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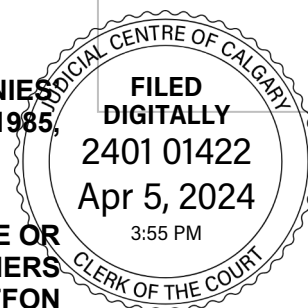
JUDICIAL CENTRE

CALGARY

MATTERS

**IN THE MATTER OF THE COMPANIES
CREDITORS ARRANGEMENT ACT, R.S.C. 1985,
c. C-36, as amended**

**AND IN THE MATTER OF THE COMPROMISE OR
ARRANGEMENT OF GRIFFON PARTNERS
OPERATION CORPORATION, GRIFFON
PARTNERS HOLDING CORPORATION, GRIFFON
PARTNERS CAPITAL MANAGEMENT LTD.,
STELLION LIMITED, 2437801 ALBERTA LTD.,
2437799 ALBERTA LTD., 2437815 ALBERTA
LTD., and SPICELO LIMITED**



DOCUMENT

BRIEF OF TAMARACK VALLEY ENERGY LTD.

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I. INTRODUCTION

1. Tamarack Valley Energy Ltd. (“**TVE**”) is the second secured creditor of Griffon Partners Operation Corp. (“**GPOC**”) pursuant to a Subordinated Secured Promissory Note in the amount of \$20 million plus interest granted by GPOC in favour of TVE (the “**TVE Promissory Note**”).

2. In this Application, TVE seeks an order directing that the equitable doctrine of marshalling applies such that GPOC’s senior secured creditors, Trafigura Canada Limited and Signal Alpha C4 Limited, and/or their agents GLAS USA LLC or GLAS Americas LLC (collectively, the “**Lenders**”), must first realize upon the entirety of shares pledged by GPOC’s guarantor, Spicelo Limited (“**Spicelo**”), pursuant to a Limited Recourse Guarantee and Securities Pledge Agreement dated July 21, 2022 between it and the Lenders (the “**Share Pledge**”), prior to realizing upon any proceeds from the sale of all or any portion of GPOC’s assets pursuant to the sale and investment solicitation process (the “**SISP**”) in these proceedings.

3. The foregoing would allow TVE and GPOC’s other creditors to potentially recover some of the funds duly owing to them by GPOC. The alternative scenario, whereby the Lenders would enforce against the proceeds of the SISP first and then against the Share Pledge would have the effect of needlessly wiping away GPOC’s second secured creditors’ security, leaving TVE with nothing for the over \$23 million secured debt owed to it.

4. Further, TVE seeks an order preventing Spicelo from advancing a subrogated claim against GPOC in the Lenders’ senior secured position, or at all, pursuant to the terms of the Share Pledge and at equity.

II. FACTS

The Debtors

5. GPOC is an entity incorporated on June 7, 2022. It is a wholly-owned subsidiary of Griffon Partners Holding Corporation (“**GPHC**”), which in turn is wholly-owned by Griffon Partners Capital Management Ltd. (“**GPCM**”).

6. GPCM is in turn owned by four holding companies, including Stellion Limited (“**Stellion**”), which is beneficially owned by Jonathan Klesch.¹

7. Stellion owns 25% of GPCM via 1 Class A share. It also owns 79.5% of GPCM’s Class B shares.² According to Mr. Klesch, the reason why Stellion owns so much of GPCM’s Class B shares is that he was the only shareholder risking anything by offering Spicelo’s Pledged Shares as a

¹ Affidavit of Daryl Stepanic, affirmed on January 29, 2024 at para 14.

² Transcript of the Cross-Examination of Jonathan William Klesch dated April 2, 2024 at pp 15:22 [“Cross Examination Transcript”].

guarantee of GPOC's loans arising from the TVE Transaction and thus allowing GPOC to obtain the loan from the Lenders.³

8. Mr. Klesch is one of two directors of each of GPOC, GPHC and GPCM (collectively, the "**Griffon Entities**").⁴ He has over 20 years of experience in commodities trading and structured finance transactions in the oil and gas sector and is the founder of Griffon Partners, an investment management partnership between various groups of people connected with Mr. Klesch including the shareholders and directors of the Griffon Entities, with an emphasis on natural resources and infrastructure.⁵ Prior to founding Griffon Partners and the Griffon Entities, Mr. Klesch spent over 20 years at the Klesch Group, which predominately owns and operates oil refineries.⁶ Mr. Klesch has extensive experience in commodities trading and structured finance transactions.

9. Mr. Klesch is also the sole beneficial owner of Spicelo, an investment company incorporated under the laws of the Republic of Cyprus and extra-provincially registered in Alberta.⁷ At all times, Mr. Klesch has acted as the directing and controlling mind of Spicelo and maintained the exclusive ability to negotiate on behalf of and direct it to enter into binding agreements.⁸

10. Spicelo's only asset is its common shares held in Greenfire Resources Ltd. (the "**Pledged Shares**"), a company of which Mr. Klesch is a director. Mr. Klesch purchased the Pledged Shares to be held by Spicelo in a previous transaction for \$250,000.00. While the Pledged Shares were issued to Spicelo, they were paid for by Mr. Klesch by transferring Julian McIntyre \$250,000.00 which was then used to purchase 15% equity on Greenfire Resources Ltd.⁹ The sole purpose of Spicelo is to hold the Pledged Shares as an investment entity for Mr. Klesch and no one else.¹⁰ Spicelo is "one and the same as GPOC" and exists in Alberta solely for the purpose of finding investment deals and act as a bank account for that purpose.¹¹

11. Ioannis Charalambides is retained by Mr. Klesch via his company of ICC Sovereign Group to act as a director and secretary of Spicelo due to his knowledge of Cypriot law and his 10-year business relationship with Mr. Klesch.¹² Mr. Charalambides offered the Pledged Shares in the Share Pledge on the instruction of Mr. Klesch and is expected to obtain approval from Mr. Klesch for any agreements on behalf of Spicelo.¹³ Mr. Charalambides would not sell any shares or assets without the input from

³ Cross Examination Transcript at pp 51:22 – 52:6.

⁴ Affidavit of Daryl Stepanic, affirmed January 29, 2024 at para 13.

⁵ Cross Examination Transcript at pp 21:10 – 22:6.

⁶ Cross Examination Transcript at 15:3 – 18:15.

⁷ Affidavit of Daryl Stepanic, sworn September 14, 2023 in BIA Proceedings, at para 11.

⁸ Cross Examination Transcript at pp 31:15 – 32:3.

⁹ Cross Examination Transcript at 31:15 – 32:5.

¹⁰ Cross Examination Transcript at 31:23 – 32:3.

¹¹ Cross Examination Transcript at pp 32:10 – 32:24.

¹² Cross Examination Transcript at pp 30:10 – 30:18.

¹³ Cross Examination Transcript at pp 35:14 – 36:4.

Mr. Klesch.¹⁴ Mr. Klesch maintains full control of Spicelo, Mr. Charalambides does not take any substantive steps without Mr. Klesch's knowledge and consent, and Spicelo was created to hold the Pledged Shares for Mr. Klesch and exists solely as his personal investment vehicle.

12. Similarly, Mr. Klesch is the sole shareholder of Stellion and is controlled by Mr. Klesch in the same way in which he owns and controls Spicelo.¹⁵ Stellion was registered in Alberta in order to file a Notice of Intent to Make a Proposal ("**NOI**") under the *Insolvency Act*. Stellion has partial ownership of GPCM which it acquired for nominal value.¹⁶ No funds were paid by the Griffon Entities to acquire the assets from TVE outside of legal costs and a Texas Reserve Report by a 3rd party.

