



No. S-124409  
VANCOUVER REGISTRY

**IN THE SUPREME COURT OF BRITISH COLUMBIA**

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

**NOTICE OF APPLICATION**

**Name of applicant:** Her Majesty the Queen in right of the Province of British Columbia (the  
"Province")

To: The Service List

TAKE NOTICE that an application will be made by the applicant to the Honourable Mr. Justice  
Grauer at the courthouse at 800 Smithe Street, Vancouver, British Columbia on September 6,  
2012 at 10:00 a.m. for the orders set out in Part 1 below.

**Part 1: ORDERS SOUGHT**

1. That the order made on June 21, 2012, as amended and restated on July 20, 2012, (the  
"Initial Order") in these proceedings be set aside.
2. In the alternative, that paragraph 15 of the Initial Order be amended to delete any  
reference to staying any action, suit or proceeding by the Province of British Columbia in  
relation to claims for unpaid stumpage.

3. In the further alternative, that the stays in paragraphs 15 and 16 of the Initial Order be lifted to allow the Province to proceed with making assessments in relation to the Petitioners under Part 11.1 of the *Forest Act*, R.S.B.C. 1996, c. 157.

## **Part 2: FACTUAL BASIS**

1. The Province was not given notice of the application for the Initial Order.
2. No urgency necessitated the Petitioners' application for the Initial Order without giving notice to the Province.
3. The Petitioners are not insolvent or otherwise a "debtor company or affiliated debtor companies" within the meaning of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("CCAA").
4. There is no need for the Petitioners to restructure and no need for the Petitioners to seek the protection of this Honourable Court.

### **The Forest Act Scheme**

5. The term "stumpage" refers to a fee for timber which is due to the Province by statute under forest tenure agreements under the *Forest Act* and related enactments. The tenure holder or party acquiring and using timber is liable to pay stumpage pursuant to sections 130 and 131 of the *Forest Act*. Stumpage rates vary according to the quality or grade of timber harvested.
6. The *Forest Act* creates a comprehensive code for the calculation, assessment and collection of stumpage in British Columbia. The payment of stumpage under the *Forest Act* is based on a self reporting system that is subject to compliance reviews and enforcement through audits and assessments.
7. The assessment of stumpage falls under Part 11.1 of the *Forest Act*. That Part gives forest revenue officials broad powers accessory to their audit function. They may enter onto land or premises for the purpose of ensuring compliance with the Act (section 142.2). They may "inspect or conduct an audit of any record, or inspect any thing or activity, that is related to information or records required to be kept... or provided to the government" under the Act (section 142.21). They may, upon notice, demand that records be provided to the government (section 142.31). And, they may rely upon other information available from third party sources (section 142.51).
8. The Ministry of Finance, Income Taxation Branch, Forest Revenue Audit Program ("FRAP") inspects, audits, and assesses for underreported and unreported stumpage pursuant to this regulatory and enforcement scheme established under Part 11.1 of the *Forest Act*.
9. Where it appears that stumpage has been underreported or unreported, FRAP may assess or reassess the person(s) liable for the amount owing (section 142.51). FRAP may also assess interest and penalties against the person(s) liable to pay stumpage (sections 142.51(5), 130(1)(b),

and 142.61). The penalty for “wilful” contravention of the Act may be up to 100 percent of the amount assessed.

10. FRAP practice is to provide clients with an audit proposal letter in advance of an assessment and to allow 30 days to respond to the proposal. Extensions beyond 30 days are granted on a case-by-case basis.

11. At the end of the response period, FRAP may make an assessment and must serve the person(s) assessed with a Notice of Assessment (sections 142.71 and 142.8).

12. Evidence that an assessment has been made is proof in the absence of evidence to the contrary that the amount assessed is due and owing in accordance with the Notice of Assessment referred to in section 142.71. The onus of proving otherwise is on the person liable to pay the amount assessed (section 142.81). A proposal letter is not an assessment, nor is it proof that an assessment has been made.

13. A person who disputes an assessment has a statutory right of appeal, first to the revenue minister (section 142.9) and subsequently to the Supreme Court (section 142.91).

#### **The Petitioners’ Financial Position**

14. The Petitioners’ financial statements (the “Financial Statements”) attached to Affidavit #1 of Eric Dutcyvich are reviewed, not audited. A review provides a lower level of assurance than an audit.

