COURT FILE NUMBER	25-81252
COURT	COURT OF QUEEN'S BENCH OF ALBERTA
JUDICIAL CENTRE	CALGARY
	IN THE MATTER OF THE *BANKRUPTCY AND INSOLVENCY ACT*, RSC 1985, c B-3, AS AMENDED AND IN THE MATTER OF THE BANKRUPTCY OF TRAKOPOLIS IoT CORP. AND IN THE MATTER OF THE BANKRUPTCY OF TRAKOPOLIS SaaS CORP.
APPLICANT	ESW HOLDINGS INC.
RESPONDENT	THE TRUSTEE IN BANKRUPTCY of the ESTATE OF TRAKOPOLIS IOT CORP. and the ESTATE OF TRAKOPOLIS SAAS CORP.
PARTY FILING THIS DOCUMENT	THE TRUSTEE IN BANKRUPTCY of the ESTATE OF TRAKOPOLIS IOT CORP. and the ESTATE OF TRAKOPOLIS SAAS CORP.
DOCUMENT	**BRIEF OF LAW AND ARGUMENT OPPOSING THE APPEALS OF ESW HOLDINGS INC. FROM NOTICES OF DISALLOWANCE**
ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT	Torys LLP 4600 Eighth Avenue Place East 525 - Eighth Ave SW Calgary, AB T2P 1G1 Attention: Kyle Kashuba / Mihai Tomos Telephone: + 1 403.776.3744 / +1 403.776.3796 Fax: +1 403.776.3800 Email: kkashuba@torys.com / mtomos@torys.com File No. 39108-2005

TABLE OF CONTENTS

PART I – OVERVIEW

1. Alvarez & Marsal Canada Inc., in its capacity as licensed insolvency trustee (and not in its personal or corporate capacity) is the trustee in bankruptcy (the "**Trustee**") of the estate of Trakopolis IoT Corp. ("**Trak IoT**") and the estate of Trakopolis SaaS Corp. ("**Trak SaaS**").

2. ESW Holdings Inc. ("**ESW**"), a creditor of Trak IoT and Trak SaaS, submitted to the Trustee a Proof of Claim against Trak IoT (the "**ESW IoT Claim**") and a Proof of Claim against Trak SaaS ("**ESW SaaS Claim**" and, together with the ESW IoT Claim, the "**ESW Claim**"), with respect to a warrant to purchase shares issued to ESW by Trak IoT (the "**Warrant**"). The Warrant was issued in connection with a loan agreement between ESW and Trak IoT.

3. ESW is claiming the sum of USD $600,000 against Trak IoT pursuant to the Warrant and is seeking the same amount against Trak SaaS pursuant to a guarantee granted by Trak SaaS with respect to the indebtedness of Trak IoT owing to ESW (the "**SaaS Guarantee**"). ESW is taking the position that the ESW Claim is a debt claim, as opposed to an equity claim, for the purpose of priority and distribution of dividends under the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 (the "**BIA**"). Following a sale transaction that occurred in the BIA proposal proceedings of Trak IoT and Trak SaaS, ESW was repaid their secured debt owing pursuant to the ARLA (as defined below) in full (i.e. inclusive of interest and costs). They have reserved their rights with respect to the certain additional claims for other amounts that they claim to be owed under the Warrant.

4. Pursuant to Notices of Disallowance issued by the Trustee on March 29, 2020 with respect to each of the ESW IoT Claim and the ESW SaaS Claim (together, the "**Notices of Disallowance**"), the Trustee rejected:

   (a) the ESW IoT Claim on the basis that it is an equity claim pursuant to s. 140.1 of the BIA and the applicable definitions included therein; and

   (b) the ESW SaaS Claim on the basis that (i) it is an equity claim pursuant to s. 140.1 of the BIA and the applicable definitions therein, and (ii) the SaaS Guarantee is

invalid and, as such, there are no grounds for ESW to seek against Trak SaaS the repayment of any indebtedness owing by Trak IoT to ESW.

5. ESW is appealing the Trustee's Notices of Disallowance. The Trustee is seeking an Order dismissing ESW's appeal and upholding each Notice of Disallowance.

6. The Trustee's position is based on the unambiguous wording of the BIA, which explicitly states that (i) an "equity claim" is a claim that is in respect of an equity interest, and (ii) an "equity interest" includes a *warrant* to acquire a share in a corporation. Further, the Trustee submits that the SaaS Guarantee is not enforceable in respect of the ESW SaaS Claim based on the express wording of the ARLA (as defined below) and an Acknowledgment entered in relation thereto.

7. The Trustee is not taking any particular issue with ESW's request to have this Honourable Court consider the evidence contained in the Affidavit of Neeraj Gupta, sworn on April 22, 2020. This additional evidence, which has been compiled to further bolster ESW's claims, contains new allegations and position-based comments that the Trustee does not support or agree with.

PART II - FACTS

8. ESW, as lender, Trak IoT, as borrower, and Trak SaaS, as guarantor, entered into a Loan and Security Agreement dated November 15, 2018 (the "**LSA**"). The SaaS Guarantee, pursuant to which Trak SaaS guaranteed the obligations of Trak IoT to ESW, was executed in connection with the LSA.

9. Subsequently, ESW, as lender, Trak SaaS, as borrower, Trak IoT and Trakopolis USA Corp., as guarantors, entered into an Amended and Restated Loan Agreement dated November 27, 2018 (the "**ARLA**"), which contains an "entire agreement clause". The relevant provisions of the ARLA are reproduced in Part IV below.

10. In connection with the ARLA, ESW, as lender, Trak SaaS, as borrower and obligor, and Trak IoT, as obligor, entered into an Acknowledgment dated November 27, 2018 (the

"**Acknowledgment**"), pursuant to which Trak SaaS and Trak IoT agreed that certain documents remained in full force and effect notwithstanding the ARLA and the "entire agreement clause" entered therein.

11. Following a sale transaction that occurred in the BIA proposal proceedings of Trak IoT and Trak SaaS, ESW was repaid their secured debt owing pursuant to the ARLA (as defined below) in full (i.e. inclusive of interest and costs).

12. On February 12, 2020, ESW submitted the ESW Claim to the Trustee, pursuing payment of the amounts owing under the Warrant.

13. On March 29, 2020 the Trustee issued the Notices of Disallowance.

14. ESW did not include the Acknowledgment in the ESW Claim. Rather, ESW included this document in the Affidavit of Neeraj Gupta sworn April 22, 2020 that was provided to the Trustee along with ESW's Notice of Appeal.

PART III – ISSUES

15. The Trustee does not oppose ESW's request that this Court consider the Supplemental Evidence (as such term is defined in ESW's Brief). The Trustee also does not take a position on whether the appeal should be heard *de novo* or as a hybrid appeal.

16. In the event that this Honourable Court decides to hear ESW's appeal as a hybrid appeal, the Trustee agrees that the applicable standard of review is correctness.

17. Based on the foregoing, the Trustee submits that the following issues are disputed and must be determined by this Honourable Court:

    (a) is the ESW Claim a debt claim or an equity claim for the purposes of priority and distribution under the BIA?; and

    (b) if the ESW SaaS Claim is a debt claim, is the SaaS Guarantee enforceable with respect to the ESW SaaS Claim?

PART IV – LAW AND ARGUMENT

A. The ESW Claim is an Equity Claim

(i) Statutory Provisions

18. The ESW Claim is subject to s. 140.1 of the BIA, which states that "A creditor is not entitled to a dividend in respect of an equity claim until all claims that are not equity claims have been satisfied."

19. The relevant definitions are set out in section 2 of the BIA:

> ***equity claim*** means a claim that is in respect of an equity interest, including a claim for, among others,
>
> (a) a dividend or similar payment,
>
> (b) a return of capital,
>
> (c) a redemption or retraction obligation,
>
> (d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or
>
> (e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d);
>
> ***equity interest*** means
>
> (a) in the case of a corporation other than an income trust, a share in the corporation — or a warrant or option or another right to acquire a share in the corporation — other than one that is derived from a convertible debt, and
>
> (b) in the case of an income trust, a unit in the income trust — or a warrant or option or another right to acquire a unit in the income trust — other than one that is derived from a convertible debt;

20. Parliament enacted the foregoing provisions in September 2009 pursuant to substantial amendments to the BIA. Similar amendments were enacted in respect of the *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 (the "**CCAA**"). The definitions of "equity claim" and "equity interest" in the BIA and the CCAA are identical.[1]

21. The words "in respect of" have been held by the Supreme Court of Canada to be words of the broadest scope that convey some connection between two subject matters.[2]

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[1] Section 2 of the BIA. [TAB A]; Section 2(1) of the CCAA. TAB [B]

[2] *Nowegijick v. The Queen*, [1983] 1 S.C.R. 29 at para 30. [TAB C]

(ii) Common Law

22. In *Sino-Forest,*[3] the claim at issue was an equity claim pursuant to subsections (d) and (e) of s. 2(1) of the CCAA. Justice Morawetz opined that the amendments to the CCAA pursuant to which the definitions of "equity claim" and "equity interest" were enacted "codified the treatment of claims addressed in pre-amendment cases and have further broadened the scope of equity claims".[4]

23. On appeal, the Ontario Court of Appeal upheld Justice Morawetz's decision and further held that "the definition of "equity claim" is sufficiently clear to alter the pre-existing common law."[5]

24. In *Re Bul River*[6], the Court held that the 2009 BIA amendments have not affected the ability of the Court to continue to analyze the substance of the claims. However, the Court also held that this analysis is to be conducted in the context of the expanded definition of "equity claim":

> Accordingly, while the 2009 amendments did represent in part a codification of the previous case law concerning equity claims, it also represented a more concrete definition of "equity claims" and by such definition a broadening and more expansive definition of such claims: *Sino-Forest Corporation* (ONCA) at paras. 24, 34-60. Parliament has now clearly cast the net widely in terms of the broad definition of equity claims such that claims that might have previously escaped such characterization will now be caught by the CCAA.

25. Accordingly, a Court may still assess the substance of the ESW Claim – however, such analysis must be made in light of the relevant definitions included in the BIA and Parliament's unequivocal intention to alter the pre-existing common law.

(iii) The ESW Claim is an "equity claim" under the clear statutory amendments to the BIA and the applicable common law

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[3] *Sino-Forest Corporation (Re),* 2012 ONSC 4377. [TAB D]

[4] *Ibid* at para 78. [TAB D]

[5] *Sino-Forest Corp., Re*, 2012 ONCA 816 at para 53. [TAB E]

[6] *Re Bul River Mineral Corp.*, 2014, BCSC 1732 at para 82. [TAB F]

26. The *Canada Deposit*[7] decision on which ESW's argument rests was determined *prior* to the 2009 BIA amendments. The statutory language and the fact that the legislative amendments came into force after the cases relied upon by ESW are critical to this Court's analysis of whether the ESW claim is an "equity claim". The foregoing is the approach adopted in *Sino-Forest*, where Justice Morawetz held that:[8]

> Critical to my analysis of this issue is the statutory language and the fact that the CCAA Amendments came into force after the cases relied upon by the Underwriters and the auditors.

27. Justice Morawetz further concluded that:

> 87 It has been argued that the amendments did nothing more than codify pre-existing common law. In many respects, I accept this submission. However, I am unable to accept this submission when considering s. 2(1) of the CCAA, which provides clear and specific language directing that "equity claim" means a claim that is in respect of an equity interest, including a claim for, among other things, "(e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d)".
>
> 88 Given that a shareholder claim falls within s. 2(1)(d), the plain words of subsections (d) and (e) lead to the conclusions that I have set out above.
>
> 89 I fail to see how the very clear words of subsection (e) can be seen to be a codification of existing law. To arrive at the conclusion put forth by E&Y, BDO and the Underwriters would require me to ignore the specific words that Parliament has recently enacted.

28. Justice Morawetz's reasoning directly applies to the situation at bar – the clear statutory language of the BIA, which states that a warrant is an "equity interest", cannot be ignored in favour of an interpretation to the contrary under jurisprudence that was altered by Parliament.

29. ESW also relies on the Federal Court of Appeal's decision in *Henderson v Minister of National Revenue*[9] to draw a distinction between share purchase warrants and share warrants and in support of the proposition that, until ESW exercised a purchase option, ESW had no rights or interest in the shares subject to the Warrant and, since ESW never exercised

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[7] *Canada Deposit Insurance Corp. v Canadian Commercial Bank*, [1992] 3 SCR 558. [TAB G]

[8] *Sino-Forest Corporation (Re)*, 2012 ONSC 4377 at para 86. [TAB D]

[9] *Henderson v Minister of National Revenue*, [1975] CTC 485 (Fed. CA), at TAB 16 of the BOA. [TAB H]

its purchase option under the warrant, it never held an equitable interest in Trak IoT.[10] ESW appears to rely on the foregoing in support of its argument that the ESW Claim is not an "equity claim" for the purposes of priority and distribution under the BIA.

30. ESW's interpretation, however, ignores the clear BIA language: Section 2 of the BIA does not define "equity interest" as an interest that must have been exercised pursuant to an option; on the contrary, section 2 clearly indicates that a warrant, such as the Warrant, is an "equity interest". Had Parliament intended to adopt ESW's position, it would have simply left out the word "warrant" from the BIA definition of "equity interest" or it would have expressly stated that a warrant is not an equity interest until it is exercised by its holder.

31. The Trustee respectfully submits that the Warrant clearly falls within the plain meaning of the definition of an "equity interest" because it is a warrant other than one that is derived from a convertible debt. Even if this Honourable Court concludes that the Warrant is derived from a debt, because it was issued in connection with the LSA, there is nothing to suggest that the LSA created a *convertible* debt. Nor is there anything to suggest that some portion of any debt owed to ESW was converted or even potentially convertible to equity or a warrant or other right to acquire equity.

32. Therefore, the Warrant is clearly an "equity interest" as defined in the BIA. The ESW Claim is "in respect of" the Warrant – as discussed in paragraph 21 above, the words "in respect of" are words of the broadest scope that convey some connection between two subject matters. Thus, the ESW Claim is an "equity claim" within the meaning of the BIA and is subordinated to the claims of secured and unsecured creditors.

(iii) The ESW Claim is an equity claim under the old common law analysis

33. ESW takes the position that the Warrant is similar to the warrants at issue in *Canada Deposit* in the sense that the Warrant was a "sweetener" or a "kicker" for ESW to extend credit to Trak IoT.[11]

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[10] Brief of ESW at paras 99 to 101.

[11] Brief of ESW at para 96.

34. However, the *Canada Deposit* decision considered the characterization of the loan as a whole and not the warrants themselves, or a claim by a lender (that also held warrants), for payment for the purchase of warrants upon a restructuring. The mere fact that an instrument was issued to support a loan transaction does not necessarily mean that the instrument is not equity.

35. As noted by the British Columbia Supreme Court in a case concerning whether certain warrants constituted "interest" under section 347 of the *Criminal Code*, RSC, 1985, c C-46, "there is nothing, in concept, that prevents equity from being issued to a creditor in support of a loan transaction.".[12]

36. If, for example, Trak IoT had simply issued shares as partial consideration for the loan from ESW, it would not logically follow that a claim by ESW pursuant to its rights as a shareholder would be classified as a debt claim. In such a situation, ESW could claim, without contradiction, both as a debtor pursuant to the loan agreement and as a shareholder pursuant to its shares. Similarly, the fact that the Warrant was issued because of a creditor-debtor relationship does not imply that the Warrant or claims under it are necessarily debt claims.

37. Further, Courts have held that the basis for the differentiation between equity and debt interests flows from the fundamentally different nature of debt and equity investments: shareholders have unlimited upside potential when purchasing shares, while creditors have no corresponding upside potential.[13] The fact that the claim payable to ESW pursuant to the Warrant may have increased if the value of the Trak IoT shares had increased supports the Trustee's view that the ESW Claim is in substance an equity claim.

38. Accordingly, the Trustee respectfully submits that the ESW Claim is an "equity claim" even under the "unaltered" common law that was in force prior to 2009.

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[12] *Cirius Messaging Inc v Epstein Enterprises Inc.*, 2018 BCSC 1859 at para 75. [TAB I]

[13] *Sino-Forest Corporation (Re)*, 2012 ONSC 4377 at para 24. [TAB D]

39. However, even if this Honourable Court finds otherwise, the Trustee submits that, pursuant to the clear BIA wording enacted in 2009 and the applicable case law in respect thereof, the ESW Claim is an "equity claim".

B. The SaaS Guarantee is not enforceable in respect of the ESW SaaS Claim

40. The issue of whether the SaaS Guarantee is enforceable in respect of the ESW SaaS Claim is moot if this Honourable Court finds that the ESW SaaS Claim is an "equity claim".

41. In the event that this Court finds otherwise, the Trustee respectfully submits that the SaaS Guarantee is invalid based on the language included in the Acknowledgment and in the ARLA and, as such, there are no grounds for ESW to seek against Trak SaaS the repayment of any indebtedness owing by Trak IoT to ESW

The Acknowledgment

42. The Acknowledgment provides, among other things, that:[14]

> As security for the indebtedness, liabilities and obligations of the Borrower [Trak Saas] to the Lender, the Lender has required that the Obligors [Trak IoT and Trak SaaS] execute and deliver certain security agreements, instruments and documents, and other agreements (collectively, as amended, restated supplemented or replaced, the "**Security Documents**"), including, without limitation, general security agreements from each of the Obligors, a share pledge agreement from the Borrower granting a security interest in the shares of Trakopolis USA Corp. and an assignment of insurance from the Obligors;
> ….
> Each of the Obligors have entered into this agreement to acknowledge and confirm the continuing enforceability and effect of all existing Security Documents.
> …
> The Security Documents shall continue in full force and effect as general continuing collateral security for any and all of the indebtedness, liabilities and obligations of each of the Obligors to the Lender, including, without limitation, under, in connection with, relating to or with respect to the Loan Agreement, and the security interests created by the Loan Documents shall charge the property of the Obligors in accordance with the terms thereof.
> …
> The Security Documents to which each of the Obligors are a party constitute legal, valid, binding and enforceable against the Obligors, as applicable, in accordance with their terms.

[14] Affidavit of Neeraj Gupta sworn April 22, 2020, at Exhibit G.

43. The Trustee's position is that the SaaS Guarantee was not granted "As security for the indebtedness, liabilities and obligations of Trak SAAS to the Lender" and, accordingly, is not a "Security Document" for the purposes of the Acknowledgment.

44. Rather, the SaaS Guarantee was granted as security for the indebtedness, liabilities and obligations of Trak IOT to ESW, since Trak IoT was the borrower at the time the SaaS Guarantee was executed.

45. The definition of "Security Documents" in the Acknowledgment cannot capture the SaaS Guarantee – the definition only captures documents granted as security for the indebtedness, liabilities and obligations of Trak SaaS.

46. Thus, the Acknowledgment does not render the SaaS Guarantee as effective and it does not incorporate it in the ARLA.

The Entire Agreement Clause

47. ESW's position is that "the Entire Agreement Clause does not exclude the SaaS Guarantee; rather, it incorporates the SaaS Guarantee through reference to "other Loan Documents" and "Obligations"."[15]

48. The "entire agreement" clause included in the ARLA provides that:[16]

> This Agreement and the other Loan Documents embody the entire agreement and understanding between the parties hereto and thereto and supersede all prior agreements and understandings between such parties relating to the subject matter hereof and thereof and may not be contradicted by evidence of prior or contemporaneous agreements of the parties. There are no unwritten oral agreements between the parties related to the subject matter of this Agreement and the other Loan Documents. Notwithstanding the foregoing, the Canadian Credit Parties [Trak SaaS and Trak IoT] acknowledge, confirm and agree that the execution and delivery of this Agreement does not, and shall not, in any way be deemed to be a novation of the Original Credit Agreement or any accommodations of credit provided to Borrower prior to the date hereof. Each [of Trak SaaS and Trak IoT] hereby further acknowledges and agrees that any of the Loan Documents granting a Lien in any of the Collateral of the Canadian Credit Parties [Trak SaaS and Trak IoT] shall continue to guarantee and secure all of the Obligations and that

[15] Appeal of Notice of Disallowance filed by ESW at para 47.

[16] Affidavit of Neeraj Gupta sworn April 22, 2020, at Exhibit F (section 12.14 of the ARLA).

> the guarantees provided by, and the Liens granted under, such Loan Documents shall not be limited, terminated, altered, amended or discharged by the execution and delivery of this Agreement.

49. The ARLA defines "Loan Documents" as follows:[17]

> "collectively, this Agreement, the Confidentiality Agreement, the Expenses Agreement, the Notice of Security Interest in Intellectual Property, the Guarantees, the General Security Agreements, the Pledge Agreement, the Control Agreement, note or notes executed by Borrower and Guarantors, and any other document, instrument or agreement entered into in connection with this Agreement or the Obligations, all as amended or extended from time to time."

50. The ARLA defines "Obligations" as follows:[18]

> "all debt, principal, interest, Lender Expenses, fees, the Prepayment Premium, if any, and other amounts owed to Lender by Borrower [Trak SaaS] pursuant to this Agreement or any other agreement, whether absolute or contingent, due or to become due, now existing or hereafter arising, including any interest that accrues after the commencement of an Insolvency Proceeding and including any debt, liability, or obligation owing from Borrower to others that Lender may have obtained by assignment or otherwise."

51. The Trustee submits that the SaaS Guarantee does not constitute a "Loan Document" because there cannot be any contingent amounts owed by Trak SaaS to ESW. This is allegedly the case given the fact that the SaaS Guarantee was executed with respect to IoT's obligations as borrower to ESW. Trak IOT, however, is simply no longer a borrower under the ARLA.

52. In any event, if the SaaS Guarantee were to constitute a "Loan Document" under the ARLA, the Trustee submits that the SaaS Guarantee is not a Loan Document "granting a Lien in any of the Collateral of Trak SaaS and Trak IoT" and, as such, is not captured by the "entire agreement" language that states that Loan Documents shall not be terminated or discharged by the execution and delivery of the ARLA. Accordingly, the Guarantee became ineffective when the parties entered into the ARLA.

53. Based on the foregoing, the Trustee respectfully submits that, pursuant to the ARLA and the Acknowledgment, the SaaS Guarantee is not enforceable, and the language included in

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[17] Affidavit of Neeraj Gupta sworn April 22, 2020, at Exhibit F (Exhibit A to the ARLA).

[18] *Ibid.*

these documents reflects the true intention of the parties and should be upheld by this Honourable Court.

PART V – RELIEF SOUGHT

54. For the foregoing reasons, the Trustee seeks an Order directing that:

(a) the ESW Claim is an "equity claim" for the purpose of priority and distribution under the BIA;

(b) the SaaS Guarantee is not enforceable in respect of the ESW SaaS claim; and

(c) ESW's appeal is dismissed and the Notices of Disallowance are upheld.

ALL OF WHICH IS RESPECTFULLY SUBMITTED on August **[4]**, 2020 at Calgary, Alberta.

TORYS LLP

_____

Per: Kyle Kashuba / Mihai Tomos
Counsel for Alvarez & Marsal Canada Inc., acting in its capacity as licensed insolvency trustee of the estate of Trakopolis IoT Corp. and the estate of Trakopolis SaaS Corp. (and not in its personal or corporate capacity)

TABLE OF AUTHORITIES

TAB “A”

CANADA

CONSOLIDATION

CODIFICATION

Bankruptcy and Insolvency Act

Loi sur la faillite et l'insolvabilité

R.S.C., 1985, c. B-3

L.R.C. (1985), ch. B-3

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eligible financial contract means an agreement of a prescribed kind; (*contrat financier admissible*)

equity claim means a claim that is in respect of an equity interest, including a claim for, among others,

(a) a dividend or similar payment,

(b) a return of capital,

(c) a redemption or retraction obligation,

(d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or

(e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d); (*réclamation relative à des capitaux propres*)

equity interest means

(a) in the case of a corporation other than an income trust, a share in the corporation — or a warrant or option or another right to acquire a share in the corporation — other than one that is derived from a convertible debt, and

(b) in the case of an income trust, a unit in the income trust — or a warrant or option or another right to acquire a unit in the income trust — other than one that is derived from a convertible debt; (*intérêt relatif à des capitaux propres*)

executing officer includes a sheriff, a bailiff and any officer charged with the execution of a writ or other process under this Act or any other Act or proceeding with respect to any property of a debtor; (*huissier- exécutant*)

financial collateral means any of the following that is subject to an interest, or in the Province of Quebec a right, that secures payment or performance of an obligation in respect of an eligible financial contract or that is subject to a title transfer credit support agreement:

(a) cash or cash equivalents, including negotiable instruments and demand deposits,

(b) securities, a securities account, a securities entitlement or a right to acquire securities, or

(c) a futures agreement or a futures account; (*garantie financière*)

General Rules means the General Rules referred to in section 209; (*Règles générales*)

failli Personne qui a fait une cession ou contre laquelle a été rendue une ordonnance de faillite. Peut aussi s'entendre de la situation juridique d'une telle personne. (*bankrupt*)

faillite L'état de faillite ou le fait de devenir en faillite. (*bankruptcy*)

fiducie de revenu Fiducie qui possède un actif au Canada et dont les parts sont inscrites à une bourse de valeurs mobilières visée par les Règles générales à la date de l'ouverture de la faillite, ou sont détenues en majorité par une fiducie dont les parts sont inscrites à une telle bourse à cette date. (*income trust*)

garantie financière S'il est assujetti soit à un intérêt ou, dans la province de Québec, à un droit garantissant le paiement d'une somme ou l'exécution d'une obligation relativement à un contrat financier admissible, soit à un accord de transfert de titres pour obtention de crédit, l'un ou l'autre des éléments suivants :

a) les sommes en espèces et les équivalents de trésorerie — notamment les effets négociables et dépôts à vue;

b) les titres, comptes de titres, droits intermédiés et droits d'acquérir des titres;

c) les contrats à terme ou comptes de contrats à terme. (*financial collateral*)

huissier-exécutant Shérif, huissier ou autre personne chargée de l'exécution d'un bref ou autre procédure sous l'autorité de la présente loi ou de toute autre loi, ou de toute autre procédure relative aux biens du débiteur. (*sheriff*)

intérêt relatif à des capitaux propres

a) S'agissant d'une personne morale autre qu'une fiducie de revenu, action de celle-ci ou bon de souscription, option ou autre droit permettant d'acquérir une telle action et ne provenant pas de la conversion d'une dette convertible;

b) s'agissant d'une fiducie de revenu, part de celle-ci ou bon de souscription, option ou autre droit permettant d'acquérir une telle part et ne provenant pas de la conversion d'une dette convertible. (*equity interest*)

localité En parlant d'un débiteur, le lieu principal où, selon le cas :

a) il a exercé ses activités au cours de l'année précédant l'ouverture de sa faillite;

Postponement of claims of silent partners

139 Where a lender advances money to a borrower engaged or about to engage in trade or business under a contract with the borrower that the lender shall receive a rate of interest varying with the profits or shall receive a share of the profits arising from carrying on the trade or business, and the borrower subsequently becomes bankrupt, the lender of the money is not entitled to recover anything in respect of the loan until the claims of all other creditors of the borrower have been satisfied.

R.S., c. B-3, s. 110.

Renvoi des réclamations d'un bailleur de fonds

139 Lorsqu'un prêteur avance de l'argent à un emprunteur, engagé ou sur le point de s'engager dans un commerce ou une entreprise, aux termes d'un contrat, passé avec l'emprunteur, en vertu duquel le prêteur doit recevoir un taux d'intérêt variant selon les profits ou recevoir une partie des profits provenant de la conduite du commerce ou de l'entreprise, et que subséquemment l'emprunteur devient failli, le prêteur n'a droit à aucun recouvrement du chef d'un pareil prêt jusqu'à ce que les réclamations de tous les autres créanciers de l'emprunteur aient été acquittées.

S.R., ch. B-3, art. 110.

Postponement of wage claims of officers and directors

140 Where a corporation becomes bankrupt, no officer or director thereof is entitled to have his claim preferred as provided by section 136 in respect of wages, salary, commission or compensation for work done or services rendered to the corporation in any capacity.

R.S., c. B-3, s. 111.

Renvoi des réclamations pour gages des dirigeants et administrateurs

140 Dans le cas où une personne morale devient en faillite, aucun dirigeant ou administrateur de celle-ci n'a droit à la priorité de réclamation prévue par l'article 136 à l'égard de tout salaire, traitement, commission ou rémunération pour travail exécuté ou services rendus à cette personne morale à quelque titre que ce soit.

S.R., ch. B-3, art. 111.

Postponement of equity claims

140.1 A creditor is not entitled to a dividend in respect of an equity claim until all claims that are not equity claims have been satisfied.

2005, c. 47, s. 90; 2007, c. 36, s. 49.

Réclamations relatives à des capitaux propres

140.1 Le créancier qui a une réclamation relative à des capitaux propres n'a pas droit à un dividende à cet égard avant que toutes les réclamations qui ne sont pas des réclamations relatives à des capitaux propres aient été satisfaites.

2005, ch. 47, art. 90; 2007, ch. 36, art. 49.

Claims generally payable rateably

141 Subject to this Act, all claims proved in a bankruptcy shall be paid rateably.

R.S., c. B-3, s. 112.

Réclamations généralement payables au prorata

141 Sous réserve des autres dispositions de la présente loi, toutes les réclamations établies dans la faillite sont acquittées au prorata.

S.R., ch. B-3, art. 112.

Partners and separate properties

142 (1) Where partners become bankrupt, their joint property shall be applicable in the first instance in payment of their joint debts, and the separate property of each partner shall be applicable in the first instance in payment of his separate debts.

Associés et biens distincts

142 (1) Dans le cas où des associés deviennent en faillite, leurs biens communs sont applicables en premier lieu au paiement de leurs dettes communes, et les biens distincts de chaque associé sont applicables en premier lieu au paiement de ses dettes distinctes.

Surplus of separate properties

(2) Where there is a surplus of the separate properties of the partners, it shall be dealt with as part of the joint property.

Surplus des biens distincts

(2) Lorsqu'il existe un surplus des biens distincts, il en est disposé comme partie des biens communs.

Surplus of joint properties

(3) Where there is a surplus of the joint property of the partners, it shall be dealt with as part of the respective

Surplus des biens communs

(3) Lorsqu'il existe un surplus des biens communs, il en est disposé comme partie des biens distincts respectifs en

TAB “B”

CANADA

CONSOLIDATION

CODIFICATION

Companies' Creditors Arrangement Act

Loi sur les arrangements avec les créanciers des compagnies

R.S.C., 1985, c. C-36

L.R.C. (1985), ch. C-36

Current to July 15, 2020

Last amended on November 1, 2019

À jour au 15 juillet 2020

Dernière modification le 1 novembre 2019

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equity claim means a claim that is in respect of an equity interest, including a claim for, among others,

(a) a dividend or similar payment,

(b) a return of capital,

(c) a redemption or retraction obligation,

(d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or

(e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d); (*réclamation relative à des capitaux propres*)

equity interest means

(a) in the case of a company other than an income trust, a share in the company — or a warrant or option or another right to acquire a share in the company — other than one that is derived from a convertible debt, and

(b) in the case of an income trust, a unit in the income trust — or a warrant or option or another right to acquire a unit in the income trust — other than one that is derived from a convertible debt; (*intérêt relatif à des capitaux propres*)

financial collateral means any of the following that is subject to an interest, or in the Province of Quebec a right, that secures payment or performance of an obligation in respect of an eligible financial contract or that is subject to a title transfer credit support agreement:

(a) cash or cash equivalents, including negotiable instruments and demand deposits,

(b) securities, a securities account, a securities entitlement or a right to acquire securities, or

(c) a futures agreement or a futures account; (*garantie financière*)

income trust means a trust that has assets in Canada if

(a) its units are listed on a prescribed stock exchange on the day on which proceedings commence under this Act, or

(b) the majority of its units are held by a trust whose units are listed on a prescribed stock exchange on the day on which proceedings commence under this Act; (*fiducie de revenu*)

créancier garanti Détenteur d'hypothèque, de gage, charge, nantissement ou privilège sur ou contre l'ensemble ou une partie des biens d'une compagnie débitrice, ou tout transport, cession ou transfert de la totalité ou d'une partie de ces biens, à titre de garantie d'une dette de la compagnie débitrice, ou un détenteur de quelque obligation d'une compagnie débitrice garantie par hypothèque, gage, charge, nantissement ou privilège sur ou contre l'ensemble ou une partie des biens de la compagnie débitrice, ou un transport, une cession ou un transfert de tout ou partie de ces biens, ou une fiducie à leur égard, que ce détenteur ou bénéficiaire réside ou soit domicilié au Canada ou à l'étranger. Un fiduciaire en vertu de tout acte de fiducie ou autre instrument garantissant ces obligations est réputé un créancier garanti pour toutes les fins de la présente loi sauf la votation à une assemblée de créanciers relativement à ces obligations. (*secured creditor*)

demande initiale La demande faite pour la première fois en application de la présente loi relativement à une compagnie. (*initial application*)

état de l'évolution de l'encaisse Relativement à une compagnie, l'état visé à l'alinéa 10(2)a) portant, projections à l'appui, sur l'évolution de l'encaisse de celle-ci. (*cash-flow statement*)

fiducie de revenu Fiducie qui possède un actif au Canada et dont les parts sont inscrites à une bourse de valeurs mobilières visée par règlement à la date à laquelle des procédures sont intentées sous le régime de la présente loi, ou sont détenues en majorité par une fiducie dont les parts sont inscrites à une telle bourse à cette date. (*income trust*)

garantie financière S'il est assujetti soit à un intérêt ou, dans la province de Québec, à un droit garantissant le paiement d'une somme ou l'exécution d'une obligation relativement à un contrat financier admissible, soit à un accord de transfert de titres pour obtention de crédit, l'un ou l'autre des éléments suivants :

a) les sommes en espèces et les équivalents de trésorerie — notamment les effets négociables et dépôts à vue;

b) les titres, comptes de titres, droits intermédiés et droits d'acquérir des titres;

c) les contrats à terme ou comptes de contrats à terme. (*financial collateral*)

intérêt relatif à des capitaux propres

TAB “C”

1983 CarswellNat 123
Supreme Court of Canada

Nowegijick v. The Queen

1983 CarswellNat 123, 1983 CarswellNat 520, [1983] 1 S.C.R. 29, [1983] 2 C.N.L.R. 89, [1983] C.T.C. 20, [1983] S.C.J. No. 5, 144 D.L.R. (3d) 193, 18 A.C.W.S. (2d) 2, 46 N.R. 41, 83 D.T.C. 5041, J.E. 83-140

Gene A Nowegijick, Appellant, and Her Majesty The Queen, Respondent, and The Grand Council of the Crees (of Quebec) et al, and Chief Henry Mianscum, et al and Grand Chief Billy Diamond, et al and The National Indian Brotherhood, Intervenants

Ritchie, Dickson, Beetz, Estey, McIntyre, Chouinard and Lamer, JJ

Judgment: January 25, 1983
Docket: 15833

Proceedings: on appeal from a judgment of the Federal Court of Appeal, reported [1979] C.T.C. 441

Counsel: *Micha Menczes* for the appellant.
Wilfred Lefebvre and *Fred Caron* for the respondent.
James O'Reilly (for the Crees) and *William Badcock* (National Indian Brotherhood) for the intervants.

Related Abridgment Classifications
Tax
VI First Nations taxation
VI.3 Liability of aboriginal persons for federal income tax
VI.3.a Income situated on a reserve
Tax
VI First Nations taxation
VI.3 Liability of aboriginal persons for federal income tax
VI.3.b Miscellaneous
Headnote
Income tax --- Exemptions — Indians — General
Income tax --- Persons liable
Income tax --- Income from office or employment
Income tax — Federal — Income Tax Act, RSC 1952, c 148 (am SC 1970-71-72, c 63) — 2(1), (2), 5(1) — Indian Act, RSC 1970, c 1-6 — 87 — Whether wages of an Indian, resident on a reserve, received from a corporation, resident on the reserve, exempt from income tax.
The appellant, an Indian who resided on an Indian reserve, was employed as a logger by a corporation which had its head office and administrative offices on the reserve. The logging operations were conducted 10 miles from the reserve. The appellant was paid by cheque at the corporation's office on the reserve. The appellant appealed from an assessment of income tax on the grounds that the tax was a tax in respect of personal property of an Indian situated on a reserve and therefore exempt under the *Indian Act*.

HELD:
The fact that the services were performed off the reserve was not relevant. The *situs* of the appellant's wages was on the reserve because that was the residence of the employer corporation and it was where the wages were payable. Income was personal property and a tax on income was a tax in respect of personal property within the meaning of section 87 of the *Indian Act* which created an exemption for both persons and property. Appeal allowed.
Annotation

This case holds that the wages of an Indian, residing on an Indian reserve, received from an employer, also residing on the reserve, were personal property situated on a reserve within the meaning of section 87 of the *Indian Act* and, therefore, exempt from income tax. Although the decision is relatively narrow in its application, it raises several points of interest.

It was held that the *situs* of the wages was where the debtor (ie, the employer) was resident and where the wages were payable. It was considered to be irrelevant that in fact the services were rendered outside the reserve. This matter of the *situs* of wages is not likely material except for Indians. For example the definition of source of income in paragraph 4(1)(b) of the *Income Tax Act* refers to the place where the duties of an office or employment are performed. Similarly in the case of non-residents the reference in subparagraph 115(1)(a)(i) is to duties "performed by him in Canada". In Article 15 of the Canada-UK Tax Convention the place where the employment "is exercised" is the test. This language is also used in tax conventions with other countries.

The Court also held that wages were personal property and that income tax was in reality a tax on property. The Court distinguished earlier decisions which held that income taxes were taxes on a person and not on property on the grounds that those decisions were not applicable in interpreting the broad language of section 87 of the *Indian Act* so as to contradict the earlier decisions referred to in the judgment. Although wages are "property" it should be noted that sections 5 to 8 specifically set forth how salary and wages are to be dealt with under the Act whereas in section 9 and in subsections 12(1) and 18(1), for example, the reference is to inccome *from* property and not to property itself.

Another interesting feature is that the Court quoted a departmental Interpretation Bulletin stating that, although administrative policy and interpretation are not determinative, they are entitled to weight and can be an important factor in case of doubt about the meaning of legislation.
Table of Authorities
Cases referred to:

The Queen v *National Indian Brotherhood*, [1979] 1 F.C. 103, [1978] C.T.C. 680, 78 D.T.C. 6488;
Jones v. Meehan, 175 US 1;
Greyeyes v *The Queen*, [1978] C.T.C. 91, 78 D.T.C. 6043;
Harel v *Dep Min of Revenue for Quebec*, [1978] 1 S.C.R. 851, [1977] C.T.C. 441;
Bachrach v. Nelson, [1932] 182 NE 909;
MNR v *Iroquois of Caughnawaga*, [1977] 2 F.C. 269, [1977] C.T.C. 49, 77 D.T.C. 5127;
McLeod v *Min of C and E*, [1926] S.C.R. 457; [1917-27] CTC 290;
Kerr v *Sup of Income Tax*, [1942] S.C.R. 435, [1943] C.T.C. 97;
Sura v *MNR*, [1962] S.C.R. 65, [1962] C.T.C. 1, 62 D.T.C. 1005;
Alworth v. Min of Finance (1977) 76 D.L.R. (3d) 99;
A-G British Columbia v *Ellett Estate*, [1980] 2 S.C.R. 466, [1980] C.T.C. 338.

Words and phrases considered:

IN RESPECT OF

The words "in respect of" are . . . words of the widest possible scope. They import such meanings as "in relation to", "with reference to" and "in connection with". The phrase "in respect of" is probably the widest of any expression intended to convey some connection between two related subject matters.

INCOME

The Supreme Court of Illinois in the case of *Bachrach v. Nelson* (1932), 182 N.E. 909considered whether "income" is "property" and responded at p.914:

The overwhelming weight of judicial authority holds that it is. The . . . [jurisprudence] . . . define[s] what is personal property and in substance hold[s] that money or any other thing of value acquired as gain or profit from capital or labor is property, and that, income, and, in accordance with the axiom that the whole includes all of its parts, income includes property and nothing but property, and therefore is itself property.

I would adopt this language. A tax on income is in reality a tax on property itself. If income can be said to be property I cannot think that taxable income is any less so. . . .

***Dickson, J*:**

1 The question is whether the appellant, Gene A Nowegijick, a registered Indian can claim by virtue of the *Indian Act*, RSC 1970 c I-6, an exemption from income tax for the 1975 taxation year.

I

2

The Facts:

3 The facts are few and not in dispute. Mr Nowegijick is an Indian within the meaning of the *Indian Act* and a member of the Gull Bay (Ontario) Indian Band. During the 1975 taxation year Mr Nowegijick was an employee of the Gull Bay Development Corporation, a company without share capital, having its head office and administrative offices on the Gull Bay Reserve. All the directors, members and employees of the Corporation live on the Reserve and are registered Indians.

4 During 1975 the Corporation in the course of its business conducted a logging operation 10 miles from the Gull Bay Reserve. Mr Nowegijick was employed as a logger and remunerated on a piece-work basis. He was paid bi-weekly by cheque at the head office of the Corporation on the Reserve.

5 During 1975, Mr Nowegijick maintained his permanent dwelling on the Gull Bay Reserve. Each morning he would leave the Reserve to work on the logging operations, and return to the Reserve at the end of the working day.

6 Mr Nowegijick earned $11,057.08 in such employment. His assessed taxable income for the 1975 taxation year was $8,698 on which he was assessed tax of $1,965.80. By notice of objection he objected to the assessment on the basis that the income in respect of which the assessment was made is the "personal property of an Indian ... situated on a reserve" and thus not subject to taxation by virtue of section 87 of the *Indian Act*.

7 Mr Nowegijick also brought an action in the Federal Court, Trial Division to set aside the notice of assessment. Mr Justice Mahoney of that Court ordered that Mr Nowegijick's 1975 income tax return be referred back to the Minister of National Revenue for reassessment on the basis that the wages paid him by the Gull Bay Development Corporation were wrongly included in the calculation of his taxable income.

8 The Crown appealed the decision of Mr Justice Mahoney. The Federal Court of Appeal allowed the appeal and restored the original assessment.

9 The proceedings have reached this Court by leave. The Grand Council of Crees of Quebec, three Cree organizations, eight Cree bands and their respective Chiefs have intervened to make common cause with Mr Nowegijick.

II

10

The Legislation

11 Mr Nowegijick, in his claim for exemption from income tax relies upon section 87 of the *Indian Act*:

> Notwithstanding any other Act of the Parliament of Canada or any Act of the legislature of a province, but subject to subsection (2) and to section 83, the following property is exempt from taxation, namely:
>
> (a) the interest of an Indian or a band in a reserve or surrendered lands; and
>
> (b) the personal property of an Indian or band situated on a reserve;
>
> and no Indian or band is subject to taxation in respect of the ownership, occupation, possession or use of any property mentioned in paragraph (a) or (b) or is otherwise subject to taxation in respect of any such property; and no succession duty, inheritance tax or estate duty is payable on the death of any Indian in respect of any such property or the succession thereto if the property passes to an Indian, nor shall any such property be taken into account in determining the duty payable under the *Dominion Succession Duty Act*, being chapter 89 of the Revised Statutes of Canada, 1952, or the tax payable under the *Estate Tax Act*, on or in respect of other property passing to an Indian.

Section 83 of the *Indian Act*, referred to in section 87 has no application. Subsection 87(2), also mentioned, was repealed in 1960 by SC 1960, c 8, although the reference to it in what was formerly subsection (1) remains.

12 Stripped to relevant essentials section 87 reads:

> Notwithstanding any other Act of the Parliament of Canada the following property is exempt from taxation, namely
>
> (a) the interest of an Indian or a band in reserve or surrendered lands, and
>
> (b) the personal property of an Indian or band situated on a reserve;
>
> and no Indian or band is subject to taxation in respect of the ownership, occupation, possession or use of any property mentioned in paragraph (a) or (b) or is otherwise subject to taxation in respect of any such property ...

13 Further distilled, the section provides that (i) the personal property of an Indian situated on a reserve is exempt from taxation; (ii) no Indian is subject to taxation "in respect of any" such property.

14 It is arguable that the first part of the quoted passage which exempts from taxation (a) the "interest of an Indian or a band in a reserve or surrendered lands" and (b) the "personal property of an Indian or band situated on a reserve", is concerned with exemption from *direct* taxation of land or personal property by a provincial or municipal authority. The legislative history of the section lends support to such an argument. But the section does not end there. It is to the latter part of the section that our attention should primarily be directed.

15 The short but difficult question to be determined is whether the tax sought to be imposed under the *Income Tax Act* 1970-71-72, c 63 upon the income of Mr Nowegijick can be said to be "in respect of any" personal property situated upon a reserve.

16 We need not speculate upon parliamentary intention, an idle pursuit at best, since the antecedent of section 87 of the *Indian Act* was enacted long before income tax was introduced as a temporary war-time measure in 1917.

17 One point might have given rise to argument. Was the fact that the services were performed off the reserve relevant to *situs*? The Crown conceded in argument, correctly in my view, that the *situs* of the salary which Mr Nowegijick received was sited on the reserve because it was there that the residence or place of the debtor, the Gull Bay Development Corporation, was to be found and it was there the wages were payable. See Cheshire *Private International Law* (10th ed) pp 536 *et seq* and also the judgment of Thurlow, ACJ in *R* v *National Indian Brotherhood*, [1979] 1 F.C. 103 particularly at pp 109 *et seq*.

18 The other piece of legislation which bears directly on the question before us is the *Income Tax Act*. I would like to refer to several sections. The first is found in Part I, Division A, of the Act, entitled "Liability for Tax". Subsections 2(1), (2) provide:

> (1) An income tax shall be paid as hereinafter required upon the taxable income for each taxation year of every person resident in Canada at any time in the year.
>
> (2) The taxable income of a taxpayer for a taxation year is his income for the year minus the deductions permitted by Division C.

Thus, income tax is paid upon the taxable income (income minus deductions) of every person resident in Canada.

19 Subsection 5(1) of the Act is worth noting. It defines the taxpayer's income from employment as the salary, wages and other remuneration received. The liability is at the point of receipt. The section reads:

> Subject to this Part, a taxpayer's income for a taxation year from an office or employment is the salary, wages and other remuneration, including gratuities, received by him in the year.

The only other section is subsection 153(1) which provides that every person paying salary or wages to an employee in a taxation year shall deduct the prescribed amount, and remit that amount to the Receiver General of Canada on account of the payee's tax for the year.

III

20

The Federal Court Judgments

21 I turn now to the conflicting views in the Federal Court. The opinion of Mr Justice Mahoney at trial was expressed in these words:

> The question is whether taxation of the Plaintiff in an amount determined by reference to his taxable income is taxation "in respect of" those wages when they are included in the computation of his taxable income. I think that it is.
>
> The tax payable by an individual under the *Income Tax Act* is determined by application of prescribed rates to his taxable income calculated in the prescribed manner. If his taxable income is increased by the inclusion of his wages in it, he will pay more tax. The amount of the increase will be determined by direct reference to the amount of those wages. I do not see that such a process and result admits of any other conclusion than that the individual is thereby taxed in respect of his wages.

22 The Federal Court of Appeal concluded that the tax imposed on Mr Nowegijick under the *Income Tax Act* was not taxation in respect of personal property within the meaning of section 87 of the *Indian Act*. The Court, speaking through Mr Justice Heald, said:

> We are all of the view that there are no significant distinctions between this case and the *Snow* case (*Russell Snow* v *The Queen*, [1979] C.T.C. 227) where this Court held: "Sec 86 of the *Indian Act* contemplates taxation in respect of specific personal property *qua* property and not taxation in respect of taxable income as defined by the *Income Tax Act*, which, while it may reflect items that are personal property, is not itself personal property but an amount to be determined as a matter of calculation by application of the provisions of the Act".

IV

23

Construction of section 87 of the Indian Act

24 Indians are citizens and, in affairs of life not governed by treaties or the *Indian Act*, they are subject to all of the responsibilities, including payment of taxes, of other Canadian citizens.

25 It is legal lore that, to be valid, exemptions to tax laws should be clearly expressed. It seems to me, however, that treaties and statutes relating to Indians should be liberally construed and doubtful expressions resolved in favour of the Indian. If the statute contains language which can reasonably be construed to confer tax exemption that construction, in my view, is to be favoured over a more technical construction which might be available to deny exemption. In *Jones v. Meehan*, 175 US 1, it was held that "Indian treaties must be construed, not according to the technical meaning of their words, but in the sense in which they would naturally be understood by the Indians".

26 There is little in the cases to assist in the construction of section 87 of the *Indian Act*. In *R* v *The National Indian Brotherhood*, [1978] C.T.C. 680, 78 D.T.C. 6488, the question was as to *situs*, an issue which does not arise in the present case. The appeal related to the failure of the National Indian Brotherhood to deduct and pay over to the Receiver General for Canada the amount which the defendant was required by the *Income Tax Act* and regulations to deduct from the salaries of its Indian employees. The salaries in question were paid to the employees in Ottawa by cheque drawn on an Ottawa bank. Thurlow, ACJ said:

> I have already indicated that it is my view that the exemption provided for by subsection 87 does not extend beyond the ordinary meaning of the words and expressions used in it. There is no legal basis, notwithstanding the history of the exemption, and the special position of Indians in Canadian society, for extending it by reference to any notional extension of reserves or of what may be considered as being done on reserves. The issue, as I see it, assuming that the taxation imposed by the *Income Tax Act* is taxation of individuals in respect of property and that a salary or a right to salary is property, is whether the salary which the individual Indian received or to which he was entitled was "personal property" of the Indian "situated on a reserve". (at p 6491)

27 The other case is *Greyeyes* v *The Queen*, [1978] C.T.C. 91, 78 D.T.C. 6043. The question was whether an education scholarship paid by the federal government to a status Indian was taxable in the Indian's hands. Mahoney, J held that it was not taxable, by reason of section 87 of the *Indian Act*.

28 Administrative policy and interpretation are not determinative but are entitled to weight and can be an "important factor" in case of doubt about the meaning of legislation: *per* de Grandpré, J *Harel* v *The Deputy Minister of Revenue of the Province of Quebec*, [1978] 1 S.C.R. 851 at 859. During argument in the present appeal the attention of the Court was directed to Revenue Canada Interpretation Bulletin IT-62 dated August 18, 1972, entitled: "Indians". Paragraph 1 of the Bulletin reads:

> This bulletin does not represent a change in either law or assessing policy as it applies to the taxation of Indians but is intended as a statement of the Department's interpretation and policies that have been established for several years.

Paragraph 5 reads:

> While the exemption in the *Indian Act* refers to "property" and the tax imposed under the *Income Tax Act* is a tax calculated on the income of a person rather than a tax in respect of his property, it is considered that the intention of the *Indian Act* is not to tax Indians on income earned on a reserve. Income earned by an Indian off a reserve, however, does not come within this exemption, and is therefore subject to tax under the *Income Tax Act*.

Counsel for the Crown said the Bulletin was simply "wrong".

29 The prime task of the Court in this case is to construe the words "no Indian ... is subject to taxation in respect of any such [personal] property". Is taxable income personal property? The Supreme Court of Illinois in the case of *Bachrach v. Nelson* (1932), 182 NE 909 considered whether "income" is "property" and responded:

> The overwhelming weight of judicial authority holds that it is. The cases of *Eliasberg Bros Mercantile Co v. Grimes*, 204 Ala 492, 86 So 56, 11 ALR 300, *Tax Commissioner v. Putnam*, 227 Mass 522, 116 NE 904, LRA 1917F, 806, *Stratton's*

Independence v. Howbert, 231 US 399, 34 S Ct 136, 58 L Ed 285, *Doyle v. Mitchell Bros Co*, 247 US 179, 38 S Ct 467, 62 L Ed 1054, *Board of Revenue v. Montgomery Gaslight Co*, 64 Ala 269, *Greene v. Knox*, 175 NY 432, 67, NE 910, *Hibbard v. State*, 65 Ohio St 574, 64 NE 109, 58 LRA 654, *Ludlow-Saylor Wire Co v. Wollbrinck*, 275 Mo 339, 205 SW 196, and *State v. Pinder*, 7 Boyce (30 Del) 416, 108 A 43, define what is personal property and in substance hold that money or any other thing of value acquired as gain or profit from capital or labor is property, and that, in the aggregate, these acquisitions constitute income, and, in accordance with the axiom that the whole includes all of its parts, income includes property and nothing but property, and therefore is itself property (at p 914).

I would adopt this language. A tax on income is in reality a tax on property itself. If income can be said to be property I cannot think that taxable income is any less so. Taxable income is by definition, subsection 2(2) of the *Income Tax Act*, "his income for the year minus the deductions permitted by Division C". Although the Crown in paragraph 14 of its factum recognizes that "salaries" and "wages" can be classified as "personal property" it submits that the basis of taxation is a person's "taxable" income and that such taxable income is not "personal property" but rather a "concept", that results from a number of operations. This is too fine a distinction for my liking. If wages are personal property it seems to me difficult to say that a person taxed "in respect of" wages is not being taxed in respect of personal property. It is true that certain calculations are needed in order to determine the quantum of tax but I do not think this in any way invalidates the basic proposition.

30 The words "in respect of" are, in my opinion, words of the widest possible scope. They import such means as "in relation to", "with reference to" or "in connection with". The phrase "in respect of" is probably the widest of any expression intended to convey some connection between two related subject matters.

31 Crown counsel submits that the effect of section 87 of the *Indian Act* is to exempt what can properly be classified as "direct taxation on property" and the judgment of Jackett, CJ in *MNR* v *Iroquois of Caughnawaga (Caughnawaga Indian Band)*, [1977] 2 F.C. 269, [1977] C.T.C. 49, 77 D.T.C. 5127, is cited. The question in that case was whether the employer's share of unemployment insurance premiums was payable in respect of persons employed by an Indian band at a hospital operated by the band on a reserve. It was argued that the premiums were "taxation" on "property" within section 87 of the *Indian Act*. Chief Justice Jackett held that even if the imposition by statute on an employer of liability to contribute to the cost of a scheme of unemployment insurance were "taxation" it would not, in the view of the Chief Justice, be taxation on "property" within the ambit of section 87. The Chief Justice continued:

> From one point of view, all taxation is directly or indirectly taxation on property; from another point of view, all taxation is directly or indirectly taxation on persons. It is my view, however, that when section 87 exempts "personal property of an Indian or band situated on a reserve" from "taxation", its effect is to exempt what can properly be classified as direct taxation on property. The courts have had to develop jurisprudence as to when taxation is taxation on property and when it is taxation on persons for the purposes of section 92(2) of *The British North America Act, 1867*, and there would seem to be no reason why such jurisprudence should not be applied to the interpretation of section 87 of the *Indian Act*. See, for example, with reference to section 92(2), *Provincial Treasurer of Alberta v. Kerr*, [1933] A.C. 710 (at p 271).

