



No. S-236214
Vancouver Registry

In the Supreme Court of British Columbia

Between:

1392752 B.C. Ltd.

Petitioner

And:

Skeena Sawmills Ltd.
Skeena Bioenergy Ltd.
ROC Holdings Ltd.

Respondents

APPLICATION RESPONSE

Application Response of: Delta Cedar Specialties Ltd. (the “**Application Respondent**”)

THIS IS A RESPONSE TO the Notice of Application of 1392752 B.C. Ltd. (the “**Petitioner**”), filed on 5 January 2024.

Part 1: ORDERS CONSENTED TO

The Application Respondent consents to the granting of the orders set out in the following paragraphs of Part 1 of the Notice of Application:

1. Nil.

Part 2: ORDERS OPPOSED

The Application Respondent opposes the granting of the orders set out in the following paragraphs of Part 1 of the Notice of Application:

1. All.

Part 3: ORDERS ON WHICH NO POSITION IS TAKEN

The Application Respondent takes no position on the granting of the orders set out in the following paragraphs of Part 1 of the Notice of Application:

1. Nil.

Part 4: FACTUAL BASIS

A. Overview

1. The Application Respondent opposes and/or seeks revisions to each of the Orders Sought in the Petitioner's application, as follows.
2. In respect of paragraphs 1 to 4 of Orders Sought, the Application Respondent agrees that the Promissory Notes and the Guarantee are enforceable, but disputes the validity of the General Security Agreement and the Mortgage (as defined in the Petitioner's application) (together, the "**Security Documents**") on the ground that the Security Documents purport to secure advances made prior to the execution and grant of the Security Documents (the "**Prior Advances**") and is therefore a fraudulent preference that is void as against other creditors.
3. The Application Respondent agrees that, if the Petitioner had caused the Security Documents to secure only those advances made after the Security Documents were created (the "**Posterior Advances**" of \$7,614,137.72), the Security Documents would not offend the *Fraudulent Preference Act*, R.S.B.C. 1996, c. 164. However, the Security Documents cannot be partially valid (*i.e.* valid for the Posterior Advances) and partially invalid (*i.e.* invalid as against the Prior Advances).
4. In any event, to the extent the Petitioner is found to have security that is enforceable in relation to the Posterior Advances, the Application Respondent requests that this Court order and declare that the Security Documents granted to the Petitioner rank behind in priority to the Application Respondent's security against inventory and accounts receivable (the "**Delta Security**"). To that end, the Application Respondent seeks an additional entry in the order stating that:

"Delta Cedar Specialties Ltd. has valid and enforceable security against all accounts receivable and inventory of Skeena Sawmills Ltd. pursuant to the security agreement between Skeena Sawmills Ltd. and Delta Cedar Specialties Ltd. dated 4 October 2021 registered in the Personal Property Registry on 4 October 2021, under registration number 282094N (the "**Delta Security**").

The Petitioner's Security Documents rank behind in priority to the Delta Security".

5. In respect of paragraph 6 of the Orders Sought, the Petitioner should not be granted liberty to apply for a declaration that the Security Documents are valid and enforceable in relation to the Prior Advances, as the Security Documents clearly convey a fraudulent preference in respect of those advances.

B. Brief Factual Background

6. On 18 September 2023, the Application Respondent filed a Response to Petition, wherein it, *inter alia*, claimed a security interest over the accounts receivable and inventory of Sawmills – *i.e.*, the Delta Security.

Response to Petition, filed 18 September 2023 at para. 6

Second Report of the Receiver, filed
13 December 2023 at para. 4.1

7. The Receiver released its Third Report to the Court on 12 January 2024 (the “**Third Report**”) that provided its comments on the Petitioner’s application materials and whether the Receiver is aware of any further documents or transactions relevant to the debt and security claimed by the Petitioner therein, including any related party transactions.

Third Report of the Receiver, filed
12 January 2024 (“**Third Report**”) at 2.1

8. The Receiver provided the following comments in its Third Report:

- a) the Posterior Advances were confirmed by the Receiver through a review of Sawmills’ banking records, subject to a \$511.59 overstatement;
- b) through a review of the available bank statements and accounting records of the Skeena Entities, the Receiver identified \$174,214.47 worth of transactions made by Sawmills and Bioenergy to the Petitioner and Shenwei Wu (one of the shareholders of the Petitioner and the Skeena Entities);
- c) the Petitioner miscalculated the interest generated on the Posterior Advances to the tune of \$11,417.05. Instead, only \$431,255.96 is owing in interest; and
- d) the Receiver did not identify anything in the records of the Skeena Entities relevant to the execution, delivery or enforceability of the Security Documents.