15. The Financial Statements are “combined” rather than “consolidated”. Combined financial statements permit the picking and choosing of which entities (and their assets and liabilities) to include. Lemare Holdings Ltd. is not included in the Financial Statements, but Lion’s Gate Forest Products Ltd is included; however its relationship to the other entities is not clear.

16. The loan guarantee liability in the Financial Statements does not take into account the value of a mortgage securing that loan, resulting in a subjectively weaker financial position.

17. In general, there is only a weak, if any, connection between asset values on a balance sheet and actual fair market value.

18. The Financial Statements are potentially misleading and do not provide sufficient information to make a determination as to the Petitioners’ solvency.

#### **FRAP’s Audit**

19. FRAP has been auditing Lemare Lake Logging Ltd. (“Lemare Lake”) and related companies for several years and asserts that Lemare Lake and Lone Tree Logging Ltd. (“Lone Tree”) wilfully reported incorrect volumes and incorrect grades and wilfully failed to report Crown timber harvested in a deliberate attempt to avoid paying the correct stumpage.

20. Lemare Lake has repeatedly failed to make full disclosure to the Province of information, records or other things that forest revenue officials have demanded of them for inspection or audit.
21. Consistent with ordinary practice, on May 23, 2012, FRAP sent Lemare Lake a proposal letter, setting out the basis for a pending assessment, and giving Lemare Lake 30 days to respond before the assessment would issue.
22. The proposed assessment included a 100 percent penalty under s. 142.61 of the *Forest Act* for wilful contravention of the Act.
23. On June 6, 2012, Lemare Lake requested an extension of time to respond to the proposed assessment. FRAP granted an additional 30 days before making an assessment under the *Forest Act*. No assessment or payment order has been made to date.
24. On June 14, 2012, FRAP sent a second proposal letter to Lemare Lake relating to a timber mark not covered by the first proposal letter. FRAP agreed to defer any action relating to both proposal letters until July 24, 2012.
25. On June 21, 2012, the Petitioners initiated the within proceeding alleging the proposed assessments against Lemare Lake rendered them insolvent.
26. The total of the two proposed assessments against Lemare Lake is \$4,996,837 plus 100 per cent penalty, plus interest.
27. Of this total, the following amounts, plus 100 per cent penalty, plus interest, were proposed to be jointly assessed against the following licensees:
  - a. \$267,069 against Lone Tree;
  - b. \$366,143 against Eric Dutcyvich; and
  - c. \$196,826 against Christopher Dutcyvich.
28. In addition to assessments against the persons named in paragraphs 25 and 26 above, assessments or other proceedings can be commenced under the *Forest Act* against other persons identified in the proposal letters as the holders of licences under which stumpage has not been paid or against other persons who acquired or dealt in the timber for which stumpage has not been paid. These persons are not parties to this *CCAA* proceeding.

### **Part 3: LEGAL BASIS**

#### **Setting aside the Initial Order**

1. Rule 8-5(8) of the *Supreme Court Civil Rules* and the common law empower the Court to change or set aside an *ex parte* order on an application of a person affected by the order.
2. Initial applications in *CCAA* proceedings should not be brought without notice merely because they are an application under the *CCAA*. The material before the court must be

sufficient to indicate an emergent situation: *Marine Drive Properties Ltd. (Re)*, 2009 BCSC 145 at para. 27.

3. When an initial order is made *ex parte* under the *CCAA*, an application to set it aside may be brought in the usual way for setting aside *ex parte* orders: *The 2012 Annotated Bankruptcy and Insolvency Act*, page 1114; *United Maritime Fishermen Co-Op (Re)*, [1988] N.B.J. No. 13; *Icor Oil & Gas Co. Ltd. et al. v. Canadian Imperial Bank of Commerce et al. (No. 1)*, [1989] A.J. No. 1388, para. 14; *Long Potato Growers Ltd. (Re)*, 2008 NBQB 231, paras. 34-35.

4. Paragraph 52 of the Initial Order grants leave “to hear any application” in the proceeding on two clear days notice.

5. Paragraph 53 of the Initial Order allows any interested party to apply to the Court to vary or amend the Initial Order on seven days notice.

