

VANCOUVER
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COURT OF APPEAL
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Court of Appeal File No. 040365

COURT OF APPEAL

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

And:

In the Matter of the *Business Corporations Act*,
S.B.C. 2002, c.57, As Amended

And:

In the Matter of a Plan of Compromise or Arrangement of Lemare Holdings Ltd., Lemare
Lake Logging Ltd., Lone Tree Logging Ltd., C. & E. Roadbuilders Ltd., Coast Dryland
Services Ltd., Dominion Log Sort Ltd., and Central Coast Industries Ltd.

Petitioners

Between:

Lemare Holdings Ltd., Lemare Lake Logging Ltd., Lone Tree Logging Ltd.,
C. & E. Roadbuilders Ltd., Coast Dryland Services Ltd.,
Dominion Log Sort Ltd., and Central Coast Industries Ltd.

Respondents
(Applicants/Petitioners)

And:

Her Majesty the Queen in right of the Province of British Columbia

Appellant
(Application Respondent)

And:

The Toronto-Dominion Bank and TD Equipment Finance Canada Inc.

Respondents
(Respondents)

MEMORANDUM OF ARGUMENT

RE: APPLICATION FOR LEAVE TO APPEAL

Her Majesty the Queen in right of the
Province of British Columbia

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Part I: Statement of Facts

1. The Petitioners/Respondents filed for protection under the *Companies' Creditors Arrangements Act* ("CCAA") and on June 21, 2012 the Chambers Judge granted an *ex parte* initial order. The initial order included a stay preventing the Province from taking any action in relation to claims for unpaid stumpage. **[Initial Order, para. 15]**
2. On September 6, 2012, the Province applied to set aside the initial order on the basis that the petitioners were not debtor companies and the CCAA proceeding was an inappropriate forum for resolving the dispute which, the Province says, arose from Lemare's wilful contravention of the *Forest Act*. Alternatively, the Province applied to lift the stay so it could proceed with audits and assessments of Lemare.
3. The Petitioners raised a preliminary objection to the admissibility of the Province's supporting affidavits, which necessitated an adjournment of the Province's application. The Petitioners' preliminary objection was heard on October 16, 2012 and the Chambers Judge ordered that portions of Affidavit #1 of Jason Kruger, a forest revenue official in the Ministry of Finance, Forest Revenue Audit Program ("FRAP"), be struck because they contravened an order of Mr. Justice Ehrcke made in an earlier proceeding (the "March 26 Order"). The Chambers Judge also found that certain portions of the exhibits contravened the March 26 Order, but ruled them admissible as hearsay documents. **[RFJ, paras. 30-32]**
4. The impugned statements from Mr. Kruger's Affidavit #1 and various exhibits were references to inspection demands made by him and another forest revenue official, Bob McCliggott, and Lemare's refusals of those demands. Lemare's counsel also objected to Mr. Kruger's reference to Lemare having "multiple versions" of scale returns, which were not produced when demanded. **[Kruger #1, paras. 25-26, pp. 12-13, 15, 16; Kruger #2, pp. 1-10]**
5. The dispute between the Province and Lemare goes back to 2008 when investigations by the Ministry of Forests, Compliance and Enforcement Branch ("CEB") revealed certain anomalies in Lemare's electronic reporting of scale data to the Province. CEB's suspicion was reinforced by the investigations of Bruce McGraw, a check scaler, in early 2009. **[Smallacombe #1, paras. 40-42; McGraw #1, para. 64]**
6. Prior to February 10, 2009 CEB reasonably suspected Lemare was not keeping a reliable back-up of primary scale data at its scale site as is required under the *Forest Act*, but was removing that data to the private residence of one of its employees, Darryl Arsenault. CEB also reasonably suspected that Lemare was modifying the

data of licensed scalers before submitting it to the Province in the form of original, unaltered scale returns. Finally, CEB had reason to believe Lemare had directed the destruction of inculpatory evidence and if it did not act quickly additional evidence would likely be destroyed. **[Smallacombe #1, paras. 72-79]**