13. Each of the Griffon Entities, Stellion and Spicelo were incorporated between April 6 and July 11, 2022, just prior to the transaction with TVE as described below.

The Asset Purchase and Sale Transaction

14. In or around July of 2022, TVE entered into negotiations with GPOC for the purchase of certain of GPOC's oil and gas assets located in Alberta and Saskatchewan (the "**TVE Transaction**").

15. Mr. Klesch was involved in the negotiation process with TVE on behalf of GPOC and Spicelo along with Elliott Choquette including negotiation of terms of the Loan Agreement (defined below).¹⁷ Further demonstrating Mr. Klesch's control and ownership over GPOC, Spicelo, and Stellion, he offered the Pledge Shares to TVE as part of the TVE Transaction to enable GPOC acquire the assets from TVE.

16. As part of the TVE Transaction, Mr. Klesch reviewed the Share Pledge, consulted legal counsel, and understood that the purpose of the Share Pledge was to offer security to the lenders. He also understood that if GPOC was in technical default that Spicelo would have been required to pay out the Pledged Shares, which was the only guarantee pledged which had asset value.¹⁸

17. As GPOC did not have nor contribute any cash or assets to complete the TVE Transaction, it required financing which it obtained from the Lenders and TVE.¹⁹

18. Despite being the entity that received the assets as a result of the TVE Transaction, GPOC had no assets and did not pay any cash for TVE's assets. The only asset of value which was pledged to support the TVE Transaction was the Pledged Shares.²⁰

¹⁴ *Ibid.*

¹⁵ Cross Examination Transcript at pp 38:23 – 39:10.

¹⁶ Cross Examination Transcript at pp 40:19 – 41:3.

¹⁷ Cross Examination Transcript at pp 42:18-21, 45:16 – 45:25; Email from Jonathan Klesch to Arun Chandrasekaran and Rahim Daredia, dated May 30, 2022, Exhibit 3 of Cross Examination Transcript.

¹⁸ Cross Examination Transcript at pp 46:16 – 48:23.

¹⁹ Stepanic January 29 Affidavit, at para 24; Affidavit of David Gallagher, sworn October 17, 2023, at para 11.

²⁰ Cross Examination Transcript at pp 57:7 – 57:21.

19. With the Lenders, GPOC entered into a Loan Agreement dated July 21, 2022, and amended as of August 31, 2022 (collectively, the “**Loan Agreement**”), whereby the Lenders agreed to advance USD\$35,869,565.21.²¹

20. Pursuant to the Loan Agreement, the Lenders are GPOC’s senior secured creditors with a security interest in all of GPOC’s present and future real and personal property.

21. As security for payment of performance of GPOC’s obligations under the Loan Agreement, Mr. Klesch offered the Pledged Shares (defined below) he beneficially owns through Spicelo.²²

22. Spicelo and the Lenders entered into the Share Pledge, pursuant to which Spicelo pledged all of the common shares it holds in Greenfire Resources Ltd. as collateral (the “**Pledged Shares**”).²³ In the recitals to the Share Pledge, the close business and financial relationship of Spicelo and GPOC is expressly acknowledged, as is the “substantial direct and indirect benefits” Spicelo will derive from the TVE Transaction.

23. Under the terms of the Share Pledge,

- (a) Spicelo, jointly and severally, irrevocably and unconditionally guarantees to the Lenders the due and punctual payment, and the due performance, of GPOC’s obligations (defined as including all debts and liabilities) under the Loan Agreement;
- (b) In the event GPOC does not duly perform any obligations under the Loan Agreement, Spicelo, as a separate and distinct obligation, will:
 - (i) Indemnify and save harmless the Lenders from and against all losses resulting from the failure of GPOC to perform its obligations;
 - (ii) perform said obligations as the primary obligor;
- (c) in the event of a default by GPOC of the Loan Agreement, *inter alia*, Spicelo will pay and perform all obligations and pay all amounts payable by GPOC to the Lenders, and the obligation to do so arises immediately after demand for such payment or performance is made in writing to it;
- (d) the Lenders may, without consent of or notice to Spicelo, exercise or enforce or refrain from exercising or enforcing any right or security against Spicelo or GPOC;
- (e) the Lenders are not obliged to exhaust their recourse against, *inter alia*, any other security it may hold before realizing upon the Pledged Shares;
- (f) Spicelo acknowledges that the Pledged Shares may be disposed of in whole or in part; and

²¹ Affidavit No. 1 of Matthieu Milandri, sworn on March 18, 2024, at para 8 and Exhibit “C”.

²² *Ibid*, at para 9 and Exhibit “D”.

²³ Stepanic January 29 Affidavit at para 41(c) and Exhibit “M”.

- (g) the Lenders are entitled to realize upon the Pledged Shares by sale, transfer, delivery or the appointment of a receiver over the Pledged Shares.²⁴

24. The TVE Transaction was also financed by TVE pursuant to a Subordinated Secured Promissory Note in the amount of \$20 million plus interest granted by GPOC in favour of TVE (the “**Promissory Note**”), pursuant to which TVE has a second priority security interest in all of GPOC’s present or after-acquired property, subordinate only to the security interests in same granted to the Lenders.²⁵

25. TVE is not a party to any share pledge agreement with Spicelo.

26. As such, TVE’s sole source of recovery of the amount owing by GPOC under the Promissory Note is from the proceeds of the SISF, as defined below.

Default by GPOC

27. At around the time the Griffon Entities entered into the TVE Transaction, they were attempting to negotiate three other transactions,²⁶ despite being heavily indebted to both the Lenders and TVE.

28. Unsurprisingly, within four months of entering into the Loan Agreement, GPOC defaulted on same.²⁷

29. GPOC and Spicelo were aware that, aside from the operation of the Viking assets obtained from TVE in the TVE Transaction, they had no means to repay the Loan Agreement or the Promissory Note and despite the 3-year repayment period, attempted to renegotiate the Promissory Note to more favourable terms almost immediately as it was “a very expensive piece of paper” which Mr. Klesch had “to get rid of as fast as we can”.²⁸

30. From in or around May of 2023 to August of 2023, GPOC and the Lenders entered into discussions regarding a potential forbearance and refinancing of the Loan Agreement. During these discussions, Mr. Klesch offered to refinance the Loan Agreement by offering various combinations of the dividend on the Greenfire Shares, the equivalent value of \$20 million dollars in Greenfire Shares to the Lenders, along with payments financed by third party lenders to satisfy the amounts owing to the Lenders.²⁹

31. No such proposals were made to TVE. Rather, Mr. Klesch stated that if the Lenders took steps to formally enforce the Loan Agreement, it “...could be a good option to eliminate the Tamarack

²⁴ *Ibid.*

²⁵ Affidavit of Daryl Stepanic, sworn on September 14, 2023, at Exhibit “N”.

²⁶ Affidavit of Daryl Stepanic, sworn January 29, 2024, at para 54.

²⁷ Affidavit of Daryl Stepanic, sworn January 29, 2024 at para 65.

²⁸ Cross Examination Transcript at pp 49:2 – 49:14.

²⁹ Affidavit of Daryl Stepanic, sworn September 14, 2023 at Exhibit “V”; Affidavit of David Gallagher, sworn September 19, 2023 at Exhibit “C” (the “Gallagher September 19 Affidavit”).

note.”³⁰ The disregard for TVE’s interests under the Promissory Note have continued in the insolvency proceedings before this Honourable Court.