Part 5: LEGAL BASIS

A. The Security Documents Are Unenforceable Against Either the Posterior Advances or the Prior Advances

1. The Security Documents are, in their totality, invalid and unenforceable instruments. The crux of this submission is that a security instrument cannot be partially valid and partially invalid.

2. As stated in the Response to Petition filed by the Application Respondent, the Security Documents constitute a fraudulent preference and/or a fraudulent conveyance, by reference to, *inter alia*, sections 3 and 5 of the *Fraudulent Preference Act* and section 1 of the *Fraudulent Conveyance Act*, R.S.B.C. 1996, c. 163.

3. The Petitioner's Security Documents, on their face, seek to secure payment of the Prior Advances (of some \$135,596,000) and to grant some priority to Prior Advances, which were otherwise unsecured. This offends section 3 of the *Fraudulent Preference Act*, which reads as follows:

3. Subject to section 6, a disposition of property by a person at a time when he is in insolvent circumstances, is unable to pay his debts in full, or knows that he is on the eve of insolvency, is void as against an injured creditor, if made

(a) with intent to defeat, hinder, delay or prejudice creditors or some of them; and

(b) to or for a creditor with intent to give the creditor preference over other creditors or some of them.

4. The Petitioner's Security Documents purport to grant security that will give the Petitioner a greater share of proceeds than "by unsecured creditors generally" and is therefore deemed under section 5 of the *Fraudulent Preference Act* to give rise to a preference irrespective of "the intent or motive of the debtor":

5 (1) A disposition is deemed to give a creditor a preference over the other creditors under section 4, if the creditor is given, recovers or is placed in a position to recover payment, satisfaction or security for all or part of the debtor's indebtedness, greater proportionately than could be recovered by unsecured creditors

generally, or on the unsecured portion of the liabilities, out of assets of the debtor left available to judgment.

5 (2) *For the purposes of section (1)*

(a) a preference is not dependent on the intent or motive of the debtor or on the disposition being entered into voluntarily or under pressure, and

(b) no pressure by a creditor, or want of notice to the creditor alleged to have been preferred of the debtor's circumstances, or of the effect of the disposition, protects it except as provided by section 6.

[Emphasis added.]

5. Finally, section 6(1)(b) of the *Fraudulent Preference Act* can only save a grant of security if granted “by way of security for a present actual advance of money in good faith”. The grant of security to the Petitioner is not for a “present actual advance of money” but rather for past and future advances, including of some \$136,000,000 in Prior Advances.

6. Here, the Petitioner’s Security Documents grant a fraudulent preference and/or represent a fraudulent conveyance. The grant of security over the assets of the Skeena Entities was made in circumstances where:

- a) the Skeena Entities were by their own admission insolvent and could not repay the Prior Advances;
- b) the Petitioner was owed unsecured debt and made the Posterior Advances in order to secure the Prior Advances (via the Security Documents) in anticipation that they would need to defeat other unsecured creditors;
- c) the Security Documents were the product of collusion between several parties who are not at arms-length – being the Petitioner, the Skeena Entities, and the shareholders of the same, Xiao Peng Cui and Shenwei Wu (the “**Shareholders**”). Given that the Shareholders controlled both companies, it was a foregone conclusion that the Shareholders would otherwise exert “pressure” on the Skeena Entities in a way that advantaged them or otherwise arrange the affairs of their various companies in a way that protected their investments; and
- d) in any event, the Petitioner’s Security Documents grant the Petitioner, on the face of these documents, “security for all or part of the debtor's indebtedness, greater proportionately than could be recovered by

unsecured creditors generally” and are therefore deemed to grant a preference.

7. It follows that the Petitioner’s Security Documents are, in their entirety, invalid as the Petitioner attempted to secure the Prior Advances in priority to the interests of the other injured creditors. Section 6 of the *Fraudulent Preference Act* does not apply because the Security Documents were not made in good faith in relation to the Prior Advances (or arguably for the Posterior Advances either), but rather the Petitioner spent the approximately \$7.614 million in order to secure the Petitioner’s total indebtedness and wipe out all of the other creditors.

8. The Application Respondent agrees that security granted for fresh consideration (*i.e.* fresh advances) is not a fraudulent preference. The Security Documents may then have been valid had the Petitioner only purported to secure the Posterior Advances. However, the Security Documents are invalid because the Petitioner sought to secure the Prior Advances as well. As proof of this, at paragraphs 12 and 14 of the Petition, the Petitioner states that the “Indebtedness plus the Further Advances totals approximately \$143,000,000” and that “[t]he Indebtedness and Further Advances are secured by the following...the ‘Security Documents’).”

Petition to the Court, filed 8 September
2023 at paras. 12 and 14

9. Because the Petitioner’s Security Documents cannot be partially valid and partially invalid, this Court cannot grant an order confirming the validity and enforceability of these Security Documents.