6. By Order of this Honourable Court made on July 20, 2012, the Province was given liberty to apply to set aside the Initial Order.

### **CCAA Jurisdiction**

7. Section 3 of the *CCAA* provides that the *CCAA* only applies in respect of a debtor company or affiliated debtor companies. Each of the affiliated companies must be a debtor company.

8. Lone Tree is not affiliated with Lemare Lake, according to information in the Monitor’s Second Report.

9. The definition of “debtor company” in section 2 of the *CCAA* requires that each of the Petitioners be bankrupt or insolvent.

10. Insolvency is determined as of the date a petition is filed under the *CCAA*: *Stelco Inc. (Re)*, [2004] O.J. No. 1257 (S.C.J.), para. 4.

11. The onus is on each of the Petitioners to prove that it was insolvent at the relevant time.

12. The Constitution gives the federal Parliament the power to make laws in relation to bankruptcy and insolvency and the provincial legislatures the power to make laws in relation to property and civil rights in the province: *The Constitution Act*, 1867, 30 & 31 Vict, c 3, ss. 91-92.

13. “Insolvent” must be interpreted in light of the Constitution and the case law considering the federal power over bankruptcy and insolvency.

14. Insolvency is not defined in the *CCAA*. However, the definition of “insolvent person” found in section 2 of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 (“*BIA*”) provides “the only appropriate definition” for the purposes of the *CCAA*: *Les Oblats de Marie Immaculee du Manitoba (Re)*, 2004 MBQB 71, paras. 34-35.

15. The *BIA* defines “insolvent person” as follows:

“insolvent person” means a person who is not bankrupt and who resides, carries on business or has property in Canada, whose liabilities to creditors provable as claims under this Act amount to one thousand dollars, and

(a) who is for any reason unable to meet his obligations as they generally become due,

(b) who has ceased paying his current obligations in the ordinary course of business as they generally become due, or

(c) the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due;

16. In determining whether paragraph (a) of the definition of “insolvent person” is met, one must look at whether the person is unable to meet its obligations currently due or will be unable to meet its obligations due in the immediate future: *Clarkson Co. v. King*, [1978] O.J. No. 2613, para. 9.

17. In determining whether paragraph (c) of the definition of “insolvent person” is met, the only obligations that are “due and accruing due” are those that are currently payable or properly chargeable to the accounting period during which the test is being applied: *Enterprise Capital Management Inc. v. Semi-Tech Corp.*, [1999] O.J. No. 5865 (S.C.J.), para. 17.

18. The valuation of a claim for the purposes of paragraph (c) of the definition of “insolvent person” should be based on probabilities, not possibilities: *Les Oblats*, para. 44.

19. While the Ontario decision in *Stelco* suggests a broad interpretation of “insolvent” should be adopted in the context of the *CCAA*, it is submitted that this approach is incorrect. This approach stretches the meaning of insolvency so far as to make it meaningless. Such a broad definition would intrude into the Province’s jurisdiction over property and civil rights in British Columbia.

20. Moreover, such a broad definition of insolvency in the *CCAA* context means that creditors would be able to initiate *CCAA* proceedings with respect to solvent companies such as the Petitioners.

21. The Petitioners are not insolvent, and were not insolvent on the date they filed their petition (the “Filing Date”), even under the broad interpretation of “insolvent” set out in *Stelco*.

22. There is no evidence the Petitioners are, or were as of the Filing Date, unable to meet their obligations as they generally become due. There is no evidence the Petitioners will be unable to meet any obligations becoming due in the immediate future.

23. The existence of a risk that, in a worst-case scenario, the Petitioners might become unable to meet their obligations at some point in the future, does not make them insolvent under paragraph (a) of the *BIA* definition.

24. There is no evidence the Petitioners had, as of the Filing Date, ceased paying their current obligations in the ordinary course of business as they generally became due. They cannot be

considered insolvent on the basis of any failure to pay pre-filing obligations since the Filing Date. Therefore, they are not insolvent under paragraph (b) of the *BIA* definition.

25. It is impossible to conclude on the basis of the Financial Statements that the value of the Petitioners' assets would not be sufficient to enable payment of their obligations due and accruing due. It is not clear which obligations are due now or within the current accounting period and which are due later. It is not clear to what extent the book value of the assets reflects a fair valuation or the value if disposed of under a fairly conducted sale under legal process. It is not clear if the figures are reliable, since the statements are unaudited. It is not clear which assets and obligations belong to each of the Petitioners and which belong to an entity other than the Petitioners.