32 There is a line of cases which hold that taxes imposed pursuant to various income tax Acts are taxes "on a person" and not taxes on property: *McLeod* v *Minister of Customs and Excise*, [1926] S.C.R. 457; *Kerr* v *Superintendent of Income Tax and Attorney General of Alberta*, [1942] S.C.R. 435; *F Sura* v *Minister of National Revenue*, [1962] S.C.R. 65, [1962] C.T.C. 1, 62 D.T.C. 1005. More recently, in *Alworth* v *Minister of Finance*, [1977] 76 D.L.R. (3d) 99 and in *Attorney General of British Columbia and The Canada Trust Company and Olga Ellett*, [1980] 2 S.C.R. 466, [1980] C.T.C. 338, this Court again had occasion to consider the distinction in the case law between a tax on persons and a tax on property or upon income.

33 In the *McLeod* case the question was whether a fund accumulating in the hands of a trustee under the deceased's will was income accumulating in trust for the benefit of unascertained persons, or persons with contingent interests, within the meaning of subsection 3(6) of the *Income War Tax Act, 1917*. In the *Kerr, Alworth* and *Ellett* cases the issue was one of constitutional law. The *Sura* decision turned on the position under the *Income Tax Act* of persons domiciled in Quebec who did not enter into a pre-nuptial contract stipulating separation as to property and were therefore, under the provisions of the *Civil Code*, married under the regime of the community of property.

34 With all respect for those of a contrary view, I cannot see any compelling reason why the jurisprudence developed for the purpose of resolving constitutional disputes or for determining the tax implications of Quebec's communal property laws, or for interpreting the phrase "unascertained persons or persons with contingent interests" in the *Income War Tax Act* should be applied to limit the otherwise broad sweep of the language of section 87 of the *Indian Act*.

35 With respect, I do not agree with Chief Justice Jackett that the effect of section 87 of the *Indian Act* is only to exempt what can properly be classified as direct taxation on property. Section 87 provides that "the personal property of an Indian ... on a reserve" is exempt from taxation; but it also provides that "no Indian ... is ... subject to taxation in respect of any such property". The earlier words certainly exempt certain property from taxation; but the latter words also exempt certain persons from taxation in respect of such property. As I read it, section 87 creates an exemption for both persons and property. It does not matter then that the taxation of employment income may be characterized as a tax on persons, as opposed to a tax on property.

36 We must, I think, in these cases, have regard to substance and the plain and ordinary meaning of the language used, rather than to forensic dialectics. I do not think we should give any refined construction to the section. A person exempt from taxation in respect of any of his personal property would have difficulty in understanding why he should pay tax in respect of his wages. And I do not think it is a sufficient answer to say that the conceptualization of the *Income Tax Act* renders it so.

37 I conclude by saying that nothing in these reasons should be taken as implying that no Indian shall ever pay tax of any kind. Counsel for the appellant and counsel for the intervenants do not take that position. Nor do I. We are concerned here with personal property situated on a reserve and only with property situated on a reserve.

38 I would allow the appeal, set aside the judgment of the Federal Court of Appeal and reinstate the judgment in the Trial Division of that Court. Pursuant to the arrangement of the parties the appellant is entitled to his costs in all courts to be taxed as between solicitor and client. There should be no costs payable by or to the intervenors.

TAB “D”

2012 ONSC 4377
Ontario Superior Court of Justice [Commercial List]

Sino-Forest Corp., Re

2012 CarswellOnt 9430, 2012 ONSC 4377, 218 A.C.W.S. (3d) 489, 92 C.B.R. (5th) 99

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

And In the Matter of a Plan of Compromise or Arrangement of Sino-Forest Corporation (Applicant)

Morawetz J.

Heard: June 26, 2012
Judgment: July 27, 2012
Docket: CV-12-9667-00CL

Counsel: Robert W. Staley, Jonathan Bell for Applicant
Jennifer Stam for Monitor
Kenneth Dekker for BDO Limited
Peter Griffin, Peter Osborne for Ernst & Young LLP
Benjamin Zarnett, Robert Chadwick, Brendan O'Neill for Ad Hoc Committee of Noteholders
James Grout for Ontario Securities Commission
Emily Cole, Joseph Marin for Allen Chan
Simon Bieber for David Horsley
David Bish, John Fabello, Adam Slavens for Underwriters Named in the Class Action
Max Starnino, Kirk Baert for Ontario Plaintiffs
Larry Lowenstein for Board of Directors

Related Abridgment Classifications
Bankruptcy and insolvency
XIX Companies' Creditors Arrangement Act
XIX.5 Miscellaneous
Headnote
Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Miscellaneous
Applicant SFC was granted stay under Companies' Creditors Arrangement Act (CCAA) in March 2012 and on same date sales process order was granted — June 20, 2012 was established as claims bar date — SFC support of 72 per cent of noteholders for intended to plan of compromise or arrangement — Class actions had been commenced against SFC in both Ontario, Quebec, Saskatchewan, and New York State for damages resulting to purchase of shares in SFC at inflated prices — Applicant brought application for declaration that claims against it which resulted from ownership, purchase, or sale of equity interest in SFC, and related indemnity claims, were equity claims as defined in s. 2 of CCAA — Application granted — Basis for differentiation flowed from fundamentally different nature of debt and equity investments; shareholders had unlimited upside potential when purchasing shares, while creditors had no corresponding upside potential — Claims advanced in shareholder claims were clearly equity claims — Shareholder claims underlay related indemnity claims — Plain language in definition of equity claim in CCAA did not focus on identity of claimant, rather, it focused on nature of claim — It would be totally inconsistent to arrive at conclusion that would enable either auditors or underwriters, through claim for indemnification, to be treated as creditors when underlying actions of shareholders could not achieve same status.
Table of Authorities
Cases considered by *Morawetz J.*:

Blue Range Resource Corp., Re (2000), 2000 CarswellAlta 12, 259 A.R. 30, 76 Alta. L.R. (3d) 338, [2000] 4 W.W.R. 738, 2000 ABQB 4, 15 C.B.R. (4th) 169 (Alta. Q.B.) — referred to

Central Capital Corp., Re (1996), 132 D.L.R. (4th) 223, 27 O.R. (3d) 494, (sub nom. *Royal Bank v. Central Capital Corp.)* 88 O.A.C. 161, 1996 CarswellOnt 316, 38 C.B.R. (3d) 1, 26 B.L.R. (2d) 88 (Ont. C.A.) — referred to

EarthFirst Canada Inc., Re (2009), 2009 ABQB 316, 2009 CarswellAlta 1069, 56 C.B.R. (5th) 102 (Alta. Q.B.) — referred to

Nelson Financial Group Ltd., Re (2010), 71 C.B.R. (5th) 153, 75 B.L.R. (4th) 302, 2010 ONSC 6229, 2010 CarswellOnt 8655 (Ont. S.C.J. [Commercial List]) — referred to

Return on Innovation Capital Ltd. v. Gandi Innovations Ltd. (2011), 2011 CarswellOnt 8590, 2011 ONSC 5018, 83 C.B.R. (5th) 123 (Ont. S.C.J. [Commercial List]) — followed

Return on Innovation Capital Ltd. v. Gandi Innovations Ltd. (2012), 2012 ONCA 10, 2012 CarswellOnt 103, 90 C.B.R. (5th) 141 (Ont. C.A.) — referred to

Stelco Inc., Re (2006), 2006 CarswellOnt 407, 17 C.B.R. (5th) 95 (Ont. S.C.J. [Commercial List]) — referred to

Statutes considered:

Bankruptcy Code, 11 U.S.C. 1982

s. 510(b) — referred to

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36

Generally — referred to

s. 2(1) — considered

s. 2(1) "equity claim" — considered

s. 2(1) "equity claim" (d) — considered

s. 2(1) "equity claim" (e) — considered

s. 2(1) "equity interest" — considered

s. 2(1) "equity interest" (a) — referred to

s. 6(8) — referred to

s. 22(1) — referred to

Securities Act, R.S.O. 1990, c. S.5

Generally — referred to

***Morawetz J.*:**

Overview

1 Sino-Forest Corporation ("SFC" or the "Applicant") seeks an order directing that claims against SFC, which result from the ownership, purchase or sale of an equity interest in SFC, are "equity claims" as defined in section 2 of the *Companies' Creditors Arrangement Act* ("CCAA") including, without limitation: (i) the claims by or on behalf of current or former shareholders asserted in the proceedings listed in Schedule "A" (collectively, the "Shareholder Claims"); and (ii) any indemnification claims against SFC related to or arising from the Shareholder Claims, including, without limitation, those by or on behalf of any of the other defendants to the proceedings listed in Schedule "A" (the "Related Indemnity Claims").

2 SFC takes the position that the Shareholder Claims are "equity claims" as defined in the CCAA as they are claims in respect of a monetary loss resulting from the ownership, purchase or sale of an equity interest in SFC and, therefore, come within the definition. SFC also takes the position that the Related Indemnity Claims are "equity claims" as defined in the CCAA as they are claims for contribution or indemnity in respect of a claim that is an equity claim and, therefore, also come within the definition.

3 On March 30, 2012, the court granted the Initial Order providing for the CCAA stay against SFC and certain of its subsidiaries. FTI Consulting Canada Inc. was appointed as Monitor.

4 On the same day, the Sales Process Order was granted, approving Sales Process procedures and authorizing and directing SFC, the Monitor and Houlihan Lokey to carry out the Sales Process.

5 On May 14, 2012, the court issued a Claims Procedure Order, which established June 20, 2012 as the Claims Bar Date.

6 The stay of proceedings has since been extended to September 28, 2012.

7 Since the outset of the proceedings, SFC has taken the position that it is important for these proceedings to be completed as soon as possible in order to, among other things, (i) enable the business operated in the Peoples Republic of China ("PRC") to be separated from SFC and put under new ownership; (ii) enable the restructured business to participate in the Q4 sales season in the PRC market; and (iii) maintain the confidence of stakeholders in the PRC (including local and national governmental bodies, PRC lenders and other stakeholders) that the business in the PRC can be successfully separated from SFC and operate in the ordinary course in the near future.

8 SFC has negotiated a Support Agreement with the Ad Hoc Committee of Noteholders and intends to file a plan of compromise or arrangement (the "Plan") under the CCAA by no later than August 27, 2012, based on the deadline set out in the Support Agreement and what they submit is the commercial reality that SFC must complete its restructuring as soon as possible.

9 Noteholders holding in excess of $1.296 billion, or approximately 72% of the approximately $1.8 billion of SFC's noteholders' debt, have executed written support agreements to support the SFC CCAA Plan as of March 30, 2012.

Shareholder Claims Asserted Against SFC

(i) Ontario

10 By Fresh as Amended Statement of Claim dated April 26, 2012 (the "Ontario Statement of Claim"), the Trustees of the Labourers' Pension Fund of Central and Eastern Canada and other plaintiffs asserted various claims in a class proceeding (the "Ontario Class Proceedings") against SFC, certain of its current and former officers and directors, Ernst & Young LLP ("E&Y"), BDO Limited ("BDO"), Poyry (Beijing) Consulting Company Limited ("Poyry") and SFC's underwriters (collectively, the "Underwriters").

11 Section 1(m) of the Ontario Statement of Claim defines "class" and "class members" as:

> All persons and entities, wherever they may reside who acquired Sino's Securities during the Class Period by distribution in Canada or on the Toronto Stock Exchange or other secondary market in Canada, which securities include those acquired over the counter, and all persons and entities who acquired Sino's Securities during the Class Period who are resident of Canada or were resident of Canada at the time of acquisition and who acquired Sino's Securities outside of Canada, except the Excluded Persons.

12 The term "Securities" is defined as "Sino's common shares, notes and other securities, as defined in the OSA". The term "Class Period" is defined as the period from and including March 19, 2007 up to and including June 2, 2011.

13 The Ontario Class Proceedings seek damages in the amount of approximately $9.2 billion against SFC and the other defendants.

14 The thrust of the complaint in the Ontario Class Proceedings is that the class members are alleged to have purchased securities at "inflated prices during the Class Period" and that absent the alleged misconduct, sales of such securities "would have occurred at prices that reflected the true value" of the securities. It is further alleged that "the price of Sino's Securities was directly affected during the Class Period by the issuance of the Impugned Documents".

(ii) Quebec

15 By action filed in Quebec on June 9, 2011, Guining Liu commenced an action (the "Quebec Class Proceedings") against SFC, certain of its current and former officers and directors, E&Y and Poyry. The Quebec Class Proceedings do not name BDO or the Underwriters as defendants. The Quebec Class Proceedings also do not specify the quantum of damages sought, but rather reference "damages in an amount equal to the losses that it and the other members of the group suffered as a result of purchasing or acquiring securities of Sino at inflated prices during the Class Period".

16 The complaints in the Quebec Class Proceedings centre on the effect of alleged misrepresentations on the share price. The duty allegedly owed to the class members is said to be based in "law and other provisions of the *Securities Act*", to ensure the prompt dissemination of truthful, complete and accurate statements regarding SFC's business and affairs and to correct any previously-issued materially inaccurate statements.

(iii) Saskatchewan

17 By Statement of Claim dated December 1, 2011 (the "Saskatchewan Statement of Claim"), Mr. Allan Haigh commenced an action (the "Saskatchewan Class Proceedings") against SFC, Allen Chan and David Horsley.

18 The Saskatchewan Statement of Claim does not specify the quantum of damages sought, but instead states in more general terms that the plaintiff seeks "aggravated and compensatory damages against the defendants in an amount to be determined at trial".

19 The Saskatchewan Class Proceedings focus on the effect of the alleged wrongful acts upon the trading price of SFC's securities:

> The price of Sino's securities was directly affected during the Class Period by the issuance of the Impugned Documents. The defendants were aware at all material times that the effect of Sino's disclosure documents upon the price of its Sino's [sic] securities.

(iv) New York

20 By Verified Class Action Complaint dated January 27, 2012, (the "New York Complaint"), Mr. David Leapard and IMF Finance SA commenced a class proceeding against SFC, Mr. Allen Chan, Mr. David Horsley, Mr. Kai Kit Poon, a subset of the Underwriters, E&Y, and Ernst & Young Global Limited (the "New York Class Proceedings").

21 SFC contends that the New York Class Proceedings focus on the effect of the alleged wrongful acts upon the trading price of SFC's securities.

22 The plaintiffs in the various class actions have named parties other than SFC as defendants, notably, the Underwriters and the auditors, E&Y, and BDO, as summarized in the table below. The positions of those parties are detailed later in these reasons.

	Ontario	**Quebec**	**Saskatchewan**	**New York**
E&Y LLP	X	X	-	X
E&Y Global	-	-	-	X
BDO	X	-	-	-
Poyry	X	X	-	-
Underwriters	11	-	-	2

Legal Framework

23 Even before the 2009 amendments to the CCAA dealing with equity claims, courts recognized that there is a fundamental difference between shareholder equity claims as they relate to an insolvent entity versus creditor claims. Essentially, shareholders

cannot reasonably expect to maintain a financial interest in an insolvent company where creditor claims are not being paid in full. Simply put, shareholders have no economic interest in an insolvent enterprise: *Blue Range Resource Corp., Re*, [2000] 4 W.W.R. 738 (Alta. Q.B.) [*Blue Range Resources*]; *Stelco Inc., Re* [2006 CarswellOnt 407 (Ont. S.C.J. [Commercial List])], (2006) CanLII 1773 [*Stelco*]; *Central Capital Corp., Re* (1996), 27 O.R. (3d) 494 (Ont. C.A.).

24 The basis for the differentiation flows from the fundamentally different nature of debt and equity investments. Shareholders have unlimited upside potential when purchasing shares. Creditors have no corresponding upside potential: *Nelson Financial Group Ltd., Re*, 2010 ONSC 6229 (Ont. S.C.J. [Commercial List]) [*Nelson Financial*].

25 As a result, courts subordinated equity claims and denied such claims a vote in plans of arrangement: *Blue Range Resource Corp., Re*, *supra*; *Stelco Inc., Re*, *supra*; *EarthFirst Canada Inc., Re* (2009), 56 C.B.R. (5th) 102 (Alta. Q.B.) [*EarthFirst Canada*]; and *Nelson Financial*, *supra*.

26 In 2009, significant amendments were made to the CCAA. Specific amendments were made with the intention of clarifying that equity claims are subordinated to other claims.

27 The 2009 amendments define an "equity claim" and an "equity interest". Section 2 of the CCAA includes the following definitions:

> "Equity Claim" means a claim that is in respect of an equity interest, including a claim for, among others, (...)
>
> (d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or
>
> (e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d);
>
> "Equity Interest" means
>
> (a) in the case of a company other than an income trust, a share in the company — or a warrant or option or another right to acquire a share in the company — other than one that is derived from a convertible debt,

28 Section 6(8) of the CCAA prohibits a distribution to equity claimants prior to payment in full of all non-equity claims.

29 Section 22(1) of the CCAA provides that equity claimants are prohibited from voting on a plan unless the court orders otherwise.

Position of Ernst & Young

30 E&Y opposes the relief sought, at least as against E&Y, since the E&Y proof of claim evidence demonstrates in its view that E&Y's claim:

> (a) is not an equity claim;
>
> (b) does not derive from or depend upon an equity claim (in whole or in part);
>
> (c) represents discreet and independent causes of action as against SFC and its directors and officers arising from E&Y's direct contractual relationship with such parties (or certain of such parties) and/or the tortious conduct of SFC and/or its directors and officers for which they are in law responsible to E&Y; and
>
> (d) can succeed independently of whether or not the claims of the plaintiffs in the class actions succeed.

31 In its factum, counsel to E&Y acknowledges that during the periods relevant to the Class Action Proceedings, E&Y was retained as SFC's auditor and acted as such from 2007 until it resigned on April 5, 2012.

32 On June 2, 2011, Muddy Waters LLC ("Muddy Waters") issued a report which purported to reveal fraud at SFC. In the wake of that report, SFC's share price plummeted and Muddy Waters profited from its short position.

33 E&Y was served with a multitude of class action claims in numerous jurisdictions.

34 The plaintiffs in the Ontario Class Proceedings claim damages in the aggregate, as against all defendants, of $9.2 billion on behalf of resident and non-resident shareholders and noteholders. The causes of action alleged are both statutory, under the *Securities Act (Ontario)* and at common law, in negligence and negligent misrepresentation.

35 In its factum, counsel to E&Y acknowledges that the central claim in the class actions is that SFC made a series of misrepresentations in respect of its timber assets. The claims against E&Y and the other third party defendants are that they failed to detect these misrepresentations and note in particular that E&Y's audit did not comply with Canadian generally accepted accounting standards. Similar claims are advanced in Quebec and the U.S.

36 Counsel to E&Y notes that on May 14, 2012 the court granted a Claims Procedure Order which, among other things, requires proofs of claim to be filed no later than June 20, 2012. E&Y takes issue with the fact that this motion was then brought notwithstanding that proofs of claim and D&O proofs of claim had not yet been filed.

37 E&Y has filed with the Monitor, in accordance with the Claims Procedure Order, a proof of claim against SFC and a proof of claim against the directors and officers of SFC.

38 E&Y takes the position that it has contractual claims of indemnification against SFC and its subsidiaries and has statutory and common law claims of contribution and/or indemnity against SFC and its subsidiaries for all relevant years. E&Y contends that it has stand-alone claims for breach of contract and negligent and/or fraudulent misrepresentation against the company and its directors and officers.

39 Counsel submits that E&Y's claims against Sino-Forest and the SFC subsidiaries are:

(a) creditor claims;

(b) derived from E&Y retainers by and/or on behalf of Sino-Forest and the SFC subsidiaries and E&Y's relationship with such parties, all of which are wholly independent and conceptually different from the claims advanced by the class action plaintiffs;

(c) claims that include the cost of defending and responding to various proceedings, both pre- and post-filing; and

(d) not equity claims in the sense contemplated by the CCAA. E&Y's submission is that equity holders of Sino-Forest have not advanced, and could not advance, any claims against SFC's subsidiaries.

40 Counsel further contends that E&Y's claim is distinct from any and all potential and actual claims by the plaintiffs in the class actions against Sino-Forest and that E&Y's claim for contribution and/or indemnity is not based on the claims against Sino-Forest advanced in the class actions but rather only in part on those claims, as any success of the plaintiffs in the class actions against E&Y would not necessarily lead to success against Sino-Forest, and vice versa. Counsel contends that E&Y has a distinct claim against Sino-Forest independent of that of the plaintiffs in the class actions. The success of E&Y's claims against Sino-Forest and the SFC subsidiaries, and the success of the claims advanced by the class action plaintiffs, are not co-dependent. Consequently, counsel contends that E&Y's claim is that of an unsecured creditor.

41 From a policy standpoint, counsel to E&Y contends that the nature of the relationship between a shareholder, who may be in a position to assert an equity claim (in addition to other claims) is fundamentally different from the relationship existing between a corporation and its auditors.

Position of BDO Limited

42 BDO was auditor of Sino-Forest Corporation between 2005 and 2007, when it was replaced by E&Y.

43 BDO has a filed a proof of claim against Sino-Forest pursuant to the Claims Procedure Order.

44 BDO's claim against Sino-Forest is primarily for breach of contract.

45 BDO takes the position that its indemnity claims, similar to those advanced by E&Y and the Underwriters, are not equity claims within the meaning of s. 2 of the CCAA.

46 BDO adopts the submissions of E&Y which, for the purposes of this endorsement, are not repeated.

Position of the Underwriters

47 The Underwriters take the position that the court should not decide the equity claims motion at this time because it is premature or, alternatively, if the court decides the equity claims motion, the equity claims order should not be granted because the Related Indemnity Claims are not "equity claims" as defined in s. 2 of the CCAA.

48 The Underwriters are among the defendants named in some of the class actions. In connection with the offerings, certain Underwriters entered into agreements with Sino-Forest and certain of its subsidiaries providing that Sino-Forest and, with respect to certain offerings, the Sino-Forest subsidiary companies, agree to indemnify and hold harmless the Underwriters in connection with an array of matters that could arise from the offerings.

49 The Underwriters raise the following issues:

(i) Should this court decide the equity claims motion at this time?

(ii) If this court decides the equity claims motion at this time, should the equity claims order be granted?

50 On the first issue, counsel to the Underwriters takes the position that the issue is not yet ripe for determination.

51 Counsel submits that, by seeking the equity claims order at this time, Sino-Forest is attempting to pre-empt the Claims Procedure Order, which already provides a process for the determination of claims. Until such time as the claims procedure in respect of the Related Indemnity Claims is completed, and those claims are determined pursuant to that process, counsel contends the subject of the equity claims motion raises a merely hypothetical question as the court is being asked to determine the proper interpretation of s. 2 of the CCAA before it has the benefit of an actual claim in dispute before it.

52 Counsel further contends that by asking the court to render judgment on the proper interpretation of s. 2 of the CCAA in the hypothetical, Sino-Forest has put the court in a position where its judgment will not be made in the context of particular facts or with a full and complete evidentiary record.

53 Even if the court determines that it can decide this motion at this time, the Underwriters submit that the relief requested should not be granted.

Position of the Applicant

54 The Applicant submits that the amendments to the CCAA relating to equity claims closely parallel existing U.S. law on the subject and that Canadian courts have looked to U.S. courts for guidance on the issue of equity claims as the subordination of equity claims has long been codified there: see e.g. *Blue Range Resources*, *supra*, and *Nelson Financial*, *supra*.

55 The Applicant takes the position that based on the plain language of the CCAA, the Shareholder Claims are "equity claims" as defined in s. 2 as they are claims in respect of a "monetary loss resulting from the ownership, purchase or sale of an equity interest".

56 The Applicant also submits the following:

> (a) the Ontario, Quebec, Saskatchewan and New York Class Actions (collectively, the "Class Actions") all advance claims on behalf of shareholders.
>
> (b) the Class Actions also allege wrongful conduct that affected the trading price of the shares, in that the alleged misrepresentation "artificially inflated" the share price; and
>
> (c) the Class Actions seek damages relating to the trading price of SFC shares and, as such, allege a "monetary loss" that resulted from the ownership, purchase or sale of shares, as defined in s. 2 of the CCAA.

57 Counsel further submits that, as the Shareholder Claims are "equity claims", they are expressly subordinated to creditor claims and are prohibited from voting on the plan of arrangement.

58 Counsel to the Applicant also submits that the definition of "equity claims" in s. 2 of the CCAA expressly includes indemnity claims that relate to other equity claims. As such, the Related Indemnity Claims are equity claims within the meaning of s. 2.

59 Counsel further submits that there is no distinction in the CCAA between the source of any claim for contribution or indemnity; whether by statute, common law, contractual or otherwise. Further, and to the contrary, counsel submits that the legal characterization of a contribution or indemnity claim depends solely on the characterization of the primary claim upon which contribution or indemnity is sought.

60 Counsel points out that in *Return on Innovation Capital Ltd. v. Gandi Innovations Ltd.*, 2011 ONSC 5018 (Ont. S.C.J. [Commercial List]), leave to appeal denied, 2012 ONCA 10 (Ont. C.A.) [*Return on Innovation*] this court characterized the contractual indemnification claims of directors and officers in respect of an equity claim as "equity claims".

61 Counsel also submits that guidance on the treatment of underwriter and auditor indemnification claims can be obtained from the U.S. experience. In the U.S., courts have held that the indemnification claims of underwriters for liability or defence costs constitute equity claims that are subordinated to the claims of general creditors. Counsel submits that insofar as the primary source of liability is characterized as an equity claim, so too is any claim for contribution and indemnity based on that equity claim.

62 In this case, counsel contends, the Related Indemnity Claims are clearly claims for "contribution and indemnity" based on the Shareholder Claims.

Position of the Ad Hoc Noteholders

63 Counsel to the Ad Hoc Noteholders submits that the Shareholder Claims are "equity claims" as they are claims in respect of an equity interest and are claims for "a monetary loss resulting from the ownership, purchase or sale of an equity interest" per subsection (d) of the definition of "equity claims" in the CCAA.

64 Counsel further submits that the Related Indemnity Claims are also "equity claims" as they fall within the "clear and unambiguous" language used in the definition of "equity claim" in the CCAA. Subsection (e) of the definition refers expressly and without qualification to claims for "contribution or indemnity" in respect of claims such as the Shareholder Claims.

65 Counsel further submits that had the legislature intended to qualify the reference to "contribution or indemnity" in order to exempt the claims of certain parties, it could have done so, but it did not.

66 Counsel also submits that, if the plain language of subsection (e) is not upheld, shareholders of SFC could potentially create claims to receive indirectly what they could not receive directly (*i.e.*, payment in respect of equity claims through the

Related Indemnity Claims) — a result that could not have been intended by the legislature as it would be inconsistent with the purposes of the CCAA.

67 Counsel to the Ad Hoc Noteholders also submits that, before the CCAA amendments in 2009 (the "CCAA Amendments"), courts subordinated claims on the basis of:

> (a) the general expectations of creditors and shareholders with respect to priority and assumption of risks; and
>
> (b) the equitable principles and considerations set out in certain U.S. cases: see e.g. *Blue Range Resource Corp., Re*, *supra*.

68 Counsel further submits that, before the CCAA Amendments took effect, courts had expanded the types of claims characterized as equity claims; first to claims for damages of defrauded shareholders and then to contractual indemnity claims of shareholders: see *Blue Range Resources*, *supra* and *EarthFirst Canada*, *supra*.

69 Counsel for the Ad Hoc Noteholders also submits that indemnity claims of underwriters have been treated as equity claims in the United States, pursuant to section 510(b) of the U.S. Bankruptcy Code. This submission is detailed at paragraphs 20-25 of their factum which reads as follows:

> 20. The desire to more closely align the Canadian approach to equity claims with the U.S. approach was among the considerations that gave rise to the codification of the treatment of equity claims. Canadian courts have also looked to the U.S. law for guidance on the issue of equity claims where codification of the subordination of equity claims has been long-standing.
>
> Janis Sarra at p. 209, Ad Hoc Committee's Book of Authorities, Tab 10.
>
> Report of the Standing Senate Committee on Banking, Trade and Commerce, "Debtors and Creditors Sharing the Burden: A Review of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement act*" (2003) at 158, [...]
>
> *Blue Range* [*Resources*] at paras. 41-57 [...]
>
> 21. Pursuant to § 510(b) of the *U.S. Bankruptcy Code*, all creditors must be paid in full before shareholders are entitled to receive any distribution. § 510(b) of the *U.S. Bankruptcy Code* and the relevant portion of § 502, which is referenced in § 510(b), provide as follows:
>
> § 510. Subordination
>
> (b) For the purpose of distribution under this title, a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution allowed under 502 on account of such a claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such security is common stock, such claim has the same priority as common stock.
>
> § 502. Allowance of claims or interests
>
> (e) (1) Notwithstanding subsections (a), (b) and (c) of this section and paragraph (2) of this subsection, the court shall disallow any claim for reimbursement or contribution of an entity that is liable with the debtor on or has secured the claim of a creditor, to the extent that
>
> . . .
>
> (B) such claim for reimbursement or contribution is contingent as of the time of allowance or disallowance of such claim for reimbursement or contribution; or

. . .

(2) A claim for reimbursement or contribution of such an entity that becomes fixed after the commencement of the case shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section, or disallowed under subsection (d) of this section, the same as if such claim had become fixed before the date of the filing of the petition.

22. U.S. appellate courts have interpreted the statutory language in § 510(b) broadly to subordinate the claims of shareholders that have a nexus or causal relationship to the purchase or sale of securities, including damages arising from alleged illegality in the sale or purchase of securities or from corporate misconduct whether predicated on pre or post-issuance conduct.

Re Telegroup Inc. (2002), 281 F. 3d 133 (3rd Cir. U.S. Court of Appeals)

[...]

American Broadcasting Systems Inc. v. Nugent, U.S. Court of Appeals for the Ninth Circuit, Case Number 98-17133 (24 January 2001) [...]

23. Further, U.S. courts have held that indemnification claims of underwriters against the corporation for liability or defence costs when shareholders or former shareholders have sued underwriters constitute equity claims in the insolvency of the corporation that are subordinated to the claims of general creditors based on: (a) the plain language of § 510(b), which references claims for "reimbursement or contribution" and (b) risk allocation as between general creditors and those parties that play a role in the purchase and sale of securities that give rise to the shareholder claims (i.e., directors, officers and underwriters).

In re Mid-American Waste Sys., 228 B.R. 816, 1999 Bankr. LEXIS 27 (Bankr. D. Del. 1999) [*Mid-American*] [...]

In re Jacom Computer Servs., 280 B.R. 570, 2002 Bankr. LEXIS 758 (Bankr. S.D.N.Y. 2002) [...]

24. In *Mid-American*, the Court stated the following with respect to the "plain language" of § 510(b), its origins and the inclusion of "reimbursement or contribution" claims in that section:

... I find that the plain language of § 510(b), its legislative history, and applicable case law clearly show that § 510(b) intends to subordinate the indemnification claims of officers, directors, and underwriters for both liability and expenses incurred in connection with the pursuit of claims for rescission or damages by purchasers or sellers of the debtor's securities. The meaning of amended § 510(b), specifically the language "for reimbursement or contribution ... on account of [a claim arising from rescission or damages arising from the purchase or sale of a security]," can be discerned by a plain reading of its language.

... it is readily apparent that the rationale for section 510(b) is not limited to preventing shareholder claimants from improving their position vis-a-vis general creditors; *Congress also made the decision to subordinate based on risk allocation. Consequently, when Congress amended § 510(b) to add reimbursement and contribution claims, it was not radically departing from an equityholder claimant treatment provision, as NatWest suggests; it simply added to the subordination treatment new classes of persons and entities involved with the securities transactions giving rise to the rescission and damage claims*. The 1984 amendment to § 510(b) is a logical extension of one of the rationales for the original section — *because Congress intended the holders of securities law claims to be subordinated, why not also subordinate claims of other parties (e.g., officers and directors and underwriters) who play a role in the purchase and sale transactions which give rise to the securities law claims?* As I view it, in 1984 Congress made a legislative judgment that claims emanating from tainted securities law transactions should not have the same priority as the claims of general creditors of the estate.

[emphasis added]

[...]

25. Further, the U.S. courts have held that the degree of culpability of the respective parties is a non-issue in the disallowance of claims for indemnification of underwriters; the equities are meant to benefit the debtor's direct creditors, not secondarily liable creditors with contingent claims.

In re Drexel Burnham Lambert Group, 1992 Bankr. LEXIS 2023 (Bankr. S.D.N.Y. 1992) [...]

70 Counsel submits that there is no principled basis for treating indemnification claims of auditors differently than those of underwriters.

Analysis

Is it Premature to Determine the Issue?

71 The class action litigation was commenced prior to the CCAA Proceedings. It is clear that the claims of shareholders as set out in the class action claims against SFC are "equity claims" within the meaning of the CCAA.

72 In my view, this issue is not premature for determination, as is submitted by the Underwriters.

73 The Class Action Proceedings preceded the CCAA Proceedings. It has been clear since the outset of the CCAA Proceedings that this issue — namely, whether the claims of E&Y, BDO and the Underwriters as against SFC, would be considered "equity claims" — would have to be determined.

74 It has also been clear from the outset of the CCAA Proceedings, that a Sales Process would be undertaken and the expected proceeds arising from the Sales Process would generate proceeds insufficient to satisfy the claims of creditors.

75 The Claims Procedure is in place but, it seems to me that the issue that has been placed before the court on this motion can be determined independently of the Claims Procedure. I do not accept that any party can be said to be prejudiced if this threshold issue is determined at this time. The threshold issue does not depend upon a determination of quantification of any claim. Rather, its effect will be to establish whether the claims of E&Y, BDO and the Underwriters will be subordinated pursuant to the provisions of the CCAA. This is independent from a determination as to the validity of any claim and the quantification thereof.

Should the Equity Claims Order be Granted?

76 I am in agreement with the submission of counsel for the Ad Hoc Noteholders to the effect that the characterization of claims for indemnity turns on the characterization of the underlying primary claims.

77 In my view, the claims advanced in the Shareholder Claims are clearly equity claims. The Shareholder Claims underlie the Related Indemnity Claims.

78 In my view, the CCAA Amendments have codified the treatment of claims addressed in pre-amendment cases and have further broadened the scope of equity claims.

79 The plain language in the definition of "equity claim" does not focus on the identity of the claimant. Rather, it focuses on the nature of the claim. In this case, it seems clear that the Shareholder Claims led to the Related Indemnity Claims. Put another way, the inescapable conclusion is that the Related Indemnity Claims are being used to recover an equity investment.

80 The plain language of the CCAA dictates the outcome, namely, that the Shareholder Claims and the Related Indemnity Claims constitute "equity claims" within the meaning of the CCAA. This conclusion is consistent with the trend towards an expansive interpretation of the definition of "equity claims" to achieve the purpose of the CCAA.

81 In *Return on Innovation*, Newbould J. characterized the contractual indemnification claims of directors and officers as "equity claims". The Court of Appeal denied leave to appeal. The analysis in *Return on Innovation* leads to the conclusion that the Related Indemnity Claims are also equity claims under the CCAA.

82 It would be totally inconsistent to arrive at a conclusion that would enable either the auditors or the Underwriters, through a claim for indemnification, to be treated as creditors when the underlying actions of the shareholders cannot achieve the same status. To hold otherwise would indeed provide an indirect remedy where a direct remedy is not available.

83 Further, on the issue of whether the claims of E&Y, BDO and the Underwriters fall within the definition of equity claims, there are, in my view, two aspects of these claims and it is necessary to keep them conceptually separate.

84 The first and most significant aspect of the claims of E&Y, BDO and the Underwriters constitutes an "equity claim" within the meaning of the CCAA. Simply put, but for the Class Action Proceedings, it is inconceivable that claims of this magnitude would have been launched by E&Y, BDO and the Underwriters as against SFC. The class action plaintiffs have launched their actions against SFC, the auditors and the Underwriters. In turn, E&Y, BDO and the Underwriters have launched actions against SFC and its subsidiaries. The claims of the shareholders are clearly "equity claims" and a plain reading of s. 2(1)(e) of the CCAA leads to the same conclusion with respect to the claims of E&Y, BDO and the Underwriters. To hold otherwise, would, as stated above, lead to a result that is inconsistent with the principles of the CCAA. It would potentially put the shareholders in a position to achieve creditor status through their claim against E&Y, BDO and the Underwriters even though a direct claim against SFC would rank as an "equity claim".

85 I also recognize that the legal construction of the claims of the auditors and the Underwriters as against SFC is different than the claims of the shareholders against SFC. However, that distinction is not, in my view, reflected in the language of the CCAA which makes no distinction based on the status of the party but rather focuses on the substance of the claim.

86 Critical to my analysis of this issue is the statutory language and the fact that the CCAA Amendments came into force after the cases relied upon by the Underwriters and the auditors.

87 It has been argued that the amendments did nothing more than codify pre-existing common law. In many respects, I accept this submission. However, I am unable to accept this submission when considering s. 2(1) of the CCAA, which provides clear and specific language directing that "equity claim" means a claim that is in respect of an equity interest, including a claim for, among other things, "(e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d)".

88 Given that a shareholder claim falls within s. 2(1)(d), the plain words of subsections (d) and (e) lead to the conclusions that I have set out above.

89 I fail to see how the very clear words of subsection (e) can be seen to be a codification of existing law. To arrive at the conclusion put forth by E&Y, BDO and the Underwriters would require me to ignore the specific words that Parliament has recently enacted.

90 I cannot agree with the position put forth by the Underwriters or by the auditors on this point. The plain wording of the statute has persuaded me that it does not matter whether an indemnity claim is seeking no more than allocation of fault and contribution at common law, or whether there is a free-standing contribution and indemnity claim based on contracts.

91 However, that is not to say that the full amount of the claim by the auditors and Underwriters can be characterized, at this time, as an "equity claim".

92 The second aspect to the claims of the auditors and underwriters can be illustrated by the following hypothetical: if the claim of the shareholders does not succeed against the class action defendants, E&Y, BDO and the Underwriters will not be liable to the class action plaintiffs. However, these parties may be in a position to demonstrate that they do have a claim against SFC for the costs of defending those actions, which claim does not arise as a result of "contribution or indemnity in respect of an equity claim".

93 It could very well be that each of E&Y, BDO and the Underwriters have expended significant amounts in defending the claims brought by the class action plaintiffs which, in turn, could give rise to contractual claims as against SFC. If there is no successful equity claim brought by the class action plaintiffs, it is arguable that any claim of E&Y, BDO and the Underwriters may legitimately be characterized as a claim for contribution or indemnity but not necessarily in respect of an equity claim. If so, there is no principled basis for subordinating this portion of the claim. At this point in time, the quantification of such a claim cannot be determined. This must be determined in accordance with the Claims Procedure.

94 However, it must be recognized that, by far the most significant part of the claim, is an "equity claim".

95 In arriving at this determination, I have taken into account the arguments set forth by E&Y, BDO and the Underwriters. My conclusions recognize the separate aspects of the Related Indemnity Claims as submitted by counsel to the Underwriters at paragraph 40 of their factum which reads:

> ...it must be recognized that there are, in fact, at least two different kinds of Related Indemnity Claims:
>
> (a) indemnity claims against SFC in respect of Shareholder Claims against the auditors and the Underwriters; and
>
> (b) indemnity claims against SFC in respect of the defence costs of the auditors and the Underwriters in connection with defending themselves against Shareholder Claims.

Disposition

96 In the result, an order shall issue that the claims against SFC resulting from the ownership, purchase or sale of equity interests in SFC, including, without limitation, the claims by or on behalf of current or former shareholders asserted in the proceedings listed in Schedule "A" are "equity claims" as defined in s. 2 of the CCAA, being claims in respect of monetary losses resulting from the ownership, purchase or sale of an equity interest. It is noted that counsel for the class action plaintiffs did not contest this issue.

97 In addition, an order shall also issue that any indemnification claim against SFC related to or arising from the Shareholders Claims, including, without limitation, by or on behalf of any of the other defendants to the proceedings listed in Schedule "A" are "equity claims" under the CCAA, being claims for contribution or indemnity in respect of a claim that is an equity claim. However, I feel it is premature to determine whether this order extends to the aspect of the Related Indemnity Claims that corresponds to the defence costs of the Underwriters and the auditors in connection with defending themselves against the Shareholder Claims.

98 A direction shall also issue that these orders are made without prejudice to SFC's rights to apply for a similar order with respect to (i) any claims in the statement of claim that are in respect of securities other than shares and (ii) any indemnification claims against SFC related thereto.

Schedule "A" — Shareholder Claims

1. *Trustees of the Labourers' Pension Fund of Central and Eastern Canada et al. v. Sino-Forest Corporation et al.* (Ontario Superior Court of Justice, Court File No. CV-11-431153-00CP)

2. *Guining Liu v. Sino-Forest Corporation et al.* (Quebec Superior Court, Court File No.: 200-06-000132-111)

3. *Allan Haigh v. Sino-Forest Corporation et al.* (Saskatchewan Court of Queen's Bench, Court File No. 2288 of 2011)

4. *David Leapard et al. v. Allen T.Y. Chan et al.* (District court of the Southern District of New York, Court File No. 650258/2012)

Application granted.

TAB “E”

2012 ONCA 816
Ontario Court of Appeal

Sino-Forest Corp., Re

2012 CarswellOnt 14701, 2012 ONCA 816, 114 O.R. (3d) 304,
225 A.C.W.S. (3d) 601, 299 O.A.C. 107, 98 C.B.R. (5th) 20

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

And In the Matter of a Plan of Compromise or Arrangement of Sino-Forest Corporation

S.T. Goudge, Alexandra Hoy, S.E. Pepall JJ.A.

Heard: November 13, 2012
Judgment: November 23, 2012
Docket: C56115, C56118, C56125

Proceedings: affirming *Sino-Forest Corp., Re* (2012), 92 C.B.R. (5th) 99, 2012 CarswellOnt 9430, 2012 ONSC 4377 (Ont. S.C.J. [Commercial List])

Counsel: Peter H. Griffin, Peter J. Osborne, Shara Roy for Appellant, Ernst & Young LLP
Sheila Block, David Bish for Appellants, Credit Suisse Securities (Canada) Inc., TD Securities Inc., Dundee Securities Corporation (now known as DWM Securities Inc.), RBC Dominion Securities Inc., Scotia Capital Inc., CIBC World Markets Inc., Merrill Lynch Canada Inc., Canaccord Financial Ltd. (now known as Canaccord Genuity Corp.), Maison Placements Canada Inc., Credit Suisse Securities (USA) LLC and Merrill Lynch, Pierce, Fenner & Smith Incorporated, successor by merger to Banc of America Securities LLC
Kenneth Dekker for Appellant, BDO Limited
Robert W. Staley, Derek J. Bell, Jonathan Bell for Respondent, Sino-Forest Corporation
Benjamin Zarnett, Robert Chadwick, Julie Rosenthal for Respondent, Ad Hoc Committee of Noteholders
Clifton Prophet for Monitor, FTI Consulting Canada Inc.
Kirk M. Baert, A. Dimitri Lascaris, Massimo Starnino for Respondent, Ad Hoc Committee of Purchasers
Emily Cole for Respondent, Allen Chan
Erin Pleet for Respondent, David Horsley
David Gadsden for Respondent, Pöyry (Beijing)
Larry Lowenstein, Edward A. Sellers for Respondent, Board of Directors

Related Abridgment Classifications
Bankruptcy and insolvency
XIX Companies' Creditors Arrangement Act
XIX.5 Miscellaneous
Headnote
Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Miscellaneous
In class actions, shareholders alleged that corporation misrepresented assets and financial situation, and that auditors and underwriters failed to detect misrepresentations — Corporation obtained protection under Companies' Creditors Arrangements Act (CCAA) — As yet uncertified class actions were stayed — Supervising judge granted claims procedure order — Auditors and underwriters filed individual proofs of claims against corporation for contribution and indemnity for any amounts they were ordered to pay under class actions — Corporation applied successfully for order that auditors' and underwriters' claims were equity claims under CCAA — Auditors and underwriters appealed — Appeal dismissed — Claims for contribution and

indemnity were equity claims under s. 2(1)(e) of CCAA — Parliament intended that monetary loss suffered by shareholder not diminish assets available to general creditors — "Equity claim" was not confined by its definition, or by definition of "claim", to claim advanced by holder of equity interest — Parliament could have but did not include language restricting claims for contribution or indemnity to those made by shareholders — Logic of s. 2(1)(a) to (e) supported notion that s. 2(1)(e) referred to claims for contribution or indemnity not by shareholders, but by others — Definition of "equity claim" was sufficiently clear to alter pre-existing common law — If shareholder sued auditors and underwriters for loss, and they claimed contribution or indemnity against debtor, assets available to general creditors would be diminished by amount of claims for contribution and indemnity.

Table of Authorities

Cases considered:

Blue Range Resource Corp., Re (2000), 2000 CarswellAlta 12, 259 A.R. 30, 76 Alta. L.R. (3d) 338, [2000] 4 W.W.R. 738, 2000 ABQB 4, 15 C.B.R. (4th) 169 (Alta. Q.B.) — referred to

CanadianOxy Chemicals Ltd. v. Canada (Attorney General) (1999), 1999 CarswellBC 776, 1999 CarswellBC 777, 171 D.L.R. (4th) 733, 29 C.E.L.R. (N.S.) 1, 23 C.R. (5th) 259, 122 B.C.A.C. 1, 200 W.A.C. 1, 133 C.C.C. (3d) 426, [1999] 1 S.C.R. 743 (S.C.C.) — considered

Central Capital Corp., Re (1996), 132 D.L.R. (4th) 223, 27 O.R. (3d) 494, (sub nom. *Royal Bank v. Central Capital Corp.)* 88 O.A.C. 161, 1996 CarswellOnt 316, 38 C.B.R. (3d) 1, 26 B.L.R. (2d) 88 (Ont. C.A.) — referred to

EarthFirst Canada Inc., Re (2009), 2009 ABQB 316, 2009 CarswellAlta 1069, 56 C.B.R. (5th) 102 (Alta. Q.B.) — referred to

Goodyear Tire & Rubber Co. of Canada Ltd. v. T. Eaton Co. (1956), 28 C.P.R. 25, 56 D.T.C. 1060, 4 D.L.R. (2d) 1, 16 Fox Pat. C. 91, 1956 CarswellNat 247, [1956] S.C.R. 610 (S.C.C.) — referred to

Markevich v. Canada (2003), 223 D.L.R. (4th) 17, [2003] 2 C.T.C. 83, [2003] 1 S.C.R. 94, (sub nom. *Markevich v. Minister of National Revenue)* 239 F.T.R. 159 (note), (sub nom. *Markevich v. Minister of National Revenue)* 300 N.R. 321, (sub nom. *R. v. Markevich)* 2003 D.T.C. 5185, 2003 CarswellNat 446, 2003 CarswellNat 447, 2003 SCC 9 (S.C.C.) — considered

National Bank of Canada v. Merit Energy Ltd. (2001), 2001 ABQB 583, 2001 CarswellAlta 913, 28 C.B.R. (4th) 228, [2001] 10 W.W.R. 305, 95 Alta. L.R. (3d) 166, 294 A.R. 15 (Alta. Q.B.) — considered

National Bank of Canada v. Merit Energy Ltd. (2002), 2002 ABCA 5, 2002 CarswellAlta 23, [2002] 3 W.W.R. 215, 96 Alta. L.R. (3d) 1, 299 A.R. 200, 266 W.A.C. 200 (Alta. C.A.) — referred to

National Bank of Greece (Canada) c. Katsikonouris (1990), 1990 CarswellQue 118, (sub nom. *National Bank of Greece (Canada) v. Katsikonouris)* 74 D.L.R. (4th) 197, (sub nom. *National Bank of Greece (Canada) v. Katsikonouris)* [1990] 2 S.C.R. 1029, (sub nom. *Panzera c. Simcoe & Érié Cie d'assurance)* 50 C.C.L.I. 1, (sub nom. *Panzera v. Simcoe & Erie Cie d'assurance)* [1990] I.L.R. 1-2663, (sub nom. *National Bank of Greece (Canada) c. Simcoe & Erie General Assurance Co.)* 115 N.R. 42, (sub nom. *National Bank of Greece (Canada) c. Simcoe & Erie General Assurance Co.)* 32 Q.A.C. 25, (sub nom. *Panzera c. Simcoe & Érié Cie d'assurance)* [1990] R.D.I. 715, 1990 CarswellQue 84 (S.C.C.) — considered

Nelson Financial Group Ltd., Re (2010), 71 C.B.R. (5th) 153, 75 B.L.R. (4th) 302, 2010 ONSC 6229, 2010 CarswellOnt 8655 (Ont. S.C.J. [Commercial List]) — referred to

Nowegijick v. R. (1983), (sub nom. *Nowegijick v. Canada)* [1983] 1 S.C.R. 29, 1983 CarswellNat 520, 83 D.T.C. 5041, 46 N.R. 41, [1983] 2 C.N.L.R. 89, [1983] C.T.C. 20, 144 D.L.R. (3d) 193, 1983 CarswellNat 123 (S.C.C.) — considered

Parry Sound (District) Welfare Administration Board v. O.P.S.E.U., Local 324 (2003), 2003 CarswellOnt 3500, 2003 CarswellOnt 3501, 2003 SCC 42, (sub nom. *Social Services Administration Board (Parry Sound) v. Ontario Public Service Employees Union, Local 324)* 308 N.R. 271, (sub nom. *Social Services Administration Board (Parry Sound District) v. Ontario Public Service Employees Union, Local 324)* 177 O.A.C. 235, 47 C.H.R.R. D/182, (sub nom. *Parry Sound (District) Social Services Administration Board v. O.P.S.E.U., Local 324)* [2003] 2 S.C.R. 157, 31 C.C.E.L. (3d) 1, 67 O.R. (3d) 256, 2003 C.L.L.C. 220-062, (sub nom. *Parry Sound (District) Social Services Administration Board v. O.P.S.E.U., Local 324)* 230 D.L.R. (4th) 257, 7 Admin. L.R. (4th) 177 (S.C.C.) — referred to

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Statutes considered:

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s. 121(1) — considered

Bankruptcy Code, 11 U.S.C.

s. 502(e)(1)(B) — referred to

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36

Generally — referred to

s. 2(1) "claim" — considered

s. 2(1) "equity claim" — considered

s. 2(1) "equity claim" (a)-(d) — referred to

s. 2(1) "equity claim" (a)-(e) — referred to

s. 2(1) "equity claim" (d) — considered

s. 2(1) "equity claim" (e) — considered

s. 2(1) "equity interest" — considered

s. 6(8) — considered

s. 22.1 [en. 2007, c. 36, s. 71] — referred to

Negligence Act, R.S.O. 1990, c. N.1

Generally — referred to

s. 2 — considered

Securities Act, 1988, S.S. 1988-89, c. S-42.2

s. 137(1) — referred to

s. 137(9) — referred to

Securities Act, R.S.A. 2000, c. S-4

s. 203(1) — referred to

s. 203(10) — referred to

Securities Act, R.S.B.C. 1996, c. 418

s. 131(1) — referred to

s. 131(11) — referred to

Securities Act, R.S.M. 1988, c. S50

s. 141(1) — referred to

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s. 130(1) — referred to

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s. 111(1) — referred to

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art. 221 — referred to

Words and phrases considered:

equity claim

This appeal considers the definition of "equity claim" in s. 2(1) of the CCAA [*Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36]. More particularly, the central issue is whether claims by auditors and underwriters against the respondent debtor . . . for contribution and indemnity fall within that definition. The claims arise out of proposed shareholder class actions for misrepresentation.

. . . . .

We agree with the supervising judge that the definition of equity claim focuses on the nature of the claim, and not the identity of the claimant. In our view, the appellants' claims for contribution and indemnity are clearly equity claims.

. . . . .

"Equity claim" is not confined by its definition, or by the definition of "claim", to a claim advanced by the holder of an equity interest. Parliament could have, but did not, include language in paragraph (e) restricting claims for contribution or indemnity to those made by shareholders.

***Per curiam*:**

I Overview

1 In 2009, the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended ("CCAA"), was amended to expressly provide that general creditors are to be paid in full before an equity claim is paid.

2 This appeal considers the definition of "equity claim" in s. 2(1) of the CCAA. More particularly, the central issue is whether claims by auditors and underwriters against the respondent debtor, Sino-Forest Corporation ("Sino-Forest"), for contribution and indemnity fall within that definition. The claims arise out of proposed shareholder class actions for misrepresentation.

3 The appellants argue that the supervising judge erred in concluding that the claims at issue are equity claims within the meaning of the CCAA and in determining the issue before the claims procedure established in Sino-Forest's CCAA proceeding had been completed.

4 For the reasons that follow, we conclude that the supervising judge did not err and accordingly dismiss this appeal.

II The Background

(a) The Parties

5 Sino-Forest is a Canadian public holding company that holds the shares of numerous subsidiaries, which in turn own, directly or indirectly, forestry assets located principally in the People's Republic of China. Its common shares are listed on the Toronto Stock Exchange. Sino-Forest also issued approximately $1.8 billion of unsecured notes, in four series. Trading in Sino-Forest shares ceased on August 26, 2011, as a result of a cease-trade order made by the Ontario Securities Commission.

6 The appellant underwriters [1] provided underwriting services in connection with three separate Sino-Forest equity offerings in June 2007, June 2009 and December 2009, and four separate Sino-Forest note offerings in July 2008, June 2009, December 2009 and October 2010. Certain underwriters entered into agreements with Sino-Forest in which Sino-Forest agreed to indemnify the underwriters in connection with an array of matters that could arise from their participation in these offerings.

7 The appellant BDO Limited ("BDO") is a Hong Kong-based accounting firm that served as Sino-Forest's auditor between 2005 and August 2007 and audited its annual financial statements for the years ended December 31, 2005 and December 31, 2006.

8 The engagement agreements governing BDO's audits of Sino-Forest provided that the company's management bore the primary responsibility for preparing its financial statements in accordance with Generally Accepted Accounting Principles ("GAAP") and implementing internal controls to prevent and detect fraud and error in relation to its financial reporting.