7. On February 10, 2009, Daniel Smallacombe, a forest official, obtained a *Criminal Code* telewarrant to search the home of Mr. Arsenault and the business offices of Lemare, in Port McNeill. Based upon CEB's investigations up to that date, Mr. Smallacombe reasonably believed scale records would be located at these addresses. The things seized included electronic storage media and paper records (the "Seized Items"). The Seized Items were all returned to Lemare, but CEB made and retained exact copies of the Seized Items (the "Copies"), which it subjected to forensic analysis. **[Ehrcke J. Reasons, para. 6]**
8. Lemare petitioned the court to have the warrants quashed and the Copies destroyed. The Province, in turn, sought an order for the preservation and detention of the Copies. The Province conceded that the warrants were defective and on July 7, 2011, Mr. Justice Ehrcke quashed the February 10, 2010 search warrants on the basis that Mr. Smallacombe was not a peace officer and did not have authority to apply for a telewarrant. He ordered that the Copies be returned to Lemare's place of business, but gave the Province 14 days "to attempt to take whatever legal processes they believe are available to them to re-seize the material". **[Ehrcke J. Reasons, paras. 44, 54]**
9. Lemare appealed the July 7, 2011 order of Mr. Justice Ehrcke, again seeking destruction of the Copies. This Honourable Court upheld Mr. Justice Ehrcke's order and made two important observations:
 - a. First, this Court found that Mr. Justice Ehrcke had "refused the Ministry's application for access to the material in the [Criminal Code] proceedings before him, but he intentionally left open the question of access in administrative proceedings." **[CA Reasons, para. 17, emphasis in original]**
 - b. Second, this Court rejected Lemare's contention that Mr. Arsenault had a personal privacy interest in the Seized Items which was impermissibly infringed by the order that the Copies be returned to Lemare's place of business. Rather, the Court concluded "no prejudice to Mr. Arsenault has been demonstrated by the return of Lemare's reconstructed business records to its premises..." **[CA Reasons, para. 22]**

10. Following the Court of Appeal ruling, the Province re-seizes the Copies, already in its possession, under the *Offence Act* on November 9, 2011. After that seizure, CEB allowed Mr. Kruger to review the Copies. **[Allen #1, p. 15]**
11. On February 8, 2012, Mr. Justice Affleck quashed the November 9, 2011 warrant and ordered return of the Copies to Lemare's place of business on similar terms to the July 7, 2011 order of Mr. Justice Ehrcke. **[Affleck J. Reasons, para. 25]**
12. For practical reasons, however, some copies of the Seized Items, such as those found on government back-up drives and in court records, could not be returned. This necessitated the March 26, 2012 proceeding before Mr. Justice Ehrcke and the March 26 Order, the relevant part being:

The [Province] shall not use the information from the items seized or any copies of such items against Lemare in any manner, including but not limited to, in any Court proceeding, administrative proceeding, audit or assessment, unless the [Province has] obtained that information lawfully. **[Ewart #1, pp. 10-11, emphasis added.]**
13. During the March 26, 2012 proceeding, Mr. Justice Ehrcke also made clear that it was not his intention to put the Province in a worse position than it would have been, but for the quashed warrants or to in any way change or augment his reasons of July 7, 2011. **[Joanes #1, pp. 29, 47]**
14. Both before and after the March 26 Order, Lemare has attempted to use the quashed warrants as a basis for resisting the Province's lawful demands for production of information pursuant to its administrative powers under the *Forest Act*.
15. On October 15, 2010 Graeme Jacques, a forest revenue official, demanded, pursuant to section 142.31 of the *Forest Act*, that Lemare produce, among other things, all copies and all versions of scale returns from Lemare scale sites. Eric Dutcyvich, Lemare's officer, director, and general manager replied on November 29, 2010, admitting that the Seized Items contained scaling returns, but refusing to provide that information to FRAP on the basis that the Seized Items contained "various other documents" as well. **[Kruger #1, pp. 12-13; Kruger #4, pp. 1-2]**
16. On December 2, 2010 counsel for Lemare wrote to Mr. Jacques indicating that FRAP's demand was premised on information unlawfully obtained and there was no legal basis for the Ministry to assert that the records provided did not include all the scaling records sought by the Ministry. **[Kruger #3, p. 25]**

