Court File No.: CV-14-10766-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

B E T W E E N:

TRISURA GUARANTEE INSURANCE COMPANY

Applicant

\- and -

EBERSOLE EXCAVATING INC. and D&S RAILWAY CONSTRUCTION INC.

Respondents

REPLY FACTUM OF TRISURA GUARANTEE INSURANCE COMPANY
(Receiver's Distribution Motion – May13, 2015)

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Court File No.: CV-09-8247-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

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Applicant

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REPLY FACTUM OF THE APPLICANT TRISURA GUARANTEE INSURANCE COMPANY

PART I - OVERVIEW

1. This factum is filed on behalf of the applicant, Trisura Guarantee Insurance Company ("**Trisura**"), in reply to each of the factums of Maynards Industries Ltd. ("**Maynards**") and the Canada Revenue Agency ("**CRA**").

2. Trisura's position is that, subject to a portion of the CRA claim relating to the source deduction deemed trust, the claims of both Maynards and CRA are subordinate to Trisura's priority claim to the funds held by the Receiver.

3. All capitalized terms have the same meaning attributed to them in Trisura's main factum and the factums of Maynards and CRA.

PART II – LAW AND ARGUMENT RE: MAYNARDS CLAIM

4. At the time of its purchase of the D&S assets pursuant to the Maynards Purchase Agreement in October, 2014 Maynards knew that D&S was going out of business and was selling substantially all of its assets.[1]

5. The only contract entered into with respect to the purchase of the assets was between Maynards as purchaser and D&S as vendor. There was no other purchase agreement between Maynards and either the respondent Ebersole or Darrell and Sandra Ebersole.[2]

6. Mr. Michael McIntosh, a long-time senior executive of Maynards, was in charge of the purchase transaction. Mr. McIntosh had had extensive experience in similar purchase transactions. As a result of that experience Mr. McIntosh, and Maynards, did not feel it necessary to retain legal counsel on some of those transactions, including the purchase from D&S.[3]

7. As a result of his extensive experience Mr. McIntosh had also developed a general understanding of the provisions of the PPSA. In particular, he understood

[1] Maynards factum, para. 9; McIntosh trans., p.8, Q.21-24
[2] McIntosh trans., p.19, Q.71-75
[3] McIntosh trans., 7, Q.14-20

that security interests in the kinds of assets Maynards was purchasing from D&S would normally be registered under the PPSA.[4] He was therefore also aware (i) of the process of searching the PPSA records to identify registered security interests, and (ii) that the search process became most important when assets were being purchased out of the ordinary course of business, as was the case with the purchase from D&S.[5] For that reason the Maynards Purchase Agreement expressly required the discharge of any security registered against the D&S assets.

8. As a result Mr. McIntosh did conduct a PPSA search before the Maynards Purchase Agreement was completed. He searched under the names of D&S and Ebersole but not under the individual names of Darrell or Sandra. He did not conduct any PPSA searches under the V.I.N.s of any of the assets that were motor vehicles and did not search the Ontario government ownership records with respect to any of the motor vehicles.[6]

9. The PPSA search results obtained by Mr. McIntosh disclosed Caterpillar, Bank of Montreal and Trisura as registered secured creditors of D&S. As a result of that search Mr. McIntosh insisted on obtaining discharges of the Caterpillar and Bank of Montreal security. However, he ignored Trisura's security.[7]

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[4] McIntosh trans., p.10, Q.29-30
[5] McIntosh trans., p.10, Q.31-35
[6] McIntosh trans., p.12, Q.37-42
[7] McIntosh affidavit, Maynards Record, Tab 1, p.6, para.21; McIntosh trans., p.28, Q.106-108

10. In his affidavit (sworn April 1, 2015) Mr. McIntosh swore that he "inadvertently missed" the Trisura registration.[8] However, on his cross-examination Mr. McIntosh clarified that he had not "missed" the Trisura registration but rather had seen it, but ignored it:

> 105. Q. … I will tell you this, is that we have come across searches before where … and this is maybe where we made our mistake, when we have seen to us, what are our obscure names, we are hoping for banks, we are looking for like Caterpillar. That's what we are looking for. And I guess our mistake is when we saw … we did see Trisura, we thought it was maybe some obscure insurance situation. We have seen many instances in the past where although a company has been registered security, their security meant nothing at the end of the day.
>
> Now, it's up to me that we ignored … we go ahead and ignore things, but we clearly made a mistake when we saw Trisura and we didn't pursue it.[9]

11. As noted, Mr. McIntosh saw the Trisura registration but didn't "pursue it." However, he did acknowledge that: (i) he would have presumed from his PPSA search that the parties with registered security interests would have had security agreements with D&S[10]; and (ii) he would expect any security agreement from a large secured lender to contain provisions that prohibit sales such as the D&S sale to Maynards without that security or the indebtedness being dealt with.[11]

[8] Maynards Record, Tab 1, p.6, para. 22
[9] McIntosh trans., p.27, Q.105
[10] McIntosh trans., p.25, Q.95-96
[11] McIntosh trans., p.28, Q.106-110

Issue (a) – Whether Maynards acquired Darrell's vehicles free and clear of Trisura's interest

12. There was no sale agreement between Maynards and Darrell Ebersole. D&S was the sole vendor and the vehicles owned by Darrell were not included in the sale. Maynards did not make any payment to Darrell for the purchase of the vehicles owned by him. Accordingly, subsection 28(5) of the PPSA does not apply to Maynards claim to those vehicles or the proceeds of sale thereof. They remain subject to Trisura's security pursuant to section 25 of the PPSA.