9 BDO's Audit Report for 2006 was incorporated by reference into a June 2007 prospectus issued by Sino-Forest regarding the offering of its shares to the public. This use by Sino-Forest was governed by an engagement agreement dated May 23, 2007, in which Sino-Forest agreed to indemnify BDO in respect of any claims by the underwriters or any third party that arose as a result of the further steps taken by BDO in relation to the issuance of the June 2007 prospectus.

10 The appellant Ernst & Young LLP ("E&Y") served as Sino-Forest's auditor for the years 2007 to 2012 and delivered Auditors' Reports with respect to the consolidated financial statements of Sino-Forest for fiscal years ended December 31, 2007 to 2010, inclusive. In each year for which it prepared a report, E&Y entered into an audit engagement letter with Sino-Forest in which Sino-Forest undertook to prepare its financial statements in accordance with GAAP, design and implement internal

controls to prevent and detect fraud and error, and provide E&Y with its complete financial records and related information. Some of these letters contained an indemnity in favour of E&Y.

11 The respondent Ad Hoc Committee of Noteholders consists of noteholders owning approximately one-half of Sino-Forest's total noteholder debt. [2] They are creditors who have debt claims against Sino-Forest; they are not equity claimants.

12 Sino-Forest has insufficient assets to satisfy all the claims against it. To the extent that the appellants' claims are accepted and are treated as debt claims rather than equity claims, the noteholders' recovery will be diminished.

(b) The Class Actions

13 In 2011 and January of 2012, proposed class actions were commenced in Ontario, Quebec, Saskatchewan and New York State against, amongst others, Sino-Forest, certain of its officers, directors and employees, BDO, E&Y and the underwriters. Sino-Forest is sued in all actions. [3]

14 The proposed representative plaintiffs in the class actions are shareholders of Sino-Forest. They allege that: Sino-Forest repeatedly misrepresented its assets and financial situation and its compliance with GAAP in its public disclosure; the appellant auditors and underwriters failed to detect these misrepresentations; and the appellant auditors misrepresented that their audit reports were prepared in accordance with generally accepted auditing standards ("GAAS"). The representative plaintiffs claim that these misrepresentations artificially inflated the price of Sino-Forest's shares and that proposed class members suffered damages when the shares fell after the truth was revealed in 2011.

15 The representative plaintiffs in the Ontario class action seek approximately $9.2 billion in damages. The Quebec, Saskatchewan and New York class actions do not specify the quantum of damages sought.

16 To date, none of the proposed class actions has been certified.

(c) CCAA Protection and Proofs of Claim

17 On March 30, 2012, Sino-Forest sought protection pursuant to the provisions of the CCAA. Morawetz J. granted the initial order which, among other things, appointed FTI Consulting Canada Inc. as the Monitor and stayed the class actions as against Sino-Forest. Since that time, Morawetz J. has been the supervising judge of the CCAA proceedings. The initial stay of the class actions was extended and broadened by order dated May 8, 2012.

18 On May 14, 2012, the supervising judge granted an unopposed claims procedure order which established a procedure to file and determine claims against Sino-Forest.

19 Thereafter, all of the appellants filed individual proofs of claim against Sino-Forest seeking contribution and indemnity for, among other things, any amounts that they are ordered to pay as damages to the plaintiffs in the class actions. Their proofs of claim advance several different legal bases for Sino-Forest's alleged obligation of contribution and indemnity, including breach of contract, contractual terms of indemnity, negligent and fraudulent misrepresentation in tort, and the provisions of the *Negligence Act*, R.S.O. 1990, c. N.1.

(d) Order under Appeal

20 Sino-Forest then applied for an order that the following claims are equity claims under the CCAA: claims against Sino-Forest arising from the ownership, purchase or sale of an equity interest in the company, including shareholder claims ("Shareholder Claims"); and any indemnification claims against Sino-Forest related to or arising from the Shareholder Claims, including the appellants' claims for contribution or indemnity ("Related Indemnity Claims").

21 The motion was supported by the Ad Hoc Committee of Noteholders.

22 On July 27, 2012, the supervising judge granted the order sought by Sino-Forest and released a comprehensive endorsement.

23 He concluded that it was not premature to determine the equity claims issue. It had been clear from the outset of Sino-Forest's CCAA proceedings that this issue would have to be decided and that the expected proceeds arising from any sales process would be insufficient to satisfy the claims of creditors. Furthermore, the issue could be determined independently of the claims procedure and without prejudice being suffered by any party.

24 He also concluded that both the Shareholder Claims and the Related Indemnity Claims should be characterized as equity claims. In summary, he reasoned that:

- The characterization of claims for indemnity turns on the characterization of the underlying primary claims. The Shareholder Claims are clearly equity claims and they led to and underlie the Related Indemnity Claims;

- The plain language of the CCAA, which focuses on the nature of the claim rather than the identity of the claimant, dictates that both Shareholder Claims and Related Indemnity Claims constitute equity claims;

- The definition of "equity claim" added to the CCAA in 2009 broadened the scope of equity claims established by pre-amendment jurisprudence;

- This holding is consistent with the analysis in *Return on Innovation Capital Ltd. v. Gandi Innovations Ltd.*, 2011 ONSC 5018, 83 C.B.R. (5th) 123 (Ont. S.C.J. [Commercial List]), which dealt with contractual indemnification claims of officers and directors. Leave to appeal was denied by this court, 2012 ONCA 10, 90 C.B.R. (5th) 141 (Ont. C.A.); and

- "It would be totally inconsistent to arrive at a conclusion that would enable either the auditors or the underwriters, through a claim for indemnification, to be treated as creditors when the underlying actions of shareholders cannot achieve the same status" (para. 82). To hold otherwise would run counter to the scheme established by the CCAA and would permit an indirect remedy to the shareholders when a direct remedy is unavailable.

25 The supervising judge did not characterize the full amount of the claims of the auditors and underwriters as equity claims. He excluded the claims for defence costs on the basis that while it was arguable that they constituted claims for indemnity, they were not necessarily in respect of an equity claim. That determination is not appealed.

III Interpretation of "Equity Claim"

(a) Relevant Statutory Provisions

26 As part of a broad reform of Canadian insolvency legislation, various amendments to the CCAA were proclaimed in force as of September 18, 2009.

27 They included the addition of s. 6(8):

> No compromise or arrangement that provides for the payment of an equity claim is to be sanctioned by the court unless it provides that all claims that are not equity claims are to be paid in full before the equity claim is to be paid.

Section 22.1, which provides that creditors with equity claims may not vote at any meeting unless the court orders otherwise, was also added.

28 Related definitions of "claim", "equity claim", and "equity interest" were added to s. 2(1) of the CCAA:

> In this Act,
>
> . . . . .

"claim" means any indebtedness, liability or obligation of any kind that would be a claim provable within the meaning of section 2 of the *Bankruptcy and Insolvency Act*;

. . . . .

"equity claim" means a claim that is in respect of an equity interest, including a claim for, among others,

(a) a dividend or similar payment,

(b) a return of capital,

(c) a redemption or retraction obligation,

(d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or

(e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d); [Emphasis added.]

"equity interest" means

(a) in the case of a company other than an income trust, a share in the company — or a warrant or option or another right to acquire a share in the company — other than one that is derived from a convertible debt, and

(b) in the case of an income trust, a unit in the income trust — or a warrant or option or another right to acquire a unit in the income trust — other than one that is derived from a convertible debt;

29 Section 2 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("BIA") defines a "claim provable in bankruptcy". Section 121 of the BIA in turn specifies that claims provable in bankruptcy are those to which the bankrupt is subject.

2. "claim provable in bankruptcy", "provable claim" or "claim provable" includes any claim or liability provable in proceedings under this Act by a creditor;

121. (1) All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act. [Emphasis added.]

(b) The Legal Framework Before the 2009 Amendments

30 Even before the 2009 amendments to the CCAA codified the treatment of equity claims, the courts subordinated shareholder equity claims to general creditors' claims in an insolvency. As the supervising judge described:

[23] Essentially, shareholders cannot reasonably expect to maintain a financial interest in an insolvent company where creditor claims are not being paid in full. Simply put, shareholders have no economic interest in an insolvent enterprise.

[24] The basis for the differentiation flows from the fundamentally different nature of debt and equity investments. Shareholders have unlimited upside potential when purchasing shares. Creditors have no corresponding upside potential.

[25] As a result, courts subordinated equity claims and denied such claims a vote in plans of arrangement. [Citations omitted.][4]

(c) The Appellants' Submissions

31 The appellants essentially advance three arguments.

32 First, they argue that on a plain reading of s. 2(1), their claims are excluded. They focus on the opening words of the definition of "equity claim" and argue that their claims against Sino-Forest are not claims that are "in respect of an equity interest" because they do not have an equity interest in Sino-Forest. Their relationships with Sino-Forest were purely contractual and they were arm's-length creditors, not shareholders with the risks and rewards attendant to that position. The policy rationale behind ranking shareholders below creditors is not furthered by characterizing the appellants' claims as equity claims. They were service providers with a contractual right to an indemnity from Sino-Forest.

33 Second, the appellants focus on the term "claim" in paragraph (e) of the definition of "equity claim", and argue that the claims in respect of which they seek contribution and indemnity are the shareholders' claims against them in court proceedings for damages, which are not "claims" against Sino-Forest provable within the meaning of the BIA, and, therefore, not "claims" within s. 2(1). They submit that the supervising judge erred in focusing on the characterization of the underlying primary claims.

34 Third, the appellants submit that the definition of "equity claim" is not sufficiently clear to have changed the existing law. It is assumed that the legislature does not intend to change the common law without "expressing its intentions to do so with irresistible clearness": *Parry Sound (District) Welfare Administration Board v. O.P.S.E.U., Local 324*, 2003 SCC 42, [2003] 2 S.C.R. 157 (S.C.C.), at para. 39, citing *Goodyear Tire & Rubber Co. of Canada Ltd. v. T. Eaton Co.*, [1956] S.C.R. 610 (S.C.C.), at p. 614. The appellants argue that the supervising judge's interpretation of "equity claim" dramatically alters the common law as reflected in *National Bank of Canada v. Merit Energy Ltd.*, 2001 ABQB 583, 294 A.R. 15 (Alta. Q.B.) , aff'd 2002 ABCA 5, 299 A.R. 200 (Alta. C.A.). There the court determined that in an insolvency, claims of auditors and underwriters for indemnification are not to be treated in the same manner as claims by shareholders. Furthermore, the Senate debates that preceded the enactment of the amendments did not specifically comment on the effect of the amendments on claims by auditors and underwriters. The amendments should be interpreted as codifying the pre-existing common law as reflected in *National Bank of Canada v. Merit Energy Ltd*.

35 The appellants argue that the decision of *Return on Innovation Capital Ltd. v. Gandi Innovations Ltd.* is distinguishable because it dealt with the characterization of claims for damages by an equity investor against officers and directors, and it predated the 2009 amendments. In any event, this court confirmed that its decision denying leave to appeal should not be read as a judicial precedent for the interpretation of the meaning of "equity claim" in s. 2(1) of the CCAA.

(d) Analysis

(i) Introduction

36 The exercise before this court is one of statutory interpretation. We are therefore guided by the following oft-cited principle from Elmer A. Driedger, *Construction of Statutes*, 2d ed. (Toronto: Butterworths, 1983), at p. 87:

> [T]he words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.

37 We agree with the supervising judge that the definition of equity claim focuses on the nature of the claim, and not the identity of the claimant. In our view, the appellants' claims for contribution and indemnity are clearly equity claims.

38 The appellants' arguments do not give effect to the expansive language adopted by Parliament in defining "equity claim" and read in language not incorporated by Parliament. Their interpretation would render paragraph (e) of the definition meaningless and defies the logic of the section.

(ii) The expansive language used

39 The definition incorporates two expansive terms.

40 First, Parliament employed the phrase "*in respect of*" twice in defining equity claim: in the opening portion of the definition, it refers to an equity claim as a "claim that is *in respect of* an equity interest", and in paragraph (e) it refers to "contribution or indemnity *in respect of* a claim referred to in any of paragraphs (a) to (d)" (emphasis added).

41 The Supreme Court of Canada has repeatedly held that the words "in respect of" are "of the widest possible scope", conveying some link or connection between two related subjects. In *CanadianOxy Chemicals Ltd. v. Canada (Attorney General)*, [1999] 1 S.C.R. 743 (S.C.C.), at para. 16, citing *Nowegijick v. R.*, [1983] 1 S.C.R. 29 (S.C.C.), at p. 39, the Supreme Court held as follows:

> The words "in respect of" are, in my opinion, words of the widest possible scope. They import such meanings as "in relation to", "with reference to" or "in connection with". The phrase "in respect of" is probably the widest of any expression intended to convey some connection between two related subject matters. [Emphasis added in *CanadianOxy*.]

That court also stated as follows in *Markevich v. Canada*, 2003 SCC 9, [2003] 1 S.C.R. 94 (S.C.C.), at para. 26:

> The words "in respect of" have been held by this Court to be words of the broadest scope that convey some link between two subject matters. [Citations omitted.]

42 It is conceded that the Shareholder Claims against Sino-Forest are claims for "a monetary loss resulting from the ownership, purchase or sale of an equity interest", within the meaning of paragraph (d) of the definition of "equity claim". There is an obvious link between the appellants' claims against Sino-Forest for contribution and indemnity and the shareholders' claims against Sino-Forest. The legal proceedings brought by the shareholders asserted their claims against Sino-Forest together with their claims against the appellants, which gave rise to these claims for contribution and indemnity. The causes of action asserted depend largely on common facts and seek recovery of the same loss.

43 The appellants' claims for contribution or indemnity against Sino-Forest are therefore clearly connected to or "in respect of" a claim referred to in paragraph (d), namely the shareholders' claims against Sino-Forest. They are claims in respect of equity claims by shareholders and are provable in bankruptcy against Sino-Forest.

44 Second, Parliament also defined equity claim as "including a claim for, among others", the claims described in paragraphs (a) to (e). The Supreme Court has held that this phrase "including" indicates that the preceding words - "a claim that is in respect of an equity interest" - should be given an expansive interpretation, and include matters which might not otherwise be within the meaning of the term, as stated in *National Bank of Greece (Canada) c. Katsikonouris*, [1990] 2 S.C.R. 1029 (S.C.C.), at p. 1041:

> [T]hese words are terms of extension, designed to enlarge the meaning of preceding words, and not to limit them.
>
> ... [T]he natural inference is that the drafter will provide a specific illustration of a subset of a given category of things in order to make it clear that that category extends to things that might otherwise be expected to fall outside it.

45 Accordingly, the appellants' claims, which clearly fall within paragraph (e), are included within the meaning of the phrase a "claim that is in respect of an equity interest".

(iii) What Parliament did not say

46 "Equity claim" is not confined by its definition, or by the definition of "claim", to a claim advanced by the holder of an equity interest. Parliament could have, but did not, include language in paragraph (e) restricting claims for contribution or indemnity to those made by shareholders.

(iv) An interpretation that avoids surplusage

47 A claim for contribution arises when the claimant for contribution has been sued. Section 2 of the *Negligence Act* provides that a tortfeasor may recover contribution or indemnity from any other tortfeasor who is, or would if sued have been, liable in

respect of the damage to any person suffering damage as a result of a tort. The securities legislation of the various provinces provides that an issuer, its underwriters, and, if they consented to the disclosure of information in the prospectus, its auditors, among others, are jointly and severally liable for a misrepresentation in the prospectus, and provides for rights of contribution. [5]

48 Counsel for the appellants were unable to provide a satisfactory example of when a holder of an equity interest in a debtor company would seek contribution under paragraph (e) against the debtor in respect of a claim referred to in any of paragraphs (a) to (d). In our view, this indicates that paragraph (e) was drafted with claims for contribution or indemnity by non-shareholders rather than shareholders in mind.

49 If the appellants' interpretation prevailed, and only a person with an equity interest could assert such a claim, paragraph (e) would be rendered meaningless, and as Lamer C.J. wrote in *R. v. Proulx*, 2000 SCC 5, [2000] 1 S.C.R. 61 (S.C.C.), at para. 28:

> It is a well accepted principle of statutory interpretation that no legislative provision should be interpreted so as to render it mere surplusage.

(v) The scheme and logic of the section

50 Moreover, looking at s. 2(1) as a whole, it would appear that the remedies available to shareholders are all addressed by ss. 2(1)(a) to (d). The logic of ss. 2(1)(a) to (e) therefore also supports the notion that paragraph (e) refers to claims for contribution or indemnity not by shareholders, but by others.

(vi) The legislative history of the 2009 amendments

51 The appellants and the respondents each argue that the legislative history of the amendments supports their respective interpretation of the term "equity claim". We have carefully considered the legislative history. The limited commentary is brief and imprecise. The clause by clause analysis of Bill C-12 comments that "[a]n equity claim is defined to include any claim that is related to an equity interest". [6] While, as the appellants submit, there was no specific reference to the position of auditors and underwriters, the desirability of greater conformity with United States insolvency law to avoid forum shopping by debtors was highlighted in 2003, some four years before the definition of "equity claim" was included in Bill C-12.

52 In this instance the legislative history ultimately provided very little insight into the intended meaning of the amendments. We have been guided by the plain words used by Parliament in reaching our conclusion.

(vii) Intent to change the common law

53 In our view the definition of "equity claim" is sufficiently clear to alter the pre-existing common law. *National Bank of Canada v. Merit Energy Ltd.*, an Alberta decision, was the single case referred to by the appellants that addressed the treatment of auditors' and underwriters' claims for contribution and indemnity in an insolvency before the definition was enacted. As the supervising judge noted, in a more recent decision, *Return on Innovation Capital Ltd. v. Gandi Innovations Ltd.*, the courts of this province adopted a more expansive approach, holding that contractual indemnification claims of directors and officers were equity claims.

54 We are not persuaded that the practical effect of the change to the law implemented by the enactment of the definition of "equity claim" is as dramatic as the appellants suggest. The operations of many auditors and underwriters extend to the United States, where contingent claims for reimbursement or contribution by entities "liable with the debtor" are disallowed pursuant to § 502(e)(1)(B) of the U.S. Bankruptcy Code, 11 U.S.C.S. [7]

(viii) The purpose of the legislation

55 The supervising judge indicated that if the claims of auditors and underwriters for contribution and indemnity were not included within the meaning of "equity claim", the CCAA would permit an indirect remedy to the shareholders when a direct remedy is not available. We would express this concept differently.

56 In our view, in enacting s. 6(8) of the CCAA, Parliament intended that a monetary loss suffered by a shareholder (or other holder of an equity interest) in respect of his or her equity interest *not* diminish the assets of the debtor available to general creditors in a restructuring. If a shareholder sues auditors and underwriters in respect of his or her loss, in addition to the debtor, and the auditors or underwriters assert claims of contribution or indemnity against the debtor, the assets of the debtor available to general creditors would be diminished by the amount of the claims for contribution and indemnity.

IV Prematurity

57 We are not persuaded that the supervising judge erred by determining that the appellants' claims were equity claims before the claims procedure established in Sino-Forest's CCAA proceeding had been completed.

58 The supervising judge noted at para. 7 of his endorsement that from the outset, Sino-Forest, supported by the Monitor, had taken the position that it was important that these proceedings be completed as soon as possible. The need to address the characterization of the appellants' claims had also been clear from the outset. The appellants have not identified any prejudice that arises from the determination of the issue at this stage. There was no additional information that the appellants have identified that was not before the supervising judge. The Monitor, a court-appointed officer, supported the motion procedure. The supervising judge was well positioned to determine whether the procedure proposed was premature and, in our view, there is no basis on which to interfere with the exercise of his discretion.

V Summary

59 In conclusion, we agree with the supervising judge that the appellants' claims for contribution or indemnity are equity claims within s. 2(1)(e) of the CCAA.

60 We reach this conclusion because of what we have said about the expansive language used by Parliament, the language Parliament did not use, the avoidance of surplusage, the logic of the section, and what, from the foregoing, we conclude is the purpose of the 2009 amendments as they relate to these proceedings.

61 We see no basis to interfere with the supervising judge's decision to consider whether the appellants' claims were equity claims before the completion of the claims procedure.

VI Disposition

62 This appeal is accordingly dismissed. As agreed, there will be no costs.

Appeal dismissed.

Footnotes

1 Credit Suisse Securities (Canada) Inc., TD Securities Inc., Dundee Securities Corporation (now known as DWM Securities Inc.), RBC Dominion Securities Inc., Scotia Capital Inc., CIBC World Markets Inc., Merrill Lynch Canada Inc., Canaccord Financial Ltd. (now known as Canaccord Genuity Corp.), Maison Placements Canada Inc., Credit Suisse Securities (USA) LLC and Merrill Lynch, Pierce, Fenner & Smith Incorporated, successor by merger to Banc of America Securities LLC.

2 Noteholders holding in excess of $1.296 billion, or 72%, of Sino-Forest's approximately $1.8 billion in noteholders' debt have executed written support agreements in favour of the Sino-Forest CCAA plan as of March 30, 2012. These include noteholders represented by the Ad Hoc Committee of Noteholders.

3 None of the appellants are sued in Saskatchewan and all are sued in Ontario. E&Y is also sued in Quebec and New York and the appellant underwriters are also sued in New York.

4 The supervising judge cited the following cases as authority for these propositions: *Blue Range Resource Corp., Re*, 2000 ABQB 4, 259 A.R. 30 (Alta. Q.B.); *Stelco Inc., Re* (2006), 17 C.B.R. (5th) 78 (Ont. S.C.J. [Commercial List]); *Central Capital Corp.*

(Re) (1996), 27 O.R. (3d) 494 (Ont. C.A.); *Nelson Financial Group Ltd., Re*, 2010 ONSC 6229, 71 C.B.R. (5th) 153 (Ont. S.C.J. [Commercial List]); *EarthFirst Canada Inc., Re*, 2009 ABQB 316, 56 C.B.R. (5th) 102 (Alta. Q.B.).

5 *Securities Act*, R.S.O. 1990, c. S.5, s. 130(1), (8); *Securities Act*, R.S.A. 2000, c. S-4, s. 203(1), (10); *Securities Act*, R.S.B.C. 1996, c. 418, s. 131(1), (11); *The Securities Act*, C.C.S.M. c. S50, s. 141(1), (11); *Securities Act*, S.N.B. 2004, c. S-5.5, s. 149(1), (9); *Securities Act*, R.S.N.L. 1990, c. S-13, s. 130(1), (8); *Securities Act*, R.S.N.S. 1989, c. 418, s. 137(1), (8); *Securities Act*, S.Nu. 2009, c. 12, s. 111(1), (12); *Securities Act*, S.N.W.T. 2008, c. 10, s. 111(1), (12); *Securities Act*, R.S.P.E.I. 1988, c. S-3.1, s. 111(1), (12); *Securities Act*, R.S.Q. c. V-1.1, ss. 218, 219, 221; *The Securities Act, 1988*, S.S. 1988-89, c. S-42.2, s. 137(1), (9); *Securities Act*, S.Y. 2007, c. 16, s. 111(1), (13).

6 We understand that this analysis was before the Standing Senate Committee on Banking, Trade and Commerce in 2007.

7 The United States Bankruptcy Court for the District of Delaware in *In Re: Mid-American Waste Systems, Inc.* 228 B.R. 816 (1999), indicated that this provision applies to underwriters' claims, and reflects the policy rationale that such stakeholders are in a better position to evaluate the risks associated with the issuance of stock than are general creditors.

TAB “F”

2014 BCSC 1732
British Columbia Supreme Court

Bul River Mineral Corp., Re

2014 CarswellBC 2702, 2014 BCSC 1732, [2014] B.C.W.L.D. 6764, [2014] B.C.W.L.D. 6765, [2014] B.C.W.L.D. 6771, [2014] B.C.W.L.D. 6779, 16 C.B.R. (6th) 173, 245 A.C.W.S. (3d) 333

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

In the Matter of the Business Corporations Act, S.B.C. 2002, c. 57 and the Business Corporations Act, R.S.A. 2000, c. B-9

In the Matter of Bul River Mineral Corporation, Big Bear Metal Mining Corporation, Earth's Vital Extractors Limited, Fort Steele Mineral Corporation, Fort Steele Metals Corporation, Fused Heat Ltd., Gallowai Metal Mining Corporation, Giant Steeples Mineral Corporation, Grand Mineral Corporation, International Feldspar Ltd., Jao Mine Developers Ltd., Kutteni Diamonds Ltd., Stanfield Mining Group of Canada Ltd., Sullibin Mineral Corporation, Sullibin Multi Metal Corporation, Super Feldspars Corporation, White Cat Metal Mining Corporation, Zeus Metal Mining Corporation, Zeus Metals Corporation and Zeus Mineral Corporation, Petitioners

Fitzpatrick J.

Heard: September 3, 5, 2014
Judgment: September 15, 2014
Docket: Vancouver S113459

Counsel: Colin D. Brousson for Petitioners
William C. Kaplan, Q.C., Peter Bychawski for CuVeras, LLC
J. Roger Webber, Q.C. for Eldon Clarence Stafford
Robert M. Curtis, Q.C. for Gordon Preston and Carol Preston
Tevia R.M. Jeffries for Monitor, Deloitte Restructuring Inc.

Related Abridgment Classifications
Bankruptcy and insolvency
IX Proving claim
IX.1 Provable debts
IX.1.g Claims of director, officer or shareholder of bankrupt corporation
Bankruptcy and insolvency
XIX Companies' Creditors Arrangement Act
XIX.5 Miscellaneous
Commercial law
I Agency
I.3 Creation of agency
I.3.a General principles
Contracts
XIII Novation
XIII.2 Proof of novation
Headnote
Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Miscellaneous

Petitioners were owners of mining properties in British Columbia — Owners went into bankruptcy and as result, were subject of proceedings under Companies' Creditors Arrangement Act (CCAA) — Owners developed plan of arrangement for their creditors and other interested parties — Owners received indication that their mining project could be viable, due to outside financing from company C — Two claims against petitioners were at issue in hearing — First was claim by creditors P, which C claimed was claim in equity rather than debt — Second claim was by individual creditor S, which owners denied was valid claim — Hearing took place to determine nature of claims — P's claim was found to be in equity — S claim found not to be debt claim — Applicable law was amended to require debt claims to be paid in full, before any equity claims were to be paid out — P claimed that their claim was transferred into debt claim — However, claim was for recovery of own capital instead of return on capital, as was true in case relied upon by P — Other preferred shareholders were in same situation, despite not having judgment — It would be against policy objective to treat these shareholders differently — Treatment of claim as equity claim was not collateral attack on judgment given elsewhere — For S claim, intentions of parties were unclear as principal of owners was dead, and S was incapacitated — Documents between parties had to be examined — S advanced loan to principal personally, and not to his companies — There was no assignment of loan agreement — As no novation occurred, S could not characterize claim as debt claim — No agency relationship was created between parties.

Commercial law --- Agency — Creation of agency — General principles

Petitioners were owners of mining properties in British Columbia — Owners went into bankruptcy and as result, were subject of proceedings under Companies' Creditors Arrangement Act (CCAA) — Owners developed plan of arrangement for their creditors and other interested parties — Owners received indication that their mining project could be viable, due to outside financing from company C — Two claims against petitioners were at issue in hearing — First was claim by creditors P, which C claimed was claim in equity rather than debt — Second claim was by individual creditor S, which owners denied was valid claim — Hearing took place to determine nature of claims — P's claim was found to be in equity — S claim found not to be debt claim — No agency relationship was created between parties.

Contracts --- Novation — Proof of novation

Petitioners were owners of mining properties in British Columbia — Owners went into bankruptcy and as result, were subject of proceedings under Companies' Creditors Arrangement Act (CCAA) — Owners developed plan of arrangement for their creditors and other interested parties — Owners received indication that their mining project could be viable, due to outside financing from company C — Two claims against petitioners were at issue in hearing — First was claim by creditors P, which C claimed was claim in equity rather than debt — Second claim was by individual creditor S, which owners denied was valid claim — Hearing took place to determine nature of claims — P's claim was found to be in equity — S claim found not to be debt claim — For S claim, intentions of parties were unclear as principal of owners was dead, and S was incapacitated — Documents between parties had to be examined — S advanced loan to principal personally, and not to his companies — There was no assignment of loan agreement — As no novation occurred, S could not characterize claim as debt claim — No agency relationship was created between parties.

Bankruptcy and insolvency --- Proving claim — Provable debts — Claims of director, officer or shareholder of bankrupt corporation

Petitioners were owners of mining properties in British Columbia — Owners went into bankruptcy and as result, were subject of proceedings under Companies' Creditors Arrangement Act (CCAA) — Owners developed plan of arrangement for their creditors and other interested parties — Owners received indication that their mining project could be viable, due to outside financing from company C — Two claims against petitioners were at issue in hearing — First was claim by creditors P, which C claimed was claim in equity rather than debt — Second claim was by individual creditor S, which owners denied was valid claim — Hearing took place to determine nature of claims — P's claim was found to be in equity — S claim found not to be debt claim — Applicable law was amended to require debt claims to be paid in full, before any equity claims were to be paid out — P claimed that their claim was transferred into debt claim — However, claim was for recovery of own capital instead of return on capital, as was true in case relied upon by P — Other preferred shareholders were in same situation, despite not having judgment — It would be against policy objective to treat these shareholders differently — Treatment of claim as equity claim was not collateral attack on judgment given elsewhere.

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s. 2 "claim provable in bankruptcy", "provable claim" or "claim provable" — considered

s. 2 "creditor" — considered

s. 54(2)(d) — considered

s. 60(1.7) [en. 1992, c. 27, s. 24(1)] — considered

s. 95 — referred to

s. 101 — referred to

s. 121(1) — considered

s. 135 — considered

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s. 193(2) — considered

s. 193(4) — considered

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36

Generally — referred to

s. 2(1) "claim" — considered

s. 2(1) "equity claim" — considered

s. 2(1) "equity claim" (a)-(c) — referred to

s. 2(1) "equity interest" (a) — considered

s. 6 — referred to

s. 6(8) — considered

s. 11 — considered

s. 22.1 [en. 2007, c. 36, s. 71] — considered

s. 36.1 [en. 2007, c. 36, s. 78] — referred to

Words and phrases considered:

equity claim

The effect of the amendments was considered by Pepall J. (as she then was) in Nelson Financial Group Ltd., Re, 2010 ONSC 6229 (Ont. S.C.J. [Commercial List]). In that case, the court had no difficulty in finding that the claims of preferred shareholders for declared but unpaid dividends and requests for redemption were equity claims within the above definition. In addition, the approach of the courts in the past in looking at the substance or true nature of the claim was applied in finding that related claims for compensatory damages or amounts due on rescission were caught by the definition of "equity claim": paras. 32-34. As such, all the claims were not provable debts under the CCAA.

***Fitzpatrick J.*:**

Introduction

1 These are longstanding proceedings under the *Companies' Creditors Arrangement Act*, R.S.C., 1985, c. C-36 (the "*CCAA*"), having been commenced some three and a half years ago in May 2011. Since that time, the petitioners have made slow and steady progress toward the goal of presenting a plan of arrangement to their creditors and certain equity participants.

2 The principal petitioners, being Bul River Mineral Corporation ("Bul River") and Gallowai Metal Mining Corporation ("Gallowai"), are the owners of certain mining properties and related assets in the Kootenay region of British Columbia. As a result of these proceedings, Bul River and Gallowai now have some indication that the mine is viable. This has been accomplished mainly due to the participation of CuVeras, LLC ("CuVeras") who has, since late 2011, provided interim financing which allowed this further development work to continue to this point in time.

3 Some years ago, Bul River and Gallowai completed a claims process to identify not only trade creditors but also claims of its common and preferred shareholders. Now that Bul River and Gallowai, with the assistance and sponsorship of CuVeras, are on the cusp of preparing a plan of arrangement for consideration by the stakeholders, those claims have become of central importance.

4 Some of the claims that were advanced through the claims process were not critically considered by either the petitioners or the court-appointed monitor, Deloitte Restructuring Inc. (the "Monitor"). However, at this late date, the characterization of certain claims and the validity of certain claims have been put in issue and will have a profound impact on the manner in which these restructuring proceedings go forward.

5 At present, the general intention is that the restructuring will take place along the lines of a Letter of Agreement between the petitioners and CuVeras dated May 23, 2014. By that agreement, a newly formed British Columbia entity ("Newco") will be created and the shares in Newco will be distributed to CuVeras and other related parties and also to non-voting preferred shareholders. Trade creditors will also participate in Newco. This Letter of Agreement is the product of some history, sometimes contentious, between the petitioners and CuVeras which was discussed in the court's earlier reasons: *Bul River Mineral Corp, Re*, 2014 BCSC 645 (B.C. S.C.).

6 One of the claims is that advanced by Gordon and Carol Preston (the "Preston Claim"), which CuVeras contends is an equity claim as opposed to a debt claim. Another claim is that advanced by Eldon Stafford (the "Stafford Claim"), which CuVeras contends is not a valid claim against Bul River or Gallowai. The substance of the issue before the court therefore is two-fold: (a) the proper categorization of the Preston Claim and (b) whether the Stafford Claim is a valid claim against the petitioners.

7 As will become apparent from the discussion below, the resolution of these issues will significantly impact how any restructuring plan can be crafted and will also impact all stakeholders in terms of how the Newco shares will be distributed between the various stakeholders. There is some urgency in resolving these last issues before the restructuring can proceed. All involved, including the Monitor, state that it is necessary for the petitioners to exit this *CCAA* proceeding as quickly as possible. At this time, a plan of arrangement sponsored by CuVeras is the only option available to the petitioners so as to avoid a liquidation and bankruptcy.

Background

8 The petitioners are also known as the Stanfield Mining Group (the "Group"). The Group carried on the business of developing a mining property situated near the Bull River just outside of Fernie, British Columbia. It is effectively controlled by the estate of Ross Stanfield ("Stanfield") which holds 100% and 99.9% of the voting common shares in the parent companies, Zeus Mineral Corporation and Fort Steele Mineral Corporation, respectively. As stated above, the two principal companies involved in the development and operation of the mine within the Group are Bul River and Gallowai.

9 The mine, known as the Gallowai Bul River Mine, is not currently in production. There has been significant underground development to this point such that the petitioners and CuVeras consider that with a relatively modest further investment the mine could be placed into production.

10 Bul River and Gallowai were incorporated in the 1980s. Commencing in the mid-1990s, Stanfield began raising funds for the development of the mine. The marketing program focused on "sophisticated investors" which are, through securities regulation statutes, defined as persons with a net worth in excess of $1 million willing to invest a minimum of $100,000 in a given venture. The persons targeted by Stanfield's marketing campaign were farmers in Alberta, particularly around Edmonton, Red Deer and Medicine Hat, as well as farmers from the area around Regina, Saskatchewan.

11 Until 2010, Stanfield engaged in a sophisticated marketing program to sell redeemable preferred non-voting shares to these investors. Over that period of time, approximately $229 million was invested in consideration of which preferred shares in Bul River and Gallowai were issued.

12 The marketing program involved repeated representations as to the ore content of the mine. Stanfield continually referred to the mine as an "elephant" mine, meaning that the mineral resources were enormous. Over the years, the program included visits to the mine site and presentations to potential investors by Stanfield. Those presentations referred to the history of the mine and the future prospects of the mine, including development plans and the levels of ore content (copper, gold and platinum). The presentations also involved discussion as to when production would commence and typically production was forecast to commence within a foreseeable period of time, be it one or two years from the date of the meeting.

13 The same representations were also made in written materials, including a report from Phillip De Souza ("De Souza"), a professional engineer.

14 Some potential investors executed subscription agreements for shares during those visits to the mine or immediately thereafter. Some returned to the mine for subsequent tours and subsequent purchases. In some instances, Stanfield recruited current investors to further market the preferred shares to other investors.

15 These representations by Stanfield were made in the face of contemporaneous reports which questioned the value of the resources announced by the Group. These included papers published by the British Columbia Ministry of Energy and Mines in 2000 in which it was reported that they were unable to confirm the gold grades reported by the Group. In 2006, a professional conduct hearing in Alberta was held arising from charges that De Souza's report was "deficient and misleading". The panel issued reasons which were published in January 2008 in which it concluded that De Souza's conduct constituted unskilled practice and unprofessional conduct.

16 Eventually, Stanfield's activities caught the attention of various provincial securities regulators. In May 2010, the British Columbia Securities Commission (the "Commission") issued a Notice of Hearing against Stanfield, Bul River and Gallowai seeking to order them to produce an independently prepared technical report fully compliant with NI 43-101 (Standards of Disclosure for Mineral Projects) that would include an estimate of the mineral resources available at the mine.

17 Ross Stanfield died on August 3, 2010.

18 By the fall of 2010, in addition to being faced with the Commission proceedings, certain preferred shareholders had taken legal action against the Group in light of the failure to comply with redemption obligations arising in respect of the preferred shares. Stanfield's grandson, George Hewison, is the sole beneficiary of Stanfield's estate. He stepped in to continue the work of the Group as best he could. In late 2010 or early 2011, undertakings were given to the securities regulators in British Columbia and Alberta by which the petitioners agreed not to issue any new securities without their consent.

19 The evidence would later establish that the representations made by Stanfield regarding the mine resources were false. A technical report was later prepared by Rosco Postle and Associates Inc. ("RPA") in March 2011 that provided some review of the available mineral resources at the mine. Both the RPA report and a later report prepared by Snowden Mining Industry

Consultants in March 2013 would indicate that while there is valuable ore in the mine, the quantity of the resources is markedly less than what was indicated in the representations made to investors.

20 On May 26, 2011, the Group sought and obtained creditor protection pursuant to the *CCAA* and an Initial Order was granted at that time.

21 At the time of the *CCAA* filing, the Class A common voting shares in Bul River and Gallowai were held by the Stanfield estate. Other Class B and Class E common non-voting shares were held by investors.

22 As of the date of filing, the petitioners had no secured creditors. The petition referenced debt obligations of $904,000 to trade suppliers and two unsecured judgments totalling $386,135. Various preferred non-voting shares were held by investors in Classes C, D and F. The petition materials indicated that amounts owing for "redeemable shares" (i.e., the preferred shares) were approximately $137,718,557. The holders of both common and preferred shares comprise some 3,500 individual investors.

23 The subscription agreements for the preferred shares provided that the shares were redeemable at the end of five years from the date of the subscription together with a "preferred cumulative annual dividend" of 12.75%. There is no evidence of any significant redemption of the preferred shares. Rather, as redemption dates arose, preferred shareholders were approached to execute extension agreements extending their redemption rights from a given date to a date defined by the commencement of production from the mine. Many preferred shareholders signed those extension agreements, some did not. For those who did not, some of them demanded redemption of their shares. For the most part, those investors were told that there was no money to redeem the shares.

24 Accordingly, the largest liability faced by the petitioners is that arising from the preferred shares. The preferred shareholders appear to have certain claims arising from their holdings. Firstly, they have a claim for payment of the redemption amount plus the accumulated dividend. Secondly, they may have a claim for misrepresentation against the Group, giving rise to potential remedies of rescission of their subscription agreements, damages, or both.

The Claims Process

25 In August 2011, the Group prepared a list of creditors (the "Creditor List") in support of seeking a claims process order. The list actually included not only trade claims but also shareholder claims. Not surprisingly, the purpose of the claims process was to assist the Group in developing its restructuring plan.

26 On August 19, 2011, the court approved a Claims Process Order, which authorized the petitioners to conduct a claims process for the determination of any and all claims against them (the "Claims Process"). The Claims Process Order defined "claims" that were to be determined in the Claims Process as follows:

> ... indebtedness, liability or obligation (including an equity obligations arising from the ownership of equity shares) ...
>
> ... all obligations of or ownership interests in the Petitioners or any of them arising from or relating to the holding of a Share.

27 Under the Claims Process Order, all "Known Creditors" (defined in the Claims Process Order as all creditors shown on the books and records of the petitioners as having a claim in excess of $250), including holders of shares, were to receive a claims package from the petitioners that included an instruction letter, a Notice of Dispute, a Proof of Claim, and a copy of the Claims Process Order (the "Claims Package"). The Claims Process was also advertised in certain publications. The Creditor List indicating such Known Creditors was posted on the Monitor's website, as was noted in the Claims Package, such that both creditors and shareholders were able to view it. The process of determining claims was as follows:

> a) all creditors and shareholders were given the opportunity to review the Creditor List;
>
> b) in the event a creditor or shareholder agreed with the "Claim Particulars" listed in the Creditor List (which included the number and class of shares), the creditor or shareholder did not need to file a Proof of Claim with the petitioners.

In that event, the Claim Particulars in the Creditor List would be deemed to be the creditor or shareholder's proven claim for voting and distribution purposes under any restructuring plan subsequently filed by the petitioners;

c) in the event a creditor or shareholder objected to the Claim Particulars in the Creditor List, or wished to advance another claim, the creditor or shareholder had to, on or before October 17, 2011 (the "Claims Bar Date"), deliver to the petitioners, with a copy to the Monitor, a notice of such objection in the form of a Notice of Dispute, together with a Proof of Claim and supporting documentation;

d) in the event a Notice of Dispute was not submitted on or before the Claims Bar Date, the creditor or shareholder was deemed to have accepted the amount owing and all other Claim Particulars set out in the Creditor List, and was forever barred from advancing any other claim against the petitioners or participating in any plan subsequently filed by the petitioners;

e) where a Notice of Dispute and/or Proof of Claim was filed by a creditor or shareholder, the petitioners were deemed to have accepted it unless they delivered to the creditor or shareholder a Notice of Disallowance on or before October 31, 2011 (later extended to November 15, 2011); and

f) in the event of the petitioners delivering a Notice of Disallowance, a creditor or shareholder had 21 days to seek a determination from the court of the validity and value of and particulars of the claim by filing and serving the petitioners and the Monitor with application materials. A creditor or shareholder who failed to file and serve such materials by the deadline was deemed to have accepted the particulars of its claim set out in the Notice of Disallowance.

28 The Claims Process Order did not contemplate the appointment of a claims officer or the participation of the Monitor in the process of assessing the validity of the Proofs of Claim and/or Notices of Dispute submitted to the petitioners through the Claims Process. Nor did the Claims Process allow any independent review of claims submitted by other creditors of the petitioners or by CuVeras as the interim financier.

(i) Jurisdiction of the Court

29 Before turning to claims process orders specifically, it is important to keep in mind the broad remedial objectives of the *CCAA* to facilitate a restructuring rather than a liquidation of assets: *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60 (S.C.C.) [hereinafter Century Services] at paras. 15-18, 56. As the Supreme Court of Canada has noted, it is now well recognized that a supervising judge of a *CCAA* proceeding has a "broad and flexible authority" or statutory jurisdiction to makes such orders as are necessary to achieve those objectives: *Century Services* at paras. 19, 57-66.

30 The discretionary authority of the court is confirmed by s. 11 of the *CCAA* which provides that the court may make any order that it considers "appropriate in the circumstances". As Madam Justice Deschamps observed in *Century Services*, whether an order will be appropriate is driven by the policy objectives of the *CCAA*:

> [70] The general language of the *CCAA* should not be read as being restricted by the availability of more specific orders. However, the requirements of appropriateness, good faith, and due diligence are baseline considerations that a court should always bear in mind when exercising *CCAA* authority. Appropriateness under the *CCAA* is assessed by inquiring whether the order sought advances the policy objectives underlying the *CCAA*. The question is whether the order will usefully further efforts to achieve the remedial purpose of the *CCAA* — avoiding the social and economic losses resulting from liquidation of an insolvent company. I would add that appropriateness extends not only to the purpose of the order, but also to the means it employs. Courts should be mindful that chances for successful reorganizations are enhanced where participants achieve common ground and all stakeholders are treated as advantageously and fairly as the circumstances permit.

31 Claims process orders are an important step in most restructuring proceedings. In *Timminco Ltd., Re*, 2014 ONSC 3393 (Ont. S.C.J.), Mr. Justice Morawetz reviewed the "first principles" relating to claims process orders and their purpose within *CCAA* proceedings:

> [41] It is also necessary to return to first principles with respect to claims-bar orders. The CCAA is intended to facilitate a compromise or arrangement between a debtor company and its creditors and shareholders. For a debtor company engaged in restructuring under the CCAA, which may include a liquidation of its assets, it is of fundamental importance to determine the quantum of liabilities to which the debtor and, in certain circumstances, third parties are subject. It is this desire for certainty that led to the development of the practice by which debtors apply to court for orders which establish a deadline for filing claims.
>
> [42] Adherence to the claims-bar date becomes even more important when distributions are being made (in this case, to secured creditors), or when a plan is being presented to creditors and a creditors' meeting is called to consider the plan of compromise. These objectives are recognized by s. 12 of the CCAA, in particular the references to "voting" and "distribution".
>
> [43] In such circumstances, stakeholders are entitled to know the implications of their actions. The claims-bar order can assist in this process. By establishing a claims-bar date, the debtor can determine the universe of claims and the potential distribution to creditors, and creditors are in a position to make an informed choice as to the alternatives presented to them. If distributions are being made or a plan is presented to creditors and voted upon, stakeholders should be able to place a degree of reliance in the claims bar process.

32 The overall objective of achieving certainty within the restructuring proceedings - for both debtor and creditor - is what drives this process. In this vein, counsel makes an effort to draft a claims process order to achieve these objectives. A claims bar date is typically set. The process is typically designed with some idea of the issues that either have arisen or might arise in the restructuring. My comments in *0487826 B.C. Ltd., Re*, 2012 BCSC 1501 (B.C. S.C.) [hereinafter Steels Products] are apposite:

> [38] Similar issues often arise in *CCAA* proceedings where counsel and the Court must be mindful of issues that may arise in relation to the determination of claims in that proceeding. There are no set rules, but care must be taken in the drafting of the claims process order to ensure that the process by which claims are determined is fair and reasonable to all stakeholders, including those who will be directly affected by the acceptance of other claims. In *Winalta Inc. (Re)*, 2011 ABQB 399, Madam Justice Topolniski stated that "[p]ublic confidence in the insolvency system is dependent on it being fair, just and accessible".
>
> [39] Many *CCAA* proceedings provide for an independently run claims process (for example, by the monitor), the cost of which again would be borne by the general body of creditors: see for example, *Pine Valley Mining Corp. (Re)*, 2008 BCSC 356. To this extent, the statutory procedure under the *BIA* and the claims process under the *CCAA* will have similar features, which is understandable since the overriding intention under both is to conduct a proper claims process: see *Century Services Inc. v. Canada (Attorney General)*, 2010 SCC 60at paras. 24 and 47.

33 Nevertheless, issues can and do arise that no one is able to foresee at the time of the claims process order. In that event, the court retains its discretion to address the application of the claims process order: *Timminco* at para. 38. In that case, the claims process order specifically allowed the court to order a further claims bar date. No such provision is found in the Claims Process Order but I do not consider that its absence is sufficient to oust the statutory jurisdiction of the court in appropriate circumstances.

34 This, of course, is a different issue in that by the failure of the petitioners to deliver a Notice of Disallowance in respect of the claims in issue, they were deemed to have been accepted by the petitioners. This is not a case where a creditor is seeking to avoid the consequences of not filing materials by the time of the Claims Bar Date. Nevertheless, in my view, the court still retains the statutory jurisdiction to consider the validity of claims that might otherwise, by the Claims Process Order, be deemed to have been accepted.

35 The Prestons and Mr. Stafford do not suggest that the court lacks the jurisdiction to reconsider the issues that arise in relation to their claims. The Prestons do, however, contend that it is not appropriate that any reconsideration take place at this time.

(ii) Review of the Claims

36 The stated purpose of the *CCAA* is to facilitate compromises and arrangements between companies and their creditors (see also s. 6 of the *CCAA*). In accordance with that fundamental objective or purpose, it is axiomatic that it is necessary to determine what are the true claims of the creditors as might be compromised or arranged.

37 A "creditor" is not defined in the *CCAA*, unlike the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c.B-3 (the "*BIA*") where it is defined as meaning "a person having a claim provable as a claim" under that *Act* (s. 2). Both the *CCAA* and the *BIA* define "claim" by reference to liabilities "provable" under the *BIA*. Specifically, s. 2(1) of the *CCAA* defines "claim" as meaning:

> any indebtedness, liability or obligation of any kind that would be a claim provable within the meaning of section 2 of the *Bankruptcy and Insolvency Act*.

Section 2 of the *BIA* defines a "claim provable in bankruptcy" as "any claim or liability provable in proceedings under this Act by a creditor".

38 Section 121(1) of the *BIA* addresses which claims are "provable claims":

> 121(1) All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act.

39 In substance, this same statutory definition is applied in the *CCAA* and represents a point of convergence consistent with the harmonization of certain aspects of insolvency law under both the *CCAA* and *BIA*: *Century Services* at para. 24. In addition, as noted by CuVeras, this definition is essentially used in the Claims Process Order by its definition of "Claim".

40 Various authorities establish that a "provable debt" must be due either at law, or in equity, by the bankrupt to the person seeking to prove a claim and must be recoverable by legal process: *Excelsior Electric Dairy Machinery Ltd., Re* (1922), 2 C.B.R. 599, [1923] 3 D.L.R. 1176 (Ont. S.C.); *Farm Credit Corp. v. Holowach (Trustee of)* (1988), 68 C.B.R. (N.S.) 255, 51 D.L.R. (4th) 501 (Alta. C.A.), leave to appeal to S.C.C. refused, (1989), 73 C.B.R. (N.S.) xxvii (note), 60 D.L.R. (4th) vii (note) (S.C.C.); *Central Capital Corp., Re* (1995), 29 C.B.R. (3d) 33, [1995] O.J. No. 19 (Ont. Gen. Div. [Commercial List]) ("*Central Capital*"), aff'd (1996), 27 O.R. (3d) 494, 38 C.B.R. (3d) 1 (Ont. C.A.) ("*Central Capital* (ONCA)"); *Negus v. Oakley's General Contracting* (1996), 40 C.B.R. (3d) 270, 152 N.S.R. (2d) 172 (N.S. S.C.).

41 In a *CCAA* proceeding, a claims process order is the means by which the "claims" of the creditors are determined. By reason of that process, the debtor is able to determine the nature and extent of its debts and liabilities so as to enable it to formulate a plan of arrangement. There are no rules as to when a claims process may be implemented although it is usually early in the process in anticipation of a plan and distributions to creditors. In that respect, a debtor company will be seeking some certainty regarding the determination of claims for that purpose.

42 In *Timminco*, the Court, prior to citing relevant authorities at para. 52, outlined many of the factors that might be considered by the court in relation to deciding whether to allow claims to be advanced after the claims bar date:

> [51] Counsel to Mr. Walsh submit that courts have historically considered the following factors in determining whether to exercise their discretion to consider claims after the claims-bar date: (a) was the delay caused by inadvertence and, if so, did the claimant act in good faith? (b) what is the effect of permitting the claim in terms of the existence and impact of any relevant prejudice caused by the delay[?] (c) if relevant prejudice is found, can it be alleviated by attaching appropriate

conditions to an order permitting late filing? and (d) if relevant prejudice is found which cannot be alleviated, are there any other considerations which may nonetheless warrant an order permitting late filing?

43 As I have stated above, the broad jurisdiction of the court under s. 11 of the *CCAA* allows the court to make such orders as are "appropriate". While the above factors have been considered in the past, there is no finite list that detracts from a consideration of all relevant circumstances. Nevertheless, the general considerations of delay and prejudice typically arise, just as they do in this case.

44 I return to the factual circumstances relating to the Claims Process and the Claims Process Order. The petitioners were themselves responsible for reviewing the Proofs of Claim and/or Notices of Dispute submitted in the Claims Process. The principal individual involved in the review was Mr. Hewison who did so with the assistance of counsel. It is apparent that the only factors considered in his review included whether a claim related to a trade debt or whether it related to an equity interest in the petitioners.

45 The Prestons argue that the Claims Process was well known to everyone and that its purpose was to establish the amount and nature of all claims. This is clearly self-evident, but back in late 2011, it was the case that the course of the restructuring proceedings was anything but certain. In fact, the ability of the petitioners to continue the proceedings was tenuous and they were scrambling to find interim financing which they eventually secured with CuVeras in November 2011. By that time, the Claims Process was essentially completed. Even so, understandably, the parties were concerned to proceed as quickly as possible to obtain further technical reports on the proven or inferred mine resources in order to determine whether a viable mine even existed. They did receive those later reports, which included a further RPA report and the Snowden report. In these circumstances, Mr. Hewison did not undertake any substantive review of the claims.

46 The Prestons further say that, since they faithfully complied with the Claims Process Order, it would be patently unfair to now revisit the characterization of their claim. While they raise the matter of the three year plus delay, no elements of prejudice have been alleged. In my view, the delay, while relevant, will have little effect on the ability of the parties to address the substance of the matter. Nor have any rights been extinguished or compromised by reason of any delay. Accordingly, the objective of certainty has less force in this case where the plan of arrangement has yet to be formulated and the claimants have yet to consider that plan and vote on it. I note that similar considerations were at play in *Timminco* where it was apparent that no plan would ever be put to the creditors.

47 Finally, the Prestons argue that the Claims Process Order constituted the sole form of adjudication of the validity and nature of the claims submitted. It is true, of course, that the petitioners had an opportunity to consider these claims.

48 As discussed below, the petitioners did not forward any Notice of Disallowance in respect of the Proofs of Claim later filed by the Prestons and Mr. Stafford. Mr. Hewison considered that the Stafford Claim should be categorized as an "investment" in the mine. Further, with respect to the Preston Claim, he was not aware of the significance of the distinction between an equity claim and a debt claim. In retrospect, and now knowing what type of plan of arrangement is possible, Mr. Hewison recognizes that this was in error. It appears that a combination of factors - including Mr. Hewison's lack of familiarity with the past transactions, inadequate record keeping, lack of resources and distraction in terms of larger issues more relevant to the survival of the mine - all contributed to a less rigorous review and analysis of these claims.

49 It is the case, however, that the petitioners were acting in good faith, albeit without a full appreciation of the issues arising in respect of these claims and the also the consequences of their inaction.

50 More importantly, aside from the petitioners, other stakeholders have a significant interest in whether a claim is valid or not and that any claim be properly characterized. Based on the anticipated form of the restructuring plan, the inclusion of the Stafford Claim and characterization of the Preston Claim will impact the recovery of these stakeholders. These other creditors or stakeholders of the petitioners did not have any opportunity up to this point in time to review the claims. I would again note that the Claims Process Order did not contemplate any review of the claims by these other stakeholders, such as was the case in *Steels Products* (see paras. 13-15).

