an arm's length transaction would not have provided financing to ABULC/USSC in the amounts and on the terms provided by USS pursuant to the Term Loan and pursuant to the Revolver Loan. The Hall Report was incorporated into, and relied upon, by Dr. Finnerty in the preparation of the Finnerty Report.

107 These conclusions in the Hall Report are based on an assessment of the terms of the Term Loan and the Revolver Loan against the standard of a bank or other institutional lender offering unsecured term loans and unsecured revolving loans (herein referred to as a "third-party lender").

108 In the opinion of Mr. Hall, a third-party lender would have based any term loan granted to USSC in 2007 on the historical financial performance of Stelco, rather than on the projections relied upon by USS for the purposes of the Acquisition, and would have disregarded any of the synergies projected by USS. In addition, a third-party lender would

not have granted a term loan on an unsecured basis, nor would it have been prepared to accept the provisions of the Term Loan in respect of the maturity date, principal repayments or interest payments.

109 Similarly, Mr. Hall was of the view that a third-party lender would not have granted an unsecured loan in the amount of the Revolver Loan in 2010 nor would it have accepted the provisions of the Revolver Loan respecting the maturity date or interest payments. In addition, the Hall Report addresses the financial performance covenants that a third-party lender would typically require, principally debt/equity, Debt/EBITDA and EBITDA/interest tests, and observed that, given USSC's financial performance after 2008, USSC would not have complied with the latter two tests as typically applied at the time of advances under the Revolver Loan.

110 The Hall Report also concluded that the terms of the Term Loan were not comparable with the loans provided by the prior arm's length lenders to Stelco or by the arm's length lenders that provided financing at or about the same time to USS. I do not find these opinions of assistance with respect to the issues in this proceeding.

The Austin Smith Report

111 USS introduced into evidence a report dated September 4, 2015 of Yvette R. Austin Smith (the "Austin Smith Report"), a principal of the Brattle Group, which addressed certain features of the Finnerty Report and the Hall Report. For present purposes, the Austin Smith Report reached three principal conclusions, aspects of which are relevant for the determinations below in these Reasons.

112 First, the Austin Smith Report says that the conclusions in the Finnerty Report — that, from a financial economics perspective, the terms of the Term Loan and the Revolver Loan, and the manner of their administration, are strongly suggestive of an equity investment — relies too heavily on hindsight to be credible. The Report suggests that, as a result, the application of the *AutoStyle* factors does not assist in establishing the substance of these transactions or the intent of the parties at the time of the establishment of the Loans.

113 Second, the Austin Smith Report concludes that the opinion in the Hall Report that USSC could not have financed the Term Loan and the Revolver Loan "in the amounts and on the terms as provided by USS" relies on a flawed credit analysis of USSC that, therefore, does not address USSC's debt capacity after the Acquisition.

114 Third, the Austin Smith Report suggests that the opinions in the Hall Report, and therefore in the Finnerty Report, ignore the reality of diverse corporate debt markets in their concentration on the third-party lender market.

Observations Regarding the Expert Financial Evidence

115 I do not propose to make any finding regarding the differences of opinion expressed in the Finnerty Report and in the Austin Smith Report on the particular issues raised in the latter as it is not necessary to do so for the purposes of the determinations herein. However, the following three observations regarding the matters addressed in the expert evidence relied upon by the Objecting Parties are relevant to the approach set out below in these Reasons.

116 First, in respect of most of the *AutoStyle* factors to which Dr. Finnerty refers as suggestive of equity rather than debt, Dr. Finnerty expressly or implicitly measures the Term Loan and the Revolver Loan against the standard of a bank or other institutional lender offering unsecured term loans and unsecured revolving loans, that is, against the standard of a third-party lender offering such loans.

117 At the risk of some oversimplification, Dr. Finnerty's logic is as follows. The Term Loan and the Revolver Loan purport on their face to be an unsecured term loan and an unsecured revolver loan. The market for such loans is the third-party lender market. However, the terms and conditions of the Term Loan and the Revolver Loan are not terms and conditions that would be acceptable to a third-party lender nor were the Loans administered in certain respects in the manner that would be expected of a third-party lender. Therefore, from the perspective of financial economics, the Loans must be equity. It is the validity of the last proposition in this chain that is at issue in this proceeding. The conclusions

of Dr. Finnerty are more or less relevant in this proceeding depending upon whether a third-party lender standard is appropriate in addressing financial arrangements between a parent corporation and its wholly-owned subsidiary. This issue is addressed below.

118 Second, as Dr. Finnerty testified, of the fifteen *AutoStyle* factors, three principal factors inform his conclusions that the Loans are more suggestive of equity rather than debt. These factors are: (1) the absence of available financing from third-party lenders on the terms and in the amount of the Term Loan and the Revolver Loan; (2) the waiver of interest payments under the Term Loan in 2010 and thereafter; and (3) the "fungibility of debt and equity", which refers to the payment of interest and repayment of principal by USSC out of equity injections received from USS, principally in respect of the Revolver Loan. It is therefore appropriate to focus on the evidentiary value of these three considerations, rather than on the larger list which effectively repeats the same considerations.

119 Lastly, I would observe that, while Dr. Finnerty was qualified as an expert in financial economics, substantially all of his expert evidence related to his view of third-party lender behaviour in various circumstances, rather than to any more formal analysis that was informed by the analytical framework of financial analysis.

Expert Legal Evidence

120 USS and the Province also introduced expert legal evidence from two lawyers who testified at trial regarding a specific issue of Pennsylvania law. The following briefly summarizes the issue of law and the testimony of these experts. The issue is significant for the analysis of the validity of the security for the USS Secured Claims.

The Issue

121 The Revolver Loan Agreement contained an event of default in section 11c as follows: "Borrower consents to the appointment of a receiver, trustee or liquidator of all or substantially all of its assets, is unable to meet debts, or files bankruptcy". The same event of default was continued after each of the First Revolver Amendment, which removed the solvency representation, the Second Revolver Amendment and the Third Revolver Amendment.

122 The expert testimony addressed the meaning of the phrase "unable to meet debts" as a matter of contractual interpretation under the laws of Pennsylvania. Both experts testified that the principles of contractual interpretation under Pennsylvania law are substantially similar to the principles under Ontario law with, based on USS' expert, a tendency toward somewhat greater emphasis on the strict construction of contracts.

123 I would observe that, while the expert testimony was tendered in respect of this provision in the Revolver Loan Agreement, the same event of default appears in section 13(c) of the Term Loan Agreement which is governed by the laws of Alberta.

The McMichael Report

124 USS introduced into evidence a report dated August 21, 2015 of Lawrence McMichael (the "McMichael Report"). It was Mr. McMichael's opinion that the phrase "unable to meet debts" connoted a balance sheet solvency test which, under Pennsylvania law, would be performed on a market value basis. Accordingly, Mr. McMichael was of the opinion that the contractual interpretation of clause 11c of the Revolver Loan Agreement resulted in an event of default in the circumstances in which the aggregate liabilities of USSC exceeded the fair market value of its assets.

The Di Massa Report

125 The Province introduced into evidence a report dated September 4, 2014 of Rudolf Di Massa, Jr. (the "Di Massa Report"). It was Mr. Di Massa's opinion that the phrase "unable to meet debts" did not connote an insolvency test as such, whether on a balance sheet basis or on a going concern basis. Mr. Di Massa was of the view that the correct statutory interpretation of this phrase meant "unable to satisfy or manage its obligations relating to operating activities on an on-going basis given its financial resources from all available sources". He described this event of default

as essentially a direction from USS to USSC to manage its financial obligations by obtaining credit from all available sources, including from trade creditors through an extension of payment terms and from USS itself by drawing up to the maximum availability under the Revolver Loan Agreement.

126 An important feature of Mr. Di Massa's interpretation is his view of the operation of the Revolver Loan Agreement, which is significant in three respects. Mr. Di Massa's opinion implies that an event of default would not arise unless and until USSC had drawn the maximum availability under the Revolver Loan Agreement and was unable to foresee obtaining credit from any other possible sources on a prospective basis. It also implies that, under the Revolver Loan Agreement, USS was obligated to continue to advance funds until such maximum availability was reached, subject to the occurrence of one of the other events of default in the Agreement. Lastly, as the phrase "unable to meet debts" is the only event of default that appears to address the state of insolvency, and, as Mr. Di Massa is of the view that this phrase does not serve as an insolvency event of default, his interpretation has the result that the Revolver Loan Agreement lacks an express insolvency event of default.

The Findings of the Court

127 The Court finds that, under the laws of Pennsylvania, the words "unable to meet debts" in the Revolver Loan Agreement mean that the fair market value of the assets of USSC are less than the total of its liabilities, that is, that the words connote a balance sheet solvency test. I reach this conclusion for the following four reasons.

128 First, this interpretation is more consistent with the plain meaning of the words "unable to meet debts" than the interpretation proposed by Mr. Di Massa. In particular, it recognizes the absence of the additional words "when due", or words to a similar effect. Such words appear in the events of default in sections 11a and 11b of the Revolver Loan Agreement. If they had been incorporated into the "unable to meet debts" event of default, I think it is clear that they would have indicated an intention to apply an event of default in the event of an inability to meet USSC's obligations as they fell due, i.e. a going concern event of default. Their absence indicates an intention that the event of default would relate to the alternative definition of insolvency under the laws of Pennsylvania, being the extent of assets relative to liabilities. For this reason, while it is true that the parties could have used more specific language if they had intended a balance sheet insolvency event of default, instead of the rather archaic phrase that appears, I do not think that such words connote a going concern event of default or the approach proposed in the Di Massa Report.

129 Second, as a related matter, the interpretation proposed in the Di Massa Report requires reading in language that is neither present nor customary. Such an interpretation should be rejected in favour of an interpretation that gives effect to the plain meaning of the language of the event of default.

130 Third, even assuming an ambiguity in the language of the event of default, the Di Massa Report relies heavily on an inference based on the removal of the solvency representation from the Revolver Loan agreement by the First Revolver Agreement. The solvency representation spoke to both balance sheet solvency and solvency on a going concern basis. It is suggested that it would have been illogical for USS and USSC to have removed the solvency representation and maintained a balance sheet event of default. It is also suggested that interpretation of the event of default as a balance sheet solvency event of default would have resulted in a continuing state of default under the Revolver Loan Agreement, with automatic acceleration of the Revolver Loan, which could not have been intended.

131 As discussed later in these Reasons, I do not think that any conclusion can be drawn regarding the intention of the parties in respect of the removal of the solvency representation. In particular, I do not think that there is any evidence regarding the surrounding circumstances in which the First Revolver Amendment was negotiated and executed that bears on the interpretation of the event of default.

132 Fourth, an important principle of contractual interpretation is that, in the case of ambiguity, a court should prefer the more commercially reasonable interpretation. In my view, for the following reasons, the interpretation proposed by Mr. Di Massa results in an unreasonable result from a commercial perspective.

133 In this case, while the interpretation in the McMichael Report may have had the result that USSC was in default as of the execution of the Third Revolver Amendment, if not before, I do not see a particular difficulty in this. Unlike a third-party lender, there is no evidence that USS had a particular concern with the occurrence of a balance sheet event of default under the Revolver Loan. It could always choose to waive any event of default and advance further funds notwithstanding the occurrence of an event of default. In this respect, the evidence of Mr. Di Massa that a commercial lender would not engage in such behaviour is not a relevant consideration.

134 On the other hand, USS would have had a significant concern with any renunciation of its ability to control the extent, if any, of future advances of funds. As Mr. McMichael testified, lenders, including parents of wholly-owned subsidiaries, do not intend to be bound to lend money that they do not believe will be repaid. This is particularly important with respect to the operation of the Revolver Loan Agreement in October 2013 given the amount of the undrawn facility — being approximately U.S. $383 million — and the cash burn of USSC in 2013, including the anticipated cash burn for the rest of the year. In addition, USS would not have intended the availability under the Revolver Loan to extend beyond what was absolutely necessary, having just completed a significant de-leveraging exercise for other reasons.

135 Further, as noted above, the interpretation in the Di Massa Report has the result that there is no balance sheet event of default in the Revolver Loan Agreement. As a parent corporation controls the advance of funds to a subsidiary, and thereby its ability to meets its obligations on an on-going basis, a parent corporation would not necessarily need an event of default for a failure to meet on-going obligations. It would, however, require a balance sheet event of default for protection against third parties in the event of an insolvency of its subsidiary.

136 Given the foregoing considerations, I consider that the interpretation proposed by Mr. Di Massa produces a commercial unreasonable result while the interpretation of Mr. McMichael results in a commercially viable loan arrangement.

The Debt Re-Characterization Claims

137 I propose to address the debt re-characterization claims of the Objecting Parties in the following order. First, I will deal with two threshold issues. Next, I will address the test to be applied by the Court in the analysis of the characterization of both the Term Loan and the Revolver Loan. I will then address the debt characterization claims of the Objecting Parties in two parts. The first part addresses certain general considerations raised by the Objecting Parties that are common to both the Term Loan and the Revolver Loan. The second part sets out my analysis of each of the Term Loan and the Revolver Loan in turn in light of the Court's determinations regarding these general considerations.

Threshold Issues

138 The two threshold questions to be addressed are: (1) the onus of proof; and (2) the test to be applied in the evaluation of the debt re-characterization claims respecting the USS Debt Claims. I will address each issue in turn.

The Onus of Proof

139 As would be expected, USS argues that the burden of proof lies with the Objecting Parties and the Objecting Parties argue that it lies with USS. I will deal separately with the burden of proof pertaining to the debt re-characterization claims of the Objecting Parties and the claims that the security for the USS Secured Claims is invalid or otherwise unenforceable.

140 The issue of the burden of proof in respect of the debt re-characterization claims appears to be a matter of first impression as the parties have been unable to find any case law on this issue. I conclude that the Objecting Parties have the burden of proof that the USS Debt Claims are properly characterized as "equity claims" under the CCAA for the following three reasons.

141 First, in a claims process under the CCAA, 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". If another creditor chooses to assert such an argument, I think it must bear the onus of proving that an otherwise proven debt claim is more properly characterized in substance as an "equity claim".

142 Second, put in procedural terms, the motion of the creditor, in this case USS, is limited to a determination of the validity and amount of its debt claim in order to establish a "Proven Claim" under the Claims Process Order. The objection of any other creditor, in this case the Objecting Parties, is in substance a cross-motion for a declaration that the debt claim, if accepted, constitutes in substance an "equity claim" for the purposes of the CCAA. I do not agree with the Objecting Parties that the motion of the objecting creditor should be regarded as the substantive equivalent of a statement of defence which must be addressed to establish the validity and amount of a moving party's debt claim.

143 Lastly, an important consideration is that the debt re-characterization claims of the Objecting Parties are based on the underlying substantive reality of the Term Loan and the Revolver Loan. These are factual matters, rather than matters based on allegations of inequitable behavior on the part of USS. I accept that there may be an argument for a reversal of the onus of proof in the circumstances of a *bona fide* allegation of bad faith or inequitable conduct on the part of an insider or a controlling shareholder of a debtor company that could engage an equitable remedy in favour of the injured party or an analogous statutory remedy. However, as mentioned, that is not the basis of the claims of the Objecting Parties on this motion.

144 The Objecting Parties' argument that the security for the USS Secured Claims is invalid or, in the alternative, unenforceable raises two issues, although I conclude that the Objecting Parties bear the onus of proof in either case.

145 With respect to the claim that the October Security Agreement and the November Security Agreement are unenforceable for lack of consideration, I think the same principles govern the issue of onus as apply with respect to the issue of onus regarding the treatment of the USS Debt Claims as "equity claims". A creditor asserting a Secured Claim must move for a determination that the security is valid. To such end, the creditor must establish that the security was delivered by the debtor company, that the security is expressed to cover the creditor's claim, and that any necessary registrations were effected under applicable legislation. An objection of any other creditor that such security is invalid or otherwise unenforceable on any other basis would involve a cross-motion by such objecting creditor seeking a declaration to such effect.

146 With respect to the claim that the October Security Agreement and the November Security Agreement constitute fraudulent preferences for purposes of section 95 of the BIA, the Objecting Parties acknowledge that the case law establishes that they bear the onus of proof.

The Test to Be Applied

147 The more difficult threshold issue is identification of the test to be applied to determine whether the USS Debt Claims are debt obligations or "equity claims".

148 The Term Loan and the Revolver Loan are, on their own terms, loans rather than equity contributions. The terms and conditions of the Term Loan Agreement and the Revolver Loan Agreement unequivocally evidence loan agreements. The Term Loan and Revolver Loan are both documented as loans in contracts entitled "Loan Agreement" in which the parties are described as lender and borrower. Each loan agreement prescribes a term and an interest rate, requires repayment, and has no terms expressly tying any payments to the financial performance of USSC. USS and USSC also had very different processes for approval and transmission of loan advances and equity contributions. The financial accounts of Canada LP or Credit Corp, as applicable, and USSC accurately recorded the loan advances separately from equity contributions.

149 The form of the documentation for the Loans, and the foregoing actions, are the point of departure. USS says it intended the outstanding advances under the Term Loan and the Revolver Loan to be loans rather than capital contributions. Accordingly, USS says that the USS Debt Claims are in respect of loans and are not "equity claims". The issue for the Court on this motion is, therefore, whether the foregoing actions and documentation are determinative. USS argues that there is no further issue for the Court for two alternative reasons based, respectively, in the language of the CCAA and in the pre-2009 Canadian case law. I will address these two arguments in turn.

The Provisions of the CCAA

150 USS argues that the most recent amendments to the CCAA, which introduced the definition of "equity claims", comprehensively codified the treatment of "equity claims" with the result that the issue of whether a particular claim is to be treated as debt or equity is solely a matter of statutory interpretation. It relies on *Sino-Forest Corp., Re*, 2012 ONCA 816, 114 O.R. (3d) 304 (Ont. C.A.), at paras. 30 and 36, for this proposition.

151 In the circumstances of this case, USS argues that the USS Debt Claims are not claims in respect of a share of USSC, or a warrant or option or another right to acquire a share of USSC. It submits that, accordingly, the USS Debt Claims are not claims in respect of an "equity interest" and, therefore, are not "equity claims". USS says that, as a result, the USS Debt Claims are claims in respect of loans.

152 I agree that the issue of whether a particular claim is to be treated as debt or equity is a matter of statutory interpretation. I also agree that the USS Debt Claims do not fall within paragraph (d) of the definition of "equity claim" which refers to "a monetary loss resulting from the ownership, purchase or sale of an equity interest". This provision addresses the circumstances of shareholders pursuing securities misrepresentation or oppression actions against a debtor company. It prevents recovery of claims by such shareholders for the value paid for their shares prior to the satisfaction of claims of debt-holders of the debtor company: see *Sino-Forest Corp., Re*, 2012 ONSC 4377 (Ont. S.C.J. [Commercial List]), at paras. 71, 80, 96, aff'd 2012 ONCA 816, 114 O.R. (3d) 304 (Ont. C.A.).

153 However, I do not read the definitions of "equity claim" and "equity interest" as narrowly as USS. The USS argument relies implicitly on the need for the demonstration of the issuance of shares as a requirement of an "equity claim". In doing so, USS ignores the reality of a sole shareholder situation and reaches an unreasonable conclusion.

154 In the circumstances of a sole shareholder, there is no practical difference for present purposes between a shareholding of a single share and a shareholding of multiple shares. Accordingly, for the purposes of the definition of an "equity claim", there should be no difference between a payment to a debtor company on account of the issuance of new shares and a payment to a debtor company by way of a contribution to capital in respect of the existing shares.

155 On this basis, I conclude that, as a matter of statutory interpretation, the definition of an "equity claim" must extend to a contribution to capital by a sole shareholder unaccompanied by a further issue of shares. Put another way, I conclude that a payment by a sole shareholder of a debtor company on account of a capital contribution constitutes a payment in respect of a share of the debtor company. Such a payment would therefore constitute an "equity interest" and a claim in respect of such payment in a CCAA proceeding would be a claim for a return of such capital and therefore an "equity claim".

156 Further, I conclude that there is no reason why the reference to "a return of capital" in paragraph (b) of the definition of "equity claim" should be limited a claim in respect of an express contribution to capital by a shareholder. A transaction can be a contribution to capital in substance even if it expressed to be otherwise.

157 Accordingly, I conclude that the issue for the Court in this proceeding is whether the USS Debt Claims constitute claims for a return of capital in respect of the shares in USSC owned by USS. In order to decide that issue, the Court must decide whether the advances made under the Term Loan and the Revolver Loan constituted loans to USSC or contributions to the capital of USSC in respect of the outstanding shares of USSC owned by USS. To the extent any

of such advances constituted a contribution to capital, any claim for such amounts as Proven Claims in these CCAA proceedings would constitute a claim for a return of capital and, therefore, an "equity claim".

Pre-2009 Canadian Case Law

158 USS makes an alternative submission in the event the Court finds that the definition of "equity claim" does not preclude a determination of whether the USS Debt Claims are be treated as debt or equity. USS says that the applicable Canadian case law regarding debt re-characterization issues, which pre-dates the recent amendments to the CCAA, requires that a court have regard solely to the intention of the parties as a matter of the contractual interpretation of the relevant documentation in determining whether any transaction gave rise to an "equity interest".

159 In this case, as mentioned above, USS says that the relevant documentation consists of the Term Loan Agreement, the Revolver Loan Agreement and the documentation pertaining to the advances and payments thereunder. USS submits that the intention of both parties at the time of execution of the Term Loan Agreement and the Revolver Loan Agreement, and at the time of all advances thereunder, is manifest on the face of such documents. It submits that, as a matter of contractual interpretation, it is clear that USS and USSC intended that such transactions would constitute debt obligations of USSC rather than capital contributions by USS to USSC. USS says that Canadian case law provides no basis for going beyond the exercise of contractual interpretation to evaluate whether the USS Debt Claims should be characterized as "equity claims" on some other basis.

160 In making this argument, USS relies, in particular, on the decision of the Supreme Court in *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558 (S.C.C.). In that decision, the issue was whether certain monies provided to the Canadian Commercial Bank (the "CCB") had been provided by way of a loan or a capital investment. At paragraph 51, the Court approached the issue before it as a matter of contractual interpretation as follows:

> As in any case involving contractual interpretation, the characterization issue facing this Court must be decided by determining the intention of the parties to the support agreements. This task, perplexing as it sometimes proves to be, depends primarily on the meaning of the words chosen by the parties to reflect their intention. When the words alone are insufficient to reach a conclusion as to the true nature of the agreement, or when outside support for a particular characterization is required, a consideration of admissible surrounding circumstances may be appropriate.

161 The Supreme Court concluded that the transaction in that case was a loan, noting that: (1) there was nothing in the express terms of the agreements in question which supported a conclusion that the money was advanced as an investment; and (2) there were express provisions supporting a characterization of the advance as a loan, including provisions for repayment, for an indemnity should full repayment not be made from the sources contemplated, and for equal ranking with the ordinary creditors of CCB: see *Canada Commercial Bank*, supra at para. 63.

162 In *Bul River Mineral Corp., Re*, 2014 BCSC 1732, 16 C.B.R. (6th) 173 (B.C. S.C.), Fitzpatrick J. summarized the principles in *Canadian Commercial Bank* in the following manner, which I find helpful in the present case:

> (a) the fact that a transaction contains both debt and equity features does not, in itself, determine its characterization as either debt or equity;
>
> (b) the characterization of a transaction under review requires the determination of the intention of the parties;
>
> (c) it does not follow that each and every aspect of a "hybrid" debt and equity transaction must be given the exact same weight when addressing a characterization issue; and
>
> (d) a court should not too easily be distracted by aspects of a transaction which are, in reality, only incidental or secondary in nature to the main thrust of the agreement.

This summary demonstrates that the issue before the court in *Canadian Commercial Bank* was the characterization of an instrument that had characteristics of both debt and equity.

163 I do not find the decision of *Canadian Commercial Bank* helpful in the present circumstances for the reason that the present circumstances differ in two important respects.

164 First, the subject-matter in *Canadian Commercial Bank* was, as mentioned, a hybrid security, i.e., a security having characteristics of both debt and equity. Therefore the issue was whether the security in question should be characterized as a debt obligation or a capital investment. The present proceeding does not involve a hybrid security. As mentioned above, the relevant documentation unequivocally evidences loan transactions on their face.

165 Second, the parties to the transaction in *Canadian Commercial Bank* were at arm's length and the transaction documentation represented the outcome of arm's length negotiations between the parties. The parties to the Term Loan Agreement and the Revolver Loan Agreement were not at arm's length. As a result, the form of the documentation, including the characterization of the transaction as debt rather than equity, was determined by USS in its sole discretion, subject only to satisfaction of any applicable Canadian legal considerations raised by USSC.

166 In such circumstances, the task of a court is qualitatively different from that in *Canadian Commercial Bank*. In that decision, given the hybrid nature of the security under consideration, the issue was whether the parties intended that the institutions providing financial support to the CCB were making a capital investment in the bank or were making a loan to it. In other words, the intentions of the parties were unclear without a contractual analysis to determine the substance of the transaction that had been agreed upon. At the same time, given the arm's length relationship between the parties, the language of the agreements could be relied upon as an accurate reflection of the intentions of the parties regarding the substantive reality of the transaction.

167 Where, however, as in the present circumstances, the parties are not at arm's length, the issue is not what the parties say they intended regarding the substance of the transaction as a matter of contractual interpretation. The expressed intention of the parties is clear. However, given the absence of any arm's length relationship, there can be no certainty that the language of the agreements reflects the underlying substantive reality of the transaction. Accordingly, the issue for a court is whether, as actually implemented, the substance of the transaction is, in fact, different from what the parties expressed it be in the transaction documentation.

168 In other words, the task of a court is to determine whether the transaction in substance constituted a contribution to capital notwithstanding the expressed intentions of the parties that the transaction be treated as a loan. It is therefore not appropriate to limit the inquiry into the intentions of the parties to a review of the form of the transaction documentation. Such an exercise reduces to a "rubber stamping" of the determination of a single party to the transaction, i.e., the sole shareholder, and it does not address the substance of the transaction as it was actually implemented. In such circumstances, the determination of whether a particular claim is to be treated as debt or equity must address not just the expressed intentions of the parties as reflected in the transaction documentation but also the manner in which the transaction was implemented and the economic reality of the surrounding circumstances.

169 USS also refers to the decision of the Court of Appeal in *Metropolitan Toronto Police Widows & Orphans Fund v. Telus Communications Inc.*, [2005] O.J. No. 2309 (Ont. C.A.), leave to appeal to S.C.C. denied, (2006), [2005] S.C.C.A. No. 379 (S.C.C.), at paras. 38-40. In these paragraphs, the Court of Appeal stated that: (1) the determination of the legal character of a transaction is not a simple mechanical exercise of assessing and tallying up a list of factors and then deciding whether they net out to one or the other; and (2) that a court must give legal effect to the intention of the parties as expressed in the language of an agreement. In that case, the Court of Appeal also recognized that the respective needs of the parties to an agreement are an indication of their intention and that parties are entitled to structure their contractual relationships as they see fit, absent a sham or public policy considerations dictating otherwise.

170 I do not find this decision to be helpful in the present circumstances for the same reasons as the decision in *Canadian Commercial Bank* does not address the issues in the present proceeding. *Metropolitan Toronto Police Widows and Orphans Fund* involved the characterization of a securitization transaction as either a sale or a loan. In that context,

the issue before the Court of Appeal was a matter of contractual interpretation. The transaction was an arm's length commercial transaction. Accordingly, the documentation before the court in that case could be relied upon to accurately reflect the intentions of the parties regarding the underlying economic reality of the transaction. I do agree, however, with the statement of the Court of Appeal in that decision that determination of the substantive nature of a transaction is not conducted by means of a simple "scorecard" of factors.

171 I would observe, however, that in large measure the difference between the parties in this proceeding — which appears to reduce to the significance to be attached to the manner in which the Loans were administered — is perhaps more semantic than real. The Objecting Parties proposed, and USS accepted, that a useful summary of the appropriate approach to be taken in the present proceeding was set out in a non-binding, American decision, *Fedders North America, Inc., Re*, 405 B.R. 527 (U.S. Bankr. D. Del. 2009), U.S. Bankruptcy Court, D. Delaware, at para. 59, as follows:

> The law regarding recharacterization is well-settled in this jurisdiction. The Third Circuit has held that the overarching inquiry with respect to recharacterizing debt as equity is whether the parties to the transaction in question intended the loan to be a disguised equity contribution. *In re SubMicron Systems Corp.*, 432 F.3d 448, 455-56 (3d Cir.2006). This intent may be inferred from what the parties say in a contract, from what they do through their actions, and from the economic reality of the surrounding circumstances. *Id.* at 456. Recharacterization has nothing to do with inequitable conduct, however. *See In re AutoStyle Plastics, Inc.*, 269 F.3d 726 at 748-49 (6th Cir. 2001) (discussing the differences between equitable subordination and recharacterization)

172 On this basis, the parties do not dispute the process so much as the result. They have fundamentally different views on the intentions of USS and USSC regarding the substance of the transaction which I think can be summarized as follows.

173 The Objecting Parties say that the Term Loan Agreement and the Revolving Loan Agreement reflect arrangements under which USS intended, at all times, on the one hand, to return excess cash to USS when it became available, and, on the other hand, to write off the principal or interest to the extent that payments of either were due and sufficient cash was not available.

174 USS acknowledges that the Term Loan and subsequently the Revolver Loan were established with the intention of constituting the principal vehicles by which cash would be advanced to USSC, initially for the purposes of the Acquisition and subsequently for working capital purposes, and by which excess cash in USSC from any source would be repatriated to USS. USS says, however, that, at all times, it extended advances and made payments under the Term Loan and the Revolver Loan in accordance with their terms. USS argues that nothing in the manner in which it established or operated the Term Loan and the Revolver Loan reflected, in substance, a contribution to the capital of USSC, and that the only contributions to capital were made outside the loan arrangements in the form of the equity injections set out in Exhibit "O" to the Monitor's Seventh Report.

175 These two competing views of the substance of the Term Loan and the Revolver Loan frame the debt re-characterization issues addressed in these Reasons.

The American Multi-Factor Analysis

176 Given these competing views of the Term Loan and the Revolver Loan, it is necessary to determine an appropriate test for the determination of whether the USS Debt Claims are in substance claims in respect of loans or are "equity claims". The Objecting Parties urge the Court to adopt the multi-factor analysis prevailing in American courts under which courts evaluate a long list of factors drawing conclusions about what factors are most determinative in any given fact scenario.

177 As referenced above, a leading case in this area is *Autostyle Plastics, Inc., Re*, 269 F.3d 726 (U.S. C.A. 6th Cir. 2001) at 749-50, in which the court articulated the following eleven factors:

> (1) the names given to the instruments, if any, evidencing the indebtedness; (2) the presence or absence of a fixed maturity date and schedule of payments; (3) the presence or absence of a fixed rate of interest and interest payments; (4) the source of repayments; (5) the adequacy or inadequacy of capitalization; (6) the identity of interest between the creditor and the stockholder; (7) the security, if any, for the advances; (8) the corporation's ability to obtain financing from outside lending institutions; (9) the extent to which the advances were subordinated to the claims of outside creditors; (10) the extent to which the advances were used to acquire capital assets; and (11) the presence or absence of a sinking fund to provide repayments.

In addition, courts in other American circuits have considered the following additional factors: (1) the right to enforce payment of principal and interest; (2) participation in management flowing as a result; (3) the failure of the debtor to repay on the due date or to seek a repayment postponement; and (4) the intent of the parties: see *Submicron Systems Corporation, Re*, 432 F.3d 448 (U.S. C.A. 3rd Cir. 2006), at 455-456. In the interest of simplicity, in these Reasons I refer to the fifteen factors enumerated in this paragraph as the "*AutoStyle* factors", although I acknowledge this is technically inaccurate.

178 The Objecting Parties refer to the following description of the multi-factor analysis from *Submicron Systems Corporation, Re*, at 455-456, which appears to restate the approach set out above in *Fedders North America, Inc., Re*:

> In defining the re-characterization inquiry, courts have adopted a variety of multi-factor tests borrowed from non-bankruptcy case law. While these tests undoubtedly include pertinent factors, they devolve to an overarching inquiry: the characterization as debt or equity is a court's attempt to discern whether the parties called an instrument one thing when in fact they intended it as something else. That intent may be inferred from what the parties say in their contracts, from what they do through their actions, and from the economic reality of the surrounding circumstances. Answers lie in facts that confer context case-by-case.

179 There does not appear to be any reported Canadian or Commonwealth cases in which courts have purported to apply the multi-factor, re-characterization tests relied upon by the Objecting Parties prevailing in American courts. The Objecting Parties urge the Court to formally adopt the foregoing eleven or fifteen factors in making a determination in this proceeding.

180 American courts find authority for this approach in the general equitable powers granted to a bankruptcy court under the provisions of section 105(a) of the United States *Bankruptcy Code*, 11 U.S.C 1982, which is the equivalent of section 11 of the CCAA. USS says the Court lacks similar authority under the CCAA on the basis that the recent amendments to the CCAA in this area have limited the scope of a court's authority under section 11. USS relies on the earlier decision of the Court in *U.S. Steel Canada Inc., Re*, 2015 ONSC 5990 (Ont. S.C.J.), at para. 51, as follows:

> ... I consider that the language of the definition of an 'Equity Claim" and of the provisions of section 36.1 operates as a "restriction set out in the Act" for the purposes of section 11 of the CCAA which has the effect of limiting the authority of the Court in any determination regarding an "Equity Claim" or in any proceedings brought under section 36.1.

However, that decision does not address the extent of the Court's authority under the CCAA in the evaluation of whether a security or a transaction expressed to be a debt claim is, in substance, an "equity interest". At a minimum, any such evaluation requires consideration of a number of the factors considered by American courts in the multi-factor analysis and by Canadian courts in evaluating the underlying substance of a transaction.

181 The more immediate, and more important, issue for the Court is a framework for identification of the specific considerations or factors to be applied in the context of the present proceeding. The American cases evidence the obvious reality that, in any given situation, different factors or considerations will be more or less persuasive. Insofar as the American cases suggest a "scorecard" approach, however, I have rejected such an approach in favour of an evaluation of the substantive reality of the USS Debt Claims. In the end, in this proceeding, the *AutoStyle* factors constituted no more

than the starting point, in the form of a list of factors upon which the parties drew to support their characterization of the USS Debt Claims. In short, it is not necessary to adopt the American, multi-factor analysis as a formal matter in the determination of the issues before the Court, and I therefore decline to do so.

The Approach of the Court

182 As a first step in the identification of the specific considerations that should inform the determination of the substance of the USS Debt Claims, I propose to start with a conceptual understanding of the dividing line between debt and equity.

183 An appropriate starting point is the definition of debt and equity for financial purposes set out in paragraphs 32 and 34 of the Finnerty Report:

> At its heart, the difference between equity and debt lies in the fundamental nature of their respective claims on the assets and cash flow of the company. Debt involves borrowing funds subject to a legal commitment to repay the borrowed money with interest at an agreed rate by a stated maturity date. This commitment is embodied in a contract, and this contract is implemented by the borrower. Lenders receive a contractually agreed set of cash flows, typically through periodic interest payments and one or more principal repayments, the last of which occur on the maturity date. ... In contrast to debt, an equity claim entitles the holder to a share of the company's profits and residual cash flows after the company has made all the contractually required debt service payments. That is, the debt ranks senior to the equity with respect to the company's cash flows. Similarly, the debt ranks senior to the equity in the event the company must be liquidated and its assets sold to repay its debt obligations. The equityholders get what is left after the holders of the debt have been paid in full; if the debtholders can't get paid in full, then the equityholders get nothing.

184 With this definition in mind, the Province suggests that the Court should address the substance of the Term Loan and the Revolver Loan from the perspective of whether the evidence is more consistent with an intention and a practice of repayment of principal plus interest under these Loans, or the payment of the residual cash flow and assets of USSC. I think this is a helpful approach, even if at a general level.

185 Therefore, in the context of a parent-subsidiary relationship, the fundamental consideration in assessing whether a transaction is a loan is whether a holder of the instrument expects at the outset to be repaid the principal amount of the loan with interest out of cash flows of the company. The definition above implies a belief on the part of a lender that its debtor has 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.

186 This approach suggests that the issue of whether the Term Loan and the Revolver Loan should be characterized as debt or equity can best be addressed by considering two issues: (1) the expectation of USS regarding repayment of principal with interest of the Term Loan and the Revolver Loan out of cash flows of USSC over the term of these Loans; and (2) the reasonableness of such expectation.

187 The first of these questions addresses a subjective issue - the expectations of USS. Obviously, if, at the time of making advances under a Loan, USS had no expectation that USSC would honour any payment obligation under the Loan when due in the absence of available cash at such time and, for example, intended from the outset to waive all interest as it became payable and to forgive the principal indebtedness when it became due, the Court would disregard the form of the documentation as, in effect, a sham.

188 The second question addresses a more objective issue assuming the existence of an expectation of repayment with interest of the Loan - the reasonableness of such expectation. This question engages, among other issues, the adequacy of capitalization of a wholly-owned subsidiary and the debt capacity of the subsidiary. If USSC were only nominally capitalized, this might be relatively easy to disprove. In this proceeding, as in most cases, however, this issue will involve, among other things, expert evidence regarding the availability of financing in capital markets generally.

189 It is important for present purposes to note that, given that the burden of proof rests with the party asserting that a purported loan is, in substance, a capital contribution, the onus lies on the Objecting Parties, as the parties seeking to re-characterize the Loans as equity, to demonstrate that there was no reasonable basis for USS's expectations. There are good policy reasons for such a standard.

190 Any determination of the reasonableness of a lender's expectations at the time of the making of a loan, or an advance under a loan, is prospective in nature and therefore highly speculative. It necessarily involves consideration of a borrower's financial capacity under a variety of possible future economic scenarios. A court should be cautious in reaching a conclusion that there was no reasonable expectation in the absence of a detailed consideration of such scenarios and compelling evidence that there was no basis for the lender's expectations under any of such scenarios. In addition, a determination that a lender acting in good faith nevertheless had no reasonable basis for believing that its subsidiary had the financial capacity to generate cash flow sufficient to pay interest and repay principal over the term of the loan will inevitably rely heavily on the opinion of financial experts. Any expert opinion on such an issue, however, is at least as much a matter of judgment as it is of fact, except perhaps in exceptional circumstances. Accordingly, a court must have a very high degree of confidence in any such expert financial evidence before it finds that a lender acting in good faith nevertheless had no reasonable basis for believing that its subsidiary had the financial capacity to generate cash flow sufficient to pay interest and repay principal over the term of the loan.

191 Given the foregoing considerations, I conclude that, in order to find that the USS Debt Claims are "equity claims", the Court must be satisfied that either: (1) at the time of making an advance under the Term Loan or the Revolver Loan, USS did not believe that USSC would be able to repay such advance with interest out of USSC's cash flows over the term of the Term Loan or the Revolver Loan, as applicable; or (2) that, at the time of such advance, there was no reasonable basis on which USS could have expected USSC to generate cash flow sufficient to pay interest on, and repay the principal of, such advance over the term of the Term Loan and the Revolver Loan, as the case may be.

192 Three related principles are also important for the analysis of the character of the USS Debt Claims.

193 First, while the Term Loan and later the Revolver Loan constituted a significant part of USS' investment in USSC, the Loans do not represent all of that investment. As described above, USS has also made a significant investment that has been expressly treated as equity. This distinction is important. In this proceeding, the issue is limited to the characterization of the debt component of that investment. Clearly, the return on the equity portion of USS' investment will be dependent on the residual cash flow from USSC after payment of trade creditors as well as repayment with interest of the Term Loan and the Revolver Loan. However, the fact that these Loans form part of USS' total investment in USSC does not automatically mean that USS' expectation of repayment of these Loans is the same as its expectation of receiving a return on its equity investment.

194 A parent corporation is able to divide its investment in an acquired corporation between debt and equity as it chooses. Such allocation of its investment is not determinative for the reasons discussed above. However, equally, such allocation must be respected unless it is demonstrated that the parent corporation did not have a reasonable expectation of repayment with interest of the portion of the investment which has been treated as debt when the loan was advanced. There is no basis in the CCAA for an automatic re-characterization into equity of a portion of an investment that has been structured as debt merely because the entire investment is, in a general sense, dependent for a return on the success of the investment. Put another way, a parent corporation can loan money to a wholly-owned subsidiary without that loan being treated automatically as part of the parent corporation's equity investment in the subsidiary.

195 Second, the characterization of the USS Debt Claims must be analysed as of the date of the advances under each of the Term Loan and the Revolver Loan. Subsequent behaviour of either or both of the parties to the Term Loan Agreement or the Revolver Loan Agreement may be relevant, but only to the extent that such behaviour illuminates the intentions of the parties regarding the Term Loan or the Revolver Loan as of the date of the advances thereunder. Behaviour subsequent to any advance cannot, on its own, justify a re-characterization of such advance.

196 Third, the characterization of the advances under each of the Term Loan and the Revolver Loan cannot be viewed in isolation from the economic circumstances in which the advances were made.

197 In this respect, the economic backdrop to the advances under the Term Loan and the Revolver Loan during the period 2008 to 2013 can be summarized as follows. The advances under the Term Loan between October 31, 2007 and December 31, 2007 were made in the context of a buoyant steel market. Economic conditions changed dramatically in the autumn of 2008 after the collapse of Lehman Brothers and the onset of the financial crisis in that year. Worsening conditions prevailed throughout 2009 and into early 2010. Thereafter, in each of 2010, 2011 and 2012, USS and USSC experienced mini-cycles consisting of one or two encouraging quarters succeeded by a weak performance for the remainder of these years. In 2013, USS and USSC experienced a weak market throughout the year with the result that matters reached a critical stage. Under a new chief executive officer and a new chief financial officer, who assumed their offices effective September 1, 2013, USS commenced a review of its operations which revealed, among other difficulties, that while USSC represented 10% of USS' revenues, it contributed 50% of its operating losses.

General Considerations Regarding Determination of the Debt Re-characterization Issues

198 Although the exercise of evaluation of the character of the Term Loan and the Revolver Loan ultimately requires a consideration of each of the advances individually, the issue is best addressed initially on a collective basis. As the Objecting Parties suggested, consideration of the characterization of the Term Loan and the Revolver Loan together recognizes, or perhaps more appropriately starts, from the position that the Term Loan and the Revolver Loan were used and administered by USS in the same manner and that the difference in their terms principally reflected tax and accounting considerations rather than any significant substantive difference in function. In this section, I propose to consider the probative value of the factors upon which the Objecting Parties principally rely as evidence that the Term Loan and the Revolver Loan were, in substance, equity contributions by USS to USSC.

199 The Objecting Parties identified the following principal considerations or factors which, in their view, demonstrated that advances under the Term Loan and the Revolver Loan were equity contributions rather than loans for USSC: (1) the absence of any arm's length negotiation regarding the terms and conditions of the Loans; (2) the deferred interest payment dates and the long maturity dates of both the Term Loan and the Revolver Loan; (3) the history of interest payments and waivers under the Term Loan; (4) the absence of any security; (5) the extent of USS' control over the business, operations and financial performance of USSC; (6) the fact, as acknowledged by USS, that USSC would not have been able to obtain financing from a third-party bank or institutional lender in the amount and on the terms and conditions of either of the Term Loan or the Revolver Loan; and (7) their view that payments on account of the Term Loan and the Revolver Loan were effectively subordinated to payment of trade creditors.

200 The Objecting Parties argue that, collectively, these considerations establish that USS had no expectation of repayment with interest of the advances under the Term Loan and the Revolver Loan out of cash flow from USSC. They say these factors demonstrate that, in substance, the Term Loan and the Revolver Loan were financial instruments under which USS was intended to receive the residual cash flow and assets of USSC as, and to the extent, available without an expectation of repayment with interest of either Loan, and were therefore capital contributions.

201 Significantly, the Objecting Parties argue that each of the foregoing factors has probative value when measured against the standard of behavior that would be expected of a third-party lender. As mentioned above, this position reflects the approach in the Finnerty Report. USS argues that such a standard is inappropriate and, accordingly, that the factors upon which the Objecting Parties rely are not indicative of "equity interests".

202 I propose to assess the submissions of the Objecting Parties respecting these general considerations in the following order. First, I will address in greater detail my understanding of the purposes and the administration of the Term Loan and the Revolver Loan. Then, I propose to address the issue of the significance of third-party lender behaviour

in the context of a wholly-owned subsidiary relationship. Lastly, I will consider the probative value of the principal considerations relied upon by the Objecting Parties in light of the conclusions regarding the third-party lender standard.

The Purposes and Administration of the Term Loan and the Revolver Loan and the Differing Perspectives of the Parties

203 As mentioned, USS established the Term Loan, and subsequently the Revolver Loan, with the intention that they would be the principal vehicles by which cash flows could be moved between USS and USSC and, in particular, surplus cash in USSC could be repatriated to USS. Additional equity injections were also made from time to time by USS, but only to the extent that USSC required additional capital to stay onside the "thin capitalization" rules under the *Income Tax Act* and for the purposes of the "de-leveraging" exercise described above.

204 The initial advances of the Term Loan were directed to ABULC for the purpose of the Acquisition. Subsequent advances prior to and including December 31, 2007 were used by USS to repay the Credit Corp Loan, repay USSC's liabilities to SHC and, in a lesser amount, for working capital purposes. The advances in 2009 totaling $211.2 million were also used for working capital purposes. A substantial portion of the interest under the Term Loan in 2008 was paid in that year, two years before its due date. Such interest was paid out of surplus cash on hand as a result of the strong financial performance of USSC in 2008 prior to the slowdown that began in the fourth quarter of that year.

205 USS then established the Revolver Loan in 2010 as a more tax-efficient means of moving cash between USS and USSC after withholding tax was eliminated on interest payments from USSC to USS, permitting tax-free interest payments from USSC to Credit Corp, which was an American corporation. For that reason, the Revolver Loan was denominated in U.S. dollars. Prior to the "de-leveraging" exercise in 2013, the outstanding balance under the Revolver Loan slightly exceeded the maximum availability of U.S. $500 million. In 2013, payments of principal and interest totaling approximately U.S. $390 million, that were funded out of equity injections aggregating over U.S. $680 million, reduced the outstanding balance to the amount of the First Tranche Indebtedness.

206 In order to maximize its flexibility for such cash management purposes, USS structured both the Term Loan and the Revolver Loan to provide for the most generous maturity dates and interest payment dates possible given constraints imposed by tax legislation. Further, both the Term Loan Agreement and the Revolver Loan Agreement contained minimal representations and warranties and very basic events of default. In addition, until the Second Revolver Amendment, both the Term Loan and the Revolver Loan were unsecured facilities. The Second Revolver Amendment in January 2013 provided for security on iron-ore pellets pursuant to the Security Agreement for the principal, if not the sole, purpose of maintaining the intended tax treatment for payments in respect of the Revolver Loan, given the interest waivers granted under the Term Loan in 2010, 2011 and 2012. As mentioned, with the arrival of a new chief financial officer effective as of September 1, 2013, USS began to evaluate its investment in USSC more closely. As of the end of October 2013, USS determined that it would only advance funds to USSC that it believed USSC would be able to repay. As a result, all subsequent advances were secured under the October Security Agreement and the November Security Agreement.

207 There is, however, no suggestion that USS and USSC disregarded the debt character of the Term Loan and the Revolver Loan in moving cash between USSC and USS. Accordingly, all advances under the Term Loan and the Revolver Loan were documented as such and were distinguished, both in terms of documentation and accounting, from equity injections. All interest payments on the Loans were similarly documented by both parties and treated accordingly for tax and accounting purposes. Principal payments were similarly documented by both parties. There is no evidence that the payments made in respect of the Term Loan or the Revolver Loan failed to satisfy the requirements under Canadian and American tax legislation for treatment as debt and, in particular, that any payments were deemed to be dividends.

208 On the other hand, there is no doubt that the Term Loan and the Revolver Loan were provided by USS to USSC on terms and conditions that USSC could not have obtained from third party banks and other non-bank institutional

providers of term financing and operating credit facilities. In particular, the payment provisions respecting interest and principal, and the absence of security, would not have been available to USSC.

209 USS says that both the documentation and the manner of administration of the Loans reflect debt obligations. USS says that there is nothing in the cash management arrangements described above between a parent and a wholly-owned subsidiary that can justify re-characterization of the Loans as capital contributions for the purposes of the CCAA. In particular, USS argues that nothing in these financing arrangements suggests that it did not expect to receive repayment with interest of the funds advanced under the Loans. It also says that the fact that the Term Loan and the Revolver Loan were provided to USSC on terms that were not available to USSC from third parties is irrelevant.

210 The Objecting Parties argue that USS established and administered the Term Loan and the Revolver Loan in the manner of, and using its rights as, a shareholder rather than a lender. They say that USS' actions are collectively more consistent with an intention to receive the residual cash flow and assets of USSC, as and when available, without any expectation of repayment with interest of the advances under the Loans. A more precise expression of their position is that the Term Loan Agreement and the Revolving Loan Agreement reflect arrangements under which USS intended at all times to return excess cash to USS when available and to write off the principal or interest in respect of the Loans to the extent that payments were due and sufficient cash was not available. I have excerpted below certain passages from the written submissions of the Union and the Province that I think capture the essential approach of these parties and which also assist in clarifying the positions of these parties.

The Relevance of the Third-Party Lender Standard

211 Clearly, a significant fact in this proceeding is that, at all relevant times, ABULC and USSC, as applicable, were wholly-owned subsidiaries of USS. In addition, unlike many parent-subsidiary relationships in which the subsidiary carries on a business independently of the parent, USSC was very closely integrated into the business of USS. After the Acquisition, all management and operational functions previously conducted by Stelco were effectively centralized within USS. USSC became a part of the North American flat-rolled steel division of USS. This relationship is significant in two related respects.

212 The Objecting Parties argue that the USS control of USSC is an important factor in assessing whether, in substance, the Term Loan and the Revolver Loan were debt instruments or contributions to capital. They say that USS had a significant ability to influence the profitability of USSC through such control. They say that such control is, in some way, an indication of an equity contribution. I will address this below in the next section.

213 The issue of control is also significant for present purposes as a gateway to the related issue of the relevance of a third-party lender standard as a basis for evaluation of the terms and conditions, as well as the administration, of the Term Loan and the Revolver Loan. As mentioned, USS provided financing to USSC that would not have been available to USSC from banks and other institutional lenders. The Objecting Parties place great weight on this factor as demonstrating that the Term Loan and the Revolver Loan were not real loan transactions, but rather were disguised equity contributions. Equally important, most, if not all, of the *AutoStyle* factors identified above upon which the Objecting Parties rely are informed, in whole, or in part, by a comparison of USS' actions against a standard of a typical third-party lender.

214 The Objecting Parties suggest the Court should look to a third-party lender standard in two principal respects - in order to assess the terms and conditions of the Term Loan and the Revolver Loan and in order to assess the actions of USS and USSC in the administration of these Loans including payments thereunder. As these are significant factors in the analysis proposed by the Objecting Parties, I propose to address these two issues in some detail.

215 It is important to recognize at the outset that there is no necessary reason why a parent corporation would act in the same manner as a third-party lender in the provision of financing facilities to its wholly-owned subsidiary. In

particular, the terms and conditions of lending arrangements between a wholly-owned subsidiary and its parent will, in many if not most cases, depart from typical lending arrangements between a third-party lender and a borrower.

216 As a practical matter, compliance with tax regulations in order to ensure favourable tax treatment will be a significant, if not the main, driver regarding these matters. In this case, USS determined the relative amounts of loans and equity injections based principally on tax considerations to the USS group of companies considered as a whole. Generally, these considerations dictated maximization of debt to obtain interest deductibility under the United States *Internal Revenue Code*, 26 U.S.C., subject to compliance with the "thin capitalization" rules under the *Income Tax Act*, which established a maximum debt/equity structure.

217 In addition, in a wholly-owned subsidiary relationship, there is no need for extensive documentation, nor is there a need for the 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 of 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. Similarly, it is not realistic to expect that a wholly-owned subsidiary will conduct its affairs pursuant to a corporate governance structure that includes independent directors until such time as the interests of the parent corporation and the subsidiary diverge.

218 There is nothing improper in any of the foregoing arrangements. To be clear, the Objecting Parties do not suggest that there is. They submit that a parent corporation can choose to structure its arrangements however it chooses for tax and other purposes. However, they say that such arrangements should not govern the determination of whether such loans give rise to "equity claims" for the purposes of the CCAA. On their approach, the determination of the treatment of such claims under the CCAA should be made on the basis of a different test than that which satisfied tax and other regulatory rules and regulations prior to an insolvency.

219 The dispute between the parties, and a principal issue on this motion, is therefore whether there are any consequences, in the context of CCAA proceedings, to a parent corporation that has structured its investment in a wholly-owned subsidiary in the manner of the Loans, that is, in a manner that complies with all applicable tax and other regulations but is not consistent with how a third-party lender would have structured any loan facilities in favour of USSC and how any such lender would have acted in the circumstances of USSC's subsequent financial performance.

220 A comparison of the relationship between USS and USSC against a notional relationship between USSC and a third-party lender provides a helpful clarification of certain factors that are relevant for present purposes, as is discussed below. However, I find that a comparison between the behavior of USS and the behavior of a notional third-party lender is not an appropriate test in the evaluation of whether the advances under the Term Loan and the Revolver Loan were capital contributions to USSC. I reach this conclusion for the following reasons.

221 First, the Loans were structured, and excess cash was moved between USSC and USS, in the manner described above for legitimate business reasons and in accordance with all applicable legal requirements. There is no express authority in the CCAA for disregarding these arrangements in such an evaluation apart from the very general language in the definition of "equity claim" referring to a return of capital. In particular, there is no express authority for disregarding the business purpose of financing arrangements in the evaluation of whether loan instruments are, in substance, "equity interests" giving rise to "equity claims".

222 Second, the Objecting Parties assert that the USS Debt Claims constitute claims for a return of capital. In the absence of any statutory definition of capital, or guidance regarding the determination of capital, for the purposes of the definition of an "equity claim", considerable weight should be given to the accounting and tax determination of capital of the debtor company in any CCAA proceedings. In this case, there is no suggestion that the Term Loan or the Revolver Loan were treated as capital for such purposes.

223 Third, the Objecting Parties submit, as an operating principle, that the less the Term Loan and the Revolver Loan resembled financing available from a third-party lender, and the less the actions of USS in the administration of the Loans resembled those that would have been expected of a third-party lender, the more the advances under the Loans resemble equity contributions. I do not accept this principle for the reason that I do not see a necessary connection between a failure to adhere to the third-party lender standard and an absence of an expectation of repayment with interest of a loan in the circumstances where the departure from the third-party lender standard reflects a valid business purpose.

224 I accept that there may be circumstances where the departure from a third-party lender standard may not serve any valid business purpose related to a parent-subsidiary relationship. In such circumstances, it may well be that such actions would suggest an equity contribution, that is, that the only explanation for the parent corporation's actions is that the loan transaction was in fact a capital contribution. However, that is not the case in the present circumstances. As mentioned above, the interest payment terms, the maturity dates of the Loans and the absence of a schedule for principal repayments provided USS and USSC with a certain amount of flexibility to align the payment of interest and the repayment of principal with the economic performance of USSC against the backdrop of a highly cyclical industry. In particular, it provided USSC with the ability to defer payments of interest and principal for a period of time in the event of adverse economic performance without triggering default provisions or a reversal of income expense for tax purposes.

225 Fourth, as a related matter, the third-party lender standard ignores the very real business purposes that a parent corporation could have for departing from a third-party lender standard in the administration of financing established in favour of a wholly-owned subsidiary.

226 The Objecting Parties submit that the less a parent corporation acts to enforce its rights in an insolvent situation in the manner that would be expected of a third-party lender, the more it demonstrates that the financing arrangements between the parent corporation and the subsidiary are in fact equity contributions rather than loans. This submission ignores the reality that a parent corporation which believes that there is value remaining in a subsidiary, even if the subsidiary is technically insolvent, will not act to enforce its security in the manner that would be expected of a third-party lender whose objective is necessarily limited to maximizing the prospects for the immediate recovery of its principal and interest. Nor would a parent corporation seek to negotiate some further benefit such as fees or additional equity in such circumstances. The subsidiary has no additional benefit to give when the parent already owns 100% of the benefit of its enterprise. Given such considerations, the actions of a parent corporation in departing from a third-party lender standard do not evidence the absence of an expectation of repayment with interest of a loan to its subsidiary when the loan was made. Moreover, in this respect, the position of the Objecting Parties contradicts the purposes of the CCAA, which should encourage efforts that seek to continue the operations of a distressed subsidiary.

227 Fifth, more generally, the premise underlying the position of the Objecting Parties, as is demonstrated by the foregoing discussion, is that a parent corporation is acting as a shareholder to the extent that it fails to act in a manner that would be expected of a third-party lender. They express this argument by saying that, to the extent a parent corporation is not looking at a loan to its subsidiary through the lens of a third-party lender, it must be looking at the loan from the perspective of a shareholder and, as such, in reality, the loan must be equity. In short, a parent corporation cannot wear two hats at the same time.

228 I do not think this is correct. A parent corporation lending to its wholly-owned subsidiary can have regard to the existence of its rights as a shareholder in structuring and administering a loan to its subsidiary without ceasing to be a lender. The issue to be considered is whether the actions of the parent corporation demonstrate that it had no expectation of repayment with interest of the loan. There is no necessary connection between a parent corporation lending to a subsidiary on a basis that departs from a third-party lender standard and the absence of such an expectation.

229 Sixth, there is also a significant issue with the definition of a third-party lender proposed as the standard by the Objecting Parties. The Objecting Parties propose the standard of a bank or an institutional lender providing unsecured term or operating facilities on the basis of their expert financial evidence regarding an appropriate proxy for the Term

Loan and the Revolver Loan. This is an unduly restrictive standard given the purpose of the test for an "equity claim", which is to assist in determining whether USS had a reasonable expectation of repayment with interest at the time it extended advances under the Term Loan and the Revolver Loans. While the willingness of a third-party to lend on the terms provided by a parent corporation could support such a conclusion, the absence of third-party lender financing is not sufficient to establish that no other financing would have been available to the subsidiary on a viable basis. Where a party seeks to disprove the alleged reasonableness of an expectation of repayment of a loan with interest, or the absence of any debt capacity of a borrower, it is necessary to canvas the availability of viable financing across capital markets more broadly.

230 Lastly, the Objecting Parties acknowledge that the standard that they propose would apply solely for purposes of proceedings under the CCAA and, perhaps, the BIA. There are three difficulties with this result.

231 First, as mentioned, a court should give considerable weight to the characterization of payments to the extent that third parties, such as the Canadian and American tax authorities, have accepted the treatment of such payments in the past in the absence of any express authority in the CCAA to do otherwise. In this case, there is a history of characterization of payments consistent with loan transactions that includes not only the loan documentation but also interest payments, principal repayments and interest waivers under the Term Loan. There is no evidence that either the Canadian or the American tax authorities have raised any issue with the treatment of any such payments for tax purposes.

232 Second, while tax treatment cannot be determinative, these tax regimes represent another third-party standard that has some independent validity in evaluating the substantive reality of loan instruments.

233 Third, as a policy matter, I see no policy benefit in having separate rules in the tax and accounting domain, on the one hand, and in the CCAA domain on the other. It is important for stakeholders in a corporation to have rules that yield reasonable certainty for planning purposes. A consequence of the approach proposed by the Objecting Parties would be that a parent corporation seeking such certainty in respect of the treatment of a loan to its subsidiary would have to limit its financing arrangements to those which an independent consultant considers to be comparable to financing facilities that would be provided by a notional third-party lender. There are a number of difficulties with this approach from a policy perspective for which there is no obvious corresponding benefit. The principal difficulty is the overriding of valid business purposes by the imposition of a restrictive standard for the purposes of any future CCAA proceedings. In addition, there would be additional costs associated with such a policy, a need for updates as advances are made over time in changing market conditions, and a potentially inefficient limitation of financing options from a financial perspective.

234 Based on the foregoing considerations, I am not persuaded that the third-party lender standard proposed by the Objecting Parties, and which underlies many of the specific factors upon which the Objecting Parties rely, is appropriate in the present context for determining whether the Loans were, in substance, capital contributions. This conclusion has the following implications in respect of the manner in which the factors identified above are to be applied in the evaluation of the Term Loan and the Revolver Loan as debt obligations or capital contributions.

235 First, with respect to factors (1) to (4), such factors are relevant to the issue of the expectations of USS at the time of advances under the Loans. However, these considerations must be evaluated in terms of what they indicate about the expectations of USS without regard to any comparison with any notional third-party lender. In other words, it is not a relevant consideration in determining whether USS had an expectation of repayment with interest that a notional third-party lender would not have provided financing arrangements to USSC having these features.

236 Second, the fact that a notional third-party lender would not have extended financing facilities to USSC on the terms and conditions of the Term Loan and the Revolver Loan is also not determinative of whether USSC had the debt capacity to service the advances under the Term Loan and under the Revolver Loan when they were made. It is therefore not determinative of the reasonableness of USS' expectation of repayment with interest of the Loan.