32. Ultimately, the Lenders and GPOC could not come to an agreement to forbear or refinance the Loan Agreement.

33. On August 16, 2023, the Lenders enforced upon their rights under the Loan Agreement and the Share Pledge and issued Demands for Payment and Notices of Intention to Enforce Security pursuant to section 244 of *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 (the “**BIA**”) to GPOC, Spicelo, and all other debtors and guarantors in these proceedings (GPHC, GPCM, Stellion, 2437801 Alberta Ltd., 2437799 Alberta Ltd., 2437815 Alberta Ltd., collectively with GPOC and Spicelo, the “**Debtors**”), demanding payment for the full amount owing under the Loan Agreement by GPOC (the “**Section 244 Notice**”).

34. As noted in the Debtors’ Bench Brief in support of the Debtors’ Application, filed March 18, 2024 at para 14, on August 23, 2023, in response to the Lenders’ issuance of the Section 244 Notice to enforce the Loan Agreement and Share Pledge,³¹ the Debtors filed NOIs. Spicelo registered as an extra-provincial corporation in the Province of Alberta in order to do so. Previously, it had only been registered in the Republic of Cyprus.

The NOI and CCAA Proceedings

35. On August 25, 2023, the Debtors (including the newly-registered Spicelo) filed Notices of Intention to Make a Proposal under the BIA (the “**NOI Proceedings**”).

36. In the course of the NOI Proceedings, counsel for the Debtors stated that, operationally, they are all related entities.³² At the hearing on September 22, 2023, counsel for the Debtors stated:³³

... Jonathan Klesch is the ultimate beneficial owner of the shareholder of Stellion. Spicelo is a related company to Stellion. And the relationship between the GPOC group of companies and Spicelo is that Spicelo granted a guarantee and a share pledge in respect of the GPOC debt.

...

So these companies are all part of the same facility. Operationally, they're separate. Spicelo is not involved in the oil and gas play that GPOC is involved in. But in terms [of] this financing, they're all in the same boat. Because the GPOC companies are the borrowers and guarantors of the credit agreement and Spicelo is a guarantor of that same credit agreement.

³⁰ Gallagher September 19 Affidavit at Exhibit “C”.

³¹ Debtors’ Bench Brief in support of the Debtors’ Application, filed March 18, 2024 at para 14.

³² Affidavit of David Gallagher, sworn January 29, 2024 at Exhibit “D”, transcript from hearing on September 22, 2023 at p. 9, l 38-40.

³³ Affidavit of David Gallagher, sworn January 29, 2024 at Exhibit “D”, p. 10, l 8-13 and l 17-21.

37. Further, counsel for the Monitor, Alvarez & Marsal Canada Inc. (“A&M”), stated that, with respect to Spicelo, it is “...an important party here, and they are an insolvent entity with common ownership and common interests. They’re part of the bundle of companies”.³⁴

38. Furthermore, repeated assurances were given by Debtors’ counsel that the Lenders would be repaid in full through the NOI Proceedings, either following a successful a sale and investment solicitation process (“**SISP**”) or in the event of a liquidation of the Debtors’ assets:³⁵

... And to grant the stay extension today will allow the debtors to do a number of things. It will allow them to undertake [the] SISP that is described in our materials to pay the lenders out and the lenders will get paid out every penny they are owed. Every penny. And they will get paid out every penny they are owed before the maturity date under the credit agreement. Under the credit agreement, they wouldn't get paid out until 2025.

...

Either the SISP will be successful and they will get paid out every penny on the dollar, or the SISP isn't successful in which case this whole thing goes into liquidation and they get paid out based on their over-collateralized position. Under either scenario, they get paid out.

39. With respect to TVE, GPOC has stated in these proceedings that the Pledged Shares “...alone should be sufficient to satisfy all obligations due and owing both to the Lenders and Tamarack [TVE]...”³⁶

40. However, aside from that statement, throughout the NOI Proceedings and as continued in the within proceedings under the *Companies’ Creditors Arrangement Act*, RSC 1985, c C-36 (the “**CCAA**”), no such assurances have been made to TVE regarding repayment of any of the amount owing under the Promissory Note. Rather, as foretold by Mr. Klesch, these insolvency proceedings appear to be a “good option” to eliminate or disregard the Promissory Note.

41. On October 18, 2023, an Order was granted by this Honourable Court approving the SISP through which GPOC’s assets were to be marketed and sold.

42. The SISP was extended on several occasions without a proposal being put to the Lenders and TVE prior to the expiry of the NOI Proceedings.

43. On February 7, 2024, an Initial Order and an Amended and Restated Initial Order were granted by this Honourable Court to allow the NOI Proceedings to continue under the CCAA proceedings and

³⁴ *Ibid*, at p 81

³⁵ Affidavit of David Gallagher, sworn January 29, 2024 at Exhibit “D”, p. 20, l 27-36 and p. 21, l 1-7.

³⁶ Affidavit of Daryl Stepanic, sworn September 14, 2023, at para 71.

staying proceedings until March 6, 2024, with a view of concluding the SISP for the benefit of the Lenders and TVE (collectively, the “**Initial Orders**”).

44. On February 22, 2024, a successful bid under the SISP was selected by the Monitor, Alvarez & Marsal Canada Inc. (the “**Monitor**”).

45. In the within CCAA proceedings, a successful bidder in the SISP process has been selected and the Monitor has advised that it does not anticipate there will be sufficient funds to satisfy all of the obligations owing by GPOC to the Lenders as senior secured creditors³⁷, let alone amounts owing to TVE. As of the date of this application, the Lenders and Tamarack are collectively owed in excess of CAD\$74 million.

46. The issues of marshalling and subrogation were raised by TVE at the hearing before this Honourable Court on February 6, 2024, and leave to bring the within application prior to any sale of the Pledged Shares was expressly granted in the Initial Order.

47. A determination of whether the doctrines of marshalling and subrogation are required as the SISP reaches its conclusion, funds become available for distribution, and the total amount of the shortfall available to TVE and the Lenders becomes known.

III. ISSUES

48. The issues to be determined in this Application are:

- (a) Whether the doctrine of marshalling applies such that the Lenders must realize upon the Pledged Shares in full prior to realizing upon the proceeds from the SISP; and
- (b) Whether Spicelo is entitled to subrogate to the Lenders’ security position as against GPOC in priority to TVE, or at all.

IV. LAW AND ARGUMENT

The Doctrine of Marshalling

49. The equitable doctrine of marshalling dictates that, if a creditor has two funds to draw upon to satisfy a debt, the court will require it to take satisfaction from that fund upon which another creditor has no security.³⁸ It is a doctrine whereby equity assumes that the senior creditor “would want to act honourably, and not capriciously, by leaving as much as possible” for the junior creditor.³⁹

50. In *Condominium Corp. No. 082 6970 v. 1117398 Alberta Ltd.* (“**111 Alberta Ltd**”), this Court stated with respect to the doctrine of marshalling and the requirements for its application as follows:⁴⁰

Marshalling is a doctrine rooted in a longstanding principle of equity which essentially provides that a “senior” creditor, or a creditor with access to multiple funds to satisfy

³⁷ Second Report of the Monitor, Alvarez & Marsal Canada Inc., at para 35.

³⁸ *Gerrow v. Dorais*, 2010 ABQB 560 at para. 21 [Tab 1].

³⁹ *Veeradon Developments Ltd.* (1988), 84 AR 364, 47 D.L.R. (4th) 446 (Alta. C.A.) at para 17 [Tab 2].