51 Nor has the Monitor participated in any review of these claims. I do not say this as any criticism of the Monitor as the Claims Process Order did not expressly provide for any such independent review. Nor does the Claims Process Order contemplate that any other independent review of the claims be completed which might have highlighted the issues. The Monitor did report on the Claims Process from time to time (particularly, its report from June 2012 and January 2013), however, no such issues were identified. As such, the Monitor did not conduct a critical review of the claims, similar to what a trustee in bankruptcy might have done under s. 135 of the *BIA*.

52 In these circumstances, and in retrospect, the Claims Process lacked procedural safeguards that might have avoided this problem: *Steels Products* at paras. 38-39.

53 In these circumstances, I disagree with the Prestons that the Claims Process Order constitutes an adjudication of these issues by which CuVeras or any other stakeholder is estopped in bringing these issues forward. It is clear that to this point, no such adjudication has occurred.

54 As I have indicated above, a Claims Process Order is intended to be a fair, reasonable and transparent method of determining and resolving claims against the estate. In certain circumstances, these objectives fail to be achieved through no fault of the participants. That does not preclude the court from considering the issues on their merits so as to achieve the fundamental objective under the *CCAA* to facilitate a restructuring based on valid claims. This would also include a consideration of the proper characterization of the Preston's claim: *Steels Products* at para. 42.

55 Simply put, if the Claims Process results in a claim being advanced which is not truly a debt of the petitioners or results in a claim being improperly characterized, the fairness and transparency of these proceedings are inevitably compromised such that the objectives of the *CCAA* will not be fulfilled.

56 My comments in *Steels Products* apply equally here:

> [46] In conclusion, an independent review of these claims is necessary in the circumstances. An adequate review of these related party claims has not been made. The consequences of a successful challenge to some or all of these claims would have significant financial repercussions to the Disputing Creditors and other unsecured creditors who have also proved their claims. To deny an independent review at this time would be to deny any creditor the fair, reasonable and transparent process that is expected in insolvency proceedings in determining claims before any distribution of estate assets is made.

57 Even at this late stage in the proceedings, and considering the ongoing supervisory role of the court, I consider that it is appropriate to address the issues relating to both the Preston Claim and the Stafford Claim on their merits. This is particularly so given the significant repercussions to other stakeholders and the lack of any prejudice to the Prestons and Mr. Stafford.

Discussion

(a) The Preston Claim

58 The Preston Claim is advanced as a debt claim in these proceedings, a position that is disputed by CuVeras who contends that in fact, it is an equity claim as defined in the *CCAA*.

(i) The Proof of Claim

59 The Creditor List referenced the Prestons as holding various Class E (2,102) and Class F (2,400) preferred shares.

60 In October 2011, the Prestons, through their counsel, submitted a Proof of Claim and Notice of Dispute.

61 The genesis of the claim was as described in a Statement of Claim filed in the Alberta Court of Queen's Bench against Gallowai on May 27, 2010. The claim was as follows: in October 2004, the Prestons subscribed for 2,400 Class F preferred shares in Gallowai in consideration of the payment to Gallowai of $120,000; Gallowai is alleged to have covenanted to redeem

the preferred shares at the expiry of five years after the allotment date; the Prestons demanded redemption of the shares and the payment of dividends which was to be by way of issuance of Class E shares; Gallowai refused to respond to their demands; and the Prestons claimed the right to redeem the Class F preferred shares for $120,000 plus either dividends in the form of Class E common shares or, alternatively, cash payment of dividends at 12.75% per annum.

62 On November 19, 2010, default judgment was granted in favour of the Prestons for the claimed amount of $120,000 plus the cash dividend interest rate for a total judgment of $214,527.10 including court ordered costs. The Prestons attempted to register their judgment in British Columbia in June 2011 after the court ordered a stay arising under the Initial Order, but nothing turns on that step.

63 The Proof of Claim indicates that the Prestons were advancing both a trade claim for the judgment amount and also a claim for non-voting shares arising from the allegation that they continue to hold the 2,102 Class E shares noted on the Creditor List.

(ii) Historical Approach to Equity Claims

64 Before I turn to the current statutory regime arising from amendments to the *CCAA* and *BIA* in 2009, I will review the authorities which applied before these amendments were enacted.

65 Historically, equity and debt claims have been treated differently in an insolvency proceeding given the fundamental difference in the nature of such claims. That different treatment resulted in the subordination of equity to debt claims. The basis for this judicially developed principle was that equity investors are understood to be higher risk participants. Creditors, on the other hand, have been held by the courts to have chosen a lower level of risk exposure that should generally result in priority over equity investors in an insolvency context.

66 In *Sino-Forest Corp., Re*, 2012 ONCA 816 (Ont. C.A.), affirming 2012 ONSC 4377 (Ont. S.C.J. [Commercial List]), the Court of Appeal commented with approval on the analysis of Morawetz J. in the court below:

> [30] Even before the 2009 amendments to the CCAA codified the treatment of equity claims, the courts subordinated shareholder equity claims to general creditors' claims in an insolvency. As the supervising judge described [at paras. 23-25]:
>
> > Essentially, shareholders cannot reasonably expect to maintain a financial interest in an insolvent company where creditor claims are not being paid in full. Simply put, shareholders have no economic interest in an insolvent enterprise.
> >
> > The basis for the differentiation flows from the fundamentally different nature of debt and equity investments. Shareholders have unlimited upside potential when purchasing shares. Creditors have no corresponding upside potential.
> >
> > As a result, courts subordinated equity claims and denied such claims a vote in plans of arrangement [citations omitted].

67 See also *Central Capital* at paras. 41-42; *Central Capital* (ONCA) at 510-11, 519.

68 In light of that key distinction, courts in the past have embarked upon a consideration as to the true characterization of certain claims in an insolvency context. There is considerable authority that in making that determination, the court will consider the true substantive nature or character of the claim, rather than the form of the claim.

69 The leading case is the Supreme Court of Canada's decision in *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558 (S.C.C.) ("*CDIC*"). In that case, the issue was whether money advanced to the debtor bank was in the nature of a loan or a capital investment for the purpose of determining whether the creditors advancing the funds ranked *pari passu* with other unsecured creditors in a winding-up proceeding. Mr. Justice Iacobucci stated that the approach was to determine the "substance" or "true nature" of the transaction (563, 588). His oft quoted statements are found at 590-91, the relevant principles of which can be summarized as follows:

a) the fact that a transaction contains both debt and equity features does not, in itself, determine its characterization as either debt or equity;

b) the characterization of a transaction under review requires the determination of the intention of the parties;

c) it does not follow that each and every aspect of a "hybrid" debt and equity transaction must be given the exact same weight when addressing a characterization issue; and

d) a court should not too easily be distracted by aspects of a transaction which are, in reality, only incidental or secondary in nature to the main thrust of the agreement.

70 One type of financial instrument that typically has elements of both equity and debt are preferred shares, where arguably rights of redemption and rights to payment of dividends evidence debt characteristics.

71 The issue of the characterization of preferred shareholder claims in an insolvency context was addressed in *Central Capital* (ONCA). In that case, the court had to characterize a claim arising from the right of retraction in respect of certain preferred shares. Although differing in the result, the majority opinions and the dissenting opinion at the appellate court level were consistent in an approach toward determining the *substance* of the claim in terms of whether it was a "provable debt". In dissent, Finlayson J.A. stated:

> ... I do not think that describing the documents as preferred shares is conclusive as to what instrument the parties thought they were creating. In the second place, it is not what the parties call the documents that is determinative of their identity, but rather it is what the facts require the court to call them. The character of the instrument is revealed by the language creating it and the circumstances of its creation.
>
> (at 509).
>
> . . .
>
> Thus, in looking at the substance of the transaction that led to the issuance of the preference shares, it appears to me that the retraction clauses were promises by Central Capital to pay fixed amounts on definite dates to the appellants. They evidenced a debt to the appellants.
>
> (at 512).

Justice Laskin specifically addressed the "substance of the relationship" at 535-36. In addition, Weiler J.A. focused on the "true nature" of the transaction or relationship:

> In order to decide whether the obligation of Central Capital to redeem the preferred shares of the appellants is a claim provable in bankruptcy, it is necessary to characterize the true nature of the transaction. The court must look to the surrounding circumstances to determine whether the true nature of the relationship is that of a shareholder who has equity in the company or whether it is that of a creditor owed a debt or liability by the company: *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558, 97 D.L.R. (4th) 385. In this case, the decision is not an easy one. Where, as here, the agreements between the parties are reflected in the articles of the corporation, it is necessary to examine them carefully to characterize the true relationship. It is not disputed that if the true nature of the relationship is that of a shareholder-equity relationship after the retraction date and at the time of the reorganization, then the appellants do not have a claim provable in bankruptcy. Consequently, they will not have a claim under the CCAA.
>
> (at 519).

72 In *Blue Range Resource Corp., Re*, 2000 ABQB 4 (Alta. Q.B.), Madam Justice Romaine found that a shareholder's claim for alleged share loss, transaction costs and cash share purchase damages was in substance an equity claim or a claim by the shareholder for a return of its investment. See also *EarthFirst Canada Inc., Re*, 2009 ABQB 316 (Alta. Q.B.).

73 In *Return on Innovation Capital Ltd. v. Gandi Innovations Ltd.*, 2011 ONSC 5018 (Ont. S.C.J. [Commercial List]), leave to appeal refused, 2012 ONCA 10 (Ont. C.A.), the Court was characterizing indemnity claims advanced by certain individual directors and officers against the debtor, the Gandi Group. That indemnity claim arose by reason of a claim by TA Associates Inc. against them for damages for claims relating in part to TA's US$50 million equity investment in the Gandi Group. Mr. Justice Newbould at the Ontario Superior Court concluded that TA's claim was an equity claim and that therefore, the indemnity claim was also, in substance, an equity claim.

74 I have also been referred to *Dexior Financial Inc., Re*, 2011 BCSC 348 (B.C. S.C. [In Chambers]). Mr. Justice Masuhara there found the claim to be an equity claim even though the shareholder had given notice of an intention to seek retraction of the shares prior to the filing. Citing *CDIC* and *Central Capital* (ONCA), the Court found that the notice did not change the original intention or substance of the claim.

(iii) The New Statutory Approach

75 In September 2009, Parliament enacted substantial amendments to the *BIA* and *CCAA* in relation to the treatment of claims arising from equity in an insolvency proceeding.

76 One of the principle amendments was the prohibition that the court may not sanction a plan of arrangement unless all debt claims are to be paid in full before payment of any "equity claims". Section 6(8) of the *CCAA* provides:

> (8) No compromise or arrangement that provides for the payment of an equity claim is to be sanctioned by the court unless it provides that all claims that are not equity claims are to be paid in full before the equity claim is to be paid.

77 The definitions of "equity claim" and "equity interest" are found in the *CCAA*, s. 2(1):

> "equity claim" means a claim that is in respect of an equity interest, including a claim for, among others,
>
> (a) a dividend or similar payment,
>
> (b) a return of capital,
>
> (c) a redemption or retraction obligation,
>
> (d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or
>
> (e) contribution or indemnity in respect of a claim referred to in any of paragraphs (*a*) to (*d*);
>
> "equity interest" means
>
> (a) in the case of a company other than an income trust, a share in the company — or a warrant or option or another right to acquire a share in the company — other than one that is derived from a convertible debt[.]

78 Section 22.1 further restricts the right of creditors having equity claims from voting on a plan of arrangement:

> 22.1 Despite subsection 22(1), creditors having equity claims are to be in the same class of creditors in relation to those claims unless the court orders otherwise and may not, as members of that class, vote at any meeting unless the court orders otherwise.

79 Substantially these same amendments were made to the *BIA* in respect of proposal proceedings under that *Act* in ss. 2, 54(2)(d) and 60(1.7).

80 The effect of the amendments was considered by Pepall J. (as she then was) in *Nelson Financial Group Ltd., Re*, 2010 ONSC 6229 (Ont. S.C.J. [Commercial List]). In that case, the court had no difficulty in finding that the claims of preferred shareholders for declared but unpaid dividends and requests for redemption were equity claims within the above definition. In addition, the approach of the courts in the past in looking at the substance or true nature of the claim was applied in finding that related claims for compensatory damages or amounts due on rescission were caught by the definition of "equity claim": paras. 32-34. As such, all the claims were not provable debts under the *CCAA*.

81 The court in *Nelson Financial Group* noted that the introduction of section 6(8) in the *CCAA* provided greater certainty in the treatment to be accorded equity claims and lessened the "judicial flexibility" that previously prevailed in characterizing such claims.

82 Accordingly, while the 2009 amendments did represent in part a codification of the previous case law concerning equity claims, it also represented a more concrete definition of "equity claims" and by such definition a broadening and more expansive definition of such claims: *Sino-Forest Corporation* (ONCA) at paras. 24, 34-60. Parliament has now clearly cast the net widely in terms of the broad definition of equity claims such that claims that might have previously escaped such characterization will now be caught by the *CCAA*.

83 The claim of the Prestons is set out in their Statement of Claim. The claim is for the return of their capital investment under the redemption rights of the preferred shares. Their claim also included a claim to unpaid dividends, whether by cash payment or the issuance of other shares, being Class E common shares. It is clear that their claims, as evidenced by the Statement of Claim, fall within the definition of "equity claim" in subparas. (a)-(c).

84 The Prestons do not dispute that their claim, as described and but for one qualification, would fall within the definition. They contend, however, that by reason of their obtaining default judgment against Gallowai, they have transformed their equity claim into a debt claim that is a provable claim in the *CCAA* proceeding.

(iv) The Effect of the Judgment

85 The 2009 amendments have not affected the ability of the court to continue to analyze the *substance* of the claims, albeit in the context of the expanded definition of "equity claim". This is evident from the approach of the court in *Nelson Financial Group* at paras. 28 and 34.

86 In *Sino-Forest Corporation*, the court found that certain Shareholder Claims for damages claimed in a class action lawsuit clearly fell within the definition of "equity claims": ONSC at para. 84. Further, certain Related Indemnity Claims were also advanced against the estate by the auditors who were named in the class action lawsuit. These auditors also faced claims for damages relating to their role in what were said to be misrepresentations in the financial statements that led to the loss of equity by the class members. Again, consistent with the historical approach of the courts, Morawetz J. focused on the "substance" of the claim: para. 85. He stated:

> [79] The plain language in the definition of "equity claim" does not focus on the identity of the claimant. Rather, it focuses on the nature of the claim. In this case, it seems clear that the Shareholder Claims led to the Related Indemnity Claims. Put another way, the inescapable conclusion is that the Related Indemnity Claims are being used to recover an equity investment.
>
> [80] The plain language of the CCAA dictates the outcome, namely, that the Shareholder Claims and the Related Indemnity Claims constitute "equity claims" within the meaning of the CCAA. This conclusion is consistent with the trend towards an expansive interpretation of the definition of "equity claims" to achieve the purpose of the CCAA.
>
> . . .

[82] It would be totally inconsistent to arrive at a conclusion that would enable either the auditors or the Underwriters, through a claim for indemnification, to be treated as creditors when the underlying actions of the shareholders cannot achieve the same status. To hold otherwise would indeed provide an indirect remedy where a direct remedy is not available.

The Court of Appeal upheld this approach: *Sino-Forest Corporation* (ONCA) at paras. 37, 58.

87 I would note in this regard that the Claims Process Order expressly provided:

THIS COURT ORDERS that the categorization of Claims into Trade Claims, non-voting Shares, and Voting Shares does not in any way set classes or categories for the purposes of priority or voting on a restructuring plan issued by the Creditors and shall not prejudice any party or the Petitioners from applying at a later date to set such classes or priorities in connection with voting on a plan;

88 The Prestons argue that their obtaining of a judgment against Gallowai has resulted in a replacement or transformation of their equity claim with a debt claim.

89 The Prestons place considerable reliance on the decision in *I. Waxman & Sons Ltd., Re* (2008), 89 O.R. (3d) 427, 40 C.B.R. (5th) 307 (Ont. S.C.J. [Commercial List]), which was decided prior to the 2009 amendments to the *CCAA*. In that case, Morris sued I. Waxman & Sons Limited ("IWS") for lost profits, profit diversions and improper distributions for bonuses paid. He obtained judgment against IWS and asserted that claim in the later bankruptcy proceedings.

90 The court began by noting that Morris' claim was not for his share of his current equity in IWS, but was, in substance, a claim related to dividends and diverted profits by way of bonuses. Justice Pepall found that the judgment was a debt claim:

[24] There is support in the case law for the proposition that equity may become debt. For example, declared dividends are treated as constituting a debt that is provable in bankruptcy. As Laskin J.A. stated in *Central Capital Corp. (Re)*, "It seems to me that these appellants must be either shareholders or creditors. Except for declared dividends, they cannot be both." And later, "Moreover, as Justice Finlayson points out in his reasons, courts have always accepted the proposition that when a dividend is declared, it is a debt on which each shareholder can sue the corporation." Similarly, in that same decision, Weiler J.A. stated, "As I understand it, counsel does not question that when a dividend has been lawfully declared by a corporation, it is a debt of the corporation and each shareholder is entitled to sue the corporation for his [portion]: see *Fraser and Stewart*, supra, at p. 220 for a list of authorities." In *East Chilliwack Fruit Growers Co-operative (Re)*, the B.C. Court of Appeal held that an agricultural co-operative member who had exercised a right of redemption and remained only to be paid was an unsecured creditor with a provable debt. Declared bonuses may also sometimes constitute debt: *Stuart v. Hamilton Jockey Club* [footnotes omitted].

[25] Secondly, the claims advanced by Morris are judgment debts. As stated by Weiler J.A. in *Central Capital*, ". . . in order to be a provable claim within the meaning of s.121 of the BIA, the claim must be one recoverable by legal process: *Farm Credit Corp. v. Holowach (Trustee of)*." Clearly a judgment constitutes a claim recoverable by legal process. By virtue of the judgment, the money award becomes debt and it is properly the subject of a proof of claim in bankruptcy. In this regard, the facts in this case are unlike those in *Re Blue Range Resource Corp. (Re)*, or *National Bank of Canada v. Merit Energy Ltd.* Those cases involved causes of action that had been asserted in court proceedings, but in neither case had judgment been rendered [footnotes omitted].

91 In my view, *Waxman* is of little assistance to the Prestons.

92 Firstly, the facts are distinguishable by reason of the fact that the Preston Claim is for recovery of their capital or equity, rather than simply a return on capital as was the case in *Waxman*. I would note that the Preston default judgment obtained in 2010 does include the dividend interest on the preferred shares. What is somewhat anomalous is that this was claimed in the alternative to the issuance of the Class E common shares. Even so, the Prestons in their Statement of Claim did advance a claim

for 2,102 Class E common shares and continue to do so by their Proof of Claim, all consistent with what the petitioners had ascribed to them in the Creditor List. It is not clear to me how they can advance both claims.

93 Secondly, in para. 24 of *Waxman*, the Court focused on the prevailing authority at the time prior to the amendments by which declared dividends were considered debt as opposed to equity. At present, the 2009 amendments make clear that this type of claim now clearly falls within the definition of "equity claim" in subpara. (a): *CCAA*, s.2(1).

94 With respect to the comments of the Court in *Waxman*, para. 25, I agree with CuVeras that the Court was simply observing that a judgment debt will normally satisfy the requirements of the claim being recoverable by legal process, one of the requirements of a "provable claim", as noted above. These comments do nothing more than note the obvious - that in ordinary circumstances, a judgment is a claim recoverable by legal process. I do not interpret these comments as obviating an analysis of the true nature of a claim, whether represented by a judgment or not.

95 Accordingly, I do not view *Waxman* as standing for the proposition advanced by the Prestons, namely that a judgment transforms an equity claim into a debt claim such that no further analysis or characterization by the court is necessary. This would have applied even before the enactment of the 2009 amendments, but certainly is more evident now given the expansive definition now contained in the *CCAA*.

96 Indeed, the later comments of Justice Pepall in *Nelson Financial Group* suggest that she only decided in *Waxman* that by reason of a judgment, an equity claim *may* become debt:

> [32] The substance of the arrangement between the preferred shareholders and Nelson was a relationship based on equity and not debt. Having said that, as I observed in *I. Waxman & Sons.* there is support in the case law for the proposition that equity may become debt. For instance, in that case, I held that a judgment obtained at the suit of a shareholder constituted debt. An analysis of the nature of the claims is therefore required. If the claims fall within the parameters of section 2 of the *CCAA*, clearly they are to be treated as equity claims and not as debt claims [footnotes omitted].

97 The Court in *Dexior Financial* at para. 16 commented on *Waxman* but those comments were clearly *obiter* as no judgment had been obtained in that case. See also *EarthFirst Canada* at para. 4.

98 At its core, the issue before the court is a narrow one - namely, whether a shareholder, having an equity claim but who obtains a judgment before the filing, has become a debt claimant rather than an equity claimant for the purposes of the insolvency proceeding? In my view, they do not, for the reasons below.

99 In light of the dearth of authority on the issue, I consider that the court must start from first principles.

100 I return to the comments in *Century Services* regarding the remedial purposes of the *CCAA* and the broad and flexible authority of this court to facilitate a restructuring that is fair, reasonable and equitable in accordance with either the express will of Parliament, as specifically dictated in the *CCAA*, or as might be reasonably interpreted as falling within those broad purposes.

101 At its core, the policy objectives of the *CCAA* are a fair and efficient resolution of competing claims in a situation (insolvency) where all obligations or expectations cannot be fulfilled. What is "fair" is a flexible or uncertain concept and needless to say, what is fair will likely be differently interpreted depending on which stakeholder you ask. Nevertheless, Parliament has clearly signalled that the policy objectives continue to be that equity will take a back seat in terms of any recovery where there are outstanding debt claims. This was so before September 2009 and is even more decidedly so now, given the express and expansive statutory treatment of equity claims that now applies.

102 In my view, the characterization of claims by the court continues to have an important role in fulfilling that purpose. I have already outlined the considerable authority from Canadian courts in respect of such claims, both pre- and post-amendments. Particularly, the court continues to have a role in applying these new equity claims provisions by considering the true nature or substance of those claims. In many cases, the matter is now considerably clearer given the definition of "equity claims". What is most important, however, is that form will still not trump substance in the consideration of this issue.

103 As was noted by counsel for CuVeras, the obtaining of a judgment does not necessarily mean that it will be recognized as a debt for the purpose of an insolvency proceeding. There are many provisions of the *BIA* and *CCAA* which allow for the challenge of certain pre-filing transactions or events that may be the basis for supposed rights in the proceeding. For example, the payment of a dividend and redemption of shares may be attacked (*BIA*, s. 101). Another example is that either the granting of a judgment against the debtor or payment of monies such as redemption amounts that resulted in a preference being obtained may be challenged (*BIA*, s. 95). Both of these provisions apply in a *CCAA* proceeding: *CCAA*, s 36.1.

104 These types of provisions reflect the policy choices of Parliament in terms of allowing for the recovery of assets transferred away from the debtor even before the filing so that those assets are brought back into the estate for the benefit of the entire stakeholder group to be distributed in accordance with the legislation. Similarly, some established rights may be challenged in certain circumstances (such as by way of the preference provisions).

105 In the same manner, the new equity provisions in the *CCAA* reinforce that it remains an important policy objective that equity claims be subordinated to debt claims. In *Sino-Forest Corporation*, the Court of Appeal focused on the purpose of the 2009 amendments and stated:

> [56] In our view, in enacting s. 6(8) of the CCAA, Parliament intended that a monetary loss suffered by a shareholder (or other holder of an equity interest) in respect of his or her equity interest not diminish the assets of the debtor available to general creditors in a restructuring. If a shareholder sues auditors and underwriters in respect of his or her loss, in addition to the debtor, and the auditors or underwriters assert claims of contribution or indemnity against the debtor, the assets of the debtor available to general creditors would be diminished by the amount of the claims for contribution and indemnity.

106 This same recognition of the sound policy objectives of insolvency legislation was noted by Laskin J.A. in *Central Capital* (ONCA). He commented at 546 that "[p]ermitting preferred shareholders to be turned into creditors by endowing their shares with retraction rights runs contrary to this policy of creditor protection."

107 I see no principled basis upon which a different approach should be taken in respect of an equity claimant who has had the foresight, energy or just plain luck to seek and obtain a judgment prior to the filing date.

108 Some arguments were advanced by CuVeras and the Prestons as to the timing of the judgment. Indeed, the Preston judgment was obtained well in advance of the filing, by some six months. The Prestons cite *Blue Range* at para. 38 in respect of the importance of timing. However, the timing issue there was the filing of the insolvency proceeding, not the granting of a judgment. I agree that the filing of the proceeding is a significant crystallizing event, however, what is important in this case is the ability of the court to analyze the true nature of the claim. Further, whether a judgment is obtained on the eve of the filing or even years before, I consider that it is a distinction without a difference in terms of the court's role in ensuring that a proper characterizing of the claim has taken place in accordance with the *CCAA*.

109 The fact remains that there are thousands of other preferred shareholders holding shares in Bul River and Gallowai whose claims are in essence the same - namely, for a return of their capital and the promised return on that capital (and perhaps other damage claims). The evidence indicates that many of them had also made demand for a return of their preferred share investments and their return on capital well before the filing date. Those claims are clearly equity claims. From the perspective of the policy objective of treating similar claims in a similar fashion (i.e., fairness), it makes little sense to me that a similarly situated preferred shareholder without a judgment should be treated differently than one who does.

110 Nor does it accord with the policy objectives particularly identified in s. 6(8) of the *CCAA* that by the simple mechanism of obtaining a judgment an equity claimant should be elevated to a debt claimant which would inevitably diminish the recovery of other "true" debt claimants.

111 The Prestons argue that this will open the floodgates to an endless analysis of claims reduced to judgments resulting in increased cost and inefficiencies in these types of proceedings. I see no merit in this submission given that this decision relates

to only equity claims and by no stretch of the imagination has the previous litigation on the point overwhelmed the court system across Canada. In any event, if that is the will of Parliament, then there is little ability in this court to take a different approach.

112 The courts have not been hesitant in preventing claimants from recharacterizing their claims such that an equity claim is indirectly advanced where no direct claim could be made: *Sino-Forest Corporation*, ONSC at para. 84 (although the Court of Appeal preferred to express the same sentiment in terms of the purpose of the *CCAA*). In *Return on Innovation*, Newbould J. stated, consistent with the "substance over form" approach that the court's decision will not be driven by the form of the legal action:

> [59] The Claimants assert that the claim for US $50 million by TA Associates cannot be an equity claim because it is based on breaches of contract, torts and equity. I do not see that as being the deciding factor. TA Associates seeks the return of its US $50 million equity investment because of various wrongdoings alleged against the Claimants and the fact that the claim is based on these causes of action does not make it any less a claim in equity. The legal tools that are used [are] not the important thing. It is the fact that they are being used to recover an equity investment that is important.

113 Similarly, in addition to the "legal tools" not being determinative, neither are the legal *forms* of recovery determinative, such as the obtaining of a judgment.

114 In summary, the *CCAA* policy objectives in relation to equity claims are clear. In my view, those objectives are best achieved by the continued approach of the court, both pre- and post-*CCAA* amendments, to consider the substance or true nature of the claim. This accords with the ongoing supervisory jurisdiction of the court to exercise its statutory discretion to achieve the purposes of the *CCAA*. In particular, the court's fundamental role is to facilitate a restructuring that is fair and reasonable to all stakeholders in accordance with the now very clearly stated objective of allowing recovery to debt claimants before any recovery of equity claims. Section 6(8) reflects that the court has no ability to proceed otherwise.

115 Within those broad objectives, in my view, it is of no importance that prior to the court filing, a claimant with an equity claim has obtained a judgment. That judgment still, in substance, reflects a recovery of that equity claim and therefore, the claim comes within the broad and expansive definition in the *CCAA*. Accordingly, for the purposes of the *CCAA*, that claim or judgment must still, of necessity, bear that characterization in terms of any recovery sought within this proceeding. I conclude that any contrary interpretation, such as advanced by the Prestons, would result in the clear policy objectives under the *CCAA* being defeated.

116 Nor I do not accept that, as argued by the Prestons, applying this characterization amounts to a collateral attack or an "undoing" of the judgment from the Alberta court. As noted by CuVeras, the obtaining of a judgment by a creditor does not mean that insolvency laws do not apply to it. Judgments are affected by insolvency proceedings all the time. Recoveries of judgments are stayed by such proceedings and as stated above, they can be attacked as fraudulent preferences. All that results from my conclusions is that notwithstanding the granting of the judgment, within these *CCAA* proceedings, the judgment is to be characterized in accordance with the true nature of the underlying claim, which is an equity claim.

117 For the above reasons, I conclude that the Preston Claim is an equity claim within the meaning of the *CCAA*.

(b) The Stafford Claim

118 The Stafford Claim is advanced as a debt claim in these proceedings. That position is disputed by CuVeras who contends that, in fact, it is a claim owed by Stanfield personally and not by either Bul River or Gallowai such that it cannot be advanced in this *CCAA* proceeding.

(i) The Proof of Claim

119 The Creditor List referenced Mr. Stafford as holding Class B common shares (3,340), Class D preferred shares (4,200) and Class E preferred shares (17,548). He therefore received a Claims Package from the petitioners.

120 Mr. Stafford took no issue with the shareholdings alleged to be held by him in accordance with the Creditor List. However, on October 14, 2011, a Notice of Dispute and Proof of Claim were submitted on behalf of Mr. Stafford. This was done by Carol Morrison, who was exercising a power of attorney for Mr. Stafford by reason of his mental and physical incapacity that occurred at least as early as November 2010.

121 The Notice of Dispute refers to "claim not listed" as the "reason for dispute". The Proof of Claim submitted by Mr. Stafford notes the "type of claim" as "other — loan and accrued interest 50% Bul River Mineral Corp. and 50% Gallowai Metal Mining Corp." The Stafford Claim submitted is for outstanding principal and interest under a loan in the total amount of $2,587,174.

122 The supporting documentation submitted for Mr. Stafford includes a copy of a loan agreement between Stanfield in his personal capacity, as borrower, and Mr. Stafford, as lender, dated June 12, 1990, 21 years before the CCAA filing (the "Stafford Loan Agreement"). The Stafford Loan Agreement references a loan in the principal amount of $150,000, accruing interest in the amount of 20% per annum "on the Principal", calculated yearly and not in advance.

123 Pursuant to the terms of the Stafford Loan Agreement, Stanfield borrowed these funds for the purpose of "investing the funds in the costs of the ongoing research and development of a Process" with "Process" being defined as a "new improved method or process for extracting precious metals from ore". Paragraphs 6 and 8 of the Stafford Loan Agreement provided for a bonus payable to Mr. Stafford equal to the amount of the Principal, if the "Process" proved successful (as declared by an independent metallurgical consultant). As CuVeras submits, on its face, this was not a loan directly related to the mine or the petitioners.

(ii) Dealings in Respect of the Stafford Loan Agreement

124 For obvious reasons, the death of Ross Stanfield and the incapacity of Mr. Stafford result in a situation where no individual is in a position to shed light on the intentions of the parties in relation to this loan. Mr. Hewison is similarly unable to provide any evidence about the loan, save for referring to such documents as have been found in relation to this loan. Those documents do provide some indication as to the how Stanfield, Bul River and Gallowai addressed this loan up to the time of the *CCAA* filing.

125 There are two resolutions of the directors of Bul River, dated October 1994 and February 1996 respectively, that are essentially the same. Both refer to the "need of major amounts of additional financing" and authorize Stanfield to negotiate, on behalf of Bul River, potential sources of debt or equity financing, to settle the terms of the financing, and to sign, seal and deliver any agreements necessary to secure funding required by the company. I agree that these resolutions on their face clearly do not authorize Stanfield to act as an agent for Bul River. They merely authorize him to act directly in the name of the company with the company as principal in respect to those transactions. These resolutions also do not reference any loan by Mr. Stafford to Stanfield made years before in June 1990.

126 Bul River also appears to have prepared a schedule of loan payments as of December 31, 2006. That schedule shows payment of interest to Mr. Stafford by Stanfield personally from June 1995 to September 1998 totalling approximately $183,000. In 1999 and 2000, Gallowai appears to have made interest payments of $40,000 and from that time forward, some person (unidentified) made interest payments of $25,000 for 2001 and 2002. From 2004 to 2006, it appears that Bul River made interest payments of $22,500 and principal payments of $26,000 to Mr. Stafford. Mr. Stafford's own calculations show further payments of interest from 2007 to 2009 totalling $58,000.

127 Accordingly, in respect of his $150,000 loan, as of 2009, Mr. Stafford had received $328,100 in interest payments and $26,000 in principal payments for a total recovery of $354,100.

128 Leaving aside the interest and principal payments referred to above, the involvement of Bul River and Gallowai in respect of the Stafford Loan Agreement arose, from a corporate perspective, in 2003. At that time, various resolutions were passed by the directors of Bul River. Mr. Stafford places great reliance on these resolutions and as will become apparent from the discussion below, the issue largely turns on the legal effect of these resolutions. As such, I will describe the resolutions in some detail.

129 The first resolution is dated May 13, 2003. It provides:

> WHEREAS:
>
> > A. Loans, loan repayments and principal and interest payments which were property for the benefit of, or were the responsibility of, the Company have for some years been done, as a matter of convenience, in the name of the Company's President, [Stanfield] - and as a result debit and credit entries have improperly been posted to Stanfield's Shareholder Loan Account.
> >
> > B. Stanfield has requested that the situation described above be corrected...
> >
> > C. The Companies' accountant has examined the financial records and has verified that the said situation has occurred with respect to the Company as well as Gallowai...
> >
> > D. Management has proposed, based on professional advice, that for convenience and simplicity the various Loan Accounts involving Stanfield, the Company and the Other Companies be consolidated in the books of the Company.
>
> . . .
>
> NOW THEREFORE, IT IS RESOLVED:
>
> > 1. THAT the Loan Accounts and payments referred to above be recognized as solely the responsibility of the Company and it be confirmed that Stanfield was, in being named in the transactions, acting solely on behalf of the Company and that he had no personal, legal or beneficial interest in, or any liabilities as a result of, any of the transactions.
> >
> > 2. THAT the Agreement dated this May 13, 2003 between the Company, Stanfield and the Other Companies be approved and that Stanfield or any other officer or director of the Company be authorized to sign and deliver it on behalf of the Company.
> >
> > 3. THAT the Company assume the obligations of the Other Companies to Stanfield pursuant to the shareholder account in their records, to be offset by inter-company accounts whereby each of the Other Companies will be indebted to the Company for the amount of shareholders accounts assumed by the Company.

130 The second resolution of Bul River is dated October 20, 2003 and relates to the May 2003 resolution. The resolution references that Stanfield is having difficulty providing full documentary verification and back-up for his expenditures for which he was requesting reimbursement. In addition, the preamble to the resolution states in part:

> D. Acceptance of liability to Stanfield at this date poses some special problems due to the fact that some of the disbursements that he has requested to be reimbursed for precede the last date that the financial statements of the company were audited — and such statements did not include the expenditures.

Concern was expressed whether or not the acceptance of these responsibilities would be acceptable to Bul River's auditors. The resolution authorizes the engagement of the auditors for the purpose of conducting a special audit of the expenditures made by Stanfield. There is no evidence as to the result of that special audit or if it even took place.

131 The third resolution of Bul River is dated November 30, 2003 and is of particular significance. It reads as follows:

> WHEREAS:
>
> > A. Ross Stanfield ...has submitted various claims for recognition of corporate liabilities to third parties ... as shareholder's loans for transactions undertaken as agent on behalf of the Company, Gallowai ... to finance the exploration of the British Columbia properties owned by the Companies ("Properties").

B. Stanfield and the Companies signed an Agreement dated May 13, 2003 recognizing the fact that Stanfield has acted as agent on behalf of the Companies since 1972 and had personally undertaken a variety of transactions as agent for the Companies to finance the exploration of the Properties.

C. Stanfield has submitted the following claims pursuant to the Agreement for the Director's consideration and approval.

1. Exploration Loans

These loans were negotiated between 1983 and 2002 personally by Stanfield, as the agent of the Company, and all funds were advanced to the Companies as shareholders loans from him. Payments were made on the loans with his own personal funds or shareholdings. The Directors were provided with a summary of individual loans and accrued interest for review. Files have been prepared for corporate record keeping purposes that include the documentation and amortization schedules supporting each loan.

Balances as at December 31, 2002

Loan principal	$1,886,413
Accrued interest	$6,281,004

. . .

NOW THEREFORE, the undersigned acting as a group excluding ... [Stanfield], RESOLVE:

1. THAT the loans, accrued interest and share subscriptions detailed in paragraph C.1 above, negotiated by Stanfield as agent on behalf of the Companies, be accepted as liabilities of the Companies.

. . .

3. THAT the resolution passed by the full Board dated May 13, 2003 that the Company accept all of the above described liabilities on behalf of the other Companies — to be offset by inter-company accounts whereby each of the other Companies will be indebted to the Company for the amounts assumed by the Company — be further approved and ratified.

132 It should be noted that the agreement between Stanfield and Bul River (and perhaps others) dated May 13, 2003 has not been located. Nor have any similar resolutions from the directors of Gallowai been found.

133 In addition, no one has been able to locate a copy of the summary of the loans as of December 2002 referred to in paragraph C.1 of the November 2003 resolution. Mr. Hewison refers in his evidence to a spreadsheet in the name of Bul River referencing "Mine Development Loans" for the year ended December 2003 which indicates a loan from Mr. Stafford of $150,000 with accrued interest of $899,236.39. The total interest figure for all loans is slightly different (lower) than the interest amount referenced in the November 2003 resolution which was as of December 31, 2002. In any event, CuVeras does not dispute that Mr. Stafford would likely have been on the list referred to in the November 2003 resolution.

134 No audited financial statements have been produced pre-2003, as might have been amended arising from the special audit authorized in October 2003.

135 Also in evidence are various letters from Bul River to Mr. Stafford concerning these loans.

136 On April 23, 2007, a letter was sent to Mr. Stafford's accountant enclosing various amended 2006 T5 (Statement of Investment Income) forms or slips that were apparently issued to Mr. Stafford by Gallowai and Bul River, each as to 50%

of interest paid or payable pursuant to the Stafford Loan Agreement. The letter indicates that as of 2006, the amount of such interest was just over $1.5 million (which included the $150,000 bonus amount supposedly due pursuant to the Stafford Loan Agreement).

137 On March 6, 2008, Mr. Stafford received correspondence from Bul River's controller concerning the 2006 T5s slips from Bul River and Gallowai. Later letters from the controller dated April 2, 2008, February 12, 2009 and January 19, 2010 refer to T5 slips being issued by Bul River and Gallowai for 2007, 2008 and 2009 relating to accrued interest on the Stafford Loan Agreement. Finally, T5 slips for 2010 appear to have been issued by Bul River and Gallowai for that taxation year.

138 There is no evidence that Mr. Stafford knew anything about the 2003 resolutions by Bul River. It does appear to be the case that he began receiving interest payments from Gallowai in 1999 and these would continue together with the payment of some principal by either Gallowai or Bul River to 2009. Bul River would also later send Mr. Stafford, commencing in 2007 and continuing to 2010, certain details or statements relating to the loan and the T5 slips.

(iii) Legal Basis for the Stafford Claim

139 For the reasons set out below, CuVeras submits that the Stafford Claim is not a debt claim against Bul River and Gallowai and ought to be expunged from the Creditor List. CuVeras argues that Mr. Stafford cannot satisfy the onus placed upon him to prove his claim against those petitioners.

140 At the outset, it is clear that Mr. Stafford advanced his loan to Stanfield personally, and not to either Bul River or Gallowai. The 2003 resolutions confirm that such was the case and, indeed, the amounts were noted in the books of Bul River and Gallowai as shareholder loans owing to Stanfield personally in that respect.

141 CuVeras made substantial arguments on the later involvement of Bul River and Gallowai in terms of whether those petitioners became the principal obligants under the Stafford Loan Agreement. These arguments related to whether or not there had been a valid assignment of the Stafford Loan Agreement from Stanfield to Bul River and Gallowai. While Mr. Stafford agreed with these submissions, it is helpful to set out these issues and arguments in order to put in focus the later arguments of Mr. Stafford (which are contested by CuVeras).

142 I agree that there is no basis upon which Mr. Stafford can contend that Stanfield assigned the Stafford Loan Agreement to Bul River and Gallowai. There is no evidence that Gallowai agreed to anything, since the resolutions were only that of Bul River's directors.

143 Even assuming that the November 2003 resolution was intended to effect a valid assignment of the obligations under the Stafford Loan Agreement from Stanfield to Bul River and Gallowai, it is of no legal effect in that it purports to assign the burden of Stanfield's obligations to Bul River and Gallowai. It is trite law that neither the common law nor equity has ever permitted a debtor to unilaterally assign the burdens or obligations (as opposed to the benefits) of a contract to a third party without the consent of the creditor. Rather, in that case a novation is required: *Mills v. Triple Five Corp.* [1992 CarswellAlta 172 (Alta. Master)], 1992 CanLII 6204 at paras. 13-14, (1992), 136 A.R. 67 (Alta. Master).

144 Novation involves the substitution of a new contract or obligation for an old one which is thereby extinguished: *Royal Bank v. Netupsky*, 1999 BCCA 561 (B.C. C.A.). In *Netupsky* at paras. 11-13, the court set out the essential elements that must be established to satisfy the test to establish novation:

1. the new debtor must assume complete liability for the debt;

2. the creditor must accept the new debtor as a principal debtor, and not merely as an agent or guarantor; and

3. the creditor must accept the new contract in full satisfaction and substitution for the old contract.

145 Mr. Stafford bears the burden of proving novation which the Court in *Netupsky* described as a "heavy onus". Further, while the courts may look at the surrounding circumstances, including the conduct of the parties, they will not infer that a novation has occurred in the face of ambiguous evidence as to the parties' intention to effect a new agreement with the substituted party.

146 As is noted by CuVeras, it is somewhat ironic to suppose that Mr. Stafford might have advanced this issue since he is the creditor and as noted in *Netupsky*, it is usually the "unwilling creditor" who is objecting to any suggestion of a novation. In any event, in this case there is no evidence to suggest that:

> a) Mr. Stafford had any knowledge of the 2003 resolutions or was in any other way even advised by Stanfield, Bul River or Gallowai that it was intended that Bul River and Gallowai would assume the obligations under the Stafford Loan Agreement in place of Stanfield; and
>
> b) Stanfield, Bul River, Gallowai and Mr. Stafford reached a consensus with respect to the terms upon which any purported new or substituted agreement would operate.

147 Accordingly, it is clear, as agreed by CuVeras and Mr. Stafford, that novation did not occur such that Bul River and Gallowai assumed the obligations of Stanfield under the Stafford Loan Agreement with the consensus of Mr. Stafford. In addition, no privity of contract arose simply by reason of later payments to Mr. Stafford or issuance of T5 slips by Bul River and Gallowai. That Mr. Stafford was not directly involved in any such new contractual arrangements and that he only later "assumed" that Bul River and Gallowai were involved is made evident by his own loan summary attached to his Proof of Claim:

> Commencing in 2006, T5 slips were issued by Bul River Mineral Corporation and Gallowai Metal Mining Corporation (50% each). Assumption is therefore that $^{1}/_{2}$ of Grand Total is receivable from each.
>
> [Emphasis added].

148 Nor is there any suggestion that Bul River or Gallowai provided a guarantee of the Stafford Loan Agreement to Mr. Stafford. Finally, Mr. Stafford does not argue that Bul River and Gallowai are somehow estopped from denying that they are debtors of Mr. Stafford, particularly by reason of the interest and principal payments made by them and the T5 slips prepared by them which were then forwarded to Mr. Stafford.

149 Having confirmed the agreement of CuVeras and Mr. Stafford on the above issues, I turn to Mr. Stafford's position, which is solely rooted in agency:

> The corporate minutes of Bul River Mineral Corporation confirm that the actions of Ross Hale Stanfield were as agent for the company and associated companies and confirmed by resolution to accept liability of agreements signed by Stanfield as legitimate debts of a company and acted on it accordingly[.]

150 Essentially, Mr. Stafford's argument is that Stanfield was retroactively appointed as the agent of Bul River and Gallowai by reason of the November 2003 resolution such that he had the express or implied authority to bind Bul River and Gallowai at the time of the loan. He relies in particular on s. 193(2) and (4) of the *Business Corporations Act*, S.B.C. 2002, c. 57:

> 193 (2) A contract that, if made between individuals, would, by law, be required to be in writing and signed by the parties to be charged, may be made for a company in writing signed by a person acting under the express or implied authority of the company and may, in the same manner, be varied or discharged.
>
> . . .
>
> (4) A contract made according to this section is effectual in law and binds the company and all other parties to it.

151 It seems to be common ground that Stanfield was not acting as the agent of Bul River and Gallowai in 1990 when the loan was made. The Stafford Loan Agreement does not reference Stanfield acting as an agent and the Proof of Claim does not

allege an agency relationship at the time of the Stafford Loan Agreement. Nor was Stanfield acting as the agent of Bul River and Gallowai during the ensuing 13 years when the loan was being administered. The allegation is that changes only occurred in 2003 when Stanfield decided he wanted to be reimbursed by Bul River and Gallowai for certain loans he had earlier made.

152 I was referred to only one authority on the agency issue by CuVeras, being *Spidell v. LaHave Equipment Ltd.*, 2014 NSSC 255 (N.S. S.C.).

153 In *Spidell*, LaHave Equipment Ltd. was a dealer for Case Canada Limited. The plaintiff Spidell purchased a Case Canada excavator from LeHave which was financed by Case Credit Limited. Spidell alleged that employees of LaHave made representations to him about the performance of the equipment. Spidell believed LaHave was a representative or agent or dealer for Case Canada. Spidell did not make the required payments to Case Credit and the equipment was repossessed. Spidell sued LaHave claiming damages for alleged misrepresentations. LaHave defended the action but subsequently went into bankruptcy. Only then did Spidell amend his pleading to add Case Credit and Case Canada as defendants, claiming LaHave was their agent. The issue on the summary trial was whether LaHave was in fact the agent of the Case companies.

154 Mr. Justice Coughlan reviewed the law of agency, as follows:

> [21] In *Halsbury's Laws of Canada First Edition*, "Agency" paragraph HAY-2 the three essential ingredients of an agency relationship are:
>
> 1. The consent of both the principal and the agent.
>
> 2. Authority given to the agent by the principal, allowing the former to affect the latter's legal position.
>
> 3. The principal's control of the agent's actions.
>
> And at Agency paragraph HAY -11 the manner in which an agency relationship may be created are set out:
>
> "1. the express or implied consent of principal and agent,
>
> 2. by implication of law from the conduct or situation of the parties or from the necessities of the case,
>
> 3. by subsequent ratification by the principal of the agent's act done on the principal's behalf, whether the person doing the act was an agent exceeding his authority or was a person having no authority to act for the principal at all,
>
> 4. by estoppel, or
>
> 5. by operation of the principles of law."
>
> [Emphasis added].

155 Mr. Stafford relies in particular on the creation of agency by ratification as referred to above. Justice Coughlan said this about agency by ratification:

> [25] The conditions for an agency by ratification to be established were set out in *Halsbury's Laws of Canada*, *supra*, at Agency HAY-22 as follows:
>
> "**Three Conditions**. Actions by a principal after the agent has purported to act on the principal's behalf may amount to creation of agency by ratification. For this to occur, three conditions must be satisfied. First, the agent whose act is sought to be ratified must have purported to act for the principal; second, at the time the act was done the agent must have had a competent principal; and third, at the time of the ratification the principal must be legally capable of doing the act himself.["]

156 The key consideration from the above quote is the first requirement. In this case, there is no evidence that Stanfield "purported to act" for Bul River and Gallowai as principals in 1990 when he entered into the Stafford Loan Agreement. In fact, the evidence is to the contrary in that he acted in his personal capacity and not as agent.

157 I agree with CuVeras that agency by ratification assumes that there exists a relationship (even though perhaps mistaken) between the principal and agent at the time of the transaction which must later be ratified. One example is as noted in the *Halsbury's* quote above, namely where the agent exceeded his or his authority but later the unauthorized transaction is ratified or adopted by the principal. That is not what occurred in this case. Ratification of an agent's actions in that case cannot occur when no agency relationship existed in the first place. The second example of ratification described in *Halsbury's* (where the person had no authority to act but their actions were later ratified) still requires that the actions be done by the agent "on the principal's behalf" in purported furtherance of an agency relationship.

158 Accordingly, the concept of ratification by Bul River and Gallowai of Stanfield's actions concerning the Stafford Loan Agreement as their agent has no application in this case.

159 What occurred in this case is that many years later, in 2003, Stanfield, Bul River and Gallowai agreed that the companies would take over responsibility for payment of the Stafford Loan Agreement in place of Stanfield. But those arrangements were only between Bul River, Gallowai and Stanfield and not Mr. Stafford.

160 Accordingly, we start from the proposition that there was no agency relationship between Stanfield and Bul River and Gallowai in 1990. The only parties to the Stafford Loan Agreement are Stanfield and Mr. Stafford.

161 The only evidence suggesting any link between Mr. Stafford and Bul River and Gallowai arise from the fact that, commencing in April 2007, Mr. Stafford began to receive T5 slips from them. Payments were also made by Bul River and Gallowai commencing in 1999. Mr. Stafford argues that by reason of such actions, Bul River and Gallowai treated the Stafford Loan Agreement as their debt since they could not have issued T5 slips for someone else's debt. The 2003 resolutions are, of course, an internal document of Bul River but do indicate that Bul River at least intended to accept the Stafford Loan Agreement as its obligation. The basis upon which Bul River was able to accept this obligation on behalf of Gallowai is unclear and not substantiated.

162 Mr. Stafford argues that these events confirm that Bul River and Gallowai had assumed the obligations of Stanfield. But this argument brings us back to the legal bases for any liability on the part of Bul River and Gallowai that CuVeras raised and I discussed above (assignment, novation, guarantee and estoppel) and which arguments Mr. Stafford agreed did not apply.

163 I agree with the submissions of CuVeras that these later actions of Bul River and Gallowai evidence an intention on the part of Bul River (and perhaps Gallowai) to take over or assume payment of the obligations of Stanfield under the Stafford Loan Agreement. In that sense, and without a novation, in substance these arrangements amount to Bul River and Gallowai agreeing to indemnify Stanfield in respect of his obligations to pay the Stafford Loan Agreement amounts and nothing more.

164 I conclude that Mr. Stafford has not met the onus of proving that the amounts under the Stafford Loan Agreement are obligations or "provable debts" of Bul River and Gallowai.

165 Both CuVeras and Mr. Stafford made submissions concerning the issue as to whether the Stafford Loan Agreement provided for compound interest or not. In light of my conclusions above, it is not necessary to address that issue.

Conclusion

166 In accordance with the above reasons, the Court declares that:

a) the Preston Claim is an equity claim for the purposes of this *CCAA* proceeding; and

b) the Stafford Claim is not a debt claim as against Bul River and Gallowai. It follows that the Creditor List should be amended accordingly and that Mr. Stafford is not entitled to vote on or receive any distribution under any plan of arrangement as may subsequently be filed by those petitioners.

167 If any party is seeking costs, then written submissions should be delivered to the court and the party against whom costs are sought within 30 days of delivery of these reasons. Any response shall be delivered within 15 days and any reply to that response shall be delivered with seven days of that date.

One claim found to be in equity; second claim found not to be in debt.

TAB “G”

1992 CarswellAlta 298
Supreme Court of Canada

Canada Deposit Insurance Corp. v. Canadian Commercial Bank

1992 CarswellAlta 298, 1992 CarswellAlta 790, [1992] 3 S.C.R. 558, [1992] S.C.J. No. 96, [1993] A.W.L.D. 003, 131 A.R. 321, 143 N.R. 321, 16 C.B.R. (3d) 14, 16 C.B.R. (3d) 154, 25 W.A.C. 321, 36 A.C.W.S. (3d) 731, 5 Alta. L.R. (3d) 193, 7 B.L.R. (2d) 113, 97 D.L.R. (4th) 385, J.E. 92-1742, EYB 1992-66961

Re Winding-up Act, R.S.C. 1970, c. W-10, as amended; Re Winding-up of CANADIAN COMMERCIAL BANK; PRICE WATERHOUSE LIMITED (Liquidator of CANADIAN COMMERCIAL BANK) v. R. IN RIGHT OF ALBERTA, ROYAL BANK OF CANADA, BANK OF MONTREAL, TORONTO-DOMINION BANK, BANK OF NOVA SCOTIA, CANADIAN IMPERIAL BANK OF COMMERCE and NATIONAL BANK OF CANADA

La Forest, L'Heureux-Dubé, Gonthier, Cory, McLachlin, Stevenson [*] and Iacobucci JJ.

Heard: April 2, 1992
Judgment: November 19, 1992
Docket: Doc./n[o] 22084

Counsel: *Charles P. Russell*, for liquidator
Earl A. Cherniak, Q.C., and *Robert J. Morris*, for general body of creditors of estate of Canadian Commercial Bank
James Rout, Q.C., for respondent R. in Right of Alberta.
Colin L. Campbell, Q.C., for respondents Royal Bank of Canada, Bank of Montreal, Toronto-Dominion Bank, Bank of Nova Scotia, Canadian Imperial Bank of Commerce and National Bank of Canada

Related Abridgment Classifications
Business associations
IV Powers, rights and liabilities
IV.6 Partnership accounting
IV.6.b Upon dissolution
Financial institutions
III Termination of business by bank
III.3 On insolvency of bank
III.3.g Priority of claims against bank assets
Financial institutions
V Powers and capacities
V.2 Permitted behaviour

Headnote
Banking and Banks --- Termination of business by bank — On insolvency of bank — Priority of claims against bank assets
Partnership --- Accounting — Upon dissolution

Corporations — Winding-up — Several parties advancing funds in attempt to save chartered bank from insolvency — Attempt failing and bank ordered wound up — Funds advanced being characterized as loan and not capital investment — Group of lenders being entitled to rank equally with bank's unsecured creditors.