237 The foregoing conclusion does not, however, foreclose entirely the relevance of the availability of financing from independent sources. As discussed above, I accept that a test based on the availability of financing from an external source of financing, not limited to a third-party lender, could be a means of evaluating the debt capacity of a wholly-owned subsidiary. Framed in such terms, such a test would bear on the reasonableness of a parent corporation's expectations of repayment of the principal with interest of a particular loan or advance based on the debt-capacity of the subsidiary. However, there is no reason to narrow consideration of such debt capacity to the availability of third-party lender financing, unless the evidence clearly establishes that no other financing facilities would have been available to the subsidiary had it sought external financing.

238 Third, in the analysis below, I do not accord any significant weight to the test suggested by the Objecting Parties — that the less the Term Loan and the Revolver Loan reflect the characteristics of a third party loan from a bank or other institutional lender, the more such Loans resemble equity. In my opinion, to the extent that such Loans depart from the third-party lender standard for reasons that have a legitimate business purpose that is related to the wholly-owned subsidiary relationship or its business, the Court cannot disregard the legitimacy of such arrangements in its analysis. Given a legitimate business purpose for departing from the standard of behavior of a third-party lender, there is no necessary reason why a parent corporation could not also have had an expectation of repayment with interest of any loan advance at the time of such advance notwithstanding that it did not act in the same manner as a third-party lender. As discussed above, there is no necessary reason why a parent corporation cannot be both a lender and a shareholder even if, as a lender, it does not conform in all respects to the standard of a third-party lender.

Analysis of the Principal Considerations Relied Upon by the Objecting Parties

239 I turn then to a consideration of the probative value of the general factors relied upon by the Objecting Parties in the analyses below of the Term Loan and the Revolver Loan. As set out above, the Objecting Parties say that the Term Loan Agreement and the Revolver Loan Agreement reflect arrangements under which USS intended at all times to return excess cash to USS when available and to write off the principal or interest in respect of the Loans to the extent that payments of either were due and sufficient cash was not available.

240 In this section, I will address, in order, the extent to which the seven principal factors relied upon by the Objecting Parties are of assistance in the analysis of the Term Loan and the Revolver Loan in light of the conclusions reached above. The seven principal factors are the following: (1) the absence of any arm's length negotiation regarding the terms and conditions of the Term Loan or the Revolver Loan; (2) the deferred interest payment dates and the long maturity dates of both the Term Loan and the Revolver Loan; (3) the history of interest payments and waivers under the Term Loan; (4) the absence of any security; (5) the extent of USS' control over the business operations and financial performance of USSC; (6) the fact, as acknowledged by USS, that USSC would not have been able to obtain financing from a third-party bank or institutional lender in the amount and on the terms and conditions of either the Term Loan or the Revolver Loan; and (7) the view of the Objecting Parties that payments on account of the Term Loan and the Revolver Loan were effectively subordinated to payment of trade creditors.

241 First, the Objecting Parties suggest that the lack of any negotiation between USS and ABULC regarding the Term Loan, and the absence of any substantive negotiations between USS and USSC regarding the Revolver Loan, suggest that the advances under the Loans were in the nature of equity injections rather than *bona fide* debt. I do not consider these circumstances to be of any value in addressing the issues on this motion. The limited negotiations between these parties is a reflection of the wholly-owned subsidiary relationship that is the starting point for such issues, but it is a neutral fact that does not bear in any way on the reasonableness of the expectations of USS regarding repayment with interest of the advances under the Term Loan and the Revolver Loan.

242 Second, the Objecting Parties submit that the two-year interest payment provision in the Term Loan and the Revolver Loan, and the lengthy maturity dates for the Loans, suggest these arrangements were capital contributions. However, the terms and conditions of the Term Loan and the Revolver Loan make express provision for the payment

of interest on fixed dates and the repayment of principal by a fixed maturity date. While these terms were acknowledged to be generous, the fact remains that each Loan fixed the maximum amount payable thereunder as interest and principal and provided fixed dates for the payment of accruing interest and the repayment of the principal amount of the Loans. In particular, the interest payment dates were time-limited. Setting aside any comparison with the terms expected in third-party lender arrangements for the reasons set out above, there is nothing in the terms of the Loans, on their own, that would support an inference that USS did not expect to receive repayment with interest of all advances made under the Loans. In particular, the existence of a long maturity date and the absence of a schedule of repayments is not a basis for inferring that USS did not expect USSC to repay the Term Loan. The Term Loan did not prevent earlier repayment of principal. In addition, USS was in a position to require USSC to repay principal without a contractual schedule of repayments.

243 Accordingly, on their face, neither the Term Loan nor the Revolver Loan is more consistent with receipt of the residual cash flow and assets of USSC as the Objecting Parties suggest. Any such inference must be based on the actions of USS and USSC in the administration of the Loans.

244 Third, accordingly, the Objecting Parties argue that the Court should infer from the manner in which interest payments were treated under the Term Loan that the Loans were intended to be capital contributions rather than debt, i.e., that there was never any expectation of repayment with interest of the Loans. There are two aspects of the interest payment history in respect of the Term Loan that will be addressed separately — the accelerated payment of interest in 2008 and the interest waivers commencing in 2010.

245 The Objecting Parties argue that the acceleration of the interest payments under the Term Loan in 2008 evidences an intention to treat the Term Loan as a capital contribution. In making this argument, the Objecting Parties rely on the testimony of Dr. Finnerty who suggested that the payment of interest under the Term Loan in 2008 ahead of the due date in 2010 exhibited behavior that was more characteristic of the payment of dividends rather than interest.

246 I accept that it is possible that the payment of interest could resemble a dividend in circumstances in which there is no reasonable explanation for the timing or amount of payments made outside the provisions of a loan agreement, for example, a payment in excess of accrued interest by way of an alleged pre-payment of interest. However, where the timing of interest payments is consistent with a legitimate business purpose and in accordance with the provisions of a loan agreement, the Court cannot disregard such circumstances in assessing the expectations of the parent corporation regarding the loan.

247 In this case, the Term Loan permitted, but did not require, a deferral of interest payments for a period of time. The argument based on Dr. Finnerty's evidence proceeds on the unrealistic premise that, given such a provision in a loan agreement, a subsidiary would not pay interest to its parent corporation until the end of the permitted interest deferral period even if an earlier payment would be more efficient financially. In other words, the argument relies on a third-party lender standard which is rejected for the reasons discussed above. More generally, where there is a legitimate business reason for the flexibility provided in the loan agreement, I do not see any necessary connection between the availment of that flexibility and either the characterization of the payment as a dividend or the expectation of the parent corporation regarding repayment of the loan with interest.

248 In the present circumstances, the accelerated interest payments reflected very favourable financial results of USSC during the first three quarters of 2008. There was no legitimate reason for USSC to defer payment of interest, which was compounding while outstanding, to the interest payment date if it had cash available for such purpose. The Term Loan Agreement permitted a deferral of interest payments for a period of time to accommodate an adverse financial performance from time to time. However, it did not require such a deferral in the event of a favourable economic performance. The presence of this provision does not evidence an intention of USS and USSC that USSC would hold on to excess cash at its own cost in such circumstances.

249 Accordingly, I am not persuaded that the acceleration of interest payments in 2008 is indicative of an intention on the part of USS to treat the Term Loan as a capital contribution rather than as a debt obligation.

250 The Objecting Parties also argue that the interest payment waivers granted in favour of USSC commencing in 2010 evidence the absence of any expectation of repayment with interest of the Term Loan. Insofar as the Objecting Parties urge the Court to draw such an inference from the existence of the interest waivers without having regard to a third-party lender standard, this issue is addressed later in these Reasons.

251 I note, however, that Dr. Finnerty's opinion was based on a somewhat different approach. He suggested that, from the perspective of financial economics, USS' actions in respect of the interest waivers reflected the behavior of a shareholder rather than a lender. The position of Dr. Finnerty and the Objecting Parties is that, in the circumstances of non-payment of interest, third-party lenders will obtain some value in negotiations with borrowers as a condition of granting such waivers. As evidence of an equity interest, they point to the absence of any enforcement proceedings on the part of USS to protect its interest as a lender, and of any negotiations to obtain a *quid pro quo* for, in particular, the grant of such waivers of interest.

252 Given the finding above regarding the appropriateness of the third-party lender standard, the Court does not draw any inference from the absence of any enforcement proceedings or other actions on the part of USS in respect of the interest waivers. In this case, the application of such a standard also reflects an unrealistic premise upon which the argument for equity treatment is based. As mentioned above, in wholly-owned situations, enforcement proceedings are counter-productive so long as the parent corporation believes the subsidiary still has value. It is also axiomatic that the subsidiary cannot give the parent any additional value as a *quid pro quo* for obtaining a waiver of its interest obligations since the parent already owns all of the subsidiary's equity value. The probative value of the interest waivers is discussed further below.

253 Fourth, the Objecting Parties submit that the absence of security for the Term Loan or the First Tranche Indebtedness is probative of the expectations of USS at the time it extended advances under the Loans. This argument also relies implicitly on a comparison with a third-party lender standard. If such a comparison is disregarded, I conclude that the absence of security is not indicative of a capital contribution for the following reasons.

254 As discussed above, and as the history of the Revolver Loan demonstrates, as the sole shareholder of USSC, USS had no need to require security for its loans to USSC until it became concerned about the ability of USSC to repay any funds advanced to it. As such, the fact that USS required security for advances made after October 2013 is more significant as evidence of the expectations of USS in October 2013 than the absence of any security for advances made prior to that date. In short, the Objecting Parties have not demonstrated a necessary connection between an absence of security for the Term Loan or the First Tranche Indebtedness and an absence of any expectation of repayment with interest of the Term Loan or the First Tranche Indebtedness.

255 Moreover, the implication of the position of the Objecting Parties is that, to protect itself in possible insolvency proceedings, a sole shareholder must lend on an asset-backed basis, i.e., take security on the assets of the enterprise, to avoid characterization of its loan as equity. This cannot have been the intention of the definition of "equity claims" under the CCAA insofar as such an implication would, among other things, encourage a parent corporation to take a priority over claims of trade creditors and thereby make a restructuring of an enterprise in an insolvency situation more difficult.

256 Fifth, for the following reasons, I am not persuaded that the extent of USS' control of USSC is a factor to be taken into account in assessing whether the Term Loan and the Revolver Loan were, in substance, equity contributions by USS.

257 As a polar case, I accept that there may be circumstances in which a parent corporation's expectation from the outset is that it will sacrifice a subsidiary's profitability over the long-term for the benefit of the consolidated enterprise. In such circumstances, a court could find that the parent corporation had no intention of causing the subsidiary to repay with interest any financing extended to the subsidiary or, more precisely, no expectation that the subsidiary would

generate sufficient cash flow to enable it to make such payments based on the parent's anticipated business plan for it. In such circumstances, a court could also find that the entire amount of the financing extended by the parent corporation to the subsidiary was, in reality, an equity contribution.

258 However, the Objecting Parties have expressly advised the Court that they do not take that position in this proceeding. In any event, the evidence is not sufficient to justify such a conclusion in the present circumstances. In particular, among other considerations, the history of the Term Loan and the Revolver Loan is too short, and the impact on the entire USS business of the recessionary environment after late 2008 was too significant, to enable the Court to draw such a conclusion.

259 This leaves the question of whether control of a wholly-owned subsidiary that does not go so far as to render the profitability of the subsidiary a matter entirely in the sole discretion of the parent corporation can constitute a consideration to be taken into account in the analysis of whether loans made by the parent corporation are debt or are, instead, equity contributions. I accept that such control requires a court to take a "good hard look" at the substantive reality of any such loans, in this case being the advances under the Term Loan and the Revolver Loan. Beyond that, however, in this case, I think that USS' control is the point of departure, rather than an independent factor, for the following reasons.

260 First, and foremost, as mentioned, there is no overriding authority in the CCAA to disregard entirely the manner in which parties, including related parties, have structured their affairs. As set out above, I think a court must give effect to such structure unless and until, in the case of a loan from a parent corporation to a subsidiary, there is other evidence establishing that the parent did not reasonably expect to receive repayment of the loan with interest at the time of the making of the loan. In other words, the existence of control is not a basis for such an inference on its own.

261 Second, the submission of the Objecting Parties that USS' control is an independent factor demonstrating an equity contribution proceeds on the basis of a distinction between a lender's rights and a shareholder's rights that is untenable in the present circumstances. The Objecting Parties argue, in effect, that USS acted in its capacity as a shareholder, rather than as a lender, in causing USSC to repay monies to it and, therefore, such payments should be treated as dividends.

262 This argument is based on a false dichotomy. No lender has a right to compel the repayment of principal or the payment of interest. The lender's rights are restricted to enforcement in the event of non-payment. The debtor alone decides whether to pay principal or interest. The implication of this argument is that a parent corporation must renounce its rights as a shareholder to cause payments under a loan agreement. This is not only unrealistic but also counter to the conclusion that a parent corporation can have regard to its rights as a shareholder while acting as a lender. Accordingly, the fact that USS instructed USSC with respect to the payments to be made cannot on that account result in a characterization of such payments as dividends, or of the Loans as capital contributions.

263 Sixth, for the reasons set out above, I conclude that the fact that USSC could not have obtained financing from a third-party lender on the terms and in the amounts of the Loans is not an independent factor that assists in evaluating USS' expectations regarding repayment with interest of the advances under these Loans at the time that they were made.

264 Seventh, the remaining consideration is the view of the Objecting Parties that USS effectively subordinated its position to the other creditors of USS by paying interest on the Term Loan and the Revolver Loan only after such other creditors were satisfied on an on-going basis. In doing so, the Objecting Parties say USS acted like a shareholder rather than a lender, thereby evidencing the absence of any expectation of repayment with interest of the Loans.

265 As a factual matter, it is correct that USSC paid interest on the Term Loan and the Revolver Loan only after its arm's length creditors were satisfied on an on-going basis. From 2007 until shortly prior to the Filing Date, USS funded USSC with debt or equity in order to permit USSC to pay its trade creditors on an ongoing basis. Moreover, as mentioned, USS waived a significant amount of interest that accrued and became due under the Term Loan and made no interest payments on the remaining accrued interest.

266 This raises the question of whether such evidence demonstrates that USS intended that the Term Loan and the Revolver Loan would be subordinated to payment of USSC's other obligations and, if so, whether such arrangements demonstrate that USS did not expect to receive repayment with interest of the Loans. There are a number of issues bound up in this argument that need to be separated.

267 First, it is important to note that there is no suggestion that USS intended a legal subordination of its claims in respect of either the Term Loan or the Revolver Loan to claims of third party creditors of USSC. Indeed, after October 2013, all fresh advances under the Revolver Loan were secured and, therefore, ranked ahead of the trade creditors of USSC.

268 Second, in any event, subordinated debt is not synonymous with a capital contribution. For present purposes, subordinated debt remains debt, subject to demonstration that a borrower could not have obtained subordinated debt on any basis from external sources, that is, did not have the debt capacity to obtain external financing in the amount of the Term Loan or the amount of the First Tranche Indebtedness. In such event, such evidence would cast serious doubt on a parent corporation's expectation with respect to repayment with interest of the alleged subordinated debt. As discussed below, however, there is no such evidence in the present case.

269 Third, I am not persuaded that the actions of USS and USSC described above are properly characterized as subordination for present purposes. In the face of a significantly changed economic and financial environment described above, USS chose to defer rather than subordinate the repayment of the principal of the Loans and the payment of interest, except to the extent of the waived interest. However, USS left its options open regarding the treatment of amounts outstanding under the Term Loan in the future.

270 Fourth, and most important, there is no evidentiary connection between the factual circumstances which the Objecting Parties describe as effective subordination of the Term Loan and the Revolver Loan and the expectation of USS regarding repayment with interest of the Loans at the time the advances were made thereunder. As described elsewhere in these Reasons, the economic circumstances commencing in 2008 established a reason for the actions that USS and USSC took subsequently which the Objecting Parties say constituted effective subordination of the Loans. There is, however, no evidence of an intention to implement such actions or, more generally, to implement a principle of effective subordination, at the time of the advances under the Loans.

271 Accordingly, I am not persuaded that the argument of alleged effective subordination of the Term Loan and the Revolver Loan supports the position of the Objecting Parties that USS did not expect to receive repayment with interest of advances under the Term Loan or the Revolver Loan.

Analysis and Conclusions Regarding the Re-characterization Claim in Respect of the Term Loan

272 I propose to set out my analysis of the debt re-characterization claim of the Objecting Parties with respect to the Term Loan after first setting out the position of the Objecting Parties in their written submissions. I would note that, at the trial, the Objecting Parties concentrated on a subset of these considerations which are addressed in these Reasons.

Positions of the Parties

The Union

273 The essence of the position of the Union with respect to both the Term Loan and the Revolver Loan is captured by the two paragraphs below which are taken from the supplementary written submissions of the Union:

> Critically, USS always expected and intended that USSC's repayment of amounts owing under both the Term Loan and the Revolver Loan was contingent on USSC's performance.

> The evidence is clear that USS only expected to receive payments on account of interest and principal if and when USSC was able to make them, and not in accordance with the terms of the agreements. On discovery, Mr. Brockway's evidence was that USS "anticipated that the ability to repay that portion of the debt would be dependent on the success of Stelco's business going forward."

274 The Objecting Parties do not merely assert that USS expected to disregard the timing requirements of the Term Loan Agreement and the Revolver Loan Agreement with respect to the movement of available cash from USSC to USS. Rather, they say that, from the outset of each of the Term Loan and the Revolver Loan, USS did not expect USSC to be able to repay the advances under such Loans, and the interest on such advances, and therefore expected to write off a significant portion of such obligations as they fell due.

275 In its factum, the Union argues that the Term Loan should be re-characterized as equity based principally on the following seven *AutoStyle* factors: (1) the ability of USSC to obtain similar financing from outside lending institutions; (2) the source of repayments of the Term Loan; (3) the presence or absence of a fixed maturity date and schedule of payments; (4) the absence of security for advances under the Term Loan; (5) the absence of a sinking fund to provide for repayments; (6) the extent to which the advances under the Term Loan were effectively subordinated to the claims of outside creditors; and (7) the inadequacy of capitalization of ABULC at the date of the initial advance under the Term Loan.

276 The Union also says that the lack of negotiation between USS and USSC regarding the Term Loan and the fact that the principal purpose of the initial advances under the Term Loan was the acquisition by USS of capital assets also support a finding of a contribution to capital rather than debt.

The Province

277 The general approach of the Province with respect to both the Term Loan and the Revolver Loan is set out in the following excerpts from its factum:

> The context of the Term Loan is crucial for the characterization exercise. ... Essentially, USSC operated as a division of the USS organization. This same context also applies to the Revolver....
>
> USS' attitude to the financing of USSC reflected what its attitude would be in funding one of its operating divisions — the money went where and when needed. There was no consideration or expectation that the funds would be treated other than equity — the investment would yield returns if, and only if, the business prospered. Advances were motivated by whether the global business would benefit from the allocation of resources to the facility, and not based upon any analysis of the profitability or credit-worthiness of the business unit....
>
> USS' loose approach to interest from USSC is understandable in the context of the complete control of USSC by USS discussed above. Whether USSC had the wherewithal at any point in time to pay interest was utterly dependent on the production USS assigned to it, the intercompany allocation of raw materials (and their cost) and USSC's personnel — all controlled by USS. Presumably, USS believed sending the money to USSC on a non-interest bearing basis allowed USS to earn a better return elsewhere in the global business.

278 In its factum, the Province argues that the Term Loan should be re-characterized as equity based principally on the following three allegations: (i) there was no expectation that USSC would pay interest on the Term Loan advances; (ii) there was no expectation that USSC would repay the principal of the Term Loan advances; and (iii) the Term Loan was not provided by, nor available from, a third-party lender on commercial terms. I note that the first two considerations are not actually referred to in *AutoStyle*, although, as discussed above, I think that they are fundamental issues in respect of the re-characterization issue.

279 The Province also suggested that the following four attributes of the Term Loan, which reflect factors referred to in *AutoStyle* and are included in the considerations upon which the Union relies, also demonstrate that it is, in substance, equity rather than debt: (1) the initial advances under the Term Loan were used to acquire a capital asset, being the outstanding shares of Stelco; (2) ABULC's capital structure was thinly or inadequately capitalised at the date of the Acquisition when the initial advances were made under the Term Loan, especially in light of Stelco's historical operating performance; (3) the failure to provide for security for the Term Loan; and (4) the failure to establish a sinking fund for repayment, particularly in view of the 30-year term of the Term Loan.

USS

280 USS submits that a number of the *AutoStyle* factors considered by American courts refute, rather than support, the Objecting Parties' re-characterization argument, including: (1) the documents entered into between USS and USSC regarding the Term Loan on their face purport to evidence indebtedness and are titled "Loan Agreements"; (2) the parties intended to enter into a loan transaction; (3) the Term Loan has a fixed maturity date; (4) the Term Loan provides for a specified applicable interest rate; (5) under the Term Loan, USS has the right to enforce payment of interest and principal; (6) USS did not acquire any management control rights in exchange for the funds advanced under the Term Loan; (7) USS did not subordinate any amounts owing under the Term Loan to USSC's other creditors as a matter of law; and (8) a substantial portion of the funds advanced under the Term Loan were used to finance USSC's ongoing operations. In addition, USS relies on statements in a recent American decision, *Alternate Fuels Inc., Re*, 789 F.3d 1139 (U.S. C.A. 10th Cir. 2015), to the effect that the identity of interest between USS and USSC and any undercapitalization of ABULC should not be material considerations in the context of a loan from a parent to a wholly-owned subsidiary.

Analysis and Conclusions

281 As set out above, the claim of the Objecting Parties that the Term Loan should be characterized as an "equity claim" requires addressing two matters: (1) the expectation of USS regarding repayment of principal and interest on the Term Loan out of cash flows of USSC over the term of the Term Loan; and (2) the reasonableness of such expectations. I note that, while these are discrete issues, the evidence referred to below that is relevant to the expectation of USS at the time of any particular advance can also be relevant to the reasonableness of such expectation.

282 As described above, most of the Term Loan advances were advanced to ABULC between October 31, 2007 and December 31, 2007. However, further advances in the aggregate principal amount of $211.2 million were made in 2009. It is therefore necessary to address the characterization of the Term Loan advances in these two periods of time separately. In each case, I will address the application of the general considerations discussed above to the USS expectation regarding repayment of the Term Loan with interest and will then consider certain additional arguments of the Objecting Parties specific to the Term Loan that have not already been addressed above.

Term Loan Advances at the Time of the Acquisition

283 The advances made to USSC in respect of the Acquisition between October 31, 2007 and December 31, 2007 have been set out above. USS says that it expected to be repaid the principal of the Term Loan outstanding at December 31, 2007 with interest over the course of the Loan, even if it could not anticipate the timing of such payments given the cyclical nature of the steel industry.

284 USS relies principally on the evidence of Brockway with respect to the facts pertaining to its expectations at the time of the Acquisition and the initial advances under the Term Loan. Brockway testified that USS based its decision to acquire Stelco on a financial model which was created by USS internally, but was reviewed by its financial advisor in the transaction and was relied upon by the USS board of directors in connection with their decision to make the Acquisition.

285 The financial model contemplated stable sales of flat-rolled steel that would rise 1%-2% annually, which would generate earnings before interest, taxes and depreciation ("EBITDA") estimated to be U.S. $368 million in 2008 and

projected to gradually rise over the next seven years. Brockway testified that, based on this financial model, USS anticipated that the Acquisition would generate sufficient free cash flow in USSC to pay the interest provided for under the Term Loan and to repay the principal over the 30-year term of the Term Loan. The financial model also included a discounted cash flow analysis. The extent to which this analysis is also supportive of the USS expectation is unclear. However, there is no evidence regarding this financial model that contradicts USS's expectation of repayment of the Term Loan with interest.

286 The Objecting Parties do not dispute that USS made its decision to acquire USSC based on the financial model described above. However, the Objecting Parties argue that the constellation of factors described above pertaining to the terms of the Term Loan Agreement, and the manner in which USS administered the Term Loan, demonstrate that USS did not expect to be repaid the principal with interest of the initial advances under the Term Loan.

Did USS Expect to be Repaid the Term Loan With Interest?

287 I do not propose to revisit the considerations that have been excluded for the reasons set out in the preceding section, including, in particular, the considerations that rely on a comparison with a third-party lender standard. Setting those considerations aside, the position of the Objecting Parties is based primarily on the following remaining factors which will be evaluated without regard to a third-party lender standard: (1) the terms of the Term Loan Agreement, in particular the deferred interest payment dates and the length of the term of the Term Loan; (2) the acceleration of interest payments in 2008; (3) the waivers of interest commencing in 2010; and (4) the view of the Objecting Parties that USS effectively subordinated payments on the Term Loan to payment of USSC's trade creditors. The Objecting Parties argue that, even considered without regard to the third-party lender standard, these factors, particularly the actions of USS after the advances were made, evidence the fact that USS did not expect to receive repayment of the principal with interest of the Term Loan. I will address each of these factors in turn and will then address the probative value of these factors considered collectively.

288 First, as mentioned, the Term Loan Agreement provided USSC and USS with considerable latitude regarding the timing of both the payment of interest and the repayment of principal. There was a legitimate business reason for these terms of the Loans. They provided USS with some, but not complete, flexibility to align the payment of interest with the receipt of excess cash flow in a highly cyclical industry. They also provided a lengthy period of time over which to repay the Loans for the same reason. These terms were permissible under applicable tax legislation without losing the tax treatment for debt. For the reasons set out above, I do not think that the terms of the Term Loan Agreement, by themselves, are more consistent with a re-characterization of the Term Loan as a capital contribution. The mere existence of provisions providing flexibility in the timing of payment of interest and repayment of principal is not a basis for inferring that USS did not expect to receive repayment with interest of the Term Loan without further evidence at the time of the initial advances. There is no such evidence in this case. In particular, as noted above, there is no evidence regarding the financial model that establishes, on a balance of probabilities, that repayment of the Term Loan was not a realistic possibility over the life of the Loan.

289 Second, the Objecting Parties suggest that the acceleration of interest payments in 2008 supports a finding that the payments were, in substance, dividend payments. For the reasons set out in the preceding section, I do not think that the two interest payments made in late 2008 are more properly characterized as dividends based on a third-party lender standard. I also do not think that the action of causing such payments in advance of their respective payment dates is, on its own, indicative of treatment of the Term Loan as a capital contribution. More generally, in the absence of any documentary or other evidence at the time of the payments suggesting otherwise, the fact that the payments were characterized as interest payments, that the payments did not exceed the amount of the accrued interest at the time, that the payments were permitted under the Term Loan Agreement, and that there was a legitimate business purpose for making interest payments in advance of their due date should be determinative.

290 Third, the Objecting Parties' reliance on the interest waivers and failure to repay any interest in the seven years between the initial advances under the Term Loan and the Filing Date is understandable. It raises a legitimate question

of whether USS ever intended USSC to pay principal or interest on the Term Loan, that is, whether it ever expected to be paid interest and/or repaid principal.

291 There is some force to this argument in one respect. Insofar as USS waived, rather than continued to accrue, unpaid interest, it appears to have acted as a shareholder rather than a lender. The evidence before the Court established that it was not economic for USS to "round-trip" the payment of interest by USSC under the Term Loan. This explains why USS did not fund USSC to enable it to pay the accrued interest. However, it does not explain why it was appropriate to write off the interest that was waived in each of the relevant years, much less why only a portion of the interest was written off. Moreover, based on an internal email dated March 29, 2011 of USS, it is possible that, in or about late 2010 or early 2011, USS decided on a policy of waiving at least some interest at the end of each year to the extent USS was not in a position to pay the accrued interest payable in such year.

292 However, the Objecting Parties suggest that the Court should infer from the interest waivers that USS did not expect to receive repayment with interest of the Term Loan at the time of the initial advances under the Term Loan. In the preceding section, I addressed the argument of Dr. Finnerty that the Court should draw such an inference from USS' failure to assert its rights as a lender in respect of the interest payment defaults that gave rise to the interest waivers. In this section, I address the alternative argument of the Objecting Parties that the granting of the interest waivers by themselves is sufficient to support the inference that USS never expected to receive repayment of the Term Loan with interest at the time that the initial advances were extended thereunder.

293 I do not think a court can reasonably draw such inferences for a number of reasons. First, and most important, there is no other evidence supporting such an expectation at the time of the establishment of the Term Loan and the making of the initial advances under the Loan. Second, the payment of interest under the Term Loan in 2008 is inconsistent with an absence of any expectation of payment of interest from the outset of the Term Loan. Third, the intervening economic events are sufficient to establish radically different economic conditions which support the USS position of altered expectations. There is no evidence that USS contemplated the possibility of a recession of the depth and length experienced in the steel market since 2008 even though it put in place flexibility regarding interest payments and a long maturity date as discussed above. Fourth, notwithstanding the waivers in 2011, 2012 and 2013, there is no evidence that such repeated waivers of interest reflected a long-term policy of USS that existed from the outset of the Term Loan.

294 Accordingly, the significant facts for this purpose are the lengthy period after the initial advances before the initial decision was made to waive interest coupled with the intervening occurrence of significantly adverse market conditions. These factors, together with the absence of any documentation or other evidence to the contrary at the time of the initial advances under the Term Loan, exclude an intention at the time of such advances to waive interest as and when it became payable under the terms of the Term Loan Agreement.

295 Lastly, with respect to the argument of subordination, I have concluded for the reasons set out above that the evidence regarding the alleged effective subordination of the Loan does not evidence the absence of an expectation of USS of repayment with interest of the Term Loan or the Revolver Loan, except to the extent of the waived interest which has been addressed above. I would add that I do not consider that the evidence of Brockway, discussed below, constitutes evidence that USS implemented a policy of subordination of the Term Loan to trade creditors from the time of the initial advances as the Objecting Parties suggest.

296 The Objecting Parties have raised one further argument that should be addressed pertaining to the use of the initial advances under the Term Loan. They suggest that both the use of the advances under the Term Loan to acquire capital assets, being the Stelco shares and other Stelco securities, and the circumstances surrounding the SHC Transaction, argue for a finding that the Term Loan constituted, in substance, a contribution to capital. I do not accept either submission for the following reasons.

297 With respect to the significance of the acquisition of the Stelco shares and other securities, the Objecting Parties say that such use of the initial advances under the Term Loan demonstrates that the primary intention of USS was the acquisition of Stelco rather than the establishment of a debtor-creditor relationship between Canada LP and ABULC.

298 This argument presumes that the purpose of debt is the provision of working capital and that the purpose of equity is the acquisition of capital assets. That is too narrow an approach. Term loans are regularly used to acquire capital assets and, indeed, are often secured on such capital assets in the case of third-party lenders. There is no necessary reason why the fact that advances under a term loan were used for the purpose of acquiring assets should be a consideration that demonstrates a capital contribution. In addition, as discussed above, there is no general principle that prevented USS from structuring a portion of its investment in USSC as a loan. Moreover, as described below, the portion of the Term Loan that reduced the Credit Corp Loan was effectively used to retire the third party debt of Stelco at the time of the Acquisition.

299 With respect to the SHC Transaction, the Union argues that the fact that advances under the Term Loan were used to satisfy the Credit Corp Loan, which was incurred to refinance the Stelco debt at the USS level, is indicative of a view of the Term Loan as an equity contribution. I do not see the connection suggested by the Union.

300 The SHC Transaction has been described above. The principal effect of the SHC Transaction was to effect a sale of SHC at its apparent fair market value by USSC and a reduction of the Credit Corp Loan in a like amount. If the SHC Transaction had not occurred, the Credit Corp Loan would have remained outstanding as of the Filing Date in the amount of such reduction and the amount of the Term Loan would have been correspondingly lower. From the point of view of the aggregate amount of outstanding debt of USSC, the SHC Transaction was therefore neutral. Moreover, the Credit Corp Loan was made for the purpose of repaying third-party debt of Stelco. To the extent that advances under the Term Loan in connection with the SHC Transaction were applied to reduce the Credit Corp Loan, such advances were therefore indirectly used to repay such third-party debt. I do not see any further significance to the SHC Transaction.

301 It is therefore necessary to address the argument of the Objecting Parties that, while none of the foregoing factors or considerations may be sufficient on its own to support a conclusion that the Term Loan was, in substance, a capital contribution, the combination of factors should support such a conclusion. This argument effectively brings together all of the factors set out and discussed above and asserts that collectively they establish that it is more probable that USS did not expect to receive repayment with interest of the Term Loan than that USS had such an expectation.

302 In considering this argument, I have looked more generally at which of the two scenarios proposed by the parties is more probable — the USS position that it expected to be repaid the principal with interest of the Term Loan at the time of the advances in 2007 or the Objecting Parties' position that, at the time of such advances, USS expected to receive only such cash flow and assets as were available after satisfaction of the obligations to third party creditors and to write off the principal or interest in respect of the Term Loan when cash was not available and such obligations fell due.

303 In addition to the factors described above, the Objecting Parties rely on the evidence of Brockway referred to above and the evidence more particularly described in certain excerpts of Brockway's discovery in these proceedings set out at pages 8 and 9 of the Union's Compendium of Key Read-in Evidence. The Union submits that these excerpts establish that USS' expectation of repayment was "contingent on USSC's performance" or was "dependent on the success of Stelco's business going forward" and that "[USS] only expected to receive interest payments if USSC was successful." I note that this argument is similar to, but separate from, the argument that USS effectively subordinated repayment of the Term Loan, and payment of interest thereon, to the payment of USSC's third party creditors.

304 I do not think that this submission accurately captures the evidence of Brockway and, accordingly, I think that the Objecting Parties rely on an interpretation of his evidence which it was not intended to carry.

305 There is a difference between the investment risks of USS' investment in Stelco, considered as a whole, and the risk of repayment of the portion of the investment that was structured as debt of USSC. Reading the entirety of Brockway's

evidence, I am satisfied that Brockway's statement was intended to acknowledge no more than that there could be no certainty that the aggregate investment in Stelco would be profitable. Brockway acknowledged no more than that the Acquisition entailed normal investment risks and that, to the extent that USS made a bad investment, there was a risk that it had made such a bad investment that USSC would be unable to repay not only its equity investment but also the Term Loan with interest. His evidence does not, however, constitute an acknowledgement that USS believed it had made an unprofitable investment in acquiring Stelco, much less an acknowledgement that USS therefore expected that USSC would be unable to repay the Term Loan with interest.

306 The foregoing discussion highlights the fact that, at times, the position of the Objecting Parties approaches the issue of repayment of the Term Loan as part of the larger issue of the profitability of the entire investment of USS in USSC. This is reflected in the position of the Union, as excerpted above, which proceeds on the basis that USS treated both the Loans and the equity component as a single investment. In so doing, the Objecting Parties disregard the reality that the Term Loan was expressly structured and documented separately from the equity injections in order to function in the manner described above. I do not think that the separate existence of the Term Loan can be simply ignored in the absence of an explanation or reason for treating the USS investment on an aggregate basis. In doing so, this approach conflates the issues of repayment of the Term Loan and the profitability of USS' acquisition of Stelco, which are very different. The Court is only concerned with USS' expectation of repayment with interest of the Term Loan. Even an unsuccessful investment may nevertheless repay with interest the portion of the investment structured as a loan.

307 Further, to the extent that Brockway was also acknowledging the existence of lending risks with respect to repayment of the Term Loan, the mere existence of lending risks is not a basis for an inference that there was no expectation of repayment of the debt portion of the USS' investment in USSC. The statement that USSC would not be able to repay the Term Loan with interest unless it was profitable is, on its own, a neutral statement. There is a considerable distance between an acknowledgement of the existence of normal lending risks and an acknowledgement that USS did not expect USSC to be able to repay the Term Loan with interest. I do not read Brockways' testimony as going to the latter statement.

308 It is also necessary to address the position of the Province as excerpted above. The Province argues, in effect, that, having made the decision to acquire Stelco and to integrate it into the USS business as an operating division, USS paid no attention to the ability of USSC to repay the Term Loan over the thirty-year life of the Loan. It says that such action demonstrates that the Term Loan was, in effect, equity. By way of explanation for this approach, the Province suggests that USS considered the investment from a business-wide perspective. The Province suggests that USS was not concerned specifically with the profitability of USSC, and its ability to repay the Term Loan, given that USS considered that an increased profitability of other companies within the USS group would more than compensate for any losses in USSC.

309 At the time of the initial advances under the Term Loan, USS undoubtedly intended to integrate Stelco into its business as an operating division. That fact alone, however, does not support the conclusion that USS had no expectation that USSC would be unable to repay with interest the portion of the acquisition cost that was provided to it in the form of the Term Loan. More importantly, the evidence does not support the conclusion that USS paid no attention to the ability of USSC to repay the Term Loan in the manner suggested by the Province for the following reasons.

310 First, as Brockway noted, it is incorrect to suggest that USS made no credit analysis of USSC in connection with the initial advances under the Term Loan. The financial model, upon which the decision to acquire Stelco was based, served the function of a credit analysis even if the principal purpose of the model was to address the financial impact of the entire investment. In its projections of cash flows of the post-acquisition Stelco, the financial model provided the basis for a conclusion regarding USSC's ability to service the Term Loan. As set out below, the evidence before the Court with respect to this financial model does not demonstrate that USS did not expect to receive repayment with interest of the initial advances under the Term Loan over the life of the Loan.

311 Second, while the financial model did anticipate the realization of substantial synergies outside of USSC, it is not suggested that the quantum of such synergies was such that they would compensate for anticipated losses in USSC.

More generally, there is no evidence that USS did not anticipate recovery of the majority of its investment in the form of profits from USSC, including the portion represented by the initial advances under the Term Loan which for this purpose is notionally senior to USS' equity investment.

312 The Brockway evidence therefore does not constitute an acknowledgement or admission of USS that it had no expectation of repayment with interest of the initial advances under the Term Loan when they were made. For the reasons set out above, I am also not persuaded by the Province's argument that USS allocated its investment in Stelco between debt and equity with no regard to USSC's ability to repay the initial advances under the Term Loan. The probative value of the other considerations upon which the Objecting Parties rely has been discussed above. The element of USS' actions which most strongly raises a doubt regarding its expectation regarding repayment of the Term Loan is the experience of the interest waivers. The Objecting Parties also rely, among other considerations, on the long maturity date, the absence of a schedule of repayments, and the alleged effective subordination. For the reasons set out above, however, none of this evidence is sufficient on its own to support a characterization of the Term Loan advances as equity. I am also not persuaded, for the reasons discussed above, that the experience of the interest waivers, together with the other considerations upon which the Objecting Parties rely, collectively demonstrate that USS did not expect to be repaid the initial advances under the Term Loan with interest as of the time such advances were made in 2007.

313 Accordingly, I find, on a balance of probabilities, that, at the time of the advances under the Term Loan in 2007, USS expected that USSC would repay interest on the Term Loan in accordance with the terms of the Term Loan Agreement and would repay principal on or prior to the maturity date of the Term Loan.

Was the USS Expectation Reasonable?

314 This raises the issue of the reasonableness of the USS expectation.

315 The Objecting Parties rely heavily on two factors which might suggest that such an expectation was unreasonable: (1) third party financing was not available to USSC on terms substantially similar to the terms of the financing provided by USS; and (2) the view of the Objecting Parties that ABULC was inadequately capitalized. I will address these issues in turn.

316 As mentioned, the Province introduced the Hall Report as expert evidence demonstrating that a third party lender would not have provided ABULC/USSC with financing in the amount and on the terms of the Term Loan provided by USS.

317 There is no actual dispute regarding this opinion in the Hall Report. However, for the reasons set out above, the standard addressed in the Hall Report — i.e., whether USSC could have obtained financing on the terms and in the amount of the Term Loan from a bank or other institutional lender — is too limited to establish that the USS expectation of repayment of the Term Loan was unreasonable. In this regard, it is noteworthy that both Mr. Hall and Dr. Finnerty, who relied on the Hall Report for the purpose of the opinion in the Finnerty Report on this issue, acknowledged that they were not expressing any opinion on the ability of USSC to have obtained financing other than from a third-party lender.

318 The question remains whether the evidence regarding the ability of USSC to raise debt on a viable basis as of December 31, 2007 contradicts the reasonableness of the USS expectation. If the Objecting Parties were able to demonstrate, on a balance of probabilities, that USSC could not have obtained external financing in the amount of the Term Loan on any viable basis, I think a court could conclude that at least the excess of the Term Loan over the amount of financing that was obtainable from external sources represented an equity contribution.

319 However, in the present circumstances, the evidence is not sufficient to establish that USSC lacked the capacity to raise an amount of debt equal to the outstanding amount of the Term Loan as of December 31, 2007, that is, that external financing would not have been available to USSC on a viable basis, although admittedly on a fully secured basis. Accordingly, the Objecting Parties cannot establish that the USS expectation in 2007 of repayment with interest of the Term Loan was unreasonable. In this regard, the following considerations are relevant.

320 First, Stelco had total debt approximating $1.16 billion at the time of the Acquisition. As the Austin Smith Report suggests and Mr. Hall acknowledged, this would appear to put a floor on the debt capacity of USSC at the time of the Acquisition.

321 Second, the historical financial results for Stelco (EBITDA and EBIT) prior to the Acquisition, when adjusted to remove non-recurring items, reflected an improving trend from 2006 to 2007 on a quarter-over-quarter comparison by year.

322 Third, the outstanding balance of the Term Loan at December 31, 2007, being approximately $1.4 million including the outstanding loan from the Province, was not significantly higher than the amount of the Stelco debt prior to the Acquisition. This level of debt represented approximately 70% of the total acquisition cost to USS of Stelco. It is not inconsistent with Brockway's testimony that USS believed that the Term Loan could be repaid over the 30-year life of the Loan as Brockway suggested. It is true that the investment failed to generate the results contemplated by the USS financial model. By any estimation, in hindsight, the investment was a significant failure. However, there is no basis for retrospectively fixing USS with such knowledge at the time of the initial advances under the Term Loan.

323 Fourth, the Hall Report bases its conclusions entirely on the historical performance of Stelco rather than on an analysis of the projected cash flow of USSC at the time of the Acquisition. However, as the Province's financial advisor in respect of the Acquisition, Ernst & Young Inc., recognized in a report dated August 22, 2007 to the Province, the Acquisition was likely to improve the financial strength of USSC relative to Stelco. The report identified a number of factors for consideration by the Province regarding the Acquisition. Purely from a cash-flow perspective, these factors would have been expected to result in an increased and more stable cash flow, other economic factors being equal. There is, therefore, a reasonable basis for concluding that the Acquisition increased USSC's debt capacity relative to Stelco's pre-Acquisition debt capacity. The fact that a third-party lender might not have been prepared to rely on USS' cash flow projections is not determinative of whether lenders in other capital markets were prepared to do so.

324 Fifth, the limited metrics in evidence do not suggest that USSC lacked the ability to incur such external financing. As noted by Brockway, in 2007, Stelco incurred slightly less than $60 million in interest expense for the nine months ended September 30, 2007, or slightly less than $80 million on an annualized basis. The Term Loan interest for 2008 approximated $100 million, which was well within the estimated EBITDA for that year.

325 Sixth, while the Acquisition was not a leveraged buyout transaction as that term is generally understood, USS, as a strategic purchaser, approached the purchase of Stelco with a similar philosophy and approach to capitalization, as the Austin Smith Report notes. In this regard, the financial metrics pertaining to aggregate debt and interest coverage, on a prospective basis, are consistent with leveraged buyout financing transactions in 2007 and are, therefore, suggestive of the availability of financing in the high-yield market.

326 Given these factors, the evidence suggests a reasonable possibility of obtaining third-party financing in other capital markets, beyond the third-party lender market addressed in the Hall Report and the Finnerty Report, in particular, in the high-yield market. For the reasons discussed above, it is not relevant for present purposes that any such financing would have been on different terms and conditions from the Term Loan. The second issue raised by the Union in its Factum is the allegedly inadequate capitalization of ABULC/USSC at the time of the initial advances under the Term Loan.

327 Insofar as the Union says that ABULC was inadequately capitalized, I think the issue is misdirected. While it is correct that ABULC had no prior operating performance and no revenues or profits of its own, that is irrelevant. At all times, ABULC was the direct parent corporation of USSC. Its financial performance on a consolidated basis was that of USSC. Accordingly, the extent to which ABULC was or was not undercapitalized was directly dependent on the extent to which USSC was or was not undercapitalized.

328 Insofar as the Objecting Parties say that post-Acquisition USSC was inadequately capitalized, I think this issue engages the same issue as the preceding discussion of the availability of external financing. To the extent that the evidence

fails to establish that USSC could not have obtained external financing on a viable basis in the amount of the Term Loan, it cannot reasonably be argued that USSC was inadequately capitalized.

329 Based on the foregoing, I find that the Objecting Parties have not satisfied the onus of demonstrating that the USS expectation of repayment with interest of the principal of the Term Loan as of December 31, 2007 was unreasonable.

Term Loan Advances in 2009

330 As mentioned, in 2009, USSC received additional advances totalling $211.2 million under the Term Loan from Canada LP. No interest or principal was paid during 2009. In addition, as set out in the table above, USS provided equity injections in the amount of $61 million during 2009.

331 The Objecting Parties do not raise any arguments regarding these advances under the Term Loan in addition to those addressed above. The relevant facts are essentially the circumstances as of December 31, 2007 carried forward, subject to the interest payments in 2008 and the occurrence of the recession in 2009. Given the history of the steel market in the period 2004 to 2008, USS had a reasonable expectation that markets would improve that justified supporting USSC in 2009 with additional working capital advances. I note as well that the first interest waiver under the Term Loan occurred subsequent to the advances in 2009.

332 Accordingly, I see no basis for reaching a different conclusion respecting the expectation of USS regarding repayment of these advances from the conclusion reached above regarding repayment of the initial advances under the Term Loan. The evidence before the Court establishes that USS expected that USSC would repay these advances with interest for the reasons set out above. Hindsight is always 20/20. There is, however, no evidence that, as of 2009 when such advances were made, USS or USSC anticipated the negative financial performance of USSC in the period 2009 to 2013 and therefore expected that USSC would be unable to repay these advances with interest. There is also no evidence before the Court that would demonstrate that the expectation of repayment with interest of these advances under the Term Loan was unreasonable.

Conclusion Regarding Characterization of the Term Loan

333 Based on the foregoing, I conclude that the outstanding Term Loan, being Claim #9, constitutes a debt claim rather than an "equity claim" for the purposes of this CCAA proceeding.

Analysis and Conclusions Regarding the Re-characterization Claim in Respect of the Revolver Loan

334 I propose to set out my analysis of the debt re-characterization claim of the Objecting Parties with respect to the Revolver Loan after first setting out the position of the Objecting Parties in their written submissions. As in the case of the Term Loan, the Objecting Parties concentrated on a subset of these considerations at the trial, which are addressed in these Reasons.

Positions of the Parties

The Union

335 The approach of the Union, as excerpted above from its written submissions, applies equally to the Term Loan and the Revolver Loan and therefore will not be repeated here. In its factum, the Union argues that the Revolver Loan should be re-characterized as equity based principally on the following seven *AutoStyle* factors: (1) the inability of USSC to obtain similar financing from outside lending institutions; (2) the source of repayments of the Revolver Loan; (3) the presence or absence of a fixed maturity date and schedule of payments; (4) the absence of security for advances under the Revolver Loan; (5) the absence of a sinking fund to provide for repayments; (6) the extent to which the advances under the Revolver Loan were effectively subordinated to the claims of outside creditors; and (7) the financial position of USSC, including an inadequate capitalization, at the date that the Revolver Loan was first put in place.

The Province

336 The Province's approach, as excerpted above from its factum, also applies equally to the Term Loan and the Revolver Loan and therefore will not be repeated here. In its written submissions, the Province argues that the Revolver Loan should be re-characterized as equity based principally on two assertions also made in respect of the Term Loan, namely: (i) there was no expectation that USSC would repay the principal of the Revolver Loan advances; and (ii) the Revolver Loan was not provided by, nor available from, a third-party lender on commercial terms. The Province also suggests that the following three attributes of the Revolver Loan further demonstrate that it is, in substance, equity rather than debt: (1) the arrangements pertaining to interest including, in particular, determination of the interest rate based on tax requirements, the timing of interest payments in the loan agreements, and the reliance on equity injections to make interest payments under the Revolver Loan; (2) thin or inadequate capitalization of USSC at the date of the Revolver Loan Agreement and USSC's operating performance at the time; and (3) the failure to establish a sinking fund for repayment.

USS

337 USS submits that the same *AutoStyle* factors upon which it relies in respect of the Term Loan also refute the Objecting Parties' re-characterization claim in respect of the Revolver Loan. Accordingly, I will not repeat them here.

Analysis and Conclusions

338 The claim of the Objecting Parties that the Revolver Loan should be characterized as an "equity claim" also requires addressing the two matters discussed above: (1) the expectation of USS regarding repayment of principal with interest on the Revolver Loan out of cash flows of USS over the term of the Revolver Loan; and (2) the reasonableness of such expectation. In the case of the Revolver Loan, it is necessary to address these issues separately in respect of each of the First Tranche Indebtedness and the Second Tranche Indebtedness. Accordingly, I will deal with each Tranche in order.

The First Tranche Indebtedness

Background

339 As set out above, the amount of the First Tranche Indebtedness outstanding as of October 31, 2013 was U.S. $116,969,996. It is understood that no payments of either principal or interest were made in respect of the First Tranche Indebtedness after October 30, 2013. The history of advances and payments under the Revolver Loan to this date is important for the determinations herein. The Monitor's Seventh Report sets out all such advances and repayments in Exhibit "O" thereto, which is briefly summarized as follows.

340 During 2010, USSC drew a total of U.S. $100,000,000 under the Revolver Loan and made no interest payments. In 2011, USSC drew U.S. $20,000,000 in June, repaid U.S. $18,339,563 in November and drew U.S. $25,223,983 in December. In the same year, USSC paid U.S. $6,660,437 of interest in November and U.S. $223,983 of interest in December. As of December 31, 2011, the amount outstanding under the Revolver Loan was U.S. $127,155,598.

341 In 2012, USSC obtained advances totaling U.S. $307,366,090. Advances were made in each month, other than March and April when it repaid U.S. $33,866,386 and U.S. $9,568,279, respectively, and October when there was no activity. In addition, small amounts of interest were paid in each of January, March and April, being U.S. $366,090, U.S. $1,133,614 and U.S. $431,721, respectively. At the end of December 2012, the outstanding balance of the Revolver Loan was U.S. $496,702,434, which amount was increased by a draw of U.S. $10,000,000 in early January 2013 to bring the outstanding amount to U.S. $507,750,128.

342 As Dr. Finnerty observed, with the qualification that money is fungible, it can be argued that the payments on account of principal and interest in the aggregate amount of U.S. $25,000,000 in November 2011, and a further interest payment of U.S. $223,983 in December 2011, were funded by an equity injection in October 2011. It can also be argued

that the payments on account of principal and interest in March and April 2012 were funded by an advance under the Revolver Loan in February 2012.

343 In 2013, as described above, USS implemented a decision to "de-lever" USSC by reducing the Revolver Loan. Accordingly, principal and interest payments totaling $383,845,848 and $11,154,152, respectively, were made in each of the months of February to July 2013 inclusive. By this means, the balance outstanding at October 31, 2013, prior to the execution of the Third Revolver Amendment and the October Security Agreement, had been reduced to the level set out above, being the amount of the First Tranche Indebtedness. Applying advances and repayments on a first-in, first-out basis, the advances outstanding under the First Tranche Indebtedness at the Filing Date were advances made in the course of 2012.

344 It is necessary to overlay the economic performance of USS and USSC during these years. As described above, the evidence establishes that market conditions improved in the second quarter of 2010 and then weakened again in the second half of 2010. Similarly, market conditions improved in the second quarter and third quarter of each of 2011 and 2012 before weakening again in the fourth quarter of each year. Essentially, the evidence is that USS thought that the improvement in the markets in the first half of 2010 signalled the start of an improving market whereas, in retrospect, it heralded the beginning of several years of "mini-cycles" in each of 2010, 2011 and 2012. The evidence also indicates that a similar improvement did not occur in the first half of 2013.

345 Exhibit "O" to the Monitor's Seventh Report sets out the equity injections made by USS during the period 2010 to October 2013 on a monthly basis, which is briefly summarized as follows. In 2010, USS made equity injections in each of June, July, September, October and December totaling $611,754,000. In 2011, USS made equity contributions in each of January, February, July, August, September and October totaling approximately U.S. $213 million. There were no equity injections in 2012. In 2013, as described above, in connection with its "de-leveraging" decision, USS contributed a total of $682,758,200 through equity injections in each month from February to and including September. It is not disputed that a significant portion of these equity injections in 2013 was used to pay interest owing, and to repay principal outstanding, on the Revolver Loan in connection with the "de-leveraging" exercise. A further $57,040,500 was injected in October 2013 prior to execution of the Third Revolver Amendment prompting a moratorium on further cash payments to USSC imposed by the new chief financial officer until security was provided.

Analysis and Conclusions

346 The evidence indicates that USS established the Revolver Loan in May 2010 during a period of improvement in market conditions after the significant slowdown in business activity during the second half of 2008 and 2009. The funding under the Revolver Loan provided additional working capital required to respond to the recovery of the steel market that was anticipated at that time. As mentioned, the advances comprising the First Tranche Indebtedness were made in 2012 based on a first-in, first-out approach to advances and repayments under the Revolver Loan. Accordingly, such advances must be considered in the context of the economic environment in which they were made in 2012.

347 USS says that it expected to be repaid all advances, with interest, when they were made under the Revolver Loan over the course of the Loan. As set out above, the principal argument of the Objecting Parties is that the terms of the Revolver Loan, as well as the manner in which the Loan was administered by USS, are more consistent with receipt of the residual cash flow and assets of the USSC, without any expectation of repayment with interest of the advances under the Revolver Loan.

348 The Objecting Parties rely largely on the general considerations that were addressed in respect of characterization of the Term Loan. This is consistent with the fact that the Revolver Loan performed the same cash management function as the Term Loan. They also rely on certain other considerations that are specific to the circumstances in which the First Tranche Indebtedness was advanced. These include the following matters: (1) the losses of USSC since 2009; (2) the failure of USSC to pay any interest on the Term Loan after 2009; (3) the negative equity of USSC in 2012; (4) the

removal of the solvency representation from the Revolver Loan; and (5) the use of equity injections to fund repayment of the Revolver Loan pursuant to the "de-leveraging" exercise described above in 2013.

349 I will first address the application of the general considerations that the Objecting Parties suggest demonstrate the equity character of both the Term Loan and the Revolver Loan and then the additional considerations which they raise that are specific to the Revolver Loan.

350 As mentioned, in the period from 2010 to 2012, that is, prior to the "de-leveraging" exercise discussed below, USS administered the Revolver Loan in the same manner as it had administered the Term Loan with the exception that: (1) in each of 2011 and 2012, USSC repaid some principal and paid some accruing interest out of available cash; and (2) USSC did not waive any interest that became payable during this period. There are no additional facts in respect of the administration of the Revolver Loan that render the combined effect of the general considerations upon which the Objecting Parties rely more compelling in the context of the Revolver Loan than the Term Loan.

351 I therefore do not think that the terms of the Revolver Loan Agreement and the manner in which USS administered the Revolver Loan are sufficient to constitute the Revolver Loan, in substance, an equity contribution. There is nothing in these circumstances, considered on their own or collectively, that casts any doubt on the evidence that USS expected USSC to repay the principal with interest of the First Tranche Indebtedness over the life of the Loan.

352 The next issue is therefore whether the financial status of USSC in 2012, when the advances comprising the First Tranche Indebtedness were made, affects this conclusion. The Objecting Parties say that the Court should infer from the four considerations set out above, which pertain to the financial state of USSC in the latter half of 2012, that USS did not expect to receive repayment with interest of the Revolver Loan. These factors raise a legitimate issue regarding both the expectation of USS and the reasonableness of that expectation at that time. I propose to address the issue of the removal of the solvency representation first and then the remaining considerations pertaining to USSC's financial state.

353 The Objecting Parties place considerable reliance on the agreement of USS to remove the solvency representation from the Revolver Loan Agreement in 2012 as evidence that USS could not have expected USSC to be able to repay any advances under the Revolver Loan. The solvency representation was removed by the First Revolver Amendment in July 2012 at the request of Michael McQuade, the chief financial officer of USSC at the time ("McQuade").

354 McQuade states in his affidavit sworn September 4, 2014 that, at the time of the execution of the First Revolver Amendment, he had a concern about USSC's solvency given its losses since 2009 and its reliance on USS for on-going liquidity and solvency. He testified at the hearing of this motion that he had a concern that USSC might become insolvent at some point over the remaining thirteen-year term of the Revolver Loan.

355 The Objecting Parties suggest the Court should draw the inference that USS was aware that USSC was insolvent in July 2012 and, from that inference, find that USS had no expectation of repayment with interest of the advances made in 2012 under the Revolver Loan. I do not think the evidence justifies such an inference or finding for the following reasons.

356 First, there is no evidence regarding the intentions of either USS or USSC in removing the insolvency representation that supports such a finding. McQuade requested its removal. His evidence at the trial was that he approached the solvency representation as a continuing representation. McQuade's concern was prospective rather than immediate. He was concerned that USSC might breach the representation at some point in the future rather than that USSC was insolvent in July 2012. In addition, McQuade also testified that he believed that USSC had a continuing right under the Revolver Loan Agreement to draw funds as needed up to the maximum availability. It is not clear how he integrated these two apparently contradictory considerations. McQuade's view of the operation of the Revolver Loan Agreement does, however, reinforce the prospective nature of his concern. In addition, there is no evidence regarding why USS agreed to remove the solvency representation at the time.

357 Second, it is not possible to draw any conclusion regarding the knowledge of USS and USSC from the terms of the Revolver Loan Agreement for the following reasons. As described elsewhere in these Reasons, I consider that the

proper interpretation of the Revolver Loan Agreement is that a balance sheet solvency test remained in the form of the "unable to meet debts" event of default. In addition, a similar event of default remained in the Term Loan Agreement. I do not see any inconsistency in the removal of the solvency representation and the retention of a balance sheet event of default. Moreover, it is not clear whether the solvency representation was a continuing representation given at the time of each advance. Even if it was, which may be more likely, the net effect of the amendment was to remove the solvency test based on meeting liabilities as they fell due. As discussed above, there was no need for such an event of default in the context of a wholly-owned subsidiary relationship. It is therefore questionable whether the removal of the insolvency representation had any real practical significance from which it would be possible to draw an inference.

358 Third, while USSC may not have been solvent on a book value basis in July 2012, there is no evidence to suggest that USS considered that USSC was insolvent on a market value basis at that time, which is the relevant issue both as a practical matter as well as a legal matter.

359 I turn then to the remaining financial performance considerations upon which the Objecting Parties say that the Court should infer an absence of an expectation of repayment of the Revolver Loan on the part of USS in 2012. With hindsight, these considerations point in the direction of continuing financial problems of USSC which were identified in the autumn of 2013. With the benefit of that hindsight, it is also clear that USS had very lax controls over the provision of additional cash to USSC from 2010 until late October 2013 and perhaps poor planning processes. In practice, USSC's requests, as set out in its rolling thirteen-week cash forecasts, appear to have been satisfied on a regular basis without close scrutiny by the USS treasury department.

360 However, such evidence, considered collectively with the other considerations relied upon by the Objecting Parties, is not sufficient to establish that USS actually expected that USSC would be unable to repay with interest the advances in 2012. The evidence is more consistent with a USS expectation that funding additional working capital in 2012 was appropriate given an anticipated improvement in the steel market, with a concomitant ability of USSC to repay such advances under the Revolver Loan as USSC returned to profitability.

361 The advances under the Revolver Loan funded USSC with a view to increasing its working capital to take advantage of more favourable steel markets that were expected at the time. As described above, there were mini-cycles in each of 2010, 2011 and 2012. In each case, USS misread these mini-cycles as the start of a more broad-based improvement that did not occur. In the case of these advances, the evidence indicates a misplaced belief that the performance of USSC would improve in 2012 and 2013. There is, however, no evidence before the Court which suggests that USS did not hold these views. Nor is there any evidence that such views were unreasonable at the time.

362 The Objecting Parties also raise the issue that the outstanding principal amount of the Revolver Loan was reduced from slightly in excess of U.S. $500,000,000 to the amount of U.S. $116,969,996 during 2013 pursuant to the "de-leveraging" exercise that was funded by equity injections from USS. They suggest that the source of funds is a factor indicating that the Revolver Loan was, in fact, an equity injection. There are three difficulties with this argument.

363 First, USS had a legitimate business purpose in reducing the outstanding amount of the Revolver Loan that was not connected in any way to its expectation regarding the ability of USSC to repay the Revolver Loan. The "de-leveraging" exercise was undertaken to remove foreign currency fluctuations from the USSC financial statements and, thereby, to address an unnecessary complication in the USS consolidated financial statements.