⁴⁰ *Condominium Corp. No. 082 6970 v. 1117398 Alberta Ltd.*, 2012 ABQB 233 at paras 10, 11, 43 and 44 (“**111 Alberta Ltd**”) [Tab 3].

its debt, should marshal its enforcement in such a way as to cause as little harm as possible to a "junior" creditor, or a creditor with access to only one of the same funds. Equity directs that the senior creditor look first to those funds that the junior creditor does not have access to, in order to avoid needlessly wiping out the junior creditor's security.

Marshalling requires that there be more than one fund to which the senior creditor has recourse, and these funds either belong to the same debtor or relate to the same debt. [...]

Marshalling applies where the funds belong to the same debtor, or to two or more debtors with respect to the same debt.

Marshalling will not allow prejudice to another junior creditor, such as where there is a third creditor with recourse only to fund "A". Nor will marshalling allow prejudice to the senior creditor's "paramount right" to be repaid in accordance with its debt agreement. However, the fact that marshalling requires the senior creditor to look to one fund versus the other is not prejudice: its only interest is in being repaid and it is immaterial which fund it is repaid from.

51. Marshalling is an equitable doctrine without well-defined or clear limits, and is to be applied with "flexibility, adaptability and utility".⁴¹ Of note, it is a doctrine that has not received any significant treatment by the Supreme Court of Canada, and limited treatment among appellate courts across Canada.⁴²

52. Further, it has been held that it can be considered under an application brought by the singly-secured creditor. In *Brown v. Canadian Imperial Bank of Commerce*, the Ontario High Court of Justice held that:

Although the doctrine of marshalling is usually relied upon in proceedings brought by the doubly-secured creditor, I do not think it should be limited to such cases [...]. I do not think the singly-secured creditor should be required to stand by and watch his security deteriorate [...].

The doctrine of marshalling is intended to achieve fairness. In the absence of any authority to the contrary, I can see no reason why marshalling should be denied in this case simply because the proceedings were brought by the singly-secured creditor, and he paid off the doubly-secured creditor out of a practical necessity to do so, but without any legal obligation.

53. The factors to be considered when applying the doctrine of marshalling include the following:

⁴¹ *House v Baird*, 2019 ONSC 1712 (ON SCJ) at para 37 [Tab 4].

⁴² *Wolfe et al v Taylor et al*, 2020 MBCA 44 at para 34 [Tab 5].

- (a) There must be at least two creditors;⁴³
- (b) The creditors must be indebted to the same debtor, known as the "single common debtor rule",⁴⁴ subject to an exception where a surety is involved;
- (c) The debtor must have two funds and the senior creditor must hold security over both funds, while the junior creditor has security in only one;⁴⁵
- (d) The two funds must be in existence at the time of the marshalling;⁴⁶
- (e) The application of marshalling must not prejudice the senior creditor nor interfere with its choice of remedy to enforce its security;⁴⁷
- (f) The application of marshalling must not result in prejudice to third parties,⁴⁸ prejudice to unsecured third parties is irrelevant.⁴⁹

54. TVE submits that each of these factors are satisfied such that the doctrine of marshalling applies in the present circumstances, as detailed below.

Two Creditors

55. In these circumstances, this criterion is satisfied as there are two creditors: the Lenders and TVE.

Exception to the Single Common Debtor Rule

56. The default under the doctrine of marshalling is that the creditors must be indebted to the same or "single common" debtor.

57. However, this factor has been applied flexibly, and there is an exception in circumstances where the two funds available are from a principal debtor and a guarantor.⁵⁰

58. In the Debtors' Bench Brief in respect of the doctrine of marshalling, they argue that the surety exception to the single common debtor requirement applies only in circumstances where the senior and junior creditor are doubly-secured against a guarantor or surety, and where the senior creditor is also secured as against the principal debtor.

59. The Debtors allege that the opposite situation, whereby the senior and junior creditors both hold security against the principal, with the senior creditor also holding security against the surety, does not satisfy the surety exception to the single common debtor rule.

⁴³ *Ernst Brothers Co. v. Canada Permanent Mortgage Corp.*, 1920 CarswellOnt 144 (ON CA) at para 21 [*Ernst Bros*] [Tab 6].

⁴⁴ *Ernst Bros*, *Ibid* [Tab 6].

⁴⁵ *Ernst Bros*, *Ibid* at para 22 [Tab 6].

⁴⁶ *Spa Springs Parks Ltd. v. Mineral Water Co. of Canada Ltd. (Receiver of)* (1991), 111 NSR (2d) 71 (NS TD) at para 24 [Tab 7]; *Scott Steel Ltd. v. "Alarissa" (The)*, [1996] 2 FC 883 (Fed TD) at para 102; affirmed 1997 CarswellNat 179 (Fed TD) [Scott Steel] [Tab 8].

⁴⁷ *Ernst Bros*, at para. 22 [Tab 6].

⁴⁸ *Ernst Bros*, *Ibid* [Tab 6].

⁴⁹ *Wolfe* at para 38 [Tab 5].

⁵⁰ *Brown v. Canadian Imperial Bank of Commerce*, 1985 CarswellOnt 729 (Ont HC) [Tab 9].

60. However, the Debtors do not cite any authorities expressly prohibiting such situation from satisfying the single common debtor rule. For example, in the passage below from *Halbury's Laws of Canada* which was cited in the Ontario Superior Court decision in *Brown v Canadian Imperial Bank of Commerce* for the proposition that a surety exception exists to this single debtor rule, it states that:⁵¹

Generally, three conditions must be satisfied in order that the doctrine of marshalling may be applied as regards claims by creditors. First, the claims must be against a single debtor. If one creditor has a claim against C and D, and another creditor has a claim against D only, the latter creditor cannot require the former to resort to C unless the liability is such that D could throw the primary liability on C, for example where C and D are principal and surety.

[Emphasis added]

61. As stated, this is an *example* and does not assert that it must be the surety's assets that are doubly-secured. There is nothing barring this Honourable Court from finding that the surety exception to the single debtor rule can be applied where the principal is doubly-secured as opposed to only a surety.

62. In the United States, courts have applied an exception to the single common debtor requirement where the singly-charged funds are in the hands of the surety where: 1) the corporation is an alter ego of the corporate guarantor and the court "pierces the corporate veil"; (2) the guarantor shareholder has committed fraud or other inequitable conduct; and (3) where the pledged asset is found to be a contribution to the capital of the corporation.⁵²

63. As outlined in greater detail below, Mr. Klesch engaged in fraudulent and inequitable conduct by, among other things, causing GPOC to enter into the Promissory Note with no intention of repaying TVE, and by, at times disregarding, and other times effectively seeking to discharge, TVE's security interest in GPOC's assets in the course of his negotiations with the Lenders to refinance and renegotiate the Loan Agreement. As stated by Mr. Klesch during his cross examination, TVE's security interest in GPOC's assets constituted an "expensive piece of paper" given its interest rate which he was looking to renegotiate as soon as possible in order to maximize his recovery from GPOC.⁵³ Mr. Klesch's interest in maximizing his personal recovery arising from the default of GPOC on the Loan Agreement is also why the Pledged Shares were not part of the SISP process as Mr. Klesch felt that the shares were currently undervalued and should not be sold at this time.⁵⁴

⁵¹ *Halbury's Laws of Canada* vol 16, 4th ed., p. 962, para. 1426 [Tab 10].

⁵² *In re Field*, 226 B.R. 178, 183 (Bankr. D. S.C. 1998) (quoting *Borges*, 184 B.R. at 879, n.3) [Tab 11]; *Fundex Capital Corp. v. Balaber-Strauss* (*In re Tampa Chain Co.* [Tab 12]), 53 B.R. 772, 778-79 (Bankr. S.D.N.Y. 1985)

⁵³ Cross Examination Transcript at pp 49:11.