17. On June 14, 2011, Shannon Jackson, Lemare's Production Administrator, deposed that there had been at least one "crash" of Lemare's computer system in which information was lost. Ms. Jackson further deposed that Lemare had provided to FRAP all stock scale records in its possession. **[Jackson #1, paras. 11, 19]**
18. The stock scale records which Lemare did provide related to only three of dozens of timber marks under audit. FRAP, nonetheless, compared those stock scale records to the stumpage Lemare reported to the Province and found Lemare had underreported over 32 kilometers of logs from a single timber mark. **[Kruger #3, para. 152]**
19. FRAP also obtained stock scale records from a third party, Terminal Forest Products Ltd., relating to a number of the timber marks under audit. These records, which corroborated FRAP's suspicion of Lemare's wilful stumpage evasion, were records Lemare claimed were lost. **[Kruger #3, paras. 150-151, 154]**
20. On November 17, 2011, Mr. Kruger made a further demand under section 142.31 of the *Forest Act*, this time specifically requesting production of the Seized Items which had been returned to Lemare. On November 25, 2011 counsel for the Province wrote to counsel for Lemare asking if Lemare still possessed, in the same usable condition, those Seized Items. Lemare refused to produce the records, or answer the question as to their existence, again citing the unlawful *Criminal Code* seizures. **[Kruger #3, p. 31; Ewart #1, pp. 3-4]**
21. On February 17, 2012, following the order of Mr. Justice Affleck, CEB returned the Copies which it had seized on November 9, 2011 to Lemare's business office. Messrs Kruger and McCliggott arrived contemporaneously to conduct an inspection pursuant to section 142.21 of the *Forest Act*. The demand was for "all electronic scale returns including all versions of scale returns as well as the audit trail..." Mr. Kruger also demanded inspection of the Copies which had been returned by CEB. Mr. Dutcyvich cited the need to review the Copies as a basis for non-production at that time. Counsel for Lemare also cited the need to protect the privacy of third parties. **[Kruger #1, p. 15; Ewart #1, p. 7]**
22. Messrs Kruger and McCliggott returned to Lemare's business offices on March 8, 2012 and made an identical demand to the February 17, 2012 inspection demand. This time Mr. Dutcyvich said his staff had reviewed the Copies and determined they did not contain scale records or other records Lemare was required to produce. That same day, counsel for Lemare wrote to Mr. Kruger attempting to excuse Mr.

Dutcyvich's conduct on the basis of the earlier, unlawful seizures. **[Kruger #1, p. 16; Kruger #3, paras. 87-89, Allen #1, p. 8]**

23. On May 23, 2012 and June 14, 2012, FRAP sent Lemare two letters proposing to assess Lemare for unpaid stumpage, penalties, and interest in the sum of approximately \$11.5 Million (the "Proposed Assessments"). FRAP did not use the information from the Seized Items or Copies to support the assessment. Instead it used the best information available and extrapolation where information had been withheld by Lemare. **[Kruger #2]**
24. Lemare sought an extension of time to respond to the proposal letters, which FRAP granted. But instead of responding, Lemare commenced the CCAA proceeding, alleging the Proposed Assessments rendered it insolvent, all the while, denying any debt obligation to the Province. **[Kruger #1, pp. 18-19; Dutcyvich #1, para. 45]**
25. In his affidavit #1, Mr. Kruger deposed as to the February 17 and March 8, 2012 inspection demands. He stated that FRAP "attempted to conduct [inspections] under s. 142.21 of the *Forest Act* of copied items that had been returned by MFLNR. Lemare refused to permit inspection of the returned items. ..." (emphasis added.) FRAP also referred to the inspection demands and refusals in the Proposed Assessments, the purpose being to evidence Lemare's wilful contravention of its obligations under the *Forest Act*. **[Kruger #1, paras. 25-26]**
26. The Chambers Judge found the underlined passage objectionable. He found that Mr. Kruger's demand to inspect the Copies depended upon his knowledge of their contents and without that information, Lemare's refusal was of no relevance. He appeared to accept Lemare's submission that forest revenue officials could not lawfully demand to inspect the Copies or take note of Lemare's refusals without unlawfully using information from the Seized Items or Copies. He appeared to reject the Province's submission that there were independent sources of information upon which FRAP reasonably suspected the Copies contained records Lemare was obliged to produce and that such suspicion was more than sufficient to ground the allegation of non-compliance. **[RFJ, paras. 30-31]**