364 Second, in any event, I do not see any necessary connection between the use of the equity injections to reduce the outstanding balance of the Revolver Loan and the characterization of the remaining outstanding balance of the Loan. It may be that the use of equity injections reflected the fact that, in the course of 2013, USS concluded that USSC was no longer likely to be able to repay an amount of the Revolver Loan equal to the amount repaid by the equity injections. However, any determination to that effect would require evidence regarding the options available to USS to address the currency fluctuation issue, including the feasibility of conversion of such advances into another debt instrument rather than equity. Such evidence was not before the Court. In addition and in any event, the issue for the Court is whether

USS expected repayment of an amount of the Revolver Loan equal to the remaining balance, being the First Tranche Indebtedness. The "de-leveraging" exercise does not demonstrate that USS also concluded that USSC would not be able to repay the amount of the Revolver Loan that it determined to leave outstanding.

365 Third, there is a significant element of hindsight to this particular argument. The advances comprising the First Tranche Indebtedness were fully advanced before a decision to undertake the "de-leveraging" exercise was taken. In the absence of any documentary evidence of USS' decision-making in 2012, it is not possible to establish that the USS decision to convert a portion of the Revolver Loan to equity in 2013 reflected a determination made earlier in 2012 at the time of the advances under the Loan regarding the ability of USSC to repay such advances. More generally, there is no evidence that demonstrates that the use of equity injections to repay a portion or all of the Revolver Loan was contemplated at any time prior to late January 2013.

366 Accordingly, I do not see any demonstrable connection between the use of the equity injections to pay down the Revolver Loan and the expectation of USS regarding repayment with interest of the Loan when the Revolver Loan was established or when the advances comprising the First Tranche Indebtedness were made in 2012.

367 Lastly, as mentioned, the Province argues that, in respect of the Revolver Loan, USS advanced monies to USSC as an operating division based on anticipated benefits to the overall USS business and without any expectation of the payment of interest or the repayment of principal of the advances. On this view, USS provided monies to USSC that would not earn interest or be repaid because it would earn sufficient additional profits elsewhere in the organization to justify the increased equity investment in USSC.

368 While such a possibility cannot be wholly discounted, the evidence for such a conclusion is lacking, apart from the absence of any credit analysis by USS before establishing the Revolver Loan in 2010, upon which the Province relies. There is no evidence that the losses that USSC generated were compensated for by profits elsewhere within the USS companies between 2010 and 2012. Moreover, there also is no evidence that, by 2010, the synergies envisaged at the time of the Acquisition outside of USSC were being realized within the USS business. As discussed above, the evidence only goes as far as demonstrating lax controls and perhaps a poor planning process. Such evidence is insufficient to demonstrate an absence of an expectation of repayment with interest of the advances under the Term Loan.

369 Based on the foregoing, I therefore find that the evidence demonstrates, on a balance of probabilities, that USS had an expectation of repayment with interest of the advances comprising the First Tranche Indebtedness at the time such advances were made.

370 I turn then to the evidence regarding the reasonableness of such expectation.

371 In this regard, the principal argument of the Objecting Parties is that USSC could not have obtained an operating loan from a third-party lender on the terms and conditions of the Revolver Loan. They argue that this fact demonstrates that the First Tranche Indebtedness was in substance an equity injection.

372 There is no doubt that a third-party lender would not have made an operating line of credit available on the terms and conditions of the Revolver Loan. The Hall Report opines that a third-party lender would not have granted an unsecured credit facility in 2010 given the circumstances that USSC was unprofitable, was experiencing negative EBITDA, had a net worth deficit on a book value basis, and had an outstanding balance under the Term Loan of approximately $1.6 billion. On the other hand, there is no evidence before the Court that would support a conclusion that secured financing would not have been available on viable terms from an external source other than a third-party lender. Neither Mr. Hall nor Mr. Finnerty expressed any opinion on this matter.

373 The more difficult question is whether any external financing would have been available given the amount outstanding under the Term Loan in 2012, that is, whether the total debt capacity of USSC would have been exceeded by the addition of a secured operating line. If it could be demonstrated that such financing would not have been available, a

court could find that it was unreasonable to expect repayment of the advances of the First Tranche Indebtedness, being Claim #10, when they were made.

374 However, there is no capital markets evidence before the Court that addresses this issue directly.

375 The limited financial evidence referred to above is not sufficient to support any inference regarding the debt capacity of USSC at such time as it is limited to the availability of an unsecured revolver loan from a third-party lender. As the Objecting Parties bear the onus of proof, there is, therefore, no basis for a conclusion that USS' expectation of repayment was unreasonable on the basis that USSC lacked the aggregate debt capacity in 2012 to establish a revolving loan facility in the amount of the Revolver Loan.

376 Based on the foregoing, I conclude that USS had a reasonable expectation of repayment with interest of the advances constituting the First Tranche Indebtedness at the time such advances were made. I therefore also conclude that the unsecured Claim in respect of the Term Loan, being Claim #10, constitutes a debt claim rather than an "equity claim" for the purpose of this CCAA proceeding.

The Second Tranche Indebtedness

377 As set out above, Credit Corp advanced loans to USSC under the Revolver Loan totaling U.S. $71 million after the execution of the Third Revolver Amendment and the October Security Agreement on or about October 30, 2013. These advances were outstanding at the Filing Date. USS did not make any equity injection after October 30, 2013. As noted above, USSC acknowledges that USSC was insolvent on a balance sheet basis as of October 31, 2013, by which it is understood that USSC's liabilities exceeded the fair market value of its assets as of that date. The Objecting Parties argue that the Second Tranche Indebtedness was also an equity contribution.

378 For clarity, I have approached the issue of characterization of the Second Tranche Indebtedness on the basis that such Indebtedness is secured by the security constituted by the October Security Agreement. Because USS required such security before advancing the Second Tranche Indebtedness, it is not realistic to address the characterization of such Indebtedness independently of such security. Accordingly, no conclusion is reached in these Reasons on the characterization of such Indebtedness to the extent that such security may be held to be void or unenforceable.

379 I find the evidence supports the conclusion that USS expected to be repaid the Second Tranche Indebtedness as advanced under the Revolver Loan for the following reasons.

380 First, there can be little doubt that USS expected to be repaid the advances made after October 30, 2013 with interest given the security over all the assets of USSC provided by the October Security Agreement. The existence of security for the Second Tranche Indebtedness overwhelms any argument that could be made for an absence of any expectation of repayment with interest based on the general considerations relied upon to seek to characterize the Term Loan and the First Tranche Indebtedness as capital contributions. The existence of security also precludes an argument based on the financial status of USSC at the time the advances comprising the Second Tranche Indebtedness were made.

381 Second, the principal argument of the Objecting Parties is that USS was legally and practically obligated to continue funding USSC. The Objecting Parties say that, if USS had not funded through the Revolver Loan, it would have had to fund the same amounts by equity injections. They argue that therefore the Revolver Loan was effectively an equity contribution. There are two difficulties with this argument.

382 First, I find that USS was not legally obligated to continue funding USSC under the Revolver Loan Agreement for the following reasons.

383 The Objecting Parties submit that, as of October 31, 2013, USS was legally obligated to continue to make all advances requested by USSC up to the limit of the availability under the Revolver Loan Agreement, being U.S. $600

million. This position is based on the contractual interpretation set out in the Di Massa Report of the "unable to meet debts" event of default in section 11c of the Revolver Loan Agreement as of October 30, 2007.

384 However, I have concluded above that the "unable to meet debts" event of default constituted a balance sheet insolvency event of default in the Revolver Loan Agreement. There is no dispute that USSC was insolvent on a balance sheet basis in October 2013. Accordingly, on this interpretation of the Revolver Loan Agreement, an event of default had occurred under the "unable to meet debts" event of default in the Agreement entitling USS to refuse to advance further funds to USSC thereunder.

385 In addition, even assuming that USS was obligated practically to ensure financing for USSC, I do not think it is correct to say that USS was obligated to provide that financing by equity injections. This argument assumes that secured financing was not available from external sources on a viable basis in the amount of the Second Tranche Indebtedness. However, there is no reason to think that a revolving loan on a secured basis in the amount advanced during the remainder of 2013, being approximately $71 million, would not have been available to USS, although admittedly on terms and conditions which would have differed from those of the Revolver Loan.

386 I note that the Objecting Parties acknowledged at the trial that, but for the foregoing argument, they would have no compelling argument for characterization of the Second Tranche Indebtedness as a capital contribution. In particular, they do not raise any argument to the effect that any expectation of USS of repayment of the Second Tranche Indebtedness as secured debt was unreasonable. The principal issue raised by the Objecting Parties in respect of the Second Tranche Indebtedness is the validity or enforceability of the security for such Indebtedness constituted by the October Security Agreement, which is discussed below.

387 Based on the foregoing, I conclude that USS had a reasonable expectation of repayment with interest of the advances comprising the Second Tranche Indebtedness at the time such advances were made.

The Validity of the Security for the Second Tranche Indebtedness

388 The Objecting Parties submit that the security for the USS Secured Claims (being, collectively, Claims # 11, 11(a), 11(b), and 11(c)) should be invalidated. They make two principal arguments: (1) that the October Security Agreement and the November Security Agreement are unenforceable for lack of consideration at the time that they were executed and delivered by USSC; and (2) that the October Security Agreement and the November Security Agreement are void as constituting a fraudulent preference for the purposes of section 95(1)(b) of the BIA.

389 In this section, I will address these issues in respect of the security for the Second Tranche Indebtedness, being the October Security Agreement. The security for the Remaining USS Secured Claims will be addressed in the last section of these Reasons.

Alleged Unenforceability of the October Security Agreement

390 The Province and the Union argue that the October Security Agreement is unenforceable due to a lack of consideration at the time that it was executed and delivered by USSC and submit that, accordingly, the security constituted by such Agreement is invalid. On this basis, they argue that USS Claim #11, being the Second Tranche Indebtedness, should be declared to be an unsecured claim.

391 USS says consideration was given for the October Security Agreement in the form of further advances under the Revolver Loan which would not have been granted without the provision of security for such advances, as referenced in the recital in the October Security Agreement cited above.

392 The position of the Objecting Parties raises the following issues pertaining to the validity of security:

1. Is consideration for the October Security Agreement necessary for an enforceable security interest?

2. If so, did USS give consideration for the October Security Agreement in the form of an agreement to advance further funds under the Revolver Loan?

3. Alternatively, did USS give consideration for the October Security Agreement in the form of a forbearance or a waiver in respect of USS' rights to declare a default or take enforcement proceedings pursuant to the Revolver Loan Agreement or otherwise?

393 I do not accept the position of the Objecting Parties that the October Security Agreement is unenforceable for want of consideration for the following reasons, which address each of these questions in turn.

394 First, I do not think consideration is required for a grant of a security interest to be effective, although it will not be enforceable until such time as an obligation arises in favour of the grantee that is secured by the security interest. This result is a consequence of the fact that security is essentially a proprietary right. Consideration is not required to effect a pledge, or a charge on property. While a security interest is a statutory creation, I see nothing in the *Personal Property Security Act*, R.S.O. 1990, c. P.10 (the "PPSA") that imposes a requirement for consideration as a condition of the effectiveness of a grant of a security interest.

395 The Objecting Parties say that a requirement for consideration is found in the statutory provisions of the PPSA that require a security agreement between the parties. Given that any agreement requires consideration in favour of a party to the agreement to be enforceable against such party, the Objecting Parties say it necessarily follows that consideration is required for a party to enforce the grant of a security interest in its favour in a security agreement. I acknowledge that, in the absence of consideration, the other covenants in favour of a grantee of a security interest in a security agreement may not be enforceable. That is, however, a different issue. In such event, the rights of the grantee would be limited to its statutory rights under the PPSA, but the grant of the security interest would still be effective.

396 Consistent with this approach, the PPSA expressly distinguishes between a security agreement and a security interest. A "security agreement" is defined in section 1(1) of the PPSA as "an agreement that creates or provides for a security interest and includes a document evidencing a security interest". I see no reason why a "document evidencing a security interest" cannot include a document or instrument containing a unilateral grant of a security interest by a grantor in favour of a grantee. Such a grant would be effective as between the parties regardless of whether consideration was given, provided the grantee could demonstrate that the grantor intended it to be delivered. It would also be effective in respect of the rights of third parties, subject to the other requirements of the PPSA regarding rights in the collateral and attachment. It is the extension of credit, and thereby the creation of an obligation in favour of the grantee that is secured by the security interest, that makes the security interest enforceable.

397 Second, if consideration is required for the security interest granted in the October Security Agreement to be effective, I think this requirement was satisfied in three separate ways.

398 First, the October Security Agreement recites that consideration was given, the receipt and sufficiency of which is acknowledged by both parties to the Agreement. It is an elementary principle that courts will not enter into an inquiry as to the adequacy of consideration: see John D. McCamus, *The Law of Contracts*, (Toronto: Irwin Law, 2005), at p. 222.

399 Second, as a related matter, as stated above, the third recital to the October Security Agreement recites, in effect, that Credit Corp required the provision of security as a condition of continued advances under the Revolver Loan Agreement. This recital is consistent with the Court's conclusion above that an event of default had occurred under the Revolver Loan Agreement entitling Credit Corp to refuse to advance further monies under the Revolver Loan. On this basis, USS was therefore in a position to provide consideration in the form of a commitment to advance further funds under the Revolver Loan Agreement. Accordingly, the commitment to advance further funds on the part of Credit Corp referred to in the third recital accurately reflected the existence of consideration for the purposes of the October Security Agreement.

400 Third, I am also of the opinion that any lack of consideration for the October Security Agreement was cured by the actual advances of monies under the Revolver Loan Agreement comprising the Second Tranche Indebtedness. If the execution of the October Security Agreement and the advance of monies had occurred concurrently, there would have been no issue regarding a lack of consideration. The advance of monies itself would have satisfied any requirement for consideration under the October Security Agreement. In other words, under such circumstances, it would have been unreasonable, and unnecessary, to require demonstration of an intermediate commitment to advance further funds. The result should not change merely because there was a period of time between the execution of the October Security Agreement and the subsequent advance of monies under the Revolver Loan. The significance of the lapse of time is that the security interest was not enforceable, in the sense that the security interest did not secure any outstanding obligation and therefore could be enforced, until such time as an advance occurred under the Revolver Loan. It did not, however, render the October Security Agreement void for lack of consideration.

401 The Objecting Parties raise three arguments to the effect that USS did not give any consideration, even if an event of default had arisen under the Revolver Loan Agreement which would otherwise have permitted USS to refuse to advance further funds under the Revolver Loan Agreement.

402 First, the Objecting Parties say that, notwithstanding the occurrence of an event of default, USS had waived its right to assert such an event of default by advancing funds prior to January 2013. They say this course of conduct constituted a waiver of USS' right to assert such an event of default in October 2013 or of USS' right to use the event of default to deny further advances under the Revolver Loan at that time.

403 This argument is rejected for three reasons. First, as a practical matter, the last advance which could have given rise to such a waiver took place in early January 2013. There is no evidence that USS knew that USSC was insolvent, and therefore that an event of default had occurred, at or prior to the time of any such advances. Second, as a legal matter, the language of the Revolver Loan Agreement excluded the operation of a waiver in October 2013 based on previous conduct on two grounds. The provisions of section 7 of the Revolver Loan Agreement require that, to be effective, any waiver must be in writing, which would exclude entirely the possibility of an unwritten waiver based on a course of conduct. In addition, section 7 expressly negates the operation of a waiver based on the granting of a previous waiver. Third, in any event, as a practical matter, there can be no doubt that, as between USS and USSC, USSC would have understood that no course of conduct by USS could have given rise to a waiver of USS' rights to determine the availability of funding under the Revolver Loan Agreement, as described above.

404 Second, the Objecting Parties submit that USSC did not, in fact, provide consideration in the form of a commitment to advance further funds under the Revolver Loan. They base this argument on the fact that McQuade testified that he was never expressly advised by any USS representative that USS would refrain from advancing funds unless the October Security Agreement was signed. They also rely upon the fact that USS did not declare an event of default in October 2013.

405 I do not accept this argument for the following reasons. By acceding to USS' position with full knowledge that USS was taking the position that it was entitled to withhold future advances, USSC must be taken to have accepted USS' legal position. In this regard, it is clear that McQuade understood that execution of the October Security Agreement was a condition of the further advance of funds to USSC at the time he signed the Third Revolver Amendment and the October Security Agreement, notwithstanding the absence of any direct conversation on the matter with any USS representative. Further, McQuade's determination that execution of the October Security Agreement was in the best interests of USSC was expressly made on the basis of his understanding that USSC needed the advances to continue to meet its obligations and that USSC would only receive the further advances if it consented to the security.

406 Accordingly, while McQuade says he believed that USS was obligated to fund under the Revolver Loan Agreement up to the limit of availability, he also knew that USS was taking the position that it was entitled to withhold funding under the Agreement until it received security for any further advances. McQuade did not challenge this legal position on behalf of USSC. Instead, USSC agreed to provide the security. In these circumstances, it was not necessary for USS

to declare an event of default as a formal matter to assert its legal position. More importantly, in the absence of a determination at the time regarding the right of USS to withhold further advances, the decision of USSC to provide security must constitute acceptance of such legal right of USS.

407 Lastly, the Objecting Parties say that, as a practical matter, USS was never going to stop advancing funds in October 2013 for reasons relating to the operational impact on USS and USSC as well as the potential triggering of cross-default provisions on the USS public debt. Whether or not this is true, I do not think it demonstrates an absence of legal consideration for the following reasons. First, the absence of a legal obligation to advance further funds is by itself sufficient to give rise to consideration. Second, the grant of security by USSC forecloses this argument as it become entirely speculative. The position of the Objecting Parties requires the Court to make a determination that, in the hypothetical situation in which USSC refused to provide the required security, USS would necessarily have advanced the monies comprising the Second Tranche Indebtedness. I do not think the Court could make such a determination on the limited evidence before it. Among other things, in order to make such a determination, the Court would need to address the other options that would have been available to USS in such circumstances, including a filing under the CCAA and DIP financing, which was raised at the time by the financial advisors to USS.Based on the foregoing, I do not accept the position of the Objecting Parties that the security constituted by the October Security Agreement is unenforceable for lack of consideration.

408 For completeness, USS also argues that it gave consideration in the form of a forbearance from declaring a default, accelerating the Revolver Loan or instituting insolvency proceedings. These arguments also turn, at least in part, on the Court's acceptance of the contractual interpretation of the "unable to meet debts" event of default proposed in the Di Massa Report. Given the determination herein regarding consideration for the October Security Agreement, it is not necessary to address these potential additional sources of consideration, and I therefore decline to make a finding on these issues.

Alleged Fraudulent Preference

409 In the alternative, if the October Security Agreement is held to be enforceable, the Objecting Parties submit that the Agreement constituted a fraudulent preference for the purpose of section 95(1)(b) of the BIA, as incorporated into the CCAA by the provisions of section 36.1 thereof. It is not disputed that the Objecting Parties bear the onus of proof in respect of this Objection.

410 The provisions of section 95 of the BIA have been set out above. To succeed in this proceeding, the Objecting Parties must demonstrate: (1) a non-arm's length relationship between USSC and USS at the time of entering into the October Security Agreement; (2) that USSC was insolvent at the time of entering into the October Security Agreement; (3) that the October Security Agreement was entered into within twelve months of the Filing Date; and (4) that the October Security Agreement had the effect of giving USS, or more particularly Credit Corp as the lender under the Revolver Loan, a preference over other unsecured creditors at the date of delivery of October Security Agreement. There is no dispute that Credit Corp was not dealing at arm's length with USSC, that USSC was insolvent on and after October 30, 2013, and that the grant of security in favour of Credit Corp occurred less than one year prior to the Filing Date.

411 USS argues, however, that the granting of security in the October Security Agreement did not give rise to a preference over another creditor entitling the Objecting Parties to relief under section 95 of the BIA. It bases this argument on the fact that the security in favour of Credit Corp is only being asserted in respect of advances made under the Revolver Loan after October 30, 2013, that is, in respect of the Second Tranche Indebtedness. USS bases its argument on the principle that there is no preference under section 95 if, and to the extent that, security is granted by a debtor company in respect of fresh advances which are used in the ongoing operations of the debtor company: see *McAsphalt Industries Ltd. v. Six Paws Investments Ltd.*, [1995] O.J. No. 2450 (Ont. C.A.), at para. 19.

412 The Objecting Parties make two submissions.

413 The principal submission of the Objecting Parties is that the October Security Agreement constituted a fraudulent preference because Credit Corp obtained security in circumstances in which it was obligated to advance monies under the Revolver Loan Agreement. They say that, if Credit Corp had an unqualified obligation to advance monies under the Revolver Loan as and when requested by USSC up to such limit, delivery of the October Security Agreement would have constituted a fraudulent preference on the basis that delivery of security in such circumstances would be similar to providing security for past debts. This argument turns on the question of the extent to which Credit Corp was legally obligated to advance funds to USSC up to the limit of availability under the Revolver Loan Agreement as and when requested by USSC. It is a novel argument that could only arise, as a practical matter, in a non-arm's length situation.

414 I have reservations regarding the merits of this argument as a matter of law. However, it is not necessary to determine the issue the alleged fraudulent preference on this basis. I have concluded above, in the context of the determination that USS provided consideration for the grant of the October Security Agreement, that Credit Corp was not obligated to advance further funds under the Revolver Loan Agreement. On this basis, this argument of the Objecting Parties cannot succeed.

415 The alternative argument of the Objecting Parties is that the security in favour of Credit Corp under the October Security Agreement must fail in its entirety to the extent that the October Security Agreement purports to secure a pre-existing debt. They rely on *Fulton (No. 2), Re*, [1926] O.J. No. 115 (Ont. C.A.), at para. 7, for this proposition.

416 I accept that the granting of security for existing or past indebtedness constitutes a preference for the purpose of section 95 of the BIA. However, USS is not asserting a secured claim in respect of any such obligations in this proceeding, notwithstanding that the definition of "Secured Obligations" in the October Security Agreement extends to pre-existing indebtedness.

417 In such circumstances, the Court of Appeal made it clear in *McAsphalt*, at para. 19, that "a security may be bad in respect to some advances, but enforceable in respect to others, thus protecting payments made by an insolvent company which would otherwise be preferential." In that case, the evidence indicated that the fresh advances at issue were used in the on-going operations of the company. On that basis, the Court of Appeal held that the repayment of the advances did not constitute a fraudulent preference.

418 In my opinion, the same principle operates in the present circumstances. There is no dispute that the advances comprising the Second Tranche Indebtedness were used in the on-going operations of USSC's business. The advances under the Revolver Loan after October 30, 2013 therefore benefitted the unsecured creditors as of the date of such advances. This factual context is sufficient under the case law to exclude a finding of a fraudulent preference under section 36.1 of the CCAA and section 95 of the BIA.

419 The decision in *Fulton* does not assist the Objecting Parties for the reason that the circumstances in *Fulton* were qualitatively different from the present circumstances. *Fulton* involved advances under a chattel mortgage totaling $3,800, of which $2,200 represented a new advance after the date of the chattel mortgage. The mortgage purported to secure the existing obligation as well as the new advance. The security was declared invalid in respect of both advances. However, there was a significant issue with the new advance that explains the result in that decision. The Court of Appeal expressly held that there was "no doubt that the $2,200 did not in fact increase the assets of the estate in any tangible way." In fact, the court concluded that there was no evidence regarding what became of the $2,200. Accordingly, the security failed in its entirety because the new advance could not be demonstrated to have been used in the operations of the debtor, not because the mortgage also purported to secure a past advance.

420 Based on the foregoing, I conclude that there is no basis for a finding that the delivery of the October Security Agreement constituted the grant of a fraudulent preference by USSC in favour of Credit Corp insofar as the security constituted thereby secured the Second Tranche Indebtedness.

Conclusion Regarding the Second Tranche Indebtedness

421 Based on the foregoing, I conclude that Claim #11, being the claim in respect of the Second Tranche Indebtedness under the Revolver Loan, constitutes a debt claim, rather than an "equity claim", which is a Secured Claim for the purpose of this CCAA proceeding.

Remaining USS Secured Claims

422 As mentioned, the Objecting Parties also submit that the security for the Remaining USS Claims (being Claims #11(a), 11(b) and 11(c)), should be invalidated on the grounds that the security for such Claims, being the November Security Agreement, is either unenforceable as a matter of contract law for lack of consideration at the time it was executed and delivered by USSC or void as constituting a fraudulent preference for the purposes of section 95(1)(b) of the BIA. The Objecting Parties do not dispute the quantum of any of these three Claims nor do they suggest that these Claims are "equity claims". For completeness, the Objecting Parties also submitted that the November Security Agreement cannot be an enforceable obligation to the extent that the Court were to find that the October Security Agreement was unenforceable. Given the determination above, it is not necessary to address this submission.

423 I propose to address the issues pertaining to the Remaining USS Secured Claims in the following order. First, I will describe the nature of the November Security Agreement. Then I will address the issues pertaining to Claim #11(c) (Intercompany Goods & Services), which relates to the provision of goods and services by USS to USSC prior to the Initial Order. Lastly, I will address the issues pertaining to Claim #11(a) (the Cliffs Transaction) and Claim #11(b) (Credit Support Payments), which involve different considerations, as these claims arose after the Filing Date.

The November Security Agreement

424 On November 12, 2013, Credit Corp, USSC, USS, United States Steel International, Inc. and SHC executed a further amendment and restatement of the October Security Agreement that provided security to each of USS, United States Steel International, Inc. and SHC (collectively, the "USS Affiliates") in respect of the provision of intercompany goods and services on credit by any of them to USSC (as so amended, the "November Security Agreement") in addition to, and alongside, the security already provided to Credit Corp in respect of advances under the Revolver Loan pursuant to the October Security Agreement.

425 The November Security Agreement contains recitals to the effect that each USS Affiliate sells "Goods" to USSC pursuant to arrangements and agreements, defined for such purposes as the "Sales Agreements", as between the USS Affiliates and USSC, that the USS Affiliates have determined that, in light of USSC's financial position and credit worthiness, they "no longer wish to sell Goods to the Debtor on terms other than cash in advance or cash on delivery, unless the Debtor provides acceptable financial accommodations" and that, "upon the Debtor's request, the [USS Affiliates] are willing to continue to sell Goods to the Debtor on credit...provided that the Debtor secures its obligations to pay for such Goods pursuant to the terms of the [November Security Agreement]". I would note that the definition of "Goods" for purposes of the November Security Agreement is "materials, goods and other products (including inventory and raw materials)".

426 The extension of security to the USS Affiliates was implemented by adding the USS Affiliates as parties to the October Security Agreement, providing that such parties were "Secured Parties" for purposes of such Agreement, and amending the definition of "Secured Obligations" to read as follows:

> ...all obligations, duties, indebtedness and liabilities of the Debtor from time to time owing by the Debtor to any Secured Party including, without limitation, obligations, duties, indebtedness and liabilities arising under, or in connection with: (i) the Loan Agreement; (ii) any amendment or restatement of the Loan Agreement, including any such amendment or restatement which increases or decreases the maximum amount of Loans and other obligations that may be made by Secured Party to Debtor thereunder; (iii) this Agreement; (iv) all obligations arising out of, in connection with or relating to the Sales Agreements or the sale of Goods by any USS Seller to the Debtor at any time and from time to time; and (v) any other document made, delivered or given in connection with any of

the foregoing; in each case whether now existing or hereafter arising, whether evidenced by a note or other writing, whether allowed in any bankruptcy, insolvency, receivership or other similar proceedings, whether arising from an extension of credit, issuance of a letter of credit, acceptance, loan, guarantee, indemnification or otherwise, and whether direct or indirect, absolute or contingent, due or to become due, primary or secondary, or joint or several.

427 By virtue of the definition of "Secured Obligations", therefore, all obligations owing by USSC to Credit Corp under the Revolver Loan Agreement, or to any of the USS Affiliates in respect of the sale of Goods, were entitled to the benefit of the general security interest granted by USSC in the Security Agreement, as amended and restated by the October Agreement and the November Security Agreement.

428 I would also note that the first advance comprising the Second Tranche Indebtedness was made at the time that the October Security Agreement was in force and that the two later advances were apparently made after the November Security Agreement came into force. However, it is not disputed that the same security interest was continued under the November Security Agreement. I would also note that the parties addressed the validity of the security for the Second Tranche Indebtedness, and the existence of a fraudulent preference in respect of the granting of security for the Second Tranche Indebtedness, in the context of the October Security Agreement rather than the November Security Agreement. As the Objecting Parties have not raised any additional issues in respect of the Second Tranche Indebtedness pertaining to the November Security Agreement, I have proceeded on the basis that such Indebtedness is secured thereunder the extent that the security for the Second Tranche Indebtedness under the October Security Agreement is not invalidated for one of the reasons discussed above.

The Intercompany Trade Claim - Claim #11 (c)

429 As mentioned, the Objecting Parties argue that the security for this Claim is either unenforceable for want of consideration from the USS Affiliates with respect to the November Security Agreement or void on the basis that the grant of the November Security Agreement constituted a fraudulent preference. I will address each issue in turn. I note that there is no issue regarding the fair market value of the goods and services relating to this Claim.

Alleged Unenforceability of the November Security Agreement

430 The principles regarding the requirement for consideration in respect of the grant of a security interest in a security agreement have been addressed above in respect of the October Security Agreement. I do not propose to repeat that discussion in this section. As applied to the November Security Agreement, I reach the following conclusions.

431 First, for the reasons set out above, I do not think that consideration is required for the grant of the security interest in the November Security Agreement.

432 Further, to the extent that consideration is required to enforce the security constituted by the November Security Agreement, I find that consideration was given for the November Security Agreement, as verified in the recitals in the Agreement and acknowledged by all the parties. In particular, the recitals to the November Security Agreement reflect the grant of consideration from the USS Affiliates in the form of a commitment to continue to provide the goods and services that are the subject of this Claim. The position of the USS Affiliates was made clear to McQuade before he executed the November Security Agreement on behalf of USSC. There is no evidence before the Court that would indicate that the USS Affiliates lacked the legal right to refuse to provide such goods and services if USSC had refused to provide the security. Insofar as the Objecting Parties suggest that the USS Affiliates were not going to stop providing these services, as a practical matter, I consider that the reasoning and conclusions reached in respect of the comparable argument made regarding the security for the Second Tranche Indebtedness is equally applicable in this context.

433 In addition, any lack of consideration was cured by the delivery and provision by the USS Affiliates of the goods and services in respect of Claim #11(c). I note that such delivery is the substantive equivalent of an advance of funds to be used in the operations of USSC to acquire such goods and services. If USS had advanced the purchase price of such goods and services to USSC under the Revolver Loan for the purpose of payment of such obligations, such advances

would have been secured pursuant to the October Security Agreement based on the conclusion reached above. There is no principled reason why the result would differ because the USS Affiliates provided goods and services rather than advanced funds for such purposes.

434 Accordingly, I conclude that the November Security Agreement is not unenforceable in respect of the amounts constituting Claim #11(c) for lack of consideration from the USS Affiliates to USSC.

Alleged Fraudulent Preference

435 The principles regarding the operation of section 95(1)(b) of the BIA have also been set out above. As discussed above, there is no evidence before the Court that the USS Affiliates were legally obligated to continue to provide the goods and services that are the basis for this Claim. The security constituted by the November Security Agreement was given in respect of a the provision of additional goods and services that would not otherwise have been provided to USSC. Accordingly, for the reasons set out above, I conclude that the grant of the security under by the November Security Agreement in favour of the USS Affiliates did not constitute a fraudulent preference in their favour for the purposes of section 95.

436 Further, as stated above, the delivery and provision of the goods and services in respect of Claim #11(c) represents the substantive equivalent of a fresh advance of funds to USSC to be used in the operation of its business. On this basis, the grant of security in respect of the delivery and provision of such goods and services did not prejudice the unsecured creditors of USSC as of the date of delivery of the November Security Agreement or the date of the delivery or provision of such goods and services and does not constitute a fraudulent preference.

437 Based on the foregoing, I conclude there is no basis for a finding that the delivery of the November Security Agreement by the USS Affiliates in respect of Claim #11(c) constituted the grant of a fraudulent preference by USSC in favour of such parties.

The Cliffs Transaction Claim and the Credit Support Payments Claim — Claims #11(a) and #(b)

438 The claims for the Cliffs transaction and the credit support payments each arose after the Filing Date in the following circumstances.

439 USSC took delivery from Cliffs of the iron ore that is the subject of the Cliffs transaction prior to the Filing Date. However, USS was not in a position to sell the iron ore to USSC until it had paid Cliffs. Because USS did not pay for the iron ore until after the Filing Date, its claim against USSC for payment of the iron ore arose after the Filing Date.

440 USSC incurred the third-party obligations that are the basis of the credit support payments claim prior to the Filing Date but had not paid them as of that date. Because USS paid such claims pursuant to its guarantees in favour of such third parties after the Filing Date, its claim against USSC in respect of these payments also arose after the Filing Date.

441 I will address each of these claims in turn.

The Cliffs Transaction — Claim #11(a)

442 The Objecting Parties argue that the security for this Claim constituted by the November Security Agreement is either unenforceable or void as a fraudulent preference on the same grounds upon which they rely in respect of Claim #11(c). In addition, they argue that this claim is a pre-filing claim that is no different from all other trade creditor claims outstanding on the Filing Date. They argue that the effect of the November Security Agreement is to elevate improperly an unsecured pre-filing claim into a secured claim.

443 This Claim involves the sale of goods by USS to USSC and is therefore similar as a factual matter to the circumstances in Claim #11(c). I conclude that the principles that governed the determinations with respect to Claim #11(c) regarding the issues of consideration for the November Security Agreement and the alleged fraudulent

preference are equally applicable in the present situation, with the following additional consideration which reinforces the conclusions therein.

444 In the case of this Claim, the Iron Ore Agreement specifically evidences fresh consideration for the grant of security pursuant to the November Security Agreement. While it is correct that USS was obligated to pay Cliffs under its agreement with Cliffs, as the Objecting Parties say, there is no evidence that USS was legally obligated to sell the iron ore to USSC once it acquired title to the ore. USS could have required that USSC deliver up possession of the iron ore to it. Instead, USS and USSC entered into a fresh agreement regarding the purchase by USSC of the iron ore at a time when USSC was independently represented. The Iron Ore Agreement provided that USSC's obligation to pay for such iron ore, when it arose, would be a "Secured Obligation" for purposes of the November Security Agreement, in return for USS' agreement effectively to sell USSC its interest in the iron ore and to pay Cliffs the purchase price of the ore on behalf of USSC.

445 Such circumstances are sufficient to satisfy any requirement for the demonstration of consideration for the grant of security pursuant to the November Security Agreement in respect of the purchase price obligation of USSC and to negate any fraudulent preference upon the grant of such security for such obligation.

446 I would add that, in the case of this claim, USSC expressly agreed to the secured treatment of the purchase price obligation prior to such obligation coming into existence. As such, the circumstances do not involve the transformation of a pre-filing unsecured claim into a post-filing secured claim.

The Credit Support Payments Claim — Claim #11(b)

447 As discussed above, USS paid these obligations pursuant to guarantees established in favour of the third-party creditors. It asserts Claim #11(b) against USSC pursuant to its rights of subrogation. USS submits that such rights of subrogation constitute "Secured Obligations" for the purposes of the November Security Agreement and, accordingly, rank ahead of all other trade creditors. If these credit support payments are secured, a consequence would be that the unsecured, pre-filing claims of the third party-creditors have become secured, post-filing claims of USS without any involvement of the Monitor or the Court pursuant to the provisions of section 10 of the Initial Order, which would otherwise govern the payment of pre-filing obligations.

448 The Objecting Parties argue that the security for this Claim constituted by the November Security Agreement is either unenforceable or void as a fraudulent preference on the same grounds upon which they rely in respect of Claims #11(a) and #11(c).

449 After a review of the documentation pertaining to this Claim, I think there is a threshold issue of whether the USS subrogation rights at issue qualify as "Secured Obligations" under the November Security Agreement. This issue was not, however, raised directly in the submissions of the parties. The parties should therefore be given an opportunity to make submissions regarding this threshold issue to the extent they wish to do so.

450 Accordingly, I do not propose to address the determination of the issues pertaining to this Claim at this time. If the parties are unable to agree on a schedule for submissions on the threshold issue, they should contact the Court to arrange a telephone case conference at their convenience.

Conclusions

451 he USS Claims referenced as Claims #1-8 inclusive in the Monitor's Third Report are not disputed in this proceeding and are therefore confirmed as unsecured Claims under the Claims Process Order. Based on the foregoing, the USS Claims referenced in such Report as Claims #9 and #10 are also confirmed as unsecured Claims under the Claims Process Order and Claims #11, #11(a) and #11(c) are confirmed as Secured Claims. The USS Claim referenced in the Report as Claim #11(b) remains to be determined.

Order accordingly.

End of Document

TAB 2

1967 CarswellOnt 125
Ontario Court of Appeal

Royal Bank v. Kiska

1967 CarswellOnt 125, [1967] 2 O.R. 379, [1967] O.J. No. 1028, 63 D.L.R. (2d) 582

Royal Bank of Canada v. Kiska

Kelly, McLennan and Laskin, JJ.A.

Judgment: June 28, 1967

Counsel: *S. G. Fisher*, for appellant.
Dennis F. O'Leary, Q.C., for respondent.

Subject: Contracts

Headnote
Statute of Frauds --- Application of statute — Contracts of guarantee

Guarantee of brother's indebtedness — Whether forbearance to sue brother constituting valuable consideration -- Memorandum in writing — Statute of Frauds, R.S.O. 1960, c. 381, s. 4.

Defendant signed a guarantee on Bank's printed form guaranteeing up to a certain amount his brother's indebtedness to Bank, as Bank was threatening action against his brother. The document had no seal, merely the printed word "seal" in brackets. Some time later when defendant again went to Bank about his brother's indebtedness he defaced the guarantee but, when the police were called, executed another in their presence. When Bank sued defendant on the guarantees, the defence was that the first guarantee was not under seal and Bank gave no consideration, while the second was void as obtained by duress. The action was dismissed at trial. On appeal, held, (Laskin J.A. dissenting), the appeal should be allowed. The first guarantee was unaffected by its unlawful destruction and was still in effect but, assuming that there was no seal, required consideration. While it contained no promise to forbear taking action against defendant's brother, there was in effect such a promise offered which was in fact extended when Bank took no action for a considerable time. This constituted a valuable consideration and completed the contract, which was then enforceable against defendant. The forbearance did not need to be for any definite time, so long as an implied request for forbearance could be inferred from the circumstances and it was in fact extended for a reasonable time. Treating the forbearance as a detriment suffered by Bank, it was immaterial that the direct benefit of the forbearance accrued to someone other than defendant. The guarantee having been signed by defendant was a sufficient memorandum to satisfy s. 4 of the Act. If the second guarantee was a nullity as signed under duress, that did not affect the first guarantee.

***Kelly, J.A.*:**

1 Although the question of law involved in this case is not uncommon, the facts are sufficiently unusual to warrant recounting in detail.

2 The defendant is a young man who attained his majority on March 16, 1963. At and prior to this time he, along with two partners, had been engaged in business under the name of Pee-Wee Pizzeria. His brother John, who is older by 15 years, conducted a hairdressing business, of which the plaintiff was the banker; in connection with credit extended

by the plaintiff to the brother the plaintiff held a demand note for $6,000 and certain securities which had been pledged to the plaintiff by the brother.

3 As a result of continued importuning of his brother, the defendant, sometime shortly after March 16, 1963, went to the plaintiff's Gage and Mohawk Branch in the City of Hamilton and there signed a document in the form of a guarantee to the extent of $3,000 of the brother's indebtedness to the bank. This will be referred to as the "first guarantee".

4 The defendant was aware that the plaintiff was threatening to realize upon the security it held for the brother's indebtedness and that the first guarantee was intended to obligate him to the plaintiff. He believed, though not as a result of anything communicated to him by the plaintiff, that the security held by the plaintiff was sufficient to satisfy the plaintiff's claim against the brother and that he himself would not be called upon to pay anything.

5 At the time he wrote his name on the first guarantee no wafer seal was affixed to it; the word "seal" in brackets was printed upon the document immediately to the right of the space in which his signature was written and an attesting witness signed his name.

6 Late in May, 1963, the defendant was requested to go to the same branch office to discuss a programme of payments to reduce or discharge the brother's indebtedness. When he realized that the security, other than his guarantee, held by the plaintiff was not adequate to discharge the brother's indebtedness, the defendant became upset and, in the belief that without his signature the first guarantee would not be enforceable, tore from the guarantee and swallowed the portion bearing his signature. Having been told that the witness could prove that his signature had been on the document, the plaintiff tore off a further portion of paper upon which the witness' signature appeared and swallowed that also. The police were immediately called and while they were present a new form of guarantee, ex. 1, was signed by the plaintiff. To distinguish this from the first guarantee, I will refer to the document signed under these conditions, ex. 1, as the "second guarantee". The second guarantee was on the plaintiff's printed form identical with the first guarantee: on the occasion of signing the second guarantee a red wafer seal had been affixed to it before the defendant wrote his signature, and the signature had been properly witnessed.

7 On June 7, 1963, to the brother's account with the plaintiff was credited the sum of $2,729.56, the proceeds of the sale of some of the pledged securities above referred to. Thereafter, between July 31, 1963, and September 1, 1964, the defendant made eight payments of $25 each which were allocated to the reduction of the amount claimed by the plaintiff to be due to it by him. In February, 1965, this action was instituted.

8 The defendant raised two principal defences:

(i) that the first guarantee was not under seal and that the plaintiff gave no consideration for it;

(ii) that the execution of the second guarantee was procured by duress.

9 It is admitted by the defendant that the first guarantee was unlawfully destroyed by him; that such destruction did not constitute a cancellation or rescission of his obligation; that his rights are to be determined as if the destroyed document was still in existence: and that ex. 1, the second guarantee, save as to date, sets out the exact terms contained in the first guarantee destroyed.

10 The plaintiff's statement of claim was framed to charge the defendant with liability under a guarantee executed under seal; it also alleged that the plaintiff had given consideration for the signing of the guarantee. In support of his defence to this claim the defendant admitted that he had signed the first guarantee knowingly and with an awareness of its meaning, but alleged that a wafer seal had not been affixed to the document before he signed it nor affixed in his presence at the time of signing. Since circumstances surrounding the signing were advanced as a defence to the claim in respect of the document under seal, in my view they constitute admissions: the defendant in setting up this defence has exposed himself to any liability that can be supported on the facts which he alleges for the purpose of protecting himself from liability under a guarantee under seal. Had ex. 1 been executed under seal the plaintiff would have been relieved of

the onus of proving consideration. But the absence of the seal on a document admittedly signed by the defendant does not completely eradicate the document. It merely becomes inoperative as a deed: its effect for all other purposes remains.

11 In a simple contract situation, it is the mutuality of the parties in settling their respective rights and obligations which gives rise to the contract's binding effect and its enforceability: the *quid pro quo* is that without which the obligation which one party is prepared to assume, remains the gratuitous willingness to assume a burden, a gift, something the enforcement of which cannot be compelled. But when he to whom the voluntary expression of willingness to be bound is conveyed, performs some act or forbears from some act, the performance of, or forbearance from, which was what the party making the proposal sought to accomplish, there is the required mutuality which converts the promise offered gratuitously into an enforceable obligation.

12 For the purpose of dealing with the defence of lack of consideration, I am assuming, without deciding, that the first guarantee was not executed under seal and that the second guarantee was signed under duress.

13 The particular facts which are relevant to this phase of the defence are as follows:

> The business of John Kiska was being operated by virtue of the extension of credit to him by the plaintiff.
>
> The brother had approached the defendant repeatedly urging the defendant to give to the plaintiff his (the defendant's) guarantee to forestall undesired action by the plaintiff.
>
> The plaintiff at the time of the signing of the first guarantee was in a position:
>
> > (i) to cut off the brother's ability to do business upon the credit of the plaintiff;
> >
> > (ii) to realize upon its security by the sale thereof;
> >
> > (iii) to sue the brother for his debit balance.
>
> The defendant without any communication to him by the plaintiff, other than through the medium of the brother, attended at the plaintiff's place of business and signed the first guarantee: this was sometime shortly after his 21st birthday which occurred on March 16, 1963.
>
> On May 30, 1963, the defendant went to the plaintiff's branch office at the request of the plaintiff's manager Brook to discuss a programme of payments to meet his guarantee of the brother's account. On this occasion the defendant destroyed the first guarantee signed in March and signed ex. 1, the second guarantee, in substitution therefor.
>
> From the statement of the account of the brother with the plaintiff, ex. 3(a), produced by the witness Brook, it must be inferred that the plaintiff did not realize upon the security deposited with it by the brother till June 7, 1963, the date upon which, according to that exhibit, there was credited to the brother's account $2,729.56, identified as "paid on account via Investors Syndicate — redemption of Contract".

14 The learned trial Judge in his reasons for judgment dealt with this defence in the following words:

> There was no evidence adduced that any promises or offers to forbear in the prosecution of a civil action against Joseph Kiska or promise or offer to forbear on the realizing of the security held by the bank was made to the defendant by the bank; nor is there evidence that the bank truly intended to take action or realize on the securities. Forbearance being the only consideration alleged, and there having been no evidence of forbearance, there is no evidence of consideration passing from the plaintiff to his defendant.

15 I look upon the concluding sentence of this quotation not as a finding of fact which, as such, I would be loath to disturb, but as a conclusion of law arrived at due to an erroneous view as to the legal consequence of the facts and inferences to be drawn from them.

16 The denial of consideration for the promise is twofold. First, that the plaintiff gave no promise nor did any act which could be qualified as consideration — second, even granted that the plaintiff did some act which, if it conferred some benefit on the defendant, would have constituted consideration, that consideration did not pass from the plaintiff to the defendant but to the defendant's brother.

17 In setting up the absence of any promise to extend time or to forbear from pursuing its remedies against the brother the defendant seeks to treat the relationship between himself and the plaintiff as if the defendant had been prepared to agree to guarantee his brother's indebtedness in return for the plaintiff agreeing to extend time or agreeing to forbear, *i.e.*, the offer of a promise for a promise. If this were the nature of the arrangement the defendant had intended to enter into, his defence would have been effective since the plaintiff does not contend that it agreed to extend time or agreed to any act of forbearance. The first guarantee, if it be treated as a contract complete on its face, does not contain any agreement or engagement on the part of the plaintiff which could have been enforced by the defendant in an action against the plaintiff. Its essential operative words are to be found in the opening paragraph whereby the defendant guarantees the indebtedness of the brother to the plaintiff. The balance of the documents sets out the terms and conditions applicable to that guarantee, some by way of restriction upon the rights which would otherwise accrue to the plaintiff by reason of the defendant becoming a guarantor, and some by way of limitation on the obligation which the plaintiff would otherwise owe to the defendant as a guarantor.

18 At the time the first guarantee was signed and given to the plaintiff's employee it was an expression of what the defendant was prepared to do in order to induce the plaintiff to accord some benefit to the brother or to incur some detriment to itself relative to the brother's indebtedness.

19 Reduced to its simplest terms, what took place was this. The first guarantee signed by the defendant, even though not a contract under seal, was an offer of what the defendant was prepared to do in exchange for future action on the part of the plaintiff and was offered to the plaintiff for the purpose of inducing the plaintiff to do some act or refrain from doing some act. At the time the defendant made this offer the plaintiff could have (a) ceased to deal with the brother; (b) demanded repayment and sued to recover the amount due to it by the brother, and (c) realized upon the other security held by it. The defendant's offer was made on or about March 16, 1963, and was not withdrawn down to the date of the institution of this action on or about February 25, 1965. Subsequent to March 16, 1963, the plaintiff for two and a half months refrained from realizing upon the security it held. For an even longer period, at least down to September 17, 1964, when the brother made an assignment in bankruptcy, the plaintiff refrained from instituting action to recover from the brother the money due to it. It is obvious that some forbearance did occur after the offer was made. It is a reasonable inference from the conduct of the plaintiff that there was forbearance. There is evidence of forbearance apart from that to be inferred from the conduct of the plaintiff. The defendant in those parts of his examination for discovery which were read into the record at the trial, admitted that, on the occasion when he signed the guarantee, he went to the plaintiff's place of business at his brother's urging and that the brother had told him, if he did not go, the plaintiff was going to sell "the shares and insurance that they had there". Looking upon the guarantee at no higher than a promise offered for an act of forbearance, unless the offer be withdrawn before the act be performed, upon the performance of the act of forbearance the contract was complete and enforceable against the defendant.

20 The following passage from the judgment of Jessel, M.R., in *Re Barker's Estate* (1875), 44 L.J. Ch. 487 at p. 490:

> In the case of further security, the lender gives time and forbearance, or he gives some other advantage to the person giving the further security, and that is valuable consideration. But if, without that, after the voluntary instrument has been executed, its contents are communicated to the person taking the benefit of it, and acting upon the faith of it he does substantially alter his position, that is, he does communicate to the donor his acceptance of the further security, and by so doing he gives value to the donor, being the value which the donor expected him to give, he has, in fact, accepted the voluntary instrument as a consideration for the action he takes upon the faith of it. In that way it comes back again really to contract, and upon that ground it is that the Courts have refused to disturb voluntary deeds where consideration has been given for them, so to say, *ex post facto*.

21 It was further argued that since there was not an agreement by the plaintiff to forbear for a specified time there was no consideration. On this point the authorities are clear. In *Alliance Bank Ltd. v. Broom* (1864), 2 Dr. & Sm. 289, 62 E.R. 631, 34 L.J. Ch. 256, 143 R.R. 120, there had been a demand by the plaintiff for payment and a promise by the defendant to give security. This promise the defendant had not carried out and the action was to enforce the giving of the promised security. The question before the Court was stated by Kindersley, V.-C. to be "whether there must be a promise on the part of the plaintiffs to abstain from bringing an action in order to constitute a valid consideration" [p. 122 R.R.]. In holding in favour of the plaintiff the Vice-Chancellor said at p. 292 Dr. & Sm.:

> It appears to me that, when the Plaintiffs demanded payment of their debt, and, in consequence of that application the Defendant agreed to give certain security, although there was no promise on the part of the Plaintiffs to abstain for any certain time from suing for the debt, the effect was, that the Plaintiffs did in effect give, and the Defendant received, the benefit of some degree of forbearance; not, indeed, for any definite time, but, at all events, some extent of forbearance. If, on the application for security being made, the Defendant had refused to give any security at all, the consequence certainly would have been that the creditor would have demanded payment of the debt, and have taken steps to enforce it. It is very true that, at any time after the promise, the creditor might have insisted on payment of his debt, and have brought an action; but the circumstances necessarily involve the benefit to the debtor of a certain amount of forbearance, which he would not have derived if he had not made the agreement.

22 This case was approved by the House of Lords in *Fullerton v. Provincial Bank of Ireland*, [1903] A.C. 309, where at pp. 313-4, Lord Macnaghten said:

> My Lords, this point seems to me to be settled by authority. In such a case as this it is not necessary that there should be an arrangement for forbearance for any definite or particular time. It is quite enough if you can infer from the surrounding circumstances that there was an implied request for forbearance for a time, and that forbearance for a reasonable time was in fact extended to the person who asked for it. That proposition seems to me to be established by the case of *Alliance Bank v. Broom* (1864), 2 Dr. & S. 289, to which my noble and learned friend Lord Lindley referred yesterday, and other cases, among which I may mention *Oldershaw v. King* (1857), 2 H. & N. 517, with the observations on that case and the case in Drewry and Smale, by Bowen L.J. in *Miles v. New Zealand Alford Estate Co.* (1886), 32 Ch. D. 289, and I may add that the proposition seems to be good sense.

23 I have to this point dealt with the general question as to whether forbearance as distinguished from a promise to forbear can be consideration. It remains to consider whether the forbearance must enure directly to the benefit of the guarantor or whether, as in this case, the forbearance in favour of the brother may be adequate consideration. I do not consider that the legal consequences resulting from the fact that the plaintiff abstained from taking action against the brother are any different from what they would have been if the plaintiff had refrained from taking action against the defendant. In circumstances similar to those prevailing in this case there is consideration if the promisee has conferred a benefit on the promisor in return for which the promisor's promise is given or if the promisee has incurred a detriment for which the promise was to compensate. If here, consideration be found in the detriment suffered by the plaintiff, it is immaterial to that issue that the direct benefit of the plaintiff's forbearance accrue to one other than the defendant. This proposition was laid down in *Morley v. Boothby* (1825), 3 Bing. 107, 130 E.R. 455, and has been supported ever since. That was a case of guarantee and Best, C.J., at p. 113 said:

> No court of common law has ever said that there should be a consideration directly between the persons giving and receiving the guaranty. It is enough if the person for whom the guarantor becomes surety has benefit, or the person to whom the guaranty is given suffer inconvenience, as an inducement to the surety to become guaranty for the principal debtor.

24 I therefore concluded that the forbearance shown by the plaintiff in pursuing the remedies against the brother available to it constitutes consideration.

25 The plaintiff's action being one "to charge the defendant upon a special promise to answer for the debt, default or miscarriage of another person", would not be maintainable unless there be some note or memorandum in writing signed by the party to be charged. Even though the first guarantee be not executed under seal either one satisfies the requirements of s. 4 of the *Statute of Frauds*, R.S.O. 1960, c. 381.

26 Being of the opinion that there was consideration for the first guarantee of the brother's indebtedness to the plaintiff and that there was a sufficient note or memorandum to forestall the operation of the *Statute of Frauds*, it is not necessary to consider what may be the rights of the parties under the second guarantee. If, as alleged, it be a nullity due to its execution having been obtained by duress, it can have no effect on the enforceability of the first guarantee.

27 I would allow the appeal with costs, set aside judgment below and direct that, in its place, judgment be entered for the plaintiff for the amount claimed in the writ of summons, with costs.

***McLennan, J.A.*, agrees with Kelly, J.A.:**

***Laskin, J.A.* (dissenting):**

28 The law is clear, even trite, that a promise of forbearance for no defined period is sufficient consideration for a guarantee of a third person's indebtedness to the promisor and that the guarantee, where given in writing, is enforceable against the guarantor although the benefit of the promise runs to the principal debtor only. Counsel for the respondent, the alleged guarantor in this case, did not challenge these propositions. He has in his favour the finding of the trial Judge on the evidence that there was no promise of forbearance by the plaintiff bank, and the further finding or conclusion that the document on which the bank's action is founded was not executed by the defendant under seal. I agree with these findings (which were, of course, strongly attacked by counsel for the bank), and they suffice to support dismissal of the action; but in deference to the submissions that were made on both sides I propose to make my own examination of the two main issues on which the appeal proceeded.

29 It is desirable to note at the outset that the plaintiff's claim is based squarely on a written guarantee, and there is no room for any transformation of the transaction between the parties into an offer of a unilateral contract by the defendant, calling for an act of forbearance by the plaintiff. Not only is the evidence inconsistent with even any suggestion of such a unilateral contract but, if that was the transaction the plaintiff would fail for want of compliance with s. 4 of the *Statute of Frauds*, R.S.O. 1960, c. 381. The long and the short of the matter, so far as the facts are concerned, is that the defendant's brother importuned him to go to the plaintiff bank because it was threatening to sell the brother's securities to realize a debt. The defendant said on discovery that he thought the securities would bring enough to discharge the entire debt. When he went to the bank, the manager saw him at an outside counter, took a blank form from a drawer and had it completed and then presented it for execution by the defendant. No conversation of any consequence, let alone any discussion, took place at the time. What the defendant signed was a printed document, headed "Guarantee and Postponement of Claim", reciting certain terms of guarantee "for valuable consideration, receipt whereof is hereby acknowledged".

30 The recital of consideration, as between the parties, merely relieves the bank of the burden of establishing consideration where this is a necessary foundation of its claim, but it does not preclude the defendant from showing that no consideration in fact passed. There was no suggestion of further advances or anything except forbearance to sue, or more precisely, a promise thereof, as the consideration recited. In this respect, the document signed by the defendant states in para. (1) (in its relevant terms) that "The Bank may ... deal with the customer [the principal debtor] and others and with all securities as the Bank may see fit ..." There is here no promise of forbearance, and the fact that the bank may have later held its hand for a time does not help its case.

31 The plain fact is that the bank cannot have it both ways. It cannot rely on the subsequent fact of forbearance to bind the defendant (who expected but did not get a promise of forbearance in return for his guarantee) and at the same time sue the defendant on the written document. Indeed, the bank never had forbearance in mind when the defendant

signed the guarantee form. What it had in mind was to bind the defendant by a deed. In para. (13) of the document it is said (and I should note that the numbered paragraphs are declared to constitute an agreement between the defendant and the bank) that:

> This instrument covers all agreements between the parties hereto relative to this guarantee and assignment and postponement, and none of the parties shall be bound by any representation or promise made by any person relative thereto which is not embodied herein.

This is, in itself, enough to dispose of any contention of forbearance to sue. I turn, therefore, to the second and more fascinating issue, namely, whether the defendant is bound as having executed a document under seal.

32 *Non est factum* is not a factor here. Nor does anything turn on the defendant's naive belief that proof of his liability would be effectively forestalled by his tearing off and swallowing the portions of the document bearing his signature and that of the subscribing witness. Again, the fact that some payments were subsequently made by him on his brother's debt is immaterial; there is no claim made for their recovery. I should add that the execution of a second form by the defendant in the presence of the police, who were called when he ate parts of the document that he first signed, was not seriously relied upon by the bank except as to proof of the contents of the first document. It is not disputed that the terms of the two documents were identical.

33 Dealing with the case then as one for the enforcement of a gratuitous promise made under seal, the trial Judge found that when the defendant signed the document in question there was no wafer seal on it, but one was subsequently affixed by the bank manager. That particular finding was not challenged on the appeal, and, indeed, it could not be in view of the evidence: see *Ray v. Gillmore* (1957), 23 W.W.R. 527, 11 D.L.R. (2d) 443 (B.C. S.C.). It is not contended that the defendant either re-executed the document or reaffirmed his signature after the wafer seal was put on. Nor was it contended that the bank manager acted at the defendant's instance in affixing the wafer seal. As is said in *Corbin on Contracts*, vol. 1A, #241, p. 396 (1963), "One man can not bind another by attaching a seal without authority any more than he can bind him by forging his signature". I think, moreover, it is mere fiction to argue that the defendant signed the document with the intention of making it his "deed" so as to bind him to it in that character, having regard to the attestation and *testimonium* clauses. I find "intention" a strange argument addressed against this 21-year-old man who was dealt with so casually and yet so peremptorily by the bank. The proper inquiry is as to the legal consequences of his act, regardless of his intention.

34 We are in the field of formality; and so long as the doctrine of consideration subsists with its present constituents, it is commercially useful to have an alternative method of concluding a binding transaction. The formal contract under seal is not as formal today as it was in the time of Coke; apart from statute (and there is none on the subject in Ontario relevant to the present case), there has been a recognized relaxation of the ancient common law requirement of a waxed impression. (An account of the origin and development of seals will be found in *Wigmore on Evidence*, vol. VII, 3rd ed., s. 2161.) Neither wax nor an impression is any longer obligatory. A gummed wafer is enough when affixed by or acknowledged by the party executing the document on which it is placed. I would hold also that any representation of a seal made by a signatory will do. The present case is an invitation to be satisfied with less than the foregoing. We confront the question of how far we should, as a common law development, relax formality and still affirm that we are not enforcing a gratuitous promise merely because it is in writing.

35 The document put forward by the bank has the familiar words "Given under seal at . . ." and "Signed, Sealed and Delivered in the presence of." At the end of the dotted line for the signature of the executing party is the bracketed word "seal". Neither the words "Given under seal" nor the formula of "Signed, Sealed and Delivered" suffice, even when taken collectively, make a signatory chargeable under a sealed instrument when it has not in fact been executed under seal. The respective words are merely anticipatory of a formality which must be observed and are not a substitute for it. I am not tempted by any suggestion that it would be a modern and liberal view to hold that a person who signs a document that states it is under seal should be bound accordingly although there is no seal on it. I have no regret in declining to follow this path in a case where a bank thrusts a printed form under the nose of a young man for his signature. Formality

serves a purpose here and some semblance of it should be preserved, especially when it is recalled that the common law did not require either a *testimonium* or an attestation clause to make a sealed instrument enforceable; the operative act was the affixing or adoption of a seal.

36 *Mutual Fire Insurance Co. v. Palmer* (1961), 20 U.C.Q.B. 441 (C.A.), was cited to show that a different view has prevailed in this Province. There, in an action on a bond, the jury was directed that there was evidence to prove that the defendant Moore (who now alleged misdirection) had sealed the bond or had authorized it to be sealed for him. In refusing a rule *nisi* the Court said:

> We do not think that the defence is at all to be favoured which was set up on the ground that the bond was not sealed by the defendants, for that the seals which stand opposite to the signatures of two of the defendants were not affixed at the time of their signing, but were put on afterwards. We should not grant a new trial upon the statements contained on that point in the affidavits filed, for it is quite clear that the defendants all knew and understood that it was a bond which they were required to execute; and they signed the instrument, which stated on the face of it that it was sealed with their seals.
>
> It is obvious that they intended it should be sealed, though they left in a hurry, without seeing that requisite properly complied with. And as to Moore, who is the defendant moving against the verdict, he wrote to the plaintiffs afterwards in such terms as admitted his liability as a surety, and may be fairly taken as recognising the authority of the person who affixed the seal to do so for him.