⁵⁴ Cross Examination Transcript at pp 66:11 – 66:18.

64. Mr. Klesch also made a necessary capital contribution to GPOC in the TVE Transaction by pledging his Pledged Shares. The Share Pledge was necessary in order for GPOC to obtain the financing required under the Loan Agreement for the purchase of TVE's assets.⁵⁵ As a condition precedent to the Loan Agreement, the Credit Parties (which include Spicelo) were to provide signed copies of the requisite Security Documents to provide a first ranking priority interest in the Collateral (i.e. the Pledged Shares) in favour of the Lenders.⁵⁶ Provision of the Pledged Shares by Mr. Klesch as a capital contribution was necessary in order for the TVE Transaction to go ahead, which is why Mr. Klesch offered the Pledged Shares to TVE and why TVE required them to move ahead with the transaction.⁵⁷

65. Further, in their Bench Brief the Debtors completely ignore the overarching equitable principles of marshalling.

66. Specifically, the case law consistently states that the doctrine of marshalling must be applied with "flexibility, adaptability and utility" with a view of ensuring that a junior or subordinate creditor's security is not needlessly wiped away.

67. In keeping with these principles, it is just and equitable in the circumstances for the Lenders to first enforce upon the Pledged Shares thus allowing TVE as a junior creditor to recoup some of its losses from GPOC.

68. Further, in the present circumstances it would not be illusory or pointless for this Honourable Court to direct that the Lenders enforce upon the Share Pledge prior to realizing upon any of the proceeds from the SISP because, as detailed below, Spicelo's right of subrogation was expressly waived under the Share Pledge and is not available to it in equity.

69. Consistent with the purpose of the equitable doctrine of marshalling, and recognizing that there is no bar to applying the surety exception where the senior and junior creditors are secured against the primary debtor, TVE submits that the surety exception to the single debtor requirement applies, especially when considering that the Debtors, by their own counsel's admission, are related for the purpose of financing the TVE Transaction and that Mr. Klesch is a director and shareholder of both GPOC and Spicelo with Mr. Klesch owning 100% of Spicelo and 79.5% of the class B shares of GPOC via Stellion. Further, Mr. Klesch stated during his cross examination that Spicelo and Stellion were set up purely as investment vehicles to allow him to hold assets and raise capital in Alberta to fund the transaction. Given Mr. Klesch's control of GPOC, Spicelo, and Stellion and that he is the owner of the Pledged Shares and the majority of the Class B shares in GPOC, there is effectively only one debtor.

⁵⁵ Affidavit of Daryl Stepanic, sworn September 14, 2023, at Exhibit "H" at Article 3.

⁵⁶ *Ibid*, at Section 4.1.

⁵⁷ Cross Examination Transcript at pp 52:21 – 54:6.

Funds Available to Senior and Junior Secured Creditors

70. In the present matter, the Lenders have access to both the Pledged Shares and the proceeds from the sale of GPOC's assets under the SISP, whereas TVE only has access to the latter. TVE does not have recourse against any of the other Debtors for the amounts owing under the Promissory Note. As such, this requirement under the doctrine of marshalling is satisfied.

The Funds Must Be In Existence

71. The funds against which the Loan Agreement and the Promissory Note will be enforced are or will be in existence imminently upon the closing of the asset sale transaction under the SISP. With respect to the Share Pledge, as per an Order of this Honourable Court pronounced on December 15, 2023 in the NOI Proceedings, the Lenders may exercise their rights under the Share Pledge (which would include enforcing upon the Pledged Shares) in the context of the ongoing NOI Proceedings which have since been continued herein under the CCAA.

No Prejudice to the Lenders

72. There is no prejudice to the Lenders through the application of the doctrine of marshalling. TVE understands that the Lenders are supportive of this application and that it is their preference to enforce upon the Share Pledge and recover the Pledged Shares rather than await the distribution of proceeds from the SISP, which will not be sufficient to satisfy the full amount owing to the Lenders by GPOC.

No Prejudice to Third Parties

73. In this case, TVE submits there is no prejudice to Mr. Klesch as a beneficial shareholder of Spicelo. First, he is just that – a beneficial shareholder – who has limited to no interests when it comes to repaying creditors, let alone secured creditors.

74. Mr. Klesch is an experienced, sophisticated businessman. He was involved in the negotiation of the terms of the Loan Agreement on behalf of GPOC, and the Share Pledge on behalf of Spicelo, acknowledged under cross examination that he was the most active partner in the Griffon Partners activities, and had effective control over Spicelo and GPOC.⁵⁸

75. The terms of the Share Pledge expressly allow for the Lenders to enforce upon the collateral, namely the Pledged Shares, in the event of GPOC's default under the Loan Agreement.

76. The fact that the Lenders, through the doctrine of marshalling, are simply enforcing upon the negotiated terms of the Share Pledge cannot now be viewed as prejudicial to Mr. Klesch.

77. Further, to allow Mr. Klesch to avoid the application of the doctrine of marshalling would be prejudicial to TVE.

⁵⁸ Cross Examination Transcript at pp 22:4-22:6, 35:14 – 36:4.

78. The doctrine of marshalling is meant to be applied flexibly and contextually, and to avoid circumstances where a junior creditor's security is "needlessly wip[ed] out".⁵⁹

79. TVE submits that the only parties facing true prejudice are TVE and GPOC's other creditors, and that preference should not be given to preserving Mr. Klesch's ownership of the Pledged Shares, especially given the non-arm's length relationships involved with the Debtors and Mr. Klesch as a director of GPOC.

Subrogation

80. Spicelo asserts that it has a right of subrogation that negates the doctrine of marshalling.

81. However, TVE submits that Spicelo expressly waived its right to subrogation under the terms of the Share Pledge negotiated by Mr. Klesch, and that in any event it is not entitled to rely on this doctrine on account of its non-arm's length dealings and fraud.

Waiver of Right of Subrogation

82. The transaction contemplated by the successful bidder under the SISP is a reverse vesting order whereby the bidder will acquire all the shares of GPOC, assume control or possession over desired regulatory licences or permits, contracts, assets, other rights and property, and dispose of those assets causing GPOC's insolvency.⁶⁰

83. Under this scenario, there would be a transfer in the entire equity of GPOC to the successful bidder.

84. However, under the terms of the Share Pledge negotiated by Mr. Klesch on behalf of Spicelo, if there is a sale, foreclosure or disposition of any of the equity securities of GPOC in connection with the exercise of the Lenders' rights and remedies under the Loan Agreement, the right of subrogation terminates. The relevant clause of the Share Pledge reads as follows:

Section 11 Suspension of Chargor's Rights.

So long as there are any Guaranteed Obligations, the Chargor will not exercise any rights which they may at any time have by reason of the performance of any of their obligations under this Agreement (i) to be indemnified by the other Credit Parties, or any of them, (ii) to claim contribution from any other guarantor of the debts, liabilities or obligations of the other Credit Parties, or any of them, or (iii) to take the benefit (in whole or in part and whether by way of subrogation or otherwise) of any rights of the Collateral Agent or the Secured Parties under any of the Credit Documents. The Chargor hereby agrees in favour of the Borrower and the other Credit Parties, that any such rights of indemnification, contribution, or subrogation terminate in the event of a

⁵⁹ 111 Alberta Ltd., *supra* note 40 at para 10 [Tab 3].