Part II: The points in issue

27. The point in issue is whether leave to appeal the October 16, 2012 order of the Chambers Judge should be granted pursuant to sections 13 and 14 of the CCAA.
28. The Province submits leave should be granted because the appeal raises serious issues which are of profound importance to the parties and to the practice.

29. The learned Chambers Judge erred in law by interpreting too broadly the March 26, 2012 order of Mr. Justice Ehrcke and interpreting too narrowly the regulatory powers under *Forest Act*, Part 11.1. The Chambers Judge also made palpable and overriding errors of fact. As a result, he erred in holding Mr. Kruger must have “used information from the seized items” to allege Lemare’s unlawful refusal of inspection demands.

Part III: Reasons leave should be granted

30. The normal test for leave applies to an application for leave from a decision in a CCAA proceeding: ***Edgewater Casinos Inc. (Re)*, 2009 BCCA 40 at para. 17**. As always, the overarching consideration is the interests of justice: ***Holland v. Marshall*, 2009 BCCA 199 at para. 19**.

a. The point on appeal is of significance to the practice

31. The proposed appeal raises points of statutory interpretation and administrative law which are of real significance to the practice. The *Forest Act* creates a complete code for the determination of stumpage in British Columbia: ***Forest Glen Wood Products Ltd. v. British Columbia (Minister of Forests)*, 2009 BCCA 492**. It is also a self-reporting scheme, modelled on tax statutes. Under such a regime, the taxpayer has a monopoly on information which is counterbalanced only by the robust audit and inspection powers of the regulator. Tax jurisprudence makes clear that these administrative powers are not to be measured on a criminal or even a quasi-criminal standard. The taxpayer, in turn, has a virtually no expectation of privacy over his/her business records: ***R. v. McKinlay Transport Ltd.*, [1990] 1. S.C.R. 672**.
32. In the *Forest Act*, the broad audit and inspection powers are found in Part 11.1. The scope and extent of these regulatory powers have never been considered by the court. Justices Ehrcke and Affleck expressly declined to comment on these powers, leaving the issue to be resolved in a later proceeding on the merits. The reasons of the Chambers Judge demonstrate a lack of appreciation for the purpose, intent, and express wording of Part 11.1 of the *Forest Act*. Yet, the implication of his unconsidered adoption of Lemare’s position is potentially far reaching.

b. The point raised is of significance to the action itself

33. The dispute over what the Province may lawfully demand and what Lemare may lawfully refuse to produce goes to the heart of the dispute between the parties. Mr. Justice Ehrcke’s July 7 reasons and March 26 Order both contemplate the Province

lawfully re-obtaining the information from the Seized Items and Copies. That is precisely what the Province was attempting to do through its inspection demands.

34. If the Province has a lawful entitlement to Lemare's business records, then Lemare's refusal to produce that information must also be unlawful. The question of the propriety of the inspection demands and refusals is of the utmost relevance and was unsuitable for summary determination on an application to strike.