It is clear that case differs from the present one but, in any event, I would not agree (if the quoted paragraphs go that far) that it is enough to bind a person to a gratuitous promise that he sign a document which purports to be under seal but is not.

37 There are cases holding that even the presence of a seal on an instrument, or something equivalent to it, may not be enough to make it enforceable as a sealed instrument: see *Sawyer & Massey Ltd. v. Bouchard* (1910), 13 W.L.R. 394 (Alta. T.D.); *Chilliback v. Pawliuk* (1956), 17 W.W.R. 534, 1 D.L.R. (2d) 611 (Alta. T.D.). I do not think it follows that because want of intention of the executing party to adopt a seal as his own may free him from liability on a sealed instrument that an intention to execute a sealed document will bind him accordingly although no seal is affixed: see *Empire Trust Co. v. Heinze* (1926), 242 N.Y. 475, 152 N.E. 266. Here, in any event, there is no evidence of intention save as it may be deduced from the written form which is in question.

38 This brings me to the final point, namely, whether sufficient formality is preserved by the inclusion in the printed form of the bracketed word "seal". I think not, because this is merely an invitation to place a seal at that spot. It affirms the need of formality rather than dispensing with it: see *Thompson v. Skill* (1909), 13 O.W.R. 887 (C.A.). A more difficult situation would exist if, instead of the bracketed word "seal", there was an imprint of a wafer seal reproduced on the document. That was the case in *Sawyer & Massey Ltd. v. Bouchard, supra*, where the Court refused to give sealed effect to the document sued upon. A different view in a similar situation but on different considerations was taken in *Imperial Canadian Trust Co. v. McKeague*, [1929] 2 W.W.R. 423, 38 Man. R. 249, [1929] 4 D.L.R. 381 (C.A.), affirming [1929] 1 W.W.R. 588 (Man. K.B.). It is not necessary, for the purpose of the present case, to come to a decision on this question.

39 There is nothing in *Stromdale & Ball, Ltd. v. Burden*, [1952] 1 All E.R. 59, to support the view of the appellant bank that the defendant had executed a document under seal. It was a case where the Court held that it was unlikely that the wafer seal on the document in question there was not put on before execution. Reliance was placed, however, on the statement of Danckwerts, J. (as he then was), that "it appears to me that at the present day if a party signs a document bearing wax or wafer or other indication of a seal with the intention of executing the document as a deed, that is sufficient adoption or recognition of the seal to amount to due execution as a deed" (at p. 62). I would not equate "indication of a seal" with indication of a place to put a seal, which is the case here. I favour the view expressed in *Empire Trust Co. v. Heinze*, 242 N.Y. at pp. 478-9, that:

> There must be something in the nature of a seal, some mark to indicate a seal affixed to the signatures to constitute a document a sealed instrument. The intention to seal under these circumstances, whether expressed or implied does not make a seal. The recital "signed, sealed and delivered," etc. or the words "whereunto we have affixed our seals" do not make a sealed instrument, if as a fact nothing is affixed to the signatures which the law recognizes as a seal.

There, by statute, the word "seal" or the letters "L.S." opposite the signature were recognized as a seal of a person other than a corporation. We do not have such a provision here.

40 I would dismiss the appeal with costs.

TAB 3

2006 CarswellOnt 5238
Ontario Superior Court of Justice

Manufacturers & Traders Trust Co. v. Amlinger

2006 CarswellOnt 5238, [2006] O.J. No. 3465, 21 B.L.R. (4th) 249

MANUFACTURERS AND TRADERS TRUST COMPANY (Plaintiff) and PATRICK M. AMLINGER, PETER J. CLARKE and DAVID JARVIS (Defendants)

Perell J.

Heard: August 16, 2006

Judgment: August 29, 2006 *

Docket: 05-CV-284736 PD3

Counsel: John Birch for Plaintiff
James G. Knight for Defendant, Amlinger
Philip H. Horgan for Defendants, Clarke & Jarvis

Subject: Corporate and Commercial; Civil Practice and Procedure; Contracts; Evidence; Insolvency

Headnote

Guarantee and indemnity --- Guarantee — Contract of guarantee — Miscellaneous issues

PA, PC and DJ were all shareholders of DM Inc., which was parent corporation of DM Ltd. — With respect to each company, PA was president and chief operating officer, and PC and DJ were directors — Management and day-to-day affairs of DM Ltd. were left in care of PA — In 1995, bank MTT Co. made loan facilities available to DM Ltd., and by 2003, indebtedness grew to around $650,000.00, around which time loan was restructured — DM Inc., PA, PC and DJ all signed guarantees — Loan was restructured again in 2004, for which no personal guarantees were signed — PA and PC eventually learned of extent of indebtedness after discovering that PA was falsely reporting financial situation — DM Ltd. defaulted on loan and ceased operating, and DM Inc. went bankrupt — MTT Co. brought motion for summary judgment to enforce personal guarantees made by PA, PC and DJ — Motion granted — Defences submitted by PA, PC and DJ raised no genuine issues for trial — None could claim that there was absence of consideration for their guarantees — MTT Co. gave consideration for promise of guarantees when it forebore from calling DM Ltd.'s loan and agreed to restructuring of it — Nor did PA have recourse to collateral agreement not forming part of personal guarantee, and purporting to limit his indebtedness — Collateral agreement was inconsistent with provisions of personal guarantee and thus could not stand with guarantee — PA, PC and DJ could not claim that 2004 loan restructuring discharged their liability under 2003 guarantees — In light of provisions in said guarantees, PA, PC and DJ each contracted out of any defences associated with restructuring of indebtedness they guaranteed to repay — Nor could PC and DJ claim that they were misled by MTT Co. into signing guarantees — There was no evidence that MTT Co. made any false representations, acted negligently, or knew or ought to have known that PC and DJ signed agreements under false premises or misapprehension — Nor could PC and DJ rely on corporate resolution limiting indebtedness to $250,000.00 — Debt already exceeded that amount when they signed guarantees in 2003, and regardless of what they knew of extent of indebtedness, DM Ltd.'s corporate resolutions did not limit borrowings to maximum of $250,000.00 — Also, DM Ltd. produced to MTT Co. banking authorization authorizing loan restructuring in 2004 — In any case, wording of guarantees obliged PC and DJ to repay any amount owing by DM Ltd. to MTT Co.

MOTION by creditor for summary judgment to enforce personal guarantees to repay indebtedness of debtor.

***Perell J.*:**

Introduction and Overview

1 The Plaintiff, Manufacturers and Traders Trust Company ("Manufacturers"), moves for summary judgment to enforce the March 2003 personal guarantees of the Defendants, Patrick M. Amlinger, Peter J. Clarke, and David Jarvis, who each guaranteed the repayment of the indebtedness of Daytech Manufacturing Inc. (Daytech-U.S.).

2 The Defendants are all shareholders of Daytech-U.S.'s parent corporation, Daytech Manufacturing Ltd. ("Daytech-Canada").

3 Manufacturers seeks a judgment in an amount of Canadian currency sufficient to purchase $564,012.59 (U.S.D.), which is the amount owing under the guarantees as of March 1, 2005. Manufacturers also seeks pre and post-judgment interest calculated in accordance with the terms of the guarantees, and costs on a substantial indemnity basis.

4 The Defendants resist the motion for a summary judgment, and they argue that their defences raise genuine issues for trial.

5 Mr. Amlinger submits a threefold defence: (1) he submits that there was no consideration for his March 2003 guarantee, and hence it is unenforceable; (2) he submits that there was a "Collateral Agreement" between Mr. Amlinger and Manufacturers that precludes the enforcement of his March 2003 guarantee; and (3) he submits that the restructuring in January 2004 of the Daytech-U.S. loan arrangements discharged his liability under the March 2003 guarantee.

6 Mr. Clarke and Mr. Jarvis submit a fourfold defence: (1) pointing an accusatory finger at Mr. Amlinger, they submit that he misled them into signing their March 2003 guarantees, which should be rescinded on the grounds of mistake or fraudulent or negligent misrepresentation; (2) like Mr. Amlinger, they submit that there was no consideration for their March 2003 guarantees; (3) they submit that Manufacturers' loans to Daytech-U.S. were limited by a corporate resolution so that the outstanding principal amount shall not exceed $250,000 and (4) like Mr. Amlinger, they submit that the restructuring in January 2004 of the Daytech-U.S. loan arrangements discharged their liability under their March 2003 guarantees.

7 It may be noted that Messrs. Clarke and Jarvis' third defence would appear to be also available for Mr. Amlinger. In my opinion, however, all the defences do not raise genuine issues for trial and Manufacturers' motion for summary judgment should be allowed.

Factual Background

8 Before analyzing whether any of the defences raise genuine issues for trial, I will begin by describing the background circumstances.

9 Daytech-Canada, which is now in bankruptcy, is an Ontario corporation that manufactured public transit shelters. Messrs. Clarke and Jarvis were original shareholders of Daytech-Canada. Daytech-U.S., which is no longer operating, was Daytech-Canada's wholly owned subsidiary.

10 Patrick Amlinger is a chartered accountant. In August 1994, he joined Daytech-Canada as a financial consultant. In February 1995, Mr. Amlinger was appointed President and Chief Operating Officer of both Daytech-Canada and Daytech-U.S. Messrs. Clarke and Jarvis, who were directors of both corporations, left the management and day-to-day affairs of Daytech-U.S., including its banking and financing arrangements, in the care of Mr. Amlinger. Mr. Clarke deposed that he and Mr. Jarvis were not directly engaged in dealings with Manufacturers, as that was the sole responsibility of Mr. Amlinger.

11 Beginning around May or June of 1995, Manufacturers, which is a bank with headquarters in Buffalo, New York, made loan facilities available to Daytech-U.S. Manufacturers' security included a general security agreement, a general subordination agreement, and a corporate guarantee from Daytech-Canada.

12 The initial loan was a $200,000 operating line of credit secured by a fixed floating charge on Daytech-U.S.'s assets and a guarantee from Daytech-Canada. Daytech-U.S.'s loan arrangements required it to maintain certain ratios between the indebtedness and Daytech-U.S.'s accounts receivable and inventories. These ratios were referred to by Mr. Amlinger as the "debt margin coverage."

13 In February 1998, at the invitation of Messrs. Clarke and Jarvis, Mr. Amlinger became a 10% shareholder of Daytech-Canada.

14 Between 1995 and early 2003, Daytech-U.S. maintained its relationship with Manufacturers, and the amount of the indebtedness grew to around $650,000. Various documents associated with the growing loans were signed by Mr. Amlinger exercising his authority as the President and COO of both Daytech-U.S. and Daytech-Canada.

15 One of the documents signed during this period was a Company General Certificate dated March 5, 2002 to which was attached a borrowing resolution of Daytech-U.S. I will have more to say about this document later, but note now that it is the centerpiece of Messrs. Clarke and Jarvis' third defence.

16 During this time, Daytech-U.S.'s business performance was inconsistent. There were some good contracts but also numerous problems, including poor economic conditions in the transit shelter industry, which apparently were adversely impacted by the aftermath of the terrorist attacks in New York City on September 11, 2001. There was a problem of slow payments of receivables from contracts with transit authorities. Daytech-U.S. lost $300,000 for the fiscal year 2001-2002, and it was having solvency problems and difficulties maintaining the ratios of the debt margin coverage.

17 In early 2003, Mr. Amlinger met with Robert Hintlemann, who was the banking officer at Manufacturers with responsibility for the Daytech-U.S. loan. Because, findings of fact are not to be made on a motion for summary judgment, I am going to assume that Mr. Amlinger's account of the meetings is true. Later, I will consider whether Mr. Amlinger's account raises a genuine issue for trial.

18 In paragraphs 22-37 of his affidavit filed in response to Manufacturers' motion for summary judgment, Mr. Amlinger deposes about his meetings with Mr. Hintlemann as follows:

> 22. Accordingly, in or about late 2002/early 2003, I had several meetings with Robert Hintlemann, Assistant Vice President of [Manufacturers]. The meetings were held by telephone and in person at the premises of Daytech [-Canada] and Daytech-U.S. The purpose of the meetings was to review the status of Daytech-U.S.'s financial position and overall progress towards regaining profitability.
>
> 23. During these meetings, Mr. Hintlemann advised me that [Manufacturers] did not intend to demand payment of Daytech-U.S.'s loan facility, but that it would continue to closely monitor the Company's financial results and its debt margin coverage on a go-forward basis. However, Mr. Hintlemann advised me that [Manufacturers] required the personal guarantees of Clarke and Jarvis to secure the balance of the loan facilities for Daytech-U.S. Mr. Hintlemann did not ask for my personal guarantee.
>
> 24. During one meeting with Mr. Hintlemann, when he and I discussed [Manufacturer's] requirement of the personal guarantees of Jarvis and Clarke, I asked Mr. Hintlemann whether I should tender my personal guarantee. I advised Mr. Hintlemann that I owned 10% of Daytech [-Canada's] shares and that I was willing to provide my personal guarantee along with Clarke and Jarvis. Mr. Hintlemann advised me that [Manufacturers] did not require my personal guarantee as a condition of continuing the loan facility with Daytech-U.S. He stated that [Manufacturers]

viewed my personal security for the loan facilities to be in the form of running the day-to-day financial affairs of the business.

25. Nonetheless, I felt it was only fair to my partners Clarke and Jarvis, that I participate in providing security for the loan facilities. Accordingly, I advised Mr. Hintlemann that, for the time being, I was willing to personally guarantee Daytech-U.S.'s loan facilities up to a maximum of the pro-rated value of my 10% shareholdings in Daytech. Mr. Hintelmann reiterated that this was not necessary and that my personal guarantee would not affect the decision to extend the loan facilities. However, at my insistence, Mr. Hintelmann produced a personal loan document for me.

26. Before I signed my personal guarantee document, Mr. Hintlemann advised me that, "in the event of a worse case scenario", [Manufacturers] would pursue enforcement of the personal guarantees against Clarke and Jarvis, and not against me. I understood this to mean that if Daytech [-Canada] and/or Daytech-U.S. were ever unable to make repayment on the loan facilities, [Manufacturers] would seek enforcement of the personal guarantees of Clarke and Jarvis and not my personal guarantee.

27. With respect to my request for a limited, pro-rata personal guarantee, Mr. Hintelmann advised me that he could not amend [Manufacturers] standard guarantee contract, but that he would draft some language for inclusion in the bank's files to indicate that my personal guarantee would be limited to 10% of the debt in accordance with my pro-rata shareholdings. Mr. Hintelmann clearly agreed that my personal guarantee for Daytech-U.S.'s loan facilities was limited to a maximum of 10% of the loan facilities extended to Daytech-U.S. My agreement (the "Collateral Agreement") was not part of the personal guarantee document, but I understood from Mr. Hintelmann that he would make a note of the terms of the Collateral Agreement and append it to the personal guarantee document and/or include it in [Manufacturers'] files.

19 Thus, it came about Mr. Amlinger signed one of the guarantees that are the subject matter of this lawsuit. It is Mr. Amlinger's evidence that his guarantee was volunteered, that Manufacturers obtained no benefit from it because the guarantee was superfluous and worthless given Mr. Amlinger's personal net worth. He submits that loan facilities would have continued whether or not he tendered a guarantee, and, in any event, Manufacturers did not rely on Mr. Amlinger's guarantee to any extent.

20 Messrs. Clarke and Jarvis also signed their guarantees. Mr. Clarke deposes that they did so based on the mistaken understanding that Daytech-U.S. financial performance was compliant with the ratios of the debt margin coverage.

21 Until these proceedings, Messrs. Clarke and Jarvis were unaware of the alleged Collateral Agreement between Manufacturers and Mr. Amlinger. For his part, Mr. Hintlemann denies any Collateral Agreement, although he acknowledges that Mr. Amlinger volunteered his guarantee.

22 It needs to be noted that Manufacturers advanced no new funds in consideration of the guarantees. However, Manufacturers also did not make demand for repayment although in a position to do so having regard to the debt margin coverage. It is not disputed that Mr. Hintlemann issued the threat to Mr. Amlinger that Manufacturers was in a position to make a demand during his discussions leading up to the guarantees. As described in paragraph 30 of the factum of Messrs. Clarke and Jarvis, "although the threat of a demand had been made to Mr. Amlinger, no communication of that threat had been made to Clarke and Jarvis in any way by the Plaintiff."

23 In January 2004, Manufacturers restructured Daytech-U.S.'s loan facilities. The restructuring was an accommodation and forebearance from calling the loan. The restructuring was arranged by Mr. Amlinger. Messrs. Clarke and Jarvis say they knew nothing about it. Approximately, $320,000 of the operating line was converted into a term debt with a five-year repayment term. The balance of the loan, $400,000 remained an operating line of credit to be covered by the debt margin coverage ratios. Daytech-U.S. signed what was described as the Demand Note, and it signed what was described as the Grid Note. These notes, which are dated January 27, 2004, set out the terms of payment. The

restructured loan facilities included increased interest rates of prime plus 2% for the $320,000 loan facility (a 0.5 percent increase in the interest rate) and prime plus 1.75% for the $400,000 loan facility (a 0.25% increase in the interest rate).

24 None of the Defendants signed any new guarantee with respect to the restructured loans. In paragraph 28 of his affidavit filed in response to Manufacturers' motion for summary judgment, Mr. Clarke deposes that he and Mr. Jarvis did not agree to any further extensions of the guarantees beyond the existing loan facilities in place as of March, 2003.

25 From January until October 2004, Daytech-Canada and Daytech-U.S. continued in business under the management of Mr. Amlinger. Mr. Clarke deposed that in the second or third quarter of 2004, he discovered the extent of Daytech-U.S.'s indebtedness to Manufacturers. He ordered an investigation into the affairs of Daytech-Canada and Daytech-U.S. These investigations have yielded allegations that Mr. Amlinger was falsely reporting the financial situation of the corporations under his management. In October 2004, Mr. Amlinger's employment was terminated.

26 It is not contested that Daytech-U.S.'s loan went into default and it did not repay its indebtedness to Manufacturers. In December 2004, Manufacturers made demand upon the guarantees, but relying on their various defences, the Defendants have refused to repay Daytech-U.S.'s indebtedness.

Analysis of Whether There is a Genuine Issue for Trial

27 On a motion for summary judgment, the motions judge must decide whether the moving party has established that there is no genuine issue for trial: *Aguonie v. Galion Solid Waste Material Inc.* (1998), 38 O.R. (3d) 161 (C.A.). Before granting summary judgment, it must be clear that a trial is unnecessary. The court's role is limited to assessing whether a trial is necessary to determine the facts upon which the existence of the claim or defence depend. If a disputed fact is not a material fact, then it cannot raise a genuine issue for trial. The court's function on a motion for a summary judgment is not to resolve any issue of fact but to determine whether a genuine issue of fact exists. On a motion for summary judgment, the court does not assess credibility, weigh evidence, or find facts.

28 The legal or persuasive burden to establish that there is no genuine issue for trial rests on the moving party throughout: *Hi-Tech Group Inc. v. Sears Canada Inc.* (2001), 52 O.R. (3d) 97 (C.A.). The motion for summary judgment places the responding party under an evidentiary burden, and the motions judge is entitled to assume that the parties have respectively advanced their best case and that the record contains all the evidence that the parties will present at trial: *Dawson v. Rexcraft Storage & Warehouse Inc.* (1998), 164 D.L.R. (4 th) 257 (Ont. C.A.); *Bluestone v. Enroute Restaurants Inc.* (1994), 18 O.R (3d) 481 (C.A.). This approach follows from rule 20.01(1), which provides that the responding party may not rest on the allegations or denials in the pleadings and who must set out in affidavit material or other evidence, specific facts showing that there is a genuine issue for trial.

29 The onus remains on the moving party to show that there is no genuine issue for trial, but the responding party must present its best case or risk losing: *Pizza Pizza Ltd. v. Gillespie* (1990), 75 O.R. (2d) 255 (Gen. Div.); *1061590 Ontario Ltd. v. Ontario Jockey Club* (1995), 21 O.R. (3d) 547 (C.A.) (where Osborne, J.A. stated: "a respondent on a motion for summary judgment must lead trump or risk losing."); *Transamerica Life Insurance Co. of Canada v. Canada Life Assurance Co.* (1996), 28 O.R. (3d) 423 (Gen, Div.), affd. [1997] O.J. No. 3754 (C.A.).

30 The Defendants submit that there are several genuine triable issues and that a trial is necessary to determine these issues.

31 As noted above, Mr. Amlinger relies on three defences. The first defence is that there is an absence of consideration between him and Manufacturers to make the guarantee enforceable. To quote from his counsel's factum: "The evidence indicates, *inter alia*, that Mr. Amlinger's guarantee was entirely voluntary and that nothing of value passed between Amlinger and Manufacturers." As noted above, Messrs Clarke and Jarvis rely on four defences. Their second defence is similar to Mr. Amlinger's in that they submit that there was no consideration for their March 2003 guarantees.

32 It appears to me that the Defendants have conflated the idea of consideration. A contract is based on bargaining, and the idea behind the requirement of consideration is that a party should not be entitled to enforce a contract promise unless he or she gave something in exchange. The Defendants, however, focus on what the party seeking to enforce a promise received. From Mr. Amlinger, Manufacturers apparently received a superfluous and worthless guarantee. However, that is not the point. The point is what did Manufacturers give for the guarantees.

33 Consideration for a promise can consist of:(a) a benefit conferred on the other contracting party; (b) a benefit conferred on a third party; (c) a detriment suffered. See *Bank of Nova Scotia v. Heilgarth* (1986), 32 D.L.R. (4th) 158 (B.C.C.A.); *Royal Bank of Canada v. Kiska* (1967), 63 D.L.R. (2d) 582 (Ont. C.A.).

34 Manufacturers gave consideration for the promise of the guarantees when it forebore from calling Daytech-U.S.'s loan and agreed to the restructuring of it. There was a promise of forebearance and actual forebearance. Although, it seems somewhat odd, Manufacturers also provided consideration by agreeing to allow Mr. Amlinger to execute a guarantee. For honour, pride, or equal stature with his fellow shareholders or for some idiosyncratic reason, this is something that Mr. Amlinger wanted to do.

35 There is no genuine issue for trial about the consideration for the guarantees.

36 Mr. Amlinger's second defence, which is exclusively his defence, is associated with what he called the "Collateral Agreement."

37 Subject to the *parol evidence* rule and to entire agreement clauses, oral or written contracts may exist collateral to another contract. The *parol evidence* rule and an entire agreement clause have the effect of precluding any collateral contracts that are inconsistent with the provisions of the written contract. See the well known cases of *Hawrish v. Bank of Montreal*, [1969] S.C.R. 515, which is quite analogous to the case at bar, and *Bauer v. Bank of Montreal* (1980), 110 D.L.R. (3d) 424 (S.C.C.).

38 In the case at bar the alleged Collateral Agreement cannot stand with the written guarantee. The defence of a collateral agreement cannot succeed, and there is no genuine issue for trial.

39 Before leaving this point, I observe that the alleged collateral agreement makes Mr. Amlinger appear duplicitous because he apparently wanted only to appear to have given a guarantee which at the same time arranging for special treatment.

40 Mr. Amlinger's third defence, which is the same as the fourth defence of Messrs. Clarke and Jarvis is that the restructuring in January 2004 of the Daytech-U.S. loan arrangements discharged their liability under the March 2003 guarantees. There are several permutations of this defence. The Defendants rely on the fact that in the original lending, the interest rate was 1.5% percent above prime but the restructured loan created two indebtedness one with an interest rate of 1.75% above prime and the other at 2.0% above prime.

41 The other permutation is that the Defendants rely on an "entire agreement" provision in the new loans that: "This Note, together with any related loan and security agreements and guarantees contains the entire agreement between the Bank and Borrower with respect to the Note and supercedes every course of dealing, other conduct, oral agreement and representation previously made by the Bank."

42 In my opinion, Manufacturers has an absolute answer to the defence of alterations to the underlying debt obligations discharging the guarantors with the result that there is no genuine issue for trial with respect to this defence. The absolute answer is that the Defendants have contracted out of the Defence. In this regard, the following provisions in their guarantees are relevant:

1. Guaranty

(a) Guarantor . . . hereby unconditionally guarantees the full and prompt payment and performance of any and all of [Daytech-U.S.'s] Obligations (as defined below) to [Manufacturers] when due, ... As used in this guarantee the term "Obligations" shall mean any and all obligations, indebtedness and other liabilities of [Daytech-U.S.] to [Manufacturers] now or hereafter existing, of each kind and nature ... including without limitation, whether such Obligations, indebtedness and other liabilities . . . (vi.) are renewed, replaced, modified, or extended; and (vii) are periodically and subsequently re-incurred or reduced and thereafter increased.

3. Guarantor's Waiver and Authorizations

(a) The Guarantor's obligation shall not be released, impaired or affected in any way including by any of the following, all of which the Guarantor hereby waives .... (ii) any new agreements or obligations of borrower or any other party with [Manufacturers]; (iii) any adjustments, compromise or release of any Obligations of [Daytech-U.S.] by [Manufacturers] or any other party;

(b) .... Guarantor further authorizes [Manufacturers], without notice, demand or additional reservation of rights against Guarantor and without affecting Guarantor's obligations hereunder, from time to time; (i) to renew, refinance, modify, subordinate, extend, increase, accelerate, or otherwise change the time for payment of, the terms of or the interest on the Obligations or any part thereof;

4. Termination

This Guarantee shall remain in full force and effect as to each Guarantor until actual receipt by [Manufacturers'] officer responsible for [Daytech-U.S.'s] relationship with [Manufacturers] of written notice of Guarantor's intent to terminate ....; provided, however, this Guarantee shall remain in full force and effect thereafter until all Obligations outstanding, or contracted or committed for (whether or not outstanding) ... shall be finally and irrevocably paid in full.

9. Non-Waiver by [Manufacturers], Miscellaneous

This Guarantee is intended by Guarantor to be the final, complete and exclusive expression of agreement between Guarantor and [Manufacturers] .... Guarantor expressly disclaims any reliance on any course of dealing or usage of trade or oral representation of [Manufacturers] including, without limitation, representations to make loans to Borrower or enter into any other agreement with [Daytech-U.S.] No course of dealing or other conduct, no oral agreement or representation made by the Bank or usage of trade shall operate as a waiver of any right or remedy of [Manufacturers] or release by [Manufacturers] shall be effective unless made specifically in writing by [Manufacturers].

43 By these provisions, in the Guarantee, the Defendants have contracted out of any defences associated with the restructuring of the indebtedness the repayment of which they guarantee. A guarantor may contract out of the protection that is normally provided by the common law or equity: *Manulife Bank of Canada v. Conlin* (1996), 139 D.L.R. (4th) 426 (S.C.C.); *A.G.F. Trust Co. v. Muhammed* (2005), 73 O.R. (3d) 767 (C.A.).

44 Further, the line of defence based on the "entire agreement" provision fails the "entire agreement" provision in the Grid Note and the Demand Note makes the note and "any related guarantees" supercede "every course of dealing, other conduct, oral agreement and representation previously made by [Manufacturers]." The March 2003 guarantees are a "related guarantee," and hence they are not superceded. If the March 2003 guarantees are not a "related guarantee," then they are not "a course of dealing, other conduct, oral agreement or representation previously made by Manufacturers"; rather, the March 2003 guarantees are a written contract.

45 Alternatively, if that interpretation of the "entire agreement" provision in the restructured loan documentation is incorrect, it is found in an agreement which is between Manufacturers and Daytech-U.S. and the provision is not

applicable to the relationship between Manufacturers and the Guarantors, whose relationship is governed by the terms of a guarantee that makes the guarantee a continuing unconditional obligation.

46 In any event, I see no genuine issue for trial arising from the defence of alterations to the underlying debt.

47 There remains for consideration two more defences raised by Messrs. Clarke and Jarvis. As I have enumerated them, there is their first defence, which is that Mr. Amlinger misled them into signing their March 2003 guarantees, which should be rescinded on the grounds of mistake or fraudulent or negligent misrepresentation, and their third defence, which is that Manufacturers' loans to Daytech-U.S. were limited by a corporate resolution so that the outstanding principal amount shall not exceed $250,000.

48 Messrs. Clarke and Jarvis submit that their guarantees should be rescinded on the grounds of mistake, negligent misrepresentation, or fraudulent misrepresentation. In their counsel's factum, they summarize these defences by asserting that they entered into the guarantees on false premises. These defences, however, are fatally flawed. There is no evidence that Manufacturers made any false representation. There is no evidence of negligence. There is no evidence that Manufacturers made a statement knowing it to be false or recklessly indifferent to whether it was true or false. There is no evidence that Manufacturers had the intent to deceive. There is no evidence that Manufacturers knew or ought to have known that Messrs. Clarke and Jarvis were signing a guarantee under false premises or some misapprehension. (See *Performance Industries Ltd. v. Sylvan Lake Golf & Tennis Club Ltd.*, [2002] 1 S.C.R. 678.) There is, however, evidence that the Defendants each signed a guarantee in which they each expressly disclaimed any reliance on any course of dealing or usage of trade or oral representation of Manufacturers.

49 In his affidavit, Mr. Clarke exclusively blames Mr. Amlinger for the loans and the guarantees. Mr. Clarke states in paragraph 46 of his affidavit:

> 46. Borrowing by Daytech-U.S. was induced in whole or in part on the basis of inaccurate reporting and/or misrepresentation of business activities reported by the Defendant Amlinger on behalf of Daytech [-Canada] and Daytech-U.S. The financial reporting that I relied upon has been determined to be the subject of gross inaccuracies and a variety of negligent or fraudulent misrepresentations on the part of the Defendant Amlinger.

Mr. Amlinger was the President and COO of Daytech-Canada and Daytech-U.S. and whatever wrongs he may have committed, there is nothing to connect them to Manufacturers. In my opinion, Messrs. Clarke and Jarvis have not raised a genuine issue for trial based on a mistake or misrepresentation defence.

50 Finally, there is Messrs. Clarke and Jarvis' defence that Manufacturers' loans to Daytech-U.S. were limited by a corporate resolution so that the outstanding principal amount shall not exceed $250,000. There are four absolute and mutually independent answers to this defence, and these answers make a trial unnecessary.

51 First, as noted above, in paragraph 28 of his affidavit filed in response to Manufacturers' motion for summary judgment, Mr. Clarke deposes that he and Mr. Jarvis did not agree to any further extensions of the guarantees "beyond the existing loan facilities in place as of March, 2003." It may be noted that in March 2003, Daytech-U.S.'s indebtedness to Manufacturers exceeded $250,000 and that no new funds were advanced thereafter. As directors of Daytech-U.S., Messrs. Clarke and Jarvis probably knew the state of indebtedness of the corporation, but more to the point, paragraph 28 in Mr. Clarke's affidavit is an admission that Messrs. Jarvis and Clarke agreed that their guarantees should extend to the existing loan facilities in place as of March, 2003.

52 Second, Messrs. Clarke and Jarvis misconstrue the corporate resolution that they submit limits the amount of the lending to Daytech-U.S. Indeed, they actually misrepresent what is the meaning of the corporate resolution. In his affidavit, Mr. Clarke states in paragraphs 22 and 23:

> 22. A few years later, on or about March 5, 2002, Amlinger provided [Manufacturers] with a "Company General Certificate," advising that he was authorized to transact business on behalf of Daytech-U.S. ... By its terms,

the President of Daytech-U.S. (Amlinger) had authority to borrow, according to the terms of the "Borrowing Resolution" which was attached as an Exhibit, under a line of credit to Daytech-U.S. from [Manufacturers], up to $250,000 USD. ....

23. However, it was stipulated in this Guaranty [sic, Borrowing Resolution] that the total of the outstanding principal amounts ... shall not at any one time exceed $250,000. Accordingly, by its own supporting documentation, the Plaintiff appears to have exceeded its own borrowing limits following this date.

53 Apart from whatever Messrs. Clarke and Jarvis knew about the extent of loans to Daytech-U.S. in March 2003, the terms of Daytech-U.S.'s corporate resolution do not limit borrowings to a maximum of $250,000. Quite the contrary. The Borrowing Resolution states:

RESOLVED, that any person with the following title or position: President [viz. Mr. Amlinger]... may ... in the name of [Daytech-U.S.] ... transact with [Manufacturers] ... any and all business as he or she (they) shall deem advisable upon such terms as he or she (they) deem proper including, but not limited to (i) obtaining loans, credits and other financial accommodations; ... Without limiting the generality of the foregoing, [the President, viz. Amlinger] has the power and the authority on behalf of [Daytech-U.S.] to obtain from [Manufacturers] from time to time such terms as he or she (they) shall deem proper; credits in such amounts as they deem necessary; and be it further

RESOLVED, <u>that without limiting the generality of the foregoing</u>, [Daytech-U.S.] hereby specifically authorizes loans under a Line of Credit, the total of the outstanding principal amounts of which shall not at any time exceed $250,000; [emphasis added]

As I read this resolution, without limiting the authority of Mr. Amlinger to conduct all business as he shall deem advisable upon such terms as he deems proper including obtaining loans on behalf of Daytech-U.S. and without limiting his authority from time to time to obtain credits in such amounts as he deems proper, a particular Line of Credit up to $250,000 is authorized. Other lines of credit, other loans, and obtaining other credits from time to time are not precluded.

54 Third, in January 2004, Daytech-U.S. provided manufacturers with another banking authorization that expressly authorized the restructured loan arrangements. This document was produced by Manufacturers in answering the undertakings on Mr. Hintleman's cross-examination. It is trite that a cross-examination on an affidavit for an interlocutory motion is not an examination for discovery where the examining party decides whether to introduce the evidence or not. Having regard to the terms of the corporate resolutions, I see no genuine issue for trial with respect to either corporate resolution.

55 Fourth, and in any event, whatever the terms of the corporate resolutions, the terms of the guarantees that they signed oblige the Defendants to repay the Demand Note and the Grid Note because, to return to the language of their guarantees, which is set out above, the Demand Note and the Grid Note "are indebtedness and other liabilities of Daytech-U.S. to Manufacturers now or hereafter existing, of each kind and nature including without limitation indebtedness and other liabilities renewed, replaced, modified, or extended." It is not disputed that Manufacturers loaned money to Daytech-U.S. and has not been repaid.

Conclusion

56 For the Reasons set out above, I conclude that Manufacturers is entitled to the summary judgment it seeks with costs on a substantial indemnity basis.

57 The costs should be on a substantial indemnity basis because of the following provision of the Guarantee, not yet mentioned:

5. Expenses

> Guarantor agrees to reimburse [Manufacturers] on demand for all [Manufacturers'] expenses, damages and losses of any kind or nature including without limitation costs of collection and actual attorney's fees and disbursements whether for internal or external counsel incurred by [Manufacturers] attempting to enforce this Guarantee, collect any of the Obligations including any workout or bankruptcy proceedings or other legal proceedings or appeal, realize on any collateral, defence or any action under the prior paragraph or for any other purpose related to the Obligations (collectively "Expenses"). ....

58 If the parties cannot agree as to the quantum of the costs, they may make submissions to me in writing beginning with Manufacturers' written submissions within 20 days of the release of these Reasons for Decision with the Defendants written submissions to follow within 10 days thereafter.

Motion granted.

Footnotes

* Additional reasons concerning costs are available at *Manufacturers & Traders Trust Co. v. Amlinger* (2006), 2006 CarswellOnt 6203 (Ont. S.C.J.).

TAB 4

2010 BCSC 429
British Columbia Supreme Court

Maocheia v. Amado

2010 CarswellBC 800, 2010 BCSC 429, [2010] B.C.W.L.D. 6068, [2010] B.C.W.L.D. 6071, [2010] B.C.W.L.D. 6134, [2010] B.C.W.L.D. 6146, [2010] B.C.W.L.D. 6254, [2010] B.C.W.L.D. 6261, 187 A.C.W.S. (3d) 849

Maria Maocheia (Plaintiff) And Delores Raposo Amado (Defendant)

Maria Maocheia (Plaintiff) And Judi Hughes (Defendant)

G.R. Gaul J.

Heard: June 1-5, 2009
Judgment: March 31, 2010
Docket: New Westminster S112316, S112317

Counsel: I.D. MacKinnon for Plaintiff
T. Watkins for Defendant, Delores Raposo Amado
T. McKendrick for Defendant, Judi Hughes

Subject: Property; Corporate and Commercial; Public; Torts; Contracts; Civil Practice and Procedure; Evidence

Headnote

Real property --- Mortgages — Nature and form of mortgage — Miscellaneous

Validity of charge against property — In 1993, plaintiff executed mortgage over her home in favour of defendant — Principal amount of mortgage was $20,000, with interest accruing at 10 percent per annum, calculated semi-annually — Notary public assisted with transfer of title to property into plaintiff's name (from joint tenancy between plaintiff and her late husband) and with execution of mortgage document — Some 16 years passed, and entire principal amount remained outstanding and significant amount of interest had accrued — Plaintiff brought action for declaration that mortgage was void and of no effect and that only debt payable was original $20,000 from promissory note which preceded mortgage — Action dismissed — Mortgage was valid and enforceable — Good and valuable consideration passed between parties; benefit conferred on mortgagor, detriment incurred by mortgagee, and benefit provided to third party could all be found — Defendant could have pursued plaintiff's late husband's estate for payment under promissory note — Defendant forgave $6,000 interest outstanding at time mortgage was executed — There was evidence that plaintiff wished to avoid legal action being taken against her family members who owed debt on promissory note — Mortgage resulting from agreement between parties was not unconscionable — While defendant was more sophisticated in financial matters, this did not create power imbalance permitting defendant to take advantage of plaintiff — Plaintiff's contention that there was no discussion with anyone of any interest that would accrue and that she was completely unaware of its existence as term of mortgage was rejected — There was no undue influence — Plaintiff was not dependent on defendant, and defendant did not exercise any form of oppression or coercion over plaintiff.

Professions and occupations --- Notaries public — Negligence

In 1993, plaintiff executed mortgage over her home in favour of defendant — Principal amount of mortgage was $20,000, with interest accruing at 10 percent per annum, calculated semi-annually — Notary public assisted with transfer of title to property into plaintiff's name (from joint tenancy between plaintiff and her late husband) and with execution of mortgage document — Some 16 years passed, and entire principal amount remained outstanding and significant amount of interest had accrued — Plaintiff sought declaration that mortgage was void and of no effect and that only debt payable was original $20,000 from promissory note which preceded mortgage — Plaintiff also brought action against notary public for negligence, alleging that notary public failed to act to proper standards and failed to properly explain to plaintiff true nature and effect of mortgage — Action dismissed — With passage of time and fact that notary public's file materials had been destroyed, it was impossible to conclude with any degree of confidence what took place at meetings involving plaintiff — Given personal dynamics and friendship existing between plaintiff and defendant mortgagee, notary public's decision to allow defendant mortgagee to be as engaged in process as she was did not breach any duty of care owed to plaintiff — Plaintiff failed to present any evidence of what accepted standard of practice is or should be in situation like one before court — On what would be expected of notary public in such circumstances, only evidence of notary public remained, and it was accepted unconditionally — Notary public properly satisfied herself that plaintiff had sufficient language skills and mental capacity to understand what was being said to her and understood nature, contents and consequences of mortgage — Plaintiff did not prove on balance of probabilities that notary public failed to live up to professional standards expected of her and in doing so breached any retainer or duty of care owed to plaintiff.

Contracts --- Consideration — What constitutes consideration — Miscellaneous

Contracts --- Formation of contract — Undue influence — Factors to be considered — Inequality of bargaining power

Equity --- Relief from unconscionable transactions — Unconscionable or improvident transactions — Inequality of bargaining power

Evidence --- Witnesses — Cogency — Credibility — Miscellaneous

ACTION for declaration that mortgage was void and of no effect; ACTION against notary public for negligence arising from execution of mortgage.

***G.R. Gaul J.*:**

Introduction

1 The plaintiff, Maria Maocheia, is 88 years old. The defendant, Delores Amado, is 76 years old. In 1993, Mrs. Maocheia and Mrs. Amado had been friends for approximately twenty-five years. The Maocheia and Amado families had grown close over the years and Mrs. Amado had become the Godmother to one of the Maocheia grandchildren. As often happens, money has come between the two long time friends and has resulted in the present lawsuit. I have no doubt that both parties wished things had turned out differently.

2 In June 1993, Mrs. Maocheia executed a mortgage over her home in favour of Mrs. Amado. The principal amount of the mortgage was $20,000 with interest on that amount accruing at the rate of 10% per annum, calculated semi-annually (the "Mortgage").

3 In 1993, Mrs. Judi Hughes was a 45-year old notary public working in Maple Ridge, British Columbia. Mrs. Hughes assisted with the transfer of title to the Property into Mrs. Maocheia's name and with the execution and registration of the Mortgage documents. After having practiced for approximately nine years, Mrs. Hughes retired in 1995.

4 Some sixteen years have passed since the Mortgage was executed and registered. The entire principal amount of the Mortgage remains outstanding and a significant amount of interest has accrued over the years.

5 Mrs. Maocheia now seeks a declaration that the Mortgage is void and of no effect and that the only debt payable to Mrs. Amado is the original $20,000 from the Promissory Note, with no accrued interest.

6 In a separate but related action, Mrs. Maocheia is suing Mrs. Hughes for negligence, alleging that Mrs. Hughes failed to act to the standards expected of her as a notary public and more particularly failed to properly explain to Mrs. Maocheia the true nature and effect of the Mortgage.

7 By order of a Master of this Court dated 5 November 2008, both actions were ordered to be tried at the same time.

Issues

8 There are two key issues in this litigation:

a. Whether the Mortgage is a valid charge against the Property; and

b. If the Mortgage is valid, whether Mrs. Hughes breached her duty of care to Mrs. Maocheia regarding the Mortgage?

9 A large number of the facts upon which this action is based are uncontested. However, there are certain critical facts upon which the evidence varies wildly. As counsel for the plaintiff eloquently submits, the first task at hand in considering the plaintiff's claims is to "wrestle the facts to the ground". This has proved to be a major challenge given the significant amount of time that has elapsed since the Mortgage was agreed to and executed and the now advanced age of Mrs. Maocheia and Mrs. Amado. The Court is also faced with the serious problem that Mrs. Hughes, a person who would have had crucial evidence regarding the Mortgage had this lawsuit been launched prior to her retirement, has no recollection of meeting Mrs. Maocheia or of assisting with the Mortgage documents and any notes and materials that might have existed have been destroyed.

Facts

10 Mrs. Maocheia was born in 1921 in Portugal and her first language was Portuguese. She had little schooling as a child.

11 In 1945, Mrs. Maocheia married Antonio Maocheia in Portugal. In or around 1959, the Maocheias immigrated to Canada, eventually settling in Kitimat, British Columbia. The Maocheias lived in Kitimat for approximately six years and during that time they met and befriended a number of other Portuguese couples, including Manuel and Delores Amado.

12 Mr. Maocheia worked as a labourer with the Aluminum Company of Canada Limited ("Alcan") and also handled most, if not all, of his family's financial and banking matters. Mrs. Maocheia only spoke a little English upon her arrival in Canada and she focussed her attention and energy taking care of the family home.

13 In or around 1961, the Maocheias obtained a mortgage from Alcan in order to finance the purchase of a new home in Kitimat. By this time, they had two young daughters, Teresa and Mary Grett. Their third child, Antonio Junior, was born shortly thereafter.

14 Mrs. Maocheia has little recollection of executing a Mortgage to Alcan; however, she does remember she and her husband obtained money from his employer to purchase their home. Both Mr. and Mrs. Maocheia signed the mortgage documents, which were in English, acknowledging their joint status as mortgagors.

15 In or around 1979, the Maocheias moved to Mission, British Columbia and established a new family home at 31953 Woodcock Crescent (the "Property"). The Amados left Kitimat two or three years later and settled in Maple Ridge, British Columbia.

16 In short order the two families resumed their relationship, with Mrs. Maocheia and Mrs. Amado rekindling their friendship.

17 Although it is not clear, it would appear that in or around the mid-1980s, Mrs. Maocheia began developing vision problems that eventually resulted in eye surgery. The surgery was not a success and consequently the condition of Mrs. Maocheia's eyes continued to deteriorate.

18 In 1986, the Maocheia's first daughter, Teresa, and her husband Rui Silva were building a family home for themselves in Mission. When it became obvious that they would require additional funding to continue with the construction, Mr. Amado came to their rescue and during the course of a gathering between the two families, he agreed to loan the Silvas $20,000. The terms of the loan were eventually confirmed in a promissory note dated 6 January 1987 and signed by the Silvas and Mr. Maocheia (the "Promissory Note"). The Promissory Note contained the following terms:

- All three signatories were jointly and severally liable to repay the principal plus and interest;
- Repayment of principal and interest was due on 6 January 1988;
- Interest would accrue at a rate of "ten percent (10%) per annum, calculated semi-annually not in advance"; and
- Interest would continue to accrue at the set rate in the event of default of payment.

19 In June 1987, six months after the Promissory Note was signed, Mr. Amado died of a heart attack and Mrs. Amado became the executor of her late husband's estate.

20 In October 1987, Mrs. Maocheia executed a new Last Will and Testament that had been written entirely in English. The signature block where Mrs. Maocheia signed her Will contained the following wording:

> SIGNED, PUBLISHED AND DECLARED by the said Testatrix, MARIA DE JESUS DE SOUSA MAOCHEIA,
>
> Who understands the Portuguese language and who only has a limited knowledge of the English language, as and for her last Will and Testament, after the same had first been read over to the Testatrix in the English language and after the necessary explanations and interpretations had been made to her in the Portuguese language...

21 For reasons that are not completely clear, the loan secured by the Promissory Note was not repaid by the due date. Instead, for the years 1988 to 1991 the Silvas only paid the interest portion of it; no payments towards the principal amount were made.

22 In the late 1980s, Mr. Maocheia's health began to deteriorate and by 1989 he was seriously ill. In April 1989, three months before succumbing to his illness, Mr. Maocheia executed a document transferring title to the Property from sole ownership in his name to joint tenancy with his wife. The transfer was entered with the New Westminster Land Title Office on 20 April 1989.

23 Upon Mr. Maocheia's death in July 1989, Mrs. Maocheia became the executor of her late husband's estate. According to the evidence of Teresa Silva and Mary Grett Hannah, as well as that of Mrs. Hannah's husband, Derek, Mr. Maocheia's estate appears to have been a modest one with only a few material assets including a motor vehicle of little value and some funds in a bank account that he shared with his wife. It would also appear that Mr. Maocheia's estate was entitled to some form of financial death benefits that were used to pay for his funeral services and related expenses. Mr. Maocheia's half interest in the Property passed to his wife on account of her status as joint tenant on title. For reasons that are not clear, no steps were taken at this time to transfer the title of the Property into Mrs. Maocheia's name as the sole owner.

24 In 1991, the Silvas encountered significant financial difficulties. Mr. Silva lost his job and the family sold their family home in Mission at a loss. It was at this time that the Silvas stopped paying Mrs. Amado anything towards the outstanding Promissory Note.

25 In 1993, the Silva family, which now included four young children, were living on a farm in Alberta. Unfortunately, this venture failed and their financial institution foreclosed on the property. The Silvas left Alberta, having lost their life savings, and returned to Mission to live with Mrs. Maocheia.

26 Sometime in the early 1990s, Mrs. Amado and Mrs. Maocheia discussed the outstanding debt on the Promissory Note. Mrs. Maocheia was clearly upset by the fact that money was still owed on the Promissory Note. Because Mrs. Maocheia was so distraught by the fact that her daughter and husband had still not repaid the debt, Mrs. Amado decided to cease raising the issue with her friend.

27 As time went on and still no monies were paid towards the debt, Mrs. Amado began to fear the debt may never be repaid. Finally, in early 1993, she decided to formally address the issue of the outstanding debt. On 9 March 1993, Mrs. Amado sought the advice of legal counsel in this regard and after meeting with her lawyer, she again spoke with Mrs. Maocheia about the debt and how the two of them could go about resolving the problem.

28 In April 1993, Mrs. Amado's counsel prepared documents designed to secure the Mortgage against the Property and a related document setting out the agreement between Mrs. Amado and Mrs. Maocheia (the "Agreement"). Mrs. Amado signed the Agreement on 21 April 1993.

29 The terms of the Mortgage mirrored those of the Promissory Note in that interest was to accrue at a rate of 10% per annum. The Agreement read as follows:

> **Agreement**
>
> DOLORES R. AMADO, of 11460 Waresley Street, Maple Ridge, British Columbia, V2X 9&9 [sic], in consideration of MARIA MAOCHEIA granting the Mortgage in the form attached hereto, HEREBY COVENANTS not to take action or proceedings against the Estate of Antonio Maocheia for monies owing under a Promissory Note signed by Antonio Maocheia, Rui Manuel Salvador Moreira Da Silva and Maria Teresa Maocheia Silva, in the principal amount of $20,000.00 together with interest on that amount at the rate of 10% per annum calculated semi-annually (which Promissory Note became due on January 6, 1988), and without limiting the generality of the foregoing will make no claim for interest due under the Promissory Note prior to March 19, 1993.
>
> Dated this 21 day of April 1993.
>
> _"Delores Amado"____ Dolores R. Amado APPROVED AND ACCEPTED ____________________________ MARIA MAOCHEIA 31953 Woodcock Crescent Mission, B.C.

30 Mrs. Amado's counsel informed her that Mrs. Maocheia and her late husband remained as joint tenants on the title to the Property and that prior to registering the Mortgage the title would need to be corrected to reflect the fact that Mrs. Maocheia was now the sole owner. In order to save costs, Mrs. Amado's counsel recommended that she and Mrs. Maocheia use a notary public to have the title to the Property transferred into Mrs. Maocheia's name and to have the Mortgage documents notarized and registered in the appropriate Land Title Office.

31 Mrs. Amado had used Mrs. Hughes as a Notary Public on previous occasions to assist her with personal matters. Consequently, she turned to Mrs. Hughes to assist Mrs. Maocheia with transferring title to the Property to herself and then executing the Mortgage document.

32 It is unclear how many meetings the parties had with Mrs. Hughes and who was present on each occasion. I am satisfied that there were at least three meetings, that Mrs. Maocheia was present for at least two of them and that Mrs. Amado organized the meetings and drove Mrs. Maocheia to them.

33 Multiple meetings with Mrs. Hughes were necessary because documentation confirming Mr. Maocheia's death was required and there were also issues relating to the spelling of Mrs. Maocheia's name on title that needed to be corrected.

34 Mrs. Amado assisted Mrs. Maocheia by taking her to obtain Mr. Maocheia's death certificate and by taking her back to Mrs. Hughes's office.

35 That the Agreement document was before Mrs. Hughes at one of the meetings is evidenced by the fact that she accidentally made a partial signature on the line reserved for Mrs. Maocheia's signature.

36 Mrs. Maocheia, Mrs. Amado and Mrs. Hughes met in Mrs. Hughes' office on 3 June 1993. At that meeting the Mortgage was discussed and Mrs. Hughes explained its terms to Mrs. Maocheia in English. Mrs. Hughes does not speak Portuguese and therefore spoke with Mrs. Maocheia in English on the occasions they met. Mrs. Amado spoke with Mrs. Maocheia in Portuguese during their meetings with Mrs. Hughes.

37 Mrs. Hughes satisfied herself that Mrs. Maocheia understood what was being discussed during the meetings and, more particularly, that Mrs. Maocheia understood the terms of the Mortgage, including its interest rate.

38 The transfer of title into Mrs. Maocheia's name and the registration of the Mortgage on title were processed over the summer of 1993; however, they were not completed until September of that year.

39 In the spring of 2006, the subject of amending Mrs. Maocheia's Last Will and Testament arose. It is unclear how this topic came up; whether it was on Mrs. Maocheia's own initiative or whether it was at the instance of her children. In any event, when Mrs. Maocheia discussed the issue with her two daughters she informed them of the existence of an agreement with Mrs. Amado regarding the Promissory Note. Surprised by this disclosure, Mrs. Maocheia's daughters eventually discovered through their own investigation the existence of the Mortgage.

Position of the Parties

The Plaintiff

40 Mrs. Maocheia challenges the validity of the Mortgage on three grounds. First, she argues that no consideration was provided by Mrs. Amado for the Mortgage. In 1993, Mrs. Maocheia owed nothing to Mrs. Amado. The estate of her husband may have been indebted to the estate of Mr. Amado on account of the unpaid Promissory Note and the Silvas may have also been indebted to Mr. Amado's estate for the same reason; however, those obligations had no bearing on Mrs. Maocheia and did not create in her a parallel obligation. According Mrs. Maocheia, both sources of repayment on the Promissory Note (the estate of Mr. Maocheia and the Silvas) were impecunious and consequently any judgment that may have been taken against either or both of them would have been hollow.

41 Second, Mrs. Maocheia argues that the execution of the Mortgage was procured by means of undue influence exerted by Mrs. Amado over Mrs. Maocheia. She submits there was a power imbalance between them, with Mrs. Maocheia being the weaker of the two.

42 Finally, according to Mrs. Maocheia, the Mortgage was executed with no explanation whatsoever by anyone of its interest component, making that portion of the instrument unconscionable and unenforceable.

43 With respect to her claim against Mrs. Hughes, Mrs. Maocheia argues that Mrs. Hughes failed in her duty to her in that she allowed Mrs. Amado, the mortgagee, to play a significant role in the preparation and execution of the Mortgage and did not ensure she understood what was transpiring. In particular, Mrs. Maocheia claims Mrs. Hughes took no steps to make sure her client appreciated the fact that there would be interest accruing on the mortgage she was granting to Mrs. Amado.

The Defendant, Delores Amado

44 Mrs. Amado asserts that valuable consideration was given to Mrs. Maocheia in return for her executing the Mortgage. First, there was an express abandonment of any claim against the estate of Mr. Maocheia. According to Mrs.

Amado, this was good consideration, thereby legitimizing the Mortgage, regardless of the fact that the estate may not have had sufficient assets to pay the debt. Mrs. Amado also argues that the release of her claim against the estate was a reciprocal detriment to her. She expressly abandoned her claim to the interest which had accrued as of 19 March 1993. This is a quantifiable amount that Mrs. Amado relinquished in return for the security of knowing that the debt plus interest would be guaranteed by the Mortgage and repaid when Mrs. Maocheia died and the Property was sold. Finally, Mrs. Amado contends that the Silvas benefited from the fact that she agreed not to take legal action against them to enforce repayment of the Promissory Note.

45 In response to Mrs. Maocheia's claim that Mrs. Amado unduly influenced her to execute the Mortgage resulting in an unenforceable agreement, Mrs. Amado submits that Mrs. Maocheia was not in any distress or dire need in 1993 that would have made her more susceptible to improper influence. Although she would visit Mrs. Maocheia semi-regularly and would take her out shopping or for coffee, Mrs. Amado says that Mrs. Maocheia was not dependent on her or beholden to her for anything. Mrs. Amado also submits that it was she who needed the help of her friend Mrs. Maocheia to assist with the growing problem of the outstanding debt after one of the principal debtors had died and the two others had relocated to Alberta.

46 With respect to the assertion by Mrs. Maocheia that the Mortgage was an unconscionable agreement, Mrs. Amado repeats her position taken on the claim of undue influence and maintains that Mrs. Maocheia was given ample time and opportunity to consider and reflect upon the idea of the Mortgage. It was not thrust upon her by surprise, nor was the interest portion of the Mortgage concealed from her. Mrs. Amado maintains that she discussed the interest provisions of the Mortgage with Mrs. Maocheia and that Mrs. Hughes explained them to Mrs. Maocheia prior to the Mortgage's execution. Mrs. Amado consequently argues it would be unconscionable to have the Mortgage declared void after she and her late husband's estate have relied upon it for the past sixteen years as good security for an outstanding debt.

The Defendant, Judi Hughes

47 Mrs. Hughes acknowledges that she owed a duty of care to Mrs. Maocheia in that she was retained to act on Mrs. Maocheia's behalf with respect to the transfer of title to the Property into her name and the execution of the Mortgage.

48 Mrs. Hughes maintains that she performed her work to the standards expected a qualified notary public and that Mrs. Maocheia obtained what she wanted and expected, that is, title to the Property solely in her name and a charge placed on title securing the debt that was owing to Mrs. Amado.

49 Mrs. Hughes has no recollection of the specific dealings she had with Mrs. Maocheia. This is not surprising, given that sixteen years have passed since their meetings and any documents or notes she may have had of the work she did for Mrs. Maocheia have been long destroyed.

50 Mrs. Hughes steadfastly maintains that her regular practice was to review all of the important aspects of a mortgage document with her clients to ensure they understood them, including any interest provisions, and that she would have followed that practice with Mrs. Maocheia. Mrs. Hughes was firm in her assertion that she would have satisfied herself that Mrs. Maocheia understood what was being said and explained to her, in particular, the terms of the Mortgage and its rate of interest. Finally, Mrs. Hughes says, after having heard Mrs. Maocheia testify at trial, that she would not have acted for Mrs. Maocheia in 1993 and more particularly would not have notarized the mortgage transaction had Mrs. Maocheia's command of the English language been as poor then as it appears to be now. By process of deduction, Mrs. Hughes concludes and submits that Mrs. Maocheia's English language skills must have been better in 1993 than they are now.

Credibility

51 The entirety of this litigation turns on the credibility of the three principal parties: Mrs. Maocheia, Mrs. Amado and Mrs. Hughes; and, to a lesser degree, on the credibility of the two Maocheia children who testified at trial.

52 From the outset of her testimony, I found Mrs. Maocheia's evidence to be exceptionally weak on most, if not all, of the critical issues and in many instances she was completely non-responsive. Having observed Mrs. Maocheia and listened to her testify, I say with no hesitation that I have little confidence in her ability to accurately recall and recount events of the past. She was easily led and directed during her evidence and appeared at times completely lost and confused during her testimony. On at least one occasion she responded to a question by saying she did not know why she was in court. Mrs. Maocheia's memory is so weak she could not remember a number of events that one would expect her to remember, including:

- getting a mortgage for her home in Kitimat;
- what year she and her husband moved to the metro Vancouver area;
- when her eyesight problems began;
- how many years she has had eyesight problems;
- the condition of her eyes in 1993;
- signing her Last Will and Testament in 1987;
- who obtained her husband's death certificate;
- telling her daughters in 2006 that she had signed "a paper" (the Mortgage) for Mrs. Amado; and
- whether it was in the past few years that she decided to re-write her Will.

53 At the outset of her cross-examination, Mrs. Maocheia candidly volunteered that her mind was "not good" and that she forgets things. My conclusion that Mrs. Maocheia's memory is faulty and completely unreliable crystallized when she indicated in cross-examination that she could not even remember being examined for discovery in October 2008.

54 I accept that Mrs. Maocheia has difficulties with the English language; however, I am not satisfied that she is presently or was in 1993 completely incapable of communicating in English. I find that she does have some basic understanding of English and am supported in this conclusion by the fact that she answered questions regarding her present residence, her age and her birth country at the outset of her testimony in English, without any assistance from the interpreter who was standing next to her. Mrs. Maocheia also responded affirmatively in English when the Court reminded her at the continuation of the evidence on day two of the trial that she was still under oath to tell the truth and asked her whether she understood.

55 I have also concluded that Mrs. Maocheia either fabricated portions of her evidence in an attempt to compensate for her memory lapses or was not being completely forthright when describing the events that led to the execution of the Mortgage. Mrs. Maocheia may have done so because she felt embarrassed by the fact that she granted the Mortgage and had kept it secret from her children for thirteen years, but had now been discovered. It could also be attributable to her failing memory or some other health issue. Irrespective of the reasons, I find I can place little to no weight on Mrs. Maocheia's evidence.

56 In general, I found Mrs. Amado's memory was stronger than Mrs. Maocheia's and on the whole I was much more impressed by Mrs. Amado's evidence. Although there were instances where Mrs. Amado was not clear or completely responsive and there were times where she too seemed confused, I do not find the degree of unreliability in her evidence that I found in Mrs. Maocheia's.

57 Where there was a conflict in the evidence between Mrs. Maocheia and Mrs. Amado, I have preferred Mrs. Amado's over that of Mrs. Maocheia.

58 With respect to Mrs. Hughes, I found her to be a forthright and credible witness and I accept her evidence in its entirety. Where I found a clash between the evidence of Mrs. Maocheia and the evidence of Mrs. Hughes, I have accepted Mrs. Hughes' evidence.

59 As for Teresa Silva and Mary Grett Hannah, I was unimpressed with their evidence. On the whole, I found their evidence to be self-serving and shallow. In particular, I found Mrs. Silva's suggestion that there was some vague oral agreement with the Amados that the interest on the Promissory Note would vary according to the rates being paid by financial institutions for long term savings accounts to be wholly unsupported on the evidence. Mrs. Silva says her husband spoke with Mr. Amado and reached this understanding with him; however, Mr. Silva did not testify at trial. Mrs. Silva also said she spoke with Mrs. Amado about the agreement however her evidence on this point was unclear and unconvincing. On the other hand, Mrs. Amado was adamant that there had been no discussions with either Mr. or Mrs. Silva about interest on the Promissory Note having been varied. I accept the evidence of Mrs. Amado over that of Mrs. Silva.