⁶⁰ Monitor's Second Report, at para 23.

sale, foreclosure or other disposition of any of the equity securities of the Borrower or any other Credit Party in connection with an exercise of rights and remedies by the Collateral Agent and the Secured Parties. The Chargor further agrees that the Borrower, the other Credit Parties and other guarantors of the debts, liabilities and obligations of the Borrower are intended third party beneficiaries of the Chargor's agreement contained in this Section 11.

[Emphasis added]

85. In the present matter, the Lenders issued Section 244 Notices to the Debtors (including GPOC and Spicelo), which precipitated their commencement of the NOI Proceedings which have been continued in the within CCAA proceedings.⁶¹ The Lenders have also been active in the NOI Proceedings and CCAA proceedings in exercising and enforcing their rights under the Loan Agreement and Share Pledge, including by bringing several applications to appoint a receiver over the Pledged Shares.

86. To repay the amounts owing to, *inter alia*, the Lenders under the Loan Agreement, GPOC engaged in the SISF, with the successful bidder structuring their bid in the form of a reverse vesting order which will require the sale or disposition of GPOC's equity to said bidder (the "**RVO**").⁶² The successful bidder has yet to execute a share purchase and sale agreement.⁶³

87. Although subrogation is an equitable remedy, it can be waived by agreement.⁶⁴ In *E C & M Electric Ltd. v. Medicine Hat General & Auxiliary Hospital & Nursing Home*, this Honourable Court cited the following passage from Halsbury's Laws of England on point:⁶⁵

193. Surety's right of subrogation. As soon as the surety has paid to the creditor what is due to the creditor under the guarantee, he is entitled, unless he has waived them, to be subrogated to all the rights possessed by the creditor in respect of the debt, default or miscarriages to which the guarantee relates.

[Emphasis added]

88. As there will be a sale of the equity of GPOC through an RVO to a successful bidder, under the terms of the Share Pledge Spicelo expressly waived its right of subrogation. Therefore, Spicelo should be precluded from advancing any subrogated claim against the proceeds of the SISF in priority to TVE, or at all.

⁶¹ Debtors' Bench Brief, at para 14.

⁶² Monitor's Second Report, at para 23.

⁶³ *Ibid*, at para 22.

⁶⁴ *Fraser River Pile and Dredge Ltd v Can-Dive Services Ltd.*, [1999] 3 SCR 108 (SCC) [Tab 13].

⁶⁵ 1987 CarswellAlta 25 (AB KB) at para 19 [Tab 14].

Subrogation and Equity

89. Further, or in the alternative, TVE submits that Spicelo is not entitled to bring a subrogated claim on the bases that Spicelo, through its beneficial shareholder and principal Mr. Klesch, engaged in fraudulent, bad-faith conduct.

90. Subrogation is an equitable doctrine whereby if a guarantor pays a creditor on behalf of a principal, the guarantor is allowed to step into the position of the creditor and bring a subrogated claim against the principal. It has been defined by Halsbury's Laws of Canada as follows:

193. Surety's right of subrogation. As soon as the surety has paid to the creditor what is due to the creditor under the guarantee, he is entitled, unless he has waived them, to be subrogated to all the rights possessed by the creditor in respect of the debt, default or miscarriages to which the guarantee relates.⁶⁶

1438. Doctrine of subrogation. Where one person has a claim against another, in certain circumstances, a third person is allowed to have the benefit of the claim and the remedy for enforcing it, even though it has not been assigned to him, and he is then said to be subrogated to the rights of the first person.⁶⁷

91. The doctrine of subrogation came into existence for the express purpose of rendering justice where an injustice would otherwise be permitted.⁶⁸ However, Canadian courts have been clear that, under the doctrine of subrogation, all of the circumstances must be balanced, and the Court must be satisfied that no injustice will be done through the substitution of one party in the place of another via a subrogation arrangement.⁶⁹

92. Given the non-arm's length relationship between Spicelo and GPOC, as well as the bad faith dealings of Mr. Klesch, TVE submits that allowing Spicelo (and namely Mr. Klesch as its sole beneficial owner and directing mind) to step into the senior secured position of the Lenders would inequitably place the interests of Mr. Klesch, a shareholder, above those of TVE, a secured creditor.

93. Specifically, allowing for the conveyance of the Lenders' senior secured position to Spicelo and to allow it to bring a subrogated claim in priority to TVE would offend the *Statute of Elizabeth* as well as the *Fraudulent Preferences Act* (the "FPA").⁷⁰

94. In this Honourable Court's decision in *Krumm v. McKay* ("Krumm"),⁷¹ Romaine J. provided a concise overview of the application of the *Statute of Elizabeth* in Alberta, noting that the purpose of this statute, and of the FPA, is to strike down any conveyances made with the intention to defeat

⁶⁶ 20 Hals. (4th ed.) 104, para. 193 [Tab 10].

⁶⁷ 16 Hals. (4th ed.) 969, para 1438 [Tab 10].

⁶⁸ *Canadian Western Bank v 1364994 Alberta Ltd*, 2021 ABQB 868 at para 87 ("CWB") [Tab 15].

⁶⁹ See: *Gerrow v Dorais*, 2010 ABQB 560 [Tab 16]; and *Alberta (Treasury Branches) v Alberta (Public Trustee)*, 2002 ABQB 781 at para 50 [Tab 17].

⁷⁰ *Fraudulent Preferences Act*, RSA 2000, c F-24("FPA") [Tab 18].

⁷¹ *Krumm v. McKay*, 2003 ABQB 437 ("Krum") [Tab 19].

creditors, except for conveyances made for good consideration and *bona fides* to persons not having notice of fraud.⁷²

95. Romaine J. further noted that the legislation must be interpreted liberally and includes any kind of transfers or conveyances made with the requisite intent no matter what the form.⁷³

96. Under the *Statute of Elizabeth*, a transfer made for nominal or no consideration is voidable if the debtor intended fraud.⁷⁴ While the *Statute of Elizabeth* includes an exception for *bona fides* transfers for consideration, it is restricted to transferees who do not have knowledge of fraud, which is not the case with Mr. Klesch.⁷⁵

97. This Court in *Krumm* noted there are “badges of fraud” that raise a *prima facie* case of a party’s intent to defraud. These badges of fraud include transfers that were made pending the creditors’ efforts to obtain judgment, instances where a close relationship existed between the parties to the transfers, and where consideration was grossly inadequate, all of which are applicable in the present circumstances given that Mr. Klesch owns Spicelo and GPOC,⁷⁶ and that Stellion (which was registered by Mr. Klesch in Alberta for the purpose of filing an NOI and making a proposal under the *BIA*⁷⁷) acquired a 25% stake in GPOC for nominal value.⁷⁸

98. Romaine J. further found that the most persuasive factor leading to a finding of fraud was the relationship between the debtor and the transferee. She applied the evidentiary rule governing cases of close relationships between a transferor and a transferee set out in *Koop v. Smith*,⁷⁹ which was that a suspicious circumstance coupled with a relationship will generally be treated as a sufficient *prima facie* case of an intent to defraud.⁸⁰ Mr. Klesch admitted that he mostly owns both the debtor GPOC and fully owns the transferee Spicelo, and that he was looking to maximize his recovery in the circumstances and get out of the Promissory Note given that it was an “expensive piece of paper”.

99. The types of close relationships covered by this rule include transactions between individuals and corporations that they control.⁸¹ Badges of fraud, and the rebuttable presumptions that arise from them, apply not only where no consideration has been exchanged, but also to situations where there has been a transfer for value.⁸²

⁷² *Ibid* at para 13 [Tab 19].

⁷³ *Ibid* citing C.R.B. Dunlop, in *Creditor-Debtor Law in Canada* (2d Ed.) (Toronto: Carswell, 1995), at page 598 (“Dunlop”) [Tab 19].