When a chartered bank found itself in financial difficulty, an arrangement to provide emergency financial assistance to the bank was entered into by the governments of Canada and of Alberta, six major Canadian financial institutions, the Canada Deposit Insurance Corporation ("CDIC") and the bank. Under the arrangement $255 million was advanced to the bank by way of a purchase of participation in a portfolio of assets held by the bank. The portfolio of assets consisted of loans and related security having a nominal value on the bank's books of over $500 million. The participation interest of each participant was proportional to its financial contribution. The bank undertook to indemnify the participants against any loss experienced under the support programme up to the amount paid by each of them to the bank. It was agreed that in the event of the insolvency or winding-up of the bank any amount remaining unpaid "shall constitute indebtedness of [the bank] to the members of the Support Group."

Despite this infusion of money, the bank became insolvent and was ordered to be wound up under the *Winding-up Act* in September 1985. A liquidator was appointed.

By August 1987, the liquidator had recovered approximately $112 million on account from the bank's portfolio assets, $5 million of which was attributable to the portion of the assets beneficially owned by the participants. The liquidator brought an application for the advice and direction of the court as to the interpretation of the support agreements. A judge of the Queen's Bench determined that the participants were entitled to the repayment of the $5 million recovered by the liquidator, but were otherwise not entitled to recover their advances until after all ordinary creditors, including unsecured creditors, were paid in full. The injection of funds by the participants was found to have been a capital investment.

The participants, apart from the Government of Canada and CDIC, successfully appealed the part of the judgment characterizing the funds as a capital investment. The Court of Appeal characterized the advance of $255 million as a loan and concluded that the participants were entitled to rank equally with the bank's unsecured creditors for all moneys advanced to the bank.

The liquidator applied for leave to appeal from the judgment of the Court of Appeal. Leave was granted. On the appeal, the Supreme Court of Canada considered (1) whether the $255 million advance was a loan: (2) if so, whether it was a loan coming within the postponement provision in s. 4 of the *Partnerships Act* (Ont.); and (3) if that Act did not apply, whether the claim of the six financial institutions and the Government of Alberta should be postponed to the claims of the general body of the bank's unsecured creditors, other than the participants, based on the United States doctrine of equitable subordination.

Held:

The appeal was dismissed.

The words chosen by the participants in the agreements covering the advance of the $255 million clearly supported the Court of Appeal's conclusion that the assistance programme involved a loan and not a capital investment. There was nothing in the surrounding circumstances that would alter this characterization. Although the transaction had some "investment features", they were incidental to the debt features of the arrangement and did not alter the substance of the debtor-creditor relationship created by the advance of the $255 million.

The loan did not fall within the ambit of the *Partnerships Act* as the participants were to receive neither a "rate of interest varying with the profits" of the bank, nor a "share of the profits arising from carrying on the business" of the bank. Therefore, the Court of Appeal did not err in declining to postpone the participants' claims under s. 4 of the Act. The participants were not to receive a rate of interest varying with the bank's profits in return for the advance of $255 million. The rate of interest was fixed according to the prime rate and was made contingent on whether or not an equity agreement could be carried out. Further, a lender does not share in profits within the meaning of ss. 3(3)(*d*) and 4 of the Act unless he or she is entitled to be paid amounts referable to profits other than in repayment of the principal amount of the loan. While the repayment was to be made from the pre-tax income of the bank, there was no direct link between the success of the bank and the overall quantum of the amount due to or payable to the participants.

The principles of equitable subordination had no application to the facts of the case. In order to make a successful claim for equitable subordination (1) the claimant must have engaged in some type of inequitable conduct; (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 statutes. The evidence adduced disclosed neither inequitable conduct on the part of the participants nor injury to the ordinary creditors of the bank as a result of the alleged misconduct.

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Table of Authorities

Cases considered

Beale, Re; Ex parte Corbridge (1876), 4 Ch. D. 246 — *referred to*

British Eagle International Airlines Ltd. v. Compagnie Nationale Air France, [1975] 1 W.L.R. 758, [1975] 2 All E.R. 390 (H.L.) — *referred to*

Cox v. Hickman (1860), 8 H.L.C. 268, 11 E.R. 431 — *distinguished*

Dickie, Re (1924), 5 C.B.R. 214 (N.S. T.D.) — *referred to/mentionné*

Fort, Re; Ex parte Schofield, [1897] 2 Q.B. 495 (C.A.) — *referred to*

Grace v. Smith (1775), 2 Wm. Bl. 997, 96 E.R. 587 — *referred to*

Hildasheim, Re, [1893] 2 Q.B. 357 (C.A.) — *referred to*

Laronge Realty Ltd. v. Golconda Investments Ltd. (1986), 63 C.B.R. (N.S.) 76, 7 B.C.L.R. (2d) 90 (C.A.) — *referred to*

Mason, Re; Ex parte Bing, [1899] 1 Q.B. 810 — *referred to*

Meade, Re, [1951] 1 Ch. D. 774, [1951] 2 All E.R. 168 — *referred to*

Mobile Steel Co., Re, 563 F. 2d 692 (5th Circ., 1977) — *referred to*

Multiponics Inc., Re, 622 F. 2d 709 (5th Circ., 1980) — *referred to*

Stone, Re (1886), 33 Ch. D. 541 — *referred to*

Sukloff v. A.H. Rushforth & Co., [1964] 1 S.C.R. 459, 6 C.B.R. (N.S.) 175, 45 D.L.R. (2d) 510 — *distinguished*

Taylor, Ex parte; Re Grason (1879), 12 Ch. D. 366 (C.A.) — *referred to*

Waugh v. Carver (1793), 2 Hy. Bl. 235, 126 E.R. 525 — *referred to*

Young, Re; Ex parte Jones, [1896] 2 Q.B. 484 — *distinguished*

Statutes considered:

Bank Act, R.S.C. 1985, c. B-1 —

s. 132

s. 173

s. 174

s. 277

Bankruptcy Act, R.S.C. 1985, c. B-3 —

s. 139

Partnership Act, 1890 (U.K.), 53 & 54 Vict., c. 39 —

s. 2(3)(d)

s. 3

Partnership Act, R.S.O. 1990, c. P.5 —

s. 3(3)(a)

s. 3(3)(b)

s. 3(3)(d)

s. 4

Partnership, 1865, Act to Amend the Law of (U.K.), 28 & 29 Vict., c. 86.

Winding-up Act, R.S.C. 1970, c. W-10.

Winding-up Act, R.S.C. 1985, c. W-11 —

s. 93

s. 94

s. 95

The judgment of the court was delivered by *Iacobucci J.*:

1 In September 1985 the Canadian public witnessed what fortunately has been an infrequent occurrence in Canadian banking. Early that month, a chartered bank known as the Canadian Commercial Bank ("C.C.B.") became insolvent and was ordered to be wound up pursuant to the provisions of the *Winding-up Act*, R.S.C. 1985, c. W-11 (formerly R.S.C. 1970, c. W-10). This appeal [from (1990), 74 Alta. L.R. (2d) 69, 69 D.L.R. (4th) 1, 107 A.R. 199, reversing (1987), 56 Alta. L.R. (2d) 244, 67 C.B.R. (N.S.) 136, 46 D.L.R. (4th) 518, 83 A.R. 122] concerns the characterization of the unique and complex financial arrangement entered into by the governments of Canada and of Alberta, six major Canadian financial institutions, the Canadian Deposit Insurance Corporation ("C.D.I.C.") and C.C.B. in the spring of 1985 in an attempt to prevent its winding-up. The main issue is whether, in substance, the $255 million advanced to C.C.B. under this arrangement was in the nature of a loan, in which case the "lenders" thereof would rank pari passu with the other unsecured creditors of C.C.B., or whether it was in the nature of a capital investment in the business of C.C.B., in which case such unsecured creditors would have priority over the "investors." If the former characterization is adopted, as I believe it should be, subsidiary issues concerning the postponement of claims under s. 4 of the *Partnerships Act*, R.S.O. 1990, c. P.5, and the doctrine of equitable subordination are also raised.

I. Facts

2 Although they are relatively uncomplicated, the facts of this case are rather extensive and warrant a full review. C.C.B. was a chartered bank involved primarily in commercial lending. In early 1985 C.C.B. faced a solvency crisis owing to a sharp deterioration in its loan portfolio. Many of its outstanding loans had become non-performing. On March 14, 1985 C.C.B.'s chief executive officer reported this crisis to the Office of the Inspector General of Banks and announced the inability of C.C.B. to continue in operation without outside assistance. At the request of the governor of the Bank of Canada, a government and banking industry funded support initiative was undertaken to assist C.C.B. and to avoid the loss of public confidence in Canada's banking system.

3 On March 24, 1985 a support group comprising Her Majesty in right of Canada ("Canada"), Her Majesty in right of Alberta ("Alberta"), C.D.I.C. and what I shall sometimes refer to as the "bank group," consisting of the Royal Bank of Canada, the Bank of Montreal, the Toronto-Dominion Bank, the Bank of Nova Scotia, the Canadian Imperial Bank of Commerce, and the National Bank of Canada, entered into a memorandum of intent to provide the "emergency financial assistance" requested by C.C.B. "on certain terms."

4 In essence, Canada, Alberta, C.D.I.C. and the bank group, collectively referred to as the "participants," agreed to purchase from C.C.B., at a total price of $255 million, an undivided interest by way of participation in a portfolio of assets held by C.C.B. consisting of loans and related security having a nominal value, on the books of C.C.B., of over $500 million ("portfolio assets"). The participation interest of each participant was proportional to its own financial contribution and was to be evidenced by participation certificates issued by C.C.B. The parties also agreed in principle that the participants would receive from C.C.B. on a proportionate basis, and until such a time as the participants received the amount they paid for their participation certificates, a portion of the money received on account of each portfolio asset as well as 50 per cent of C.C.B.'s pre-tax income, or alternatively 100 per cent of C.C.B.'s pre-tax income plus interest. In other words, it was agreed that the $255 million advanced by the participants would be repaid by C.C.B. After repayment, the payments from the portfolio assets and from C.C.B.'s pre-tax income would cease.

5 Under the memorandum of intent, C.C.B. undertook to indemnify each participant against any loss experienced under the support program up to the amount paid by them to C.C.B. It was agreed that in the event of the insolvency or winding-up of C.C.B., any amount remaining unpaid "shall constitute indebtedness of C.C.B. to the members of the Support Group." Finally, the parties agreed in principle that each participant would receive from C.C.B., on a proportionate basis, transferable rights or warrants to purchase common shares of C.C.B. at a price of $0.25 per share. The warrants were to expire ten years after the day that C.C.B. had repaid the full amount advanced for the participation certificates.

6 On March 25, 1985 the Department of Finance issued a press release announcing a joint agreement involving "an infusion of capital with repayment provisions ... designed to provide the Canadian Commercial Bank with sufficient funds to ensure solvency following a recent and sharp deterioration in its U.S. loan portfolio." The agreement was described as resulting in the "purchase by the support group of a package of nonperforming loans," leaving C.C.B. "in a strong position of solvency in order to support its deposit base." After setting out the general terms of the support program, the Minister of State (Finance) said she had "full confidence" that this program "involving Canada's largest chartered banks and the two Governments will permit the Canadian Commercial Bank to continue its active and important role in the growing economy of Western Canada." The minister concluded that the support program represented "a strong collective vote of confidence in the health of the economy of Western Canada."

7 In order to carry out the letter and spirit of the memorandum of intent, the participants and C.C.B. were to execute, among other documents, a "participation agreement" (also referred to as "P.A."), an "equity agreement" (also referred to as "E.A.") and an "amending and subordination agreement." These agreements, which incorporate and refine the general principles agreed to earlier in the memorandum of intent, were ultimately entered into as of April 29, 1985. The participation agreement and the equity agreement formed the core of the support program. There are no relevant inconsistencies between these documents and the memorandum of intent. I will, however, review in closer detail the former documents as their provisions are of crucial importance to the resolution of the issues raised by this appeal.

8 Section 2 of the participation agreement provided for the participants to purchase from C.C.B., at a total price of $255 million, an undivided interest by way of participation in 255,000,000 units in the portfolio assets of C.C.B. Each participant's interest was proportional to its financial contribution. For example, C.D.I.C. advanced $75 million and received a participation interest in 75,000,000 units. The total participation in the portfolio assets was divided into 529,798,627 units, with the portion of 255,000,000 units purchased by the participants commonly referred to as the "syndicated portion." C.C.B. retained beneficially an undivided participation interest in the remaining 274,798,627 units which comprised the aggregate of the "C.C.B. portion" of the portfolio assets.

9 Under s. 5 of the participation agreement, C.C.B. warranted that the C.C.B. portion for each portfolio asset represented its "best estimate of the amount likely to be recovered from or with respect to that Portfolio Asset." Thus, as found by the learned chambers judge, the participants purchased, in essence, a portfolio of bad loans or that portion of a loan not likely to be recovered.

10 C.C.B. was appointed and authorized to act as agent to ad minister the portfolio assets (P.A. s. 6(a)). Pursuant to s. 9 of the participation agreement, all money received by C.C.B. on account of each portfolio asset, whether principal, interest or otherwise, was first to be retained by C.C.B. until the C.C.B. portion of that portfolio asset was completely recovered; then to be paid to the participants (except C.D.I.C.) proportionately to reduce or retire their respective advances; then to be paid to C.D.I.C. to reduce or retire its proportionate share; and finally to be retained by C.C.B. Each participant was entitled to receive these proceeds up until such time as it received an amount which, when taken together with all amounts received by that participant from C.C.B.'s pre-tax income pursuant to s. 10, was equal to the price paid by that participant for its participation certificate.

11 In addition to proceeds from C.C.B.'s portfolio assets, the participants were entitled to receive proportionately from C.C.B., on a quarterly basis, an amount equal to 50 per cent of C.C.B.'s pre-tax income (P.A. s. 10). C.C.B.'s "pre-tax income" was defined in s. 10 of the participation agreement as C.C.B.'s "net income ... before making any allowance for the payments to be made pursuant to this section, accrued interest on any presently existing bank debenture of CCB or any provision for income taxes payable to Canada, the United States of America and any political division of either." Again, C.C.B.'s obligation to make

such payments would terminate after each participant received an amount pursuant to ss. 9 and 10 equal to the price paid by such participant for its participation certificate (P.A. s. 10).

12 Under s. 11 of the participation agreement, if C.C.B. failed by October 31, 1985 to obtain the shareholder and regulatory approval necessary for it to increase its authorized capital to the extent required for it to perform the equity agreement, as discussed below, then s. 10 of the participation agreement would be deemed to have been amended and would be construed as requiring C.C.B. to pay to the participants 100 per cent of C.C.B.'s pre-tax income. This obligation would continue until such time as the total amount received by each participant from the portfolio assets and C.C.B.'s pre-tax income satisfied the amount paid by that participant for its participation certificate, together with interest at prime rate. It should be noted that this was the only circumstance under which C.C.B. was to pay interest to the participants.

13 Section 8 of the participation agreement provided that C.C.B. indemnified each participant against any loss suffered by it by reason of the amounts realized from the portfolio assets and from 50 per cent of C.C.B.'s pre-tax income failing to equal the price paid by that participant for its participation certificate. This indemnity was to be paid only by payments of the amount and source described in ss. 10 and 11, with one important exception: "if CCB becomes insolvent or is wound up, any amount remaining unpaid and required to be paid in order to indemnify that Participant completely in accordance with the foregoing indemnity, shall constitute indebtedness of CCB, to which the provisions of section 13 shall apply."

14 The relevant parts of s. 13 of the participation agreement read as follows:

> **13. Priorities on Insolvency**
>
> (*a*) *Notwithstanding the provisions of section 277 of the Bank Act* [which otherwise gives Canada and a province a first and second charge respectively on the assets of an insolvent bank] or any other rule of law, each of the Participants agrees that, in the case of the insolvency or winding-up of CCB:
>
> (i) neither Canada, CDIC nor Alberta shall, in connection with any money owing to it under this agreement, claim any charge on the assets of CCB;
>
> (ii) *the right of each of the Participants other than CDIC* to money owing to it under this agreement *shall rank pari passu with the right of the depositors* of CCB to payment in full of the deposit liabilities of CCB;
>
> (iii) the right of CDIC to money owing to it by CCB, under this agreement but not by reason of the subrogation of CDIC to the claims of depositors of CCB (if any) shall be subordinate in right of payment to the prior payment in full of all money owing to the other Participants under this agreement and to the depositors of CCB, but shall rank in priority to any outstanding bank debentures of CCB.
>
> *Each of Canada, CDIC and Alberta acknowledges that it has waived, as set out above, any priority to which it would otherwise be entitled*. Each Participant agrees that this *section 13 is intended to benefit the depositors of CCB*, and to ensure to the benefit of the successors of CCB and any curator, liquidator or receiver that may be appointed to supervise or to wind up the business of CCB.

[Emphasis added.] Moreover, s. 13 provided that each participant would rank pari passu with each other except C.D.I.C. and that each would, as necessary, redistribute payments received by it in order to achieve this ranking.

15 Pursuant to s. 12 of the participation agreement, C.C.B. could not, without the consent of the participants, declare or pay any dividend or reduce its issued capital until such time as C.C.B. paid to each participant its purchase price, and any additional amount (interest at prime rate) payable under s. 11. Moreover, the participants required as a condition to their purchase, inter alia: (1) the execution of an amending and subordination agreement; (2) the execution of the equity agreement; and (3) the opinion of the Inspector General of Banks that C.C.B. would be solvent following the purchase (P.A. ss. 14 and 16). Finally, the parties expressly declared that the participants were not partners or joint venturers with each other (P.A. s. 18(j)) and that the law governing the agreement would be the law applicable in the province of Ontario (P.A. s. 18(d)).

16 The equity agreement (C.O.A. at pp. 154-74) gave the participants warrants providing for the right to subscribe to a total of 24,062,517 common shares of C.C.B. at a price of $0.25 per share, on a basis proportionate to each participant's participation interest (E.A. ss. 2, 3, 5 and 6). At the date of the agreement, C.C.B. had an authorized capital of 10,000,000 common shares with a par value of $10 each, of which 6,529,768 were issued and outstanding (E.A. s. 4). If all outstanding employee stock options to purchase common shares were exercised and all issued convertible preferred shares were converted into common shares, the issued capital of C.C.B. would consist of a total of 8,020,839 common shares (E.A. s. 4). Thus, if the warrants were fully exercised, the participants would own 75 per cent of C.C.B.'s common shares.

17 Shareholder and regulatory approval were required to increase C.C.B.'s authorized capital from its current level of 10,000,000 common shares to the 32,100,000 required in order to give full effect to the equity agreement. Pursuant to s. 15 thereof, C.C.B. had to first obtain shareholder approval no later than October 31, 1985, and next had to apply to the Minister of Finance pursuant to the *Bank Act*, R.S.C., 1985, c. B-1 (formerly S.C. 1980-81-82-83, c. 40), for the necessary change in its authorized capital. If such an application was not made by October 31, 1985, the provisions of s. 11 of the participation agreement (100 per cent pre-tax income plus interest) were triggered. In s. 8 of the memorandum of intent, Canada had agreed that "an application for such alteration in capital when made shall be approved for purposes of the Bank Act."

18 The limited authorized capital of C.C.B. was not the only obstacle to the issuance of common shares to the participants. Under present law, the chartered banks which were participants could not legally exercise their right to subscribe to common shares of C.C.B. This was recognized by the parties in para. (d) of the preamble to the equity agreement as well as in s. 10 of the agreement. Under s. 8 of the equity agreement, the warrants were made fully assignable and it was the declared intention of the participants, as recorded in the preamble, "that unless the present law is materially changed, they shall assign such rights."

19 The participants' right to purchase these shares was to continue for a period of ten years after the date on which each participant had been repaid the full amount it had advanced under the terms of the participation agreement (E.A. ss. 1 and 12). Again, this agreement would be governed by and construed in accordance with the law applicable in the province of Ontario (E.A. s. 19).

20 Finally, under the amending and subordination agreement, the holders of all outstanding subordinated debentures issued by C.C.B. pursuant to s. 132 of the *Bank Act* (i.e., Canada, British Columbia, Alberta and the Workers' Compensation Board of British Columbia), agreed to postpone the repayment of the amounts represented by their debentures until such time as C.C.B. had paid to each participant an amount equal to the price paid by that participant for its participation certificate.

21 To summarize, the participants were to receive in return for the $255 million advanced under the support program, proportionally to their own financial contribution and up to that amount: (1) payments from the portfolio assets; (2)(a) 50 per cent of C.C.B.'s pre-tax income and warrants to buy up to 75 per cent of C.C.B.'s common shares, or (b) 100 per cent of C.C.B.'s pre-tax income, with interest on the amount contributed; and (3) an indemnity for any losses caused. Under these agreements, the participants could receive a return which was greater than their contribution only in two ways, namely, by exercising or assigning their warrants up to ten years after full repayment (however, this option was contingent on shareholder, regulatory and legislative approval) or, if these warrants could not be granted, by receiving interest on the amount advanced at the prime rate.

22 C.C.B. was advised by the Office of the Inspector General of Banks, by a letter dated April 24, 1985, as to the appropriate accounting treatment to be applied to these transactions. Following these guidelines, C.C.B. wrote down its loan assets by $255 million, charged the write-down to tax-allowable appropriations for contingencies and credited the $255 million received from the participants to tax-paid appropriations for contingencies. C.C.B. was not specifically directed by the Inspector General of Banks to record its indemnity towards the participants as a liability, nor did C.C.B. do so. By effectively "selling" that portion of its loan portfolio not likely to be recovered and by not recording its indemnity obligation under the participation agreement to repay the $255 million as a liability, C.C.B. was able to restore a position of solvency on its books, thereby allowing it to remain in business, which was, after all, the raison d'être of the support program.

23 Despite this financial assistance, C.C.B.'s financial status con tinued to deteriorate. For reasons beyond the scope of this appeal, the support program was unsuccessful in ensuring C.C.B.'s long-term solvency. By an order made September 3, 1985 on a petition by C.D.I.C., Wachowich J. of the Alberta Court of Queen's Bench ordered C.C.B. to be wound up pursuant to the *Winding-up Act*, R.S.C. 1970, c. W-10. At that point, none of the participants had exercised or assigned (or even been granted) any of their warrants under the equity agreement as the preliminary conditions of shareholder and regulatory approval, for the authorization and issuance of additional common shares had not been fulfilled. Price Waterhouse Limited was appointed, and remains, the sole liquidator of C.C.B. ("liquidator").

24 As of August 18, 1987 the liquidator had recovered approximately $112 million on account from C.C.B.'s portfolio assets, of which $5 million was attributable to the portion thereof beneficially owned by the participants (namely, the syndicated portion). The liquidator brought an application before Wachowich J. for advice and direction as to the interpretation of the support agreements. In particular, the liquidator sought to determine the validity and ranking of the claims of the participants pursuant to the participation agreement.

25 In a judgment rendered on December 7, 1987 Wachowich J. held the participants to be entitled to the repayment of sums recovered by the liquidator on the syndicated portion of the portfolio assets (the $5 million), but otherwise not entitled to recover their advances until after all ordinary creditors, including unsecured creditors, were paid in full. Wachowich J. interpreted the injection of funds by the participants to have been a capital investment. The participants, apart from Canada and C.D.I.C., the respondents in this appeal, successfully appealed the latter part of this judgment. The Alberta Court of Appeal disagreed with Wachowich J., preferring to characterize the advance of $255 million as a loan. The Court of Appeal concluded that the participants were entitled to rank pari passu with C.C.B.'s unsecured creditors for all moneys advanced to C.C.B. pursuant to the participation agreement and not repaid by moneys recovered from the syndicated portion of the portfolio assets.

26 On an application by the liquidator, Wachowich J. directed the liquidator to present an application to this court for leave to appeal from the Court of Appeal's decision. Wachowich J. further ordered that Lerner & Associates be appointed as legal representative ("legal representative") of C.C.B.'s general body of creditors, other than the participants, for purposes of the application for leave to appeal and further on the appeal. Leave to appeal to this court was granted on March 14, 1991. The liquidator, as an officer of the court and as the representative of all the creditors of C.C.B., takes no position in this appeal. The bank group and Alberta, the respondents before this court, made separate written and oral submissions.

II. Judgments in the Courts Below

A. Alberta Court of Queen's Bench

27 On the initial application, the participants took the position that they were entitled under the terms of the support agreements: (1) to receive their proportionate shares of the moneys received by the liquidator or C.C.B. on account of the portfolio assets; and (2) to rank pari passu with all the other unsecured creditors of C.C.B. for any amounts not recovered from the portfolio assets and still owing to them pursuant to the participation agreement. Wachowich J. agreed with the first proposition but rejected the second.

28 According to Wachowich J., the participants' first submission involved a consideration of the validity of the participation agreement. The learned chambers judge confessed it was a "difficult task" to determine the position of the participants with respect to C.C.B.'s estate given the "extraordinary nature of the agreement" involved (at p. 126) [A.R.]. He noted there were no precedents dealing with similar commercial agreements. In his view, the participation agreement in question was not prohibited by ss. 173 and 174 of the *Bank Act*. While the agreement did not relate to business in which a bank would normally or commonly engage, he noted that "given the unique circumstances and the stated purpose of the Participation Agreement as a whole, one can hardly regard this as an invalid transaction" (at p. 127). He found it was a valid contractual document binding on all parties and held that the participants were entitled to receive their proportionate share from moneys recovered by the liquidator from the portfolio assets, in the manner provided for in s. 9 of the participation agreement (i.e., to the extent such recoveries exceed the C.C.B. portion).

29 Next, Wachowich J. turned to a consideration of the ranking of the participants with the general body of creditors of C.C.B. for any amounts not recovered from the syndicated portion of the portfolio assets, and still owing pursuant to the participation agreement. He noted that the participants would have "valid claims" under the terms of the participation agreement for such amounts (at p. 128). However, whether they could rank pari passu with other unsecured creditors depended on the interpretation of the agreement taken as a whole and a determination of the "real basis upon which the $255 million was paid to C.C.B." (at p. 128).

30 In Wachowich J.'s view, the essence of the participation agreement was not the creation of a mere purchase and sale of assets with an added indemnity as to the value of those assets. Rather, the transaction reflected an investment of capital into C.C.B. (at p. 129):

> The agreement, as evidenced by all the surrounding circumstances, was really to effect an infusion of capital into C.C.B. whereby the Participants would be risking their monies in hope that the C.C.B. would continue as a viable and profitable business. If this in fact had occurred, the Support Group Participants stood to gain a healthy return on their investments.

31 The learned chambers judge found support for his characterization in the following: (1) the portion of the portfolio assets purchased by the participants was of little value; (2) s. 2 of the participation agreement masked the true nature of the transaction, that is, the investment of working capital into C.C.B.; (3) the indemnity provision and repayment structure set up by the agreement were directly connected to the profits and income of C.C.B.; (4) the repayment of the purchase price was to come not only from the portfolio assets, but mainly from C.C.B.'s pre-tax income; (5) if C.C.B.'s business was successful, the participants would benefit not only in recovering their purchase price, but as well by purchasing common shares in C.C.B. under the equity agreement; (6) "[w]hile the transaction may not be a typical investment situation, where for example there is an outright purchase of shares, it is difficult to ignore the investment features of the agreement" (at p. 130); (7) while the accounting treatment had to be looked at with caution, the fact there was no liability to the participants recorded on the balance sheet of C.C.B., as created by the indemnity provisions of the agreement, supported the conclusion that the transaction was an investment; (8) the cases of *Laronge Realty Ltd. v. Golconda Investments Ltd.* (1986), 7 B.C.L.R. (2d) 90, 63 C.B.R. (N.S.) 76 (C.A.) ("*Laronge Realty*"); *Re Dickie* (1924), 5 C.B.R. 214 (N.S.T.D.); and *Re Meade*, [1951] 1 Ch. D. 774, [1951] 2 All E.R. 168, "stand for the general proposition that advances of monies will be classed as capital investments where the monies were used in the business and the business was carried on for the joint benefit of the parties involved" (at p. 131); and (9) the participants here did have a stake in the continued profitability of C.C.B. in that (a) the repayment of the money advanced would come from the income of C.C.B. and (b) their warrants allowed them to "continue to share in the profits of C.C.B." (at p. 131).

32 Thus, according to Wachowich J., the participants could not rank pari passu with the ordinary creditors of C.C.B., including unsecured creditors, for the amounts not recovered from the portfolio assets. In so doing, he applied the principle that "if a person contributes capital to a business, even though that person is not a partner in the business and may have received no share of the profits, they cannot prove their claim in bankruptcy in competition with the creditors of the business" (at p. 131): Halsbury's Laws of England (3rd ed.), vol. 2, at p. 495; *Laronge Realty*, supra; and *Re Beale; Ex parte Corbridge* (1876), 4 Ch. D. 246.

33 In concluding, Wachowich J. held the provisions of the participation agreement which attempt to rank the participants pari passu and to create a debt on insolvency are ineffective to alter the "existing legal nature of their relationship" with C.C.B. These provisions would be void as they are an attempt to alter insolvency laws through a private agreement: *British Eagle International Airlines Ltd. v. Compagnie Nationale Air France*, [1975] 1 W.L.R. 758, [1975] 2 All E.R. 390 (H.L.).

B. Alberta Court of Appeal

34 The respondents (the participants apart from Canada and C.D.I.C.) appealed from Wachowich J.'s conclusion with respect to their ranking on insolvency, whereas the then legal representative cross-appealed from the conclusion that the participants could receive funds from the syndicated portion of the portfolio assets. Harradence J.A. (writing for the Court of Appeal) began by stating that the learned chambers judge had erred in law in his interpretation of the decisions in *Laronge Realty*, supra, *Re Dickie*, supra, and *Re Meade*, supra (at p. 207) [A.R.]:

> I have examined closely the cases relied upon as well as others to which I have been referred and the inescapable conclusion to be reached is that the proposition as stated [by Wachowich J.] can only be correct where one implies into the term 'monies were used in the business' a necessary condition that the investor has not expressly stipulated a requirement for the repayment of monies advanced. A failure to imply this term into the proposition results in a misstatement of the appropriate test and, further, is inconsistent with the decision of the Supreme Court of Canada in *Sukloff v. Rushforth* (1964), 45 D.L.R. (2d) 510 (S.C.C.).

35 Harradence J.A. reviewed the cases cited by Wachowich J. and noted that, unlike the case at bar, none of them involved transactions where provisions for the repayment of the money advanced had been included by the parties. Turning specifically to *Sukloff v. A.H. Rushforth & Co.*, [1964] S.C.R. 459, 6 C.B.R. (N.S.) 175, 45 D.L.R. (2d) 510 ("*Sukloff v. Rushforth*"), Harradence J.A. said that while it was "difficult to glean" from that case the exact reason for concluding that the transaction under consideration therein was a loan rather than a capital investment, "the only reasonable conclusion to be reached is that the provision for repayment was determinative of the nature of the transaction" (at p. 209). He concluded his review of the jurisprudence by stating (at p. 210): "where, as in this case, the evidence indicated that monies advanced to a business are to be repaid, and particularly when the terms of repayment are specified, the transaction is classified as a loan."

36 Harradence J.A. next turned to the interpretation of the participation agreement. He noted at the outset the rule prohibiting extrinsic evidence from contradicting express contractual terms. He reviewed a number of factors favouring interpreting the agreement as a loan, namely: (1) there is nothing in the express terms of the agreement which supports a conclusion that the money was advanced as an investment; (2) there are express provisions pointing to the opposite conclusion, including provisions for repayment and for an indemnity that full repayment will be made; (3) pursuant to the participation agreement, upon insolvency or winding-up, any amount remaining unpaid was to constitute indebtedness and, in such circumstances, the participants were to rank pari passu with other creditors; and (4) the intention of the participants was consistent with a "loan" characterization. He did not find it necessary to determine whether the accounting treatment was consistent with an investment, holding that such a factor is not determinative of the legal relationship of the parties.

37 Harradence J.A. found that repayment of the money advanced was intended and was coupled with express repayment provisions. Thus, relying on *Sukloff v. Rushforth*, supra, and the other cases cited, he concluded that the $255 million advanced was not to be characterized as an investment in capital but rather as a "loan coupled with a purchase agreement to C.C.B." (at p. 211).

38 The observation made by the learned chambers judge that the business of C.C.B. was carried on for the "joint benefit" of C.C.B. and the participants, because (1) repayment was to come from the income of C.C.B. and (2) the warrants, if exercised, would allow the participants to continue to share in the profits of C.C.B., was next addressed. With respect to the first factor, Harradence J.A. held that Wachowich J. erred in considering the *source of the funds for* repayment in concluding that the participants would be sharing in C.C.B.'s profits. His comments warrant citation (at p. 211):

> It is important to recognize that while repayment was to be made from pre-tax income of C.C.B., there was no direct link between the success of the C.C.B. and the overall quantum of the amount due to or payable to the Support Group Participants. I have been referred to no authority which supports the proposition that a repayment, the instalments of which are referable to the quantum of the income of the debtor, is a situation of 'joint benefit'. Since the sums to be received by the Participants were limited to repayment of monies advanced, with a contingent right to interest, the source of the repayment monies is not relevant and, with respect, the learned Chambers Judge erred in concluding the Participants were 'sharing in profits' in this respect.

39 As for the second factor, Harradence J.A. summarily rejected it as an indicium of investment and "joint benefit" mainly because of the *contingent nature* of the warrants in question, as recognized by both the participation agreement and the equity agreement. He added (at p. 212): "Had shares actually been issued or even approval obtained, or if there was an obligation to purchase or if a purchase had been made, then the 'joint benefit' argument might have some merit and it would have been necessary to fully address this issue."

40 Finally, Harradence J.A. considered whether repayment to the respondents was nevertheless postponed pursuant to what are now s. 139 of the *Bankruptcy Act*, R.S.C. 1985, c. B-3, and s. 4 of the *Partnerships Act*, R.S.O. 1990, c. P.5. In his view, the application of these provisions was precluded by his earlier conclusion that the participants were not to receive a rate of interest varying with the profits of C.C.B. or a share in the profits of C.C.B.

41 Thus, the appeal was allowed and it was ordered that the respondents were entitled to rank pari passu with the ordinary creditors of C.C.B. for all moneys advanced to C.C.B. pursuant to the participation agreement and not repaid by moneys recovered from the portfolio assets. In view of this result, the cross-appeal brought by the then legal representative, alleging an inconsistency in Wachowich J.'s conclusions, was dismissed.

III. Issues

42 There are many ways of characterizing the issues raised by this appeal. As I see it, the three main questions which need to be addressed are:

> (1) Was the Court of Appeal correct in characterizing the advance of $255 million by the participants to the C.C.B. as a loan, as opposed to an investment in capital, thereby creating a debtor-creditor relationship between the parties?
>
> (2) If the true legal nature of this transaction is indeed a loan, does this loan come within the postponement provision found in s. 4 of the *Partnerships Act*?
>
> (3) If the *Partnerships Act* does not apply, should the respondents' claim for the money loaned under the participation agreement nonetheless be postponed to the claims of the general body of C.C.B. unsecured creditors, other than the participants, based on the United States doctrine of equitable subordination?

The legal representative raises a subsidiary issue concerning the portion of the moneys recovered attributable to the syndicated portion of the portfolio assets:

> (4) Was the Court of Appeal correct in upholding the conclusion of the learned chambers judge that the participants are entitled to receive from the liquidator, pursuant to the participation agreement, the sums recovered on the syndicated portion of the portfolio assets?

43 For the reasons that follow, it is my view that the first and fourth questions should be answered in the affirmative while the second and third should be answered in the negative. In summary, the words chosen by the parties in their agreements clearly support the Court of Appeal's conclusion that the assistance program involved, in substance, a loan of $255 million and not a capital investment. The surrounding circumstances provide additional support for, rather than detract from, this conclusion. Although the transaction did have an equity component (the warrants), this aspect alone does not, in the circumstances of this case, transform the essential nature of the advance from a loan to an investment. Put another way, while it is true that this transaction does have "investment features," these features were incidental to the debt features of the arrangement and do not alter the substance of the debtor-creditor relationship that was created by the parties with respect to the $255 million advanced by the participants to C.C.B. Moreover, the fact that C.C.B.'s pre-tax income was the main source for repayment does not affect this characterization as the amount to be repaid from this source was limited to the sum advanced to C.C.B., plus a contingent interest at prime rate. Thus, the respondents are creditors of C.C.B. and, as such, are entitled to what may be called a "prima facie" pari passu ranking with the other unsecured creditors of C.C.B. in the distribution of C.C.B.'s assets.

44 In the circumstances of this case, this prima facie ranking is not altered by the principles of law and equity relied upon by the legal representative. Indeed, the loan in question does not fall within the ambit of the Ontario *Partnerships Act* (ss. 3(3)(*d*), 4) as the participants were to receive neither a "rate of interest varying with the profits" of C.C.B. nor a "share of the profits arising from carrying on the business" of C.C.B. In my view, the principles of equitable subordination have no application to the facts of this case. Finally, in light of these conclusions, the legal representative's subsidiary issue concerning the moneys recovered on the syndicated portion of the portfolio assets must also fail. Accordingly, I would dismiss the appeal.

IV. Relevant Statutory Provisions

Winding-up Act:

45

Distribution of Assets

93. The property of the company shall be applied in satisfaction of its debts and liabilities, and the charges, costs and expenses incurred in winding-up its affairs.

94. All costs, charges and expenses properly incurred in the winding-up of a company, including the remuneration of the liquidator, are payable out of the assets of the company, in priority to all other claims.

95. The court shall distribute among the persons entitled thereto any surplus that remains after the satisfaction of the debts and liabilities of the company and the winding-up charges, costs and expenses, and unless otherwise provided by law or by the Act, charter or instrument of incorporation of the company, any property or assets remaining after the satisfaction shall be distributed among the members or shareholders according to their rights and interests in the company.

Partnerships Act:

46

3. In determining whether a partnership does or does not exist, regard shall be had to the following rules:

. . . . .

3. The receipt by a person of a share of the profits of a business is proof, in the absence of evidence to the contrary, that the person is a partner in the business, but the receipt of such a share or payment, contingent on or varying with the profits of a business, does not of itself make him or her a partner in the business, and in particular,

(*a*) the receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business does not of itself make him or her a partner in the business or liable as such;

. . . . .

(*d*) the advance of money by way of loan to a person engaged or about to engage in a business on a contract with that person that the lender is to receive a rate of interest varying with the profits, or is to receive a share of the profits arising from carrying on the business, does not of itself make the lender a partner with the person or persons carrying on the business or liable as such, provided that the contract is in writing and signed by or on behalf of all parties thereto;

. . . . .

4. In the event of a person to whom money has been advanced by way of loan upon such a contract as is mentioned in section 3, or of a buyer of the goodwill in consideration of a share of the profits of the business, becoming insolvent or entering into an arrangement to pay his or her creditors less than 100 cents on the dollar or dying in insolvent circumstances, the lender of the loan is not entitled to recover anything in respect of the loan, and the seller of the goodwill is not entitled to recover anything in respect of the share of profits contracted for, until the claims of the other creditors of the borrower or buyer, for valuable consideration in money or money's worth, are satisfied.

V. Analysis

A. Characterization of the $255 million advanced: capital investment or loan?

47 The first and foremost issue in this appeal concerns the determination of the true nature of the transaction in question between the participants and C.C.B. Was the $255 million advanced by the participants in the nature of a loan, as found by the Court of Appeal, or in the nature of an investment of capital, as found by the learned chambers judge? If the Court of Appeal was correct in describing the transaction as a loan, it follows that the participants are creditors of C.C.B. and as such, pursuant

to both the participation agreement and ss. 93 to 95 of the *Winding-up Act*, they would be entitled, subject to the statutory (s. 4 of the *Partnerships Act*) and equity ("equitable subordination") principles raised by the legal representative, to rank pari passu with the other ordinary creditors of C.C.B. in the distribu tion of C.C.B.'s assets. If, however, Wachowich J.'s characterization is to be preferred, then, relying on an old common law principle, it is argued the participants would not be creditors entitled to an equal ranking with C.C.B.'s true creditors: *Re Beale*, supra; *Re Meade*, supra; *Laronge Realty*, supra; and Halsbury's Laws of England (4th ed.), vol. 3(2), at p. 315. Under this approach, it is said the participants would have an equitable right to share in the distribution of the assets of C.C.B., but only at such time as the ordinary creditors have been paid in full.

48 The principal argument raised by the legal representative in favour of finding the transaction to have been that of a capital infusion is the potential for unlimited returns and control over C.C.B. by reason of the warrants granted to the participants under the equity agreement. Other indicia of capital investment are also suggested. First, C.C.B.'s accounts did not show their obligation to the participants as a liability. It is submitted that, if the financial statements could have led creditors, including depositors, to believe that there was adequate capitalization, this should be taken into consideration in determining the rights of the ordinary creditors and the respondents. Second, it is argued that the Court of Appeal's interpretation of ss. 8 and 13 of the participation agreement fails to recognize that the rights of differing classes of people who provide funds for the use of a business crystallize prior to insolvency, and cannot be altered by an agreement. It is argued that the Court of Appeal erred in assuming that the characterization by the participants and C.C.B. of their rights and obligations inter se should be determinative of the relative priority of the claims of the participants and the ordinary creditors of C.C.B. According to the legal representative, "Section 13 should be disregarded by the Courts, as being a self-serving attempt by the Participants to enhance their position for distribution purposes in the event of insolvency." Finally, the legal representative argues that the Court of Appeal erred in its interpretation of *Sukloff v. Rushforth*, supra, which, according to him, stands for proposition that, if someone has an interest in a business, in the sense that his or her potential for return is unlimited except by the enterprise's actual ability to generate profits, that person may not rank as a creditor if the business becomes insolvent. The key, according to the legal representative, is the right or potential to an unlimited return, not the right to repayment.

49 The respondent Alberta, on the other hand, submits that the advance was a loan and offers the following arguments: (1) the agreement for the advance contained no express provision that the advance was an investment in capital but did contain express provisions to the contrary, including provisions for repayment and an indemnity for that repayment; (2) the parties intended the advance to be repayable; (3) C.C.B. was contingently liable to pay interest; (4) in its financial state ments C.C.B. accounted for the advance as being a debt by disclosing the outstanding balance of the advance at the opening, repayments during, and the obligation for the outstanding balance at the closing of each reporting period; (5) Mr. Justice Estey considered the advance to be a loan in the *Report of the Inquiry into the Collapse of the CCB and Northland Bank* (1986) ("Estey report"), at pp. 115, 118 and 125; (6) the participants could not and did not invest in C.C.B.'s equity capital; (7) the decision of this court in *Sukloff v. Rushforth*, supra, as correctly demonstrated by the Court of Appeal, supports the conclusion that the advance to C.C.B. was a loan; and (8) according to *Sukloff v. Rushforth*, supra, and other decisions, an advance of money which is to be repaid, without more, is a loan and not an investment in equity capital or the supply of capital for the business of the recipient for the joint benefit of the advancer of money and the recipient, even if it is described as an investment of capital or if the person advancing the money is to share the profits or to receive shares of the recipient or if the advance is repayable when funds are available or out of profits. Alberta also takes issue with the legal representative's characterization of s. 13 of the participation agreement. It submits that this is a common provision in loans and, rather than enhance the participants' ranking on insolvency, has the effect of reducing the otherwise priority ranking of Canada, Alberta and C.D.I.C.

50 For their part, the bank group notes that the agreements in question represent a unique response to a unique situation, and thus, cannot be perceived as a normal investment in a business. For the reasons given therein, they commend the Court of Appeal's characterization of the advances as a loan in the form of a purchase of doubtful assets. Specifically, they submit that Harradence J.A. was correct in finding that, because of the contingent nature of the warrants, the support agreements did not provide a right to share in profits or for a rate of interest that varied with profits. They characterize the equity agreement as a mere "sweetener." The bank group submits that the cases, including *Sukloff v. Rushforth*, supra, do not support the conclusion that a contingent right to profits in circumstances like the case at bar can represent an interest in the business. With respect to the accounting issue, they argue that they should be considered on a basis different from the other participants because they were

prohibited from controlling or attempting to control C.C.B. Indeed, they had no control over how C.C.B. showed its obligations to them in its financial statements. Further, such a factor should not determine the nature of the legal relationship between the parties to the agreement.

51 For my part, I agree in essence with the position advanced by Alberta and the bank group. Briefly put, the words chosen by the parties in their agreements strongly support the Court of Appeal's conclusion that the financial assistance program involved, in sub stance, a loan of $255 million rather than a capital investment and there is nothing in the surrounding circumstances which distracts from this characterization. On the contrary, the surrounding circumstances offer additional support for the Court of Appeal's conclusion. As noted by Wachowich J. and the legal representative, the transaction did indeed have an equity component (the warrants) and did involve a repayment scheme linked to the profits of C.C.B. However, for reasons which I shall elaborate, these aspects are insufficient to justify the conclusion reached by Wachowich J.Similarly, the other indicia of capital investment put forward by the legal representative, such as the accounting treatment given to the advance, do not affect the substance of this transaction.

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

53 In the case at bar, it should be noted that the circumstances surrounding the financial arrangements between C.C.B. and the participants, and the agreements themselves, are somewhat unique. At the heart of this matter is the attempted rescue of a Canadian chartered bank. Recourse to emergency measures in order to preserve the solvency of a bank is, fortunately, relatively rare in our country. I say this not because financial support programs are harmful (quite the contrary), but because the events surrounding the C.C.B. rescue in the mid-1980s infrequently arise. Part of the result, however, is that the task of ascertaining the intention of the participants and of C.C.B. with respect to the advance of $255 million is not particularly simple. Indeed, the learned chambers judge described the participation agreement as a "unique document based on a unique set of facts" as well as an "extraordinary transaction," and he found it "most difficult" to characterize (at pp. 132 and 126). Similarly, Harradence J.A. said that "The unique situation of C.C.B. and the Participants resulted in novel and complex documentation, the interpretation and characterization of which is a challenging and difficult task" (at p. 206).

54 It is evident from reviewing the agreements in question that characteristics associated with both debt and equity financing are present. The most obvious examples are, on the one hand, ss. 8 and 13 of the participation agreement pertaining to C.C.B.'s indemnity towards the participants and their ranking in the event of a winding-up and, on the other hand, the provisions of the equity agreement con cerning the warrants granted by C.C.B. to the participants. Such a duality is apparently quite common in loan participation agreements. Indeed, in an article entitled "Characterization of Loan Participation Agreements" (1988), 14 Can. Bus. L.J. 336, Professor Ziegel uses the heterogeneity in some loan participations to explain, in part, the divergence of judicial and academic opinion in the United States on the proper characterization of a participation agreement (at p. 337):

> This issue [the characterization of the participation agreement] has provoked a large body of case law and textbook and periodical literature, most of it American, and the conclusions are not always the same. At one time or another one or more of the following descriptions have been applied to a participation agreement: a simple debtor-creditor relationship, with or without the benefit of security; an agency agreement; a partnership or joint venture; a trust; and, finally, a sale or assignment of an undivided interest in the loan.
>
> It is easy to see why there should be this divergence of opinion. As with any agreement, the parties are free to verbalize it as they see fit and ambiguous or neutral language may reflect their unwillingness to answer hard questions, perhaps in the hope that the need to do so may never arise. Frequently, the several parts of a participation agreement lend themselves to different characterizations and the agreement is really a composite of cumulative legal elements. Finally, there is a significant overlap between such flexible concepts as a secured loan or trust and the sale or assignment of an undivided share of a loan, and the language of the agreement may be consistent with more than one of them. Faced with such ambiguity,

the job of the adjudicator, when a dispute arises, is to find the characterization that best seems to fit the parties' intentions as derived from the total agreement and all the surrounding circumstances.

55 As I see it, the fact that the transaction contains both debt and equity features does not, in itself, pose an insurmountable obstacle to characterizing the advance of $255 million. Instead of trying to pigeonhole the entire agreement between the participants and C.C.B. in one of two categories, I see nothing wrong in recognizing the arrangement for what it is, namely, one of a hybrid nature, combining elements of both debt and equity but which, in substance, reflects a debtor-creditor relationship. Financial and capital markets have been most creative in the variety of investments and securities that have been fashioned to meet the needs and interests of those who participate in those markets. It is not because an agreement has certain equity features that a court must either ignore these features as if they did not exist or characterize the transaction on the whole as an investment. There is an alternative. It is permissible, and often required, or desirable, for debt and equity to co-exist in a given financial transaction without altering the substance of the agreement. Furthermore, it does not follow that each and every aspect of such an agreement must be given the exact same weight when addressing a characterization issue. Again, it is not because there are equity features that it is necessarily an investment in capital. This is particularly true when, as here, the equity features are nothing more than supplementary to and not definitive of the essence of the transaction. When a court is searching for the *substance* of a particular transaction, it should not too easily be distracted by aspects which are, in reality, only incidental or secondary in nature to the main thrust of the agreement.

56 The weight to be given to one aspect of the support agreements over another in assessing the true intention of the parties underlies the difference in opinion between the learned chambers judge and the Court of Appeal's characterization of the transaction. Wachowich J. emphasized both the fact that the recovery by the participants of their contribution was dependent upon the income generated by C.C.B. and the participants' potential to share in the future success of C.C.B. by the warrants, even after having been repaid, as evidencing that the essence of the transaction was that of a capital investment. The Court of Appeal, however, largely dismissed the relevance of the equity agreement because of its contingent nature and emphasized instead that the participants were only entitled to receive from C.C.B. the amount advanced to it and that the parties had included specific provisions in the participation agreement referring to debt; all of which amounted to a very strong indicium of a loan.

57 In the circumstances of this case, it is my view that the learned chambers judge and the legal representative give far too much weight to the equity features associated with the equity agreement in characterizing the overall nature of the advance of $255 million. It is true the participants received warrants to purchase common shares of C.C.B. through the equity agreement. It is also true, at least in theory, that by fully exercising their warrants the participants would own 75 per cent of the common shares issued by C.C.B. However, it is evident on the face of the record that this possibility was not only a mere hypothesis, but it was unlikely to occur. As noted by the respondents and the Court of Appeal, shareholder and regulatory approval was required to permit an increase in C.C.B.'s authorized capital and, unless the warrants were assigned, an amendment to the *Bank Act* was necessary before the participants who are chartered banks could fully exercise their rights to purchase shares. It is not without significance that none of the participants ever exercised any of their warrants nor did they assign them. In these circumstances, I agree with the Court of Appeal that the true effectiveness of the equity agreement was highly contingent and that the learned chambers judge erred in not considering the warrants for what they really were, namely, so-called "sweeteners" or "kickers" with respect to the advance of $255 million which were simply additional features to the underlying loan arrangement between the parties. Undoubtedly, the warrants are an equity feature of the transaction supporting a conclusion that the advance was an investment. However, in the facts of this case, only minimal weight should be given to this factor in the overall characterization of the agreement. Alone, the highly contingent warrants are surely insufficient to tip the scales when faced with the strong indicia of debt present here as identified by the Court of Appeal.

58 Wachowich J. also erred in concluding that the participants would be "sharing in the profits" of C.C.B. under the support agreements. The participation agreement simply *referred to* C.C.B.'s profits (i.e., pre-tax income) as one of the *sources* for repayment. The other source for repayment, the moneys recovered on the syndicated portion of the portfolio assets, was not linked with C.C.B.'s profits. While full repayment from the portfolio assets alone was unlikely, the fact remains that the amount of money to be paid to the participants from both sources was fixed at the amount advanced by each for their participation certificate. Regardless of where the repayments were coming from, they remained mere repayments for moneys advanced. Of

course, the participants would benefit from the success of C.C.B.'s business; however, this benefit would be capped by the amount of the advance. I shall examine in greater detail the "sharing in profits" argument of the legal representative when I deal with s. 4 of the *Partnerships Act*. For now, it is sufficient to state that, in the circumstances of this case, the source from which C.C.B. was to repay the advance made does not carry any weight in favour of a finding that said advance was an investment in capital rather than what it appears to be on the face of the agreements, namely, a loan of $255 million coupled with an equity "sweetener" or "kicker."

59 Another error committed by the learned chambers judge relates to his reliance on the decisions of *Laronge Realty*, supra, and *Re Meade*, supra. The latter case together with *Re Beale*, supra, are said to have established the common law principle applied in *Laronge Realty* and upon which Wachowich J. relied in order to deny ranking the participants pari passu with C.C.B.'s unsecured creditors other than the participants. This principle is stated as follows in Halsbury's Laws of England (4th ed.), vol. 3(2) (at p. 315):

> If a person advances money to another, not by way of loan but as a contribution to the capital of a business carried on for their joint benefit, the person who has made the advance, even though he is not a partner in the business and has received no share of the profits as such, is debarred from proving in the bankruptcy of the recipient of the money in competition with the creditors of the business.

Briefly, I agree with Harradence J.A.'s conclusion that none of the agreements at issue in the cases relied upon by Wachowich J. contained express provisions for the repayment of the money advanced and that such a factor was crucial to the conclusions reached therein. I also agree that the express repayment scheme set out in the participation agreement clearly distinguishes the case at bar from those in which the common law rule relied upon by Wachowich J. has been applied.

60 This rule was referred to, but *not* applied, by this court in *Sukloff v. Rushforth*, supra, a case upon which the legal representative strongly relies. There, Ritchie J. declined to apply the common law rule since he found that the money advanced by Mr. Sukloff was more in the nature of a loan, thereby creating a debtor-creditor relationship between the parties. Indeed, just after citing the above excerpt, Ritchie J. stated (at p. 467): "As I have indicated, I do not construe Mr. Sukloff's role as that of one who was supplying capital for a business carried on for the joint benefit of himself and the two limited companies." Earlier, he had specifically agreed with the trial judge's finding that Mr. Sukloff's relationship with the companies in question "was confined to that of a *lender or financier* who had a right to share in the profits, if any, of the undertakings of these companies" (at pp. 465-66) (emphasis added). This "share in the profits" aspect was later used by Ritchie J. in order to postpone part of the money advanced by Mr. Sukloff (the unsecured $10,000 upon which the legal representative asks this court to focus on) under what was then s. 98 (now s. 139) of the *Bankruptcy Act*, a provision similar to s. 4 of the *Partnerships Act*. However, this aspect had no effect whatsoever on the characterization of the true nature of the transaction involved and on the application of the common law rule set out in *Re Beale*, supra, and *Re Meade*, supra, and applied in *Laronge Realty*, supra. As found on the evidence, the advances in *Sukloff v. Rushforth*, supra, amounted to a loan.