26. The Financial Statements indicate that the book value of Lemare Lake's assets is significantly more than its total liabilities. It is only when speculative liabilities—the \$10 million relating to the RCA Trust Transaction and the amount of the proposed assessment under the *Forest Act*—are considered that there appears to be any possibility of negative equity.

27. There is no evidence that it is appropriate to treat the \$10 million relating to the RCA Trust Transaction as a liability at this time. Even if it were appropriate to treat it as a liability, the value of the mortgage against the property owned by 3L Cattle and/or 626309 Saskatchewan Ltd. should be factored into a determination of the value of the liability.

28. The evidence does not establish that the Petitioners are insolvent under paragraph (c) of the *BIA* definition. There is no evidence as to the value of the Petitioners' obligations that are either due now or accruing due in the immediate future. Even if one assumes that all their liabilities are due or accruing due, it cannot be concluded that all of the Petitioners are insolvent under paragraph (c) of the *BIA* definition. At most there is a possibility of this test being met against some of the Petitioners in a worst-case scenario.

### **The Court's Discretion**

29. Even if the legal prerequisites for the making of an order under the *CCAA* are satisfied, the making of such an order is discretionary.

30. The discretion must be exercised judicially based on credible evidence; it should be used according to common sense and in a manner which does not result in an injustice. If there is no pressing need to restructure then the court's discretion should be judicially exercised against granting *CCAA* protection and ancillary relief: *Stelco*, paras. 8-11.

31. The court must determine whether in all the circumstances it is appropriate that an order be made pursuant to the *CCAA*, and in making that determination the court must have regard to the interests of all the stakeholders and must take into account any public interest involved: *Enterprise Capital Management Inc.*, para. 20.

32. The circumstances of this case make it inappropriate for summary resolution under the *CCAA* process.

33. The *Forest Act* creates a complete code for the assessment and payment of stumpage in British Columbia: *British Columbia v. Lemare Lake Logging Ltd*, 2012 BCSC 193; *Forest Glen Wood Products Ltd. v. British Columbia (Minister of Forests)*, 2007 BCSC 273, aff'd 2009 BCCA 492.

34. The practical effect of the Initial Order is to create a proceeding whereby the Petitioners may circumvent the regulatory and enforcement scheme set out in Part 11.1 of the *Forest Act*.

35. The Province's claim for unpaid stumpage includes a penalty for "wilful" contravention of the *Forest Act*. Under section 19 (2) of the *CCAA*, such a claim is not subject to compromise. This type of claim should not be determined summarily in *CCAA* proceedings.

36. More generally, insolvency proceedings are not a suitable forum for this Honourable Court to consider allegations akin to fraud. Such allegations are serious and require a full investigation of the circumstances. They should not be resolved (or ignored) summarily through the *CCAA* mechanism: *Kemper (America British Canadian Catering Service) (Re)*, [1961] O.J. No. 380 (S.C. H.C.J.) at para. 11; *Sidhu (Re)*, 2004 BCSC 1589 at paras. 5-6; *Asuncion (Re)*, [1992] B.C.J. No. 598 (S.C.).

37. Since the Province's right of recourse for unpaid stumpage is against Lemare Lake as broker and Lemare Lake and Lone Tree as licensees and also against several licensees and other persons who acquired or dealt in the timber who are not parties to the *CCAA* proceeding, allowing the *CCAA* matter to stand will only invite duplicative proceedings.

38. Given Lemare Lake's and Lone Tree's stated intention to challenge any assessment that may issue and their denial of any liability to the Province for any amount of unpaid stumpage, the initial application is at best premature.

### **Scope and Effect of the Stay**

39. In the alternative, if this Honourable Court determines that the *CCAA* process is appropriate, the legal requirements for a stay of proceedings against the Province have not been met by the Petitioners and cannot be met in any event.

40. Section 11.1(2) of the *CCAA* states that:

(2) Subject to subsection (3), no order made under section 11.02 [the stay provisions] affects a regulatory body's investigation in respect of the debtor company or an action, suit or proceeding that is taken in respect of the company by or before the regulatory body, other than the enforcement of a payment ordered by the regulatory body or the court.