⁷⁴ *Ibid* at Dunlop at 600, 601 [Tab 19].

⁷⁵ *Krum* *supra* note 71 at para 15 [Tab 19].

⁷⁶ Cross Examination Transcript at pp 39:1.

⁷⁷ Cross Examination Transcript at pp 40:8 – 40:11.

⁷⁸ Cross Examination Transcript at pp 49:15 – 50:8.

⁷⁹ *Koop v. Smith* (1915), 1915 CanLII 26 (SCC), 8 W.W.R. 1203 (S.C. C.) (“Koop”) [Tab 20].

⁸⁰ *Koop* at 1205 [Tab 20].

⁸¹ *Burton v. R & M Insurance Ltd.* (1977), 1977 CanLII 626 (AB KB), 5 Alta. L.R. (2d) 14, 9 A.R. 589 (T.D.) [Tab 21]; *Surkan (Trustee of) v. Niton Junction Holdings Ltd.*, [1979] 3 A.C.W.S. 570, 32 C.B.R. (N.S.) 141 (Alta. Q.B.) [Tab 22].

⁸² *Krum* *supra* note 71 at para 21 [Tab 19].

100. The presumption created by a transfer involving a close relationship is an evidentiary rule, given the difficulty of a court "engaging in [a] metaphysical excursion into the debtor's state of mind" it is not unreasonable to shift the burden of adducing evidence to rebut a *prima facie* case to the debtor in circumstances where strong suspicions of a relationship that may give rise to collusion are apparent.⁸³ An intent to defraud may be inferred from all the circumstances surrounding a transaction.⁸⁴

101. Various authorities have also held that, where the debtor receives some benefit, either direct or indirect, the *Statute of Elizabeth* may be applied to set aside a conveyance.⁸⁵ In order to invoke the protection of the *Statute of Elizabeth* a fraudulent transaction must be established. To do so, an intention to defraud must be proven. In this respect, the Court may look to the badges of fraud to determine if the necessary intent existed.⁸⁶

102. In cases where there are suspicious circumstances surrounding a conveyance a legitimate explanation may be required in circumstances of suspicion.⁸⁷ The existence of one or more of the traditional 'badges of fraud' may give rise to an inference of intent to defraud in the absence of an explanation from the defendant.⁸⁸

103. In the present matter, Spicelo and the Griffon Entities are related and not at arm's length as admitted by Mr. Klesch under cross examination and elsewhere on this Court's record. Mr. Klesch further admitted under cross examination that he owns most 79.5% of, and had substantial control over, the Debtor GPOC and fully owns the transferee Spicelo. As such, Mr. Klesch is not an arm's length person to either GPOC or Spicelo as anticipated under the *BIA*.

104. Further, the CCAA adopts section 4 of the *BIA* for the purpose of determining whether a person is related to or dealing at arm's length with a debtor company. Under the *BIA*, two entities are deemed to be related if they are both controlled by the same person or group of persons. Further, if a person has an ownership interest in two entities, that person as holder of those ownership interests, is deemed to be related to themselves. Finally, section 4(5) of the *BIA* provides that, for the purposes of establishing whether persons are dealing at arm's length in a transfer at undervalue, persons who are

⁸³ *Ibid* at para 22 [Tab 19].

⁸⁴ *Rogers Realty Ltd. v. Prysiazny* (1996), 1996 CanLII 19959 (AB KB), 182 A.R. 118, 61 A.C.W.S. (3d) 862 (QB) at para. 18 [Tab 23].

⁸⁵ *Canada Life Assurance Co. v. 494708 Alberta Ltd.*, 1995 CanLII 9149 (AB KB), [1996] 1 W.W.R. 21, 173 A.R. 172 (QB) (at para 76) [Tab 24]; *Andersen Lumber Co. v. Canadian Conifer Ltd.* (1977), 1977 CanLII 1665 (AB CA), 25 C.B.R. (NS) 35, [1977] 5 W.W.R. 41 (Alta C.A.), at pp. 42-43 [Tab 25]; *Krumm*, at para 32 [Tab 19]; *Optical Recording Laboratories Inc. v. Digital Recording Corp.* (1990), 1990 CanLII 6672 (ON CA), 1 O.R. (3d) 131, 75 D.L.R. (4th) 747 (C.A.) [Tab 26].

⁸⁶ *Nuove Ceramiche Ricchetti S.p.A. v. Mastrogiovanni* (1988), 76 C.B.R. (N.S.) 310 (Ont. H.C.J.) [Tab 27].

⁸⁷ *Bank of Montreal v. Peninsula Broilers Ltd.*, [2009] O.J. No. 2129 (Ont. Sup. Ct.J.) where Quinn J., stated at paras. 82 and 93 [Tab 28].

⁸⁸ *Fancy, Re*, 1984 CarswellOnt 137, 25 A.C.W.S. (2d) 322, 46 O.R. (2d) 153, 51 C.B.R. (N.S.) 29, 8 D.L.R. (4th) 418 [Tab 29].

related to each other are, in the absence of evidence to the contrary, deemed not to deal with each other at arm's length.

105. Regarding the term "arm's length", it is not defined in the CCAA or the BIA. Courts in Alberta have adopted the definition set forth in the *Income Tax Act* (the "*ITA*")⁸⁹ when interpreting the BIA provisions, as the *ITA* definition of "non-arm's length" and the BIA definition of "related persons" are similar.

106. In *Piikani Nation v. Piikani Energy Corp.*⁹⁰, the Alberta Court of Appeal considered *Canada v McLarty* ("*McLarty*").⁹¹ In *McLarty*, Rothstein J discussed the term "not dealing at arm's length" in section 69 of the *ITA*. Justice Rothstein stated that the general concern in non-arm's length transactions is that "there is no assurance that the transaction 'will reflect ordinary commercial dealing between parties acting in their separate interests'".⁹² Thus, the *ITA* provisions dealing with non-arm's length parties are "intended to preclude artificial transactions from conferring tax benefits on one or more of the parties".⁹³ Justice Rothstein also cited from the Canada Revenue Agency Income Tax Interpretation Bulletin IT-419R2 "Meaning of Arm's Length" (June 8, 2004) for criteria generally used by the courts in determining whether parties to a transaction are not dealing at "arm's length":

- was there a common mind which directs the bargaining for both parties to a transaction;
- were the parties to a transaction acting in concert without separate interests;
- and
- was there "*de facto*" control.

107. In the present matter, by their own admission, the Debtors are all related. Mr. Klesch is the sole beneficial shareholder of Spicelo and its controlling and directing mind. He is also a beneficial shareholder, director and controlling mind of GPOC.

108. When the Share Pledge was granted, Mr. Klesch was aware of the subrogation rights it possessed as against GPOC, and did not disclose that to TVE in the course of negotiating and finalizing the TVE Transaction.

109. He also had no intention of repaying TVE on its Promissory Note. After GPOC's near-immediate default under the Loan Agreement and Promissory Note, Mr. Klesch's primary focus was negotiating a forbearance and refinancing of the Loan Agreement. He did not engage in meaningful negotiations with TVE on repayment of the Promissory Note. Rather, he saw an opportunity, through

⁸⁹ *Income Tax Act* (R.S.C., 1985, c. 1 (5th Supp.)) [Tab 30].

⁹⁰ *Piikani Nation v. Piikani Energy Corp.* 2013 ABCA 293 [Tab 31].

⁹¹ 2008 SCC 26 [Tab 32].

⁹² *Ibid* at para 43 citing *Swiss Bank Corp. v. Minister of National Revenue* (1972), [1974] S.C.R. 1144 (S.C.C.), at 1152 [Tab 33].