61 As observed by Harradence J.A. in the case at bar, it is somewhat difficult to discern what specific evidence Ritchie J. was referring to when he agreed with the finding of the trial judge in *Sukloff v. Rushforth*, supra. However, I would note, as did Harradence J.A., that the agreements involved therein contained express repayment provisions similar to those contained in the participation agreement. It is not unreasonable to suggest that these provisions played an important role in the characterization of the advances as a loan. In any event, what is most important for our purposes is the fact that *none* of the moneys advanced by Mr. Sukloff was "postponed" under the common law principle advanced by Wachowich J. and the legal representative. The only part which was indeed postponed (the $10,000), was done so under the *Bankruptcy Act* and not following *Re Meade*, supra. I will explain in the context of my analysis of s. 4 of the *Partnerships Act* why, contrary to *Sukloff v. Rushforth*, supra, such statutory postponement has no application to the facts of this case (namely, because there is no profit sharing in the case at bar, simply a repayment out of profits). Suffice it here to say that, contrary to the legal representative's submissions, *Sukloff v. Rushforth* has no bearing on the characterization issue facing this court.

62 Similarly, contrary to the legal representative's submissions, the accounting treatment is not by itself of great weight in the characterization of the advance. I agree with the learned chambers judge that this "evidence" should be "looked at with

caution" (at p. 130). I say this for the following interrelated reasons. First, C.C.B. was following the express directives given by the Office of the Inspector General of Banks, who is not a party to any of the agreements, in using the accounting methods it did. Second, as noted by the bank group, the accounting methods used by C.C.B. were beyond the control of many of the participants. Third, the legal representative is really asking us to look at the conduct of one party, after an arrangement has been signed, in order to discern the common intention of all contracting parties at the time of signing. This type of unilateral and after the fact "evidence" is clearly of little relevance and reliability with respect to the issues before this court. Fourth, as previously noted, the accounting treatment used and the success of the support program were closely linked and it is unwise to draw inferences on the legal relationship of the parties therefrom. For all these reasons, I would not place much weight on the accounting treatment used by C.C.B. in determining the true nature of the advance of $255 million. In so concluding, I do not wish to say that there may not be other cases where the accounting treatment *could* be helpful in determining the nature of a given transaction.

63 Finally, I cannot agree with Wachowich J. about the relevance to the characterization issue of the fact that the portion of the portfolio assets purchased by the participants was of little value. Even assuming that courts are entitled to weigh the value of the consideration given for a particular promise when characterizing an agreement, there was more to the support agreements than the mere purchase of participations in bad loans. Regardless of the true value of the syndicated portion, the participants were to be *repaid* the entire $255 million they had advanced to purchase their participation certificates. The source of this repayment was also the profits of C.C.B. and the parties agreed that any amount remaining unpaid upon insolvency would be considered an indebtedness by C.C.B. towards the participants.

64 On the other hand, the factors noted by the Court of Appeal of Alberta and the respondents as providing indicia of the "loan" nature of the advance of $255 million are clearly relevant to the characterization issue and they strongly support such a conclusion. I have already referred to these factors in summarizing the reasons of Harradence J.A. and the submissions made by Alberta and the bank group. To repeat the most important ones: (1) there is nothing in the express terms of the agreements which supports a conclusion that the money was advanced as an investment; and (2) there are express provisions supporting a characterization of the advance as a loan, including provisions for repayment (P.A. ss. 9-11), for an indemnity should full repayment not be made from the sources contemplated (P.A. s. 8), and for equal ranking with the ordinary creditors of C.C.B. (P.A. s. 13).

65 It is interesting to note that my conclusion that the $255 million advance was a loan also accords with the views of Mr. Justice Estey in his report. The relevant passages are found at pp. 115, 118 and 125 of the Estey report:

> The $255M reduced the bank's debt to the Bank of Canada, but itself became an obligation to be retired by collections on the Support Package loans or on liquidation, out of the assets of the bankrupt bank. The receipt of the $255M therefore is irrelevant to the presence or absence of solvency. Whatever state the bank was in at that time remained unaffected by the receipt of the Support Package moneys. The Inspector General, therefore, was in error in finding the bank to be solvent upon receipt of the $255M. It should be borne in mind that the $255M, by the terms of the interim and final agreements, remains an obligation in debt of the CCB.
>
> . . . . .
>
> The Support Package should have classified these moneys as an unrecoverable purchase price, as a capital grant of some nature or as a subordinated loan, repayable out of earnings only. What CCB needed at this time of crisis was a loan without recourse in the nature of a capital grant repayable only from future profits and not a loan which would retain that characteristic and revive when the bank ran into further difficulties.
>
> . . . . .
>
> The object of this Support Program therefore was to replace lost income and thereby protect and renew capital. The banks could not in law contribute equity capital, and the government agencies likewise were not in a position, either legally or practically, to do so. Resort was had to what amounted to a long-term loan repayable out of the prospects of collections from bad debts and future earnings. The money infused, therefore, could not be treated as capital, but only served to reduce liquidity advances.

66 Contrary to the legal representative's submissions, s. 13 of the participation agreement is not an attempt to enhance the ranking of the participants upon C.C.B.'s insolvency. As evidenced by the passages from this clause which I earlier emphasized,

the main purpose and effect of s. 13 is to reduce, rather than enhance, the ranking of certain of the participants (Canada and Alberta) upon insolvency as the parties agreed to do away with s. 277 of the *Bank Act*. As for the other participants, there is nothing in s. 13 other than a confirmation that the ordinary principles of common law and of ss. 93 to 95 of the *Winding-up Act* apply upon insolvency, namely, the participants, as unsecured creditors of C.C.B., are entitled to rank pari passu with the other ordinary creditors of C.C.B.

67 For all the foregoing reasons, I find that the Court of Appeal did not err in characterizing the advance of $255 million to C.C.B. as being, in substance, a loan rather than an investment of capital. While indicia supporting both conclusions are present, the overall balance clearly tilts in favour of the characterization put forward by the respondents. Accordingly, I would dismiss this first ground of appeal.

B. Postponement under s. 4 of the Partnerships Act

68 In the alternative, the legal representative submits that, even if the advance of $255 million was properly characterized as a loan, the Court of Appeal erred in declining to postpone, under existing statutory and common law principles, the respondents' claims for the moneys not repaid until the claims of the other ordinary creditors of C.C.B. were satisfied. Relying on ss. 3(3)(*d*) and 4 of the *Partnerships Act*, he argues that, where a lender advances money to a business borrower under a contract providing that the lender shall "participate in the profits of that business," and the borrower subsequently becomes insolvent, the lender is not entitled to recover anything in respect of the loan until the claims of all other creditors of the borrower have been satisfied. It is submitted that the support agreements in question are contracts of such a nature because the participants contracted to be repaid their advances out of C.C.B.'s pre-tax income (either 50 per cent or 100 per cent plus interest, depending on whether the equity agreement could be carried out), and because of the potential for profits inherent in the warrants granted to the participants under the equity agreement.

69 As noted earlier, the Alberta Court of Appeal rejected a similar argument on the grounds that, notwithstanding the source for repayment and the warrants, the participants were *not* to receive under the agreements a "rate of interest varying with the profits" or a "share of profits" (at p. 212). In other words, the loan in question was not one to which s. 4 of the *Partnerships Act* applied. The respondents before this court adopt a similar position on this issue.

70 Alberta argues, persuasively in my view, that a lender does not receive a "share of the profits" within the meaning of ss. 3(3)(*d*) and 4 of the Ontario *Partnerships Act* unless he or she is entitled to be paid amounts referable to profits other than in repayment of the principal amount of the loan. It is submitted that a lender does not share in profits merely by having a contingent right to acquire or possibly even by having the right to acquire or by owning shares of the borrower. In the case at bar, Alberta submits that all amounts which the participants were entitled to be paid were to be applied only in repayment of the principal amount due and hence they were not entitled to and did not share in C.C.B.'s profits. As for the bank group, it is submitted that in the case of the insolvency of a bank, the *Winding-up Act* and not the *Partnerships Act* or the *Bankruptcy Act* determine the priority of claims. Moreover, they argue that the transaction at hand is not one to which the *Partnerships Act* applies because the participation agreement referred to profits only as a means of determining the source of the participants' right to repayment, and because any alleged "share of the profits" would stop when the sum advanced was repaid.

71 I have already found that the Court of Appeal was correct in characterizing the advance of $255 million under the support program as a loan. In order to determine the applicability of s. 4 of the *Partnerships Act* to the facts of this case, a provision which may apply regardless of whether a partnership exists, the general question to be answered is whether this loan was made "upon such a contract as is mentioned in section 3" of the Act. If so, then, subject to any constitutional arguments not made herein, the respondents would not be entitled to recover anything in respect of the loan until the claims of the other ordinary creditors of C.C.B. are satisfied.

72 The only provisions in s. 3 of the *Partnerships Act* which make specific reference to a "contract" are s. 3(3)(*b*) and (*d*). Section 3(3)(*b*) is clearly irrelevant to this appeal. Thus, at least at first glance, the contracts in the case at bar must fall within the ambit of s. 3(3)(*d*) of the *Partnerships Act* in order to trigger the application of s. 4. The specific question then becomes whether or not the support agreements provided that the participants were to receive a "rate of interest varying with the profits"

of C.C.B, or a "share of the profits arising from carrying on the business" of C.C.B. While the legal representative originally structured his s. 4 argument exclusively around the wording in s. 3(3)(*d*) of the *Partnerships Act*, he expanded this argument during oral submissions to include s. 3(3)(*a*). He submitted that, even if the transaction does not fall within the ambit of the former subsection, it clearly falls within the latter. Accordingly, another specific question to be considered is whether s. 4 of the *Partnerships Act* can be triggered by "the receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business" which does not involve a contract of the sort described in s. 3(3)(*d*). I will deal with both of these questions in turn.

73 Sections 3(3)(*d*) and 4 of the *Partnerships Act* originate from the now repealed *Act to Amend the Law of Partnership*, 1865 (U.K.), 28 & 29 Vict., c. 86 ("Bovill's Act"). The intent of what is now s. 3 of the *Partnerships Act* was evidently to mitigate the harshness of the old common law rule, which was that any person who shared in the profits of the partnership was deemed to be a partner, and so liable for any debts of the partnership on insolvency: *Grace v. Smith* (1775), 2 Wm. Bl. 997, 96 E.R. 587 (at p. 588 per De Grey C.J.: "Every man who has a share of the profits of a trade ought also to bear his share of the loss"); and *Waugh v. Carver* (1793), 2 Hy. Bl. 235, 126 E.R. 525.

74 The old common law rule was first modified by the decision in *Cox v. Hickman* (1860), 8 H.L.C. 268, 11 E.R. 431, which in some respects was very similar on the facts to the present case. The company of Smith and Son fell into financial difficulties and was unable to pay its creditors. The Smiths entered into an arrangement with five of its creditors assigning the company to them (as trustees for all of the creditors), for a term of 21 years. During that period, the trustees were to carry on the business of the company "and to pay the net income, after answering all expenses; which net income was always to be deemed the property of the two Smiths, among [all] the creditors of the Smiths" (at p. 269) [H.L.C.]. In other words, the creditors "were to be paid their debts out of the profits of their debtors' business" (*Lindley on the Law of Partnership*, 15th ed. (London: Sweet & Maxwell, 1984), at p. 104). The most significant fact for our purposes is that the repayment was to be only to the extent of the debts; when all the debts had been paid, the trustees were to hold the estate in trust for the Smiths. Financial troubles continued under the new management, and the company once again became unable to pay its debts.

75 Since at that time the law was thought to be that a person who shared in the profits was liable as a partner, the question in *Cox v. Hickman*, supra, was not, as here, whether those creditors who were being paid out of profits were to be ranked equally with subsequent creditors, but whether the former group were to be themselves liable as partners to subsequent creditors. In deciding that they were not so liable, the House of Lords is considered to have established, amongst other things, that receipt of a share of the profits is not conclusive proof of a partnership as was previously thought (*Lindley on the Law of Partnership*, at p. 104).

76 However, it is interesting to note one excerpt of the opinion of Wightman J. (one of the judges who came to advise the House of Lords in *Cox v. Hickman*) who, instead of modifying the old common rule, would simply have not applied it to the facts of the case (at p. 443 E.R.):

> It is said that a person who shares in net profits is a partner; that may be so in some cases, but not in all; and it may be material to consider in what sense the words, 'sharing in the profits' are used. In the present case, I greatly doubt whether the creditor, who merely obtains payment of a debt incurred in the business by being paid the exact amount of his debt, and no more, out of the profits of the business, can be said to share the profits. If in the present case, the property of the Smiths had been assigned to the trustees to carry on the business, and divide the net profits, not amongst those creditors who signed the deed, but amongst all the creditors, until their debts were paid, would a creditor, by receiving from time to time a rateable proportion out of the net profits, become a partner? I should think not.

In my view, the undesirability of the result foreseen by Wightman J. is equally compelling in the context of ss. 3(3)(*d*) and 4 of the *Partnerships Act*.

77 Historically, s. 3(3)(*d*) of the *Partnerships Act* appears to refer to loans similar to those involved in *Sukloff v. Rushforth*, supra, namely, loans in which the creditor advances money to the debtor on the terms that it shall be repaid with interest, and in addition the creditor is to receive a share of the profits over and above any payments on principal until the amount is paid off, as opposed to loans such as those in the present case where the share of the profits is used solely to repay the principal. In

other words, s. 3(3)(*d*) applied to loans which had no cap or limit on the amount to be paid to the creditor from the profits of the debtor's business or which had a cap unrelated to the principal owing on the debt.

78 It is not entirely clear in *Sukloff v. Rushforth*, supra, whether the lender actually received any of the profits of the company via the arrangement for 50 per cent of the profits. However, in many older cases it is clear that the lender did receive interest and the stated share of the profits for a period, and then claimed for the *entire amount* of the principal on bankruptcy of the debtor. In these cases ss. 2(3)(*d*) and 3 of the *Partnership Act*, 1890 (U.K.), 53 & 54 Vict., c. 39 (similar to ss. 3(3)(*d*) and 4 of the *Partnerships Act*) were applied to subordinate the claims: see *Ex parte Taylor; Re Grason* (1879), 12 Ch. D. 366 (C.A.); *Re Stone* (1886), 33 Ch. D. 541; *Re Hildesheim*, [1893] 2 Q.B. 357 (C.A.); *Re Mason; Ex parte Bing*, [1899] 1 Q.B. 810; and *Re Fort; Ex parte Schofield*, [1897] 2 Q.B. 495 (C.A.). These sections of the *Partnership Act*, 1890 essentially repeated Bovill's Act so it seems reasonable that this was the specific situation envisaged by the Act.

79 Contrary to the oral submission of the legal representative, *Re Young; Ex parte Jones*, [1896] 2 Q.B. 484, is not inconsistent with the distinction I am drawing. There, Mr. Jones lent money to Mr. Young which was to be used to pay the expenses of Mr. Young's business. The terms of the agreement provided that, in return for the use of this sum, Jones was to be paid a fixed weekly sum out of the profits of the business. When Young became insolvent, Jones claimed for the entire amount of principal, without making allowance for the amounts received by virtue of the weekly payments. In other words, the weekly sum received by Jones out of profits was not for the purpose of repaying the principal sum of the debt. Thus, *Re Young* is clearly distinguishable from the facts of this case and should not be seen as foreclosing the interpretation of s. 3(3)(*d*) that I am advancing.

80 In addition, s. 3(3)(*a*) of the *Partnerships Act* provides strong support for the distinction between profits as the source of repayment, and a share in the profits, with any repayment of a fixed debt falling into the former category. Indeed, it provides that:

> (*a*) the receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business does not of itself make him or her a partner in the business or liable as such.

This seems to preclude any reading of s. 3(3)(*d*) which would catch debts which are to be repaid "out of profits." In this respect, it is interesting to note that the authors of *Lindley on the Law of Partnership* are of the view that the equivalent of s. 3(3)(*a*), not s. 3(3)(*d*), applies to cases such as *Cox v. Hickman*, supra, where, as we have seen, an arrangement similar to the one at bar was involved (at p. 108).

81 For the foregoing reasons, I would conclude that any fixed debt to be repaid out of profits does not in itself constitute a "share of the profits" within the meaning of s. 3(3)(*d*) of the *Partnerships Act*. As argued by Alberta, a lender does not receive a "share of the profits" under this provision unless he or she is entitled to be paid amounts referable to profits other than in repayment of the principal amount of the loan.

82 Having said this, the question of whether the support agreements provided that the participants were to receive a "rate of interest varying with the profits" of C.C.B., or a "share of the profits arising from carrying on the business" of C.C.B., as to trigger s. 4 of the *Partnerships Act*, may be readily answered. Clearly, the participants were not to receive in return for the advance of $255 million a rate of interest varying with C.C.B.'s profits. The rate of interest to be paid was fixed according to the prime rate and was contingent on whether or not the equity agreement could be carried out. As for C.C.B.'s profits, they merely represented the source from which the participants were to be repaid their advance. In this respect, I entirely agree with the following excerpt taken from the reasons of Harradence J.A. in the case at bar (at p. 211):

> It is important to recognize that while repayment was to be made from pre-tax income of C.C.B., there was no direct link between the success of the C.C.B. and the overall quantum of the amount due to or payable to the Support Group Participants. I have been referred to no authority which supports the proposition that a repayment, the instalments of which are referable to the quantum of the income of the debtor, is a situation of 'joint benefit'. Since the sums to be received by the Participants were limited to repayment of monies advanced, with a contingent right to interest, the source of the repayment monies is not relevant and, with respect, the learned Chambers Judge erred in concluding the Participants were 'sharing the profits' in this respect.

83 The participants had a fixed debt which would be repaid in part by the moneys received from the syndicated portion of the portfolio assets and in part by C.C.B.'s pre-tax income. With the exception of the contingent interest at prime rate, under no circumstances were the payments from the pre-tax income to be applied to anything but the repayment of the loan. All amounts that the participants were entitled to be paid were to be applied only in repayment of the principal amount of the loan. Once the loan was fully repaid, all payments from C.C.B.'s pre-tax income were to stop. Accordingly, I find that the participants were not to receive a "share of the profits" of C.C.B. within the meaning of s. 3(3)(*d*) of the *Partnerships Act* by virtue of the repayment scheme for the $255 million advance. I also do not accept that the contemplated granting of warrants under the highly contingent circumstances of this case alters this conclusion.

84 The question then is whether s. 4 of the *Partnerships Act* can be triggered by an arrangement falling under s. 3(3)(*a*). Indeed, as previously noted, the legal representative takes the alternative position that, even if s. 3(3)(*d*) does not apply, the transaction in this case is surely one contemplating "the receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business." While one cannot seriously dispute this proposition, the fact remains that s. 4 cannot apply unless "money has been advanced by way of loan upon such a contract as is mentioned in section 3." The first point to note is that s. 3(3)(*a*) of the *Partnerships Act* makes no reference whatsoever to a "contract" and thus appears to be beyond the realm of s. 4. Clearly, the legislature could have chosen a more general term than "contract" in s. 4 had it wished this postponement provision to apply to every transaction described in s. 3. The same could also be said about the absence of the word "loan" in s. 3(3)(*a*). It is not without significance that we were not presented with any jurisprudence in which a person who had a fixed debt to be paid out of profits (i.e., who would fall under s. 3(3)(*a*) and not s. 3(3)(*d*)) was subordinated under the Act.

85 Further, if the policy on which s. 4 of the *Partnerships Act* is based is that a person who reaps the rewards of profits must share some risk, then this would not apply to a creditor with a fixed debt, notwithstanding that the fund or source of repayment is profits, because his or her total return will not vary with the profitability of the company.

86 From the above, I conclude that s. 4 of the *Partnerships Act* cannot be triggered by what is described in s. 3(3)(*a*) as "the receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business," which does not involve a contract of the sort described in s. 3(3)(*d*). The present case may very well fall within s. 3(3)(*a*) of the Act. However, that section only deals with a guideline for determining whether or not a partnership has been created, an issue which is not raised in this appeal. Contrary to s. 3(3)(*d*) of the *Partnerships Act*, s. 3(3)(*a*) does not have the added function of triggering the postponement provision of the Act. As the participants were not to receive a "rate of interest varying with the profits" of C.C.B. or a "share of the profits arising from carrying on the business" of C.C.B., their claims for the return of the moneys advanced cannot be postponed under s. 4.

87 Accordingly, I would dismiss this ground of appeal. The Court of Appeal did not err in declining to postpone the respondents' claims under s. 4 of the *Partnerships Act*.

C. Equitable subordination

88 In the further alternative, the legal representative submits that even if the transaction in question is a loan and the *Partnerships Act* does not apply, the participants' claims should be subordinated on equitable grounds based on the United States doctrine of "equitable subordination."

89 More specifically, it is argued that the equitable jurisdiction of superior courts gives them authority in insolvency matters to subordinate claims that, while valid as against the insolvent's estate, arise from or are connected with conduct prejudicial to the interests of other creditors. While the legal representative does not assert that the conduct of the participants was fraudulent or worthy of censure, he argues that the participants acted to the detriment of the ordinary creditors of C.C.B. in ways (which I shall outline below) that should invoke this equitable jurisdiction. Both the bank group and Alberta challenge the proposition that equitable subordination is available under Canadian law in insolvency matters. In addition, the respondents argue that the facts of this case do not call for the application of equitable principles.

90 This issue does not appear to have been raised before Wachowich J. or the Court of Appeal and consequently this court does not have the benefit of any findings of fact as to the actual or potential prejudice suffered by C.C.B.'s depositors and other creditors as a result of the conduct of the participants. In this respect, the evidence presented to this court by the legal representative is limited to certain excerpts of the Estey report, incorporated by reference in the affidavit of Mr. Allan Taylor of the Royal Bank of Canada (C.O.A. at pp. 236-41). The excerpts in question are those found at pp. 114-21 of the Estey report under the heading "Flaws in the Support Program."

91 This court also does not have the benefit of the insight of the courts below as to whether or not, in the first place, the doctrine of equitable subordination should become part of Canadian insolvency law. As I see the matter, however, it is not necessary in the circumstances of this case to answer the question of whether a comparable equitable doctrine should exist in Canadian law and I expressly refrain from doing so. Assuming, for the sake of argument only, that Canadian courts have the power in insolvency matters to subordinate otherwise valid claims to those of other creditors on equitable grounds relating to the conduct of these creditors inter se, this court has been presented with insufficient grounds to justify the exercise of such a power in the case at bar. Briefly put, the reasons and limited evidence advanced by the legal representative before this court disclose neither inequitable conduct on the part of the participants nor injury to the ordinary creditors of C.C.B. as a result of the alleged misconduct.

92 As I understand it, in the United States there are three requirements for a successful claim of equitable subordination: (1) the claimant must have engaged in some type of inequitable conduct; (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: see *Re Mobile Steel Co.*, 563 F. 2d 692 (5th Circ., 1977), at p. 700; *Re Multiponics Inc.*, 622 F. 2d 709 (5th Circ., 1980); A. DeNatale and P.B. Abram, "The Doctrine of Equitable Subordination as Applied to Nonmanagement Creditors" (1985), 40 Bus. Law. 417, at p. 423; and L.J. Crozier, "Equitable Subordination of Claims in Canadian Bankruptcy Law" (1992), 7 C.B.R. (3d) 40, at pp. 41-42. Even if this court were to accept that a comparable doctrine to equitable subordination should exist in Canadian law, I do not view the facts of this case as giving rise to the "inequitable conduct" and ensuring "detriment" necessary to trigger its application.

93 In this regard, the actions cited by the legal representative as being detrimental to the ordinary creditors of C.C.B., thereby giving rise to equitable subordination, come down to two elements: (1) the press release of March 25, 1985 issued by the Department of Finance announcing to the general public that the support program would leave C.C.B. "in a strong position of solvency" and that sufficient funds were being advanced "to ensure solvency"; and (2) the flaws in the support program outlined in the Estey report and described by the legal representative as (a) the inadequacy of the support program to ensure C.C.B.'s solvency, (b) the accounting treatment disguised the fact that the participation agreement required the entire amount advanced to be repaid, (c) the accounting treatment used by the bank group gave rise to tax benefits not available to ordinary depositors, (d) the participation agreement allegedly obliged C.C.B. to apply all amounts received on the syndicated portion of the portfolio assets to the participants, (e) the warrants would have the effect of prohibiting C.C.B. from raising funds in the equity market since they would enable the participants to acquire 75 per cent of the common shares of C.C.B. up to 10 years after the advances had been paid in full, and (f) after making their advances and receiving their participation certificates, the bank group ceased dealing with C.C.B. in the normal manner.

94 At the outset, I note that many of the actions relied on by the legal representative cannot be attributable to the participants. For example, the press release was not issued by the respondents and the accounting treatment given by C.C.B. to the advance of $255 million simply followed the instructions given by the Office of the Inspector General of Banks. Thus, even if some inequitable connotation could be given to these actions, they would not represent misconduct on the part of the respondents to whom the ordinary creditors of C.C.B. are now attempting to rank in priority.

95 Another difficulty with the legal representative's submission, however, is that I fail to see anything remotely inequitable in the conduct complained of. With respect to the press release, the evidence does not show that the participants were necessarily of a different opinion from that set out in the press release. Certainly, they advanced the funds on the condition that the Inspector General of Banks provide them with an opinion letter confirming the solvency of C.C.B. on the infusion of the proposed funds.

As for the flaws in the support program, there is nothing to show that the participants' plans were other than well intentioned. As stated at the beginning of these reasons, it is beyond the scope of this appeal to engage in a detailed review of the reasons which led to the failure of the support program. Suffice it to say that the assertions of the legal representative in substance do not show wrongdoing or unfairness on the part of the participants, but merely show that the support program did not work, and perhaps with hindsight, offer some explanations as to why.

96 In any event, it does not appear to have been suggested at any time in the courts below nor was any evidence led to suggest that any creditor of C.C.B. was misled by any of the above actions or that the press release, accounting treatment or any flaw in the support program operated to cause any creditor to act to its detriment. Thus, even if this court were to find that the participants acted in an inequitable manner in their dealings with C.C.B. and its depositors and other creditors, we do not have a shred of evidence upon which to conclude that the improper conduct resulted in actual harm to the ordinary creditors of C.C.B. now before this court. One can only speculate that depositors and other creditors relied on the press release or accounting treatment and thereby suffered damages. We have been offered no United States' decision in which mere speculation of harm to other creditors has been found sufficient to meet the second requirement of the doctrine of equitable subordination. Of course, the ordinary creditors of C.C.B. who appear before this court have, to a varying extent, suffered from the winding-up of C.C.B., just as any creditor (including the participants) suffers following an insolvency or bankruptcy. The legal representative has not shown, however, that these ordinary creditors have suffered identifiable prejudice attributable specifically to the alleged misconduct of the participants.

97 Accordingly, I would reject this alternative ground of appeal. Even if equitable subordination is available under Canadian law, a question which I leave open for another day, the facts of this case do not call for an intervention with the pari passu ranking of the respondents in the name of equity.

D. The $5 million attributable to the syndicated portion of the portfolio assets

98 The last matter to be addressed pertains to the moneys recovered from the portfolio assets and attributable to the syndicated portion thereof. In his oral submissions, the legal representative argued that the learned chambers judge erred in allowing the participants to recover funds from the syndicated portion of the portfolio assets. A similar submission was made in the Alberta Court of Appeal but was summarily rejected (at p. 212). As I understand it, the argument is one of inconsistency between the treatment given, on the one hand, to the respondents' claim for their portion of the moneys recovered from the portfolio assets and, on the other hand, to the respondents' claim for all moneys advanced to C.C.B. pursuant to the participation agreement and not repaid by moneys recovered from the portfolio assets. According to the legal representative, these two claims stem from the same financial arrangement and cannot be given different legal effects. It is argued that, if the advance of $255 million is really an investment of capital, as found by Wachowich J., then it is wrong to rank the respondents behind the ordinary creditors of C.C.B. only with respect to the claim for what is not repaid by moneys recovered from the portfolio assets. Similarly, if the transaction is really a loan but the loan is one to which s. 4 of the *Partnerships Act* applies, then both claims ought to be postponed.

99 This submission has already been answered by my conclusion that the advance of $255 million to C.C.B. was substantially in the nature of a loan and that the *Partnerships Act* does not apply to postpone the loan.

VI. Disposition

100 For the foregoing reasons, I would dismiss the appeal with costs here and in the courts below. As found by the learned chambers judge and upheld by the Court of Appeal, the participants are entitled to their proportionate share of the moneys recovered from the portfolio assets of C.C.B. in the manner set out in the participation agreement, that is, to the extent such recoveries exceed the C.C.B. portion of each of the portfolio assets. Moreover, as found by the Court of Appeal, the respondents are entitled to rank pari passu with the ordinary creditors of C.C.B. for all moneys advanced pursuant to the participation agreement and not repaid by moneys recovered from the portfolio assets.

Appeal dismissed.

Footnotes

* Stevenson J. took no part in the judgment.

TAB “H”

1975 CarswellNat 188
Federal Court of Canada — Appeal Division

Henderson v. Minister of National Revenue

1975 CarswellNat 188, [1975] C.T.C. 485, [1975] F.C.J. No. 613, 12 N.R. 91, 75 D.T.C. 5332

Jack N Blinkoff and Janet Beach Henderson, Executors of the Estate of A M Collings Henderson, deceased, Appellants, and Minister of National Revenue, Respondent

Pratte, Urie and Ryan, JJ

Judgment: July 25, 1975

Proceedings: on appeal from a judgment of the Federal Court — Trial Division, reported [1973] C.T.C. 636

Counsel: *J M Roland* for the appellants.
N A Chalmers, QC and *R G Pine*for the respondent.

Related Abridgment Classifications
Estates and trusts
I Estates
I.15 Estate tax and succession duties
I.15.d Taxable property
I.15.d.i Situs
I.15.d.i.A Securities
Estates and trusts
I Estates
I.15 Estate tax and succession duties
I.15.e Valuation
I.15.e.vii Securities
Estates and trusts
I Estates
I.15 Estate tax and succession duties
I.15.g Payments
I.15.g.ii Liability for payment
I.15.g.ii.C Personal representative

Headnote
Estates --- Estate tax and succession duties — Taxable property — Situs — Securities
Estates --- Estate tax and succession duties — Valuation — Securities
Estates --- Estate tax and succession duties — Payments — Liability for payment — Personal representative
Succession duty — Federal — Dominion Succession Duty Act, RSC 1952, c 89 — 6(1)(b), (2), 13, 23, 24 — Canada-US Succession Duty Convention — Article II(f) — Valuation of mining shares — Valuation of share purchase warrants — Meaning of "fair market value" — Situs of share purchase warrants.
The deceased died in 1957 resident and domiciled in the State of New York. Among his assets were a large number of shares in two Canadian mining companies, "Campbell Chibougamau" and "Chibougamau Mining" and also some share purchase warrants, which were physically situate in New York, issued by Campbell Chibougamau.
In issue was the determination of the fair market value of the shares and share purchase warrants and also the situs of the warrants. On the valuation question, which reduced itself to the valuation of the Campbell Chibougamau shares, the closing

market price on the date of death was $10 $^{7}/_{8}$ and, in recognition of the depressing effect the sale of the deceased's substantial holdings would have on the market if sold all at once, the Minister considered the fair market value of these shares to be $8 each, representing a discount of about 26%. The appellants contended that the market price was not indicative of "fair market value" because the market was not in possession of accurate information concerning the ore reserves, that it was being manipulated by the deceased, and that it was under the influence of a "transient boom".

As to the situs of the share purchase warrants, the appellants contended that since title passed on delivery their situs was where they were physically located, in New York, not in Canada. The Minister, on the other hand, considered them "rights in or over shares" within Schedule B, Article II of the Canada-US Succession Duty Convention, thus classifying them as shares and placing their situs in Canada.

The appellants appealed from a judgment of the Trial Division dismissing their appeal on the valuation of the shares and the Minister cross-appealed in respect of the allowance of the appellants' appeal on the situs of the share purchase warrants.

HELD (per curiam):

On the valuation of the shares, the evidence was not such as to destroy the stock market price as the best evidence of their fair market value.

On the situs of the share purchase warrants, these were not "rights or interest, legal or equitable, in or over" shares because, in relation to the warrants, there were no shares in being. The share purchase warrants did not fall within the wording of Schedule B, Article II invoked in support of the cross-appeal, which was dismissed.

Table of Authorities

Case referred to:

Isaac Untermyer Estate v *Attorney-General (BC)*, [1929] S.C.R. 84.

Words and phrases considered:

RIGHTS OR INTEREST, LEGAL OR EQUITABLE, IN OR OVER

. . . reliance was placed on the words " . . . the situs of any rights or interest, legal or equitable, in or over . . . shares . . . shall be deemed to be situated at the place where the company is incorporated" [within the meaning of the *Canada-United States of America Taxation Act, 1944*, S.C. 1950, c. 27, Schedule B, Article 11(f)]. It was submitted that the share purchase warrants were rights or interests, legal or equitable, in or over Campbell Chibougamau shares, and that Campbell Chibougamau was a company incorporated in Quebec; thus it was submitted that the warrants were situated in Canada.

. . . . .

. . . the share purchase warrants were not "rights or interest, legal or equitable, in or over" shares of Campbell Chibougamau; in relation to the warrants there were no shares in being. Whatever may be the precise moment of creation of shares in a corporation, it had certainly not been reached in this case in respect of any rights conferred by the warrants owned by the deceased.

***Ryan, J* (concurred in by Pratte and Urie, JJ):**

1 Mr Collings Henderson died on February 2, 1957. At the date of his death, Mr Henderson owned 471,984 and 6/8 shares of Campbell Chibougamau Mines Limited ("Campbell Chibougamau") and 56,234 warrants to purchase Campbell Chibougamau shares at $4 per share.

2 In August 1959 the Minister of National Revenue assessed duties under the *Dominion Succession Duty Act*, RSC 1952, c 89 (as amended), against the Henderson estate in the sum of $1,703,250.88. In so doing, he placed a value of $8 per share on the shares of Campbell Chibougamau and valued the share purchase warrants at $4 per warrant.

3 Mr Henderson also owned 288,384 shares of Chibougamau Mining and Smelting Company ("Chibougamau Mining") which the Minister valued at $2.65 per share. For purposes of the trial of this action, it was agreed that the value of the Chibougamau Mining shares should be adjusted in relation to their listed market price as at February 2, 1957 in the same proportion as the value of the Campbell Chibougamau shares is adjusted, if at all.

4 The assessment of succession duties was appealed to the Trial Division by the executors of the estate. They claimed that the value of the assets of the estate situated in Canada and subject to tax should be amended by reducing the assessed value of the Campbell Chibougamau shares from $8 per share to not more than $2.25 and that of the Chibougamau Mining shares from $2.65 per share to not more than $0.92. They also claimed that the warrants to purchase shares of Campbell Chibougamau should be excluded from the assets situated in Canada and subject to tax. There was a further claim that one-half of provincial duties paid by the estate should be deducted from the duties otherwise payable. The respondent, in the Statement of Defence, conceded and was prepared to allow, in computing the duty otherwise payable, an amount in respect of any duty paid to the Province of Quebec and to the Province of Ontario and, for this purpose, prayed that the appeal be allowed and the assessment referred back to the respondent for the purpose of allowing as a deduction one-half of the provincial duties paid to the Province of Ontario; otherwise the respondent prayed that the appeal be dismissed. The agreement between the parties as to the adjustment of the value of the Chibougamau Mining shares had, as was stated by the learned trial judge, "... the effect of narrowing the issues between the parties to (1) the value of the shares of Campbell Chibougamau as at the date of Henderson's death for estate tax purposes, rather than evaluation of shares in the two mining companies, and (2) the situs and value of share purchase warrants in Campbell Chibougamau".

5 The Trial Division allowed the appeal in respect of the situs of the share purchase warrants and referred the matter back to the Minister in order that the warrants should be excluded from the assets of the estate situated in Canada and thus that they should not be subject to tax under the *Dominion Succession Duty Act* and that the Minister should reassess accordingly. In all other respects the appeal was dismissed.

6 This is an appeal by the appellants, the executors, from the judgment of the Trial Division in so far as their appeal to that Division was dismissed. The respondent cross-appealed in respect of the allowance of the appeal to the Trial Division in relation to the share warrants.

7 For purposes of the appeal to the Trial Division, counsel agreed on this statement of facts:

1. Collings Henderson (Henderson) died on February 2nd, 1957.

2. Henderson at the date of his death owned 471,984 and 6/8ths shares of Campbell Chibougamau Mines Limited ("Campbell Chibougamau") and 56,234 warrants to purchase Campbell Chibougamau shares at $4.00 per share.

3. The Minister of National Revenue on August 2nd, 1959, assessed duty against the Henderson Estate in the sum of $1,703,250.88 and in doing so placed a value of $8.00 per share on the shares of Campbell Chibougamau and valued the share purchase warrants at $4.00 per warrant.

4. Henderson also owned 288,384 shares of Chibougamau Mining and Smelting Company ("Chibougamau Mining"), which the Minister valued at $2.65 per share in assessing the Henderson Estate. It has been agreed for the purposes of trial that the value of the Chibougamau Mining shares be adjusted in relation to their listed market price as at February 2nd, 1957, in the same proportion as the value of the Campbell Chibougamau shares is adjusted, if at all.

5. Campbell Chibougamau is a public company incorporated under the laws of Quebec on March 10th, 1950. Initially the stock traded over the counter and eventually in 1952 it was listed and traded on the Toronto Stock Exchange, the Canadian Stock Exchange (then known as the Montreal Curb Market), and the American Stock Exchange. On February 1st, 1957, which was a Friday, Campbell Chibougamau closed at $10 $^{7}/_{8}$ths on the Toronto Stock Exchange.

6. On February 2nd, 1957, there were 3,029,985 issued, allotted and outstanding shares of Campbell Chibougamau.

7. Campbell Chibougamau was incorporated for the purpose of acquiring exploring and developing mining claims in the Chibougamau area of northern Quebec. For the first few years Campbell Chibougamau was engaged in exploration on such claims and in the period 1952-1955 development work followed the discovery of the Merrill Island Mine, production

commencing on May 29, 1955. The history of the activities of Campbell Chibougamau and its financial affairs are reported in a series of annual and semi-annual reports commencing with a report for the year ended May 31st, 1953.

8. During his life Henderson was the Chairman of the Board of Campbell Chibougamau from its incorporation and had responsibility for arranging financing for the company. Henderson maintained his office in New York and it was from New York that most of the financing of the company was arranged.

9. Shortly after the incorporation of Campbell Chibougamau an agreement was entered into among EOD Campbell and others including a nominee of Henderson providing an arrangement whereby certain optioned shares of Campbell Chibougamau would be taken down under the agreement through the syndicate thereby organized. Of the initial 3,000,000 issued shares all, except 360,375 which went to Consolidated Chibougamau Gold Fields Limited in exchange for mining claims, were taken down through the syndicate. Some of these shares were then sold to the public at the times and prices stipulated by Henderson who under the syndicate agreement controlled the sale of all the shares. The syndicate agreement is dated April 25th, 1950.

10. Under the agreement, the syndicate became entitled to take down shares under option as follows:

400,000 shares	@	60cents per share
1,800,000 shares	@	$1.00 per share
439,625 shares	@	no cost after the initial 400,000 shares were taken down.

11. The syndicate, at the direction of Henderson, took down all the shares under option prior to April 1953. All of these shares were taken down either by brokerage houses pursuant to Henderson's direction, or by EOD Campbell. Subsequently, the shares were either held in margin accounts under syndicate control, or transferred into accounts of individuals who were part of the syndicate agreement. Mr Henderson at all times controlled the sale by the syndicate to the public of all shares so taken down.

12. In 1953, Henderson commenced litigation against EOD Campbell for the purpose of enforcing the provision of the syndicate agreement relating to sale of syndicate shares. EOD Campbell was selling such shares without Henderson's authorization. The litigation was eventually settled in March 1955 on the basis that Henderson took over EOD Campbell's stock.

13. Henderson himself retained shares of Campbell Chibougamau as part of the syndicate and from 1955 until his death the number of shares of Campbell Chibougamau he personally owned remained about constant. Although Henderson's personal holdings of Campbell Chibougamau remained more or less constant, he bought and sold shares of Campbell in the market up to the time of his death. From available stockbroking records some of his buying and selling is indicated below:

	Bought			Sold		
1951	41,700	@	$1.70 - $2.50	155,400	@	$2.05 - $2.70
1952	58,900	@	$2.00 - $2.95	49,750	@	$2.20 - $3.25
1953	76,500	@	$2.20 - $4.00	191,065	@	$2.28 - $4.60
1954	12,600	@	$2.00 - $3.75	3,900	@	$2.75 - $2.80
1955	14,400	@	$7.25 - $9.00	--		
1956	--			16,100	@	$18.00 - $28.00 1/8

14. It appears from the records of the three above-mentioned stock exchanges that the trading of Campbell Chibougamau shares during the years 1955-1958 was as follows:

1955 -- 2,214,200

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1956 -- 2,803,667
1957 -- 2,596,405
1958 -- 3,529,733
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15. Annexed hereto and marked as Exhibit "A" is a graph which illustrates the prices at which the shares of Campbell Chibougamau were trading on the stock market from the listing of the shares of the company until the end of 1958 on a monthly basis. It can be noted that the shares of Campbell Chibougamau rose from a market price of between $2.00 and $3.00 after the market was initially established to a high of $28.95 in 1956 before they started to fall in price.

16. Campbell Chibougamau started to produce copper concentrate on May 29th, 1955. In doing so, during the first year of operation, it milled its highest grade ore (2.95%). In succeeding years the grade of ore milled was lower (i.e. 2.38% in 1957 and 2.07% in 1958).

17. Prior to 1957, Campbell Chibougamau discovered and owned three ore bodies known as the Main Mine (Merrill Island Group), Cedar Bay Mine and Koko Creek Mine. Of these three the largest ore body was the Main Mine and it is from this mine that ore was mined prior to 1958.

18. In February 1956, Newlund Mines (Can Co) held 45 claims as part of a group of 437 claims in the Chibougamau area. The 45 claims were assigned under an option to New York and Honduras Rosario Mining Co and they in turn commenced exploration on the 45 claims. Chibougamau Mining had 50 neighbouring claims on which they were carrying out geophysical and magnetometer surveys. Yorcan Explorations Limited was incorporated on April 30th, 1956. Ownership of Yorcan was approximately 50% by Chibougamau Mining, 25% by New York and Honduras Rosario Mining Company and the remainder by Newlund and other interests. New York and Honduras Rosario Mining Company is an American company with long experience in the mining industry. The principal purpose of Yorcan was to explore the 95 claims previously mentioned. In the winter of 1956, Yorcan drilled approximately 25 holes on Lake Chibougamau, none of which were subsequently found to contribute to the Henderson ore body. Also in 1956, Campbell Chibougamau was carrying on surface exploration and diamond drilling in an area adjacent to the Yorcan holdings. This area was known as the "K" group and consisted of 2,006 acres held by Chibougamau Venture Ltd. At this time it was worked under the exclusive control of Campbell Chibougamau and was later acquired by Campbell Chibougamau. During 1956, Campbell Chibougamau drilled fifteen holes, three of which gave favourable indications that further drilling was warranted in the area of the three holes. The holes and the dates of completion were as follows:

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K --  8 completed April 7th, 1956
K -- 11 completed April 12th, 1956
K -- 12 completed April 20th, 1956
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Annexed hereto and marked as Exhibit "B" is a table listing the results of the drill holes. Also annexed hereto and marked as Exhibit "C" is a copy of a map indicating all the drilling which was done in discovering the Henderson Mine.

19. As a result of the above favourable indications arising on the border of Yorcan and Campbell Chibougamau property, a joint exploration program was carried on in the winter of 1957. Prior to the death of A M Collings Henderson on February 2nd, 1957, the following holes had been drilled to completion and were among the holes which contributed to the discovery and delineation of the Henderson ore body. The holes and dates of completion are as follows:

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T -- 23 completed January 12th, 1957
T -- 24 completed January 12th, 1957
T -- 27 completed January 21st, 1957
T -- 26 completed January 25th, 1957
T -- 33 completed January 27th, 1957
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T -- 32 completed January 28th, 1957

(See Exhibit "B").

20. In the Semi-Annual Report for the period ended December 31st, 1956, the president of Campbell Chibougamau, in a letter to the shareholders dated February 15th, 1957, discusses the drilling program that was being carried on in conjunction with Yorcan under the heading "Activities in the Chibougamau Area". The stated indications from the drilling done as of that date, was that "underground development is warranted". No mention is made of probable ore reserves and the letter also indicates that some of the ore body was still unexplored. The following holes were mentioned in the letter:

T -- 33 completed January 27th, 1957
T -- 37 completed February 7th, 1957
T -- 38 completed February 18th, 1957
T -- 39 completed February 14th, 1957
T -- 45 completed February 9th, 1957
T -- 46 completed February 16th, 1957
T -- 47 completed February 13th, 1957

(See Exhibit "B").

The last six of the above holes were all completed after Mr Henderson's death on February 2nd, 1957. The following holes which were completed shortly after Mr Henderson's death also contributed to the ore body:

T -- 34 completed February 3rd, 1957
T -- 35 completed February 3rd, 1957
T -- 36 completed February 6th, 1957

Drilling continued over the whole of the winter of 1957 and many more holes were drilled which also contributed to the Henderson ore body's discovery.

21. In the Annual Report of Campbell Chibougamau for the year ended June 30th, 1957, the chief geologist, Dr S E Malouf, gave a report dated June 30th, 1957, which indicated the probable ore reserves in the Henderson ore body. An independent consulting geologist, Dr J E Gill, studied the ore body and recommended that it be integrated as a unit. On July 22nd, 1957, Campbell Chibougamau entered into an agreement with Yorcan to purchase all the assets of Yorcan, in return for 506,667 shares of Campbell Chibougamau. The price of the Campbell stock at that time was $9.00 per share. The agreement was ratified by the stockholders of Campbell Chibougamau on October 30th, 1957, when the price per share was $5.50.

22. The following is a table of the sales of shares of Campbell Chibougamau made by the executors from the Henderson Estate after Henderson's death and the prices received therefor which are within the range that such shares traded at the time of sale.

YEAR	SHARES	TOTAL	AVERAGE PRICE
1957	20,845	$ 95,915.90	$4.60
1958	123,000	$ 779,173.18	$6.33
1959	107,940	$ 831,895.44	$7.70
1960	108,760 6/8	$ 657,563.62	$6.08
1961	42,814	$ 328,929.88	$7.68
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403,359 6/8 $2,693,478.02

23. The parties have agreed that the share purchase warrants owned by Henderson at the date of his death were in the form of a certificate which has been agreed upon. It is also agreed that the certificates were physically located in the State of New York at the date of Mr Henderson's death.

8 The exhibits referred to in the statement are not reproduced in these reasons.

The Executors' Appeal

9 Under the *Dominion Succession Duty Act*, succession duties are assessed and levied upon successions to all property of a deceased which is situated in Canada in cases in which the deceased was domiciled outside of Canada at the time of his death, as was Mr Henderson. [1] It was not disputed that the shares in Campbell Chibougamau owned by Mr Henderson at his death were situated in Canada. [2] Succession duties are assessed at rates provided in the First Schedule to the Act; in the case of so-called "initial duties" the rates applied are dependent on the "aggregate net value" of the property of the deceased [3] and in the case of "additional duties" the rate applied to a succession is the rate set forth in the Schedule corresponding to the "dutiable value" as stated in the Schedule. [4]

10 Paragraph 2(a) of the Act defines "aggregate net value" as follows:

> • "aggregate net value" means the fair market value as at the date of death, of all the property of the deceased, wherever situated, together with the fair market value, as at the said date, of all such other property wherever situated, mentioned and described in section 3, as deemed to be included in a succession or successions, as the case may be, from the deceased as predecessor, after the debts, encumbrances and other allowances are deducted therefrom as authorized by subsection (9) of section 7 and by section 8;

11 "Dutiable value" is defined in paragraph 2(e):

> • "dutiable value" means, in the case of the death of a person domiciled in Canada, the fair market value as at the date of death, of all property included in a succession to a successor less the allowances as authorized by subsection (9) of section 7 and by section 8 and less the value of real property situated outside of Canada, and means, in the case of the death of a person domiciled outside of Canada, the fair market value of property situated in Canada of the deceased included in a succession to a successor less the allowances as authorized by subsection (9) of section 7 and by sections 8 and 9;

12 Under section 23 of the Act the Minister of National Revenue assesses the duties payable.

13 Subsection 34(1) provides:

> 34. (1) Subject to the provisions of this Act, the fair market value of the property included in any succession for the purpose of duty shall be ascertained by the Minister in such manner and by such means as he thinks fit, and, if he authorizes a person to inspect any property and report to him the value thereof for the purposes of this Act, the person having the custody or possession of that property shall permit the person so authorized to inspect it as such reasonable times as the Minister thinks necessary.

14 The learned trial judge described the manner in which the Minister ascertained the fair market value of the shares owned by the deceased immediately before his death and included in the successions taxed:

> This is what the Minister did. He placed a value of $8 per share on the shares of Campbell Chibougamau as at February 2, 1957. It is quite obvious how he arrived at the amount of $8 per share. February 2, 1957 was a Saturday and the stock

exchanges were closed on that day. The closing price of Campbell Chibougamau on the Toronto Stock Exchange on Friday, February 1, 1957 was $10.78 per share. The deceased held 471,984 6/8 shares out of 3,029,985 issued shares which is a very large holding. No prudent shareholder would place the whole of such a large holding on the market at one time. To do so would result in an inevitable depression of the market. It is only reasonable to suppose that, if the shares were to be disposed of, they would have been fed into the market gradually as the market was capable of absorbing them without undue disturbance. To do otherwise would be to require the shares to be sold at a sacrifice or dumping value. On the other hand to dispose of the shares to best advantage requires time. The Minister allowed a discount from $10.78 to $8 per share or approximately 26% by some rule of thumb to offset that inconvenience, delay and uncertainty in realizing upon the shares. This is the amount that the Minister ascertained to be the "fair market value" per share.

15 It is this amount, $8 per share, ascertained by the Minister to be the fair market value of each of the shares in question that was disputed by the appellants.

16 The shares were traded on three stock exchanges. On the face of it, their fair market value would be their price set by the interplay of forces on the exchanges. The block of shares owned by the deceased was, however, very substantial, measured both absolutely and in relation to the shares of the corporation traded on the markets. To dump the shares on the exchange in a block would, as the trial judge said, "result in an inevitable depression of the market". The very act of offering to sell would distort the market price. The decision of the Supreme Court of Canada in *Executors of the Estate of Isaac Untermyer* v *Attorney-General for the Province of British Columbia*, [1929] S.C.R. 84, makes it clear, however, that the fact that the property in question consists of a block of shares, the sale of which at a single stroke would reduce their market price, is not in itself enough to destroy the market as the best indicator of fair market value. That decision holds in contemplation the possibility of a gradual release of shares over a period. It follows that, for purposes of ascertaining fair market value of such a block, it is not necessary to postulate a hypothetical sale of the entire block on the day of death or on the preceding business day if the death occurs on a non-trading day. It is enough in such cases to postulate a decision to sell by the most convenient means and, if the most convenient means is to sell gradually, to estimate fair market value as of the day of death, having in mind that it would take a while to dispose of the lot. Given a consistent market in the sense of a market that is not "the effect of a transient boom or a sudden panic" or that is "not spasmodic or ephemeral", to adopt the terms used by Migneault, J in the *Untermyer* case, the stock market is the best evidence of fair market value.

17 It was argued that, to be a consistent market, the market in the stock in question must exhibit stable prices, prices with only minor variations, over a significant period within which the date of death falls. In my view, however, for the purpose of using the market as a test of fair market value, price stability, at least in the sense argued, is not essential. The stock market may be a consistent market, though prices of the stock in question vary fairly substantially, if the market is not significantly out of line with market patterns for the type of stock.

18 The learned trial judge analyzed the evidence concerning the consistency of the market for Campbell Chibougamau shares, and in particular evidence of an expert witness, called by the appellants, in relation to a submission that at the date of Mr Henderson's death the shares were within a phase of transient boom. He concluded his analysis by saying:

> I do not think that the words "transient boom" in the context in which they are used by Mr Mars are synonymous with these same words in the context of Mr Justice Migneault's statement. In the latter context the words "transient boom" are used in association with the words "sudden panic" as being diametric opposites. In my view the adjective "transient" as used by Mr Justice Migneault must take its meaning from the use of the words "sudden panic" and that being so it must mean a sudden or unusual circumstance not normally contemplated and which will pass away quickly.
>
> On the contrary the various stages through which a mining company passes, as were described by Mr Mars, are the usual stages through which it must pass from the very nature of things. Accordingly the prices for which shares of a mining company are traded for on the marker are the usual market fluctuations due to the economic factors through which a mining company must pass coupled with other factors which habitually affect the price at which shares in mining companies are traded.

> There was extensive trading in the shares of Campbell Chibougamau both before and after the death of Mr Henderson. In 1955, 2,214,200 shares were traded, in 1956, 2,803,667, in 1957, 2,596,405 and in 1958, 3,529,733.
>
> In November and December 1956 and January 1957, the three months prior to Mr Henderson's death, some 600,000 shares were traded at prices averaging out to $13.78 per share and in the three months following his death, that is February, March and April 1957 500,000 shares were traded at prices averaging out to $11.45 per share. Over this six-month period there was an element of consistency present which, in my view, makes the market price the best guide to the fair market value.

19 The learned trial judge expressed the opinion that the appellants had not discharged the onus cast on them to rebut the presumption that the market price, in a case of this kind, is the best guide to fair market value and, with respect, I agree. In so far as consistency is concerned, the market seems to have been a consistent one, at least in the sense I have indicated above.

20 Price stability may, however, have significance for a somewhat different purpose. When it comes to fixing fair market value of shares which, as in this case, would reasonably be disposed of over a period of time, consideration need not be given to discounting the stock market price at the date of death if the price is not tending to vary, except possibly for inconvenience, extra costs, and the fact that cash is not at once realizable. If, however, price has exhibited some variation, it may be appropriate to discount with this in mind. In this case, for example, the assessment of the fair market value at $8 per share rather than at the market price of $10.78 the day before death might well be justified on this basis. At any rate, there is no complaint made that the assessment was too low. I would conclude that the assessment must stand, absent a showing by the appellants that, for some reason other than inconsistency of the stock market, the Minister proceeded on an improper basis. I would only add that the finding of the trial judge that it would be reasonable to dispose of the shares by feeding them on the market gradually was in my view supported by the evidence. It is significant that attempts were made by the executors to sell the shares in a block to several different mining companies, and that these attempts failed. There was evidence that a mining company would probably not be interested in acquiring so large a block of shares in another mining corporation at the stage of development that Campbell Chibougamau had reached by that time.