60 I will make one last point on this subject. I am not satisfied that left to her own devices, Mrs. Maocheia would have commenced these legal proceedings against her former friend Mrs. Amado and against Mrs. Hughes. Having heard Mrs. Maocheia's evidence as well as that of her two daughters, I am of the opinion that the guiding force behind these lawsuits is not Mrs. Maocheia but rather her daughters and more particularly Mrs. Silva. The Silvas have much to lose, and to a lesser extent so do the two other Maocheia children, if Mrs. Maocheia's lawsuits against Mrs. Amado and Mrs. Hughes fail. Given the amount of interest that has accrued on the Mortgage, it is quite likely that Teresa Silva will receive little from her share of the proceeds of sale when the Property is eventually sold.

Analysis

Is the Mortgage a valid charge against Mrs. Maocheia's property?

61 In answering this question there are three issues that must be considered:

a. Whether Mrs. Amado provided good consideration to Mrs. Maocheia in return for the Mortgage;

b. Whether the transaction resulting in the Mortgage was unconscionable; and

c. Whether Mrs. Amado exerted undue influence over Mrs. Maocheia and in doing so unfairly obtained her agreement to the Mortgage.

Consideration

62 Consideration between two parties executing a security agreement such as a promissory note or a mortgage can be evidenced in a number of ways: there can be a benefit conferred on the mortgagor; there can be a detriment incurred by the mortgagee; or there can be a benefit provided to a third party that otherwise would not have existed: *Bank of Nova Scotia v. Hallgarth*, [1986] B.C.J. No. 1051 (B.C. C.A.).

63 In my opinion, consideration of all three types indentified can be found on the facts of the case.

64 I find Mrs. Amado could have pursued Mr. Maocheia's estate for payment under the Promissory Note and though such an action may not have resulted in complete satisfaction of the debt, it would have yielded some results. I accept Mrs. Amado's argument that on obtaining such a judgment she would have been entitled to demand a proper accounting of all estate assets and income and possibly further investigated how Mr. Maocheia's assets, including his exclusive ownership of the Property, were dealt with prior to his death. I also agree with the submission of Mrs. Amado that the evidence of Mrs. Maocheia and her daughters presented twenty years after the fact regarding what assets were in the estate and their respective value was not persuasive and I do not accept it as being anywhere near determinative of this issue.

65 I accept that Mrs. Amado forgave the $6,000 interest outstanding at the time the agreement was made and the Mortgage executed and that this too was a detriment that Mrs. Amado offered to shoulder in return for Mrs. Maocheia granting her the Mortgage.

66 Finally, I find merit in Mrs. Amado's submission that Mrs. Maocheia was desperate to avoid having any legal action taken against the Silvas. This fact is clearly born out in the evidence of both Mrs. Amado and Mrs. Maocheia. In cross-examination, Mrs. Maocheia acknowledged that when speaking with Mrs. Amado during the time prior to the execution of the Mortgage, she tried to persuade Mrs. Amado not to sue the Silvas for the debt outstanding on the Promissory Note. Mrs. Maocheia also told Mrs. Amado that upon her death, her children would inherit her estate and that if the Silvas had not paid the debt by then, they could pay it out of their share of the estate. It is not surprising, given the financial hardship that her daughter Teresa and her family had suffered in the early 1990s that Mrs. Maocheia wanted to shield them from any further financial setbacks. Although not articulated within the written terms of the Agreement, I find Mrs. Amado and Mrs. Maocheia did discuss this factor prior to agreeing upon the Mortgage and that it played an important role in realizing the Mortgage.

67 I accept that the granting of the Mortgage was akin to Mrs. Maocheia giving Mrs. Amado a guarantee that the Promissory Note debt would eventually be paid. In 1993, Mrs. Maocheia believed the Silvas would repay Mrs. Amado; however, it is clear that both parties harboured some doubts that this would actually happen. It was because the debt was secured by the Mortgage that Mrs. Amado no longer had to sue the Silvas. The fact that Mrs. Amado mentioned the debt to Mr. Silva at some point after the Mortgage had been registered (and not disclosed by Mrs. Maocheia to her family) is not surprising, and I do not take that as a sign that Mrs. Amado was breaching her Agreement not to pursue the Silvas.

68 For all of these reasons, I find good and valuable consideration passed between Mrs. Amado and Mrs. Maocheia justifying and confirming the Mortgage.

Unconscionability

69 In *Lidder v. Munro*, 2004 BCSC 857 (B.C. S.C.) [*Lidder*], Mr. Justice Rice considered the validity of a settlement Agreement between the Insurance Corporation of British Columbia ("ICBC") and a plaintiff following a motor vehicle accident. The issue was whether a release the plaintiff had executed in favour of ICBC in return for a sum of money should be set aside on account of a number of factors including the alleged unconscionability of the agreement. Rice J. observed, at paras. 45-46:

> To prove that a transaction is unconscionable, two factors must be present, a weakness in bargaining position on one side and a taking of unfair advantage on the other.
>
> . . . . .
>
> An alternative formulation was suggested by Mr. Justice Lambert in *Harry v. Kreutziger* (1978), 9 B.C.L.R. 166 (C.A.):
>
>> ... questions as to whether use of power was unconscionable, an advantage was unfair or very unfair, a consideration was grossly inadequate, or bargaining power was grievously impaired, to select words from both statement of principle, the Morrison case and the Bund case, [1974] 3 All E.R. 757, are really aspects of one single question. That single question is whether the transaction, seen as a whole, is sufficiently divergent from community standards of commercial morality that it should be rescinded.

70 I do not find the Mortgage that resulted from the agreement between Mrs. Maocheia and Mrs. Amado to be unconscionable. While I accept that Mrs. Amado was more sophisticated than Mrs. Maocheia when it came to finances, in that she had worked outside of the home when Mrs. Maocheia had not and had been involved in more real estate transactions than Mrs. Maocheia, I do not find these differences in experience created a power imbalance between the two that permitted Mrs. Amado to take advantage of Mrs. Maocheia.

71 I specifically reject Mrs. Maocheia's contention that there was no discussion with anyone of any interest that would accrue on the Mortgage and that she was completely unaware of its existence as a term of the Mortgage. I find as a fact that in early 1993 Mrs. Amado approached Mrs. Maocheia and proposed the idea of a Mortgage with interest accruing at the same rate as the Promissory Note and that the topic was discussed again with Mrs. Amado and Mrs. Hughes prior to executing the Mortgage. In reaching this conclusion I have taken note that during her examination for discovery Mrs. Amado indicated that she had not discussed the rate of interest that would be on the Mortgage with Mrs. Maocheia. Mrs. Amado's evidence at trial was at odds with her examination for discovery and she explained the discrepancy by confessing she was nervous and confused during the course of the examination. Mrs. Amado's memory is not perfect; however I have no difficulty in concluding it is better than Mrs. Maocheia's. Having said that, I also find Mrs. Amado is of advanced age, and accept that she was flustered and confused during portions of her examination for discovery. I accept Mrs. Amado's evidence explaining the reason for the apparent contradiction between her evidence on this point given at her examination for discovery and her evidence at trial and accept her evidence at trial as the truth.

72 The situation that confronted the two friends in 1993 was that a debt that had been incurred in 1987 remained unpaid. Mrs. Amado was seeking a means of securing that debt without creating additional stress for her friend Mrs. Maocheia. Mrs. Maocheia was trying to find a way to secretly protect her daughter and her family from further financial hardship. I accept Mrs. Amado's evidence that after meeting with her lawyer in March 1993, she proposed the Mortgage to Mrs. Maocheia and then let her consider it for a reasonable period of time before revisiting the idea. When Mrs. Maocheia decided that the idea was a good one, Mrs. Amado assisted in making the arrangements, including retaining Mrs. Hughes to act on behalf of Mrs. Maocheia. I do not see the steps taken by Mrs. Amado, including paying Mrs. Hughes' account on behalf of Mrs. Maocheia, in the sinister light Mrs. Maocheia now says I should. Mrs. Maocheia had limited financial resources available to her at the time and she wanted to keep the transaction secret from her family. The steps taken by Mrs. Amado to assist with the transfer of the title into Mrs. Maocheia's name and the registration of the Mortgage were nothing more than a friend helping a friend for mutual benefit. Mrs. Maocheia got the peace of mind that the Silvas would someday be free from the debt they owed to Mr. Amado's estate and Mrs. Amado would get the peace of mind that someday she would get the monies owed to her husband's estate over which she was the executrix. This was a positive result for everyone.

73 I agree with the submission made by counsel for Mrs. Amado that to find the Mortgage unenforceable sixteen years after it was executed, when much of the relevant evidence relating to the Mortgage is either no longer available or faded from memory would be grossly unfair to Mrs. Amado.

Undue Influence

74 As Rice J. noted at para. 43 of *Lidder*, "Undue influence requires some form of oppression, coercion, or abuse of power or authority."

75 Mrs. Maocheia argues there was a stark and unfair difference between her financial acumen and that of Mrs. Amado and asserts that on account of that imbalance Mrs. Amado was the "dominant player" in their relationship.

76 I accept that Mrs. Amado was more capable than Mrs. Maocheia; however, I do not find that this disparity in abilities led to a power imbalance that was improperly employed by Mrs. Amado to her benefit and the detriment of Mrs. Maocheia.

77 The fact that sixteen years has passed since Mrs. Maocheia and Mrs. Amado reached an agreement that led to the Mortgage makes it impossible to assess with any degree of confidence the strength and nature of the relationship that existed between the two women at the time the Mortgage was agreed to and more importantly whether one maintained an unfair advantage over the other.

78 Mrs. Amado was one of a number of Mrs. Maocheia's Portuguese friends in the lower mainland in 1993. She would visit Mrs. Maocheia and occasionally take her out shopping. I am not persuaded that Mrs. Maocheia was dependent on Mrs. Amado or that Mrs. Amado exercised any form of oppression or coercion over Mrs. Maocheia.

79 Mrs. Maocheia may not have been the most financially sophisticated person; however, I find she understood and agreed with the idea and reason for the Mortgage. I have not been persuaded on the evidence before me that Mrs. Maocheia granted the Mortgage not understanding its implications, including the fact that it would be a charge of $20,000 secured against her home and that it would accrue interest at the rate of 10% per annum.

80 Having decided to encumber her home on account of the debt owing by the Silvas, Mrs. Maocheia took steps to hide her actions from the rest of her family. In my opinion, Mrs. Maocheia's decision to do so leads to the conclusion that she understood what she was doing and appreciated the implications of the Mortgage. Mrs. Maocheia's response to the suggestion that she intended to keep the Mortgage a secret from her children is particularly illuminating:

> Q: Did you deliberately conceal what you had done of signing the Mortgage from your children?
>
> A: Yah, yah, that's what I did. I told them that I wouldn't tell them about what I did. That's what I did. Because I wouldn't expect that things would end up like this. I would expect them to pay what they owed them but things went all wrong.
>
> Q: By "they" you mean you expected Theresa and Rui to pay the debt?
>
> A: They are always ready to pay their debt. The thing is that they have not made enough money to pay it yet.

81 I find Mrs. Maocheia knew and understood that a lien was being placed on the title to her home and that she intentionally concealed that fact from her children. I also find that she purposely left the Mortgage documents with Mrs. Amado so that the Maocheia children would not discover them and thereby find out what she had done in relation to the Property. On this last point, I accept the evidence of Mrs. Amado that it was Mrs. Maocheia's idea that the documents stay with Mrs. Amado and that Mrs. Maocheia was adamant about that happening.

82 The evidence presented by Mrs. Maocheia does not persuade me that Mrs. Amado forced the issue of the Mortgage or acted in an aggressive and persistent manner. On the contrary, I find Mrs. Amado acted reasonably in encouraging Mrs. Maocheia to consider the idea of the Mortgage and not to make a decision on it immediately.

83 Mrs. Maocheia did not want any further financial grief to come to her daughter, nor did she want her friend Mrs. Amado to suffer from the Silvas' inability to repay the debt. The proposal of a Mortgage was a sensible one and one that I find Mrs. Maocheia agreed to freely and voluntarily.

84 I do not find Mrs. Maocheia executed the Mortgage because of any undue influence exercised by Mrs. Amado.

85 Having found there was good and valuable consideration, there was no undue influence and the Mortgage agreement was not an unconscionable one, I find that the Mortgage is valid and enforceable. In light of this conclusion, Mrs. Maocheia's action against Mrs. Amado must fail.

Did Ms. Hughes breach her duty of care to Mrs. Maocheia regarding the Mortgage?

86 Mrs. Hughes acknowledged that she acted on behalf of Mrs. Maocheia during the preparation and execution of the Mortgage in 1993 and that, consequently, she owed a duty of care to Mrs. Maocheia.

87 Unfortunately, with the passage of time and the fact that Ms. Hughes' file materials have been destroyed, it is impossible to conclude with any degree of confidence exactly what took place at the meetings involving Mrs.

Maocheia and, more particularly, what Mrs. Hughes said to Mrs. Maocheia and what her opinion of Mrs. Maocheia's understanding of the English language was at the time.

88 At first blush it may appear to be odd that Mrs. Hughes would permit the mortgagee creditor, Mrs. Amado, to play the role she did in arranging and coordinating the execution of the Mortgage and in participating to the extent she did in the meetings between the mortgagor debtor, Mrs. Maocheia, and her notary public. However, given the personal dynamics and the friendship that obviously existed at the time between Mrs. Amado and Mrs. Maocheia, I do not find Mrs. Hughes decision to allow Mrs. Amado to be as engaged in the process as she was breached any duty of care owed to Mrs. Maocheia. Having reached this conclusion, I must note that Mrs. Maocheia failed to present any evidence of what the accepted standard of practice is or should be in a situation like the one before the Court. With that void in the evidence, I am left only with the evidence of Mrs. Hughes, which I accept unconditionally, on what would be expected of a notary public in such circumstances.

89 On the whole, I accept the evidence of Mrs. Hughes without any reservations and find that she properly satisfied herself that Mrs. Maocheia had sufficient language skills and mental capacity to understand what was being said to her and understood the nature, contents and consequences of the Mortgage. In arriving at this conclusion I have relied on and given some weight to the evidence of Mrs. Silva. According to Mrs. Silva, in 1993 her mother attended a local church that held its services in English and she communicated with the other parishioners in English. Mrs. Silva also confirmed that if a legal document drafted in English were read to her mother in English slowly, then she would likely understand it as long as the document was not complicated.

90 Overall, I am not satisfied that Mrs. Maocheia has proven on a balance of probabilities that Mrs. Hughes failed to live up to the professional standards expected of her and in so doing breached any retainer or duty of care she owed to Maocheia.

91 Consequently, the plaintiff's action against Mrs. Hughes must fail.

Limitation Period

92 Mrs. Hughes' alternative argument that Mrs. Maocheia's claim against her is statute barred as having been initiated beyond the limitation period established by section 3(5) of the *Limitation Act*, R.S.B.C. 1996, c. 266 (the "Act"), is an academic one in light of my finding she did not act outside of the standards expected of a notary public and breached no duty owed to Mrs. Maocheia. However, I will briefly address the issue for the sake of completeness.

93 Mrs. Hughes argues that Mrs. Maocheia failed to file her lawsuit within the time period mandated by the *Act* and that her pleadings were devoid of any plea for relief in the nature of an order under the *Act* postponing the limitation period. She also vigorously maintains that to raise the issue at trial without having pled it seriously prejudices her defence. Mrs. Maocheia has responded by suggesting the issue has never been a hidden one and that Mrs. Hughes or her counsel should have been aware of it from the beginning of these proceedings. Alternatively, she seeks an order granting her leave to amend her statement of claim to include a plea under section 6(4) of the *Act* suspending the commencement of the limitation period to 2006 when she says the impugned Mortgage was discovered and the cause of action arose. As this argument was only raised at the conclusion of submissions, I granted leave to both counsel for Mrs. Maocheia and counsel for Mrs. Hughes to file additional written submission on this issue.

94 Having reviewed those written submissions and the accompanying case authorities, I will say that if I had to decide the issue, I would have found the plaintiff's pleadings were deficient in that they failed to plead and thereby put Mrs. Hughes on proper notice that Mrs. Maocheia intended to rely on section 6(4) of the *Act*. I would also have denied the application to amend Mrs. Maocheia's statement of claim because allowing the sought after amendment at such a late stage of the proceedings would have been unfair to Mrs. Hughes and seriously prejudicial to her defence.

95 I would therefore have acceded to Mrs. Hughes' argument and found Mrs. Maocheia's claim against her to be statute barred.

Order

96 In light of my findings and conclusions, I make the following order:

- The plaintiff's claim against the defendant Delores Amado is dismissed; and

- The plaintiff's claim against the defendant Judi Hughes is dismissed.

97 Both defendants are entitled to their costs at Scale B, with leave to apply.

Actions dismissed.

TAB 5

2002 CarswellOnt 4535
Ontario Superior Court of Justice

XDG Ltd. v. 1099606 Ontario Ltd.

2002 CarswellOnt 4535, [2002] O.J. No. 5307, 121 A.C.W.S. (3d) 18, 23 C.L.R. (3d) 67, 41 C.B.R. (4th) 294

XDG Limited, Plaintiffs and 1099606 Ontario Limited and General Electric Caoutak Canada Inc., Defendants

Gordon J.

Heard: July 9-12, 2002

Judgment: December 23, 2002 *
Docket: 1424/99

Counsel: I. Duncan, M. Van Bodegom for Plaintiff, XDG Limited
A. Speciale for Plaintiff, William Green Roofing Ltd.
L. Ricchetti for Defendant, General Electric Capital Canada Inc.
No one for 1099606 Ontario Limited

Subject: Corporate and Commercial; Property; Contracts; Torts; Insolvency

Headnote

Mortgages --- Nature and form of mortgage — Mortgage as security for other debts

Defendant numbered company ("109") purchased property and leased it to E Corp. — R was sole director, officer and shareholder of 109 and president of E Corp. — In 1998 and 1999, lien claimants provided services and materials to leased property — When contractors were not paid for work, claims for lien were registered in October 1999 — E Corp. was financed under credit agreement by GECC, which was large lending institution well known in commercial finance business — In March 1999, GECC determined E Corp. was in default position under credit agreement and amended agreement resulting in 109 providing guarantee and mortgage on leased property in favour of GECC regarding indebtedness of E Corp. — Both 109 and E Corp. were declared bankrupt in 2000 and leased property was sold resulting in insufficient funds to pay lien claimants and mortgage holder — In proceedings by lien claimants to determine priority between lien claimants and mortgage, issue arose as to whether mortgage was void as result of contravening s. 20 of Business Corporations Act — Mortgage was void — Purpose of s. 20(1) is to prevent dissipation of corporate assets that might otherwise prejudice financial position of creditors and shareholders — GECC, inconsistent with its usual practice, failed to perform due diligence investigation of 109 — E Corp. and 109 were affiliated corporations and guarantee and mortgage provided by 109 constituted financial assistance within meaning of s. 20(1) — Evidence indicated that when mortgage was granted, 109 failed both solvency and balance sheet tests under ss. 20(1)(c) and (d) of Act — GECC's failure to conduct due diligence test was wilful blindness by GECC and therefore GECC was not lender for value within meaning of safe harbour provision in s. 20(3) of Act — Business Corporations Act, R.S.O. 1990, c. B.16, ss. 20, 20(1), 20(1)(c), 20(1)(d), 20(3).

Fraud and misrepresentation --- Fraudulent conveyances — Fraudulent intent — Presumption of fraudulent intent — General

Defendant numbered company ("109") purchased property and leased it to E Corp. — R was sole director, officer and shareholder of 109 and president and controlling shareholder of E Corp. — In 1998 and 1999, lien claimants provided services and materials to leased property — When contractors were not paid for work, claims for lien were registered in October 1999 — E Corp. was financed under credit agreement by GECC, which was large lending institution well known in commercial finance business — In March 1999, GECC determined E Corp. was in default position under credit agreement and amended agreement resulting in 109 providing guarantee and mortgage on leased property in favour of GECC regarding indebtedness of E Corp. — Both 109 and E Corp. were declared bankrupt in 2000 and leased property was sold, resulting in insufficient funds to pay lien claimants and mortgage holder — In proceedings by lien claimants to determine priority between lien claimants and mortgage, issue arose as to whether mortgage was void as being fraudulent conveyance under Fraudulent Conveyances Act — Mortgage was void — GECC, inconsistent with its usual practice, failed to perform due diligence investigation of 109 — Evidence indicated that when mortgage was granted 109 failed both solvency and balance sheet tests under ss. 20(1)(c) and (d) of Business Corporations Act — R, knowing poor financial situation, caused 109 to guarantee indebtedness of E Corp., company of which he was president and controlling shareholder, to provide collateral mortgage security on leased property which was 109's only real asset — R's actions were facilitated by wilful blindness of GECC in not performing due diligence investigation — In circumstances, there was prima facie presumption of intent on part of GECC to defeat current and future creditors which GECC was unable to rebut — GECC could not save situation by claiming it acted in good faith since wilful blindness was not good faith — Fraudulent Conveyances Act, R.S.O. 1990, c. F.29 — Business Corporations Act, R.S.O. 1990, c. B.16, ss. 20(1)(c), (d).

Fraud and misrepresentation --- Fraudulent preferences — Intention to prefer

Defendant numbered company ("109") purchased property and leased it to E Corp. — R was sole director, officer and shareholder of 109 and president and controlling shareholder of E Corp. — In 1998 and 1999, lien claimants provided services and materials to leased property — When contractors were not paid for work, claims for lien were registered in October 1999 — E Corp. was financed under credit agreement by GECC, which was large lending institution well known in commercial finance business — In March 1999, GECC determined E Corp. was in default position under credit agreement and amended agreement resulting in 109 providing guarantee and mortgage on leased property in favour of GECC regarding indebtedness of E Corp. — Both 109 and E Corp. were declared bankrupt in 2000 and leased property was sold, resulting in insufficient funds to pay lien claimants and mortgage holder — In proceedings by lien claimants to determine priority between lien claimants and mortgage, issue arose as to whether mortgage was void as being unlawful assignment or preference under s. 4 of Assignments and Preferences Act — Mortgage was void — GECC, inconsistent with its usual practice, failed to perform due diligence investigation of 109 — Evidence indicated that when mortgage was granted, 109 failed both solvency and balance sheet tests under ss. 20(1)(c) and (d) of Business Corporations Act — R, knowing poor financial situation, caused 109 to guarantee indebtedness of E Corp., company of which he was president and controlling shareholder, to provide collateral mortgage security on leased property which was 109's only real asset — R's actions were facilitated by wilful blindness of GECC in not performing due diligence investigation — In circumstances, there was prima facie presumption of intent on part of GECC to defeat current and future creditors which GECC was unable to rebut — Assignments and Preferences Act, R.S.O. 1990, c. A.33, s. 4 — Business Corporations Act, R.S.O. 1990, c. B.16, ss. 20(1)(c), (d).

Construction law --- Construction and builders' liens — Priorities — General principles

Defendant numbered company ("109") purchased property and leased it to E Corp. — R was sole director, officer and shareholder of 109 and president and controlling shareholder of E Corp. — In 1998 and 1999, lien claimants provided services and materials to leased property — When contractors were not paid for work, claims for lien were registered in October 1999 — E Corp. was financed under credit agreement by GECC, which was large lending institution well known in commercial finance business — In March 1999, GECC determined E Corp. was in default position under credit agreement and amended agreement resulting in 109 providing guarantee and mortgage on leased property in favour of GECC regarding indebtedness of E Corp. — Both 109 and E Corp. were declared bankrupt in 2000 and leased property was sold, resulting in insufficient funds to pay lien claimants and mortgage holder — Plaintiff claimants brought action for declaration that they were entitled to priority over mortgage — Action allowed — GECC, inconsistent with its usual practice, failed to perform due diligence investigation of 109 — Failure to conduct due diligence test was wilful blindness by GECC — GECC gave no satisfactory answer to explain this neglect — In circumstances it would be unconscionable and inequitable to allow mortgagee to obtain priority based on its wilful blindness or negligence — Due diligence investigation would have led GECC to decide against mortgage security on leased property — Assignments and Preferences Act, R.S.O. 1990, c. A.33, s. 4 — Business Corporations Act, R.S.O. 1990, c. B.16, ss. 20(1)(c), (d).

ACTION by lien claimants for declaration that they had priority over mortgage with respect to leased lands.

***Gordon J.*:**

1 A trial of this consolidated construction lien action was directed to determine the priority as between the lien claimants and the mortgagee with respect to certain lands in the City of Kitchener described as the "Dielcraft property".

Background

2 109606 Ontario Limited ("109") was incorporated on 30 November 1994. In December 1994 it purchased the Dielcraft property for $1,515,000. The property was leased to Euro United Corporation ("Euro United"), commencing 1 April 1995 for the purposes of storing raw material and finished product.

3 Mr. Sam Rehani was the sole director, officer and shareholder of 109. He was also the controlling shareholder and president of Euro United.

4 In 1998 and 1999 the lien claimants provided services and material to the Dielcraft property. Various contractors were involved, commencing with certain demolition work to the ultimate renovation, being the raising of the building roof. In the fall of 1999 the contractors left the job site as they were not being paid by 109. Claims for lien were registered on title commencing in October 1999.

5 Euro United, and related companies operating under a similar name in different jurisdictions, was financed by General Electric Capital Canada Inc. ("GECC") pursuant to a credit agreement dated 13 November 1998. By the end of March 1999 GECC determined Euro United was in a default position regarding certain covenants in the credit agreement. In April 1999 an amendment to this agreement resulted in 109 providing a guarantee and mortgage on the Dielcraft property in favour of GECC regarding the indebtedness of Euro United.

6 Euro United temporarily corrected its default position, but by August 1999 GECC determined there were significant problems. On 24 November 1999 GECC demanded payment from Euro United and 109. In December 1999 KPMC Inc. was appointed interim receiver of Euro United and 109. In June 2000, both companies were declared bankrupt and KMPG Inc. was appointed trustee of their estates. Sale of the property by the trustees was authorized in January 2002.

7 The sale proceeds are held by KPMG Inc. pending the outcome of this litigation. There are insufficient funds to pay the lien claimants and the mortgage holder.

Issues

8 Pursuant to the order of Sills J., granted 17 December 2001, the statement of issues identified the following:

1. Section 20 of the Ontario *Corporations Act*. Is the mortgage invalid or void as against the plaintiffs as a result of contravening section 20 of the Ontario *Business Corporations Act*?

2. Section 4 of the *Assignments and Preferences Act* and section 2 of the *Fraudulent Conveyances Act*.

Is the mortgage invalid or void as against the plaintiffs as an unlawful assignment or preference or as a fraudulent conveyance?

3. Section 78 of the *Construction Lien Act*.

(a) Was the mortgage registered prior to the time when the first lien arose in respect of the subject improvement, and, if so, to what extent does the mortgage have priority under section 78 of the Construction Lien Act?

(b) Was the mortgage registered as a subsequent mortgage, and, if so, to what extent does the mortgage have priority under section 78 of the *Construction Lien Act*?

Analysis

(i) Section 20 Business Corporation Act

(a) 109 and GECC

9 Euro United was involved in the manufacture and sale of plastic injection mould products, such as patio furniture. Some of their product was supplied to large retail stores in Canada and the United States. According to Mr. Paul Feehan, Senior Vice President of GE Capital Commercial Finance, Inc., a related company to GECC, Euro United was growing rapidly. Mr. Feehan, who was involved in the underwriting of Euro United's financing by GECC, reported the growth in sales went from $10,000,000 in 1996 to $102,000,000 in 1998.

10 The Canadian Imperial Bank of Commerce was the lending institution providing financing to Euro United. GECC, acting as agent for a syndicate of lenders, including itself, provided new replacement financing in November 1998 consisting of a revolving line of credit in the notional amount of $127,000,000 and a term loan of $50,000,000. The line of credit authorized from time to time was based on a formula pertaining to receivables and inventory.

11 Mr. Feehan, and others at GECC, conducted a due diligence investigation of Euro United from July to November 1998. The new financing terms were set out in the credit agreement dated 13 November 1998. GECC acquired security on the assets of Euro United.

12 GECC was aware of Euro United leased the Dielcraft property from the outset. A Landlord's Waiver and Consent, signed by Mr. Rehani on behalf of 109 and Euro United, dated 16 November 1998, was one of the documents in the security package. A copy of the lease was attached to this document indicating an annual rent to be paid by Euro United in the sum of $700,000 on a net net basis commencing 1 April 1996 and ending 31 March 2002. GECC was also aware Mr. Rehani controlled both companies.

13 By the end of March 1999, less than five months after the advance on the credit agreement, GECC became aware Euro United was in a default position. Amongst other items, Euro United had overstated its receivables, resulting in an overadvance on the line of credit of $15,300,000. In addition, Euro United had paid Mr. Rehani $525,000, apparently with respect to his shareholder loan, and purchased and mortgaged their head office property in Oakville, both items lacking the required consent of GECC. At this point in time, GECC's exposure was $89,900,000 on the line of credit and $50,000,000 on the term loan.

14 Mr. Feehan, and others involved in the financing, met with Mr. Rehani on 5 April 1999. Mr. Rehani offered to add his real estate, the Dielcraft property, as collateral and indicated its value to be $7,000,000 to $8,000,000. There was an indication equity investors might become involved in Euro United. Mr. Feehan said GECC wanted to resolve the existing financing problems and move forward in their relationship with Euro United. He also acknowledged GECC wanted to buttress its existing security to cover Euro United's indebtedness.

15 On 6 April 1999 Mr. Feehan reported to his superior, setting out the issues and possible solutions. In addition to taking security on the Dielcraft property, he recommended a two percent bonus on the indebtedness and a $200,000 fee to charged to Euro United as well as acquiring an option to purchase equity on favourable terms. Mr. Feehan testified GECC had not yet concluded to retract its financing, that Euro United was thriving and although it had significant management and administrative problems, he felt GECC should "take the risk" and provide bridge financing.

16 Nevertheless, in his written report dated 5 April 1999, he told his superior:

> Therefore we recommend that GECC choose the least disruptive solution because it allows Advent to work towards our quickest and easiest exit (i.e. Lehman). In addition, GECC is receiving additional boot collateral and is getting paid for its risk with an equity opportunity in the future.

17 Upon receipt of approval from his superior, Mr. Feehan submitted a written proposal to Mr. Rehani on 9 April 1999. It was accepted the same date.

18 The security documentation was prepared and signed by 14 April 1999, within five days of the accepted proposal. The mortgage was registered on 15 April 1999. The documentation appears to have been prepared by the solicitors for GECC, McMillan, Binch, although it is noted Euro United and 109 were represented by Bennett Jones. Mr. Rehani signed all documentation for 109, including the guarantee for $11,5000,000 and the mortgage for $300,000,000. Numerous declarations and other documents were also executed by Mr. Rehani, including an insolvency certificate.

19 Mr. Feehan stated the amounts described in the guarantee and mortgage were determined by GECC's solicitors. The $11,500,000 stated in the guarantee resulted from Mr. Rehani's representation the value of 109's assets was $12,000,000 with only $100,000 in liabilities. The $300,000,000 referred to in the mortgage was to cover loans of the syndicated loan agreement although Mr. Feehan was not clear on this explanation.

20 The GECC proposal dated 9 April 1999 permitted it to conduct a due diligence investigation. For some unexplained reason, GECC chose not to make any inquiry with respect to 109. According to Mr. Feehan, GECC relied exclusively on the representations of Mr. Rehani.

21 In due course, GECC receive the executed security documents from its solicitors. There was no reporting letter regarding certification of title with respect to the Dielcraft property. Mr. Feehan indicated a certification was required and mistakenly assumed it was provided by the solicitors for 109.

22 GECC did not request financial statements from 109, nor did they conduct a credit check. They were unaware 109 had never filed income tax returns. GECC did not inspect the Dielcraft property nor did they obtain an appraisal.

23 The proposal contained a provision whereby GECC would release its mortgage if 109 obtained another mortgage, so long as the proceeds therefrom of at least $4,000,000 were contributed to Euro United as equity and applied to reduce the line of credit with GECC. This item was not included in the amending agreement.

24 Mr. Feehan said his only concern was the Dielcraft property be worth at least $4,000,000. He was not concerned with Mr. Rehani's representations as to the property value, nevertheless, no inquiry was made to appraise the property.

25 City Management & Appraisals Ltd. provided an appraisal report dated 3 April 2000 to KPMG Inc., in which they estimated the market value, as of 1 June 1999, at $3,190,000. This valuation appears to be accepted by the parties as the market value on 15 April 1999. The stated value, however, may be high as the appraiser also estimated market value as of 1 April 2000 to be $5,000,000, yet the property only sold for $2,896,000 in January 2002. There may have been intervening market conditions affecting the sale price although no evidence was presented.

26 Mr. Feehan also said GECC had no reason to question the representations made by Mr. Rehani although he offered to explanation. Without due diligence, it is equally reasonable to say GECC had no reason to believe those representations.

27 The declarations and certificates signed by Mr. Rehani, on or before 14 April 1999, as part of the security documents required by GECC contained numerous errors or, perhaps, deliberate false statements, examples of which are as follows:

(a) there was no change in the financial condition 109 which would have a material adverse effect on its ability to pay GECC and all rental payments where current when, in fact, Euro United had not paid its rent for at least four months and, therefore, 109 had no income;

(b) no material or services had been provided to the property, nor contracts signed, nor estimates given or, alternatively, all amounts have been paid in full and no liens have arisen within the meaning of the *Construction Lien Act* when, in fact, 109 had entered into substantial contracts in excess of $3,000,000 to renovate the building, work had started in August or September 1998, there were monies owing to one contractor, and, accordingly, liens had arisen;

(c) there were no encumbrances against the assets of 109 when, in fact, Engel Canada had an outstanding debenture or general security agreement;

(d) the value of assets was inflated and liabilities were not disclosed;

(e) 109 was up-to-date in filing income tax returns when, in fact, 109 had never filed a return since incorporation in 1994 and, further, there was significant, income tax owing.

28 All of these errors or misrepresentations would have been discovered on a due diligence investigation. GECC and its related companies are well known in the commercial finance business. They specialize in large commercial loans starting at $5,000,000. They are a sophisticated lending institution. Failure to perform a due diligence investigation of 109 is inconsistent with GECC's normal practice.

29 On 27 April 1999 Mr. Feehan was informed 109 and Euro United had increased the rental payment required from $700,000 to $1,400,000 per annum. No explanation was requested. Mr. Feehan was still unaware rent was not being paid.

30 Equity investors contributed $70,000,000 to Euro United over the two months following 15 April 1999 and the overadvance was paid off by 25 May 1999. GECC, however, did not release its mortgage on the Dielcraft property.

31 In August 1999 Euro United requested an overadvance of $300,000. GECC refused. Mr. Feehan said Euro United was growing rapidly without the proper financing to support the growth. In fact, this was similar to the comment he made in April 1999.

32 Mr. Feehan stated GECC discovered the construction project on the Dielcraft property in November 1994 when Mr. Rehani made mention of it, he says, for the first time.

33 On 24 November 1999 GECC demanded payment from Euro United and 109. The end result was the bankruptcy of these companies and the ultimate sale of assets by the trustee.

(b) Subsection 20(1). Business Corporations Act

34 Subsection 20(1) of the Ontario *Business Corporations Act*, as at the relevant time of the events, said:

20(1) Financial assistance by corporation —

Except as permitted under subsection (2), a corporation with which it is affiliated, shall not, directly or indirectly, give financial assistance by means of a loan, guarantee or otherwise,

(a) to any shareholder, director, officer or employee of the corporation or affiliated corporation or to an associate of any such person for any purpose; or,

(b) to any person for the purpose of or in connection with a purchase of a share, or a security convertible into or exchangeable for a share, issued or to be issued by the corporation or affiliated corporations.

where there are reasonable grounds for believing that,

(c) the corporation is or, after giving the financial assistance, would be unable to pay its liabilities as they become due; or

(d) the realizable value of the corporation's assets, excluding the amount of any financial assistance in the form of a loan and in the form of any secured guarantee, after giving the financial assistance, would be less than the aggregate of the corporation's liabilities and stated capital of all classes.

35 The parties acknowledge 109 and Euro United were affiliated corporations and the guarantee and mortgage provided by 109 constituted financial assistance within the meaning of subsection 20(1).

36 The purpose of subsection 20(1), in part, is to prevent the dissipation of corporate assets that might otherwise prejudice the financial position of creditors and shareholders: see: Wayne D. Gray, *Corporate Guarantees*, 1999, Law Society of Upper Canada, Continuing Legal Education Lectures.

37 The initial determination is the amount of the financial assistance. The guarantee says $11,500,000, the mortgage says $300,000,000. There is some merit in relying on the amount stated in the mortgage, insofar as the mortgage is central to the issue in this litigation; however, I am of the view such is misleading. The explanation provided for this sum bears little, if any relationship to the actual credit agreement amendment. Further, 109's liability is from the guarantee, the mortgage only providing collateral security.

38 GECC suggests the financial assistance is limited to $4,000,000, relying on its 9 April 1999 proposal which allowed for such payment, but on strict conditions. This provision was not inserted in the amendment to the credit agreement, the guarantee or any of the security documents delivered on 14 April 1999. Further, GECC has always claimed entitlement to the full amount of the guarantee, namely $11,500,000, as confirmed by its demand letter on 24 November 1999 and, as well, Mr. Feehan's testimony at trial.

39 Accordingly, I find the amount of financial assistance was $11,500,000.

40 The test in subsection 20(1)(c) and (d) is an objective one, that is, were there reasonable grounds on 15 April 1999.

41 The practical difficulty regarding a review of the financial problems of Euro United and 109 is that much of the evidence relates to subsequent events. Their ultimate bankruptcy, however, cannot be relied upon as the basis for finding a breach of this statutory provision. There are, however, a number of matters that existed on 15 April 1999 and are relevant to this issue. The evidence established the following facts:

(i) 109 had no income as Euro United had not paid its rent for at least four months;

(ii) the only prior source of income for 109 had been rental payments from Euro United which it relied on to meet its obligations;

(iii) 109 had an outstanding debt to Engel Canada, subsequently calculated by KPMG to be $279,913, as at 30 June 1999;

(iv) 109 had never filed income tax returns and there was income tax owing, subsequently calculated by KPMG to be $1,441,200 as at 30 June 1999;

(v) similarly, there was goods and services tax owing by 109, subsequently calculated by KPMG to be $26,618 as at 30 June 1999;

(vi) it is reasonable to assume 109 had other ongoing expense in the normal course of business, particularly if Euro United was also not paying the property related expense;

(vii) 109 had $102,275 on deposit in its bank account;

(viii) the property was valued at $3,190,000;

(ix) other assets of 109 were described as rent owing from Euro United and monies owing from its shareholder, Mr. Rehani, but there was no evidence these were tangible assets;

(x) 109 had entered into construction contracts in excess of $3,000,000, much of it for future work, and, although contractors had been substantially paid to date, there were holdback monies owing to one contractor;

(xi) the GECC mortgage prevented the property being used by 109 as security to fund the construction project.

42 On 15 April 1999, 109 was not paying, nor was able to pay, its outstanding liabilities. It had no income and significant debt had accumulated. Even if Euro United had been paying rent, there would be insufficient income to pay liabilities. The construction project, commenced some months prior, would require substantial funding which could not come from income. The guarantee and mortgage to GECC compounded the situation by preventing use of the property as security for funding to pay liabilities.

43 In addition, the value of 109's assets on 15 April 1999, excluding the amount of the financial assistance, was less than its outstanding liabilities. The construction expense alone was equal to or exceeded the property value. The outstanding income tax liability suggests it was only a matter of time before failure would occur.

44 In my review of the evidence, it appears 109 failed the solvency and the balance sheet tests without having to take into account the financial assistance provided in the guarantee and mortgage, although it is possible 109 might have been able to meet most of its liabilities if Euro United was paying its rent and it could mortgage the property to fund the construction. Neither event occurred, nor was there evidence to suggest it would occur.

45 Nevertheless, consideration must given to whether there were reasonable prospects of GECC calling on the guarantee as of 15 April 1999. In this regard, the comments by Farley J. in *Clarke v. Technical Marketing Associates Ltd. (Trustee of)* (1992), 8 O.R. (3d) 734 (Ont. Gen. Div.) at p. 750:

> It does not seem to me that the words 'after giving the financial assistance' under either s. 44(1)(c) or (d) mean that the tests have to be applied on the assumption that the corporation giving the guarantee has had to make payment. The guarantee has been given as financial assistance when it was entered into and not when it might actually be called upon (or as if it had been called upon). Thus a guarantee would no appear to impinge upon the 'cash flow' requirement contemplated by s. 44(1)(c) if given on a naked basis.
>
> However, one has to go back to the lead-in words 'where there are reasonable grounds for believing that'. This implies that one must form a reasonable opinion based on the facts of each case to see what the likelihood would be of the guarantee being called upon in the future so as to constitute it a 'liability' which must be paid as part of the 'liabilities as they become due' (s.44(1)(c).

46 The guarantee had only just been signed and, therefore, it might be said 109, Euro United and GECC were optimistic the financial problems at Euro United had been resolved, however, a more detailed analysis is required. GECC was buttressing its security, as acknowledged by Mr. Feehan. Within two months, equity investors inject $70,000,000 into Euro United and the overadvance is paid in full. The basis for the extra security appears resolved yet GECC does not release 109.

47 Despite Mr. Feehan's expressed optimism on 15 April 1999, it is clear GECC wanted more security as they were contemplating further default by Euro United. This is the only conclusion that can be drawn from Mr. Feehan's report on 5 April 1999 "our quickest and easiest exit". There was no acceptable evidence to the contrary and, therefore, I conclude

the guarantee must be considered a liability in the solvency test under subsection 20(1)(c). It is also included on the basis it prevented 109 mortgaging the Dielcraft property to fund the construction project.

(c) Subsection 20(3), Business Corporations Act

48 Subsection 20(3) of the Ontario *Business Corporations Act*, as at the relevant time of the events, said:

> (3) Validity of Contract — A contract made by a corporation in contravention of this section may be enforced by the corporation or by a lender for value in good faith without notice of the contravention.

49 GECC seeks to rely on this safe harbour provision.

50 It is apparent, on the evidence, GECC did not have actual "notice of contravention." The question is whether it can rely on the representations of Mr. Rehani and its failure to perform a due diligence investigation on as stated in the subsection, was GECC "a lender for value in good faith."

51 109 received no benefit from the guarantee and mortgage. The sole purpose of these documents, as said by Mr. Feehan, was so secure past indebtedness of Euro United. Monies may have been advanced by GECC to Euro United after 15 April 1999 but such was merely a continuation under the revolving letter of credit. Given the subsequent injection of funds by equity investors and the payment of the overadvance, GECC's failure to release 109 clearly demonstrates the purpose of this additional security to cover past indebtedness of Euro United. Therefore, in my view, GECC was not "a lender for value" within the meaning of subsection 20(3) as it relates to the financial assistance.

52 Further, failure to conduct a due diligence investigation cannot be used to establish "good faith" in the circumstances of this case. GECC made no attempt to investigate 109 which was inconsistent with their corporate practice as demonstrated in their inquiry in 1998 with respect to the Euro United application for financing. Here, a property inspection would, in a matter of minutes, reveal the construction project on the Dielcraft property and caused further inquiry. The normal request for financial statements would have led to finding the income tax liability. GECC also knew Mr. Rehani was responsible for several covenant breaches which ought to have raised concerns about his honesty.

53 In this regard, I adopt the comment by Huband J.A. in *Petro-Canada v. Cojef Ltd.*, [1992] M.J. No. 575 (Man. C.A.) where, at p. 2, he said:

> There is merit in the argument that Petro-Canada cannot turn a blind eye toward the obvious. Moreover, Petro-Canada must be judged, not on the basis of an unsophisticated lender, but as one whose business it is to extend credit on the basis of guarantees. Petro-Canada is aware of the hazards of relying on a guarantee which proves unenforceable by virtue of sec. 42(1). It cannot claim the benefit of sec. 42(3) by ignoring the obvious and neglecting to ask questions.

54 *Upper Mapleview Inc. v. Stolp Homes (Veterans Drive) Inc.* (1997), 36 B.L.R. (2d) 31 (Ont. Gen. Div.), is comparable in many respects to the case at bar. In discussing this issue, Swinton J. also indicated the defendant "should not be held to the same standard of sophistication as Petro-Canada".

55 GECC is a sophisticated financial institution that well knows the necessity of a due diligence investigation. As such, it cannot rely on the suggestion a solvency certificate satisfies the test. GECC knew enough about the relationship between 109, Euro United and Mr. Rehani that necessitated further inquiry. The evidence clearly indicated GECC made no inquiry, not even a property inspection or search of title, and, further, there was an urgency in completing the transaction.

56 In this regard, the statement by Carthy J.A. in *Assaad v. Economical Insurance Group*, [2002] O.J. No. 2356 (Ont. C.A.), at p. 4, is appropriate:

> Suspicions combined with blindness adds up to an absence of good faith.

57 Mr. Wayne Gray, in his paper *Corporate Guarantees*, supra, offered this conclusion, at p. 3-39:

> Thus a prudent lender should not expect to rely on the safe harbour provision. Instead, it will take all steps available to it to ensure that it not only has on notice of the contravention but that it can also, if necessary, produce compelling evidence to a court that the lender addressed its mind to the statutory requirements and reasonably satisfied itself that the corporation providing the financial assistance was not contravening the provisions of its incorporation statute. Unless the lender takes appropriate steps so that it can adduce such evidence should the issue arise in litigation, it will risk encountering significant enforcement difficulties if its primary security from the borrower should become insufficient to meet the borrower's obligations.

58 GECC took no steps and, therefore, has no evidence to demonstrate its good faith. Reliance on Mr. Rehani's representations and failure to conduct a due diligence investigation was, in my view, willful blindness by GECC.

(d) Summary

59 In summary, I find 109 failed both the solvency and balance sheet test under subsections 20(1)(c) and (d) and, further, GECC cannot rely on the sale harbour provision of subsection 20(3). Accordingly, I find the mortgage from 109 to GECC is void as against the plaintiffs, as a result of contravention of section 20, *Business Corporations Act*.

(ii) Section 2, Fraudulent Conveyances Act Section 4, Assignment and Preferences Act

60 Although Mr. Rehani did not testify, it is likely he was optimistic, on 15 April 1999, Euro United and 109 would be successful business ventures. Optimism, however, is not evidence of good intentions. The mortgage to GECC, if it stands up, has the actual effect of defeating creditors. An objective analysis of the circumstances is necessary to determine if either, or both, of these statutory provisions apply.

(a) Section 2 Fraudulent Conveyances Act

61 Section 2 of the *Fraudulent Conveyances Act* says:

> Every conveyance of real property or personal property and every bond, suit, judgment and execution heretofore or hereafter made with intent to defeat, hinder, delay or defraud creditors or others of their just and lawful actions, suits debts, accounts, damages, penalties or forfeitures are void as against such persons and their assigns.

62 The financial circumstances of 109 were identified previously. In April 1999 Mr. Rehani, sole director, officer and shareholder of 109, knowing the financial situation, caused 109 to guarantee the indebtedness of Euro United, a company of which he was the president and controlling shareholder, and to provide collateral mortgage security on its only real asset. Mr. Rehani's actions were facilitated by the willful blindness of GECC. Mr. Rehani was not truthful. He deliberately misrepresented the situation to GECC. GECC failed to make any inquiry.

63 At issue, therefore, is whether there was an intent to defeat or delay creditors, such as the lien claimants, some of whom had already commenced work on the Dielcraft property by 15 April 1999. There was no direct evidence of intent, however, as West J. said in *Home Savings & Loan Corp. v. Mathews* (1995), 49 R.P.R. (2d) 79 (Ont. Gen. Div.), at p. 87, "Intent can be inferred from the surrounding circumstances."

64 Over the years, the case law has referred to suspicious circumstances demonstrating "badges of fraud": see, for example *Solomon v. Solomon* (1977), 16 O.R. (2d) 769 (Ont. S.C.); and *Prodigy Graphics Group Inc. v. Fitz-Andrews*, [2000] O.J. No. 1203 (Ont. S.C.J.).

65 The evidence established the following, which may be appropriately considered in this analysis:

(i) the conveyance by 109 was in support of a related party, Euro United;

(ii) Mr. Rehani controlled both corporations;

(iii) 109 received no consideration;

(iv) the property conveyed was all of 109's real assets;

(v) 109 had existing and substantial debt such as for income tax, for creditors and was incurring future and substantial liability for creditors regarding the construction project;

(vi) the conveyance was completed with considerable haste, within five days;

(vii) disclosure to GECC was incomplete and in error which could have been discovered upon investigation;

(viii) Mr. Rehani had already committed acts of dishonesty regarding payment on his shareholders loan and acquisition and mortgaging of other property without the consent of GECC;

(ix) The conveyances exceeded the property value;

(x) Euro United was in financial difficulties, having defaulted on the credit agreement within five months of the advance; and,

(xi) There was good reason for GECC and Mr. Rehani to consider Euro United and 109 were insolvent, or about to be.

66 As Cameron J. said in *Prodigy Graphics*, supra, at p. 22:

> The badges of fraud are of evidentiary value in determining the issue of intent but are not conclusive evidence of fraud. Fraudulent intent is a matter of fact to be determined in the circumstances of each case or the basis of the evidence as a whole: *Meeker v. Cedar Products v. Edge* (1968), 12 C.B.R. (N.S.) 49 (B.C.C.A.).
>
> Once the suspicious circumstances raise a prima facie presumption of intent to hinder, defeat or defraud a creditor, the court may find the intent unless the presumption is displaced by corroborative evidence of the bona fides of the debtor in the suspect transaction: *Kingsbridge Grand Ltd. v. Vacca*, [1999] O.J. No. 4914 citing *Koop v. Smith* (1915), 51 S.C.R. 554; *Applecrest Investments Ltd. v. Toronto Masonry (1986) Ltd.*, [1997] O.J. No. 436; *Rinaldo v. Rosenfeld*, [1999] O.J. No. 4665.

67 In *Petrone v. Jones* (1995), 33 C.B.R. (3d) 17 (Ont. Gen. Div.), Wright J. at p. 20 provided this comment:

> In the absence of any direct proof of intention, if a person owing a debt makes a settlement which subtracts from the property which is the proper fund for the payment of those debts, an amount without which the debts cannot be paid then, since it is the necessary consequence of the settlement that some creditors must remain unpaid, it is the duty of the judge to direct a jury that they must infer the intent of the settler to have been to defect or delay his creditors. (*Sun Life Assurance Co. v. Elliott* (1900), 31 S.C.R. 91). ...
>
> Further: even if the plaintiff did not intent to defeat, hinder or delay their creditor but effected the transfer with a view to defeating, hindering or delaying potential future creditors his defence would still fail.

68 There are strong suspicious circumstances, or badges of fraud, as noted previously. Mr. Rehani knew of the construction project and the cost of same. He knew Euro United was not paying rent to 109. He knew 109 required the property to be mortgaged for the construction project expense as rent, if paid, was insufficient. He knew 109 already had significant liabilities, particularly for unpaid income tax. In spite of this knowledge, he caused 109 to pledge its only asset to GECC to secure Euro United's existing indebtedness. The only logical inference is that Mr. Rehani used 109 to

support the financial difficulties of Euro United and, in so doing, used the property from which the contractors would look for payment.

69 Therefore, there is, in my view, a prima facie presumption of intent to defeat current and future creditors. GECC is unable to rebut this presumption as they failed to conduct a due diligence investigation and, therefore, had no knowledge, but should have, of the true circumstances on 15 April 1999.

70 Section 7 of the *Act* says:

> 3. Section 2 does not apply to an estate or interest in real property or personal property conveyed upon good consideration and in good faith to a person not having at the time of the conveyance to the person notice or knowledge the intent set forth in that section.

71 109 received no consideration for the conveyance. In *Courtesy Chevrolet Oldsmobile Ltd. v. Dhaliwal* (1987), 67 C.B.R. (N.S.) 72 (Ont. H.C.), Austin J. at p. 79 indicated:

> The jurisprudence makes it clear that where there is no 'good consideration', then the intent of the transferor alone is relevant.

72 Further, GECC cannot rely on section 3 for the same reasons as with respect to subsection 20(3) of the *Business Corporations Act*. Willful blindness is not good faith.

73 The plaintiffs argue a conveyance from 109 to Euro United for no consideration would be void under section 2 and, as the conveyance from 109 to GECC has the same effect, it should also be void. I agree. Substance, not form, is the determining factor.

(e) Section 4, Assignments and Preferences Act

74 Subsection 4(1) of the *Assignments and Preferences Act* says:

> 4(1) Subject to section 5, every gift, conveyance, assignment or transfer, delivery over or payment of goods, chattels or effects, or of bills, bonds, notes or securities, or of shares, dividends, premiums or bonus in any bank, company or corporation, or of any other property, real or personal, made by a person when insolvent or unable to pay the person's debts in full or when the person knows that he, she or it is on the eve of insolvency, with intent to defeat, hinder, delay or prejudice creditors, or any one or more of them, is void as against the creditor or creditors injured, delayed or prejudiced.

75 Subsection 4(1) includes a solvency test. As previously noted, under section 20, *Business Corporation Act*, 109 was, in my view, insolvent on 15 April 1999. 109 was also insolvent as defined in subsection 2(1) of the *Bankruptcy and Insolvency Act*: see also *Robinson v. Countrywide Factors Ltd.* (1977), 23 C.B.R. (N.S.) 97 (S.C.C.), at p. 136.

76 On 15 April 1999, 109 had no income and had existing liability for income tax and other debts. Construction work had commenced and there was an outstanding debt to one contractor. 109's liabilities exceeded its assets. The conveyance to GECC compounded 109's insolvency.

77 The evidence supports a prima facie case for insolvency of 109 and there is, therefore, a presumption of intent to defeat creditors, as noted in the analysis under the *Fraudulent Conveyances Act*. No evidence was presented to rebut the presumption.

78 Subsection 5(5)(d) of the Act says:

> Nothing in this Act,
>
> ellipsis;

(d) invalidates a security given to a creditor for a pre-existing debt where, by reason or on account of the giving of the security, an advance of money is made to the debtor by the creditor in the belief that the advance will enable the debtor to continue the debtor's trade or business and to pay the debts in full.

79 No advance was made to 109. The pre-existing debt was Euro United's. There was no evidence to suggest any advance to Euro United would enable 109 to continue its business and pay its debts in full. Indeed, the evidence showed otherwise as confirmed by subsequent events. GECC, therefore, cannot rely on subsection 5(5)(d).

(f) Summary

80 In summary, I find the mortgage from 109 to GECC is void as against the plaintiffs, as a result of contravention of section 2 of the *Fraudulent Conveyances Act* and section 4 of the *Assignments and Preferences Act*.

(iii) Section 78, Construction Lien Act

81 Subsection 78(1) of the *Construction Lien Act* says:

(1) Except as provided in this section, the liens arising from an improvement have priority over all conveyances, mortgages or other agreements affecting the owner's interest in the matters.

Other subsections provide exceptions to this general priority in favour of construction liens. It is, therefore, necessary to determine if the mortgage to GECC is prior or subsequent to the construction liens.

82 In *Boehmers v. 794561 Ontario Inc.* (1993), 14 O.R. (3d) 781 (Ont. Gen. Div.); affirmed (1995), 21 O.R. (3d) 771 (Ont. C.A.), Killeen J. said:

Section 78(1) is the overarching principle of the regime of the Act for the determination of priorities. It is, if you will, the central interpretative principle for the adjudication of conflicts of this type before the court in this case. Surely, it necessarily implies that, in cases of conflicts, as here, the burden must be on the mortgagee to persuade the court that it somehow falls clearly within a specified exception to the generalized priority of the liens.

83 The comment by Rosenberg J. in *697470 Ontario Ltd. v. Presidential Developments Ltd.* (1989), 69 O.R. (2d) 334 (Ont. Div. Ct.) is also of assistance where, at p. 337, he said:

Accordingly, while the Act may merit a liberal interpretation with respect to the rights it confers upon those to whom it applies it must be given a strict interpretation in determining whether it does in fact apply: *Clarkson Co. Ltd. v. Ace Lumber Ltd.* (1963), 36 D.L.R. (2d) 554 (S.C.C.)

84 Before proceeding to consider whether the mortgage was prior or subsequent, a preliminary finding is necessary as to whether there was one improvement or several improvements. "Improvement" is defined in the *Act* as:

(a) any alteration, addition or repair to, or

(e) any construction, erection or installation on any land and includes the demolition or removal of any building, structure or works or part thereof, and 'improved' has a corresponding meaning.

85 Various contractors provided services and materials for 109 at the Dielcraft property at different times. 109 entered into specific contracts with Jannick Electric Limited ("Jannick"), Aim Waste Management Limited ("Aim") and XDG Limited ("XDG"). Numerous subcontractors were also involved.

86 In the summer of 1998 Mr. Raymond El Jarnal, vice-president of Euro United and general manager of 109, began inquiring of contractors and consulting engineers as to renovations of the building located on the Dielcraft property.

Several contractors expressed an interest and provided quotations for various components of the intended project. Contracts were then negotiated with the successful firms.

87 Jannick was on site in early September or perhaps August 1998 to disconnect electrical services. Aim commenced demolition work on 15 September 1998. Negotiations with XDG continued to January 1999 at which point Mr. El Jamal presented XDG with a draft contract. Giffel's Associates Limited ("Giffels"), 109's consulting engineers, prepared the contract in final form based on the terms as already negotiated. Although the written contract is dated 15 April 1999, it is on the same terms as negotiated and agreed to and, therefore, I find the contract between 109 and XDG was orally entered into in early January 1999.

88 XDG employees and others were on site on 7 June 1999, however, actual work was commenced on 3 March 1999 when Mr. Wayne Nosal of Design Plus started to prepare the architectural drawings. XDG employees also commenced work on its metal fabrication drawings on the same day.

89 The ultimate goal of the project was to raise the roof on the building, a large undertaking. XDG was to perform the actual work, however, demolition and electrical disconnection was required before they could commence work on site. In my view, therefore, this appears to be one project, or improvement, not several, as suggested by GECC.

90 Additional evidence confirms this observation. Aim was initially approached by another contractor in July 1998 to provide a quote for part of the project. 109 eventually contracted directly with Aim on 10 September 1998. Jannick's proposal to 109, dated 28 August 1998, stated it was "...to assist you in raising of your roof...". Also, the minutes of meeting on 19 November 1998, prepared by Giffels, refers to one project with numerous components.

91 Accordingly, I find there was one improvement. A comparison can be found in the situation in *Moffatt & Powell Ltd. v. 682901 Ontario Ltd.* (1992), Kirsch's C.L.C.F., 61.3 [49 C.L.R. 205 (Ont. Gen. Div.)] where Misener J. said:

> The 'construction' (and therefore the 'improvement') that Kuco undertook on the lands in question here was the erection of a three-storey residence for the elderly that contained 66 separate suites. All 16 lien claimants contracted with Kuco to perform work or services or to supply materials of that 'construction' (and therefore for that 'improvement'). Therefore, all performed work or services in respect of the same 'construction' — and therefore the 'same improvement.'

Section 15 of the *Act* says:

> 15. A persons' lien arises and takes effect when the person first supplies services or materials to the improvement.

92 Jannick was on site to disconnect electrical services, likely in August 1998, however, the evidence was not clear. Aim was on site to commence demolition on 15 September 1999. Therefore, the first lien arose at least by 15 September 1998 and, accordingly, the mortgage from 109 to GECC was a subsequent mortgage, and I so find.

93 Subsections 78(5) and (6) of that *Act* say:

> **78(5) Special priority against subsequent mortgages —**
>
> Where a mortgage affecting the owner's interest in the premises is registered after the time when the first lien arose in respect of an improvement, the lien arising from the improvement have priority over the mortgage to the extent of any deficiency in the holdbacks required to be retained by the owner under Part IV.
>
> **(6) General priority against subsequent mortgages —**
>
> Subject to subsections (2) and (5), a conveyance, mortgage or other agreement affecting the owner's interest in the premises that is registered after the time when the first lien arose in respect of the improvement, has priority over

the liens arising from the improvement to the extent of any advances made in respect of that conveyance, mortgage or other agreement, unless,

(a) at the time when the advance was made, there was a preserved or perfected lien against the premises; or

(b) prior to the time when the advance was made, the person making the advance had received written notice of a lien.

94 As previously stated, the mortgage was provided as collateral security with respect to the prior indebtedness of Euro United. No advance was made to 109 nor did 109 benefit in any manner whatsoever. The statutory provisions refer to amounts advanced, not amounts secured: See *561861 Ontario Ltd. v. 1085043 Ontario Inc.* (1998), Kirsh's C.L.C.F. 78.50 [1998 CarswellOnt 2935 (Ont. Bktcy.)]

95 In *Marsil Mechanical v. A Reissing-Reissing Enterprise Ltd.* (1996), Kirsh's C.L.C.F. 78.40 [1996 CarswellOnt 301 (Ont. Gen. Div.)], Klowak J. said:

In considering the definition of 'advance' it seems to me that, for purposes of the *Construction Lien Act*...it must mean when the owner, or the owner's delegate, acquires actual control of the money.

96 Accordingly, I find there was no advance under the mortgage from 109 to GECC and, therefore, the lien claimants have priority pursuant to section 78 of the *Construction Lien Act*.