41. Section 11.1(1) of the *CCAA* defines "regulatory body" very broadly:

11.1(1) In this section, "regulatory body" means a person or body that has powers, duties or functions relating to the enforcement or administration of an Act of Parliament or of the legislature of a province....



42. FRAP is a “regulatory body” within the meaning of the *CCAA*, section 11.1(1). It has powers, duties and functions relating to the enforcement and administration of Part 11.1 of the *Forest Act*.

43. The inspection and audit steps taken by FRAP up to this point, and any further inspection or audit steps that may be taken with respect to Lemare Lake and Lone Tree under Part 11.1 of the *Forest Act*, are not the “enforcement of a payment ordered” and should not be precluded by a court order (i.e., the Initial Order) issued under section 11.02 of the *CCAA*.

44. Moreover, even the making of an assessment against Lemare Lake and Lone Tree under Part 11.1 of the *Forest Act* would not be the “enforcement of a payment ordered” and, as a result, should not be stayed by a court order issued under section 11.02 of the *CCAA*.

### **Conclusion**

45. The Initial Order should be set aside in its entirety as *CCAA* jurisdiction has not been established and the circumstances are not suitable for adjudication under the *CCAA*.

46. Alternatively, the stay in paragraphs 15 and 16 of the Initial Order should be lifted or amended to remove any limits on the Province’s ability to proceed with stumpage assessments under the *Forest Act*.

### **Part 4: MATERIAL TO BE RELIED ON**

1. Affidavit #1 of Jason Kruger, sworn July 19, 2012;
2. Affidavit #2 of Jason Kruger, sworn July 19, 2012;
3. Affidavit #1 of Terrence MacDonald, sworn July 19, 2012;
4. Affidavit #1 of Charlene Joanes, sworn July 19, 2012;
5. Affidavit #1 of Hanjia Yu, sworn July 18, 2012;
6. The cases and enactments cited in this application;
7. The pleadings and other materials filed and to be filed herein; and
8. Such further and other material as counsel may advise and this Honourable Court may allow.

The applicant estimates that the application will take one (1) day.

☐ This matter is within the jurisdiction of a master.

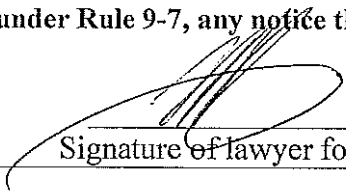
☒ This matter is not within the jurisdiction of a master. This matter is to be heard before the Honourable Mr. Justice Grauer.

**TO THE PERSONS RECEIVING THIS NOTICE OF APPLICATION:** If you wish to respond to the application, you must, within 5 business days after service of this notice of application or, if this application is brought under Rule 9-7, within 8 business days after service of this notice of application,

- (a) file an application response in Form 33,

- (b) file the original of every affidavit, and of every other document, that
- (i) you intend to refer to at the hearing of this application, and
  - (ii) has not already been filed in the proceeding, and
- (c) serve on the applicant 2 copies of the following, and on every other party of record one copy of the following:
- (i) a copy of the filed application response;
  - (ii) a copy of each of the filed affidavits and other documents that you intend to refer to at the hearing of this application and that has not already been served on the person,
  - (iii) if this application is brought under Rule 9-7, any notice that you are required to give under Rule 9-7 (9).

Date: August 23, 2012

  
Signature of lawyer for applicant, David Hatter

*To be completed by the court only:*

Order made

☐ in the terms requested in paragraphs ..... of Part 1 of  
this notice of application

☐ with the following variations and additional terms:

.....  
.....  
.....

Date: .....[dd/mm/yyyy].....

Signature of ☐ Judge ☐ Master

#### APPENDIX

#### THIS APPLICATION INVOLVES THE FOLLOWING:

- ☐ discovery: comply with demand for documents
- ☐ discovery: production of additional documents
- ☐ other matters concerning document discovery
- ☐ extend oral discovery
- ☐ other matter concerning oral discovery
- ☐ amend pleadings
- ☐ add/change parties
- ☐ summary judgment
- ☐ summary trial
- ☐ service
- ☐ mediation
- ☐ adjournments
- ☐ proceedings at trial
- ☐ case plan orders: amend
- ☐ case plan orders: other
- ☐ experts