21 It was also submitted, however, that the stock market price at death was not acceptable evidence of the fair market value because information available to the market was far from accurate, and therefore that the market was unfair. Particular reliance was placed on the submission that the most recent estimates of ore reserves of the corporation prior to Mr Henderson's death were estimates given by Mr Henderson himself at the annual meeting in the fall of 1956 and that these estimates were exaggerated with respect of tonnage and grade. Reliance was also placed on the submission that earlier in 1956 and during 1955 reports were issued by brokerage houses which were inaccurate.

22 The learned trial judge weighed the evidence in relation to these submissions, as well as in relation to a submission that the annual profits of the corporation had been overstated, and concluded in effect that the evidence was not such as to destroy the stock market price as the best evidence of fair market value. Considering the evidence as a whole in relation to these submissions, I see no reason for disagreeing with this conclusion.

23 There was a further submission that the stock market price was not a reliable guide because stock market prices had reached high levels during 1955 and 1956 as a result of market manipulation by Mr Henderson. This submission was not pressed in argument before us. Clearly it was not established.

24 Reference should also be made to the so-called Henderson ore body and to its effect on the valuation of the shares. In his reasons for judgment, the learned trial judge stated that

> Campbell Chibougamau recognized that a mining company possessed of only one ore body can expect that that ore body will be depleted and accordingly it was engaged actively in other exploration. There was a copper property in Mexico and current exploration of another ore body which became the Henderson Mine and entered into the production stage in 1960.

The activities of Campbell Chibougamau in relation to the exploration that resulted in the Henderson Mine are set out in paragraphs 18 to 21 of the agreed statement of facts. The learned trial judge found that

> ... the results of diamond drilling ... were known shortly prior to Mr Henderson's death and sufficient information was then available to justify an optimistic estimate of that discovery.

The appellants submitted that the trial judge erred in so finding and that accordingly he erred in finding that information about the results of the drilling could have had an effect upon the ascertainment of the fair market value of the shares at the date of Mr Henderson's death. There was, however, evidence to support the finding, particularly in the evidence of Mr Hudson, but also in paragraph 19 of the agreed statement of facts. Even, however, if there were not, it remains true that the burden was on the appellants to upset the assessment and there was nothing to indicate that, in valuing the shares at $8 per share, the Minister had in mind availability or otherwise to the market of information on the exploratory drilling that resulted in the Henderson Mine.

25 For the reasons I have stated, I would dismiss the appeal with costs.

Respondent's Cross-Appeal

26 As indicated in the agreed statement of facts, at the date of his death Mr Henderson owned 56,234 warrants to purchase Campbell Chibougamau shares at $4 per share. The parties agreed that these share purchase warrants were in the form of a certificate that was agreed upon and entered in evidence. They also agreed that the certificates were physically located in the State of New York at the date of Mr Henderson's death. In assessing succession duties against the Henderson Estate, the Minister included the warrants in the assessment and valued them at $4 per warrant. The learned trial judge allowed the appeal of the executors in respect of this part of the assessment on the ground that the warrants did not have their situs in Canada. The Minister cross-appealed.

27 Paragraph 6(1)(b) of the *Dominion Succession Duty Act* provides:

> 6. (1) Subject to the exemptions mentioned in section 7, there shall be assessed, levied and paid at the rates provided for in the First Schedule duties upon or in respect of the following successions, that is to say,
>
> > (b) where the deceased was at the time of his death domiciled outside of Canada, upon or in respect of the succession to all property situated in Canada.

28 As was noted above, the applicable Convention between Canada and the United States for the avoidance of double taxation in the case of succession duties deems shares in a company to be situated at the place where the company is incorporated. There was thus no question that the Campbell Chibougamau shares were situated in Canada. The Minister, before us, relied on this Convention in support of his submission that the warrants also had their situs in Canada. I quote the relevant provision of the Convention: [5]

ARTICLE II

> Where a person dies a citizen of the United States of America or domiciled in the United States of America or Canada, the situs of any rights or interest, legal or equitable, in or over any of the following classes of property, which for the purposes of tax form or are deemed to form part of the estate of such person or pass or are deemed to pass on his death, shall, for the purposes of the imposition of tax, and for the purposes of the credit to be allowed under Article V, be determined exclusively in accordance with the following rules, but in cases not within such rules the situs of such rights or interests shall be determined for these purposes in accordance with the laws in force in the other contracting State:
>
> > (f) Shares, stock, bonds, debentures or debenture stock in a company (including any such property held by a nominee, whether the beneficial ownership is evidenced by scrip certificates or otherwise) shall be deemed to be situated at the place where the company is incorporated;

29 Specifically, reliance was placed on the words "... the situs of any rights or interest, legal or equitable, in or over ... shares ... shall be deemed to be situated at the place where the company is incorporated". It was submitted that the share purchase warrants were rights or interests, legal or equitable, in or over Campbell Chibougamau shares, and that Campbell Chibougamau was a company incorporated in Quebec; thus it was submitted that the warrants were situated in Canada.

30 The learned trial judge carefully considered the nature of rights involved in share purchase warrants of the kind involved in this case, and in so doing distinguished a share purchase warrant from a share warrant. He said:

> The basic difference between a share warrant and a share purchase warrant is that in a share warrant share capital has actually been issued and funds acquired by the Company, instead of a share certificate the holder gets a share warrant, whereas on a share purchase warrant no capital shares have been issued by the Company.

In respect of the share purchase warrants owned by the deceased, the trial judge stated:

> It is unquestionably a share purchase warrant as described above rather than a share warrant in that it entitles the bearer to purchase a specified number of shares of the par value of $1 each in Campbell Chibougamau for $4 per share, to be exercised by presentation of the share purchase warrant together with a certified cheque in payment of the subscription price to the Company's transfer agent at Montreal, PQ on or before December 1, 1960. It is specifically stated in the conditions attaching to the warrant that title to the warrant shall pass by delivery. The warrant is signed by the Company by its president and is countersigned by the transfer agent.

The learned trial judge said this:

> The right which the share purchase warrants in the present appeal bestow in the holder thereof is the right to subscribe for shares in accordance with the terms of the warrant whereas the Company on its part warrants that such shares will be available from its authorized capital when application is made. However until subscription and allotment is made and communicated to the subscriber no shares come into existence. That being so the share purchase warrant does not confer rights on its holder in or over shares but only the right to have shares issued. It is a right in itself and property in itself.

31 I agree that the share purchase warrants were not "rights or interest, legal or equitable, in or over" shares of Campbell Chibougamau; in relation to the warrants there were no shares in being. Whatever may be the precise moment of creation of shares in a corporation, it had certainly not been reached in this case in respect of any rights conferred by the warrants owned by the deceased. Thus, the share purchase warrants do not fall within the words of Schedule B, Article II invoked in support of the cross-appeal.

32 I would dismiss the cross-appeal with costs.

Footnotes

1 *Dominion Succession Duty Act*, para 6(1)(b).

2 Schedule B, Article II(f) to *An Act to Amend the Canada-United States of America Tax Convention Act*, 1943, and the *Canada-United States of America Tax Convention Act*, 1944, SC 1950, c 27. See also *Dominion Succession Duty Act*, subsection 6(2).

3 *Dominion Succession Duty Act*, section 10.

4 Ibid, section 11. See Schedule B to *An Act to Amend the Canada-United States of America Tax Convention Act*, 1943, and the *Canada-United States of America Tax Convention Act*, 1944, SC 1950, c 27, particularly Article IV.

5 Schedule B, Article II(f) to *An Act to Amend the Canada-United States of America Tax Convention Act*, 1943, and the *Canada-United States of America Taxation Act*, 1944, SC 1950, c 27.

TAB “I”

2018 BCSC 1859
British Columbia Supreme Court

Cirius Messaging Inc. v. Epstein Enterprises Inc.

2018 CarswellBC 2825, 2018 BCSC 1859, 152 W.C.B. (2d) 56, 16 B.C.L.R. (6th) 380, 300 A.C.W.S. (3d) 542

Cirius Messaging Inc. (Plaintiff) and Epstein Enterprises Inc. (Defendant)

Voith J.

Heard: June 18-27, 2018
Judgment: October 26, 2018
Docket: Vancouver S156019

Counsel: D.B. Kirkham, Q.C., for Plaintiff
J. McArthur, P. Bychawski, for Defendant

Related Abridgment Classifications
Criminal law
XIV Offences against rights of property
XIV.3 Criminal interest rate
Headnote
Criminal law --- Offences against rights of property — Criminal interest rate
Plaintiff was start-up technology company — Defendant advanced credit to plaintiff under convertible loan agreement that provided for conversion of principal amount of credit advanced by defendant into plaintiff's shares upon certain terms and conditions — Parties signed agreement under which non-transferable warrants were issued to defendant in order to acquire shares in plaintiff — Plaintiff brought action for damages on basis that transaction offended s. 347 of Criminal Code — Action dismissed — Plaintiff's issuance of converted shares or disputed warrants did not offend s. 347 of Code — Converted shares and disputed warrants were not charge or expense that was paid by plaintiff or that was paid by shareholders of plaintiff and as result, they did not fall within definition of interest in s. 347 — Loans of company were undertaken by company on its own behalf and shareholders did not incur expense on behalf of company when company issued shares or warrants in connection with its borrowings — Though it was "effective annual rate of interest" that was to be "calculated" and not inputs or components that go into that calculation, it made little sense to ascribe and require great precision in final result that was calculated if components of calculation were imprecise or were approximations or estimates — It was clear that process relied on in this case, of having court first determine value for converted shares and disputed warrants before any "calculation" was undertaken under s. 347 of Code, was inconsistent with intended structure of ss. 347(4)-(6) of Code.
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Generally — referred to

s. 347 — considered

s. 347(1) — considered

s. 347(1)(a) — considered

s. 347(1)(b) — considered

s. 347(2) "criminal rate" — considered

s. 347(2) "credit advanced" — considered

s. 347(2) "interest" — considered

s. 347(3) — considered

s. 347(4) — considered

s. 347(4)-347(6) — referred to

s. 347(5) — considered

s. 347(6) — considered

Small Loans Act, R.S.C. 1970, c. S-11

Generally — referred to

s. 3 — considered

Words and phrases considered:

Charge

The ordinary definitions of the terms "charge" and "expense" implied a claim for the payment of money by an obligor to an obligee; i.e., an obligation to repay a debt.

***Voith J.*:**

Introduction

1 The plaintiff, Cirius Messaging Inc. ("Cirius"), argues that various transactions it entered into with the defendant, Epstein Enterprises Inc. ("Epstein"), on July 23, 2013 offend s. 347 of the *Criminal Code*, R.S.C. 1985, c. C-46 ("*Criminal Code*"). Section 347 addresses criminal interest rates.

2 On July 23, 2013, Epstein advanced credit to Cirius under a convertible loan agreement (the "CLA") that provided, *inter alia*, for the conversion of the principal amount of the credit advanced by Epstein into shares of Cirius upon certain terms and conditions. On that same date, the parties signed an Advisory Services Agreement that was dated April 1, 2013 (the "ASA"), under which 2,080,000 $0.01 non-transferable warrants were issued to Epstein to acquire shares in Cirius (the "Disputed Warrants").

3 Each party raised numerous issues and sub-issues. I consider that the central issues raised in this action are:

a) whether the ASA was a sham and whether the Disputed Warrants were, in fact, issued on account of the loan that Epstein was making to Cirius; and

b) if so, whether the Disputed Warrants and/or the conversion rights that were granted to Epstein under the CLA constitute a "charge or expense", that was "paid or payable", "by or on behalf" of Cirius within the definition of "interest" in s. 347 of the *Criminal Code*.

General Facts and Background

4 Many of the facts that underlie this action are not in issue. I have described these general and uncontested facts first, and I have subsequently addressed additional evidence in relation to the issues where that evidence is most pertinent.

5 Cirius is a start-up technology company that was created in 2005. Cirius had various names over time, one of those names being EMAIL2 SCP SOLUTIONS INC. That name appears on a number of relevant emails and agreements. Cirius was engaged in developing and providing secure email and messaging services to various entities. It struggled financially from the time of its formation through to and after July 2013.

6 Epstein is an investment company that is based in Ontario.

7 The relationship between Cirius, or its predecessor companies, and Epstein commenced in 2007. The precise details of the various transactions and agreements that the parties entered into between 2007 and 2015 are described in a detailed Agreed Statement of Facts. Several matters that arise from those earlier transactions are relevant:

a) Epstein was granted various warrants in connection with the loans it made to Cirius in 2007 and 2009, which it chose not to exercise. Epstein was also granted various options to purchase common shares in Cirius in 2009 that it similarly did not exercise before those options were terminated.

b) In December 2009 or early 2010, Cirius repaid the amounts that it had borrowed from Epstein in 2007 and 2009. A 2007 General Security Agreement that Cirius had granted Epstein was discharged on March 5, 2010. The two entities had

no outstanding commercial relationship until February 2011 when Cirius again approached Epstein for a further loan. One aspect of that 2011 loan gave Epstein 750,000 warrants to purchase up to 750,000 common shares in Cirius that were exercisable at $0.01 and that were to expire on February 14, 2021. Those 2011 warrants have not yet been exercised. Epstein subsequently agreed to forbear on certain of its rights under its 2011 loan and, when the 2011 loan was amended, Epstein was granted a further 25,000 warrants to purchase 25,000 common shares in Cirius exercisable at $0.01 and expiring on August 31, 2021. Those further warrants have not been exercised.

8 Epstein and Cirius entered into a loan agreement dated December 17, 2012 (the "2012 Loan Agreement"), under which Epstein granted Cirius a demand loan of $250,000. At the same time, Cirius granted Epstein 325,000 warrants to purchase up to 325,000 common shares in Cirius exercisable at $0.01 and expiring on December 17, 2022. Those warrants have not been exercised.

9 As of July 2013, the $250,000 that Cirius owed under the 2012 Loan Agreement remained unpaid.

10 In July 2013, Epstein and Cirius entered into the CLA, pursuant to which the parties agreed that:

a) Epstein would grant Cirius a convertible loan of up to $400,000 with a term of 730 days and a regular interest rate of prime plus 6% per annum, calculated monthly, and payable in arrears on the last British Columbia business day of each calendar quarter;

b) the $250,000 owed under the 2012 Loan Agreement would be rolled into the CLA and would be subject to the terms of the CLA;

c) under the terms of the CLA, an automatic conversion of a minimum of $250,000 of the funds advanced under the CLA into common shares in Cirius would occur if Cirius received further common share subscriptions in the minimum amount of $1 million (the "Automatic Conversion"). That $1 million figure was exclusive of the $250,000 amount and it was exclusive of a $150,000 amount that was to be advanced by what was known as the B&T Group. I will return to the B&T Group later in these reasons for judgment; and

d) subject to the terms of the CLA, Epstein would have an option to convert the balance of whatever amount of the $400,000 was advanced under the CLA into common shares in Cirius (the "Optional Conversion").

11 I have referred to the Automatic Conversion and the Optional Conversion collectively as the "Conversion Rights". I have referred to the shares that were converted by Epstein under the Conversion Rights as the "Converted Shares".

12 Concurrently with the CLA, Epstein and Cirius signed the ASA and Cirius issued Warrant No. 012 granting Epstein the Disputed Warrants. The Disputed Warrants expire on April 1, 2023.

13 Epstein made the following advances under the CLA:

a) $100,000 on July 23, 2013;

b) $100,000 on August 6, 2013;

c) $100,000 on August 28, 2013; and

d) $100,000 on February 26, 2015.

14 The Automatic Conversion occurred on December 1, 2014.

15 The Optional Conversion of $400,000 occurred on May 4, 2015.

16 Schedule "I" to the Agreed Statement of Facts reflects the interest that accrued and that Cirius paid on both the $250,000 that was first advanced under the 2012 Loan Agreement and the $400,000 that was advanced, over time, under the CLA.

17 On July 31, 2015, Epstein provided Cirius with a Release and Discharge of Security confirming that the $400,000 loan amount had been converted into common shares in Cirius, and that all interest accrued and payable pursuant to the terms of the CLA had been repaid to Epstein.

18 This action was commenced on August 13, 2015.

19 Epstein has not, to date, exercised the Disputed Warrants.

Credibility

20 This case overwhelmingly turns on questions or principle rather than on issues of credibility. With that said, I consider that the various lay witnesses who gave evidence were generally credible. There are, however, a few qualifications to this.

21 First, I consider that Mr. LeVasseur, the founder and President of Cirius, unfairly sought to portray Epstein's commercial behaviours as predatory. He said, for example, that Cirius was held "hostage" by Epstein. I do not consider that such descriptions are fair or accurate. There is no doubt that Epstein sought to look out for its own commercial interests. The reality is, however, that Epstein endeavored to assist Cirius in multiple respects over several years. The further reality is that Cirius was free to deal with anyone it wanted to. It was Cirius that again turned to Epstein in 2011 when it needed further funds, after it had repaid the amounts it had borrowed earlier. Still further, Cirius' financial viability was often precarious and uncertain. The objective and contemporaneous record, a limited portion of which I will refer to, indicates that in the context of these commercial realities, Cirius generally considered that Epstein's commercial terms were fair. This extends to the July 2013 transactions that are at issue in this case.

22 The second general area where I do not accept the evidence of Mr. LeVasseur and of Mr. Cytrynbaum, an advisor to Cirius who also sat on its Board, is in relation to the fortunes of Cirius at different times and, in particular, in July 2013. I consider that both gentlemen sought to portray those fortunes as more positive and more certain than the objective evidence suggests. In particular, they sought to portray the certainty that Cirius would enter into a commercial transaction with a company called Open Text Corporation in terms that are more optimistic than the record before me suggests.

Section 347 of the Criminal Code

23 The relevant parts of s. 347 of the *Criminal Code* provide:

> 347 (1) Despite any other Act of Parliament, every one who enters into an agreement or arrangement to receive interest at a criminal rate, or receives a payment or partial payment of interest at a criminal rate, is
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> (a) guilty of an indictable offence and liable to imprisonment for a term not exceeding five years; or
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> (b) guilty of an offence punishable on summary conviction and liable to a fine not exceeding $25,000 or to imprisonment for a term not exceeding six months or to both.

Definitions

(2) In this section,

credit advanced means the aggregate of the money and the monetary value of any goods, services or benefits actually advanced or to be advanced under an agreement or arrangement minus the aggregate of any required deposit balance and any fee, fine, penalty, commission and other similar charge or expense directly or indirectly incurred under the original or any collateral agreement or arrangement;

criminal rate means an effective annual rate of interest calculated in accordance with generally accepted actuarial practices and principles that exceeds sixty per cent on the credit advanced under an agreement or arrangement;

. . .

interest means the aggregate of all charges and expenses, whether in the form of a fee, fine, penalty, commission or other similar charge or expense or in any other form, paid or payable for the advancing of credit under an agreement or arrangement, by or on behalf of the person to whom the credit is or is to be advanced, irrespective of the person to whom any such charges and expenses are or are to be paid or payable, but does not include any repayment of credit advanced or any insurance charge, official fee, overdraft charge, required deposit balance or, in the case of a mortgage transaction, any amount required to be paid on account of property taxes;

. . . ..

Presumption

(3) Where a person receives a payment or partial payment of interest at a criminal rate, he shall, in the absence of evidence to the contrary, be deemed to have knowledge of the nature of the payment and that it was received at a criminal rate.

Proof of effective annual rate

(4) In any proceedings under this section, a certificate of a Fellow of the Canadian Institute of Actuaries stating that he has calculated the effective annual rate of interest on any credit advanced under an agreement or arrangement and setting out the calculations and the information on which they are based is, in the absence of evidence to the contrary, proof of the effective annual rate without proof of the signature or official character of the person appearing to have signed the certificate.

Notice

(5) A certificate referred to in subsection (4) shall not be received in evidence unless the party intending to produce it has given to the accused or defendant reasonable notice of that intention together with a copy of the certificate.

Cross-examination with leave

(6) An accused or a defendant against whom a certificate referred to in subsection (4) is produced may, with leave of the court, require the attendance of the actuary for the purposes of cross-examination.

. . . .

24 It is noteworthy that s. 347(1) was structured differently prior to Parliament's 2007 amendment. That earlier language provided:

> 347 (1) Notwithstanding any Act of Parliament, every one who
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> > (a) enters into an agreement or arrangement to receive interest at a criminal rate, or
> >
> > (b) receives a payment or partial payment of interest at a criminal rate,
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> > is guilty of
> >
> > > (c) an indictable offence and is liable to imprisonment for a term not exceeding five years, or
> > >
> > > (d) an offence punishable on summary conviction and is liable to a fine not exceeding twenty-five thousand dollars or to imprisonment for a term not exceeding six months or to both.

25 This earlier language is only pertinent because several leading authorities, that I will discuss shortly, refer to the offences set out in the former s. 347(1)(a) and (b). The case law which follows the amended s. 347(1) confirms that no substantive change ensued from these amendments: see *Smith Estate v. National Money Mart Co.*. ([2008] O.J. No. 2248 (Ont. S.C.J.)) at para. 324

aff'd at 2008 ONCA 746 (Ont. C.A.); *Fawcett v. Western Canadian Coal Corp.*, 2009 BCSC 446 (B.C. S.C. [In Chambers]) at paras. 52 and 54, rev'd on appeal at 2010 BCCA 70 (B.C. C.A.) but not on this point; see para. 24 of the appeal decision.

Issue I: The ASA — A Sham?

26 "Credit advanced" in s. 347(2) of the *Criminal Code* "means the aggregate of the money and the monetary value of any goods, *services* or benefits actually advanced or to be advanced under an agreement or arrangement . . . " (underlining added).

27 Though counsel for Cirius argued that even if the ASA was a *bona fide* agreement for the provision of advisory "services", it might still offend s. 347(2) of the *Criminal Code*, I did not understand this position to be seriously advanced. Furthermore, on account of the conclusions I have reached in relation to the ASA, I do not consider that I need to address this issue. The primary position advanced by Cirius is that the ASA had nothing to do with Epstein providing advisory services to Cirius, that the agreement was a sham and that the true purpose or reason Epstein was granted the Disputed Warrants was as a further inducement for the loans Epstein made to Cirius under the CLA. The question of whether the ASA was a sham transaction raises various legal and factual issues.

a) The Legal Positions of the Parties

28 Epstein argues that the ASA was a legally binding document that was enforceable against either party according to its terms. It argues that the various forms of parol evidence that Cirius seeks to rely on, and that largely arise from the negotiations of the parties, are inadmissible. It further argues that prior draft agreements, and other evidence of the negotiations between the parties that led to a final agreement, are not proper factual matrix evidence and may not be considered as part of the interpretive process: *Geoff R. Hall, Canadian Contractual Interpretation Law*, 2d ed. (Markham, Ontario: LexisNexis Canada Inc., 2012) at 3.1.1.

29 Accordingly, "factual matrix" or evidence of the "surrounding circumstances" should only consist of objective evidence of the background facts. For this reason, the opinion of one of the negotiating parties to a contract, about why something was included in that contract, is not admissible evidence of context. Furthermore, evidence of the subjective intentions of the parties is inadmissible for the purposes of contractual interpretation; *British Columbia (Technology, Innovation and Citizens' Services) v. Columbus Real Estate Inc.*, 2017 BCSC 940 (B.C. S.C.) at paras. 127 — 135, citing *Creston Moly Corp. v. Sattva Capital Corp.*, 2014 SCC 53 (S.C.C.). See also *Black Swan Gold Mines Ltd. v. Goldbelt Resources Ltd.* (1996), 25 B.C.L.R. (3d) 285 (B.C. C.A.) at para. 17.

30 Cirius, in turn, argues that parol evidence is admissible to show that the ASA was a sham and that it did not reflect the intentions of either of the parties. If the ASA was a sham, the court is required to determine the terms of the agreement that was made between the parties and it can look to the whole of the evidence in doing so.

31 In aid of these submissions, Cirius relies on *Bryce v. Golam* (1996), 3 R.P.R. (3d) 98 (B.C. C.A.). In that case, the appellant challenged the trial judge's conclusion that neither party had intended a listing agreement to become a binding agreement according to its terms. Williams J.A., in upholding the findings of the trial judge, said:

> 32. In *The Law of Contract*, 9th ed. (London: Sweet & Maxwell, 1995), Trietel states the following, at p.179:
>
> > (b) VALIDITY. The [parol evidence] rule only prevents a party from relying on extrinsic evidence as to the contents of the contact, and not as to its validity. Such evidence can therefore be used to establish the presence or absence of consideration or contractual intention, or some invalidating cause such as incapacity, misrepresentation, mistake or non est factum. Evidence has similarly been held admissible to show that provisions in an agreement purporting to be a licence to occupy a room (as opposed to a lease of it) were a "mere sham" in that they had failed to state the parties' true intention and had been inserted simply in an intent to evade the Rent Act.
>
> 33. The author of Phipson on *Evidence*, (12th ed.), writes at p.804:

> Extrinsic evidence is admissible to prove any matter which by substantive law affects the validity of the document, or entitles a party to any relief in respect thereof, notwithstanding that such evidence tends to vary, add to or, in some cases, contradict the writing . . .

34. In *Kelly v. Sayle* (1914), 15 D.L.R. 776 (B.C.C.A.), one Mr. Dick advanced money to Mr. Sayle in order to buy out Mr. Sayle's former business partner. Mr. Dick and Mr. Sayle then drew up a partnership agreement purporting to be signed, sealed and delivered. The business failed and Mr. Dick claimed the money advanced as a creditor, even though the advance was treated in the partnership agreement as a contribution to capital. The trial judge, whose decision was supported by the Court of Appeal, found that the document was merely executed for the purpose of enabling future executors of Mr. Dick's estate to prove Mr. Sayle was indebted to Mr. Dick. The courts' reasoning was:

> The non-existence of a partnership in fact may be proved by oral testimony in the face of a partnership agreement, and where a trial judge accepts as true the harmonious evidence of the only two persons who knew the facts and who signed the partnership agreement and thereupon found the written agreement to have been in fact merely contingent although on its face absolute, the finding will not on appeal be disturbed.

35. Here, the trial judge found that neither party intended the multiple listing contract to become a binding agreement and, accordingly, the parol evidence rule does not apply in this case since the extrinsic evidence was not adduced for the purpose of altering, varying or contradicting the terms of the listing agreement but, rather, for the purpose of challenging the validity thereof.

36. In my opinion the extrinsic evidence was properly admitted. The trial judge's finding that neither party intended the multiple listing contract to become binding is one which should be respected by this Court.

32 More recently, in *Luu v. Wang*, 2011 BCSC 1078 (B.C. S.C.), Justice Pearlman relying in part on *Bryce*, concluded that extrinsic evidence was admissible to determine both whether a settlement agreement made between the parties was a sham and in order to determine the true agreement between the parties; at paras. 103, 105 — 107. He considered the evidence that the defendants tendered in support of their position that the agreement in question was a sham and he ultimately rejected that position; at paras. 108 — 135.

b) The Relevant Evidence

33 The negotiations that culminated in the CLA and the ASA began in March 2013 and concluded on July 23, 2013 with the execution of these two agreements.

34 Mr. Levi, the President of Epstein, sought to justify or support the issuance of the Disputed Warrants, under the ASA or otherwise, with reference to three factors:

> i) the past advisory services that Epstein had provided to Cirius;
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> ii) the future advisory services that Epstein intended to provide Cirius; and
>
> iii) the fact that Epstein was agreeing, under the automatic conversion provisions of the CLA, to acquire, for the first time, shares in Cirius.

35 In relation to the issue of past advisory services, Mr. Levi testified that Epstein had, over the years, provided Cirius with different types of assistance and advice. This included, for example:

> a) reviewing agreements being negotiated or entered into by Cirius, including licensing agreements, reseller agreements, commission structures with sales personnel, and employee contracts;

b) assisting with the review of Cirius' cash flows, financial statements, internal accounting, and tax returns, particularly in connection with Cirius' applications for tax credits under the Scientific Research and Experimental Development Tax Incentive Program;

c) providing general assistance with financial matters such as the review of acquisition offers and financing term sheets;

d) promoting Cirius' product to Epstein's contacts, including the Law Society of Upper Canada and others;

e) assisting Cirius with making introductions to potential investors and business partners; and

f) advising Cirius on strategic and business matters generally.

36 Mr. Levi testified that between 2007 and 2013 he spoke to Mr. LeVasseur, as regularly as once or twice a week. He estimated that, on average, he and others within Epstein spent 75 to 100 hours per year advising and assisting Cirius in this early stage of its business.

37 In addition, Mr. Levi said, and the evidence indicates that, when Mr. Cytrynbaum began to assist Cirius in a variety of capacities in 2012, Cirius proposed paying Mr. Cytrynbaum for these various services, including his advisory services, with, *inter alia*, warrants. Mr. Levi believed that this was unfair and he communicated these views to Mr. LeVasseur.

38 Mr. LeVasseur sought to downplay the range and value of the services that Epstein provided to Cirius saying, for example, that when he spoke to Mr. Levi he would merely be reporting on the status of matters, as he was required to, or that he was being "polite".

39 I do not accept that evidence. Mr. LeVasseur, by his own admission, lacked many of the administrative and business skills that were necessary to get Cirius off the ground. He described himself as an "inventor" and not a "financier or lawyer". Until Mr. Cytrynbaum appeared and was able to assist in these capacities, it was Mr. Levi, or others within Epstein, who often performed these functions.

40 This conclusion is also consistent with other objective evidence. Epstein did, for example, introduce Cirius to potential investors. Furthermore, Mr. Levi was described by Cirius, in an information sheet that was sent to investors, as being on the "Advisory Board" of Cirius. Thus, I am satisfied that Mr. LeVasseur, on behalf of Cirius, regularly looked to Mr. Levi, and to others within Epstein, for various forms of assistance, advice and guidance.

41 As it relates to future advisory services, other evidence is relevant. On March 13, 2013, when the parties began their discussions and negotiations concerning a new or further financing arrangement, Mr. LeVasseur wrote to Mr. Levi and to Mr. Cytrynbaum in relation to a potential financing arrangement between Epstein and Cirius on the following terms:

MC & Oded

Please approve below and I will circulate to shareholders for approval:

DEAL:

EEI to lend to Email2 $300,000 in secured lending at prime plus 6% for 12 months.

EEI to receive 1.5M advisor $0.01 10 year warrants. These warrants cover advisory services describe below.

EEI commits to convert the $300,000 loan into equity/convertible debt raise at agreed upon terms once $1.2M of additional funding is subscribed.

Currently proposed to be 9% 36 month convertible loan at $0.32.

EEI understands the risky nature of the investment.

Interest is to be paid monthly.

GSA on assets until round is closed.

Default interest is prime plus 15%.

EEI is not willing to share the deal (e.g. 5% equity is a minimum required to proceed).

ADVISORY SERVICES (may include but not limited to):

EEI to help with the full raise with introductions and DD on behalf of the company.

EEI to act as CFO (Oded) and join board when created (TBA).

EEI to help as an investor and financial backer for certain deals (E.G. Ontario Gov).

Please find attached the updated cap table with both of your 5% now pro-rated. MC, you are adjusted to 1,500,000 from previously 1,375,000. [. . .]

42 Various aspects of this email are important. First, the email contemplates that Epstein is to provide Cirius with various advisory services and that it is to receive 1.5 million $0.01 10 year warrants for these services. This component of the transaction equated to Epstein receiving approximately a 5% equity interest in Cirius. Second, several other broad terms of the deal, a $300,000 loan at prime plus 6% and a commitment to convert that $300,000 loan into "equity/convertible debt" at $0.32 once an additional $1.2 million of additional funding was subscribed for, remained largely consistent throughout the parties' negotiations. In the CLA, as I have said, the parties agreed to a new loan for $400,000 with an interest rate of 6.5% over prime and an option to convert that loan into equity at $0.32 once Cirius had raised a further $1 million. Finally, I consider it relevant that Mr. LeVasseur emphasized that Epstein "understands the risky nature of the transaction".

43 After further discussions with Mr. Cytrynbaum, Mr. LeVasseur sent out a further email to several shareholders describing the terms of the proposed financing:

Epstein Enterprises offered to help [outlined in the deal below] They are willing to loan the required amount, plus commit to some advisory services that will be essential going forward. The offer below has already been negotiated and offer little room for adjustment. It may seem expensive on the surface, but after careful deliberations, I am OK with it. The loan also serves as our "lead" in our round of financing where Epstein is willing to convert to the terms outlined in the Term Sheet if we subscribe to another $1.2M.

In short: bridge loan in place by end of next week, lead investment from existing investor sets the tone of the round, and help with the Ontario Gov financial audit makes it a pretty favourable deal for all of us.

44 Had negotiations ended at that point, there would be a sound basis for concluding that the ASA and the terms within it, that provided Epstein with the Disputed Warrants, were at least, in part, on account of Epstein providing Cirius with various future advisory services. Certainly, there would be little reason to suggest that the ASA was a "sham" or that it did not properly reflect the intentions of the parties.

45 The reality is that while several central terms of the transaction, proposed in March, ultimately made their way into the CLA, the transaction, as it related to the provision of "advisory services", was fundamentally altered. The following pieces of evidence, individually and in combination, support that conclusion:

i) From May to July 10, 2013, there was no discussion between the parties about Epstein providing Cirius with advisory services. This is true with respect to future advisory services. It is also true in relation to any compensation for past services.

This conclusion is consistent with the evidence of Mr. LeVasseur and with the admissions that were made by Mr. Levi at both his examination for discovery and at trial. It is significant that the ASA itself says nothing about compensation or payment for past advisory services.

ii) From May to July 10, 2013, the parties prepared six different drafts of the CLA. Each of these drafts included a recital that had been prepared by Epstein and that stated:

> "And whereas, as inducements to the creditor to grant such requests, the debtor has offered to grant to the creditor 2,080,000 warrants at $.01 per common shares based on 32,000,000 fully diluted shares."

iii) The number of Disputed Warrants issued to Epstein was equivalent to 1% of the fully diluted shares of Cirius for each $100,000 of the loan amount. Thus, under the CLA, Epstein was prepared to advance Cirius $400,000 of new money, and it agreed, conditionally, to extend the existing $250,000 loan it had made to Cirius in 2012. The agreement was that Epstein would receive 6.5% of Cirius' fully diluted share capital in return. 6.5% of 32 million fully diluted shares, that being the share capital of Cirius, produces 2,080,000 warrants.

> The foregoing calculation, based on 1% of the fully diluted shares of Cirius for each $100,000 that Epstein advanced to Cirius, strongly suggests that the Disputed Warrants were directly tied to the $650,000 loan.

iv) Messrs. Cytrynbaum and LeVasseur apparently became concerned that other potential investors who saw the terms of the Epstein loan and, in particular, saw that Epstein was to receive the Disputed Warrants, might seek similar terms. This might then impede the ability of Cirius to raise capital in the future. On July 11, 2013, Mr. LeVasseur sent Mr. Cytrynbaum an email that states, in part: " . . . Decoupled the bonus from the loan and use your advisory agreement for Epstein so the next investor does not tie the loan to the bonus (e.g. it will be for advisory services, same as you)". On July 11, 2013 the parties agreed that the "current warrant issue of 2,080,000 to Epstein Enterprises Inc . . . . . will be covered in a separate consulting agreement . . . .. similar to the Cytrynbaum agreement."

v) The parties entered into the ASA a few days later. In his cross-examination, Mr. Levi accepted that there was never any further discussion of Epstein providing future advisory services to Cirius or of Epstein receiving compensation for past advisory services. He further accepted that Cirius never requested any advisory services from Epstein after the ASA was executed.

vi) Epstein, in a subsequent exchange of correspondence with Cirius, insisted that the Disputed Warrants vest immediately rather than over the three year term of the ASA. If the Disputed Warrants were truly being paid on account of advisory services, one might reasonably expect the Disputed Warrants to vest over time. This is, in fact, how Mr. Cytrynbaum received his warrants under the separate Advisory Services Agreement that his company had entered into with Cirius, and under which it is clear that he did provide ongoing advisory services.

vii) In March 2014, Cirius again requested that Epstein agree to modify the ASA to provide that the Disputed Warrants would vest over three years. Mr. Levi would not agree and he responded:

> "The whole reason we did the agreement was to make it look like it was not tied to the funding and/or for past services, not future services".

This language is explicit and confirms that the purpose or object of the ASA was to "make it look like" the agreement existed independently of the loan. This was not, however, true.

c) Conclusions

46 I return to the three justifications that Mr. Levi believed supported the issuance of the Disputed Warrants to Epstein. First, although I accept that Mr. Levi had raised the issue of past advisory services with Mr. LeVasseur, he admitted, and the objective record shows, that this consideration never formed a part of the parties' negotiations from March 2013 to the date that the ASA was signed. Second, although the issue of future advisory services and the receipt by Epstein of warrants for

those services was expressly discussed early in the parties' negotiations (in March), that issue came off the table as the parties' negotiations continued. Certainly, it formed no part of the various draft CLA documents that the parties exchanged through to July 10, 2013. Mr. Levi also confirmed both of these facts in his evidence. Third, Mr. Levi admitted that the parties never expressly discussed Epstein receiving warrants on account of Epstein being prepared to commit to acquiring equity in Cirius upon certain terms and conditions.

47 The only remaining basis for the Disputed Warrants was, as the earlier drafts of the CLA had stated, as "an inducement" for the loan that Epstein was to make to Cirius. Accordingly, I consider the ASA did not represent the parties' true intentions and that its central terms were known, to both parties, to be a sham or fiction.

48 I wish to address several further matters that arise from this conclusion. First, counsel for Epstein had argued that in *Bryce*, for example, the parties had never relied on the multiple listing agreement in issue. In this case, however, the ASA had some limited terms that were relied on by both parties. Thus, the ASA contemplated that a representative of Epstein would be placed on the Board of Cirius; clauses 2.2 and 2.6. Mr. Levi did subsequently become a member of the Board of Cirius.

49 I do not consider that this circumstance alters the conclusions that I have expressed. The expressed purpose of the ASA was to have Epstein provide Cirius with the various advisory services that are described in Clause 2.1(a) to (i) and for Cirius to pay Epstein under clause 2.4, "the equity compensation set out in Schedule A" of the ASA. Schedule "A" pertains to the Disputed Warrants. That expressed purpose was not forthright and it did not align with the expectations of either party.

50 Second, I recognize the inherent unpalatability of the conclusions that I have expressed. It was Cirius, when it suited it to do so, that proposed the agreement that it now describes as a "sham" agreement. It also apparently proposed this sham transaction to either mislead other potential investors or to misrepresent to them the true state of the transaction between Cirius and Epstein, though Cirius now asserts that it never actively or directly misled anyone.

51 Ultimately, however, counsel for Epstein accepts that this lack of corporate candour on the part of Cirius, as it related to the ASA, does not ground any principled legal theory that would prevent Cirius from seeking the relief that it does in this action.

52 Finally, I should note that Cirius also entered into an "Advisory Services Agreement" with four individuals who were described at trial as the "B&T Group". These four individuals, who were referred to by Mr. LeVasseur as "either friends or relatives", were each issued 120,000 warrants in Cirius, at an exercise price of $0.01 per share. The B&T Group thereafter entered into a Tolling Agreement with Cirius after Cirius had commenced its action against Epstein. Under the terms of this Tolling Agreement, the B&T Group agreed (i) to toll any limitation period that would apply in any action that Cirius might bring and (ii) "that the B&T Warrants would be subject to adjustment to the same pro rata extent" that the Disputed Warrants might be adjusted under either a settlement between the parties or the final judgment of a court in this action.

Issue 2: Did the Terms of the CLA and/or Epstein's Receipt of the Disputed Warrants Offend Section 347 of the Criminal Code?

a) The Relevant Case Law

53 There is very little relevant judicial authority and no binding authority that has addressed the question before me. This is so over the nearly 40 years since s. 347 was first enacted. To be precise, s. 347 has been considered approximately 350 times in a commercial or civil context. It has been considered approximately 15 times in the criminal context. Both of these figures exclude appeals from trial decisions.

54 In this province, one of the only cases that has considered whether equity interests, such as shares, can constitute "interest" was *J.D.M. Capital Ltd. v. Smith* (1997), 39 B.C.L.R. (3d) 340 (B.C. S.C.), rev'd (1998), 58 B.C.L.R. (3d) 272 (B.C. C.A.). The facts in *J.D.M. Capital* are complex, but they were succinctly summarized by the Court of Appeal:

> 5. The trial judge found that the appellant J.D.M. Capital Inc. (JDM) agreed to lend $2,280,000 to Robert Atkinson to enable Mercer [a defendant] to acquire 70,000 Nalcap shares. The shares would secure the loan, which was to be repaid

within six months (later extended to eight months) with interest at prime plus 1 per cent. As well, Mercer would use its best efforts to enable JDM's related company, Fusion Capital Corporation (Fusion), to acquire treasury shares in Bison at a discount of 75.1 from book value, such that the appellants would receive tax free what they described as a "lift" of $1.666 million dollars. After paying $5 million to acquire the shares, the value of the appellants' interest in Bison would be $6.66 million, calculated with reference to the book value of the shares. Thus, the $1.666 million lift was the financial benefit anticipated by the appellants in return for making the $2.28 million loan to Mr. Atkinson as a conduit for Mercer and investing $5 million in Bison treasury shares. No issue is taken with these findings.

55 The trial judge in *J.D.M Capital* had concluded that the plaintiffs had obtained a collateral benefit of $1.66 million from an investment [i.e. loan] of $2.28 million. Specifically, the trial judge in *J.D.M. Capital* concluded that:

> 18. . . . the $1.66 million claimed by the plaintiffs is a collateral advantage connected with the loan which the plaintiff in effect granted to the defendants, even though it was most effectively guaranteed by Mr. Robert Atkinson. A collateral advantage of this type comes, in my view, within the meaning of the word "interest" as defined by s. 347 (2) of the *Criminal Code*, and as such is unenforceable. . . .

56 The *J.D.M. Capital* trial judgment was appealed to the British Columbia Court of Appeal where the appellants argued that the trial judge erred: "(1) in holding that the acquisition of Bison shares by Fusion falls within the definition of "interest"; (2) by failing to recognize that "credit advanced" means the aggregate of the money and the monetary value of any goods, services or benefits actually advanced or to be advanced; and (3) by equating the yield earned by the lender to the cost incurred by the borrower"; see para. 14.

57 The Court of Appeal addressed the appeal before it on the basis of the third ground alone and the Court remitted the matter to the trial division for quantification of the loss caused to the appellants by the respondents' denial of its best efforts promise; see paras. 15, 27.

58 Significantly, the Court did not expressly address whether the acquisition of shares can constitute or always constitutes "interest" within the meaning of that word in s. 347(2). Instead, the Court in *obiter*, at paras. 17-18, expressly reserved judgment on that issue, while noting the intuitive appeal of the position that such interests should be outside of the scope of s. 347:

> [The appellants'] submission that an [investment] opportunity "should" not be included as a charge or expense coming within "interest" as defined in s. 347(2), suggests an attractive means of limiting the incursion of s. 347 into the commercial realm.
>
> However, I do not accept that an investment opportunity given as a cost of a loan must necessarily be excluded from the definition of interest in s. 347(2).

59 Counsel for Cirius argues that because the Court of Appeal in *J.D.M. Capital* did not expressly overturn that portion of the trial judge's judgment, which had concluded that the acquisition of Bison shares by Fusion fell within the definition of "interest", that conclusion remains alive and is binding on me. In aid of this submission, Cirius also relied on the trial judgment in *Boyd v. International Utility Structures Inc.*, 2001 BCSC 559 (B.C. S.C.), aff'd on appeal 2002 BCCA 438 (B.C. C.A.).

60 In *Boyd*, the borrower had agreed to pay both interest and a royalty on every utility pole that it manufactured to the lender (*Boyd*). The trial judge, Justice Henderson, in considering whether the royalty payment at issue constituted "interest", referred to the *J.D.M. Capital* decision and, at para. 20, said:

> 20. . . . The result of this share acquisition, if it came to fruition, would have been the acquisition of shares with a book value of $6,600,000 for the price of $5,000,000, resulting in a tax-free "lift" of $1,660,000. The trial judge held that this tax-free lift was a collateral advantage connected with the loan and was caught by the definition of "interest" in s. 347(2). In the Court of Appeal this analysis was accepted, although the appeal was allowed for other reasons.

61 Respectfully, I do not understand or read the Court of Appeal's judgment in *J.D.M. Capital* in the same way that Henderson J. did. Indeed, at para. 15, the Court of Appeal was quite clear that it did not consider it needed to address the additional issues or findings that had been raised on appeal, including the specific conclusions and findings at trial that Henderson J. referred to. The judgment of Henderson J. in *Boyd* was upheld on appeal but the Court of Appeal did not so much as refer to the *J.D.M. Capital* decision.

62 Accordingly, I do not consider that I am "bound" by the conclusions of the trial judges in either the *J.D.M. Capital* or *Boyd* decisions.

63 Epstein, conversely, argues that the trial decision in *Bimman v. Neiman*, 2015 ONSC 2313 (Ont. S.C.J.), though not binding, is dispositive of the issues before me. *Bimman* was upheld on appeal at 2017 ONCA 264 (Ont. C.A.), but the trial judge's conclusion, that s. 347 of the *Criminal Code* had not been engaged on the facts of the case, were not pursued on appeal; at para. 20 of the Appeal decision.

64 In *Bimman*, Mr. Bimman and 2182474 Ontario Inc. ("218") were minority investors in Corayana Enterprises Limited ("CEL"). CEL owned several multi-unit residential complexes. CEL acquired these properties and then renovated them for subsequent sale or lease. The Ontario Court of Appeal set out the relevant facts, at paras. 2-4, as follows:

> 2. Bimman's company, 218, initially held 20% of CEL's issued shares. In early 2010, CEL required further funds to renovate its properties. Unable to secure third party financing, CEL's shareholders made two cash calls . . . Bimman declined to participate in either cash call; all other shareholders participated.
>
> 3. Relying on a provision in their November 3, 2009 Shareholders' Agreement (the "SHA"), the majority of CEL's shareholders approved the issuance of additional shares to shareholders who had participated in the cash calls, thereby diluting Bimman's ownership interest in CEL.
>
> 4. As a result of that and other conduct, Bimman commenced an action, in which he ultimately sought relief under the oppression remedy provisions of s. 248 of the Ontario *Business Corporations Act*, R.S.O. 1990, c. B.16. By the time of the trial, the parties had agreed that a parting of the ways was required. The main issues for trial therefore became: (i) had the respondents engaged in oppressive conduct; and (ii) if they had, how many CEL shares did the appellants own and what was their value as of December 31, 2013, the agreed-upon valuation date for a buy-out?

65 In the context of this claim, Mr. Bimman had also argued that his interest in CEL should not be diluted at all because the issuance of shares in response to the two cash calls engaged the criminal interest rate provisions in s. 347 and should be set aside. The trial judge rejected that argument. That issue, as I have said, was not pursued on appeal.

66 Though *Bimman* clearly arose in a different context, I consider the portions of the trial judgment that address the application of s. 347 are helpful and I propose to return to various aspects of that judgment.

67 Finally, I was also provided with several academic articles within which the various authors express their respective, and different, views on whether s. 347 of the *Criminal Code* extends to shares or equity granted by a borrower in support of a loan.

b) Interpretation and Related Issues

68 The defendant emphasizes that s. 347 appears in a criminal statute and its breach can give rise to an indictable offence. Accordingly, it argues that s. 347 should be construed narrowly, that any ambiguity should be resolved in favour of the person subject to conviction or penalty and that interpretations that lead to uncertainty and unpredictability are to be avoided.

69 Various aspects of this submission have been expressly addressed by the leading authorities that govern the interpretation, purpose and application of s. 347. These cases are *Garland v. Consumers' Gas Co.*, [1998] 3 S.C.R. 112 (S.C.C.) and *Degelder Construction Co. v. Dancorp Developments Ltd.*, [1998] 3 S.C.R. 90 (S.C.C.). These two decisions were released concurrently.

The two cases addressed very different circumstances and each established various principles that are relevant to the issues before me. Because of the importance of these two decisions, I have quoted from them at some length.

70 In *Garland*, the court had to consider whether a late payment penalty, that the defendant utility company imposed on accounts that were not paid by their due date, fell within the purview of s. 347. Justice Major, for the majority, said:

> 24. Under s. 347, an effective annual rate of interest which exceeds 60 percent of the credit advanced under an agreement or arrangement is a criminal interest rate. The statute creates two offences with regard to such interest. Section 347(1)(a) makes it illegal to enter into an agreement or arrangement to receive interest at a criminal rate. Section 347(1)(b) makes it illegal to receive a payment or partial payment of interest at a criminal rate. The scope of the language in s. 347 is extremely broad. Interest is defined, with the exception of six specific items, as the aggregate of all charges and expenses, in any form, that are paid or payable for the advancing of credit under an agreement or arrangement. The definition of credit is similarly expansive. It includes the aggregate of the money and the monetary value of any goods, services or benefits advanced under an agreement or arrangement, minus any fees, commissions or similar charges incurred by the creditor.
>
> 25. . . . However, it is clear from the language of the statute — e.g., its reference to insurance and overdraft charges, official fees, and property taxes and mortgage transactions — that's. 347 was designed to have a much wider reach, and in fact the section has most often been applied to commercial transactions which bear no relation to traditional loan- sharking arrangements. Although s. 347 is a criminal provision, the great majority of cases in which it arises are not criminal prosecutions. Rather, like the case at bar, they are civil actions in which a borrower has asserted the common-law doctrine of illegality in an effort to avoid or recover an interest payment, or to render an agreement unenforceable. . . . Nevertheless, it is now well settled that s. 347 applies to a very broad range of commercial and consumer transactions involving the advancement of credit, including secured and unsecured loans, mortgages and commercial financial agreements.
>
> . . .
>
> 28. . . .
>
> . . . It is the substance, and not merely the form, of a charge or expense which determines whether it is governed by s. 347.
>
> . . .
>
> 52. It should be noted however that s. 347 is a deeply problematic law. Some of its terms are most comfortably understood in the narrow context of street-level loansharking, while others compel a much broader application. The two facets of the statute do not comfortably co-exist. The Court is aware that the present decision may have the effect of increasing the importance of s. 347 in some consumer and commercial transaction. Given the interpretive difficulties inherent in the provision and the volume of civil litigation which it has already spawned, is with some reluctance that we are legally driven to this conclusion. However, the plain terms of s. 347 must govern its application. If the section is to be given a more directed focus, it lies with Parliament, not the courts, to take the required remedial action.

71 In the *Degelder* decision, the appellant obtained a mortgage loan from the respondent trust company to finance the completion of a construction project. The loan agreement required the appellant to pay substantial fees and bonuses in addition to a conventional interest rate. The term of the agreement was for 11 months, but the loan was not in fact repaid for more than three years. The appellant challenged the validity of the loan and filed a certificate, as required by s. 347(4) of the *Criminal Code*, stating that the bonuses, fees and interest received under the mortgage loan produced an effective rate of interest exceeding 75% per annum. These calculations, however, assumed repayment of the entire debt within the 11 month period contemplated in the loan agreement. The respondent trust company, conversely, submitted evidence establishing that the effective interest rate fell below 20% per annum when the interest was calculated over the period during which credit was actually outstanding.

72 In *Degelder*, Major J. said:

19. For the purposes of s. 347(1)(a), the appropriate time period for calculating an interest rate is the term of repayment set forth in the loan agreement. If that period produces a criminal rate of interest, then the entire agreement is illegal on its face under subs. (1)(a).

20. Ascribing an interest rate to a "payment or partial payment of interest" under subs. (1)(b), however, is more complicated. In some cases, the period over which a loan will actually be repaid is not clearly defined in advance, for instance where the agreement grants a right of prepayment or acceleration, or where the period of repayment simply differs in fact from what was contemplated by the parties. In either case, the period during which credit is actually extended -- and therefore the rate at which an interest payment is actually received -- may vary from the rate which appears on the face of the agreement, particularly where, as here, the transaction involves substantial fees, commissions, penalties, or flat percentage charges such as bonuses. The question is whether liability under subs. (1)(b) should reflect that variation in rates, or whether, as a matter of law, a "criminal rate" of interest under subs. (1)(b) should be grounded in the same contractual terms which govern liability under subs. (1)(a).

. . .

28. The respondent submits that subss. (1)(a) and (1)(b) are separate and independent provisions: the first targets transactions that are inherently illegal, and the second catches transactions that are illegal in their operation. In the respondent's submission, subs. (1)(b) may be violated even if the "criminal rate" at which an interest payment is received is not ascertainable as such on the face of the loan agreement. This interpretation was adopted by the trial judge, who held (at pp. 209 — 10):

> [Section] 347(1) creates two offences:
>
> > 1. The offence of entering into an agreement or arrangement to receive interest at a criminal rate. The actus reus of this offence is the entering into the agreement or arrangement. . . .
> >
> > 2. The receipt of a payment or partial payment of interest at a criminal rate. The actus reus of this offence is receiving the payment or partial payment.

This approach provides a coherent framework for the interpretation of s. 347. For the purposes of subs. (1)(a), the relevant question is: "what rate of interest does the agreement require?" For subs. (1)(b), the question is: "at what rate of interest has a payment actually been received?" As the respondent contends, a payment of interest may be illegal under subs. (1)(b) even if the loan agreement under which it is made did not itself violate subs. (1)(a) at the time it was entered into.

. . .

34. For the foregoing reasons, s. 347 should be interpreted according to the following general principles:

> (1) Section 347(1)(a) should be narrowly construed. Whether an agreement or arrangement for credit violates s. 347(1)(a) is determined as of the time the transaction is entered into. If the agreement or arrangement permits the payment of interest at a criminal rate but does not require it, there is no violation of s. 347(1)(a), although s. 347(1)(b) might be engaged.
>
> (2) Section 347(1)(b) should be broadly construed. Whether an interest payment violates s. 347(1)(b) is determined as of the time the payment is received. For the purposes of s. 347(1)(b), the effective annual rate of interest arising from a payment is calculated over the period during which credit is actually outstanding.
>
> (3) There is no violation of s. 347(1)(b) where a payment of interest at a criminal rate arises from a voluntary act of the debtor, that is, an act wholly within the control of the debtor and not compelled by the lender or by the occurrence of a determining event set out in the agreement.