Conclusion

97 KPMG Inc., trustee in bankruptcy of 109, filed a statement of defence in this action but did not participate in the trial for obvious reasons. Representatives of 109 and Euro United were not called as witnesses by the participating parties. The issues dealt with the relationship between those corporations and GECC and, as well, the lien claimants. The plaintiffs were able to establish their case based upon the documents and oral testimony.

98 In many respects, GECC required testimony of representatives of 109 and Euro United. Although there was sufficient evidence for the findings made, there is a strong argument to also rely on findings of adverse inference as against GECC for failure to call these witnesses.

99 One theme was central to all issues in this litigation; that is, GECC's failure to perform its usual and customary due diligence investigation with respect to 109. There was no satisfactory answer for this neglect. GECC is a sophisticated lending institution. It normally performs due diligence. Was its failure to do so an oversight or was GECC scrambling to gain additional security for a customer they knew was on the edge of failure?

100 It would be unconscionable and inequitable to allow a mortgagee to obtain priority based upon its willful blindness or negligence. Even the simplest of investigations would have revealed the construction project and led GECC to make further inquiry. They would easily have determined Mr. Rehani was not being truthful.

101 A due diligence investigation would, in my view, have led GECC to decide against mortgage security on the Dielcraft property.

102 A trial of issues was directed to determine the priority as between the lien claimants and the mortgagee. There were secondary issues that arose during the trial pertaining to the validity and quantum of some liens. Those issues were beyond the scope of the trial.

103 In result, the plaintiffs are entitled to a declaration the lien claimants have priority over the mortgage from 109 to GECC, subject to proof as to validity and quantum of the liens for which a further trial, if necessary, is directed.

104 If the parties cannot agree on the issue of costs, written submissions are required. The party seeking costs shall serve such submissions within 28 days of the release of this decision. The responding party shall have 14 days to serve submissions and a further 7 days is allowed for reply. All written submissions are to be filed by the last day for reply.

Action allowed.

Footnotes

* Additional reasons at (2003), 2003 CarswellOnt 1316, 41 C.B.R. (4th) 315 (Ont. S.C.J.) .

TAB 6

2016 ONCA 406
Ontario Court of Appeal

Montor Business Corp. (Trustee of) v. Goldfinger

2016 CarswellOnt 8324, 2016 ONCA 406, [2016] W.D.F.L. 3770, 267 A.C.W.S. (3d) 274, 351 O.A.C. 241, 36 C.B.R. (6th) 169, 58 B.L.R. (5th) 243

In the Matter of the Bankruptcy of Summit Glen Waterloo/2000 Developments Inc., of the City of Toronto, in the Province of Ontario

A. Farber & Partners Inc., the Trustee of the Bankruptcy Estate of Montor Business Corporation, Annopol Holdings Limited and Summit Glen Brantford Holdings Inc., Applicant (Appellant/ Respondent by way of cross-appeal) and Morris Goldfinger, Goldfinger Jazrawy Diagnostic Services Ltd., Summit Glen Bridge Street Inc., Mahvash Lechcier-Kimel, Annopol Holdings Limited and Summit Glen Brantford Inc., Respondents (Respondents/Appellants by way of cross-appeal)

E.A. Cronk, S.E. Pepall, P. Lauwers JJ.A.

Heard: October 14-15, 2015
Judgment: May 30, 2016 [*]
Docket: CA C57879

Proceedings: affirming *Montor Business Corp. (Trustee of) v. Goldfinger* (2013), [2013] O.J. No. 4871, 8 C.B.R. (6th) 200, 2013 CarswellOnt 14983, 2013 ONSC 6635, D.M. Brown J. (Ont. S.C.J. [Commercial List]); additional reasons at *Montor Business Corp. (Trustee of) v. Goldfinger* (2014), 2014 CarswellOnt 1169, 9 C.B.R. (6th) 86, 2014 ONSC 756, D.M. Brown J. (Ont. S.C.J. [Commercial List])

Counsel: Patrick Shea, Brent Arnold, for Appellant / Respondent by way of cross-appeal
Maurice J. Neirinck, Michael McQuade, for Respondents / Appellants by way of cross-appeal

Subject: Civil Practice and Procedure; Contracts; Corporate and Commercial; Estates and Trusts; Insolvency; Property; Public; Restitution; Torts

Headnote

Bankruptcy and insolvency --- Avoidance of transactions prior to bankruptcy — Fraudulent preferences — View to prefer — Relevance of creditor's intent or knowledge

G invested in companies controlled by his friend, real estate developer K — Relationship between G and K soured — After G threatened litigation, G and K negotiated settlement involving various payments and transactions — Settlement included payment of $2.5 million to G from A Ltd., K's holding company — Several of K's companies went bankrupt in 2009 — Trial judge refused trustee in bankruptcy's request to set aside transactions arising from settlement, rejecting trustee's assertions that transactions were transfers at undervalue, unjust preferences, fraudulent conveyances, oppressive and unjust enrichment — Trial judge concluded that A Ltd. did not have requisite intent to defeat, hinder, delay or prejudice creditor — Trustee appealed — G cross-appealed — Appeal and cross-appeal dismissed — Trial judge did not err in concluding that payments did not constitute transfer at undervalue — Trustee did not show that A Ltd. intended to defeat, hinder, delay or prejudice creditor.

Debtors and creditors --- Fraudulent conveyances — Conveyances for valuable consideration — Sufficiency of consideration

G lent approximately $6.5 million to companies controlled by his friend, real estate developer K — Relationship between G and K soured and G threatened litigation — G and K negotiated settlement, involving payments of $2.5 million from A Ltd. to G, and other transactions — Several of K's companies went bankrupt in 2009 — Trial judge refused trustee in bankruptcy's request to set aside transactions arising from settlement — Trial judge rejected trustee's assertions that transactions were transfers at undervalue, unjust preferences, fraudulent conveyances, oppressive and unjust enrichment — Trustee appealed; G cross-appealed — Appeal and cross-appeal dismissed — Trial judge did not err in concluding that G's forbearance from suit constituted consideration — But for $2.5 million payment, G would have commenced and continued with litigation — It was open to trial judge to conclude that payment of $2.5 million in return for compromise of G's remaining rights was adequate consideration.

Debtors and creditors --- Fraudulent conveyances — Fraudulent intent — Miscellaneous

G lent $6.5 million to companies controlled by his friend, real estate developer K — Relationship between G and K soured — After G threatened litigation, G and K negotiated settlement involving various payments and transactions — One of K's companies, SG B, made $471,000 payment to G — Several of K's companies went bankrupt — Trial judge refused trustee in bankruptcy's request to set aside transactions arising from settlement, rejecting trustee's assertions that transactions were transfers at undervalue, unjust preferences, fraudulent conveyances, oppressive and unjust enrichment — Trial judge set aside $471,000 payment to G on basis that it was contrary to s. 2 of Fraudulent Conveyances Act (FCA) and oppressive under s. 248 of Ontario Business Corporation Act — Trial judge found G had notice or knowledge of K's and SG B's intent to defeat, hinder, delay or defraud another creditor, and he knew payment would prefer his interests over those of other creditor — Trial judge dismissed trustee's other claim under Fraudulent Conveyances Act (FCA) as no intent to defeat, hinder, delay or defraud was proven — Trustee appealed; G cross-appealed from setting aside of $471,000 payment — Appeal and cross-appeal dismissed — Trial judge was correct in dismissing trustee's claim under FCA — Issue of intent was fatal to trustee's ground of appeal — With respect to cross-appeal, G identified no palpable and overriding error that would displace trial judge's findings.

Bankruptcy and insolvency --- Avoidance of transactions prior to bankruptcy — Fraudulent preferences — Miscellaneous

G lent approximately $6.5 million to companies controlled by his friend, real estate developer K — Relationship between G and K soured — After G threatened litigation, parties negotiated settlement including payments and transactions involving K's companies and G — Settlement included $2.5 million payment from K's holding company A Ltd. to G — Several of K's companies subsequently went bankrupt — Trial judge refused trustee in bankruptcy's request to set aside transactions arising from settlement, rejecting trustee's assertions that transactions were transfers at undervalue, unjust preferences, fraudulent conveyances, oppressive and unjust enrichment — Trial judge found A Ltd. was insolvent, and G was not creditor of A Ltd. within meaning of s. 5(1) of Assignments and Preferences Act, but concluded that A Ltd. did not have requisite intent to defeat, hinder, delay or prejudice creditor — Trustee appealed — G cross-appealed — Appeal and cross-appeal dismissed — Trial judge did not err in concluding that payments did not constitute transfer at undervalue — Trustee did not show that A Ltd. intended to defeat, hinder, delay or prejudice creditor — Trial judge did not err in concluding that G's forbearance from suit constituted consideration — But for $2.5 million payment, G would have commenced and continued with litigation.

Business associations --- Specific matters of corporate organization — Shareholders — Shareholders' remedies — Relief from oppression — Oppressive conduct — Miscellaneous

G lent $6.5 million to companies including SG Group and A Ltd., which were controlled by G's friend, real estate developer K — Relationship between G and K soured — After G threatened litigation, parties reached settlement involving various payments and transactions — Several of K's companies went bankrupt — Trustee in bankruptcy sought to set aside transactions arising from settlement, and challenged transactions under oppression provisions in s. 248 of Ontario Business Corporations Act — Oppression claim was rejected — Trial judge found that there was no intent to defeat, hinder, delay or defraud creditors, and concluded that transactions did not violate reasonable expectations of its creditors — Trustee appealed; G cross-appealed — Appeal and cross-appeal dismissed — Trial judge's decision on oppression reflected exercise in discretion and was entitled to deference — K believed payments and transactions would permit companies to continue as going concerns and that they would generate profit — Cataclysmic, unforeseen global economic meltdown that occurred months after payments were made could not be ignored — In that context, trial judge did not err in exercising his discretion and dismissing trustee's claim of unfair disregard for interests of creditors.

Restitution and unjust enrichment --- General principles — Requirements for unjust enrichment — No juristic reason for enrichment

G lent $6.5 million to companies controlled by his friend, real estate developer K — Relationship between G and K soured — After G threatened litigation, G and K negotiated settlement — Settlement involved various payments and transactions, including total of $2.5 million payment from A Ltd. to G — Several of K's companies went bankrupt in 2009 — Trustee in bankruptcy sought to set aside transactions resulting from settlement on basis of unjust enrichment, alleging $2.5 million payments were re-purchase of shares or equity distribution — Trial judge refused trustee's request to set aside transactions arising from settlement, rejecting trustee's assertions that transactions were transfers at undervalue, unjust preferences, fraudulent conveyances, oppressive and unjust enrichment — Trustee appealed — G cross-appealed — Appeal and cross-appeal dismissed — Trusteee appealed, alleging trial judge failed to consider test for unjust enrichment — Appeal dismissed — First two requirements for unjust enrichment were met, as G was enriched and there was corresponding deprivation to A Ltd. — However, there was juristic reason for enrichment — Settlement provided established rationale for payments and hence amounted to juristic reason, as did G's advance of $2.9 million to A Ltd. — Juristic reason was also made out based on reasonable expectations of parties.

Held:

APPEAL by trustee in bankruptcy from judgment reported at *Montor Business Corp. (Trustee of) v. Goldfinger* (2013), 2013 ONSC 6635, 2013 CarswellOnt 14983, 8 C.B.R. (6th) 200, [2013] O.J. No. 4871 (Ont. S.C.J. [Commercial List]), dismissing trustee's request to set aside payments and transactions arising from settlement; CROSS-APPEAL from setting aside of certain payment on basis that it was contrary to s. 2 of *Fraudulent Conveyances Act* and was oppressive under s. 248 of *Ontario Business Corporations Act*.

***S.E. Pepall J.A.*:**

Introduction

1 A failed relationship between an investor, Dr. Morris Goldfinger, and a real estate developer, Jack Lechcier-Kimel ("Kimel"), and the subsequent bankruptcy of several of Kimel's companies has generated three appeals. The appeals involve claims to funds asserted by A. Farber & Partners Inc. ("Farber"), the Trustee in bankruptcy of five companies: Annopol Holdings Limited ("Annopol"), Summit Glen Brantford Holdings Inc. ("SG Brantford"), Summit Glen Waterloo/2000 Developments Inc. ("SG Waterloo"), Summit Glen Group of Companies Inc. ("SG Group") and Montor Business Corporation ("Montor"). All but Montor were companies owned and controlled by Kimel or his then-spouse, Mahvash Lechcier-Kimel ("Mahvash").

2 In the primary appeal, which is the subject matter of these reasons, Farber, in its capacity as Trustee of Annopol, challenges the trial judge's refusal to set aside transactions arising from a settlement between Goldfinger, Kimel and some of Kimel's companies. In particular, Farber seeks to set aside certain transactions arising from the settlement: (1) payments totalling $2.5 million to Goldfinger from Annopol (the "Payments"); and (2) mortgages granted to Goldfinger by SG Brantford and Summit Glen Bridge Street Inc. ("SG Bridge") over their respective properties, and Annopol's subordination of mortgage security in favour of Goldfinger (the "Brantford/Bridge 2008 Transactions").

3 The trial judge rejected Farber's assertions that the transactions were:

- transfers at undervalue under s. 96 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the "*BIA*");
- unjust preferences under s. 4 of the *Assignments and Preferences Act*, R.S.O. 1990, c. A.33 (the "*APA*");
- fraudulent conveyances under s. 2 of the *Fraudulent Conveyances Act*, R.S.O. 1990, c. F.29 (the "*FCA*");
- oppressive under s. 248 of the Ontario *Business Corporations Act*, R.S.O. 1990, c. B.16 (the "*OBCA*"); and
- an unjust enrichment.

4 Goldfinger cross-appeals on the basis that the trial judge erred in setting aside a $471,000 payment in his favour from SG Brantford. The trial judge found that the payment was contrary to s. 2 of the *FCA* and oppressive under s. 248 of the *OBCA*.

5 In the remaining two appeals, both Farber and Goldfinger or his company, 1830994 Ontario Ltd., take issue with the treatment of certain claims asserted in the various bankruptcy proceedings. These appeals are addressed in separate sets of reasons released contemporaneously with these reasons, bearing court file numbers C57898 and C58356.

6 For the reasons that follow, I would dismiss this appeal and Goldfinger's cross-appeal.

Background Facts

A. The Parties' Relationship

7 Kimel was a real estate developer. He incorporated numerous companies for that purpose. He attracted investors to lend to and invest in his companies. Those companies would then lend money to other Kimel companies that would in turn acquire real estate. The investor loans were to be repaid from the proceeds generated from selling the real estate. The investors would also receive a portion of the profit generated from the sales.

8 Goldfinger was not a real estate developer; he was a radiologist. He was also a good friend of Kimel. He decided to lend and invest money into some of Kimel's companies. From February 1999 to December 2005, Goldfinger lent approximately $6.5 million to Kimel's companies, $2,956,000 of which he claimed was advanced to Annopol. Annopol's affairs were directed by Kimel. Annopol then lent these funds to other Kimel companies for the purpose of acquiring properties in the Kitchener/Waterloo and Brantford areas.

9 The terms of the arrangements with Goldfinger were not reduced to writing. Goldfinger described the funds advanced as "interest-free loans" and claimed that he was engaged in a "joint venture" with Kimel.

10 In 2007, the relationship between Goldfinger and Kimel broke down. Goldfinger discovered that Kimel had misled him and that many of the properties that had been acquired were encumbered by mortgages of which he was unaware. He sought explanations and the return of his money, but Kimel stalled. Goldfinger retained counsel who, in letters dated November 12 and 13, 2007, threatened litigation. Goldfinger prepared a draft affidavit in support of a request for a court-appointed receiver over some of Kimel's companies, including Annopol. In that affidavit, he asserted that he had repeatedly requested an accounting from Kimel without success and had concluded that Kimel had not been dealing in good faith. Kimel also retained counsel.

B. The First Settlement

11 The parties commenced settlement negotiations and negotiated the dissolution of their business relationship (the "First Settlement"). Goldfinger and Kimel reached a resolution independently and arrived at an amount to be paid to Goldfinger, but the overall structure and details of the settlement were negotiated with the assistance of counsel. The

parties agreed that Goldfinger would withdraw from the various projects and would be repaid his shareholder loans of $6.5 million, plus an additional $5 million in return for his shares in the various companies. At the time, this latter sum was thought to represent his equity in the properties.

12 As agreed, between December 2007 and January 2008, Annopol paid $2.5 million to Goldfinger. The Payments were broken down as follows. On December 5, 2007, Annopol transferred $1.5 million to Goldfinger. Annopol also issued four cheques in his favour dated December 12 and 28, 2007 in the amount of $300,000 each and December 21, 2007 and January 10, 2008 in the amount of $200,000 each, for a total of $1 million. Each cheque bore the notation "re-purchase shares". Annopol relied on transfers of funds from other Summit Glen entities to cover the amounts paid to Goldfinger.

13 The settlement was memorialized in a Memorandum of Agreement (the "Memorandum") dated December 11, 2007 but signed on May 20, 2008 and amended on June 6, 2008. The terms of the Memorandum originated around the time that the aforesaid payments were made. Goldfinger testified that the Payments of $2.5 million were consideration in contemplation of the settlement. Kimel also stated that the Payments were made in anticipation of the settlement.

14 The parties to the Memorandum were: Goldfinger, Kimel, Mahvash, Annopol, and enumerated Summit Glen companies including SG Brantford and SG Bridge (collectively, the "Summit Glen Companies").

15 The Memorandum provided that:

- Notwithstanding that shares of the Summit Glen Companies had not been formally issued, Goldfinger was, and for all purposes deemed to be, the legal and beneficial owner of 50% of the share capital of each of the Summit Glen Companies.

- The Summit Glen Companies acknowledged the $6.5 million debt to Goldfinger which, in aggregate, was allocated to each of them in separate amounts. The advances were described as shareholder loans.

- The Memorandum accurately recorded the parties' understanding of the discussions that had taken place.

- Each of the Summit Glen Companies was to deliver an interest-free promissory note for its share of the $6.5 million to Goldfinger, one-half payable on December 11, 2008 and the other half payable on December 11, 2009.

- Kimel and each of the Summit Glen Companies were to guarantee the payment of $6.5 million.

- The Summit Glen Companies were to provide $6.5 million in collateral mortgages to Goldfinger. These included mortgages on 176 Henry St., Brantford, which was owned by SG Brantford, and on 70 Bridge St. W., Kitchener, which was owned by SG Bridge.

- Kimel would purchase Goldfinger's shares for $5 million. The parties agreed that the $2.5 million already paid represented a partial payment of the purchase price. The remainder was to be paid by a $1.5 million secured promissory note and a $1 million unsecured promissory note.

- Each of the Summit Glen Companies, including SG Brantford and SG Bridge, was to guarantee payment to Goldfinger of these secured and unsecured promissory notes and was to give collateral third mortgages as security for the guarantees. SG Brantford granted a third mortgage over 176 Henry St. in Brantford and SG Bridge granted a third mortgage over 70 Bridge St. W. in Kitchener to secure the sum of $1.5 million.

- Annopol, Kimel and Mahvash postponed all of their claims against the Summit Glen Companies, including SG Brantford and SG Bridge, in favour of Goldfinger.

- Annopol also postponed its mortgages, including those over 176 Henry St. and 70 Bridge St. W., in favour of Goldfinger (the "Annopol Subordinations").

• Kimel and the Summit Glen Companies provided Goldfinger with an indemnity and they, together with Mahvash and Annopol, also provided him with a release.

16 Lawyers acted for the parties on the settlement, but Goldfinger's lawyers testified that Kimel and Goldfinger had agreed on the $2.5 million figure prior to approaching them.

17 The settlement "was designed in such a way as to repay to Goldfinger the amounts already lent to the SG Companies and to enable Goldfinger to extract an amount representing his notional equity or profit in the various real estate developments": reasons, at para. 213.

18 The Memorandum transactions closed in June 2008 and Goldfinger received the promissory notes, guarantees, postponements and mortgages due to him pursuant to the terms of the Memorandum.

C. The Brantford/Bridge 2008 Transactions

19 Prior to the closing, the 176 Henry St. property owned by SG Brantford was subject to: a first mortgage of $2.85 million in favour of First National Financial Corporation ("First National"); a second mortgage of $450,000 in favour of Montor; and a third mortgage of $750,000 in favour of Annopol. Montor was owned by Jack Perelmuter, an accountant who had provided accounting services to Kimel's companies.

20 As a result of the settlement, SG Brantford provided Goldfinger with two mortgages over 176 Henry St. and Annopol agreed to postpone its third mortgage in favour of Goldfinger's two mortgages. As such, Goldfinger's mortgages were in third and fourth position on the property and Annopol's mortgage was in fifth place.

21 The 70 Bridge Street property owned by SG Bridge was subject to a mortgage in favour of Annopol. As a result of the settlement, SG Bridge provided Goldfinger with two mortgages over 70 Bridge Street and Annopol postponed its mortgage in favour of Goldfinger's two mortgages.

D. Events Surrounding the Bankruptcies

22 By July 2008, Goldfinger alleged that Kimel had breached the terms of the Memorandum and he proceeded to serve demand notices on some of Kimel's companies.

23 Meanwhile, the global credit market crisis was brewing, with matters coming to a head with Lehman Brothers' Chapter 11 filing in mid-September 2008.

24 In November 2008, the 176 Henry St. property had to be refinanced, as the first mortgage in favour of First National was due. It was renegotiated and the principal sum secured was increased. As part of the transaction, Kimel signed an agreement on behalf of Montor to subordinate its second mortgage so that the principal amount of the first mortgage could be increased. SG Brantford then paid $471,000 to Goldfinger, and his third and fourth mortgages were discharged. This payment to Goldfinger was made in the absence of any payment to Montor.

25 On December 1, 2008, Goldfinger obtained an order appointing Zeifman & Partners Inc. as receiver of a number of Kimel's companies to which Goldfinger had made loans, including SG Waterloo, but not including Annopol. Following this, some other Kimel companies defaulted on loans.

26 Perelmuter assigned his company, Montor, into bankruptcy on February 6, 2009. Farber was subsequently appointed Montor's Trustee in bankruptcy.

27 Annopol and SG Brantford were each adjudged bankrupt on May 27, 2010, the initial bankruptcy event having occurred on May 26, 2009, in the case of Annopol, and on April 30, 2009 in the case of SG Brantford. Farber was

appointed Trustee in bankruptcy of both companies, as well as of SG Group and SG Waterloo. SG Waterloo was adjudged bankrupt on June 28, 2010, the date of its initial bankruptcy event being April 3, 2009.

E. The Litigation

28 As mentioned, Farber, in its capacity as Trustee in bankruptcy of Annopol, challenged the $2.5 million Payments from Annopol to Goldfinger. It argued that the Payments were: (1) transfers at undervalue contrary to s. 96 of the *BIA*; (2) unjust preferences under s. 4 of the *APA*; (3) fraudulent conveyances under s. 2 of the *FCA*; (4) oppressive under s. 248 of the *OBCA*; and (5) an unjust enrichment.

29 The trial judge heard the proceedings in a hybrid trial conducted over the course of eight days. He heard *viva voce* evidence and also reviewed extensive documentary records, including several transcripts of out-of-court cross-examinations.

30 The trial judge dismissed all of Farber's challenges to the Payments. Farber now appeals from that judgment, arguing that the trial judge erred in upholding the Payments on each of the grounds set out above.

31 Also relying on the same statutory provisions, before the trial judge Farber challenged the Brantford/Bridge 2008 Transactions (the mortgages granted by SG Brantford and SG Bridge to Goldfinger and the Annopol Subordinations) and the $471,000 paid to Goldfinger. The trial judge dismissed Farber's claims with the exception of the $471,000 payment to Goldfinger, which he found to be contrary to s. 2 of the *FCA* and s. 248 of the *OBCA*. On appeal, Farber submits that the trial judge erred in failing to set aside the Brantford/Bridge 2008 Transactions under the *OBCA*.

32 Goldfinger cross-appeals from the trial judge's decision ordering him to repay Farber the $471,000.

Appeal Relating to the Payments

A. Are the Payments Transfers at Undervalue under the BIA?

(i) Introduction

33 Dealing first with the *BIA* claim, Farber challenged the Payments as transfers at undervalue contrary to s. 96 of the *BIA*. In order to succeed on this ground, Farber was required to establish that:

(a) the Payments were transfers at undervalue;

(b) the transfer occurred:

(i) within one year before the initial bankruptcy event (May 26, 2009), if Goldfinger was at arm's length with the debtor, Annopol; or

(ii) within five years before the initial bankruptcy event (May 26, 2009), if Goldfinger was not at arm's length with the debtor, Annopol; and

(c) the debtor, Annopol, was insolvent at the time of the Payments or was rendered insolvent by the Payments; and

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

34 As I will discuss, undervalue means either that no consideration has been received by the debtor or that the consideration received is conspicuously less than the fair market value of the consideration given by the debtor: *BIA* s. 2. Section 96 is reproduced in Schedule "A" attached to these reasons.

(ii) Trial Judge's Decision on s. 96 of the BIA

35 Before the trial judge, Farber argued that it had established all of the s. 96 requirements and therefore was entitled to an order that the Payments were transfers at undervalue.

36 The trial judge rejected this argument. He found that the transfers were not at undervalue because consideration was given to Annopol by Goldfinger.

37 The trial judge explained that forbearance from suit, either actual or promised, can constitute good consideration. He found that Goldfinger had lent $6.5 million to Kimel's companies and could bring proceedings for that amount. Moreover, formal demand had been made on Kimel and in November 2007, Goldfinger had his counsel prepare an affidavit for him to swear in an action he was contemplating against Kimel, Annopol and the Summit Glen Companies, for the appointment of a receiver over a number of their properties. Instead, Goldfinger settled and did not proceed with his threatened litigation.

38 The trial judge held that the terms of the settlement reflected a compromise of Goldfinger's claims to recover his investment of $6.5 million. Goldfinger deposed that: (1) but for the prior payment of $2.5 million, he would not have entered into the settlement and would have proceeded with the litigation against Kimel and his various companies; and (2) over the course of his dealings, $2.956 million of his money had been deposited into Annopol. Goldfinger's forbearance from suit was not consideration that was conspicuously less than the fair market value of the Payments and there were no transfers at undervalue. This was the ratio of the trial judge's decision on s. 96 of the *BIA*.

39 Nonetheless, he proceeded to consider the other elements Farber was required to establish under s. 96 of the *BIA*.

40 The trial judge concluded that at the time of the Payments (December 2007 and January 2008), Annopol was insolvent using a balance sheet test.

41 The trial judge also addressed the nature of the relationship between Goldfinger and Annopol and considered whether they were at arm's length. Although the Memorandum deemed Goldfinger to be a shareholder, the trial judge found that Goldfinger was not a registered shareholder of Annopol. He found that this deal structure was simply a technical device that was probably tax-driven. Goldfinger never exercised any control over the affairs of Annopol, or any of Kimel's other companies. As a result, Goldfinger and Annopol were not related persons within the meaning of ss. 4(2) and (3) of the *BIA*.

42 In addition, he addressed s. 4(4) of the *BIA*, which provides that "[i]t is a question of fact whether persons not related to one another were at a particular time dealing with each other at arm's length." He concluded that they were acting at arm's length.

43 Although the trial judge accepted that Goldfinger and Kimel had been close friends, he acknowledged that one had to examine the nature of their relationship at the time the Payments were made. Goldfinger had not been involved in the operation of Kimel's companies and had quite limited information about their affairs. In 2007, Goldfinger discovered that he had been misled. He sought explanations, but Kimel stalled. Although Goldfinger and Kimel arrived at the amount of $2.5 million together, the overall structure and details of the settlement were negotiated with the assistance of counsel. The trial judge determined that the facts did not disclose bonds of "dependence, control or influence", which are generally necessary in order to find that two parties are not acting at arm's length.

44 Given that the parties were found to be at arm's length, to succeed under s. 96 of the *BIA*, Farber had to show that the Payments were made within one year prior to the initial bankruptcy event. Annopol's initial bankruptcy event was May 26, 2009 and therefore, the one-year statutory review period commenced on May 26, 2008. The Payments, having occurred between December 5, 2007 to January 10, 2008, were outside the one-year statutory review period reflected in s. 96(1)(a) of the *BIA*. Accordingly, the trial judge concluded that the Payments were not reviewable under s. 96.

45 Lastly, the trial judge considered whether, by making the Payments, Annopol intended to defraud, defeat or delay a creditor. He accepted Farber's submission that Annopol's intention should be determined by reference to the intention of Kimel, who directed Annopol's affairs.

46 The trial judge recognized that an inference of intent may arise from suspicious facts or circumstances, sometimes referred to as "badges of fraud". He found that when making the Payments, Kimel and Goldfinger did not intend to defraud, defeat or delay any of Annopol's creditors. In making that finding, he relied on the following facts:

• the terms of the Memorandum, which originated around the time the Payments were made, indicated that the parties thought the Summit Glen Companies would continue as going concerns and that the properties would generate sufficient value to repay the remaining amount owing to Goldfinger by December 11, 2009;

• the parties to the Memorandum also believed that the properties owned by the Summit Glen Companies had significant future value;

• the Memorandum was not put together in a rush, but was negotiated over six months and both parties were represented by counsel;

• the parties were at arm's length;

• the two lawyers' evidence on the parties' thought processes at the time suggested a genuine belief in the sufficient value of the subject properties;

• consideration was given;

• the Payments and the Memorandum were not put in place in the face of claims by Annopol's judgment creditors; and

• this was all done prior to the collapse of the credit markets, which occurred months after the execution of the Memorandum.

(iii) Farber's s. 96 Submissions on Appeal

47 On appeal, Farber advances three arguments with respect to the trial judge's treatment of the s. 96 *BIA* claim.

48 First, in concluding that the Payments were not transfers at undervalue, Farber submits that the trial judge erred in deciding that Goldfinger provided valuable consideration. Compromising his potential legal claim did not amount to sufficient consideration, as s. 96 requires that the consideration be given at the same time as the transfer and the compromise only occurred at the time of the Memorandum. Furthermore, Annopol did not receive anything in exchange for the Payments; the Memorandum lists the $2.5 million as payment for a debt owing by Kimel. Farber also submits that the trial judge erred in failing to examine the sufficiency of the consideration provided — there was no documentary evidence of any forbearance or settlement with Annopol at the time of the Payments.

49 Second, Farber submits that the trial judge erred in finding that the parties were acting at arm's length. Although he identified the correct test, he failed to apply it. Specifically, he failed to consider the parties' relationship at the time of the Payments and that the Payments were the opposite of what one would expect from arm's-length parties. The trial judge also failed to consider that Goldfinger refused to produce his e-mail exchanges with Kimel from the time of the Payments and failed to consider Goldfinger's evidence that he used his relationship with Kimel to obtain the Payments.

50 Third, Farber argues that the trial judge erred in his analysis of Annopol's intention to defraud, defeat or delay a creditor. Again, Farber states that the trial judge focused on the evidence relating to the Memorandum rather than the Payments themselves and also failed to identify and consider the badges of fraud that were present. In addition,

Annopol had a subjective intent to defraud its creditors, HSBC and a third-party investor, Srubiski, and its actions were deliberate. It had borrowed money from those creditors on the basis that the funds would be invested in real estate; instead, Annopol gave the money to Goldfinger. The effect of the Payments was to defraud and defeat its creditors.

(iv) Analysis

(1) Transfers at Undervalue

51 Section 2 of the *BIA* defines a "transfer at undervalue" as follows:

> [A] disposition of property or provision of services for which no consideration is received by the debtor or for which the consideration received by the debtor is conspicuously less than the fair market value of the consideration given by the debtor.

52 In the absence of evidence to the contrary, Farber's opinion on both the fair market value of the property or services and the value of the actual consideration given or received by the debtor are to be accepted by the court: see s. 96(2) of the *BIA*.

53 Weighing the adequacy of consideration is not an exercise in precision but one of judgment. Nominal or grossly inadequate consideration is insufficient and may be an indication or badge of fraud: see *Feher v. Healey*, [2006] O.J. No. 3450 (Ont. S.C.J.) at para. 45, aff'd 2008 ONCA 191 (Ont. C.A.).

54 Forbearance from suit and a settlement agreement may constitute adequate consideration: see *Ronald Elwyn Lister Ltd. v. Dunlop Canada Ltd.*, [1982] 1 S.C.R. 726 (S.C.C.), at p. 743; *Stott v. Merit Investment Corp.* (1988), 63 O.R. (2d) 545 (Ont. C.A.), at pp. 558-60, leave to appeal dismissed, [1988] S.C.C.A. No. 185 (S.C.C.).

55 Here, formal demand had been made on Kimel and in November 2007 Goldfinger had his counsel prepare an affidavit for him to swear in an action he was contemplating against Kimel, several of the Summit Glen Companies and Annopol. Rather than proceeding with the litigation, Goldfinger negotiated a resolution to the parties' dispute. He abandoned his pursuit of the legal action against Kimel and his companies, including Annopol. But for the $2.5 million payment, he would have commenced and continued with his litigation.

56 The evidence supports the finding that Goldfinger was genuinely threatening legal action. In particular, the record contains Goldfinger's draft affidavit and, as well, his lawyer prepared a memorandum referring to the proposed settlement and that as a result, "Jack [Kimel] staves off receivership". In addition, Annopol was to be a beneficiary of a release under the settlement. The trial judge did not err in concluding that Goldfinger's forbearance constituted consideration.

57 One must then consider whether the consideration given by Goldfinger was adequate, or, to use the language of s. 2 of the *BIA*, was "conspicuously less than the fair market value" of the consideration given by Annopol.

58 Of the $6.5 million invested by Goldfinger, $2.956 million had been paid to Annopol. Based on the record before him, it was open to the trial judge to conclude that a payment of $2.5 million in return for a compromise of Goldfinger's remaining rights was adequate consideration. At a minimum, Goldfinger paid Annopol and Kimel $2.9 million. Given the potentially ruinous consequences of a lawsuit, the trial judge did not err in concluding that the Payments did not constitute a transfer at undervalue.

59 Farber also asserts that s. 96 requires that consideration be given at the same time as the transfer and, in this case, the compromise only occurred at the time of the Memorandum.

60 Section 96 does not address timing and Farber provided no authority for this proposition. However, assuming without deciding that Farber's proposition is correct, the trial judge found at para. 274 of his reasons that the terms of

the settlement originated around the time the $2.5 million was paid. This finding of fact is also relevant to the trial judge's determination that the Payments were not motivated by a desire to defraud, defeat or delay a creditor.

61 This finding was also available on the record. Goldfinger testified that he and Kimel came up with the terms of the settlement themselves and only then approached the lawyers to structure and paper the agreement. In one of his affidavits, he stated that the parties had reached an agreement in November 2007, before the first payment was made. The evidence of Goldfinger's two lawyers lends credence to Goldfinger's version of events.

62 In addition, one of the lawyers, Carl Schwebel, prepared a memo dated November 28, 2007 that recorded discussions with Goldfinger, Kimel and members of Schwebel's firm at a meeting that same day. Although not identical to the terms of the Memorandum, the memo recorded the terms of the settlement negotiated by Goldfinger and Kimel, including the payment of $2.5 million.

63 In light of this evidence, I would not give effect to Farber's submission that the trial judge erred in his transfer at undervalue analysis.

(2) Acting at Arm's Length

64 Given my conclusion on the transfer at undervalue issue, it is not strictly necessary to address Farber's other arguments about s. 96 of the *BIA.* I will do so because my conclusions on the balance of the s. 96 factors inform my conclusions on Farber's other grounds of appeal attacking the validity of the Payments.

65 On the issue of whether the parties were at arm's length, Farber does not challenge the trial judge's description of the applicable test or his finding that Goldfinger and Annopol were unrelated. Rather, it challenges his application of the test and his conclusion that Goldfinger and Annopol were acting at arm's length.

66 Section 4(4) of the *BIA* states: "It is a question of fact whether persons not related to one another were at a particular time dealing with each other at arm's length." As a result, absent a palpable and overriding error, the trial judge's finding on this issue is entitled to deference.

67 The trial judge considered the *dicta* in *Abou-Rached, Re*, 2002 BCSC 1022, 35 C.B.R. (4th) 165 (B.C. S.C.), at para. 46:

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

68 He also considered *Piikani Nation v. Piikani Energy Corp.*, 2013 ABCA 293, 556 A.R. 200 (Alta. C.A.), which identified factors that provide guidance on non-arm's length analysis in the context of *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) jurisprudence. These factors, enumerated at para. 29 of *Piikani*, are: was there a common mind which directed the bargaining for both parties to a transaction; were the parties to the transaction acting in concert without separate interests; and was there *de facto* control?

69 There was no common mind directing Goldfinger and Annopol or indeed, Kimel. They were adverse in interest and on the verge of litigation. The evidence also fails to suggest that they were acting in concert. As discussed, the trial judge did not fail to consider the parties' relationship at the time of the Payments. Nor did Goldfinger or Annopol exercise *de facto* control over the other.

70 Goldfinger was never involved in the operation of the companies, had little information about their operation or finances, discovered Kimel had misled him and then threatened to sue. As mentioned, although Goldfinger and Kimel decided on the amount Goldfinger would be paid, the overall structure and details of the settlement were negotiated with the assistance of counsel.

71 Farber argues that the Payments were the opposite of what one would expect from arm's length parties and that the trial judge erred in declining to draw certain inferences from the evidence. However, the trial judge is the fact finder, not this court, and he was not required to recite every piece of evidence in his 372 paragraphs of reasons. Moreover, there was a dearth of evidence suggesting that the parties were not at arm's length and the trial judge did not err in finding to the contrary. I would reject this argument.

(3) Intention to Defraud, Defeat or Delay a Creditor

72 The burden was on Farber to establish the requisite intent under s. 96 of the *BIA*. An inference of intent may arise from the existence of one or more badges of fraud. However, the presence of such indicia does not mandate a finding of intent. Whether the intent exists is a question of fact to be determined from all of the circumstances as they existed at the time of the conveyance: see *Fancy, Re* (1984), 46 O.R. (2d) 153 (Ont. Bktcy.), at p. 159.

73 Case law has identified the following, non-exhaustive list of "badges of fraud" (see *DBDC Spadina Ltd. v. Walton*, 2014 ONSC 3052 (Ont. S.C.J. [Commercial List]), at para. 67; *Indcondo Building Corp. v. Sloan*, 2014 ONSC 4018, 121 O.R. (3d) 160 (Ont. S.C.J.), aff'd 2015 ONCA 752, 31 C.B.R. (6th) 110 (Ont. C.A.), at para. 52):

• the transferor has few remaining assets after the transfer;

• the transfer was made to a non-arm's length person;

• the transferor was facing actual or potential liabilities, was insolvent, or about to enter a risky undertaking;

• the consideration for the transaction was grossly inadequate;

• the transferor remained in possession of the property for his own use after the transfer;

• the deed of transfer contained a self-serving and unusual provision;

• the transfer was secret;

• the transfer was effected with unusual haste; or

• the transaction was made in the face of an outstanding judgment against the debtor.

74 As stated, Farber complains that the trial judge failed to consider the presence of badges of fraud, focused on the evidence relating to the Memorandum rather than the Payments themselves, and ignored Annopol's intent to defraud its creditors.

75 The trial judge found that the terms of the settlement originated around the time that the $2.5 million was paid. Furthermore, the evidence suggested that the parties expected the Summit Glen Companies and Annopol to continue as going concerns. As is evident from paras. 260 and following of his reasons, the trial judge did consider the issue of badges of fraud, but ultimately concluded that there was no intent. Indeed, his findings undermine Farber's assertions that badges of fraud were present. He assessed the evidence and made findings of fact that supported his reasons for finding an absence of intent. Those findings were available on the record. I see no basis to interfere with them.

76 As for Farber's submissions relating to Annopol's alleged subjective intent to defraud its creditors, HSBC and Srubiski, the evidence did not support such a finding of intent. Neither the Payments nor the settlement were effected

in the face of claims by Annopol's judgment creditors. No evidence was tendered from any creditor and there was no evidence that established that Annopol paid creditor funds to Goldfinger.

77 In conclusion, I would reject Farber's submissions on s. 96 of the *BIA*.

B. Are the Payments Unjust Preferences under the APA?

(i) Introduction

78 At the trial, Farber also argued that the Payments were void as unjust preferences pursuant to s. 4 of the *APA*. To be successful, Farber needed to establish that:

(a) Annopol was insolvent at the time of the Payments;

(b) Annopol intended to defeat, hinder, delay or prejudice a creditor; and

(c) Goldfinger was not a creditor of Annopol within the meaning of s. 5(1) of the *APA*.

79 Sections 4 and 5 of the *APA* are reproduced in Schedule "A" attached to these reasons.

(ii) Trial Judge's Decision on the APA

80 The trial judge did not accept Farber's *APA* argument. He found that the first and third requirements under the *APA* were satisfied — Annopol was insolvent, and Goldfinger was not a creditor of Annopol within the meaning of s. 5(1) of the *APA*. However, the trial judge relied on his earlier analysis under s. 96 of the *BIA* to conclude that the second requirement was not met: Annopol did not have the requisite intent to defeat, hinder, delay or prejudice a creditor.

(iii) Parties' APA Submissions on Appeal

81 On appeal, Farber reiterates its position on intent. In response, Goldfinger takes issue with the trial judge's finding that he was not a creditor within the meaning of s. 5(1).

(iv) Analysis

82 I have already addressed the issue of intent under s. 96 of the *BIA* and that analysis is equally applicable to the requirement of intent under the *APA*. For these reasons, I would dismiss Farber's *APA* ground of appeal. Given that conclusion, there is no need to address Goldfinger's submission on his status.

C. Are the Payments void under the FCA?

(i) Introduction

83 Before the trial judge, Farber submitted that the Payments were also contrary to s. 2 of the *FCA*. To succeed, Farber had to demonstrate that:

(a) Annopol made the Payments with an intent to defeat, hinder, delay or defraud creditors or others; and

(b) Goldfinger did not provide good consideration in exchange for the Payments; or

(c) if Goldfinger did provide good consideration, he had notice or knowledge of Annopol's intent to defeat, hinder, delay or defraud creditors or others.

84 Sections 2 and 3 of the *FCA* are reproduced in Schedule "A".

(ii) Trial Judge's Decision on the FCA

85 The trial judge confined his *FCA* analysis to an examination of intent. He concluded that the evidence concerning intent under the other statutes applied equally to Farber's claim under the *FCA*. Consequently, he dismissed the *FCA* claim.

(iii) Farber's Submissions on Appeal

86 On appeal, Farber submits that the trial judge erred in failing to consider the factual matrix surrounding the Payments; the evidence relating to Annopol's actual or imputed intent; and that Goldfinger was wilfully blind.

(iv) Analysis

87 I have already addressed the issue of intent, which is equally fatal to this ground of appeal. There is therefore no need to address the issue of Goldfinger's knowledge. The trial judge was correct in dismissing Farber's claim under the *FCA*.

D. Oppression Claim

(i) Introduction

88 Before the trial judge, Farber submitted that the Payments were oppressive within the meaning of s. 248 of the *OBCA*. To succeed, Farber had to establish that:

(a) it was a "complainant" within the meaning of s. 245 of the *OBCA*; and

(b) the Payments were oppressive, unfairly prejudicial or unfairly disregarded the interests of Annopol's creditors.

Section 248 of the *OBCA* is reproduced in Schedule "A".

(ii) Trial Judge's Decision on Oppression

89 The trial judge proceeded with his analysis of the oppression claim on the basis that Farber, as Trustee in bankruptcy of Annopol, had status as a complainant under s. 245 of the *OBCA*. In that regard, he noted that in *Olympia & York Developments Ltd. (Trustee of) v. Olympia & York Realty Corp.* (2003), 68 O.R. (3d) 544 (Ont. C.A.), at para. 46, this court held that where it was likely the creditors of a bankrupt would have been recognized as complainants for the purpose of challenging a transaction under s. 248 of the *OBCA*, it was proper to recognize the Trustee of the bankrupt as a complainant "in effect on behalf of the creditors" of the bankrupt.

90 The trial judge accepted that creditors of a corporation have a reasonable expectation that the corporation will not engage in conduct that runs afoul of provincial preference legislation or the preference/transfer for undervalue provisions of the *BIA*. However, the trial judge had already found that the Payments by Annopol to Goldfinger did not run afoul of the *BIA*, the *APA* or the *FCA*, and he therefore relied on the same findings to conclude that the Payments did not violate the reasonable expectations of Annopol's creditors.

91 Farber also argued that Goldfinger was a shareholder of Annopol at the time of the Payments and the $2.5 million represented the repurchase of shares or the payment of a dividend. However, the trial judge rejected this contention. Rather, in substance, Goldfinger received the re-payment of $2.5 million of the funds he had loaned to Kimel and his companies, together with some additional security. He wrote, at para. 300 of his reasons: "The business substance of the December, 2007 and January, 2008 payments was that Goldfinger received back some of the principal he had invested; there was no profit or equity yet available for distribution." For these reasons, he rejected Farber's oppression claim.

(iii) Parties' Oppression Submissions on Appeal

92 Goldfinger submits that while the court has discretion to recognize a Trustee in bankruptcy as a complainant under the *OBCA*, the exercise of that discretion was unjustified in this case. Furthermore, Farber put forward no evidence on

the reasonable expectations of the creditors on whose behalf it purported to act. Goldfinger submits that the trial judge erred in recognizing Farber as a complainant.

93 For its part, Farber asserts that Goldfinger is raising the issue of Farber's status as a complainant for the first time on this appeal. The decision was within the trial judge's discretion and there is no basis on which this court should interfere.

94 On the issue of oppression, Farber reiterates that the Payments were unlawful preferences. In addition, Farber submits that Annopol's creditors expected that its funds would be used for real estate development. The Payments to Goldfinger resulted in unfair prejudice, as Annopol's creditors will likely recover nothing from its bankrupt estate. Annopol and Kimel acted with unfair disregard for Annopol's creditors' interests. As a result, Farber submits that Goldfinger should be ordered to repay the $2.5 million to Annopol's bankrupt estate.

(iv) Analysis

95 Dealing first with the issue of Farber's status as a complainant, s. 245 of the *OBCA* defines "complainant" for the purposes of the oppression remedy as follows:

> (a) a registered holder or beneficial owner, and a former registered holder or beneficial owner, of a security of a corporation or any of its affiliates,
>
> (b) a director or an officer or a former director or officer of a corporation or of any of its affiliates,
>
> (c) any other person who, in the discretion of the court, is a proper person to make an application under this Part.

96 Farber relied on subsection (c) in support of its position that it should be given standing as a complainant. In *Olympia & York Developments Ltd.*, at para. 45, this court held that Trustees in bankruptcy are neither automatically barred nor automatically entitled to standing, but it is a matter of discretion in each case whether to grant standing.

97 I do not read the trial judge's reasons as having conclusively held that Farber was a proper person to be a complainant under s. 245. Rather, given his other findings, the trial judge simply proceeded on the assumption that Farber, in its capacity as Trustee in bankruptcy of Annopol, was a complainant. In light of his conclusion on the merits of the oppression claim, and my concurrence with it, I see no need to interfere with his approach. I would also observe that Goldfinger objected to Farber's status to assert a claim for oppression for the first time on this appeal.

98 Turning to the merits of the oppression ground of appeal, this court has recognized that the oppression remedy contained in s. 248 of the *OBCA* is a "flexible, equitable remedy that affords the court broad powers to rectify corporate malfeasance": see *Unique Broadband Systems Inc., Re*, 2014 ONCA 538, 121 O.R. (3d) 81 (Ont. C.A.), at para. 107. The granting of an oppression remedy is a discretionary decision.

99 In *BCE Inc., Re*, 2008 SCC 69, [2008] 3 S.C.R. 560 (S.C.C.), the Supreme Court addressed the oppression provision found in the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, which is similar to the provision found in the *OBCA*. At para. 68, the Court outlined the following two-step test: (1) Does the evidence support the reasonable expectations asserted by the claimant? and (2) Does the evidence establish that the reasonable expectation was violated by conduct falling within the terms "oppression", "unfair prejudice" or "unfair disregard" of a relevant interest?

100 The Court addressed the concept of reasonable expectations under the first part of the test, at paras. 62 and 63:

> [T]he concept of reasonable expectations is objective and contextual. The actual expectation of a particular stakeholder is not conclusive. In the context of whether it would be "just and equitable" to grant a remedy, the question is whether the expectation is reasonable having regard to the facts of the specific case, the relationships at issue, and the entire context, including the fact that there may be conflicting claims and expectations.

> Particular circumstances give rise to particular expectations. Stakeholders enter into relationships, with and within corporations, on the basis of understandings and expectations, upon which they are entitled to rely, provided they are reasonable in the context. These expectations are what the remedy of oppression seeks to uphold. [Citations omitted.]

101 The court addressed the second stage of the test, at para. 67:

> Even if reasonable, not every unmet expectation gives rise to a claim under [s. 248]. The section requires that the conduct complained of amount to "oppression", "unfair prejudice" or "unfair disregard" of relevant interests. "Oppression" carries the sense of conduct that is coercive and abusive, and suggests bad faith. "Unfair prejudice" may admit of a less culpable state of mind, that nevertheless has unfair consequences. Finally, "unfair disregard" of interests extends the remedy to ignoring an interest as being of no importance, contrary to the stakeholders' reasonable expectations. The phrases describe, in adjectival terms, ways in which corporate actors may fail to meet the reasonable expectations of stakeholders. [Citations omitted.]

102 The trial judge's analysis under the *BIA*, the *APA* and the *FCA* effectively disposed of that part of Farber's submissions relating to unjust preferences. As for Farber's argument that there was unfair disregard for the interests of Annopol's creditors, this submission must be placed in context. While Kimel stated that he was not thinking of his creditors when he made the Payments, Kimel and his companies were facing the prospect of potentially ruinous litigation. He believed that the Payments would permit the companies to continue as going concerns and that they would generate profit. The evidence did not suggest that this was a misguided proposition at that time. The cataclysmic, and unforeseen, economic meltdown that enveloped the global economy months after the Payments were made cannot be ignored. In this context, the trial judge did not err in exercising his discretion and dismissing Farber's claim of unfair disregard for the interests of Annopol's creditors.

103 As for the expectations of HSBC and Srubiski as creditors, Farber claims that Annopol paid Goldfinger with funds it had received from Srubiski. The trial judge found that it was not possible to trace the vast majority of funds to any particular source or creditor. As the trial judge noted, Kimel's evidence was that money *may* have come from Srubiski or Mahvash. There was also no conclusive evidence that the funds paid by Annopol to Goldfinger came from Srubiski. Moreover, the line of credit from HSBC was provided to SG Group and not to Annopol. Consequently, HSBC was not a creditor of Annopol. HSBC, a sophisticated party, would have known that it was not a creditor of Annopol. There could be no reasonable expectation to the contrary.

104 The trial judge's decision reflected an exercise in discretion and is entitled to deference. I would not accede to Farber's submissions on oppression.

E. Did the Payments Unjustly Enrich Goldfinger?

(i) Introduction

105 Before the trial judge, Farber submitted that the Payments unjustly enriched Goldfinger. To succeed, Farber had to establish that:

> (a) the Payments enriched Goldfinger;
>
> (b) there was a corresponding deprivation suffered by Annopol; and
>
> (c) there was no juristic reason for that enrichment.

(ii) Trial Judge's Decision on Unjust Enrichment

106 The trial judge gave brief reasons for his dismissal of Farber's unjust enrichment claim. In essence, he relied on his reasons for dismissal of the oppression claim, stating at para. 304 of his reasons: "Farber also advanced a claim sounding in unjust enrichment on the basis that the $2.5 million payments were a re-purchase of shares or equity distribution. For similar reasons [*i.e.* similar to those for dismissing the oppression claim], I dismiss that claim."

(iii) Parties' Submissions on Appeal

107 Farber submits that the trial judge failed to consider the test for unjust enrichment, which it says was met based on the evidence. Farber says that the first two parts of the test were easily satisfied on the basis of the Payments from Annopol to Goldfinger. With respect to lack of a juristic reason, the Payments were contrary to the reasonable expectations of Annopol's creditors and it was contrary to public policy for Goldfinger to have received the Payments from an insolvent company.

108 Goldfinger responds that he merely received his money back and Annopol got what it bargained for. The Payments were a repayment of an obligation and in line with the parties' expectation of a settlement of their dispute. Settlement of disputes is supported by public policy and may constitute the rationale for a payment.

(iv) Analysis

109 As Iacobucci J. noted in *Garland v. Consumers' Gas Co.*, 2004 SCC 25, [2004] 1 S.C.R. 629 (S.C.C.), at para. 30, the test for unjust enrichment requires that a claimant establish the following three elements:

a) an enrichment of the defendant;

b) a corresponding deprivation of the plaintiff; and

c) an absence of juristic reason for the enrichment.

110 As noted in *Garland*, at para. 31, the first two elements are determined by applying a "straightforward economic approach". Iacobucci J. explained, at para. 36: "Where money is transferred from plaintiff to defendant, there is an enrichment."

111 The analysis in respect of the third element proceeds in two steps.

112 At the first stage, the claimant has the burden of demonstrating that "no juristic reason from an established category exists to deny recovery." The established categories include a contract, a disposition of law, a donative intent, and other valid common law, equitable or statutory obligations: see *Garland*, at para. 44.

113 If the claimant can show that there is no established juristic reason, then, at the second stage, the defendant bears the burden of demonstrating that there is another reason to deny recovery. When determining if there is a reason to deny recovery at this stage, courts are required to consider the reasonable expectations of the parties and public policy considerations: see *Garland*, at paras. 45-46.

114 As this court noted in *Campbell v. Campbell* (1999), 43 O.R. (3d) 783 (Ont. C.A.), at pp. 794-95, and *Simonin v. Simonin*, 2010 ONCA 900, 329 D.L.R. (4th) 513 (Ont. C.A.), at para. 24:

> [W]hat is at the heart of the third requirement is the reasonable expectation of the parties, and whether it would be just and fair to the parties considering all of the relevant circumstances, to permit the recipient of the benefit to retain it without compensation to those who provided it.

115 Applying these principles to the issues on appeal, the first two requirements for unjust enrichment were clearly met. Goldfinger was enriched and there was a corresponding deprivation to Annopol. The real issue turns on the third element: was there a juristic reason for the enrichment?

116 Farber was unsuccessful in attacking the Memorandum and, in any event, it did not ask that the Memorandum be set aside. A contract is a recognized category on which to reject a claim for unjust enrichment. The settlement provided an established rationale for the Payments and hence amounted to a juristic reason. In addition, Goldfinger's advance of $2.9 million to Annopol amounted to a juristic reason.

117 Finally, a juristic reason may be made out based on an examination of the reasonable expectations of the parties. On the facts of this case, Goldfinger advanced funds to whichever company Kimel requested. He advanced a total of about $2.9 million to Annopol itself. Kimel treated all the companies as, effectively, a common pool. Therefore, it was in line with past practice and the reasonable expectations of the parties that Goldfinger received payment in respect of funds from Annopol.

118 This ground of appeal therefore fails.

Appeal Relating to the Brantford/Bridge 2008 Transactions

A. Are the Brantford/Bridge 2008 Transactions Oppressive under the OBCA?

(i) Introduction

119 As mentioned, Farber had originally advanced an oppression claim with respect to the Brantford/Bridge 2008 Transactions. Ultimately, the dispute devolved into a claim to approximately $280,000 in proceeds from the sale of the Bridge Street property that is held in trust pending resolution of the action. The payment of this sum turns on whether the Brantford/Bridge 2008 Transactions were oppressive within the meaning of s. 248 of the *OBCA* and therefore ought to have been set aside by the trial judge.

(ii) Trial Judge's Decision on the Brantford/Bridge 2008 Transactions and Oppression

120 The trial judge relied on his findings under the *BIA*, the *APA* and the *FCA* claims to conclude that Goldfinger's charges over the SG Brantford and SG Bridge properties, as well as the Annopol Subordinations, did not violate the reasonable expectations of creditors. There was no intent to defeat, hinder, delay or defraud creditors. He concluded that no s. 248 *OBCA* remedy was justified.

(iii) Farber's Submissions on Appeal

121 Farber submits that the trial judge did not consider whether the transactions should be set aside pursuant to s. 248 of the *OBCA*. Its primary submission is that the trial judge dismissed its claim on the basis of lack of intent; however, this is an irrelevant consideration in an oppression analysis. Goldfinger was at best an unsecured creditor, and Annopol held prior security over the Henry Street and Bridge Street properties. As a result of the Memorandum, Goldfinger became secured. But for the transactions, Annopol's creditors would be entitled to the $280,000 in sale proceeds.

122 Farber argues that the trial judge erred in failing to make a finding of oppression and in refusing to set aside the Brantford/Bridge 2008 Transactions.

(iv) Analysis

123 The trial judge clearly turned his mind to the oppression claim as is evident from paras. 317, 327, 328, 348, 349 and 351 of his reasons. It is a fair inference from his reasons and his conclusion on the Brantford/Bridge 2008 Transactions that he was of the view that his prior findings supported his conclusion that they did not violate the reasonable expectations of creditors.

124 The trial judge relied on his same reasons, found at paras. 274-280, for concluding that Annopol did not intend to defeat, hinder, delay or defraud its creditors by making the Payments to Goldfinger. In addition, the trial judge's reasons

were that the Payments were part of a global settlement meant to avoid potentially ruinous litigation; the settlement in question was concluded at arm's length after fairly lengthy negotiations; and the parties' compromise was reasonable at the time they reached it.

125 The trial judge's decision that the Payments and the Brantford/Bridge 2008 Transactions were defensible for the same reasons was justified on the record. Both sets of transactions resulted from the same settlement. Therefore, the validity of the Brantford/Bridge 2008 Transactions falls to be decided on the same basis as that applicable to the Payments. For the reasons given, I would reject Farber's submissions with respect to the Brantford/Bridge 2008 Transactions.

Cross-Appeal

A. Is the $471,000 Payment to Goldfinger a Fraudulent Conveyance?

(i) Introduction

126 Farber, in its capacity as Trustee in bankruptcy of SG Brantford, asked the trial judge to order Goldfinger to return the sum of $471,000 to SG Brantford. Goldfinger objected.

(ii) Trial Judge's Decision

127 To recap, about five months after the Memorandum, the mortgage from the first mortgagee, First National, on 176 Henry St., a property owned by SG Brantford, came due. As part of the refinancing, the First National mortgage was to be increased. To complete the refinancing with First National, SG Brantford had to arrange for the postponement of the second mortgage in favour of Montor.

128 The trial judge was not prepared to find that Kimel forged Montor's signature on the postponement. He instead found that the Montor postponement was signed by Kimel purporting to act as the secretary-treasurer of Montor.

129 However, he did find that the postponement arose as a result of Kimel's and SG Brantford's deliberate misrepresentation of the true state of affairs to Montor. Moreover, Perelmuter, the sole shareholder of Montor, was unaware that part of the refinancing proceeds would be paid to a junior secured creditor, namely Goldfinger. The trial judge concluded that Kimel and SG Brantford made the misrepresentation in order to defeat, hinder, delay or defraud Montor.

130 He held that the evidence on intent as of November 26, 2008 was materially different from the evidence at the time of the Memorandum. By November 2008, Goldfinger knew that Kimel and his companies, including SG Brantford, had defaulted on their obligations. He and Kimel also knew that there were insufficient funds to pay Goldfinger's charges over the SG Brantford and SG Bridge properties if Montor were to be paid from the refinancing.

131 On the trial judge's findings, when Kimel and SG Brantford misrepresented the true state of affairs to Montor, they did so intending to defeat, hinder, delay or defraud Montor. Goldfinger had notice or knowledge of that intent within the meaning of s. 3 of the *FCA*.

132 The trial judge concluded that Goldfinger knew that the payment of $471,000 to him would prefer his interests over those of Montor. He based his conclusion on the *FCA*, but held that he would have reached a similar result under s. 248 of the *OBCA*. Therefore, the payment by SG Brantford to Goldfinger of $471,000 in preference to the payment of that amount to Montor violated s. 2 of the *FCA* and was not saved by s. 3 of the *FCA*.

133 Accordingly, Goldfinger was ordered to repay the sum of $471,000 to Farber, as Trustee in bankruptcy of SG Brantford.

(iii) Goldfinger's Submissions on Appeal

134 Goldfinger argues that he was not involved with, and did not know, the terms of the postponement. He asserts that the trial judge erred in finding that he had the intent to defeat Montor's interest. He had nothing to do with the postponement of the Montor mortgage. Goldfinger was unconditionally entitled to payment of the $471,000.

135 He asks that if his cross-appeal is denied, he should, in the alternative, be given judgment for the restoration of his position, including judgment for $183,000 representing the net proceeds from the sale of the Henry Street property on August 31, 2010 being held by the Trustee pending the outcome of the appeals.

(iv) Analysis

136 I would reject Goldfinger's cross-appeal. As Goldfinger notes in his factum, at para. 53, where the issue on appeal involves the trial judge's interpretation of the evidence as a whole, his findings should not be overturned absent palpable and overriding error: *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235 (S.C.C.), at paras. 23-24.

137 The trial judge's conclusion on this issue rested on factual findings. In particular, he found that Goldfinger had notice or knowledge of Kimel's and SG Brantford's intent to defeat, hinder, delay or defraud Montor and that he knew the $471,000 payment would prefer his interests over those of Montor. Goldfinger has not identified any palpable and overriding error that would serve to displace these findings.