c. The appeal is prima facie meritorious

35. The merits threshold on an application for leave to appeal is low. Leave should only be refused for lack of merit where the proposed appeal is frivolous and bound to fail: ***Houweling Nurseries Ltd. v. Amethyst Greenhouses Ltd.*, 2003 BCCA 347.**
36. The Province submits the appeal is *prima facie* meritorious on a number of grounds, none of which calls into question a discretionary decision of the Chambers Judge.
37. First, the Chambers Judge erred in law by misinterpreting the March 26 Order. In finding that Mr. Kruger must have used information from the Seized Items or Copies to make inspection demands and allege Lemare's refusal, he must have interpreted "information from" to mean something more than that contained in the Seized Items, themselves. The Province submits that none of the following can, properly understood, be "information from" the Seized Items:
 - a. the fact that seizures occurred following a CEB investigation;
 - b. the fact that CEB made exact copies of the Seized Items;
 - c. the fact that the Seized Items were nothing other than business records of Lemare which included records of scaling;
 - d. the fact that both the Seized Items and Copies were ordered returned to Lemare's place of business by the Supreme Court;
 - e. the fact the Seized Items and Copies were returned to Lemare's place of business at a particular time and in a particular manner (i.e. in five boxes).
38. The Chambers Judge made a further error of law in failing to appreciate that the audit and inspection powers of forest revenue officials under part 11.1 of the *Forest Act* are unaffected by the March 26 Order. As stated above, those powers are necessarily broad. They provide, among other things:
 - a. That a forest revenue official may enter, at any reasonable time, on any land or premises and conduct an inspection or audit **[section 132.2(1)]**;
 - b. That a forest revenue official may inspect or conduct an audit of any record, or inspect any thing or any activity, that is related to information or records

required to be kept by the person or to be provided to the government under this Act or an agreement entered into under this Act [section 142.21(a)];

- c. That a forest revenue official may require production of and copy any record referred to in paragraph (a) [Section 142.21(b)];
- d. That a person required to keep records under the *Forest Act* must keep each record in a prescribed category of records for a period of 6 years after the date the record was created [section 142.3(1)];
- e. That the person being audited must produce, if and as requested by the forest revenue official, any information and any record required under section 142.21 [section 142.41(e)]; and,
- f. That an affidavit by a forest revenue official that states the facts necessary to establish default under section 142.41 by a person to whom a request was made must be admitted as evidence in any court and is proof, in the absence of evidence to the contrary, of the facts stated [section 142.5].

(Emphasis added.)

39. The categories of records Lemare is required to keep are also broad: **Forest Revenue Audit Regulation, section 2**. They encompass a whole range of forestry business records, including, among other things:
 - a. records that relate to the ownership of timber or the right to harvest timber;
 - b. records that relate to the harvesting of timber;
 - c. records that relate to the transportation or possession of timber;
 - d. records that relate to dealing in or the acquisition or disposition of timber;
 - e. records that relate to the scaling of timber; and,
 - f. records that relate to the ownership or operation of a scale site.
40. Lemare is in the forestry business. It cannot lawfully withhold its business records, including records of scaling, from auditors. The notion that unlawful seizures in a previous criminal proceeding, or phantom privacy concerns, provide Lemare with a pretext to resist inspection demands is simply untenable. Yet that is precisely the position which was adopted by the Chambers Judge in this case.
41. By denying the Province's right to demand the Copies (and by necessary implication the Seized Items, themselves) and holding Lemare's refusals to be of "no relevance", the Chambers Judge failed to give effect to the earlier orders of Justices Ehrcke and Affleck, that the Copies be returned to Lemare's place of business. If the Chambers Judge is correct, then there is no practical difference between the order for destruction, which Lemare sought and was refused, and the status quo which allows Lemare to hide the returned material away and pretend it does not exist.

42. The Chambers Judge also made several palpable and overriding errors of fact. By ignoring the fact that Mr. Dutcyvich first admitted that the Seized Items contained scale records, but then denied that the Copies contained scale records, the Chambers Judge effectively endorsed Lemare's deception.
43. The Chambers Judge erroneously rejected Mr. Kruger's sworn evidence that he did not use the information from the Copies in demanding them for inspection. Mr. Kruger admitted that he had seen the Copies, but that knowledge was irrelevant as it did not preclude him from making inspection demands. There is no requirement that forest revenue officials have knowledge or even a suspicion to exercise their powers under Part 11.1. Moreover, the onus is on the person being audited to demonstrate that they had a lawful excuse for not complying. [**Forest Act, section 163.1**]
44. In addition to ignoring relevant facts and focusing on irrelevant ones, the Chambers Judge also misapprehended facts central to the dispute. He referred to "the unlawfully seized boxes" in paragraph 30 of his reasons, apparently failing to recognize that the "boxes" were never unlawfully seized. The boxes contained the Copies ordered returned by Mr. Justice Affleck, a fact independent of any "information from" the Seized Items, themselves.
45. In paragraph 31, the Chambers Judge referred to the items Mr. Kruger sought to inspect as being "the very items he had just returned" (emphasis added). Mr. Kruger deposed that he did not return the Copies, which were returned by employees of the Ministry of Forests Range and Natural Resource Operations ("Forests"). Mr. Kruger deposed that he arrived separately, during normal business hours on February 17, 2012. The date, time, and location for the return of the Copies was also not "information from" within the meaning of the March 26 Order.