73 A further decision is relevant. Recently in *Bodnar v. Community Savings Credit Union*, 2018 BCCA 121 (B.C. C.A.), the Court of Appeal, in addressing the issue of whether certain overdraft fees constituted "interest" as defined in s. 347, confirmed the proper framework for that question:

> 22. The modern rule of statutory interpretation guides the interpretation of s. 347 of the Code:
>
> > Today there is only one principle or approach, namely, the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.
>
> E.A. Driedger, Construction of Statutes (2nd ed., 1983) at 87.
>
> Professor Sullivan describes the modern rule again in Driedger on the *Construction of Statutes* (3d ed., 1994) at 131:
>
> > There is only one rule in modern interpretation, namely, courts are obliged to determine the meaning of legislation in its total context, having regard to the purpose of the legislation, the consequences of proposed interpretations, the presumptions and special rules of interpretation, as well as admissible external aids. In other words, the courts must consider and take into account all relevant and admissible indicators of legislative meaning.

c) The Nature of Debt and Equity

74 Corporations can raise funds or capital in various ways including by way of debt or the issuance of equity. The distinction between debt and equity has, with time, and from a commercial perspective, become blurred; *McGuiness, Canada Business Corporation Law*, 3d ed., Lexis Nexis, Vol 2 at 1154 and 1160. Furthermore, there are many financings that are hybrid in nature; *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558 (S.C.C.) at para. 55.

75 I raise this because there is nothing, in concept, that prevents equity from being issued to a creditor in support of a loan transaction. That, however, is not the question before me. The question before me, as I have said, is whether the issuance of the Converted Shares and/or the Disputed Warrants fall within s. 347 of the *Criminal Code*. In *Garland*, the Court determined that the late payment penalties imposed by a utility company fell within the language of s. 347 even though that result did not appear to be consistent with the intended purpose of the provision. So too, in this case, the primary question is what the language of s. 347 dictates or captures.

Analysis

76 The parties agree that the central question that arises from the second broad issue that I identified at the outset is whether the Conversion Rights that were granted under the CLA and/or the Disputed Warrants constitute "interest" under s. 347(2) of the *Criminal Code*. It is important that I am only addressing this issue in the context of the specific parties and the specific agreements before me. Thus, though counsel for Epstein argued that "equity" can never constitute "interest" for the purposes of s. 347(2), it is not clear that this is so. It may be, for example, and I need not determine this, that the payment of a specified number of shares in a publicly traded company, in exchange for a lender advancing credit, constitutes "interest" under s. 347. I raise this because "equity" can take multiple forms in multiple situations or circumstances.

77 In this case, the Conversion Rights and the Disputed Warrants pertain to the issuance, or potential issuance, of common shares from treasury in a private company with some dozens of shareholders.

78 There are several reasons, some of them interrelated, and others distinct, for my conclusion that neither the Conversion Rights nor the Disputed Warrants constitute "interest" as defined in s. 347.

a) The Words within s. 347(2) — "Charges and Expenses"

79 Section 347(2) confirms that "interest" means "the aggregate of all charges and expenses. The terms "charges" and "expenses", as used in the definition of "interest" found in s. 347(2), are not defined in that provision or elsewhere in the *Criminal Code*.

80 The term "charge" has been defined as meaning:

> *Charge, n.* [. . .] 2. The amount required, as the price of a thing or service sold or supplied; *Dictionary of Canadian Law*, 4th ed.

81 The term "expense" has been defined as meaning:

> *Expense, n.* 1. Money laid out; *Dictionary of Canadian Law*, 4th ed.

82 The ordinary definitions of the terms "charge" and "expense" imply a claim for the payment of money by an obligor to an obligee; i.e., an obligation to repay a debt.

83 The ordinary legal meaning of the term "debt" has been held to be "an obligation to pay a sum certain or a sum readily reducible to a certainty"; *Canadian Imperial Bank of Commerce v. International Brokers Co.*, [1994] 8 W.W.R. 191 (Sask. C.A.) at para. 7, see also C.R.B. Dunlop*, Creditor-Debtor Law in Canada*, 2d ed., (Toronto, Ontario: Carswell, 1994) at p. 16.

84 Furthermore, each of the specific examples of a "charge" and "expense" within the definition of "interest" defined in s. 347(2) — "a fee, fine, penalty, commission or other similar charge or expense" — contemplates a fixed or specific payment. This was confirmed in each of *Garland* and *Degelder*. In *Garland*, Major J. said that " . . . for the purposes of s. 347 "interest" is an extremely comprehensive term, encompassing many types of fixed payments . . . "; para. 27. In *Degelder*, Major J. said " . . . that definition includes not only common-law interest — i.e., a price for money which accrues day by day — but also fixed payments, such as fees, commissions and penalties, which may be incurred by a borrower for the advancing of credit"; para. 18.

b) Ejusdem Generis

85 Epstein argued that the principle of *ejusdem generis* necessarily extends these conclusions to the words "any charge or expense . . . in any other form" in the definition of "interest" in s. 347(2). I do not agree with this aspect of the submission or analysis advanced by Epstein.

86 In R. Sullivan's *Sullivan on the Construction of Statutes*, 6th ed. (Markham, Ontario: LexisNexis, 2014), the author, at §8.84 refers to the *National Bank of Greece (Canada) c. Katsikonouris*, [1990] 2 S.C.R. 1029 (S.C.C.) at para. 12, where Justice La Forest described *ejusdem generis* (or the limited class rule) and said:

> 12. . . . Whatever the particular document one is construing, when one finds a clause that sets out a list of specific words followed by a general term, it will normally be appropriate to limit the general term to the genus of the narrow enumeration that precedes it.

87 For *ejusdem generis* to arise, several conditions must be present:

> 1. There must be an identifiable class to which each item in the list of specific items belongs;
>
> 2. The class inferred from the list of specific items must be narrower in scope than the general words that follow the list;
>
> 3. The class inferred from the list of specific items must have something, apart from those items, to apply to, otherwise the general words would add nothing to the provision, violating the presumption against tautology.

(Sullivan at §8.66)

88 I do not consider that the definition of "interest" in s. 347 of the *Criminal Code* satisfies the third of these conditions. Tautology occurs when the specific terms that precede the general term are exhaustive of the whole scope of genus which they represent. In such circumstances, the general term is left without a purpose. This was addressed in *Construction Equipment Co. v. Bilida's Transport Ltd.* (1966), 58 D.L.R. (2d) 674 (Alta. T.D.). The provision at issue was s. 19(6) of the *Conditional Sales Act*, R.S.A. 1955, c. 54:

> 19(6) This section does not apply where, after seizure, the goods are destroyed or damaged to such an extent that the seller's security is materially impaired either by the wilful act of the buyer or by his neglect or otherwise.
>
> [Emphasis added.]

89 Justice Allen in *Bilida's Transport Ltd.* described the relevant principles and concluded that *ejusdem generis* did not apply:

> 45. However, the author goes on to say:
>
> > If the particular words exhaust a whole genus, the general word must be construed as referring to some larger genus."
>
> 46. On this last-mentioned point, reference should be made to the judgment of the Ontario Court of Appeal delivered by Kellock, J.A., in *Re Gravestock and Parkin*, [1944] 1 D.L.R. 417 at p. 419, in which he said:
>
> > Further it has been held that the *ejusdem generis* doctrine is not to be applied to general words, following specific words where the specific words embrace all objects of their class. To do so is to render the general words meaningless. In such a case the general words must have been intended to have a meaning different from the specific words.
>
> 47. It seems to me that the words "wilful act of the purchaser or by his neglect" used in subsec. 19(6) of *The Conditional Sales Act* exhaust or embrace the whole genus or class of circumstances under which the purchaser could be deemed to be at fault or in error and, accordingly, that the general words following would have no meaning if they were not taken in their ordinary sense, e.g. "in other manner" or "in another way, or in other ways," applying definitions of the word "otherwise" appearing in the *Shorter Oxford English Dictionary.*
>
> See also *Grini v. Grini* (1969), 5 D.L.R. (3d) 640 (Man. Q.B.) at paras. 12, 17 — 20.

90 The specific terms in the definition of "interest", i.e., "a fee, fine, penalty, commission or other similar charge or expense", are exhaustive of the whole genus which they represent. I say this for two reasons.

91 First, this list of specific terms already includes an item in the form of a general term: "or other similar charge or expense". In other words, had the definition of "interest" been limited to only "a fee, fine, penalty, commission or other similar charge or expense", there would be a persuasive argument that *ejusdem generis* would apply to the general term "or other similar charge or expense" in reference to the specific terms "fee, fine, penalty, commission". As a result, the genus for "fee, fine, penalty, commission" would already be as broad as possible before the addition of the words "or in any other form".

92 Second, the word "whether" precedes the specific and general terms in the definition of "interest":

> ***interest*** means the aggregate of all charges and expenses, whether in the form of a fee, fine, penalty, commission or other similar charge or expense or in any other form, . . .
>
> [Emphasis added.]

93 In *Bilida's Transport Ltd.*, Allen J. said:

> 57. There is one more reason why I do not think the *ejusdem generis* rule is applicable to this case. This is based upon the use of the word "either" preceding both the specific and general words of subsec. (6). The word "either" is a compound of the word "whether" and has substantially the same meaning and it means "each of two" or "any one of more than two." (See

Shorter Oxford English Dictionary, 3rd ed.) Here it should be noted that neither the word "either" or the word "whether" preceded the phraseology considered by Johnson, J.A. in *Calgary (City) v. Reid and Vincent* cited above. I think that the use of either of these words must be taken into consideration when dealing with the application of the *ejusdem generis* rule to any case in which they are used.

94 Similarly, the word "whether" in the definition of "interest" appears to confirm that the inclusion of the second general term, "or in any other form", is meant to refer to some larger genus apart from "a fee, fine, penalty, commission or other similar charge or expense".

c) The Meaning of "Charges or Expenses" in the Context of s. 347

95 There are, however, other reasons that suggest that "a charge or expense" in "any other form" would have to be either a fixed amount or an amount that can be calculated or determined with precision.

96 Both the definition of the words "criminal rate" and the regime in ss. 347(4)-(6) are directly relevant. "Criminal rate" is defined in s. 347(2) to mean "an effective annual rate of interest calculated in accordance with generally accepted actuarial practices and principles". This definition is then directly related to ss. 347(4)-(6). Section 347(4) requires the delivery of a certificate of a Fellow of the Canadian Institute of Actuaries that "calculates" "the effective annual rate of interest on any credit advanced under an agreement or arrangement and setting out the calculations and the information on which they are based . . . ". Section 347(5) confirms that the certificate referred to in s. 347(4) "shall not be received in evidence unless the party intending to produce it has given to the accused or defendant reasonable notice of that intention together with a copy of the certificate". Section 347(6) provides for the potential cross-examination of the actuary who has produced the certificate contemplated by s. 347(4).

97 In this case, the parties and I agreed during the trial that I would, based on the evidence I heard, determine an appropriate value for the Conversion Rights and/or the Disputed Warrants. With that determination in hand, Cirius would then obtain the necessary actuarial certificate and return to court with the "calculation" of the effective annual rate of interest that had been generated. On reflection, however, this course of conduct is not consistent with s. 347(2) or with the requirements of ss. 347(4)-(6). This is so on both a principled and on a pragmatic basis.

98 Both the definition of "criminal rate" and s. 347(4) specifically require that the "effective annual rate of interest" be "calculated". The word "calculated" can have different meanings but its primary meaning is to "determine mathematically"; *Concise Oxford English Dictionary*: 11th ed. Revised, Oxford University Press. This definition accords with the requirement, in s. 347(4), that the necessary "calculation" be undertaken by a Fellow of the Canadian Institute of Actuaries.

99 Though it is the "effective annual rate of interest" that is to be "calculated", and not the inputs or components that go into that calculation, it makes little sense to ascribe and require great precision in the final result that is "calculated" if the components of the calculation are imprecise or are approximations or estimates.

100 In this case, each of Cirius and Epstein called experts to estimate the value of the Converted Shares and the Disputed Warrants as of various dates. Those experts then engaged in a valuation exercise that used different precedent transactions, different dates, different models, different assumptions, different discount rates, and different further adjustments to arrive at an "estimate" for a "range of potential values". Their respective analyses looked to multiple additional factors including, for example, the state of the North American economy and the state of the North American Technology Sector Index at different times.

101 Not surprisingly, the two experts arrived at different conclusions. Indeed, neither expert was able, of necessity, to arrive at a fixed value for the Converted Shares or for the Disputed Warrants. I say, of necessity, because the exercise they engaged in was not a "calculation" and it was not amenable to yielding a precise or calculated value. The expert for Cirius, Mr. Weston, for example, initially provided the following opinion in his report:

9) Based on the scope of our review, major assumptions and the restrictions and qualifications set out in this Report, we estimate the en bloc fair market value of the common shares of Cirius as of the Valuation Date to be in the range of $10,200,000 ($0.36 per fully diluted common share) to $12,700,000 ($0.45 per fully diluted common share) as detailed in Schedule 1.

10) Although we consider any point within the range to be supportable, if asked for a specific point we would suggest the midpoint, being $11,450,000 ($0.41 per fully diluted common share).

102 At trial, Mr. Weston revised his opinion, for various reasons, to "a range" of between $0.32 to $0.40 per fully diluted share as of July 23, 2013, and he again considered that the midpoint, of $0.36 per fully diluted share, would be reasonable and/or appropriate.

103 Numerous and varied difficulties arise from an inability on the part of either a plaintiff or defendant to "calculate" or determine with precision, in advance of trial, what effective annual rate has been paid for credit advanced under an agreement or arrangement.

104 First, the usual context in which shares are valued, as reflected by the exercise that each of Mr. Weston and Epstein's expert, Mr. Crosson, engaged in, is fundamentally inconsistent with the issues that arise under s. 347. This would be true in either a prosecution or in a civil commercial case.

105 In the corporate context, shares are often valued when minority shareholders seek to obtain "fair value" or "fair market value" for their shares in circumstances where they have been rendered vulnerable by the actions of the majority. This can arise in various contexts including takeovers, mergers, going private proceedings and under the oppression and appraisal remedies. Valuations of equity can also arise in family law disputes, in estate disputes and in other contexts.

106 What is clear is that the valuation of shares, in such proceedings, is a relatively unstructured and largely judgment based exercise. A classic description of the subjective and imprecise nature of this exercise is found in the judgment of Lambert J.A. in *Cyprus Anvil Mining Corp. v. Dickson* (1986), 33 D.L.R. (4th) 641 (B.C. C.A.):

50. From there I would pass on to *Re Wall & Redekop Corp. et al.* (1974), 50 D.L.R. (3d) 733, [1975] 1 W.W.R. 621 (B.C.S.C.), (affirmed by an unreported decision of this court dated April 29, 1975, C.A. 712/74.) In that case, Mr. Justice Macfarlane, then sitting as a judge of the Supreme Court of British Columbia, reviewed a number of United States authorities on determining the value or fair value or fair market value of the shares of dissenting shareholders whose shares were being compulsorily acquired. In particular, he considered *American General Corp. v. Camp et al.* (1937), 190 A. 225; *Warren v. Baltimore Transit Co.* (1959), 154 A. 2d 796; *Roessler et al. v. Security Savings & Loan Co.* (1947), 72 N.E. 2d 259; *Phelps et al. v. Watson-Stillman Co.* (1956), 293 S.W. 2d 429; *Martignette et al. v. Sagamore Manufacturing Co. et al.* (1959), 163 N.E. 2d 9; *Woodward et al. v. Quigley* (1965), 133 N.W. 2d 38, and *Southdown, Inc. v. McGinnis et al.* (1973), 510 P. 2d 636. It is not necessary for me to analyze those cases or to quote from them. The point that they emphasize is that the problem of finding fair value of stock is a special problem in every particular instance. It defies being reduced to a set of rules for selecting a method of valuation, or to a formula or equation which will produce an answer with the illusion of mathematical certainty. Each case must be examined on its own facts, and each presents its own difficulties. Factors which may be critically important in one case may be meaningless in another. Calculations which may be accurate guides for one stock may be entirely flawed when applied to another stock.

51. The one true rule is to consider all the evidence that might be helpful, and to consider the particular factors in the particular case, and to exercise the best judgment that can be brought to bear on all the evidence and all the factors. I emphasize: it is a question of judgment. No apology need be offered for that. Parliament has decreed that fair value be determined by the courts and not by a formula that can be stated in the legislation.

. . . .

54. In summary, it is my opinion that no method of determining value which might provide guidance should be rejected. Each formula that might prove useful should be worked out, using evidence, mathematics, assessment, judgment or whatever is required. But when all that has been done, the judge is still left only with a mixture of raw material and processed material on which he must exercise his judgment to determine fair value.

[Emphasis added.]

107 In *Grandison v. NovaGold Resources Inc.*, 2007 BCSC 1780 (B.C. S.C.), the Court was required to value the shares of a company. Justice Pitfield said:

80. It goes without saying that a DCF valuation is particularly difficult in the case of a company such as Coast Mountain where the project is in the development stages, there is no operating history, the components of revenue and cost are uncertain, and the manner in which and time within which the undertaking is likely to be brought to fruition by is affected by a variety of objective and subjective factors. Mr. Harder aptly described it as an exercise in "educated speculation".

108 Many of the factors referred to in the *Grandison* decision are relevant to the circumstances and business of Cirius in 2013. Indeed, Mr. Weston's report states:

11) The valuation of a business is not a precise science and the conclusions arrived at in many cases will, of necessity, be subjective and dependent on the exercise of individual judgement. As such, our estimate of value has been expressed as a range.

109 Mr. Crosson, in his report, which is some 40 pages long, not including a further dozen pages of schedules, said:

2.3 Early stage companies such as Cirius are not conductive to precise valuation. While values may be mechanically calculated using standard valuation models and assumed inputs, the values derived will only be reliable if expressed as a wide value range.

2.4 While a range of standard and accepted valuation methods are available to value early stage private companies similar to Cirius, many of the methods rely on inputs that are difficult to reliably estimate. For example, although income approach methodologies such as the discounted cash flow and the First Chicago method are theoretically valid, the inputs required to apply them are often not available or too uncertain to be relied on.

2.5 In the absence of indicative transactions, the preferred valuation method for revenue positive early stage information technology companies is the Multiple of Revenue method. The results of applying that method are imprecise, as selection of market multiples is highly subjective, which introduces a significant judgemental uncertainty into the value determination.

2.6 Where bona fide transactions in a company's shares, indicative offers to transact or transactions in other instruments granting share rights have taken place within a reasonable period preceding the valuation date, the Precedent Transaction method is generally accepted as the most reliable basis of valuation. As a general rule, the greater the number of meaningful value events, the more reliable the valuation estimate will be. With the passage of time, however, the reliability of values based on past value events diminishes.

110 Engaging in a valuation exercise that is context specific, that is highly subjective, that ultimately devolves to an exercise of educated speculation and that can easily, with the best of intentions, give rise to a wide range of "fair values" or "fair market values" is inconsistent with the nature and focus of s. 347. Certainly such an exercise is not a "calculation" and it has little to do with the work of an actuary.

111 In *Degelder*, Major J., at para. 28, said:

> 28. . . . This approach provides a coherent framework for the interpretation of s.347. For the purposes of subs.(1)(a), the relevant question is: "what rate of interest does the agreement require?" For subs.(1)(b), the question is: "at what rate of interest has a payment actually been received?" . . . . . .

112 When dealing with the Converted Shares or the Disputed Warrants, both parties, in this case, could fairly say, in response to both of these questions, "I don't know . . . We'll have to hire expert valuators to tell us and we may still not know until the court hears their evidence and then decides what a reasonable or fair value for the shares/warrants might be".

113 Other difficulties arise from the uncertainties that are inherent in valuing shares. Some of these difficulties arise from the fact that s. 347 is a criminal provision that often grounds a civil claim alleging that a particular loan transaction was illegal. It would not be surprising, based on the different burdens of proof in the criminal and civil contexts respectively, for the same facts to potentially give rise to different results.

114 That said, the word "interest" in s. 347(2) can only have one meaning. Similarly, the need to "calculate" an "effective annual rate of interest" is a requirement that pertains in both the criminal and the civil context.

115 It is clear that the process relied on in this case, of having the court first determine a value for the Converted Shares and the Disputed Warrants before any "calculation" is undertaken under s. 347, is inconsistent with the intended structure of ss. 347(4)-(6). Furthermore, and more importantly, such a process would be impossible in the criminal context. The obligation on the Crown, in a prosecution under s. 347, would be to (i) actually "calculate" an effective annual rate of interest and (ii) to establish, beyond a reasonable doubt, that that calculation yielded a "criminal rate" of interest. This would have to be done before the close of the Crown's case.

116 The second of these obligations further highlights the difference between a "calculation" and a "valuation" as well as the difficulties with the position that is advanced by Cirius. In a criminal prosecution, the Crown is required to prove each element of an offence beyond a reasonable doubt; *R. v. Moreau* (1986), 26 C.C.C. (3d) 359 (Ont. C.A.) at para. 85. Proof beyond a reasonable doubt, in turn, contemplates a standard of proof that is "much closer to absolute certainty than to proof on a balance of probabilities"; *R. v. Starr*, 2000 SCC 40 (S.C.C.) at para. 242.

117 The *actus reus* of the offence that is created by s. 347(1) is either "entering into an agreement or arrangement to receive interest at a criminal rate" or receiving "a payment or partial payment of interest at a criminal rate"; *Degelder* at para. 28. A "criminal rate" of interest means, as I have said, a rate of interest "calculated in accordance with generally accepted actuarial practices and principles that exceeds 60%".

118 Neither the wording of this definition, nor the requirement that the Crown prove, beyond a reasonable doubt, that the rate being charged under an agreement or arrangement is a "criminal rate", is consistent with the nature of the exercise that a court undertakes when it values the shares of a company.

119 To establish the *actus reus* of the offence under s. 347 there is no room, on an imprecise and relatively subjective basis, to select a share value that falls within a range of fair and/or reasonable share values. To be specific, in some prosecutions it may not matter where, within a range of values, the shares or warrants or options in issue are valued. All such values, when subsequently calculated, may yield a "criminal rate" of interest. In other cases, however, the value that is ascribed to such shares or warrants or options will matter considerably.

120 For example, if shares were valued at between $0.32 and $0.42, it may be that using the $0.32 value would not yield or generate a "criminal rate" of interest while using, for example, $0.36 or $0.42 would give rise to a "criminal rate" of interest.

121 Still further, with the uncertainty that is inherent in the valuation exercise, it is hard to imagine that an expert who had, for example, valued certain shares at between $0.32 to $0.42 would not concede that he or she could say "to a near certainty" that the value of those same shares might not, for example, fall within a range of $0.30 to $0.40, or $0.28 to $0.38, or $0.26

to $0.36 and so on. This reality is confirmed in the opinion of Mr. Crosson who, after providing various ranges of value for what he defined as the Share Rights, said:

> 2.17 While I believe that the indicated ranges of value would have been within the range of prices that might have been obtained if the Share Rights had been offered for sale at the specified valuation dates, the confidence levels of the indicated value ranges are relatively low. To increase the confidence level of the results would require wider value ranges.

122 Indeed, in a criminal prosecution the proper question to pose to an expert, if it was possible to do so, is "What is the lowest value, beyond a reasonable doubt, that those shares can have?" It is that value, that would be one of the inputs in the "calculation" that an actuary would then undertake, that determined whether the rate of interest was a "criminal rate" and that was then provided to the defence.

123 Obviously different considerations and different standards of proof arise in the civil context. Nevertheless, the "calculations" that are undertaken should be the same. To be specific, it seems unlikely, or at least incongruous, that the same loan transaction would give rise, in a criminal and civil case respectively, to two different calculations of the applicable effective annual rate of interest and, consequently, to potentially two different answers to the question of whether that transaction gave rise to a "criminal rate" of interest.

124 Accordingly, I consider that the level of certainty and precision necessary to undertake the "calculations" that are expressly required under s. 347 is fundamentally inconsistent with the manner in which shares or warrants are or can be valued. This conclusion is reflected in the fact that, to my knowledge, of the approximately 365 civil and criminal cases that have relied on s. 347, over a period of nearly 40 years, not one has addressed a form of "charge" or "expense" that has had to be "valued" or "appraised" by the Crown or by a plaintiff.

d) The Converted Shares and/or the Disputed Warrants Are Not an "Expense" that was "Paid or Payable" "By or on Behalf of" Cirius

125 A further independent difficulty exists in seeking to include the Conversion Rights and/or the Disputed Warrants within the definition of "interest" in s. 347. Cirius asserts, as its primary position, that s. 347 allows a court to focus on the profit or "benefits" of a transaction to a lender as opposed to the costs or "expenses" of that transaction to the borrower. This is apparent in the written submissions of Cirius where, on the first page of those written submissions, it poses the following question as one of the central issues arising from the case: "Do the benefits received by Epstein pursuant to the warrants and conversion rights constitute "interest" within the meaning of the *Criminal Code?*"

126 Cirius is pressed to this position because it is unable to establish that the Converted Shares and/or the Disputed Warrants constitute an "expense" of Cirius. This arises on account of a series of straightforward principles of corporate law.

127 First, corporations are distinct legal persons. Second, because of the separate legal personality of corporations, it is necessary and important to maintain the distinction between the rights and assets of a corporation and those of its shareholders. Third, the share capital of a corporation reflects the capital investment of the shareholders in the corporation.

128 Accordingly, the issuance of shares by a company from treasury is not an expense of that company. Rather, such transactions, if they take place for inadequate consideration, affect the shareholders whose shares will have been diluted and who may, thereby, suffer some loss of value in the shares that they hold; F. Buckley and M. Connelly, *Corporations, Principles and Policies*, 2d ed. (Toronto, Ontario: Emond Montogomery Publications Limited, 1988) at 191.

129 In *Bimman*, Justice Gans said:

> 197. Furthermore, while there may be a cost associated with issuing shares at sub-market value, it is a cost that is borne by the shareholders of the company as distinct from the company itself. Similarly, in this case, the cost of issuing shares is borne by CEL's shareholders in one of two ways: either in the lending shareholders' failure to pay fair market value for

the issued shares, thereby depriving CEL of capital; or in the diminution of each share's value as a result of the increased number of shares without a corresponding increase in CEL's value.

198. In either case, it is the shareholders — the residual owners of the company — who have suffered any detriment resulting from the impugned transactions. While CEL and the defendant shareholders are separate legal entities, their relationship is of such a nature that the issuance of shares as compensation for the interest-free loans cannot be characterized as a "charge or expense."

130 In this case, Mr. Crosson's uncontradicted opinion stated:

1.17 As the issuance of options/warrants does not change total equity, it would have no impact on Cirius' en bloc value. It can impact the values of the individual interests of Cirius' shareholders.

1.18 The issuance of options/warrants can dilute the values of the interests of the existing shareholders. The extent of the dilution will depend on the exercise price of the options/warrants and the number of options/warrants issued relative to the total outstanding pool of Shares and other Share rights.

131 A further difficulty exists. Apart from the fact that the grant and exercise of the Converted Shares and the grant of the Disputed Warrants are not properly an "expense" of Cirius, these are also transactions where nothing is "paid or payable" by Cirius. Cirius has not, and will not, pay any funds to Epstein from its revenues, or otherwise, in connection with these equity interests.

132 Cirius advances a series of arguments to address the fact that the Converted Shares and/or the Disputed Warrants are an "expense" that is borne by the shareholders of Cirius rather than by the company itself.

133 First, Cirius argues that the comments of the Court of Appeal in the *J.D.M. Capital* case should be limited to the unusual circumstances of that decision and that there is no legal impediment in considering the benefit that a lender receives from a loan transaction. I do not accept this for several reasons. The specific issue that was addressed by the Court of Appeal is the very issue that arises in this case and that I have identified.

134 In the *J.D.M. Capital* decision, the appellant argued that the trial judge had erred by "equating the yield earned by the lender to the cost incurred by the borrower"; at para. 14. This is the narrow issue on which the Court of Appeal decided the case.

135 The Court of Appeal said:

17. I agree with the appellants that interest for the purposes of s. 347 must be calculated on the basis of total cost to the borrower of the loan, whether that cost is incurred by the borrower or on its behalf, and regardless of the person or entity to whom it is paid.

. . .

21. The trial judge did not address the cost to Mercer of its promise directly . . . .When he did so, in my view, he fell into the error of equating the benefit to the lender with the cost to the borrower of the credit agreement.

. . .

25. If the question to be answered is what Mercer was required to pay or to see paid to affect its best efforts promises to JDM, the court must look at the substance of the loan transaction, bearing in mind that the purpose of s. 347 is to protect the borrower from usurious terms, not to prevent a profit to a lender.

136 Furthermore, the definition of "interest" in its focus on "charges and expenses", "paid or payable" "by or on behalf of" directs the relevant inquiry to the position of the borrower. It is only the borrower that "pays" anything or that incurs any

"expense". In saying this I recognize that the offence that is created under s. 347(1) focuses on " . . . everyone who enters into an agreement or arrangement *to receive* interest at a criminal rate . . . ." [emphasis added].

137 The comments of the Court of Appeal in *J.D.M. Capital*, and the focus on the position of the borrower, are supported in other authorities. In *Garland*, at para. 51, Major J. referred to the judgment of Huddart L.J.S.C., as she then was, in *Mira Design Co. v. Seascape Holdings Ltd.* (1981), 34 B.C.L.R. 55 (B.C. S.C.), at 60, where she had said:

> The thrust of the definitions of "credit advanced" and "interest" is to cover all possible aspects of any transaction to ensure that the cost of using someone else's money never exceeds the criminal rate. Thus, they focus on the actual benefit given to the borrower and the real cost of borrowing. . . .

138 Justice Major also said in *Garland*, at para. 30, that the question that had to be answered in *Garland* was whether the penalty in question " . . . constitutes, in substance, a cost incurred by customers to receive credit . . . "?

139 Recently, in referring to this passage, the Court of Appeal in *Bodnar*, at para. 32, said: " . . . Major J. endorsed an approach to the characterization of a given charge that focuses on the effect on the borrower, rather than on the intent of the lender". The Court, at para. 33, further said: "The question is answered by asking whether the Fee in substance increases the effective cost of borrowing to the borrower, and does not depend on the reason attributed to why the Fee was charged."

140 Third, the central object of statutes that prohibit usury is to protect borrowers. In *Garland*, Major J., at para. 23, made reference to the *Small Loans Act*, R.S.C. 1970, c. S-11, s. 3 which, he said, was "designed to protect borrowers seeking small personal loans". He again referred to the *Small Loans Act*, at para. 28, saying:

> 28 In adopting s. 347, Parliament opted for the more inclusive "cost of the loan" concept derived from the *Small Loans Act*, which s. 347 replaced. Section 2 of the Act provided:
>
> 2. . . .
>
> "cost" of a loan means the whole cost of the loan to the borrower whether the same is called interest or is claimed as discount, deduction from an advance, commission, brokerage, chattel mortgage and recording fees, fines, penalties or charges for inquiries, defaults or renewals or otherwise . . . .

141 Alternatively, Cirius argues that the Converted Shares and/or the Disputed Warrants were an "expense" of Cirius. It does so on two related bases. It relies on the authority of *Alcatel Canada Inc. v. R.*, 2005 TCC 149 (T.C.C. [General Procedure]), where the court concluded that, for tax purposes, stock options that had been issued by a company to its employees were an "expenditure of the company." Second, Cirius relies on the opinion evidence of Mr. K. Gagnon, a chartered accountant, who opined that under a particular accounting standard, called the Accounting Standard for Private Enterprise (ASPE), the Disputed Warrants would be treated as a financing fee or expense.

142 Mr. Gagnon accepted that different sets of accounting standards might be relevant or applicable to private companies though he believed that the ASPE was likely the most relevant and broadly used standard. I observe that there is no evidence that Cirius, in fact, relies on the ASPE standards in its accounting.

143 I do not consider either submission persuasive. In *Garland* and *Degelder*, the Court emphasized the importance of focusing on the essence or substance of the transaction being considered; *Garland* at paras. 28, 30, 32 and 51 and *Degelder* at paras. 27 and 30. The same point was recently made in *Bodnar* at paras. 31 and 33.

144 Here, the grant of the Converted Shares and/or the Disputed Warrants does not, in substance, or as a matter of legal principle, create an "expense" that is "paid or payable" by Cirius. In *Garland*, Major J. noted, at para. 27, that the definition of "interest" was a comprehensive term that encompassed "many types of fixed payments which would not be considered interest proper at common law or under general accounting principles"; see also *Bodnar* at para. 27.

145 Though the accounting treatment of a transaction, under a specific set of accounting standards, or the tax treatment for that transaction may be informative, such considerations can neither limit nor expand the definition of "interest" beyond the governing legal principles or beyond what the substance of the underlying transaction properly reflects.

146 This point has been made by other courts in other contexts. In *Canada Deposit Insurance Corp.*, the Court addressed the question of whether a particular $255 million advance was "in substance a loan or a capital investment"; at para. 43. The Court determined, at para. 62, that the accounting treatment used by one of the parties was "not . . . of great weight in the characterization of the advance"; see also *Buck Consultants Ltd. v. R.* (1999), [2000] 1 C.T.C. 93 (Fed. C.A.), at para. 9 citing *Shell Canada Ltd. v. R.*, [1999] 3 S.C.R. 622 (S.C.C.) at para. 73.

147 Finally, as a further alternative, Cirius argues that if the issuance of the Converted Shares and/or the Disputed Warrants was a cost or "expense" incurred by Cirius' shareholders, rather than by Cirius, this was a cost that was incurred by the shareholders "on behalf of" Cirius. This would then be sufficient to bring the Converted Shares and/or the Disputed Warrants within the definition of "interest".

148 I do not consider that the words "on behalf of" can be extended in the way that Cirius suggests. The proposition advanced by Cirius is, again, inconsistent with the separate legal personalities that companies and their shareholders respectively have. The loans and borrowings of a company are undertaken by the company on its own behalf. The directors who make the decision to have a company borrow funds are required, subject to the articles and bylaws, to do so in the best interest of the company.

149 The shareholders, conversely, have no direct role in these decisions or in such transactions. Importantly, they are not personally liable for the ensuing financial obligations of a company. Instead, the rights of the shareholders, broadly speaking, are limited to the right to vote at meetings, to receive any dividends that the company declares and to receive the property of the company, if any, that exists on dissolution.

150 There is no real overlap in these sets of rights and obligations. There is also no principled basis upon which to say that shareholders incur an "expense" "on behalf of" a company when that company issues shares or warrants in connection with its borrowings.

151 Thus, the Converted Shares and/or the Disputed Warrants are not (i) a "charge or expense" of Cirius, (ii) that was "paid or payable" by Cirius or (iii) that was paid by the shareholders of Cirius "on behalf" of Cirius". Accordingly they do not fall within the definition of interest in s. 347.

e) The Purpose of s. 347

152 When interpreting a provision in a statute, a court will normally consider the purpose of that provision: *Bodnar* at para. 22. In *Garland*, however, the Court concluded that the language of s. 347 was "deeply problematic" in that it was broader than the expressed or intended purpose of the provision and, indeed, was somewhat inconsistent with that expressed purpose; at para. 52.

153 I do not, accordingly, intend to address the issue of statutory purpose at any length. I will say that the claim being advanced by Cirius has nothing to do with loan sharking or heavy handed conduct by a creditor. Cirius' decision to enter into the CLA and the ASA was a measured decision made with the benefit of both sophisticated advice from Mr. Cytrynbaum and legal advice from a national law firm. This case, instead, reflects the reality of many start-up companies. They lack assets or revenue and are often required to pay their employees, their Board and their lenders with, for example, shares or options or warrants.

Valuation Issues

154 This conclusion, that the grant of the Conversion Rights under the CLA and of the Disputed Warrants does not fall within s. 347 of the *Criminal Code*, obviates the need, in concept, to value these interests. I was advised, however, that one or the other party to this action is likely to appeal this judgment. Accordingly, I have addressed the various valuation issues that were raised so that, if I am mistaken in the conclusions that I have expressed, there would be no need for the parties to return to court and to revisit or re-argue these matters.

155 The valuation reports of Mr. Weston and of Mr. Crosson are, in a sense, ships that pass each other in the dead of night. While there is some overlap and agreement on some of the methodologies that they relied on, both the focus of their respective reports and their conclusions are inconsistent.

156 Mr. Weston, on behalf of Cirius, was asked to provide an "estimate of the *en bloc* fair market value of the common shares" of Cirius "as at July 23, 2013" or the date on which the CLA and the ASA were signed. He was not asked to, nor did he, address any other valuation issue on any other date.

157 Mr. Crosson, on the other hand, considered that he was unable to value the shares of Cirius, the Disputed Warrants or the Conversion Rights under the CLA, which he collectively described as the "Share Rights", on July 22 or July 23, 2013 because he lacked sufficient meaningful precedent transactions to do so. Mr. Crosson was, for various reasons, unaware of a particular transaction that Cirius was negotiating during this time period with an entity called Open Text Corporation. He accepted that if he had this information, he would have been able to generate a valuation of Cirius' shares on July 23, 2013. For reasons that I will develop, I do not consider that this is relevant.

158 Mr. Crosson's report, on the other hand, provided valuations for the Share Rights, as he defined them, in late 2014 and on May 4, 2015, when the Automatic Conversion of the $250,000 portion of the loan took place and when the Optional Conversion of the balance of the $400,000 loan took place respectively.

159 Several distinct questions arise from these reports and from the submissions of the parties.

a) The Amount of the Loan that Epstein Made to Cirius

160 One aspect of Cirius' submissions suggested that the calculation of the "interest" paid by Cirius should only be based on the $400,000 loan of "new money" that was made on July 23, 2013 and not on the $250,000 amount that had first been loaned to Cirius in 2012 and that was then "rolled into" the CLA.

161 I do not agree. First, the CLA expressly addresses both the $250,000 and $400,000 amounts and confirms that the whole of the $650,000 amount was to be secured by a security agreement. The CLA also confirms that a figure "up to a maximum amount of four hundred thousand dollars" and the $250,000 figure together constituted the "Principal Sum" under the agreement. Finally, the words "Event of Default" include any failure to pay the "Obligation". "Obligation", in turn, is defined to mean all obligations and liabilities of any kind "including, without limitation, the payment of the Principal Sum and any accrued but unpaid interest".

162 Second, in *Garland*, at para. 35, Major. J. confirmed that s. 347(2) extends to circumstances where a debt is deferred and a debtor is permitted "to pay later than the time at which payment would otherwise be due". This addresses or captures the $250,000 amount that was loaned to Cirius and that was subsequently made a part of the CLA.

163 Accordingly, any interest calculation that is undertaken should be based on the principal loan amount of $650,000.

b) Using July 23, 2013 as the Valuation Date

i) Mr. Weston's Report

164 I consider that the central instruction given to Mr. Weston, being that he undertake a valuation of the *en bloc* value of the shares of Cirius on July 23, 2013, was misconceived. I further consider that if Cirius was pressed to rely on the report of Mr. Weston alone it would be unable to make out its case.

165 In *Degelder*, the Court dealt at length with the earlier differences that existed between s. 347(1)(a) and s. 347(1)(b). These differences were expressed in several ways. At para. 28, Major J. said that s. 347(1)(a) "targets transactions that are inherently illegal" whereas s. 347(1)(b) "catches transactions that are illegal in their operation." Later in that same paragraph, Major J.

identified, as I have earlier said, that the relevant question for s. 347(1)(a) is "what rate of interest does the agreement require?" while s. 347(1)(b) raises the question "at what rate of interest has a payment actually been received?"

166 Ultimately these various distinctions were distilled in the following statement:

> 29. However, if there is merely a possibility that the rate of interest could become illegal under the agreement, subs.(1)(a) is not violated. That case can arise where the period of repayment is subject to change, or where a substantial interest charge payable on demand or upon the occurrence of a named event. On the face of the agreement, there is no requirement of criminal interest in such cases; the effective annual rate of interest remains speculative until the actual amount of interest and the actual period of repayment are known."

167 In this case, various aspects of the preceding statement are engaged. The Automatic Conversion, of the $250,000, did not and could not take place on July 23, 2013. Instead, under the terms of the CLA, it was only to take place on the occurrence of certain named events. Thus, the Automatic Conversion was contingent on Cirius first receiving common share subscriptions in the minimum amount of $1 million. That $1 million excluded certain subscriptions including the $250,000 from Epstein and monies from the B&T Group. These subscriptions were received on or about February 11, 2014. The Automatic Conversion was also expressly contingent on the preparation of a shareholders' agreement for Cirius. That shareholders' agreement was only executed on October 19, 2014; Statement of Agreed Facts, para. 30. When or whether these various preconditions to the Automatic Conversion would be satisfied was uncertain as of July 23, 2013.

168 This same conclusion can be expressed even more forcefully for the Optional Conversion of the $400,000 portion of the loan. Epstein had no immediate ability to convert the $400,000 loan it ultimately made to Cirius. That principal sum was advanced over time, on the dates described at para. 13 of these reasons, and with the last $100,000 advance only being made on February 26, 2015 or some 19 months after the first such advance. As Mr. Gagnon notes in his report, at p. 4: "Any future advances are at the sole discretion of Cirius and Cirius could thus avoid any further advances under the CLA". The advances had to be repaid on or before July 23, 2015. Cirius had the ability, however, to repay any advances under the CLA at any time prior to that date. Thus, it could have repaid the full amount it owed, or any portion of it, prior to the Automatic Conversion being exercised.

169 Furthermore, the CLA contemplated that the Optional Conversion would take place at the lesser of $0.32 per common share and whatever price per common share Cirius was able to obtain from the financing that it intended to undertake and that it completed in February 2014. Thus, those values had to be ascertained before the Optional Conversion could take place.

170 Until these things took place, the questions of whether the Optional Conversion would occur, what loan amount would be converted, and at what price that conversion would occur, were speculative. No calculation of an effective annual rate of interest was possible. Assuming that the question of what benefit Cirius received was relevant under s. 347(2), it would still be completely artificial to value that benefit as of July 23, 2013.

171 The Disputed Warrants were also made subject, as a condition of exercise, to an executed shareholders' agreement for Cirius. In addition, there is still no basis upon which to value the Disputed Warrants in the context of what was previously a s. 347(1)(b) analysis. More than five years have elapsed since those warrants were issued and it is unclear when, if ever, they will be exercised. At paras. 7 and 8 of these reasons for judgment, I identified several instances in the past where Epstein had been issued warrants or options by Cirius that it ultimately chose not to exercise. Until they are exercised, warrants represent inchoate rather than vested rights in a corporation; *Canadian Business Corporation Law*, Vol. 2 at p. 1328.

172 The fact that the Disputed Warrants have not yet been exercised gives rise to a further problem. In *Degelder*, Major J. said:

> 32. Where a time factor is present, it is not possible to calculate a "criminal rate" of interest under subs. (1)(b) until the lender has been fully repaid and the actual term of the loan has then been defined . . . .
>
> 33. If a loan agreement permits but does not require the payment of illegal interest, there is no breach of subs. (1)(a), and the analysis shifts to whether a payment of illegal interest was in fact received by the lender . . . .. By the same token, the

lender may be released from liability entirely in cases where a charge has been paid over such a long period of time that the resulting interest rate does not exceed the criminal limit.

173 In this case, Epstein provided Cirius, on July 31, 2015 with confirmation that all interest accrued and payable under the CLA had been repaid to Epstein. As of that date, only the Conversion Rights had been exercised. On Cirius' theory of the case, however, the Disputed Warrants form a part of what it has paid, or will pay, for the loan made by Epstein. The Disputed Warrants, have not, however, been exercised.

174 Furthermore, as of July 31, 2015, Epstein was no longer a lender. It was solely an equity holder. These facts give rise to an independent but further difficulty in "calculating" an effective annual rate of interest. I would repeat the comments of Major J. in *Degelder*, at para. 32, cited above at para. 172 of these reasons.

175 In this case, the loan to Cirius was repaid by July 31, 2015 but the Disputed Warrants had not, as of that date, been exercised. It is not clear to me how an effective annual rate of interest could be calculated if, for example, Epstein exercised a part or all of the Disputed Warrants a few years from now.

c) Mr. Crosson's Report

i) Has Any Value Been Established on the Balance of Probabilities?

176 I have described the significant uncertainty that is attached to the valuation of shares generally and I have referred to portions of the reports of Mr. Weston and Mr. Crosson that speak to these uncertainties. The degree of uncertainty in the report of Mr. Crosson, however, calls into question whether that report has established any value, on the balance of probabilities, for either the Converted Shares or the Disputed Warrants.

177 In *C. (R.) v. McDougall*, 2008 SCC 53 (S.C.C.), Justice Rothstein, for the court, confirmed at para. 40, that "there is only one civil standard of proof at common law and that is proof on a balance of probabilities". That standard applies to each element of a cause of action.

178 Mr. Crosson expressed the following additional opinions in his report:

> 2.12 As such, while I was able to provide indications of the values of Share Rights at various points, the reliability of my estimates was limited by the lack of transaction data available and the inherent imprecision of the valuation methods applied.
>
> 2.17 While I believe that the indicated range of value would have been within the range of prices that might have been obtained if the Share Rights had been offered for sale at the specified valuation dates, the confidence levels of the indicated value ranges are relatively low. To increase the confidence level of the results would require wider value ranges.

179 In relation to the potential values for Cirius' shares in late 2014, Mr. Crosson said:

> 9.22 While it is reasonable to assume that the value of Cirius' intangible business assets increased between February 2014 and late 2014, the above Share value indications are based on a single Precedent Transaction, adjusted on a somewhat subjective basis. The reliability of the indicated values of the Disputed Warrants and the Conversion Rights are subject to the same limitations.

180 The discussion that precedes this paragraph suggests that Mr. Crosson's opinion would not have been altered in a meaningful way by a further precedent transaction that occurred in July 2013.

181 In relation to the potential values for Cirius' shares on May 4, 2015, the date of the Optional Conversion, Mr. Crosson said:

> 2.27 I adjusted the February 2014 share value range to recognize increases in Cirius revenues and changes in market conditions between February 2014 and May 2015. My analysis indicated primary market values of $0.74 to $0.96 per

share in late 2014, which is discounted by 20% to 40% indicate secondary market values of $0.44 to $0.77 per share. The resulting range of share values would be less reliable than the February 2014 and the late 2014 value ranges.

182 Though this issue was not put to Mr. Crosson during his direct examination or his cross-examination, it does not appear, from the foregoing reservations or qualifications, that Mr. Crosson's various indications of value were advanced with sufficient confidence for Cirius to say that they had been established on the balance of probabilities. His various opinions are filled with qualifications, and a "relatively low level of confidence" is not consistent with the language normally used to establish the civil burden of proof. Accordingly, I do not consider that Mr. Crosson's opinions satisfy the applicable burden of proof.

ii) What Value within a Range of Potential Values Should Be Chosen?

183 Alternatively, if the various values in Mr. Crosson's report can be said to represent, on the balance of probabilities, the value of Cirius' shares in late 2014 and on May 4, 2015, is this true for each of the values in the suggested range? Again, this issue was never addressed in Mr. Crosson's evidence.

184 Assuming that this is so, a further difficulty arises, namely *what* value, within the range of suggested values, should be selected as the appropriate value of the Converted Shares and/or the Disputed Warrants for the calculation of an effective annual rate of interest?

185 This is not a case, for example, that seeks to value the shares of a dissenting shareholder or the interests of a spouse making a claim for family property. This is a claim in which the plaintiff asserts that a part of a contract offends a provision of the *Criminal Code* and is, therefore, illegal and unenforceable. Accordingly, different considerations and policy objectives pertain.

186 In the context of an assertion that a contractual provision is ambiguous or uncertain, for example, the courts will endeavour to find meaning for the contract; Hall, *Canadian Contractual Interpretation Law* at pp. 36 — 39. Similar considerations pertain in the case of an assertion of illegality. In *1298417 Ontario Ltd. v. Lakeshore (Town)*, 2014 ONCA 802 (Ont. C.A.), leave to appeal ref'd, Feldman J.A. said at para. 14:

> 14. . . . when interpreting contracts, courts prefer to give the contractual provisions a meaning that will make them legal, rather than illegal and unenforceable. . . .

See also *Unique Broadband Systems Inc., Re*, 2014 ONCA 538 (Ont. C.A.) at paras. 87 — 89.

187 This approach can be justified on the basis that such an interpretation would give effect to the intentions of the parties as it existed at the time the contract was created, so far as their intentions are lawful, by upholding the contract as much as possible.

188 Further considerations are directly relevant to s. 347. In *Transport North American Express Inc. v. New Solutions Financial Corp.*, 2004 SCC 7 (S.C.C.), Justice Arbour, for the majority, determined that the offending interest rate should be read down or notionally severed to best reflect the intentions of the parties. She said:

> 32. The preferred severance technique is the one that, in light of the particular contractual context involved, would most appropriately cure the illegality while remaining otherwise as close as possible to the intentions of the parties expressed in the agreement.

189 Arbour J. considered that the parties were experienced and independently advised commercial parties that entered into the contract for the plaintiff to acquire "commercially necessary working capital", unaware that the agreement would contravene s. 347 (para. 44). She further considered that the inadvertent violation of s. 347 and unjustified windfall to the plaintiff from possibly not having to repay interest on the loan were factors that favoured a remedy that would remain as close as possible to the intentions of the parties (paras. 45-46).

190 Similarly, I consider that when faced with a range of values that, on a balance of probabilities, could represent the value of Cirius' shares at the time periods in question, I too should favour a value that upholds as much of the contract that was made

by the parties as possible, namely by choosing a value at the low end of the range rather than the midpoint value that has been suggested to me. I say this for two reasons.

191 First, as I have said, in para. 120, the values at the low end of the suggested range are less likely to yield a "criminal rate" of interest compared to the values at the high end of the range, and are therefore less likely to contravene s. 347 of the *Criminal Code*. Choosing the lowest value from the range of suggested values will uphold more of the contract. This accords with the intentions of the parties which was not to contravene s. 347 but to repay Epstein the monies that Cirius had borrowed.

192 Second, the exercise of valuing Cirius' shares by choosing from a range of suggested values operates apart from the terms of the CLA. This is not a circumstance in which the court must interpret a vague contract or alter an illegal contract through a blue-pencil test or notional severance: *Transport North American Express*. There are no concerns that the court is essentially making a contract for the parties: *Canadian Contractual Interpretation Law* at p. 39. Both Cirius and Epstein, commercial parties negotiating at arm's length and with the benefit of independent legal advice, already agreed to the material terms of the CLA. Choosing the lowest value from the suggested range as the value of Cirius' shares ensures that I uphold the CLA, and the parties' intentions, to the greatest extent possible.

iii) The Secondary Market Issue

193 Mr. Crosson's report, and his evidence at trial, indicated that a further discount of 20% to 40% would be necessary to indicate secondary market share values. The plaintiff argues that such a discount would be inappropriate because, as Mr. LeVasseur testified, there was no secondary market available for the shares of Cirius. Whether such a discount is appropriate is a matter of fact to be assessed in each case: *Halpin v. Halpin* (1996), 27 B.C.L.R. (3d) 305 (B.C. C.A.) at para. 32; *Reid v. Reid*, 2014 BCSC 1691 (B.C. S.C.) at paras. 192 — 196. Mr. Weston did not address this issue in his report.

194 In circumstances where what is being valued is what a notional purchaser would pay for a minority interest in a company, it would seem "an obvious point" that the notional purchaser will pay less than the rateable en bloc value for a non-controlling interest: *Reid* at para. 194. This conclusion is supported by the explanation and the definitions that were provided by Mr. Crosson in his primary report:

> 5.28 Fractional discounts describe the reduction in prices available for assets where the ownership interest does fully confer the rights and benefits enjoyed by an owner of a 100% interest. The primary disadvantages that may accompany fractional ownership arise from relative lack of control or lack of marketability.
>
> 5.29 Fractional discounts can comprise:
>
> > a) Discount for Lack of Control which is "an amount or percentage deducted from the pro rata share of value of 100% of an equity interest in a business to reflect the absence of some or all of the powers of control."
> >
> > b) Discount for Lack of Marketability, which is "an amount or percentage deducted from the value of an ownership interest to reflect the relative absence of marketability."
>
> 5.30 In this report, I describe the fractional discounts required to adjust base values determined in a primary market context to secondary market prices as "secondary market discounts".
>
> 5.31 Discounts applied by valuators in valuing fractional interests can vary widely depending on facts and circumstances. In the absence of shareholder agreements, the discounts observed in practice vary from nil to as high as 90%. The ranges of minority discounts applied to fractional share interests in corporations with less than 50% voting control are typically in the 20% to 40% range. In the case of early stage venture investments, appropriate discounts are less certain and therefore the range of discounts may be wider.

195 These details are developed further in Mr. Crosson's Reply Report dated May 30, 2018 at paras. 1.11 — 1.14. Mr. Crosson fixed values for Cirius' shares in late 2014, that were discounted for what he had defined as "secondary market discounts", at between $0.37 to $0.66 per share. He fixed values for those shares on May 4, 2015, that were discounted on the same basis,

at between $0.44 to $0.77 per share. For the reasons I have described, I would choose the lowest value possible on each of these dates. In saying this, I observe that Mr. Crosson, in his Reply Report, considered that a more thorough consideration of the characteristics of the Converted Shares and of the Disputed Warrants would have likely yielded an even wider range of values; at para. 1.13.

Conclusions

196 I do not consider that Cirius' issuance of either the Converted Shares or the Disputed Warrants to Epstein offended s. 347 of the Criminal Code. Accordingly, Cirius' claim is dismissed and Epstein is to have the costs of this action.

197 If I am mistaken in this conclusion, I would, nevertheless, dismiss Cirius' claim and award costs of this action to Epstein. I do not consider that the report of Mr. Weston answers a relevant question or fixes values for the Converted Shares and/or the Disputed Warrants as at a relevant date. I also do not understand the report of Mr. Crosson to fix a value, on the balance of probabilities, for either the Converted Shares or the Disputed Warrants.

198 If I am mistaken in either of the foregoing conclusions, I consider that the value of Cirius' shares that were converted on Dec. 1, 2014 should be fixed at $0.37 per share. The value of Cirius' shares that were converted on May 4, 2015 should be fixed at $0.44 per share. I do not consider it to be appropriate to value the Disputed Warrants because they have not been exercised. Indeed, they may never be exercised. In addition, Epstein has not been a creditor of Cirius since July 31, 2015.

Action dismissed.