138 For these reasons, I would dismiss the cross-appeal.

139 Further, I see no basis on which to grant the alternative relief Goldfinger requests. Based on the evidence, even with the repayment of the $471,000, there will be a significant shortfall in recovery on account of Montor's mortgage. Moreover, no such request was made of the trial judge.

Disposition

140 For these reasons, I would dismiss both the appeal and the cross-appeal. As agreed by the parties, I would order Farber to pay Goldfinger $40,000 in costs of the appeal and Goldfinger to pay Farber $20,000 in costs of the cross-appeal, both sums inclusive of disbursements and applicable taxes.

***E.A. Cronk J.A.*:**

I agree

***P. Lauwers J.A.*:**

I agree

Schedule "A"

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

> **96 (1)** On application by the trustee, a court may declare that a transfer at undervalue is void as against, or, in Quebec, may not be set up against, the trustee — or order that a party to the transfer or any other person who is privy to the transfer, or all of those persons, pay to the estate the difference between the value of the consideration received by the debtor and the value of the consideration given by the debtor — if
>
> (a) the party was dealing at arm's length with the debtor and
>
> (i) the transfer occurred during the period that begins on the day that is one year before the date of the initial bankruptcy event and that ends on the date of the bankruptcy,

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

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

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

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

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

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

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

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

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

Assignments and Preferences Act, R.S.O. 1990, c. A.33

4. (1) Subject to section 5, every gift, conveyance, assignment or transfer, delivery over or payment of goods, chattels or effects, or of bills, bonds, notes or securities, or of shares, dividends, premiums or bonus in any bank, company or corporation, or of any other property, real or personal, made by a person when insolvent or unable to pay the person's debts in full or when the person knows that he, she or it is on the eve of insolvency, with intent to defeat, hinder, delay or prejudice creditors, or any one or more of them, is void as against the creditor or creditors injured, delayed or prejudiced.

(2) Subject to section 5, every such gift, conveyance, assignment or transfer, delivery over or payment made by a person being at the time in insolvent circumstances, or unable to pay his, her or its debts in full, or knowing himself, herself or itself to be on the eve of insolvency, to or for a creditor with the intent to give such creditor an unjust preference over other creditors or over any one or more of them is void as against the creditor or creditors injured, delayed, prejudiced or postponed.

(3) Subject to section 5, if such a transaction with or for a creditor has the effect of giving that creditor a preference over the other creditors of the debtor or over any one or more of them, it shall, in and with respect to any action or proceeding that, within sixty days thereafter, is brought, had or taken to impeach or set aside such transaction, be presumed, in the absence of evidence to the contrary, to have been made with the intent mentioned in subsection (2), and to be an unjust preference within the meaning of this Act whether it be made voluntarily or under pressure.

(4) Subject to section 5, if such a transaction with or for a creditor has the effect of giving that creditor a preference over the other creditors of the debtor or over any one or more of them, it shall, if the debtor within sixty days after the transaction makes an assignment for the benefit of the creditors, be presumed, in the absence of evidence to the contrary, to have been made with the intent mentioned in subsection (2), and to be an unjust preference within the meaning of this Act whether it be made voluntarily or under pressure.

(5) The word "creditor" when used in the singular in subsections (2), (3) and (4) includes any surety and the endorser of any promissory note or bill of exchange who would upon paying the debt, promissory note or bill of exchange, in respect of which the suretyship was entered into or the endorsement was given, become a creditor of the person giving the preference within the meaning of those subsections.

5. (1) Nothing in section 4 applies to an assignment made to the sheriff for the area in which the debtor resides or carries on business or, with the consent of a majority of the creditors having claims of $100 and upwards computed according to section 24, to another assignee resident in Ontario, for the purpose of paying rateably and proportionately and without preference or priority all the creditors of the debtor their just debts, nor to any sale or payment made in good faith in the ordinary course of trade or calling to an innocent purchaser or person, nor to any payment of money to a creditor, nor to any conveyance, assignment, transfer or delivery over of any goods or property of any kind, that is made in good faith in consideration of a present actual payment in money, or by way of security for a present actual advance of money, or that is made in consideration of a present actual sale or delivery of goods or other property where the money paid or the goods or other property sold or delivered bear a fair and reasonable relative value to the consideration therefor.

(2) In case of a valid sale of goods or other property and payment or transfer of the consideration or part thereof by the purchaser to a creditor of the vendor under circumstances that would render void such a payment or transfer by the debtor personally and directly, the payment or transfer, even though valid as respects the purchaser, is void as respects the creditor to whom it is made.

(3) Every assignment for the general benefit of creditors that is not void under section 4, but is not made to the sheriff nor to any other person with the prescribed consent of creditors, is void as against a subsequent assignment that is in conformity with this Act, and is subject in other respects to the provisions thereof until and unless a subsequent assignment is executed in accordance therewith.

(4) Where a payment has been made that is void under this Act and any valuable security was given up in consideration of the payment, the creditor is entitled to have the security restored or its value made good to him before, or as a condition of, the return of the payment.

(5) Nothing in this Act,

(a) affects the *Wages Act* or prevents a debtor providing for payment of wages due by him or her in accordance with that Act;

(b) affects any payment of money to a creditor where the creditor, by reason or on account of the payment, has lost or been deprived of, or has in good faith given up, any valid security held for the payment of the debt so paid unless the security is restored or its value made good to the creditor;

(c) applies to the substitution in good faith of one security for another security for the same debt so far as the debtor's estate is not thereby lessened in value to the other creditors; or

(d) invalidates a security given to a creditor for a pre-existing debt where, by reason or on account of the giving of the security, an advance in money is made to the debtor by the creditor in the belief that the advance will enable the debtor to continue the debtor's trade or business and to pay the debts in full.

Fraudulent Conveyances Act, R.S.O. 1990, c. F.29

2. Every conveyance of real property or personal property and every bond, suit, judgment and execution heretofore or hereafter made with intent to defeat, hinder, delay or defraud creditors or others of their just and lawful actions, suits, debts, accounts, damages, penalties or forfeitures are void as against such persons and their assigns.

3. Section 2 does not apply to an estate or interest in real property or personal property conveyed upon good consideration and in good faith to a person not having at the time of the conveyance to the person notice or knowledge of the intent set forth in that section.

Business Corporations Act, R.S.O. 1990, c. B.16

248. (1) A complainant and, in the case of an offering corporation, the Commission 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.

(3) In connection with an application under this section, the court may make any interim or final order it thinks fit including, without limiting the generality of the foregoing,

(a) an order restraining the conduct complained of;

(b) an order appointing a receiver or receiver-manager;

(c) an order to regulate a corporation's affairs by amending the articles or by-laws or creating or amending a unanimous shareholder agreement;

(d) an order directing an issue or exchange of securities;

(e) an order appointing directors in place of or in addition to all or any of the directors then in office;

(f) an order directing a corporation, subject to subsection (6), or any other person, to purchase securities of a security holder;

(g) an order directing a corporation, subject to subsection (6), or any other person, to pay to a security holder any part of the money paid by the security holder for securities;

(h) an order varying or setting aside a transaction or contract to which a corporation is a party and compensating the corporation or any other party to the transaction or contract;

(i) an order requiring a corporation, within a time specified by the court, to produce to the court or an interested person financial statements in the form required by section 154 or an accounting in such other form as the court may determine;

(j) an order compensating an aggrieved person;

(k) an order directing rectification of the registers or other records of a corporation under section 250;

(l) an order winding up the corporation under section 207;

(m) an order directing an investigation under Part XIII be made; and

(n) an order requiring the trial of any issue.

(4) Where an order made under this section directs amendment of the articles or by-laws of a corporation,

(a) the directors shall forthwith comply with subsection 186 (4); and

(b) no other amendment to the articles or by-laws shall be made without the consent of the court, until the court otherwise orders.

(5) A shareholder is not entitled to dissent under section 185 if an amendment to the articles is effected under this section.

(6) A corporation shall not make a payment to a shareholder under clause (3) (f) or (g) if there are reasonable grounds for believing that,

(a) the corporation is or, after the payment, would be unable to pay its liabilities as they become due; or

(b) the realizable value of the corporation's assets would thereby be less than the aggregate of its liabilities.

Appeal and cross-appeal dismissed.

Footnotes

* Affirmed at *Montor Business Corp. (Trustee of) v. Goldfinger* (2013), 2013 ONSC 6635, 2013 CarswellOnt 14983, 8 C.B.R. (6th) 200 (Ont. S.C.J. [Commercial List]).

TAB 7

1968 CarswellBC 6
British Columbia Court of Appeal

Meeker Cedar Products Ltd. v. Edge

1968 CarswellBC 6, [1968] B.C.J. No. 164, 12 C.B.R. (N.S.) 49, 68 D.L.R. (2d) 294

Meeker Cedar Products Limited v. Edge et al.

Norris, Tysoe and McFarlane JJ.A.

Judgment: March 22, 1968

Counsel: *A. C. Sharp*, for appellant.
R. E. Cocking, for respondent.

Subject: Corporate and Commercial; Insolvency; Contracts; Torts

Headnote

Fraud and Misrepresentation --- Fraudulent conveyances — Fraudulent intent — "Badges of fraud"

Fraudulent conveyances — Asset sold for alleged undervaluation — Transaction for good and valuable consideration — Notice or knowledge of purchaser of intent to delay.

The debtor had acquired a timber licence from W. in respect of certain lands. G. assisted the debtor in financing its timber operations but the debtor became involved in serious financial difficulties and was in danger of losing the licence. After negotiation G. purchased the licence from the debtor for $70,000.

On appeal from an order setting aside the sale as a fraudulent conveyance, *held*, the appeal should be allowed.

As to fraudulent conveyances, to support a transfer on the ground that it was made for valuable consideration, it is not necessary to show that the full value of the property has been given; it must, however, be more than nominal or entirely inadequate. On the evidence the price of $70,000 amounted to good and valuable consideration and the consideration was not inadequate.

Where a sale is made for good and valuable consideration, the transaction will not be void by reason of the purchaser's having notice or knowledge of the vendor's intent to delay, hinder or defraud creditors and others; it must be proved that the purchaser was actually privy to the fraud. Fraudulent intent in a transferee is essentially a matter of fact to be proved in the circumstances of each particular case and there is no authoritative list of badges of fraud. An important factor is whether a benefit, direct or indirect, has been reserved to the transferor. On the facts as proved, it was not established that there was such a fraudulent intent on the part of the purchaser.

Appeal from 61 D.L.R. (2d) 388.

The judgment of the Court was delivered by *McFarlane J.A.*:

1 This is an appeal from the judgment of Seaton J., pronounced 25th January 1967 whereby it was adjudged that the respondent recover against the appellants Edge and Edgewood Logging Limited the sum of $71,036.13 and whereby a declaration was granted that the transfer by Edgewood Logging Limited to the appellant Getson of a timber licence,

7558P, was void as against the respondent as a fraudulent conveyance. The appellant Getson was also enjoined from rendering the licence unavailable to satisfy claims of the respondent pending final disposition of the action and costs were awarded against him. The appeals of Edge and Edgewood Logging Limited have been dismissed as abandoned and Getson's appeal from the provisions of the judgment which affect him is now to be dealt with.

2 I shall refer to the appellant Getson as "Getson", to the appellant Edgewood Logging Limited as "Edgewood", and to Westminster Mills Ltd., as "Westminster Mills".

3 Westminster Mills was the holder of timber licence 7558P which had been issued in 1912 by the Deputy Minister of Lands of British Columbia. By an agreement in writing dated 13th March 1964 Edgewood acquired from Westminster Mills the right to cut and remove all timber situate on the lands included in the licence paying to Westminster Mills stipulated amounts of money per thousand feet board measure for different species of logs, plus payment in cash of $5,000. As an alternative to making the stumpage payments Edgewood was entitled to pay a sum of $30,000 in monthly instalments of $3,000 each with interest on deferred payments. Westminster Mills also agreed to accept $30,000 including interim payments (except interest) "for said Licence in full" at any time prior to 30th September 1964. Edgewood agreed to commence logging operations by 1st May 1964, to complete one-half the logging in 1965 and all logging in 1966.

4 An agreement in writing was then entered into in June 1964 between the respondent and Edgewood whereby the respondent provided certain financing for Edgewood's operations including in particular the construction of a logging road. The respondent by this agreement became entitled to delivery of the log production (except pulp logs) at agreed prices and to collateral security for its advances in the form of a chattel mortgage on certain equipment owned by Herbert Edge and of a mortgage of real property owned by Edge's wife. I interpolate that, I agree with the learned trial Judge that the respondent obtained no security upon the timber licence itself or the timber and that Edgewood cannot be regarded as holding its rights under the March agreement with Westminster Mills as trustee for the respondent.

5 Edgewood failed to perform its obligations to log as required by its agreement with Westminster Mills and with the respond ent's assistance obtained extensions of time from Westminster Mills. In spite of the fact that it received substantial advances of money from the respondent, for which the latter now has judgment against Edge and Edgewood, it became apparent early in 1966 that Edgewood was doomed to the loss of its rights under the March 1964 agreement without further financing which the respondent was unable or unwilling to provide. The last extension of time granted by Westminster Mills to Edgewood expired 15th April 1966.

6 In the early spring of 1966 Getson became interested in acquiring the timber licence if he could get it with no strings attached. Following discussions with Edge and the president of the respondent, during which he clearly became aware of Edgewood's poor financial position and of the fact that the respondent was its creditor, he examined the property and became aware of the fact that neither Edgewood nor the respondent could sell him the licence because it belonged to Westminster Mills. Getson offered $70,000 for the timber licence and left the working out of the transaction to his solicitor in New Westminster. By an agreement dated 22nd April 1966 Edgewood agreed to transfer to Getson the timber licence which it represented it had the right to acquire from Westminster Mills and all its rights under the March 1964 agreement. At the same time Westminster Mills executed and delivered to Edgewood an instrument assigning the licence to it and authorizing a trust company, which had held the licence in escrow under the March 1964 agreement, to release the document "so that the rights to cut timber on said timber licence may be transferred on the records of the Forest Service in favor of Edgewood Logging Limited or Herbert J. Edge as their interests may appear, and according to their instructions". Contemporaneously a transfer of the licence from Edgewood to Getson was executed and delivered. Both of these transfers required the formal consent of the Minister of Lands, Forests and Water Resources before they could become fully effective.

7 On Friday 22nd April 1966 the part of the total price of $70,000 which was payable to Westminster Mills, namely $22,943.66, was left in the form of Getson's certified cheques in the hands of that company's solicitor to be held by him pending final consent by the Minister. Getson and Edge, in possession of the licence and transfers thereof from Westminster Mills to Edgewood and from Edgewood to Getson, then proceeded at once to Victoria for the purpose of

obtaining ministerial consent to the transfers. They were informed the documents were in order but that the necessary signatures of the Minister or his Deputy could not be obtained until the following Monday. On the afternoon of that day, being informed by telephone that the formal consents were signed in Victoria and being sent to him by mail, Getson proceeded to turn over the remainder of the agreed purchase price of $70,000 to Edgewood. He did this by giving two promissory notes for $17,500 each payable to Edgewood, assuming statutory obligations of Edgewood to the Workmen's Compensation Board and Unemployment Insurance Commission arising out of Edgewood's logging operations on the property, and giving his cheque to Edge for the remainder. The cheque given to Edge, who was the controlling officer of Edgewood, in the sum of $4,660 included deductions of comparatively small amounts for advances which Getson had made to him. The transaction was therefore for value so far as Getson is concerned. As the respondent contends that the consideration was inadequate it is necessary to refer briefly to the evidence in that regard with the preliminary observations:

8 (1) That to support a transfer on the ground that it was made for valuable consideration it is not necessary to show that the full value of the property has been given, though it must be more than nominal or entirely inadequate (17 Hals., 3rd ed., p. 654, para. 1262; May on Fraudulent Dispositions of Property, 3rd ed., pp. 191 *et seq.*); and

9 (2) That the only finding of credibility made by the learned trial Judge relates to Edge as follows:

> I cannot accept the evidence of Mr. Edge as either accurate or an attempt to be accurate.

10 No evidence by an independent valuer was adduced. The total price agreed to by Westminster Mills in March 1964 was $35,000. On 22nd April 1966 Westminster Mills received approximately $7,500 more than would have been payable to it under the March 1964 agreement but it must be remembered that that company was in a very strong bargaining position *vis-a-vis* Edgewood after 15th April 1966. In the interval approximately one quarter of the timber had been removed by Edgewood and as against that a valuable and useful logging road was constructed. Early in 1966 the president of the respondent suggested in negotiations a price of $78,000 and then $85,000. Getson's evidence was that he would not have paid more than $70,000 in April 1966 and that the licence is worth less now than it was then because of log prices going down and costs going up. In answer to questions by the Court, Edge, with unconvincing reasons, said he thought the licence worth about $150,000. With respect to the learned trial Judge I must conclude on the whole of the evidence that $70,000 amounted to good and valuable consideration within the meaning of the authorities. I am satisfied the learned Judge was clearly wrong in his view that the consideration was inadequate. For the purpose of applying the provisions of The Fraudulent Conveyances Act, R.S.B.C. 1960, c. 155, the sale must, in my opinion, be regarded as having been made for good and valuable consideration. It was clearly not merely nominal or entirely inadequate.

11 Counsel for the respondent submitted that Getson had knowledge of Edgewood's weak financial position, of its substantial indebtedness to the respondent, and of Edge's intention to defraud the respondent. He said that by virtue of these facts Getson cannot claim the protection of s. 4 of The Fraudulent Conveyances Act which reads:

> 4. This Act, or anything therein contained, shall not extend to any estate or interest in lands, tenements, hereditaments, leases, rents, commons, profits, goods, or chattels had, made, conveyed, or assured, or hereafter to be had, made, conveyed, or assured, which estate or interest is or shall be upon good consideration and bona fide lawfully conveyed or assured to any person or persons, or bodies politic or corporate, not having, at the time of such conveyance or assurance to them made, any manner of notice or knowledge of such covin, fraud, or collusion as is aforesaid, anything before mentioned to the contrary hereof notwithstanding.

12 I think it is clear as a matter of interpretation of the statute as a whole and upon authority that where a sale is made for good and valuable consideration the transaction will not be void by reason of the purchaser's having notice or knowledge of the vendor's intent to delay, hinder, or defraud creditors and others unless it be proved that the purchaser was actually privy to the fraud, *i.e.*, a party to carry out the fraudulent intention and pur pose. The Fraudulent Conveyances Act, to the extent to which it is not *ultra vires*, is a part of the law of this province by reason of the introduction here of the Statute of Elizabeth, 13 Eliz. I, c. 5 (English Law Act, R.S.B.C. 1960, c. 129), and subsequent

inclusion of parts thereof in Revisions of the provincial statutes. The earlier authorities are collected conveniently and discussed in May on Fraudulent Dispositions of Property, pp. 53-69. I think it unnecessary to discuss any of them because the principle has been adopted and approved by the Supreme Court of Canada dealing with an Ontario statute, indistinguishable in relevant aspects, in *Perkins Electric Co. v. Orpen* (1922), 70 D.L.R. 397. In that case the majority of the learned Judges expressly agreed with the judgment of Middleton J.A., delivered in the Appellate Division of the Supreme Court of Ontario, reported in the same volume commencing at p. 403. The Appellate Division had dismissed, on an equal division, an appeal from the trial Judge. At p. 407 Middleton J.A. said:

> The general question was discussed in *Hopkinson v. Westerman* (1919), 48 D.L.R. 597, 45 O.L.R. 208, and the law need not again be reviewed. I adhere to the conclusion there stated, which I do not think is disputed, that where a conveyance is for valuable consideration the fraudulent intention necessary to avoid the conveyance must be established in the particular case when it comes for decision. It is a question of fact in each case, and in its solution, as already indicated, the necessity of establishing an actual fraudulent intention as distinct from a mere intention to prefer must be kept well in mind. The familiar words of Fry, J., in *Re Johnson* (1881), 20 Ch.D. 389, at p. 393 may be quoted: —
>
>> The effect on a deed of this sort of its being for good consideration is very great. It does not necessarily show that the deed may not be void under the statute, because in many cases good consideration has been proved, and yet the object of the deed has been to defeat and delay creditors; such has been, therefore, for an unconscientious purpose, and the fact that there has been good consideration will not uphold the deed. But nevertheless it is a material ingredient in considering the case, and for very obvious reasons: the fact that there is valuable consideration shows at once that there may be purposes in the transaction other than the defeating or delaying of creditors, and renders the case, therefore, of those who contest the deed more difficult.
>
> The Judge then quotes the similar words of Turner, L.J., in *Harman v. Richards* (1852) 10 Hare 81 at p. 89, 68 E.R. 847: 'Those who undertake to impeach for *mala fides* a deed which has been executed for valuable consideration have, I think, a task of great difficulty to discharge.'

13 To complete the quotation from the judgment of Fry J. in *Re Johnson, supra*, approved and adopted by Middleton J.A., I add the following language of Fry J. in that case at p. 394:

> I therefore proceed to inquire, looking to all the circumstances of the case and at the nature of the instrument itself, whether I can or ought to infer an intent to defraud creditors in the parties to the deed. I say in the parties to the deed, because it appears to me to be plain that whatever fraudulent intent there may have been in the mind of *Judith Johnson* it would not avoid the deed unless it was shewn to have been concurred in by *Alice*, who became the purchaser under the deed. It has not been contended, and it could not be contended, that the mere fraudulent intent of the vendor could avoid the deed, if the purchaser were free from that fraud.

14 Assuming therefore, that Getson had notice or knowledge of the fraudulent intent of Edge and Edgewood the present case must be examined for the purpose of deciding whether an actual fraudulent intention on the part of Getson is proved. The learned trial Judge expressed his finding as follows:

> I am satisfied that the defendants [*i.e.*, Edge, Edgewood and Getson] conspired to defraud the plaintiff [respondent] and am obliged to find the transfer void as against the plaintiff [respondent].

15 I interpret this as a finding that Getson was privy to the fraud, *i.e.*, a party to the fraudulent intention and purpose to delay, hinder or defraud the respondent as a creditor of Edgewood. In reaching that conclusion the learned trial Judge referred to *Twyne's Case* (1602), 3 Co. Rep. 80 b., 76 E.R. 809, as indicating certain badges of fraud "to be looked for" in relation to Getson. It must be observed that *Twyne's* was a case of a fraudulent gift of goods which remained in the possession of the donor and that the result of *Twyne's Case* was that Twyne was convicted of fraud. Moreover the case cannot be considered as setting up an authoritative list of badges or *indicia* from which fraud ought to be inferred.

Fraudulent intent in a transferee is essentially a matter of fact to be proved in the circumstances of each particular case. The learned trial Judge proceeded to enumerate 10 badges of fraud. I shall set them out *seriatim* with my comments following each, noting as an important factor that no benefit, direct or indirect, such as a further right to log or anything of that nature, was reserved to Edgewood by Getson in the transaction.

(1) The inadequate consideration.

16 I have already dealt with the evidence in this regard. I am quite unable to agree that the consideration of $70,000 was in fact inadequate.

(2) The only payment made was to Edge personally and not to Edgewood.

17 In fact $22,943.66 was paid by Getson to Westminster Mills. $35,000 is payable by Getson to Edgewood evidenced by two promissory notes. The amount of money paid to Edge, the controlling officer of Edgewood, was approximately $5,000 taking earlier advances into account. The balance of the total price of $70,000 is covered by Getson's assumption of Edgewood's statutory obligations relating to the licence and payable to the Workmen's Compensation Board and Unemployment Insurance Commission. I cannot regard the payment of approximately $5,000 by cheque to Edge as a badge of fraud on Getson's part. The latter had no reason to think that Edge would fail to account to Edgewood. From Getson's point of view, and in fact, Edge was in complete control of all Edgewood's affairs. A cheque made to such a person in the case of a small company, while a factor to be taken into consideration, is by no means an impelling fact when fraud by the person paying is the issue.

(3) The great secrecy surrounding the transfer.

18 On analysis this resolves into a failure by Getson to inform the respondent of the negotiations for and completion of the transfer of the licence. Having regard to all of the circumstances I think this failure cannot be regarded properly as secrecy in the sense envisaged by the statute. Three reputable solicitors and the president of Westminster Mills were involved as well as Edge and Getson themselves in addition to officials in the department of the Minister at Victoria.

(4) The haste to complete the transfer before the plaintiff learned of it.

19 From Getson's point of view expedition was necessary as a result of the demands of Westminster Mills through its president and its solicitor. Whatever may be said of Edge in this regard the evidence clearly does not show any undue haste on the part of Getson caused by apprehension of interference by the respondent. The evidence is preponderant that all Getson wanted was the licence "without strings attached". There is nothing to support an inference that Getson acted in haste in order to prevent the consideration passing to Edgewood from becoming available to meet the respondent's claim as a creditor.

(5) The trip to Victoria to get the transfer through before it was blocked by the plaintiff as a creditor.

20 The reason for the trip has been adverted to above. It was to obtain the ministerial consents to the transfers of the licence, a step necessary to render the transfers effectual and thus permit handing over of the consideration. The evidence is clear that Getson acted on his solicitor's advice in making the trip when he did. The solicitor testified as to the reasons for this advice, which reasons are entirely *bona fide*. The trip cannot be regarded properly as showing fraud on the part of Getson.

(6) The false stating of the down payment.

21 Upon analysis this item relates to the document dated 26th April 1966 referred to above and constituting an agreement between Edgewood and Getson for the sale of the timber licence "in consideration of the sum of $70,000 payable as hereinafter provided". The last paragraph of the document reads:

> The Purchaser covenants to pay the said price of seventy thousand dollars ($70,000.00) by payment of the sum of thirty-five thousand dollars ($35,000.00) upon the transfer of the said timber licence to the Purchaser and the approval of the British Columbia Forest Service thereto and by delivery of a promissory note for the sum of seventeen thousand five hundred dollars ($17,500.00) payable to the Vendor with interest thereon at the rate of six per cent (6%) per annum on the first day of December 1966 and by delivery of a promissory note for the sum of seventeen thousand five hundred dollars ($17,500.00) payable to the Vendor with interest thereon at the rate of six per cent (6%) per annum on the first day of December 1967.

22 The fact that the cash portion of the purchase price namely $35,000 was actually made up of separate amounts paid to Westminster Mills and Edge, and payable to the Workmen's Compensation Board and the Unemployment Insurance Commission clearly, in my opinion, does not demonstrate a false stating of the down payment. This is particularly so when in the circumstances the payments of the separate amounts totalling $35,000 is proved to have been *bona fide* for the purpose of obtaining the transfer from Westminster Mills and obtaining the ministerial consents necessary to effectually complete the vesting of the licence in Getson.

(7) The ignoring of the plaintiff's claim to an interest in the timber licence.

23 In the first place it is clear that the respondent never had a proprietary interest in the licence. Further Getson did not ignore the possibility of such an interest. He sought and acted upon his solicitor's advice in this regard. He was entitled to do so and moreover the advice was correct. The respondent's status was and is simply that of a creditor of Edgewood.

(8) The lack of any other significant assets.

24 It is clear that when Getson agreed to buy the licence Edgewood did not own it and could obtain a transfer only by paying a substantial sum to Westminster Mills which was the holder. With the exception of the approximate sum of $5,000 paid to Edge, and with which I have already dealt, Getson did nothing to prevent the portion of the total purchase price payable to Edgewood from becoming available to Edgewood's creditors. In the circumstances Getson's knowledge of Edgewood's shortage of assets cannot be made a basis for imputing fraud to him. In fact his promissory note to Edgewood created an asset in that company which would not have existed unless some responsible person was prepared to assist Edgewood in obtaining a transfer from Westminster Mills. It is true that the respondent was hopeful of obtaining a further extention of time from Westminster Mills but the fact that Getson acted promptly when the respondent failed to do so does not amount to a badge of fraud on Getson's part.

(9) The ignoring of Westminster's solicitor's alarm.

25 Westminster Mills's solicitor was a witness at the trial. His evidence shows that his concern was because of a proposal by Edge that the transfer of the licence by Westminster Mills be made to Edge personally and not to Edgewood. He communicated his concern to Getson's solicitor who insisted that the transfer be made to Edgewood rather than Edge and further that Getson's notes should also be payable to Edgewood and not to Edge. On this aspect of the matter it is clear that Getson relied and acted upon his solicitor's advice. Even if that advice had been wrong, which it was not, there is no badge of fraud by Getson in this item.

(10) The lack of security for the promissory notes.

26 There is no suggestion whatever in the evidence that Getson is other than a financially responsible man and no indication of any kind that he will be unable to honour his notes at maturity. The notes were delivered to Edgewood and have not been returned to Getson. In the circumstances the fact that Edgewood apparently did not insist on further security from Getson is no badge of fraud on the part of Getson.

27 My consideration of the evidence as a whole convinces me that the learned trial Judge was clearly wrong in finding Getson guilty of fraud. The respondent's disappointment at finding the timber licence no longer available to Edgewood

cannot be attributed to Getson's being privy to the alleged fraud. I note that The Fraudulent Preferences Act, R.S.B.C. 1960, c. 156, does not apply because Getson was not a creditor of Edgewood.

28 In the result I would allow Getson's appeal, set aside those parts of the judgment appealed from which affect him, and dismiss the respondent's action as against him. It follows that I would also dismiss the cross-appeal. I would also allow Getson his costs here and below against the respondent.

TAB 8

1983 CarswellMan 28
Manitoba Court of Queen's Bench

Bank of Nova Scotia v. Bass

1983 CarswellMan 28, [1983] M.J. No. 52, 22 Man. R. (2d) 153, 47 C.B.R. (N.S.) 203

BANK OF NOVA SCOTIA v. BASS et al.

Kroft J.

Judgment: April 8, 1983
Docket: Suit No. 0898/82

Counsel: *L.B. Cherrett*, for plaintiff.
A.D. Hoffer, for defendants.

Subject: Corporate and Commercial; Insolvency; Contracts; Torts

Headnote

Fraud and Misrepresentation --- Fraudulent conveyances — Fraudulent intent — Evidence of intention

Fraudulent conveyances — Conveyances fraudulent as against creditors — Voluntary conveyances — Father guaranteeing son's debt — Father agreeing to transfer his interest in matrimonial home to wife due to marital problems — Creditor notifying father of son's default — Father formally transferring interest in house to wife — Plaintiff not proving conveyance made with intent to defraud creditors.

The plaintiff brought an action to set aside as a fraudulent conveyance the transfer by the defendant husband of his one-half interest in their matrimonial home to his wife. The husband had guaranteed his son's indebtedness to the plaintiff. The husband and wife had separated on several occasions. Prior to any concern over the financial stability of the son, the husband agreed to transfer his interest in the home to his wife, but no enforceable agreement or formal transfer was signed, partly because of the dereliction of their son who as a lawyer had been asked to look after the matter. After the plaintiff had notified the husband that the son had defaulted in recent payment promises a formal transfer to the wife of the one-half interest in the home was registered.

Held:

Action dismissed.

The original intent of the grantor to transfer his one-half interest in the home to his wife had never been abandoned or changed. There was no intent on the part of the grantor to defraud the creditors in general or the plaintiff in particular. The plaintiff had therefore failed to establish that there was a conveyance made with the intent of defrauding creditors.

Application to set aside as fraudulent the conveyance by husband of his one-half interest in matrimonial home to wife.

***Kroft J.*:**

1 At the outset of the trial, with the consent of counsel and the approval of the court, the plaintiff discontinued its action against Jack Bass and abandoned its damage claims against the remaining defendants. The defendants, for their part, abandoned the counterclaim.

2 There remains in issue only the plaintiff's claim that a certain transfer of residential property, from Joseph Bass and Lorraine Bass as joint tenants to Lorraine Bass alone, was a fraudulent conveyance within the meaning of the Fraudulent Conveyances Act, C.C.S.M., c. F160.

3 Joseph and Lorraine Bass have been married for more than 40 years. The marriage has been marked by hard work, meagre financial success and periods of discord. The only known asset presently belonging to either of them is the marital home which was purchased in 1949, in their joint names, but now stands in the name of Lorraine Bass alone. It has an acknowledged market value of approximately $40,000 and is free of any mortgage. For reasons which will become clear, Joseph Bass is substantially indebted to various financial institutions in an amount which it is unlikely he will ever be able to discharge.

4 The particular liability with which we are here concerned arises out of an unlimited guarantee executed on 9th July 1976 by Joseph Bass in favour of his son, Jack Alexander Bass, and upon which he was ultimately called. Pursuant to that guarantee, an action was commenced on 12th January 1981 against Jack as debtor and against Joseph Bass and one of Jack's corporations as guarantors. A default judgment for $31,013.70 was obtained on 28th May 1981. Subsequent to obtaining that judgment the plaintiff discovered that the jointly owned residence had, by way of transfer of land registered in the Winnipeg Land Titles Office on 12th February 1980, been conveyed to Lorraine Bass. It is that conveyance which the plaintiff seeks to set aside in order to pursue the judgment against Joseph Bass.

5 The particular statutory provision on which the plaintiff bases its case is s. 3 of the Fraudulent Conveyances Act. It provides:

> 3 Every conveyance of real property or personal property and every bond, suit, judgment, and execution at any time had or made, or at any time hereafter to be had or made, with intent to defeat, hinder, delay or defraud creditors or others, of their just and lawful actions, suits, debts, accounts, damages, penalties, or forfeitures is void as against such persons and their assigns.

That section and similar provisions in other jurisdictions have received frequent judicial attention. Of particular assistance to me in the circumstances of this case were *Union Bank v. Murdock*, 28 Man. R. 229, [1917] 3 W.W.R. 820, 37 D.L.R. 150 (C.A.); *Mandryk v. Merko*, 15 C.B.R. (N.S.) 246, [1971] 2 W.W.R. 542, 19 D.L.R. (3d) 238 (Man. C.A.); *Commerce Capital Mtge. Corp. v. Jemmett* (1981), 37 C.B.R. (N.S.) 59 (Ont. S.C.); and *Tempo Bldg. Supplies Ltd. v. Pitura* (1979), 33 C.B.R. (N.S.) 23 (B.C.S.C.).

6 So that my more detailed review and assessment of the evidence can be placed in context, I will now deal briefly with several general principles which I am satisfied can be safely drawn from the Fraudulent Conveyances Act and from the authorities.

7 If a conveyance is made for good consideration which defeats or delays creditors, the plaintiff must show the fraudulent intent of both the grantor and the grantee. If, however, the conveyance is voluntary, it is only necessary to show the fraudulent intent of the grantor.

8 If the conveyance is voluntary and particularly if, as here, it is between relatives, the transaction will be regarded with suspicion and there will be a substantial evidentiary burden upon the grantor to explain why the transaction should not be regarded as fraudulent. Considerable judicial attention has been given to the question of whether, when the transaction is voluntary and within a family, the trial judge must presume the transaction to have been fraudulent or whether the presumption is rebuttable. I am satisfied, based on the reasons expressed by Freedman J.A. (as he then was) in the *Mandryk* case and Lerner J. in the *Commerce Capital Mortgage* case (both supra), that while a judge may treat the

evidence as to the nature of the transaction as sufficient to establish a prima facie case, he is not, in law, bound to do so. In the final analysis, even in circumstances which fall in the category of being "suspicious", if the plaintiff is to succeed, it is necessary to show that there was in fact a fraudulent intent on the part of the grantor to defeat the plaintiff creditor.

9 The final question to be considered in cases of this sort is, assuming that the evidentiary burden has shifted to the defendant, what sort of evidence is necessary to rebut the initial assumption of a fraudulent intent? Is the credible statement of bona fides by the grantor sufficient or do the "suspicious" circumstances make it incumbent upon the defendant to adduce supportive or corroborative evidence?

10 As the cases reviewed in the *Union Bank* case, supra, indicate, there is some authority for saying that it is competent for the trial judge, if he is impressed with the veracity of the grantor, to accept and act upon his unsupported testimony. I have concluded, however, from the reading of authorities, that the more prudent approach is to require independent supporting testimony.

11 I turn now to a consideration of the evidence.

12 In 1976 when Joseph Bass gave a statement of affairs to the plaintiff and signed a guarantee in its favour, he and his wife were living together in their jointly owned residence and were together operating a seven day a week "mom and pop" type grocery store. Mrs. Bass drew a salary and Mr. Bass kept whatever profits were earned. At that time they were not well off but were solvent. They had some modest investments; some in her name, some in his. It is quite clear to me, however, that they made no real distinction as to who owned what. Although it is of no relevance, it seems that everything they owned was either joint property or property that would have been equally divisible under marital property legislation.

13 As already indicated, the guarantee was in support of an investment loan made by their son, Jack, who was then a practising lawyer. This commitment of Joseph Bass was one of a number of involvements that Jack induced his father to make to support his business dealings. It, like the others, was a mistake. Jack's dealings clearly brought financial ruin upon himself and his parents, and it would appear were a contributing cause to his own trouble with the law society.

14 Sometime in the summer of 1977 Joseph and Lorraine Bass separated, with Joseph leaving the home. I need not explore the reasons. On 29th July 1977 Mrs. Bass consulted Mr. Perry Schulman, Q.C., concerning her marital situation. Mr. Schulman testified (with the consent of Mrs. Bass) that he was advised that the Basses were already living separate and apart and that they wanted a separation agreement prepared. He was told that Mr. Bass had agreed to "sign over the house", and that Mrs. Bass would remain employed in the store at a stipulated salary. Mr. Schulman wrote to Mr. Bass advising of his instructions, and received a letter dated 12th August 1977 from a Mr. Earl Essers, another Winnipeg solicitor, advising that he was acting. Discussions took place between Essers and Schulman. Mr. Essers (who testified with the consent of Mr. Bass) was concerned that the only point that was ever in issue was the amount of salary that Mrs. Bass would get from the store. Mr. Schulman drafted a short separation agreement, which bears the date 30th August 1977, and which both lawyers confirm accurately expresses the instructions of their clients. It included the agreement by Mr. Bass to transfer his interest in the house. The document was, though, never executed.

15 Later in the fall Mr. and Mrs. Bass resumed cohabitation in the marital home.

16 I jump ahead here somewhat in the chronology of events to 1978 when Mr. and Mrs. Bass again separated for a few months. Mrs. Bass visited Mr. Schulman on 15th August 1978 at which time, upon her instruction, he prepared a two-paragraph form of agreement simply confirming that the parties had again been living separate and apart since 15th February 1978 and intended to continue doing so, and that the husband was not to enter the premises where the wife was living. Mr. Schulman received no instructions that suggested that the earlier intentions with respect to the transfer of the home, and employment, had been changed.

17 That form of agreement was sent to Mr. Essers. However, when he called his client he was told simply that he would let him know later what was to be done. Neither Mr. Schulman nor Mr. Essers received further instructions and the second form of agreement was never signed. In fact, shortly thereafter Mr. and Mrs. Bass resumed cohabitation.

18 I return now to the summer of 1977. On 22nd August of that year, at the instance of the plaintiff, Mr. Bass completed his second and last statement of affairs. It showed the house as being jointly owned, which of course was the fact, although the Basses had already agreed that it was to be conveyed into Mrs. Bass's name alone. There is no suggestion that this matter was in any way discussed with the bank and Mr. Bass says that he simply updated the earlier statement by reference to his own rather unsophisticated financial statements.

19 There is nothing in the evidence that causes me to think that either the bank or Mr. Bass had concern for his financial stability at that time.

20 In August or September 1977, according to Mr. Bass and Jack, instructions were given to Jack to transfer the home pursuant to the agreement. Jack did, in fact, open a file in his office about that time. The precise date is not known because Jack's records are still in the possession of the law society; however, there was a 1977 file folder entered in evidence with some miscellaneous papers relating to the transaction on the file. It is Jack's evidence that a form of transfer was prepared soon after the file was opened. There is, amongst the miscellaneous papers still on that file, a carbon copy of a transfer signed by Lorraine Bass and Jack Bass. The front page of that copy bears no date, although the affidavits of value and of execution are dated 4th February 1980 which is just prior to the date of actual registration.

21 Jack testified that sometime in the fall of 1977 he obtained the signatures of his parents on the transfer. He is unable to give any precise date of the signing and it is, of course, the position of the plaintiff that the document was not signed until February 1980.

22 One of the other papers on the file is an undated handwritten memo by Jack to his then law student, Mary Beehler, requesting that she take the transfer to his parents to be signed. Mary Beehler gave evidence confirming that she was Jack's student at that time and that she remained in his employ after her call to the bar until the fall of 1978.

23 She recollects discussing the file with Jack at a time which she places as being in July or August 1977. She says, however, that she requested Jack to look after the matter himself because she would be uncomfortable dealing with his parents on their marital matters. Ms. Beehler is unable to say when the transfer was actually signed.

24 Jack says that there was no reason why the completion of the transaction was not attended to promptly, other than his own oversight. Jack pointed out that in the law society proceedings against him he was found to be derelict in his attention to his files, and suggested that this transaction is one of those meeting that description.

25 I refer here to the testimony of yet another lawyer, Mr. Harry Gordon, Q.C. In 1979 and 1980 he was giving Jack Bass professional advice relating to his various difficulties. He acknowledges that in late 1979 (he at first said late 1980 but that was obviously an error), Jack came to him to seek advice as to whether the transfer, which Jack said had been executed some time previously, could be back-dated to the date of execution or whether it should be executed more contemporaneously with the date of registration. He advised that regardless of when it had been signed it should be dated and the affidavits completed with current dates. He did not actually see the document, so that he is unable to confirm if or when it was signed. His testimony is, however, consistent with evidence relating to an earlier signing.

26 I return now to 24th January 1978. It was on that date that Mr. Turner of the Bank of Nova Scotia hand delivered to Mr. Bass a demand for the payment of $24,278.46, together with interest of $845.44, all pursuant to the guarantee. Mrs. Bass was present. Thereafter, Mr. Bass had further communications with the bank, at meetings and by correspondence, concerning Jack's payment progress or lack of it. There is no evidence however that there was any particular pressure on Mr. Bass for payment. In fact, in a letter of 7th February 1980 from the bank to Joseph Bass, he was advised that Jack had been defaulting on recent payment promises and was requested to attend at the bank on 15th February 1980 so that

the bank could "again review the loan and be brought up to date on Jack's personal circumstances". It was not until 6th March 1980 that the second formal demand for payment was made upon Joseph Bass. It was several weeks prior to this that the actual registration of the questioned transfer of title took place.

27 The findings of fact set forth to this point are supported by the admissions of counsel, the documents tendered, and the credible evidence of witnesses other than the parties. I have referred little to the testimony of Mr. Turner, the bank's sole witness, or to the testimony of Joseph and Lorraine Bass.

28 Mr. Turner's evidence was not open to any criticism but understandably bore only on the bank's direct involvement. Nothing to which he testified bore directly on the essential issues in the case and none of what he said is the subject of any real controversy.

29 I found both Joseph Bass and Lorraine Bass to be credible, although obviously not disinterested. For the reasons relating to evidentiary onus, I think it wise not to rely on their testimony more than need be. It is, however, necessary to observe that both of them testified that the intent to transfer Mr. Bass's interest in the residence had been formed in 1977 and had never been abandoned or changed. From the time they requested Jack to look after the matter in the fall of 1977 they seemed to have put it out of their minds and assumed that it had been done. It would have served both their purposes to have testified that they signed the transfer, as I find they probably did, in 1977, but neither of them pretended that they could remember. In my opinion that serves to enhance their credibility. Mrs. Bass claims that it was the 1979 real property tax statement received from the city of Winnipeg, which showed her and her husband still to be the joint owners, that caused her to press Jack to complete the transfer. I believe her, although I cannot ignore the possibility that it was the general state of their, and Jack's, financial circumstances at that time which made them realize the vulnerability of their positions.

30 In any event, the transfer of the home took place at a time when Joseph Bass either was, or knew he was in real danger of becoming, insolvent, and that is the context in which I must consider the matter.

31 Some time was spent in argument by Mr. Hoffer to convince me that in light of the circumstances in which the initial undertaking to transfer the land was made in 1977 and in light of the reference to the $1 consideration, I should treat this conveyance as one made for good and valuable consideration. I do not dismiss the argument as being without merit. Certainly the adequacy of consideration is an element to be considered in determining, in cases like this, whether there was fraud. In my opinion, however, that portion of the submission is weak and should be dismissed.

32 There was then a conveyance which was completed, between a husband and wife, on a voluntary basis, at a time when the husband as transferor knew that he was, or was about to become, insolvent. The plaintiff has unquestionably been hindered in the collection of its just debt. In accordance with the concepts earlier enunciated, this is a "suspicious" circumstance in which Joseph Bass has a significant evidentiary onus if the plaintiff's request for a declaration that the transaction is void is to be defeated. Nonetheless, the plaintiff can only succeed if this court is satisfied that there was, in fact, an intent to defraud.

33 If the parties had entered into and executed a binding agreement with respect to the transfer of land in August 1977, or if there were any certainty that a transfer of land had been completed at that time, then I think that the ultimate registration of the transfer could not, in itself, result in a finding of fraud. There was not, however, an enforceable agreement entered into in 1977 and there is uncertainty as to when the transfer was signed. Nonetheless, it is the bona fides of the intent, and not the date of the registration of the transfer, that to me is the most significant.

34 On the testimony of Mr. and Mrs. Bass, which I have found to be honestly given and not seriously impugned, and on the basis of a good deal of supportive evidence, both documentary and viva voce, I am satisfied that in August 1977 Mr. and Mrs. Bass, at a time when Mr. Bass was facing no apparent threat of insolvency, mutually formed the intent to convey their residence from their joint names into the name of Mrs. Bass alone. In a general sense they were, in all

likelihood, thinking of Mrs. Bass's security and protection. There is no reason, however, to think that their motive was to defeat creditors in general or the plaintiff in particular.

35 I am satisfied from the evidence that their intent continued from at least August 1977 uninterrupted, notwithstanding their reconciliation, up until the actual date of conveyance. By that time, Mr. Bass's vulnerability and a concern to protect Mrs. Bass may have been a factor. That however, in my mind, does not detract from my conclusion that the registration of the transfer was the culmination of a longstanding, continuing, bona fide intent that would have been brought to fruition much sooner if not for their son's dereliction.

36 In light of this finding it cannot be said that the plaintiff has established that there was a conveyance made with the intent of defrauding creditors, and its action is dismissed.

37 The defendants Joseph and Lorraine Bass will have their costs in an amount that can be spoken to if not agreed.

Application dismissed.

TAB 9

2000 CarswellOnt 1178
Ontario Superior Court of Justice

Prodigy Graphics Group Inc. v. Fitz-Andrews

2000 CarswellOnt 1178, [2000] O.J. No. 1203, [2000] O.T.C. 237, 96 A.C.W.S. (3d) 177

Prodigy Graphics Group Inc. and Andy Patel, Plaintiffs and Kenneth Gregory Derry Fitz-Andrews, Gina Suzanna Fitz-Andrews and Ampito Investments Inc., Defendants

Kenneth Gregory Derry Fitz-Andrews, Gina Suzanna Fitz-Andrews and Ampito Investments Inc., Plaintiffs by Counterclaim and Prodigy Graphics Group Inc., Andy Patel, Prodigy Printing Services (1993) Inc. and Sulekha Patel, Defendants by Counterclaim

Cameron J.

Heard: January 24, 2000
Heard: January 25, 2000
Heard: January 26, 2000
Heard: January 27, 2000
Heard: January 28, 2000
Heard: January 31, 2000
Heard: February 1, 2000
Heard: February 2, 2000
Heard: February 3, 2000
Heard: February 4, 2000
Heard: February 7, 2000
Heard: February 8, 2000
Heard: February 9, 2000
Heard: February 10, 2000
Heard: February 11, 2000
Heard: February 14, 2000
Heard: March 16, 2000
Heard: March 17, 2000
Heard: March 20, 2000
Judgment: April 10, 2000
Docket: 94-CQ-58835

Counsel: *Messod Boussidan* and *James Diamond*, for Plaintiffs.
Kenneth Fitz-Andrews, for himself.

Subject: Contracts; Corporate and Commercial; Torts; Civil Practice and Procedure

Headnote

Torts --- Conversion — Elements of right of action — Wrongful act — Unauthorized disposition

Accountant provided consulting services to clients' corporation and clients over number of years — In 1992, clients wrote three cheques to company owned by accountant — Accountant applied cheques to account for consulting services allegedly provided — Account was addressed to clients personally, and was dated six days prior to accountant's purchase of company — Account was allegedly for "off-hours" work performed by accountant in addition to his firm's work related to same transaction — Clients claimed purpose of cheques was to pay corporation's tax liability and that accountant produced receipts from Revenue Canada which they photocopied — Revenue Canada denied receiving amounts noted in receipts — Handwriting expert testified to high probability that handwriting on receipts was that of accountant — Client sued accountant for conversion and misappropriation of funds — Action allowed — Accountant produced only diary showing time spent, not detailed dockets, computer records or evidence from files to explain details of services provided — Account was inflated if not wholly without foundation and was never delivered to client prior to cheques being drawn — Cheques were not to pay account for services but to pay employee withholding tax liabilities — Accountant had no right to appropriate money and was liable to repay clients — Accountant also appropriated to himself cheques payable to clients' corporation, which he had not authority to appropriate — Accountant was liable to repay amount to clients' corporation — Accountant's wife, who owned shares in company, had no knowledge of accountant's appropriation of funds — It would be unjust to pierce corporate veil to make wife personally liable or make her accessory to breach of trust — No evidence existed that proceeds of clients' cheques could be traced to payment of any part of purchase price of house bought by accountant and his wife.

Fraud and misrepresentation --- Fraudulent conveyances — Fraudulent intent — General principles

Accountant was in dispute with clients over application of series of cheques to payment of account for services rendered — Accountant was also involved in litigation with former partners and landlord — Accountant and wife bought house in both names, subject to mortgage, and subsequently transferred title to wife's name exclusively — Application was brought by clients to have transaction set aside as fraudulent conveyance — Application granted — Intention of accountant was to be determined as of date of transfer being executed — Conveyance was made with intent to delay creditors — As number of badges of fraud were present, including fact accountant continued to live in house and had few other assets, presumption of intent was raised — Wife's lack of knowledge of accountant's intent was irrelevant.

Injunctions --- Procedure on application — Undertaking regarding damages — Inquiry or reference to enforce damages

Clients suing accountant for conversion and misappropriation of funds obtained interlocutory injunction freezing accountant's assets and certificate of pending litigation against his residence — Affidavits provided by clients failed to disclose clients' involvement in, and suggested accountant was responsible for, scheme to withhold taxes, which was initiated prior to accountant's retainer — Shortly before trial, accountant brought motions to set aside injunction and certificate of pending litigation — Both motions were dismissed on basis of imminent trial and failure to move forthwith — At trial, claim was brought by accountant for damages related to difficulties experienced borrowing money and maintaining bank accounts, as well as damage to reputation with banks and clients — Action dismissed — Clients' failed to make full and frank disclosure — Non-disclosure was material and might have effected outcome of motion, but accountant failed to provide evidence of his damages.

ACTION by clients against accountant for misappropriation and conversion of funds; COUNTER-CLAIM by accountant for damages related to interlocutory injunction freezing accountant's assets and certificate of pending litigation.

***Cameron J.*:**

1 The plaintiffs claim damages of $180,783.04 for fraud and conversion. The counterclaim for damages is based on inadequate disclosure in obtaining injunctive relief and the balance owing on accounts for professional services. Both cases turn on credibility and assessing alleged forgeries.

I. The Parties

1. The Patels and Prodigy

2 Andy Patel is the president, a director and 50% shareholder of Prodigy Graphics Group Inc., a 1995 amalgamation which includes Prodigy Industrial Printers Inc., later called Prodigy Printing Services (1993) Inc. (collectively "Prodigy"). Since 1975 Prodigy has operated a printing business in Mississauga. The business grew and expanded and by December 1992 had 23 employees. Sulekha Patel, Mr. Patel's wife, was and is a director and 50% shareholder of Prodigy. She worked about half of her time in Prodigy's office. Prodigy's accountant from 1986 to 1992 was a firm of chartered accountants in Brampton named Savage and Moles.

2. The Fitz-Andrews and Ampito

3 Kenneth Fitz-Andrews is a chartered accountant who had been with an international accounting firm in Trinidad and Tobago from the mid 1970s until he came to Canada in August 1989, followed shortly by his wife Gina Fitz-Andrews and their four children. They rented a home at 1224 Highgate Place in Mississauga. In October 1989, Mr. Fitz-Andrews was hired by Savage and Moles. Mr. Fitz-Andrews became one of two partners in the firm on May 1, 1990 and borrowed about $180,000 from Royal Bank to finance the purchase of his capital interest in the firm. His draw cheques were often paid in advance. The partnership agreement required the partners to devote their full time and attention to partnership affairs.

4 Gina Fitz-Andrews is the president, a director and sole shareholder of Ampito Investments Limited ("Ampito"). She is also the registered owner of the family home purchased on March 26, 1993, which she and Mr. Fitz-Andrews had leased since September 1989.

5 Gina Fitz-Andrews purchased the shares of Ampito, an Ontario corporation, on November 16, 1992 to operate a business of selling school uniforms similar to that operated by his sister in the United Kingdom. Gina Fitz-Andrews, Mr. Fitz-Andrews and his sister are the directors of Ampito.

II. Outline of the Relationship 1990-1994

6 Mr. Fitz-Andrews started providing consulting services on behalf of Savage and Moles to Prodigy and the Patels in early 1990. These services included work relating to the sale of Mr. Patel's minority interest in another company, the purchase of a Komeri press, the purchase of a larger building on Creekbank Road to house Prodigy's growing operations and consolidation of Prodigy's borrowings with The Royal Bank of Canada ("Royal Bank").

7 In February 1991, Mr. Fitz-Andrews became involved in Prodigy's negotiations of a contract for the purchase from Mitsubishi Litho Press Canada ("MLP") of three large new presses for $3 million and the financing of the purchase by Royal Bank. Mr. Fitz-Andrews testified that this involved him in much evening and weekend work in the preparation of business plans, financial projections and proposals on behalf of Prodigy. Savage and Moles rendered accounts for this work in September and December 1991 and October 1992.

8 Mr. Patel testified that he came to regard Mr. Fitz-Andrews as a "partner I didn't have".

9 In March 1992, Mr. Fitz-Andrews gave, and later withdrew, notice to terminate his partnership in Savage and Moles.

10 In April, September, October and November 1992, Prodigy paid to or for Mr. Fitz-Andrews' personal account at Royal Bank amounts of $10,000, $7,000, $7,000 and $1,500 respectively.

11 In September 1992, Mr. Fitz-Andrews started to withdraw from Savage and Moles and set up his own practice in temporary quarters. He formally registered with the Institute of Chartered Accountants of Ontario as a sole practitioner effective November 10, 1992.

12 In October 1992, Revenue Canada issued assessments against Prodigy for unremitted taxes withheld from employees in 1988 and 1989 plus penalty and interest. Mr. Fitz-Andrews delivered Prodigy's payment to Revenue Canada on

October 28, 1992. On November 13, 1992 Revenue Canada issued an assessment against Prodigy in respect of 1990 unremitted employee withholdings for $26,809.

13 On November 17, 1992, Mr. Patel and his wife wrote cheques from their personal accounts totalling $130,000 to Ampito, the shares of which Gina Fitz-Andrews had purchased the day before for $500 for the purpose of establishing a school uniform business.

14 The purpose of this payment is at the centre of this action.

15 In 1992, Mr. Fitz-Andrews and Carrol Meisner his partner in Savage and Moles were sued by a former landlord of the partnership. In December 1992, Mr. Fitz-Andrews commenced an action against Mr. Meisner arising out of the break-up of their partnership.

16 In March 1993, Mr. Fitz-Andrews moved his accounting practice from its initial temporary location to a nearby permanent office.

17 At about the same time Mr. and Mrs. Fitz-Andrews agreed to purchase the house they had been renting for the previous three years for $300,000 cash. The transaction closed on March 26 with a deed to Gina and Mr. Fitz-Andrews. On the same day Mr. Fitz-Andrews transferred his interest to his wife

18 In May 1993, Mr. Fitz-Andrews rendered an account to Prodigy of $29,000 for professional services to which Mr. Patel objected without supporting documentation.

19 In July 1993, Revenue Canada issued a Statement of Account showing unpaid amounts in respect of assessments for unremitted withholdings in 1990 and 1991 and an assessment for $2,700 in respect of 1992. In November 1993 and January 1994 further amounts were assessed respecting 1991.

20 In completing the audit of Prodigy and a related company Prodigy Graphics Inc., Mr. Fitz-Andrews submitted to Mr. Patel in November 1993 audit engagement letters for each of the companies. Two "original" copies were submitted in evidence. The letter from Mr. Fitz-Andrews' file signed by Mr. Patel authorized Mr. Fitz-Andrews to apply rebates received from Revenue Canada to his outstanding accounts. There was no such authorization in Prodigy's copy.

21 In early 1994, Mr. Fitz-Andrews wrote to Mr. Patel respecting his concern with his outstanding accounts, including the May 1993 account which remained unpaid.

22 On March 3, 1994, Mr. Fitz-Andrews wrote to Mr. Patel and Royal Bank withdrawing Prodigy's audited financial statements for the fiscal year ended July 31, 1993 because of Prodigy's failure to include a contingent liability for employee withholdings owing to Revenue Canada in respect of the calendar year 1992.

23 On the same day Mr. Fitz-Andrews wrote to Mr. Patel complaining of the non-payment of his outstanding accounts, explaining the work done and recording his upset at the request for supporting dockets "in view of previous transactions not requiring this". He concluded with a refusal to provide further services until his outstanding accounts were settled.

24 In May 1994, Mr. Fitz-Andrews remitted a statement of account to the Prodigy companies respecting accounts dating back to the disputed May 1993 account and showing payments received. The balance owing was $46,233, less amounts held in trust of $25,283.04, leaving a "net balance due" of $20,946.06. The accounts in trust included the proceeds of two cheques from Revenue Canada payable to Prodigy totalling $24,181.58 received by Mr. Fitz-Andrews in February 1994 and cashed by him.

25 In June of 1994 Mr. Patel, with his new accountant Joel Levitt, voluntarily disclosed to Revenue Canada Prodigy's failure to remit employee withholdings in the calendar year 1992. Prodigy was assessed for principal amounts owing in respect of 1992, $19,146 on July 27, 1994 and $38,679 on November 17, 1994. Additional amounts were assessed for 20% penalty and interest.

26 This action was commenced on November 29, 1994. On December 12, 1994 the plaintiffs filed affidavits in support of an *ex parte* motion resulting in a certificate of pending litigation against the home registered in Gina Fitz-Andrews' name and a *mareva* injunction freezing Mr. Fitz-Andrews' assets. The defendants filed responding material on December 21, 1994. On return of the motion the injunction was amended to release $10,000 to Mr. Fitz-Andrews, otherwise it was to continue pending deposit of security of $25,000 in cash and a letter of credit for $50,000. The motion was adjourned to allow for cross-examinations. The cross-examinations were not held until almost six years later in the autumn of 1999. On return of the motion the court continued the injunction and certificate of pending litigation until this trial.

27 There were numerous interlocutory proceedings arising out of the discovery process.

III. The Claims and Counterclaims

28 Mr. Patel has sued the defendants for damages of $130,000. Prodigy has sued the defendants for $25,500 and the defendant Mr. Fitz-Andrews for a further $24,181 based on fraud and conversion. The plaintiffs have sued Gina Fitz-Andrews to void a fraudulent conveyance to her and to make her personally liable as a director of Ampito for a fraud by Ampito.

29 Mr. Fitz-Andrews counterclaims against Andy and Sulekha Patel and Prodigy for outstanding fees of $46,233.10.

30 He also claims damages resulting from obtaining *ex parte* a certificate of pending litigation and an interim *mareva* injunction, and continuation thereof pending cross-examinations. Mr. Fitz-Andrews claims the affidavits used to obtain the certificate of pending litigation and *mareva* injunction were materially misleading and lacked material disclosure respecting Mr. Patel's participation in the tax evasion scheme which he blamed on Mr. Fitz-Andrews.

31 Mr. Fitz-Andrews' claims for damages based on allegations of libel by statements contained in the statement of claim and in the affidavits used to obtain the certificate of pending litigation and interim *mareva* injunction must be dismissed. Statements in pleadings and affidavits in court proceedings are absolutely privileged: *Dooley v. C.N. Weber Ltd.* (1994), 19 O.R. (3d) 779 (Ont. Gen. Div.). In addition, the libel charged has not been pleaded with sufficient particularity.

32 The claims against Sulekha Patel based on an alleged duty to disclose known shortcomings in the affidavits supporting the motions for interlocutory relief must be dismissed because she was not a party at the time of swearing the affidavits. She can only be liable if her conduct was such as to make her liable in her capacity as a director of Prodigy.

IV. The Issues

33 The five issues in this case turn on credibility.

1. The $130,000 Paid to Ampito

34 Mr. Patel alleges that Mr. Fitz-Andrews defrauded him of $130,000 by misappropriating the proceeds of Mr. Patel's personal cheques paid to Ampito, to pay off an account of Ampito of $130,500 for consulting services allegedly rendered by Mr. Fitz-Andrews in 1991 and 1992. Mr. Patel alleges the purpose of the cheques was to pay Prodigy's tax liabilities to Revenue Canada.