⁹³ *Ibid* at para 43 [Tab 33].

these NOI and CCAA proceedings, stating that it was a good option to eliminate the Promissory Note with TVE, which he considered an expensive piece of paper.

110. Mr. Klesch structured the TVE Transaction in such a manner that would ensure that upon the inevitable default of GPOC on the Loan Agreement and Promissory Note, his interests would be protected to the prejudice of TVE.

111. In these circumstances, Mr. Klesch is attempting to use subrogation as a sword to benefit himself, not remedy a hardship. There should not be a conveyance of the Lenders' senior secured position to Spicelo to allow it to advance a subrogated claim against GPOC. There are sufficient badges or indices of fraud that should preclude Mr. Klesch to benefit from the equitable doctrine of subrogation. These badges of fraud include:

- (a) Mr. Klesch's control and ownership of Spicelo, Stellion, and in GPOC;
- (b) Spicelo offering the Pledged Shares to enable GPOC to transact in the market, including entering into the Loan Agreement without receiving anything in return;
- (c) Mr. Klesch providing the \$250,000.00 in funds for the Pledged Shares to be purchased by Spicelo;
- (d) Mr. Klesch entering into the Share Pledge with subrogation rights allowing him to recover from GPOC in advance of his creditor TVE effectively removing any security TVE had bargained for in the TVE transaction;
- (e) Mr. Klesch's acknowledgment that as the founder of Griffon Partners he was the most active participant in it;
- (f) Mr. Klesch's testimony under cross examination that the Promissory Note constituted an "expensive piece of paper" which he was looking to "get rid of it as fast as we can"; and
- (g) Mr. Klesch incorporated Spicelo in Cyprus via a bare trust and admitted that he was still the controlling mind of Spicelo and needed to be consulted on any and all substantive decisions despite the involvement of Mr. Charalambides.

The Doctrine of Equitable Subordination

112. Equitable subordination is a doctrine originating in the United States that allows a court "to subordinate otherwise valid claims to those of other creditors on equitable ground relating to the conduct of those creditors *inter se*".⁹⁴ The Supreme Court of Canada described the three requirements for relief under the doctrine as follows:

- (1) the claimant must have engaged in some type of inequitable conduct;

⁹⁴ *Canada Deposit Insurance Corp. v Canadian Commercial Bank*, 1992 CanLII 49 (SCC), [1992] 3 S.C.R. 558 at p. 609 ("CBB") [Tab 34].

- (2) the misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant; and
- (3) equitable subordination of the claim must not be inconsistent with the provisions of the bankruptcy statute.

113. Although the application of this doctrine has been inconsistent,⁹⁵ it has not been held by the Supreme Court of Canada to be of no force and effect in this country.⁹⁶ Further, there are instances where it has been applied to subordinate a creditor's claim where there is evidence of fraud.⁹⁷

114. When considering the first factor, inequitable conduct, Courts have looked at whether a creditor committed or engaged in fraud.⁹⁸

115. In this case, as outlined below, Mr. Klesch engaged in fraudulent conduct throughout his involvement in the negotiation of the Loan Agreement and Share Pledge, through which he positioned his interests to be protected in priority to TVE's when GPOC inevitably defaulted. Mr. Klesch never intended for TVE to be repaid on the Promissory Note, and this Court should exercise its inherent jurisdiction to avoid allowing Mr. Klesch to benefit from his fraud.

116. That Mr. Klesch was attempting to gain an interest in or potentially repurchase the assets sold in the TVE Transaction for a significant discount exemplifies his fraudulent, bad faith conduct. TVE submits that this Court should exercise its discretion under section 18.6(1) of the CCAA and not permit Mr. Klesch, through Spicelo, to subrogate against the GPOC estate to the prejudice of TVE.

117. When asked under oath whether he was directly involved in negotiations with bidders in the SISP process, Mr. Klesch stated that it was in his best interest to maximize the value of his recovery from GPOC.⁹⁹ While Mr. Klesch denied being involved in negotiations, talking with, or offering financing to bidders in the SISP process he admitted that he had intended to bid on the GPOC asset at a certain stage but decided against it.¹⁰⁰

118. Regarding the second factor, misconduct resulting in injury to creditors or an unfair advantage to the claimant, it is clear that Mr. Klesch's misconduct will injure TVE and cause himself and Spicelo to gain an unfair advantage. TVE is at risk of not recovering any of the over \$23 million secured debt owed to it, while Mr. Klesch potentially stands to forfeit only a portion of the Pledged Shares to satisfy debts in excess of \$73 million arising from the TVE Transaction he orchestrated. A shareholder's interests should not trump those of a secured creditor.

⁹⁵ *Alberta Energy Regulator v Lexin Resources Ltd*, 2018 ABQB 590, at para 89 [Tab 35].

⁹⁶ *CBB*, *supra* note 94 at para 96 [Tab 34].

⁹⁷ *Lloyd's Non-Marine Underwriters v JJ Lacey Insurance Ltd*, 2009 NLTD 148 ("Lloyd's") [Tab 36].

⁹⁸ *Lloyd's*, *supra* note 97 at para 16; *Re Pine Valley Mining Corp*, 2007 BCSC 926, at para 42 [Tab 36].

⁹⁹ Cross Examination Transcript at pp 62:8 – 62: 17.

¹⁰⁰ Cross Examination Transcript at pp 62:18 – 63: 3.

119. Finally, in considering whether applying the doctrine of equitable subordination would be inconsistent with the CCAA, in *Lloyd's Non-Marine Underwriters v JJ Lacey Insurance Ltd.* the Supreme Court of Newfoundland and Labrador Trial Division noted that, by subordinating the fraudulent unsecured creditor to the claims of all other unsecured creditors, it would not be bringing the distribution scheme under the *BIA* into "chaos". Rather, it would only affect the rights of the unsecured creditors relative to each other. In the present matter, the Lenders and TVE are the primary secured creditors whose priority follows only those with Court-ordered or statutory super-priorities. By subordinating Spicelo's potential subrogated claim to the TVE's secured claim, it would not otherwise disrupt or offend the distribution scheme in this CCAA proceeding as Spicelo is attempting to transform itself into a secured creditor.

120. TVE therefore submits that in the event Mr. Klesch is found to have a subrogated claim through his investment company, Spicelo, any such claim should be equitably subordinated to TVE's secured claim for amounts owing under the Promissory Note it negotiated with Mr. Klesch in good faith, to its detriment.

V. CONCLUSION

121. TVE submits that the doctrine of marshalling applies, and that as such the Lenders must enforce against the Share Pledge negotiated and granted by Spicelo in satisfaction of the debt owed by GPOC prior to recovering any of the proceeds available under the SISP.

122. TVE further submits that Spicelo, by virtue of the terms of the Share Pledge it negotiated and by reason of equity, should not be entitled to advance any subrogated claim against the SISP proceeds. In the event Spicelo is entitled to bring a subrogated claim, equity demands it should be subordinated to TVE's secured claim.

123. The relief sought would maximize the recovery of the amounts owed by GPOC to the Lenders, TVE and GPOC's other creditors, enforce the terms of agreements negotiated by sophisticated parties, and would ensure the most equitable outcome for all relevant stakeholders.

ALL OF WHICH IS RESPECTFULLY SUBMITTED at Calgary, Alberta this 3rd day of April, 2024.

STIKEMAN ELLIOTT LLP

Per:



Matti Lemmens

Counsel to Tamarack Valley Energy Ltd.

VI. TABLE OF AUTHORITIES

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