d. The appeal will not unduly hinder the progress of the action

46. This is not a case where the Petitioners are experiencing serious financial difficulties such that the delay associated with an appeal could jeopardize their ability to reorganize and continue their business. The Province remains stayed from taking any steps in relation to its ongoing audit and Proposed Assessments of Lemare. Meanwhile, Lemare's financial position is good and getting better.
47. The proposed appeal is of significant utility in the circumstances of the parties. By acceding to Lemare's summary application, the Chambers Judge denied the Province a fundamental procedural right. The Province seeks a reasoned consideration of the rights and obligations of the parties, based on a full factual

inquiry, and having regard to the legislation which governs them. This determination will likely facilitate, rather than hinder, a proper and early resolution of the dispute.

48. If leave is granted, the Province intends to cooperate with the other parties to have the proposed appeal heard as soon as practicable, hopefully in early January 2013. This represents no real prejudice to the parties in the context of this unconventional CCAA proceeding, where little has transpired over approximately five months. Any delay in the CCAA proceeding is, in the Province's submission, significantly outweighed by the important issues and strong prospect of success of the proposed appeal.
49. Finally, the interests of justice weigh heavily in favour of the Province in this case. The order of the Chambers Judge represents a clear departure from earlier judicial pronouncements in this litigation and represents a major prejudice to the Province's ability to prove its claim. As Mr. Justice Affleck noted in an earlier proceeding [***British Columbia v. Lemare Lake Logging Ltd.*, 2012 BCSC 939 at para. 11**]:

The Province challenges the assertion made by Lemare in the course of argument that the Province has no right "to obtain the things they've been told that they were not entitled to". The Province submits that it has an unequivocal statutory right to obtain the information it seeks pursuant to the Forest Act. I make no finding on that alleged "unequivocal" right but I doubt Lemare's assertion is correct.
50. Put simply, the Chambers Judge's Order gives Lemare's deliberate concealment the imprimatur of judicial approval and brings the administration of justice into disrepute.

Part IV: The nature of the orders requested

1. An order granting leave to appeal the order of the Honourable Mr. Justice Grauer striking portions of Mr. Kruger's Affidavit #1, dated October 16, 2012 pursuant to sections 13 and 14 of the CCAA.
2. An order that the CCAA proceeding be stayed, in all or in part, until the resolution of this appeal, pursuant to sections 18 and 10(2)(b) of the *Court of Appeal Act*.
3. An order that the appeal be heard together with CA Action numbers 040370 and 040371 (collectively the "Appeals"), pursuant to sections 10(2)(a), (c) and (f) of the *Court of Appeal Act*.
4. An order that the Appeals be heard on an expedited basis pursuant to sections 10(1) and 10(2)(a), (b), (c), (d) and (f).

Part V: Table of the authorities

British Columbia v. Lemare Lake Logging Ltd., 2012 BCSC 193

British Columbia v. Lemare Lake Logging Ltd., 2012 BCSC 939

Edgewater Casinos Inc. (Re), 2009 BCCA 40

Forest Glen Wood Products Ltd. v. British Columbia (Minister of Forests), 2009 BCCA 492

Holland v. Marshall, 2009 BCCA 199

Houweling Nurseries Ltd. v. Amethyst Greenhouses Ltd., 2003 BCCA 347

Lemare Lake Logging v. British Columbia, 2011 BCCA 474

Lemare Lake Logging v. British Columbia, 2011 BCSC 903

R. v. McKinlay Transport Ltd., [1990] 1. S.C.R. 672

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