35 Mr. Patel alleges the Ampito account is fabricated. He denies receiving the account and further denies that such work was done. Mr. Patel alleges that Mr. Fitz-Andrews (a) presented to him false receipts of Revenue Canada to hide the misappropriation, (b) allowed him to make a copy of the receipts, and (c) received back from him the original receipts.

36 Mr. Fitz-Andrews asserts that his account is *bona fide* and based on time spent on evenings and weekends on Prodigy's affairs noted in his calendar diaries. Mr. Fitz-Andrews says he delivered the Ampito account to Mr. Patel. Mr. Fitz-Andrews asserts the payment of the account is in accordance with a private oral agreement between the parties respecting his services performed for Prodigy. Mr. Patel denies any such agreement.

37 Mr. Fitz-Andrews denies he obtained the Revenue Canada receipts or showed them to the Patels. He asserts that the receipts were fabricated by Mr. Patel. A handwriting expert has opined that there is a "high probability" that the handwriting on the receipts is that of Mr. Fitz-Andrews.

2. Cheques for $25,500

38 In 1992 Prodigy wrote four cheques totalling $25,500 payable to Royal Bank, which were given to Mr. Fitz-Andrews, as follows: April 10 - $10,000; September 1 - $7,000; October 1 - $7,000 and November 1 - $1,500. These were deposited to Mr. Fitz-Andrews' account.

39 Mr. Patel says these were payments for setting up a payroll computer programme and for deferral of payment of taxes withheld from employees for the purpose of making Prodigy's profits look greater so Royal Bank would fulfill its agreement to lend part of the purchase price for new printing presses payable to MLP Canada eleven months after their delivery in January, 1992. Mr. Fitz-Andrews denies participating in any such arrangement and claims the payments were for legitimate consulting services. Mr. Patel says Mr. Fitz-Andrews promised to send him an account for these payments but did not do so.

3. Mr. Fitz-Andrews' Accounts $46,233

40 Mr. Fitz-Andrews rendered accounts to the Prodigy group of companies for work done in late 1992, 1993 and early 1994 which Mr. Patel disputes. Mr. Fitz-Andrews appropriated to himself in February 1994 two Revenue Canada refund cheques payable to Prodigy totalling $24,181 alleging that he was authorized to do so by reason of an authorization on page 2 of Prodigy's engagement letter dated November 22, 1993 signed by Mr. Patel which retained Mr. Fitz-Andrews to audit the financial statements for the year ended July 31, 1993.

41 Mr. Patel alleges that Mr. Fitz-Andrews substituted the page 2 containing an authorization for the page which he says he signed which contained no such authorization. Mr. Fitz-Andrews alleges that Mr. Patel fraudulently substituted the page 2 in the letter that Mr. Patel produced for the page containing the authorization which Mr. Fitz-Andrews produced.

4. Fraudulent Conveyance

42 Was the conveyance of the family home by Mr. Fitz-Andrews to his wife made with the intent to defeat or hinder his creditors as contemplated in s.2 of the *Fraudulent Conveyances Act*?

5. Claim on Undertaking to Pay damages

43 Mr. Fitz-Andrews alleges that the Patels and Prodigy gave materially misleading evidence in the affidavits used to obtain and continue the certificate of pending litigation and the interlocutory *mareva* injunction freezing the Fitz-Andrews' house and other assets following commencement of this action in November 1994. Mr. Fitz-Andrews alleges it wrongfully accused him of fraudulent conduct and failed to disclose Mr. Patel's involvement in tax evasion.

V. Burden of Proof

44 In civil cases, where there is an allegation of criminal or morally blameworthy conduct, the civil burden of proof, namely the balance or preponderance of probabilities, applies. In determining whether it is satisfied, the court may consider the cogency of the evidence and scrutinize the evidence with greater care, bearing in mind the consequences of its decision: J. Sopinka, S.N. Lederman and A.W. Bryant, *The Law of Evidence in Canada*, 2rd ed. (Toronto: Butterworths, 1998) at p. 156-158 citing *Continental Insurance Co. v. Dalton Cartage Ltd.*, [1982] 1 S.C.R. 164, 131 D.L.R. (3d) 559 (S.C.C.), per Laskin, C.J.C., *Boykowych v. Boykowych*, [1955] S.C.R. 151, [1955] 2 D.L.R. 81 (S.C.C.); and *Smith v. Smith*, [1952] 2 S.C.R. 312, [1952] 3 D.L.R. 449 (S.C.C.) per Cartwright J. In this case Mr. Fitz-Andrews' professional licence is clearly at risk.

VI. Assessing Credibility

45 A most difficult task for a finder of fact is to determine the truth. The process is more difficult if both sides may have a motive to offer less than the whole truth or if the events occurred so long ago as to permit human nature and time to work on the recollection of a witness. I call this unconsciously selective hindsight through rose coloured glasses.

46 I have examined and assessed the evidence of each witness and the exhibits presented at trial using, where appropriate, the following traditional criteria:

1) Lack of testimonial qualification

2) Demeanor of Witness: apparent honesty, forthrightness, openness, spontaneity, firm memory, accuracy, evasiveness

3) Bias/Interest in the Outcome (if a party, motive)

4) Relationship/Hostility to a party

5) Inherent probability in the circumstances i.e. in the context of the other evidence does it have an "air of reality"

6) Internal consistency i.e. with other parts of this witness' evidence at trial and on prior occasions.

7) External consistency i.e. with other credible witnesses and documents

8) Factors applicable to <u>written evidence</u>:

(a) Presence or absence of details supporting conclusory assertions

(b) Artful drafting which shields equivocation

(c) Use of language in an affidavit which is inappropriate to the particular witness

(d) Indications that the deponent has not read the affidavit

(e) Affidavits which lack the best evidence available

(f) Lack of precision and factual errors

(g) Omission of significant facts which should be addressed

(h) Disguised hearsay

See for example, Alan W. Mewett and Peter J. Sankoff, *Witnesses*, chapter 11, (Toronto: Carswell, Looseleaf).

47 An adverse inference may be drawn against a party for failure, without adequate explanation, to call a relevant witness or submit relevant evidence which would be expected to support the party's case against the other party. The court may infer that the witness was not called out of a fear that he would not have supported that party's case. The inference may be drawn notwithstanding the witnesses' availability to be subpoenaed by either party in the case: *Goldstein v. Davison* (1994), 39 R.P.R. (2d) 61 (Ont. Gen. Div.) per Ground J., citing *Murray v. Saskatoon (City) (No. 2)* (1951), [1952] 2 D.L.R. 499 (Sask. C.A.) and *Claiborne Industries Ltd. v. National Bank of Canada* (1989), 69 O.R. (2d) 65 (Ont. C.A.). See also *Medalist Holdings Ltd. v. General Electric Capital Equipment Finance Inc.* (1997), 10 R.P.R. (3d) 111 (Ont. Gen. Div.) per Greer J. and *Zelmer v. Victor Projects Ltd.* (October 31, 1995), Doc. Kelowna 16665 (B.C. S.C.) per Lowry J.

48 A proper application of these principles requires that the finder of fact be provided with, or create, a detailed overall chronology of events relevant to the facts in issue in the pleadings and to the facts on collateral issues such as credibility of the evidence. The evidence on each of these issues must also be analyzed in the context of the chronology of the facts relevant to each of the issues. I have attempted to do this.

49 I do not intend to record in this judgment all the evidence offered during 16 days of trial or referred to in three days of argument. The evidence on the numerous collateral issues includes time diaries for three years, purchase, loan and lease agreements on which Mr. Fitz-Andrews worked, accounts rendered to Prodigy or the Patels for accounting and consulting services, inconsistent computer generated payroll records, financial statements, T4 summary reports to Revenue Canada, Revenue Canada notices of assessments for 1988, 1989, 1990, 1991 and 1992 and statements of account over the period September 1992 to November 1994 respecting Prodigy, photocopy of receipts of payments ostensibly issued by Revenue Canada, documents relating to the purchase and mortgages of the Fitz-Andrews' home, the Savage and Moles partnership agreement, a summary of Mr. Fitz-Andrews' docketing, correspondence respecting his withdrawal from his partnership or its cessation, motion records on the application for an interim *mareva* injunction and certificate of pending litigation and the return of the motion for interlocutory relief, two versions of an audit engagement letter, Prodigy cheques payable to Mr. Fitz-Andrews' account at Royal Bank and the purchase or establishment and organization of various companies.

50 In assessing the evidence of Sulekha Patel, I found her to be well prepared on the two issues for which she was called to testify but, considering her share ownership and long involvement with Prodigy, totally unresponsive on cross-examination and on discovery with too many replies such as "I don't remember" to harmless questions on which she should have known the answers. Her lawyer interrupted so frequently in the discovery as to make me wonder what she was hiding. I readily acknowledge that most of his other objections respecting relevance, harassment and repetition by Mr. Fitz-Andrews were quite proper. This assessment of Mrs. Patel raises a question as to the reliability of Mr. Patel's evidence beyond the scrutiny accorded an interested and otherwise open and forthright party.

VII. The Payroll Scheme and Revenue Canada Assessments

51 Mr. Patel testified that Mr. Fitz-Andrews became involved in setting up a computer payroll program and in calculating pay and deductions in early 1992 after Prodigy's part-time payroll clerk Paul Frimpong disappeared, allegedly taking with him most of Prodigy's payroll records.

52 Mr. Fitz-Andrews denies becoming involved in setting up such a program or in calculating Prodigy's payroll and deductions. Mr. Fitz-Andrews testified that as accountant for Prodigy, he only prepared the T-4 slips and T-4 summary following the calendar year end and reviewed the internal monthly statements before they were forwarded to Prodigy's bankers.

53 Mr. Patel alleges that Mr. Fitz-Andrews was party with him in a scheme to mislead the Royal Bank into thinking Prodigy was more profitable than it really was by giving it false statements to ensure advance of a loan. Did Mr. Fitz-Andrews withhold from Prodigy's monthly statements provided to its bankers accrued liabilities for employee remittances to Revenue Canada by showing these employees as employees of Ampito and deferring the monthly payments of the withholdings to Revenue Canada? The evidence on this collateral issue is conflicting and inconclusive. Mr. Patel says the reason for Prodigy paying $25,500 to Mr. Fitz-Andrews' account at Royal Bank was for his part in developing this scheme and as a bonus for helping Prodigy achieve a profit in the fiscal year ended July 1992. Mr. Fitz-Andrews denies this allegation and asserts the payments were for professional services rendered. Mr. Patel denies liability because it has never been specifically billed.

54 In October 1992, Prodigy received assessments for employee deductions for income tax, unemployment insurance and Canada Pension Plan which had not been remitted in respect of the calendar years 1988 and 1989 totalling $24,510.03, including penalties and interest. Prodigy gave Mr. Fitz-Andrews a cheque which he delivered to Revenue Canada.

55 Within a few days after November 13, 1992 Prodigy received an assessment for unpaid employee withholdings in 1990 totalling $26,089.85 including penalty and interest. Mr. Fitz-Andrews said that following discussions with Revenue Canada he told Mr. Patel that Prodigy's file was being reviewed. Prodigy made payments often in the subsequent months.

56 In July 1993 Prodigy received a statement of account from Revenue Canada showing assessments and payments as follows:

	Total Assessed	Total Owing (Including Penalty and Interest
1990	80,717	21,394
1991	79,652	62,130
1992	2,753	3,152

57 Prodigy continued to make payments on account. In November 1993 and January 1994, a further $14,506 was assessed in respect of employee withholdings for 1991 and on February 25, 1994 a further $11,890 plus interest and taxes as assessed in respect of 1990.

58 On July 27, 1994 and November 17, 1994, following self reporting on the advice of its new accountant Joel Levitt, Prodigy was assessed in respect of 1992 a further $19,146 and $38,679 which, with penalties and interest, totalled $71,884.

59 The total withholdings assessed for 1992 were $60,578.88 plus 10% penalty plus interest from the 15th day of the month following deduction from the employees' pay.

60 Prodigy paid all amounts assessed by Revenue Canada in respect of unpaid payroll deductions by 1995.

61 I am satisfied from the Revenue Canada assessments in October and November 1992 and in 1993 that Mr. Patel caused Prodigy to withhold reporting and payment of employee payroll deductions during the period 1988 to 1993. Contrary to Mr. Patel's allegations, Mr. Fitz-Andrews had nothing to do with these activities until 1992, if at all, following the disappearance of Prodigy's part-time bookkeeper, Paul Frimpong, in late 1991.

XIII. Purpose of the Three Personal Cheques: $130,000

62 The central issue in this case is the purpose for which Mr. Patel drew three personal cheques in his office in the presence of Sulekha Patel and Mr. Fitz-Andrews. One cheque was drawn by Mr. Patel on a joint account with his wife and two were drawn on Mr. Patel's personal account. The cheques were payable to Ampito in the amounts of $30,000 dated November 17, 1992, $50,000 dated November 27, 1992 and $50,000 dated December 4, 1992. The latter cheques were said to be post dated to coincide with the maturity dates of some personally held guaranteed income certificates. The cheques were handed to Mr. Fitz-Andrews in the presence of both Patels who testified that Mr. Fitz-Andrews said that the proceeds would be paid to Revenue Canada. Mr. Patel testified that the cheques were for the withholding taxes payable on account of Prodigy employees for 1992 which he and Mr. Fitz-Andrews agreed would be transferred to Ampito's payroll, without accruing the liability on Prodigy's books, to reduce the costs and increase the revenues of Prodigy so as not to default on the loan agreement with Royal Bank. Mr. Patel further testified that the amount of the cheques was recommended by Mr. Fitz-Andrews.

63 Mr. Fitz-Andrews denies there was any such agreement between them to transfer Prodigy employees to Ampito or that the proceeds of the cheques were to be used to pay Revenue Canada. Mr. Fitz-Andrews says the purpose of the cheques was to pay the account of Ampito dated November 10, 1992 for $130,000 for consulting services during evenings and week-ends for Prodigy and the Patels noted in his diaries during 1991 and 1992. Mr. Fitz-Andrews said this work was in accordance with an oral agreement he had with Mr. Patel that such services would be billed by Mr. Fitz-Andrews to Mr. Patel.

64 I heard much evidence concerning Mr. Fitz-Andrews' participation in the negotiations and the agreed terms for the purchase of three printing presses and financing of the purchase through a loan agreement with Royal Bank in 1991 and early 1992.

1. The Ampito Account

65 Mr. Fitz-Andrews says the account was delivered to Mr. Patel on November 11, 1992. The account is headed "Ampito Investments Ltd., 1 Regan Rd., Unit 20, Brampton, Ontario", is addressed to "Narendra and Sulekha Patel" at their home and is dated November 10, 1992. The body of the account reads as follows:

As per private agreement:

For special consulting services and preparation of special feasibility studies, cash flow projections, financial projections for 5 year period re: Prodigy Industrial Printers Inc.

For several consultations and meetings with M.L.P. re: the negotiations and eventual purchase of three (3) printing presses valued at $4,500,000.00. Consultation commenced - one-year period - for negotiation with Royal Bank of Canada and the finalization of financing of $3,090,000.00 to purchase three (3) printing presses from Royal Bank of Canada.

For drafting and preparation of buy-back agreement re: Royal Bank and M.L.P. to secure equipment loan.

For negotiating three (3) year interest free loan for Prodigy Industrial Printers Inc. in the sum of $370,000.00 from M.L.P. (Japan).

To visits to several manufacturers in U.S.A. to review equipment and to meet with company officials.

To negotiations and finalization of purchase of two industrial condominium units from Ravpan Investments Limited - Purchase Price $240,000.00.

To negotiations and finalization of 1 residential condominium unit at Webb Drive, Mississauga.

To several meetings with your solicitors re: the above matters.

TOTAL STAFF HOURS = 645 HOURS

TOTAL MY FEE	$145,000.00
COURTESY DISCOUNT	14,500.00
NET FEE	$130,500.00

66 Mr. Patel denies seeing this account before the commencement of this litigation. He alleges it was prepared after the commencement of this litigation to justify appropriation of the $130,000. The account appeared in the defendants' responding materials and motion record filed December 21, 1994 following receipt on December 16, 1994 of the material used on the *ex parte* injunction motion on December 12, 1994. The responding material included vehement denials of the allegations in the plaintiffs' materials of fraud and participation in the scheme to put Prodigy employees in Ampito.

67 The account is addressed to the individuals and not to Prodigy. It is addressed to the individuals in the names used on two of the cheques and not to "Andy" Patel as he was normally addressed by Mr. Fitz-Andrews.

68 Why would the Patels want the account personally when they could not deduct it as an expense but Prodigy could?

69 The account is dated six days before Mr. Fitz-Andrews purchased the shares of Ampito for $500. When asked why he billed in the name of a company he did not yet own, Mr. Fitz-Andrews said he was not comfortable billing in his own name because of his uncertainty respecting the break-up of his partnership, this in spite of having letterhead in the name of his accounting practice at the time.

70 He later said he had a one page written agreement to purchase Ampito which was replaced by the formal share purchase agreement of November 16, 1992, the date of closing. No such preliminary agreement was produced. Further, Mr. Fitz-Andrews said he needed the money to start his new practice which was registered with Institute of Chartered Accountants of Ontario in November 10, 1992, and needed a corporation to bill the account for tax postponement purposes. He said he could not wait until his lawyers effected his instructions to incorporate his consulting firm, Fitz-Andrews and Associates Inc. ("Associates"). That company was incorporated December 4, 1992. Mr. Fitz-Andrews testified that Ampito transferred its net assets of $81,462 to Associates and Associates declared it as income in its fiscal year ending January 31, 1994.

71 The invoice used a typed address, different from the print font on the rest of the document, of "1 Regan Rd." On November 10, 1992, Mr. Fitz-Andrews' new accounting practice was located at 18 Regan Rd., Suites 28 and 29. He did not move to 1 Regan Rd. until February or March 1993. In January and February 1993, he was using stationery for his accounts and fax transmittal sheets on which were printed the address of 18 Regan Rd. However, the Toronto Dominion Bank monthly statements for Ampito for the periods ending November 30, and December 31, 1992 showing the deposits of the Patel's cheques on November 18 and 27, and December 4, 1992 show Ampito's address as 1 Regan Road. During that period Ampito's address was not on its cheques. The *Corporations Information Act* notice recording the purchase of Ampito was not filed until June 1993. It showed the Fitz-Andrews' home address as the principal place of business and a lawyer's office as the head office.

72 Ampito's income tax returns show no income for the taxation year ended April 30, 1993. Mr. Fitz-Andrews testified that he transferred the net amount remaining, after some expenses and payments to himself, to Associates in its fiscal year ended January 31, 1994 and that the tax was paid on it there.

73 The Ampito invoice charged no GST. Ampito had not registered with GST. Had it applied for and obtained a GST number it would have had to explain the invoice on a GST audit.

74 Mr. Fitz-Andrews testified that he had agreed with Carroll Meisner, his partner, to modifying the partnership agreement so as to permit him to work evenings and week-ends or "off hours" on his own account without accounting to the partnership because an employed accountant had also been permitted to do so. Carroll Meisner, who was Mr. Fitz-Andrews' partner until Mr. Fitz-Andrews set up his own practice in the fall of 1992, testified that he never agreed to amend the "whole time and attention" clause in their partnership agreement to allow Mr. Fitz-Andrews to do accounting work on his own time for his own account. While this is a collateral matter, it shows the source of obvious friction between the two former partners and Mr. Fitz-Andrews' unhappiness in the firm.

75 Mr. Meisner explained the Savage and Moles accounts rendered to Prodigy. On September 25, 1991, Savage and Moles billed Prodigy $2,100 for preparation of a review of annual statements and corporate tax returns. On December 18, 1991, Savage and Moles billed Prodigy $6,500 in respect of $3,675 docketed time in Prodigy's fiscal year ended July 31, 1991 for consulting services on the purchase of three presses from MLP and the related financing from Royal Bank. On October 5, 1992, Savage and Moles billed Prodigy for services in Prodigy's 1992 fiscal year respecting meetings with MLP and Royal Bank to review the financings: $2,850, application for an FBDB loan: $1,245; and GST matters and assessments: $1,150.

76 Mr. Meisner testified that Mr. Fitz-Andrews' hourly billing rates in 1990-1992 were $130 for accounting work and $160 for consulting work, that it was firm policy to enter docketed time into the computerized accounting system daily and that bills were sent based on docketed hours at these rates.

77 Mr. Meisner also reviewed a summary of Mr. Fitz-Andrews' billable and non-billable hours docketed in 1992 until about September 15, 1992. If projected to year end Mr. Fitz-Andrews would have docketed about 2240 hours for 1992 compared to 2266 hours docketed in 1991 when he was an employee. None of Mr. Fitz-Andrews' docketed time at Savage and Moles included the 645 hours billed by Ampito to the Patels on November 10, 1992.

78 Mr. Fitz-Andrews produced no dockets or computer records showing time docketed to Prodigy. He did present diaries for January 1, 1991 to December 31, 1993 noting appointments and the names of clients, sometimes with time recorded in tenths of hours. There are comparatively few entries for other clients. The totals of these entries in 1992 for Prodigy do not seem to match the time he docketed at Savage and Moles in May and June 1992. There are many entries, sometimes during normal working hours but generally in the evenings and on holidays and weekends, bracketing off blocks of time often in pencil, with "P.I.P." or "Prodigy" or "Andy" noted generally in ink and frequently with a similar quick hand, or "P.I.P." with a number of hours noted. In virtually all of these cases there is no description whatsoever of the work done. While different pens are used even on the same day, the same pen seems to have been used for "P.I.P." over a period of time, while the bracketed hours are often in pencil. Sometimes time was blocked off in "off hours" when there were gaps in the regular work hours.

79 Mr. Fitz-Andrews suggests no description of the work is required because it was all on the MLP purchase and the Royal Bank financing.

80 I am not persuaded, on the balance of probabilities, that Mr. Fitz-Andrews spent 645 hours, or anything approaching it, on the work described in the Ampito account in addition to the billings by Savage and Moles for that work. In view of the evidence of the scope of Mr. Fitz-Andrews' involvement in the work described in the Ampito account, particularly in respect of projections, analysis and proposals inherently necessary for the contract for the three new presses with MLP and proposals for its financing and settling the Royal Bank financing, he possibly docketed some additional "off hours" work for Prodigy in 1991 and 1992 which was not billed by Savage and Moles. However these records are not credible.

81 Mr. Fitz-Andrews did not present in evidence his files to show details of the work he did, such as telephone memos, correspondence, draft budgets, draft business plans, draft financial projections, etc. He did have a handwritten proposal, apparently to Royal Bank, a handwritten draft "buy back" agreement for execution by MLP to facilitate Royal Bank's financing, some handwritten notes commenting on terms of an agreement, handwritten financial calculations and other handwritten documents.

82 Mr. Fitz-Andrews says he waited so long to bill this "off hours" work, going back to February 1991, because he had an agreement with Mr. Patel that this off hours work would not be billed until Royal Bank advanced the loan to be made under the loan agreement of December 2, 1991 eleven months after delivery of the three new presses from MLP in January, 1992. Mr. Patel denies there was any such agreement and he claims he thought this work was billed by Savage and Moles only.

83 If a professional person renders an account for services he or she must be prepared to justify that account with credible supporting evidence based on not only docketed hours but also other elements such as result achieved, value to client and the client's ability to pay. Mr. Fitz-Andrews' time entries lack an air of reality both in the manner of their entry and the absence of any written description of the work done. In as much as docket entries of a professional are self serving, they must contain sufficient detail of the services performed to give them an air of reality and provide a means of testing their veracity, both by internal comparison and comparison with external events such as the work product. This is equally so when the professional has a contractual, and possibly fiduciary obligation, to account to his employer and to his partner for such work. There is no evidence that Mr. Fitz-Andrews discussed the matter with Mr. Patel before rendering the account, which one might expect with an account of this size for this client.

2. Revenue Canada Receipts

84 A critical piece of evidence in this case is a photocopy of what purports to be five forms of small bilingual preprinted receipts, obviously available to tax payers for payment of taxes, each of which is filled in with handwriting to show Account Number "AQB 916905" and each of which has the impression of a rubber stamp reading in capital letters:

DEPARTMENT OF NATIONAL REVENUE

TAXATION DIVISION

(Date - stamped)

DELIVERED BY HAND

The receipts are unsigned. They contain neither the location of the Revenue Canada office nor a number to identify the location or user of the stamp.

85 The other particulars on each receipt are handwritten as follows:

Date	**Deduction Period**	**Amount**	**Date on DNR Stamp**
20.11.92	1992	29,652	Nov. 22, 1992
9.12.92	1992	14,758.12	Dec. 9, 1992
15.12.92	1992	37,697.14	Dec. 15, 1992
15.1.93	-	23,912.00	Jan. 15, 1993

Mr. Patel and Sulekha Patel testified that they pressed Mr. Fitz-Andrews for evidence that he had applied the proceeds of Mr. Patel's personal cheques to Prodigy's account with Revenue Canada. They said that Mr. Fitz-Andrews showed up at Prodigy's office in early 1993 and, in the presence of the Patels, gave the originals of these receipts to Sulekha Patel and asked her to photocopy them. She did so. They said Mr. Fitz-Andrews asked that she return the original receipts to him, which she did. The Patels said that Mr. Fitz-Andrews wrote on the bottom of the photocopy of the receipts left with them "128,644.45". The Patels testified that this photocopy was placed in Prodigy's files and that Mr. Fitz-Andrews left the office with the original receipts. The original receipts were not listed in either party's affidavit of documents or produced on discovery.

86 Mr. Patel testified that in July 1993 Revenue Canada assessed Prodigy for 1992 withholdings of $2,752.99 plus interest and penalties which Mr. Patel thought had been paid in 1992 by Mr. Fitz-Andrews. This, says Mr. Patel, was the first indication that the proceeds of the three cheques might not have been used to pay Prodigy's taxes.

87 In 1994 Mr. Patel, on the advice of his new accountant Joel Levitt, disclosed under Revenue Canada's voluntary disclosure procedure his failure to remit substantial employee withholdings in respect of 1992. Revenue Canada subsequently assessed Prodigy $57,825.89 plus penalties and interest. Mr. Patel and Mr. Levitt testified that Revenue Canada denied receiving any of the amounts noted on the five receipts. Prodigy paid the subsequently assessed taxes, interest and penalty. Revenue Canada is prevented by statute from disclosing amounts assessed against and paid by other taxpayers without their consent. There was no evidence presented as to the state of Ampito's accounts with Revenue Canada.

88 Prodigy alleges that the receipts were fabricated by Mr. Fitz-Andrews after this litigation was started to support his statement that he had fulfilled his undertaking to pay the proceeds of the three personal cheques totaling $130,000 to Revenue Canada to cover up the appropriation of the proceeds to himself.

89 Mr. Fitz-Andrews vehemently denies the Patels' allegation. He testified that he has never seen either the original receipts or the photocopy entered as an exhibit. He testified that he first saw the photocopy following the commencement of this litigation. He alleges that Mr. Patel fabricated the receipts to support his story that the proceeds of the cheques

were to be paid to Revenue Canada rather than to Ampito for Mr. Fitz-Andrews' services. Mr. Fitz-Andrews notes that the total taxes assessed for 1992 total only $60,578.88, nothing approaching $130,000, and there is no set of figures to which the $130,000 relates except for the Ampito account.

90 Mr. Fitz-Andrews further notes that all payments of taxes for Prodigy were with cheques drawn on Prodigy's account and not on the Mr. Patel's personal accounts.

91 There is no evidence before me as to who or what taxpayer has account number AQB 916905. Prodigy's account number with Revenue Canada was VHX 087883. There is in evidence a photocopy of an employee copy (No. 3) of a T-4 Supplementary for 1992 for the Patels' son, Kamlesh Patel, which Mr. Patel said he prepared from information dictated to him by Mr. Fitz-Andrews. This shows an employer No. ABQ 9-690 (a different sequence of letters) in the blacked out area of the employee copy. This is unreliable evidence as to whether this sequence of numbers is on the original of this T-4 Supplementary. This document adds nothing to the issue of credibility. The original of this document was not in evidence and Kamlesh Patel did not testify.

92 There was a three-page computer printout of "Ampito Investments Inc. YTD Payroll Journal as at December 31, 1992" showing 13 employees, including Kamlesh Patel, showing the same gross income for him as the T-4 Supplementary. There is also in evidence a copy of a similar printout of seven pages for 23 employees including the 13 employees on the "Ampito" list except that it is headed "Prodigy Industrial Printers Inc. YTD Payroll Journal as at December 31, 1992". The first three pages of the two documents are the same. The last four pages of the latter document contains ten additional names and are separately totalled. These documents are inconclusive of anything except that someone may have been fiddling with Prodigy's computer for conflicting printouts. Mr. Levitt clearly obtained the Ampito list from Mr. Patel in 1994.

93 Mr. Fitz-Andrews points out that total liability for withholdings from the 13 employees common to these printouts would be either $137,000 or $139,000 for withholding tax plus the employee portions of CPP and UIC, a further $18,000. In addition, the employer would be liable for its portion of payments for CPP and UIC. Even at the end of October this liability would have been about $^{5}/_{6}$ of the year's total of about $180,000 or about $150,000 or slightly more because of CPP usually being paid up before year end. This amount bears no direct relationship to the $130,000 in the cheques. The same is true for the 1992 withholdings assessed at $60,000.

3. Handwriting Expert

94 I find the evidence of Ms. Diane Kruger, the handwriting expert called and qualified on behalf of Mr. Patel and Prodigy, to be convincing. She testified as to the methodology of her comparison of the handwriting on the photocopy of the receipts with original and photocopied documents containing known samples of the handwriting of Mr. Fitz-Andrews. These included fax transmittal sheets, two lengthy handwritten memoranda and sheets of accounting paper containing many rough arithmetic calculations. She said this sample size was more than sufficient to form an opinion. She compared each letter, number, bracket, dollar sign and punctuation mark on the receipts with similar writings on the known documents. She acknowledged a number of differences or variations between the receipts and the known handwriting and limitations in working with photocopies. It was Ms. Kruger's opinion that it is "highly probable" that the person who wrote out the originals of the receipts was the writer of the known documents. In cross-examination she explained that she could not be certain but her opinion was stronger than merely probable. She noted none of the hallmarks of forgery, such as tremor, poor line quality, pen lifts or difference in formation. Her evidence was not shaken on cross-examination by Mr. Fitz-Andrews.

95 Mr. Fitz-Andrews offered no expert evidence to contradict that of Ms. Kruger. He argued that the documents used by the expert as known samples of his handwriting were not properly admitted in evidence. However each of these known samples was contained in Exhibit 1 which he agreed to admit as evidence at the beginning of the trial.

96 I am persuaded, on comparing the known examples of copies of Mr. Fitz-Andrews' handwriting with that on the Revenue Canada receipts and with the support of Ms. Kruger's evidence as to the authorship of the receipts, that Mr. Fitz-Andrews produced the receipts for photocopying and that the proceeds of the personal cheques were to be used by Mr. Fitz-Andrews to pay Prodigy's and Ampito's employee withholding tax liabilities. The cheques were not to pay the Ampito account for services dated November 10, 1992. No other explanation for the false receipts was offered by either Mr. Fitz-Andrews or by Mr. Patel.

97 Mr. Patel's new accountant Mr. Levitt, made some inquiries of Mr. Fitz-Andrews in August 1994 respecting the fate of the proceeds of the three personal cheques drawn by Mr. Patel in November 1992 totalling $130,000. In a telephone conversation on August 15, 1994, Mr. Fitz-Andrews told Mr. Levitt that the cheque proceeds were used to pay off invoices rendered by Mr. Fitz-Andrews. Mr. Fitz-Andrews undertook to provide copies of the invoices to Mr. Levitt. On August 22, 1994, Mr. Fitz-Andrews met with Mr. Levitt and told him the $130,000 was used for personal investments on behalf of the Patels and that Mr. Levitt should speak to the Patels to obtain supporting documentation. No supporting documentation was given to Mr. Levitt. Mr. Levitt made a handwritten note on August 22, 1994 of the essence of his conversations on August 15 and August 22.

98 Mr. Fitz-Andrews denied Mr. Levitt's evidence and said that his refusal was based on the fact that this was personal information and he was put off by Mr. Levitt's attitude. I find this a strange attitude in light of this being a conversation between two professionals acting for the same client where Mr. Fitz-Andrews' knowledge was not privileged. At this time Mr. Fitz-Andrews had had his falling out with Mr. Patel.

99 I am satisfied that the Ampito account was highly inflated, if not wholly without foundation. It cannot be justified. I am further satisfied the account was never delivered prior to the cheques being drawn in November 1992. I am satisfied that Mr. Fitz-Andrews had no right to appropriate this money to himself. He is liable to repay it to the Patels.

IX. Royal Bank Payments: $25,500

100 Prodigy claims recovery of the proceeds of the following cheques payable to Royal Bank in 1992 and deposited to Mr. Fitz-Andrews' Account:

April 10	$ 10,000
September 1	7,000
October 1	7,000
November 4	1,500
	$ 25,500

101 Mr. Patel said he paid Mr. Fitz-Andrews' account at Mr. Fitz-Andrews' direction after he told Mr. Patel that he was having trouble obtaining draws from his partnership. Mr. Patel said the $10,000 set by Mr. Fitz-Andrews was paid in April for a payroll computer programme, supervising the payroll in the months following Mr. Frimpong's departure and advising on deductions and was intended to be paid to Savage and Moles and not just Mr. Fitz-Andrews. Prodigy claims recovery because no account had been issued. Mr. Patel said the September payment was for persuading Royal Bank of the profitability of Prodigy in the audit and for a "job well done" in completing the financial statements showing a profit for the fiscal year ended July 31, 1992. He said $7,000 paid in October was related to the payroll manipulations, successful negotiation of the price of the new presses with MLP Canada and the successful financing with Royal Bank.

102 Mr. Fitz-Andrews acknowledges receipt of the payments but denies the purposes alleged by Mr. Patel. Mr. Fitz-Andrews says the purpose of the payments to him was payment for the incorporation of the four new companies, GST advice and advising Prodigy on the software to bring together the accounts for these four companies. It was not for deferral of payroll deductions payments to Revenue Canada so as to mislead Royal Bank. Mr. Fitz-Andrews denies any

part in any payroll deferral. I have found that Mr. Patel was engaged in this activity before Mr. Fitz-Andrews came on the scene.

103 Mr. Fitz-Andrews also stated that he had an arrangement with Mr. Patel to review Prodigy's monthly financial statements before they were forwarded to Royal Bank, as required by Prodigy's borrowing arrangement with Royal Bank. These payments were merely a catch up for previously missed payments.

104 Mr. Patel alleges that the reorganization of Prodigy Industrial Printing in October-November, 1992 was part of Mr. Fitz-Andrews' plan for postponing tax liabilities. The following companies were incorporated on the following dates:

October 29, 1992	Post Prodigy Finishing Inc.
October 29, 1992	Prodigy Colour Systems Inc.
November 9, 1992	Prodigy Printing Services Inc.

Mr. Patel testified that this latter incorporation was supposed to be a change of name of Prodigy Industrial Printers Inc. This was remedied, he says, on July 30, 1993 when the following articles of amendment were filed to effect changes of name:

1) Mr. Patel's original company Prodigy Industrial Printers Inc. became Prodigy Printing Services (1993) Inc.

2) Prodigy Printing Services Inc. became 1007067 Ontario Inc.

105 Prodigy Graphics Group Inc., the plaintiff in this action, was incorporated in June 1993 and was amalgamated with Prodigy in 1995.

106 I see nothing sinister in dividing Prodigy's original business into separate corporations according to function.

107 Prodigy has not established a right to claim these payments to Royal Bank from Mr. Fitz-Andrews. In view of Mr. Patel's explanation of the reasons for the payments, I see no grounds to support the claim. I dismiss the claim for the $25,500.

X. Mr. Fitz-Andrews' Accounts: $46,233

108 On April 30, 1994, Mr. Fitz-Andrews prepared a Statement of Account for Prodigy summarizing statements of account he had rendered to the various companies in the Prodigy Group totalling $58,609.25 and showing payments in 1993 of $12,386.15, leaving a balance owing of $46,233.10. The statement showed a trust balance of $25,283.04 which was appropriated to reduce the balance due to $20,940.06.

109 The accounts on the Statement of Account include one to Prodigy Colour dated April 20, 1993 (which was reduced and re-sent on May 5, 1993) for $27,500 plus GST for a total of $29,425 for organization in 1992, pro-forma statements, financing of a purchase from Crossfield, a new accounting system, discussions with Royal Bank and the lease of a property. Mr. Patel objected to the account pending a review of Mr. Fitz-Andrews' dockets and refused to pay it. Mr. Fitz-Andrews did not provide supporting evidence sufficient to support the account.

110 In determining Mr. Fitz-Andrews entitlement to the balance of $46,233.10 owing on his accounts, I am in effect assessing his accounts in the absence of detailed time dockets and on the basis of the notes contained in his appointment book and the description and product of his efforts.

111 Mr. Fitz-Andrews justified these accounts as follows:

1991	Time for Prodigy Printers (noted above)	500 hrs.
1992	Time for all companies	690 hrs.
		1190.3 hrs.

Less:				
	Ampito Account November 10, 1992 645 hrs.			
	Payments in April, September, October and November 1992 totalling $25,500 say 130 hrs.			775 hrs
	Unbilled balance			415 hrs.
Less:				
	Prodigy Colour May '93 $27,000, say 218 hrs			
	Other 1993 accounts approx. $12,800 say 65 hrs.			283 hrs.
				132 hrs.
Less:				
	Post Prodigy March '94	-	68 hrs.	
	Prodigy Graphics March '94	-	15 hrs.	
	Prodigy Paper March '94	-	3 hrs	86 hrs.
Unbilled				46 hrs.

112 This reasoning is spurious! An account should state the period covered by the account. These don't, lending themselves to this sort of carrying forward of "unbilled work in process" without notice to blindside the client in the future and to suit the convenience of the person rendering the account.

113 Further, Mr. Fitz-Andrews' reasoning relied on an allegedly docketed 500 hours, in excess of that billed by Savage and Moles and the 645 hours by Ampito which I have rejected.

114 I have considered the accounts, the dates of incorporation of the billed companies, the work described therein, Mr. Fitz-Andrews' evidence, the work product made available to me and Mr. Fitz-Andrews billing rate of $160 per hour.

115 I have also considered Mr. Patel's evidence on the bills and the circumstances surrounding the date of the bill.

116 The bills, inclusive of GST, are as follows:

Prodigy Colour - May 5, 1993			$ 29,425.00
Individual Tax returns - April 1993			508.25
Prodigy Printing - December 14, 1993			12,294.30
649337 Ontario Ltd. - January 20, 1994			3,076.25
Post Prodigy - March 3, 1994			10,566.23
Prodigy Paper - March 3, 1994			535.00
Prodigy Graphics - March 3, 1994			2,204.25
Total:			58,609.25
I would allow on these accounts, including G.S.T.			45,000.00
Less:			
	Payments	$12,286.15	
	Transfer from trust	1,101.46	13,487.61
Net amount owing:			$ 31,512.39

XI. Appropriation of Revenue Canada Refunds

117 Mr. Patel objects to the appropriation in February 1994 of the proceeds of two cheques totalling $24,181 from Revenue Canada payable to Prodigy as rebates of over payments. Mr. Fitz-Andrews, as the addressee for service of Prodigy by Revenue Canada, received these cheques payable to Prodigy in February 1994 and persuaded his bank to cash them and deposit the proceeds in Mr. Fitz-Andrews' "trust account". Mr. Patel discovered this appropriation in early May 1994 on receipt of Mr. Fitz-Andrews' statement of account and demanded the proceeds of the cheques.

118 Mr. Fitz-Andrews refused the request saying he was authorized to seize them by a term on page 2 of the audit engagement letter for Prodigy Printing Services (1993) Inc. for its fiscal year ended July 31, 1993 dated November 22, 1993 which stated:

> 5. It is further understood and agreed that with the filing of all corporate tax returns it is agreed that all corporate tax refunds will be applied in trust against outstanding fees for the Prodigy Group of companies in view of the substantial nature of the services provided and substantial amounts outstanding.
>
> 6. It is further understood and agreed that you will be personally responsible for any fees billed and not paid by the group of companies.

Mr. Fitz-Andrews signed at the bottom of page 2 of the letter which requests Mr. Patel to sign a copy of the letter in the space provided and return it to Mr. Fitz-Andrews. The third page contains the agreement signed by Mr. Patel dated December 17, 1993. This document was produced from Mr. Fitz-Andrews' files.

119 Mr. Patel denies signing such a letter. He produced a copy of the letter he says he signed which does not contain paragraphs 5 and 6. It is signed by Mr. Fitz-Andrews on page 2 and there is provision for signing by Mr. Patel on page 3.

120 Each declares the other's version a forgery. Mr. Fitz-Andrews says he gave Mr. Patel four letters on that day. The others did not contain either the authorization to apply tax rebates to accounts or the personal "guarantee". He suggests Mr. Patel has taken the page 2 out of one of the other letters and substituted it for the page 2 which contains the authorization and the guarantee.

121 Mr. Patel accuses Mr. Fitz-Andrews of fabricating his version of page 2, removing the shorter page 2 he says he signed and substituting the longer version with the authorization and guarantee. Mr. Patel produced copies of engagement letters which he signed in previous years which do not contain such provisions.

122 The cross-examination of Mr. Fitz-Andrews straddled a weekend. On the Friday Mr. Fitz-Andrews said he merely inserted the two clauses in his word processor's standard form. On the Monday he acknowledged talking to someone about his evidence and said he must have created a new document by retyping the page without properly justifying the right margin.

123 Clause 5 respecting appropriation of tax refunds payable to the client is highly suspect. It is unlikely Mr. Patel would have signed such a clause in November 1993 in view of his refusal to pay Mr. Fitz-Andrews account of May 5, 1993, which replaced a larger account dated April 20, 1993, until he had received satisfactory evidence of dockets to support the account.

124 The cheques were payable to Prodigy rather than Mr. Fitz-Andrews. Why would either of them expect Mr. Fitz-Andrews to be able to negotiate the cheques with his bank and appropriate them to his own account without endorsement by an authorized signing officer of Prodigy? There is no evidence that Mr. Fitz-Andrews had such an authority.

125 In view of my findings on credibility in respect of the Ampito account, I have greater confidence in Mr. Patel's evidence, generally, than I have in the evidence of Mr. Fitz-Andrews'.

126 On this issue I find that Mr. Fitz-Andrews had no authority to appropriate to himself the $24,181 represented by cheques payable to Prodigy. He is liable to pay this amount to Prodigy.

XII. Claim Against Gina Fitz-Andrews

1. As Director of Ampito

127 There is no evidence that Gina Fitz-Andrews played any part whatsoever in the preparation or rendering of the Ampito account or the receipt or disbursement of the $130,000. There is no evidence that she had any knowledge of these events. While she was the sole shareholder, a director and an officer of Ampito, she was unaware of her husband's use of his authority as a director, officer and bank signing authority and did not authorize it. She played no part in the operation of the company. It would be wholly unjust to pierce the corporate veil to make her personally liable or make her an accessory to a breach of trust: see *Transamerica Life Insurance Co. of Canada v. Canada Life Assurance Co.* (1996), 28 O.R. (3d) 423 (Ont. Gen. Div.).

2. Tracing

128 There is no evidence that any of the proceeds of the Patels' cheques for $130,000 can be traced to the payment of any part of the purchase price of the house. The use of the $75,000 G.I.C. purchased with the proceeds of the $130,000 and used as a "carrot" for the CIBC mortgage, but which was not in fact used in the purchase, cannot justify making Gina Fitz-Andrews liable for it.

129 Accordingly, I find that Gina Fitz-Andrews is not personally liable to the Patels for any part of the $130,000 or to Prodigy for the $25,500 paid to Royal Bank for Mr. Fitz-Andrews'. However, the plaintiffs allege that Gina Fitz-Andrews may be liable for the share of the property transferred to her by her husband in a deed from him to her of his interest by reason of the transaction being void under the *Fraudulent Conveyances Act*, R.S.O. 1990, c. F.29.

3. Recipient of Fraudulent Conveyance

130 On February 25, 1993, Gina and Mr. Fitz-Andrews signed an agreement to purchase for $300,000 cash the house they had been renting at 1224 Highgate Place since 1989. The purchase price was payable $10,000 down as a deposit and the balance on closing. It was conditional on the purchaser being approved for mortgage financing by Canadian Imperial Bank of Commerce ("CIBC") within 10 days. The purchase price included "existing appliances". No real estate commission was payable.

131 Gina Fitz-Andrews applied to CIBC for a mortgage of $225,000 with Mr. Fitz-Andrews to be the guarantor. Their total incomes, all out of Mr. Fitz-Andrews' practice where Gina Fitz-Andrews did some work with payables, was stated to be slightly over $100,000. Their investments consisted of a $75,000 GIC with CIBC and $9,000 with "Royal". They had a bank account of $15,000, $10,000 in the house purchase, $200,000 in Mr. Fitz-Andrews' practice and $30,000 in two cars. Mr. Fitz-Andrews owed Royal Bank $71,000 in respect of his practice. The Fitz-Andrews said they would have $75,000 cash equity in the property.

132 There is no indication whether the $71,000 indebtedness to Royal Bank was in respect of his old practice or his new practice. Cheques and bank records in late 1993 indicate his new firm was using CIBC.

133 The purchase closed on March 26, 1993 with a deed to Gina and Mr. Fitz-Andrews as joint tenants. The land transfer tax affidavit sworn by Mr. Fitz-Andrews showed the consideration as $300,000 cash.

134 There was a first mortgage by Gina and Mr. Fitz-Andrews to CIBC of $225,000. While disclosure was called for in the land transfer tax affidavit, it was not mentioned.

135 The Amended Statement of Adjustments showed:

Sale Price		$300,000.00
Deposit	$10,000.00	
Vendor Mortgage Back	30,945.16	
Last Month's Rent	1,500.00	
Adjustment for Rent Payments	33,500.00	
(Tax Adjustment calculation)		945.16
Balance Due on Closing	225,000.00	

	$300,645.16	$300,945.16

The balance due on closing was the proceeds of the CIBC mortgage.

136 The adjustment for rent paid was described by the defendants as a credit for the air conditioner they had installed, a negotiated deduction for unpaid real estate commission, credit for repairs they had made as tenants and credit for appliances they had purchased and were entitled under the lease to take with them. In as much as these adjustments were not required under the agreement, I see no legitimate reason whey they were made. If, instead of justifying $33,500 adjustment the price had been reduced by that amount, their equity and the land transfer tax payable would have been less.

137 The mortgage back, not called for under the agreement, was negotiated by Mr. Fitz-Andrews. He told the vendors he could not close without it. In view of the vendor's intent to move back to India, they were motivated vendors. This explanation by Mr. Fitz-Andrews is credible.

138 The mortgage back to the vendors was for $30,945.16 at 7.5% per year for 3 years, repayable interest only quarterly. It was from Gina Fitz-Andrews only and was guaranteed by Mr. Fitz-Andrews.

139 On March 25, 1993, Mr. Robert Filkin, solicitor for the Fitz-Andrews, wrote to Mr. Michael Bukovac, solicitor for the vendors, to confirm the terms of the second mortgage and "it not be registered". This is a risky and highly unusual position for any mortgagor to take. No explanation was offered. In fact, this mortgage was registered on August 6, 1993. On maturity in 1996 it was assigned to a corporation owed by the Fitz-Andrews family.

140 On the date of closing, March 26, 1993, Mr. Fitz-Andrews executed a transfer of the property to Gina Fitz-Andrews. The land transfer tax affidavit sworn by Mr. Fitz-Andrews states the consideration is "$2 and natural love and affection" and "no consideration passing directly or indirectly". In response to a question in the affidavit as to whether the land is subject to any encumbrance it recites only: "Yes ($225,000)". This deed was registered on April 2, 1993.

141 Mr. Fitz-Andrews testified that this deed was intended to rectify their intent prior to closing that Gina Fitz-Andrews be the registered owner of the property. Gina and Mr. Fitz-Andrews have continued to live in the house with their family.

142 There is no evidence that CIBC would be concerned with subordinate financing but perhaps Mr. Fitz-Andrews thought CIBC would object if his cost was little more than the amount of its mortgage. First mortgagees generally want a cushion of owner equity in the range of 25 to 35 per cent. The lawyer acting for the Fitz-Andrews on the purchase, Mr. Filkin, was also acting for CIBC.

143 There is no evidence why the "correcting" deed, which was signed on the same date as the deed from the vendors, was not registered until a week later.

144 Neither Mr. Filkin, nor a representative of CIBC nor Mr. Bukovac was called to testify on behalf of the Fitz Andrews.

145 The *Fraudulent Conveyance Act* provides:

> 2. Every conveyance of real property or personal property and every bond, suit, judgment and execution heretofore or hereafter made with intent to defeat, hinder, delay or defraud creditors or others of their just and lawful actions, suits, debts, accounts, damages, penalties or forfeitures are void (sic) as against such persons and their assigns.

3. Section 2 does not apply to an estate or interest in real property or personal property conveyed upon good consideration and in good faith to a person not having at the time of the conveyance to the person notice or knowledge of the intent set forth in that section.

4. Section 2 applies to every conveyance executed with the intent set forth in that section despite the fact that it was executed upon a valuable consideration and with the intention, as between the parties to it, of actually transferring to and for the benefit of the transferee the interest expressed to be thereby transferred, unless it is protected under section 3 by reason of good faith and want of notice or knowledge on the part of the purchaser.

146 There need only be an intention to defeat or hinder "creditors or others" of their lawful claims. There need not be an intention to defraud.

147 Mr. Fitz-Andrews acknowledged that the reason for putting title in his wife's name was because he was following the advice of his lawyer based on Mr. Fitz-Andrews' advice that he was a defendant in an outstanding lawsuit by a former landlord against Savage and Moles and because he was involved in litigation with his former partner Mr. Meisner. While not necessarily creditors yet, those parties were certainly "others" for the purpose of the Act: *Waterline Products Co. v. Lisaco Investments Ltd.* (January 24, 1991), Doc. 41431/89 (Ont. Gen. Div.) (Ont.Gen.Div.); *Gauthier v. Woollatt*, [1940] 1 D.L.R. 275 (Ont. S.C.); *Canadian Imperial Bank of Commerce v. Boukalis* (1987), 34 D.L.R. (4th) 481 (B.C. C.A.) at 487.

148 At the time Mr. Fitz-Andrews signed the deed, his creditors included the Patels in respect of the $130,000.

149 The date on which the intent is to be assessed is the date the transfer was executed: *Bank of Montreal v. Chu* (1994), 17 O.R. (3d) 691 (Ont. Gen. Div.).

150 Where proper consideration is lacking, the intent of the transferee is irrelevant; where the intent of the parties to the conveyance is to defraud creditors, the question of consideration is irrelevant: *Son v. Kim* (October 13, 1994), Doc. C5442/91 (Ont. Gen. Div.).

151 Accordingly, by reason of s.2 of the *Fraudulent Conveyances Act*, the correcting deed was void and the title reverts to Gina and Mr. Fitz-Andrews as joint tenants.

152 Even if Mr. Fitz-Andrews had not stated his intent, a court may infer intent from suspicious circumstances which are referred to as the "badges of fraud", having their origins in *Twyne's* Case *Twyne's Case* (1602), 3 Co. Rep. 80b (Eng. K.B.). These include:

(1) Transfer to a non-arms length person.

(2) Grossly inadequate consideration.

(3) The transferor remains in possession on occupation of the property for his own use after the transfer.

(4) The transferee is holding the property in trust for the transferor.

(5) There are actual or potential liabilities facing the transferor or he is about to enter upon a risky undertaking.

(6) The transferor has few remaining assets after the transfer.

(7) The transfer was effected with unusual haste.

(8) The transaction was secret.

(9) The absence of a sound business or tax reason for the transaction.

(10) Destruction or loss of relevant papers or inaccurate documents supporting the transaction.

(11) Cash is taken in payment instead of a cheque.

(12) The deed contains false statements as to the consideration.

(13) The deed gives the grantor a general power to revoke the conveyance.

(14) The deed contains the self-serving and unusual provision "that the gift was made honestly, truly and *bona fide*".

See *Canadian Imperial Bank of Commerce v. Graat* (1992), 5 B.L.R. (2d) 271 (Ont. Gen. Div.), per Granger J.; C.R.B. Dunlop, *Creditor, Debtor Law in Canada*, 2nd ed. (Toronto: Carswell, 1995).

153 The badges of fraud are of evidentiary value in determining the issue of intent but are not conclusive evidence of fraud. Fraudulent intent is a matter of fact to be determined in the circumstances of each case on the basis of the evidence as a whole: *Meeker Cedar Products Ltd. v. Edge* (1968), 12 C.B.R. (N.S.) 49 (B.C. C.A.).

154 Once the suspicious circumstances raise a *prime facie* presumption of intent to hinder, defeat or defraud a creditor, the court may find the intent unless the presumption is displaced by corroborative evidence of the *bona fides* of the debtor in the suspect transaction: *Kingsbridge Grand Ltd. v. Vacca* (December 20, 1999), Doc. 98-CV-143861, 98-CV-14960 (Ont. S.C.J.) citing *Koop v. Smith* (1915), 51 S.C.R. 554 (S.C.C.); *Applecrest Investments Ltd. v. Toronto Masonry (1986) Ltd.* (1997), 23 O.T.C. 277 (Ont. Gen. Div.); *Rinaldo v. Rosenfeld* (December 2, 1999), Doc. 98-CV-154750 (Ont. S.C.J.).

155 At the time of the correcting deed, Mr. Fitz-Andrews was being sued by a former landlord, was in litigation with a former partner that could result in an adverse costs order and was jointly liable on the mortgage to CIBC, notwithstanding the agreement that he would be a guarantor only, and was liable to the Patels to repay the $130,000. He transferred to his wife his interest in the property, on the day he acquired it, for $2 and natural love and affection. He continued to live in the house. Judging from his mortgage application to CIBC he had few other assets outside his accounting practice, on which he owed a substantial amount. The presumption of intent has been raised.

156 Mr. Fitz-Andrews argues that the deed from the vendors was supposed to be solely to his wife but his lawyer erred. While they both agreed to purchase the house the mortgage application showed Gina Fitz-Andrews would be the borrower and Mr. Fitz-Andrews would be the guarantor. Gina Fitz-Andrews' evidence confirmed that she alone was to be the purchaser but Mr. Fitz-Andrews was to be the guarantor of both mortgages.

157 My response is that a direction by the purchasers, under the agreement to purchase, to the vendors on closing to convey the property to Gina Fitz-Andrews would qualify equally with a subsequent deed to constitute a conveyance for the purpose of s. 2 of the *Fraudulent Conveyances Act*.

158 The failure of the land transfer tax affidavit to particularize the consideration or note the mortgages, the credits given in the statement of adjustments not called for in the agreement of purchase and the five month delay in registering the mortgage back to the vendors remain unexplained. Mr. Fitz-Andrews could reasonably have been expected to call the vendors, CIBC or his lawyer to provide evidence of his *bona fides*. He did not call any of them. I am entitled to draw an adverse inference respecting Mr. Fitz-Andrews *bona fides* and find the conveyance was made with an intent to delay his creditors.

159 Again, the result is the same. The amending deed is void.

XIII. Claims for Failure to Disclose on the Motion for Mareva Injunction

160 Mr. Fitz-Andrews alleged that the evidence in the affidavits used to obtain the certificate of pending litigation on the house and the *ex parte mareva* injunction freezing his assets, misstated and omitted material facts. It failed to

make full and frank disclosure on the *ex parte* application: *Chitel v. Rothbart* (1982), 39 O.R. (2d) 513 (Ont. C.A.). Accordingly he says he is entitled to claim damages based on the plaintiffs' undertaking in the affidavit of Mr. Patel dated November 29, 1994.

161 Generally, if the plaintiff obtaining an injunction is unsuccessful at trial, an inquiry as to damages will result, unless there are special circumstances respecting compliance with the undertaking. Such special circumstances would exist where the plaintiff can make out an equitable defence to the claim for damages based on the defendant's conduct and the plaintiffs' *bona fides*. The defendant's conduct might raise an issue of estoppel, a delay amounting to laches, other prejudice to the plaintiff, and whether the defendant comes to court with clean hands. The damages are to be assessed on the same basis as damages for breach of contract including causation, remoteness, forseeability and mitigation: See *Nelson Burns & Co. v. Gratham Industries Ltd.* (1987), 23 C.P.C. (2d) 279 (Ont. C.A.) and the annotation thereto by Paul Bates.

162 Even if there had not been a trial, innocent non-disclosure or the mere omission of a significant single fact will not necessarily warrant dissolving an injunction. The non-disclosure or misstatement must be such as was material to the decision and either would have made the decision doubtful or may have affected the outcome of the motion: *Waites v. Alltemp Products Co.* (1987), 19 C.P.C. (2d) 185 (Ont. Dist. Ct.) (Ont.Dist.Ct.).; *Edmonton Northlands v. Edmonton Oilers Hockey Corp.* (1994), 23 C.P.C. (3d) 72 (Alta. C.A.) (Alta.C.A.) affirming (1993), 23 C.P.C. (3d) 49 (Alta. Q.B.); *Pulse Microsystems Ltd. v. SafeSoft Systems Inc.* (1996), 47 C.P.C. (3d) 360 (Man. C.A.); *Girsberger v. Kresz* (1998), 19 C.P.C. (4th) 57 (Ont. Gen. Div.).

163 In this case Mr. Patel did not disclose his involvement in the scheme of withholding taxes dating back to 1988 and clearly suggested that Mr. Fitz-Andrews was party to a scheme to do so since 1989. That is information material to the exercise of a judge's discretion in granting the injunction. It may have affected the outcome.

164 Mr. Fitz-Andrews pointed out numerous other omissions or misstatements which I do not think were material. There were numerous other allegations which were consistent with my findings particularly with respect to the misapplication of the $130,000 and the misappropriation of Revenue Canada cheques.

165 In this case the defendants filed responding affidavits within five days after being notified of the injunction but did not proceed to a timely cross-examination. The injunction was varied in early 1995 to allow payment of $10,000 to Mr. Fitz-Andrews and substitution for it of a $50,000 letter of credit and payment into court of the $25,283 he held in trust. The proceedings were adjourned pending cross-examinations. Mr. Fitz-Andrews parted company with his lawyers and was ill for some time. However bitterly contested interlocutory proceedings continued.

166 In January 1999, Mr. Fitz-Andrews obtained an order permitting cross-examination of Mr. Patel on his November 29, 1994 affidavit.

167 Mr. Fitz-Andrews brought motions on October 25, 1999 and again on January 18, 2000 to set aside the *mareva* injunction and the certificate of pending litigation. Both were denied on the basis of an imminent trial. The latter was also based on the refusal or failure to move "forthwith".

168 Mr. Fitz-Andrews has failed to provide evidence of his damages. He said in opening that (a) he had trouble borrowing money; and (b) could not maintain a bank account personally but had to do is financing through his wife. In closing he said the injunction and litigation damaged his reputation with banks and obtaining client referrals from them. No particulars were offered in evidence. No cross-examination was based on it.

XIII. Summary

169 I order as follows:

(a) I order Mr. Fitz-Andrews to repay to the Patels the $130,000 paid in November - December 1992.

(b) I dismiss Prodigy's claim for the $25,500 paid to Royal Bank.

(c) I order Prodigy to pay to Mr. Fitz-Andrews $31,512.39 on the accounts rendered to Prodigy.

(d) I order Mr. Fitz-Andrews to repay to Prodigy the proceeds of the tax refunds totalling $24,181 received in February 1994.

(e) I dismiss Mr. Fitz-Andrews counterclaim for damages.

(f) I declare the conveyance of Mr. Fitz-Andrews' interest in the house to Gina Fitz-Andrews on March 26, 1993 void.

(g) I dismiss the claim against Gina Fitz-Andrews.

(h) Interest is payable on all amounts at the rate of 5% per year from the first day of the month following their receipt or the dates of the accounts.

170 Costs may be addressed in written submissions.

Action allowed; counter-claim dismissed.

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF URBANCORP (WOODBINE) INC. URBANCORP (BRIDLEPATH) INC., THE TOWNHOUSES OF HOGG'S HOLLOW INC., KING TOWNS INC., NEWTOWNS AT KING TOWNS INC. AND DEAJA PARTNER (BAY) INC. (COLLECTIVELY, THE "APPLICANTS")

AND IN THE MATTER OF TCC/URBANCORP (BAY) LIMITED PARTNERSHIP

Court File No.: CV-16-11549-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceedings commenced at **Toronto**

BOOK OF AUTHORITIES OF TERRA FIRMA CAPITAL CORPORATION

THORNTON GROUT FINNIGAN LLP
100 Wellington Street West
Suite 3200
P.O. Box 329, TD West Tower
Toronto, Ontario
M5K 1K7

John T. Porter (LSUC# 23844T)
Tel: 416-304-0778
Fax: 416-304-1313
Email: jporter@tgf.ca

Lawyers for Terra Firma Capital Corporation