B. Alternatively, the Security Documents Are Valid Only with Respect to the Posterior Advances

10. In any event, nothing in any order of this Court of the Petitioner’s application should be construed as confirming or declaring that the Petitioner holds any valid security for the Prior Advances.

11. As well, because the Petitioner’s Security Documents are clearly fraudulent preferences, the Petitioner should not be afforded the ability to apply at a later date to argue in favour of the validity of the same with respect to the Prior Advances.

12. Counsel for the creditors, and this Court during the 22 December 2023 hearing, have appreciated the great costs that have come with the Petitioner's application. The Petitioner's application was allowed to proceed in spite of these costs, due to the potential upside to the creditor base *if* the Petitioner made the leading offer to purchase the assets, property, and undertakings of the Skeena Entities. Given the amount of expenses incurred by the parties and the Receiver with respect to this single application (for the Petitioner's benefit), the Petitioner should not be permitted to further reduce the available resources of the Receivership to advance a clearly fraudulent preference.

**Receivership Order of Madam Justice
Blake, dated 22 December 2023**

13. In any event, in respect of paragraphs 1 to 4 of the Orders Sought, to the extent that the Petitioner has valid security with respect to the Posterior Advances only, that security ranks behind in priority to the Delta Security.

C. In Any Event, the Application Respondent's Security Has Priority over any Security Held by the Petitioner over the Accounts Receivable and Inventory of Sawmills

14. The Application Respondent also seeks a revision to paragraph 5 of the Orders Sought to confirm that it has valid security and priority over any security held by the Petitioner as against the accounts receivable and inventory of Sawmills.

15. Pursuant to a log purchase and loan agreement dated 4 October 2021, Sawmills owes the Application Respondent at least \$3,137,951.65. This debt is secured by the Delta Security. The Application Respondent is therefore a secured creditor as against Sawmills' inventory and receivables.

**Affidavit #1 of Glen Franke, sworn 18 September
2023 ("Franke Affidavit") at paras. 2 and 3**

16. Pending the determination of the validity and enforceability of each creditor's security instrument, the following table sets out the order of priorities over the accounts receivable or inventory of Sawmills. Given the date of the perfection of the Delta Security, the Application Respondent has priority over all other creditors for the accounts receivable and inventory of Sawmills, to the tune of approximately \$3.138 million.

Table of Priorities over the Accounts Receivable or Inventory of Sawmills

	<u>Entity</u>	<u>Value of Security (Approx.)</u>	<u>Date of Perfection of Security</u>
1.	Delta Cedar Specialties Ltd.	\$3,138,000	4 October 2021
2.	Timber Baron Contracting Ltd.	\$491,000	5 August 2022
3.	Deuce Creek Contracting Ltd.	\$152,000	9 February 2023
4.	Infinity West Enterprises Inc.	\$50,000	22 March 2023
5.	Bank of Montreal	\$10,000	12 July 2023
6.	Antler Creek Contracting Ltd.	\$1,347,000	29 August 2023
7.	Silvicon Services Inc.	\$41,000	19 September 2023
8.	K'alii Aks Timber Corporation	\$576,000	19 September 2023

Response to Petition, filed 18 September 2023 at para. 6

Franke Affidavit

Affidavit #1 of Cecilia Conto, dated 3 January 2024

First Report of the Receiver, filed 25 October 2023 at 3.16 and 3.18

17. In light of the above, this Court should make an order recognizing that the Application Respondent has valid security and priority over the accounts receivable and inventory of Sawmills.

Part 6: MATERIAL TO BE RELIED ON

1. The Receivership Order of Madam Justice Blake, made in these proceedings on December 22, 2023.
2. The Receiver's First Report to Court, dated October 25, 2023 .
3. The Receiver's Second Report to Court, dated December 13, 2023.
4. The Receiver's Third Report to Court, dated January 12, 2024.
5. Petition to the Court, dated September 8, 2023.

6. Response to Petition of Delta Cedar Specialties Ltd., dated September 18, 2023.
7. Affidavit #1 of Glen Franke, dated September 18, 2023.
8. Affidavit #1 of Cecilia Conto, dated January 3, 2024.
9. The other pleadings and materials filed in these proceedings and such further and other materials as counsel may advise and this Honourable Court may permit.


The Application Respondent estimates that the application will take two days.

This matter is not within the jurisdiction of a master.

The Application Respondent's ADDRESS FOR SERVICE is:

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Dated: January 19, 2024


 Signature of Francis Lamer
 Lawyer for the Application Respondent,
 Delta Cedar Specialties Ltd.

This **APPLICATION RESPONSE** is prepared by Francis Lamer of the law firm of Kornfeld LLP whose place of business is 1100 – 505 Burrard Street, Vancouver, BC, V7X 1M5, Telephone: 604-331-8300, Email: flamer@kornfeldllp.com.