13. In any event, any purported sale of the assets owned by Darrell constituted a breach of Trisura's security agreement which provides, among other things, that the indemnitors (including Darrell) shall maintain the equipment secured as collateral available for the performance of the contracts bonded by Trisura.[12]

14. The provision of the Trisura security agreement referred to in paragraph 34 of Maynards' factum is not a licence to sell the collateral out of the ordinary course of business. It merely deals with Trisura's continuing rights as against any "successor" of the indemnitors.

15. Finally, even if subsection 28(5) of the PPSA were to apply, a purchaser in the position of Maynards cannot take advantage of that provision if it "knew the sale constituted a breach of the security agreement."

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[12] Trisura security agreement, Receiver's M.R., Part 1, Tab 2, p.90, para. 15

16. What constitutes knowledge in these circumstances is governed by section 69 of the PPSA, which provides in part as follows:

> 69. For the purposes of this Act, a person learns or knows or has notice Or is notified when service is effected in accordance with section 68 or the Regulations or when,
>
> > (a) in the case of an individual, information comes to his or her attention under circumstances in which a reasonable person would take cognizance of it;
> >
> > ...
> >
> > (c) in the case of a corporation, other than a municipal corporation or local board therof, information has come to the attention of a senior employee of the corporation with responsibility for matters to which the information relates under circumstances in which a reasonable person would take cognizance of it.

17. Maynards knew that the sale by D&S (and Darrell) of all of their assets out of the ordinary course of business constituted a breach of Trisura's security agreement because all of the information pointing to such a breach had come to the attention of Mr. McIntosh under circumstances in which a reasonable person would take cognizance of it:

(a) Mr. McIntosh knew Trisura had a registered security interest;

(b) he knew that Trisura would have had a security agreement;

(c) he knew that the Trisura security agreement would likely prohibit such a sale;

(d) he knew the sale would require the discharge of all registered security interests; and

(e) although he knew all of the above information he willfully ignored Trisura's interest.

18. Maynards' actions amounted to willful blindness. Subsection 28(5) of the PPSA was not intended to reward willful blindness.

Issue (b) – Whether Trisura's security was subordinated to BMO's security

19. The authorities cited by Maynards in paragraphs 37 to 47 of its factum have no bearing on the issues in this case. In particular, the authorities dealing with the *Bulk Sales Act* have no relevance to the interpretation and application of the PPSA.

20. Trisura's claim is based entirely, and simply, upon the application of section 25 of the PPSA. Its security interest continues to apply to its collateral and the proceeds thereof. Maynards purchased that collateral while willfully ignoring Trisura's registered interest. It now seeks to avoid the consequences of that action by arguing that Trisura's interest in the proceeds should be reduced by the amount of the indebtedness owed to a prior security holder (i.e. BMO).

21. However, that argument is based on the false premise that an auction of the D&S assets would have been the inevitable and exclusive result had Maynards or D&S taken the appropriate steps of notifying Trisura of the transaction or seeking a discharge of Trisura's security. That, however, is not the case. Any number of results short of an auction could have occurred.

22. One of the primary purposes of the PPSA is certainty. It would be contrary to that purpose for the court to speculate on, or inquire into, what might have

happened if the vendor had fulfilled its contractual obligations and the purchaser had adhered to the provisions of the PPSA of which it was well aware.

23. Section 25 of the PPSA provides a clear and certain result: Trisura's security interest continues to attach to the proceeds of its collateral. No other inquiry is contemplated by the PPSA.

Issue (c) – Whether Maynards acquired the D&S vehicles free and clear of Trisura's security interest.

24. For the reasons set forth in paragraphs 13 to 18 above, subsection 28(5) of the PPSA does not apply to Maynards' purchase of the D&S vehicles as Mr. McIntosh knew that the sale constituted a breach of Trisura's security agreement.

Issue (d) – Whether Trisura can pursue other remedies

25. Trisura acknowledges that it is entitled to pursue the DLPC Funds referred to in paragraph 51 of Maynards' factum. In fact it has done so. However, those funds are subject to other claims, including that of CRA, and Trisura's recovery therefrom is uncertain.

26. In any event, the fact that Trisura may have other avenues of recovery is irrelevant to its claim to proceeds pursuant to section 25 of the PPSA. It should be noted that Maynards also has other avenues of recovery of its losses, including claims against the Ebersoles personally.

Issue (e) – Bidspotter fees

27. The Interim Receivership Order (para. 28) is clear on this issue and there are no further fees payable to Maynards.[13]

PART III – LAW AND ARGUMENT RE: CRA CLAIM

28. Trisura does not dispute CRA's deemed trust claim to the extent of $94,583.64 for D&S source deductions referred to in paragraphs 2 and 4 of the CRA factum. Trisura does dispute the CRA's remaining claims based on the allegations of an express trust.

29. As noted above and in the previous factums, D&S and Ebersole were controlled by Darrell and Sandra Ebersole. As officers and directors of the Debtors they bore personal liability for certain of the Debtors' tax obligations.

30. Prior to the Interim Receivership Order both D&S and Ebersole were in financial difficulty and were preparing to go out of business. In july, 2014 Ebersole made a proposal to its creditors pursuant to the BIA.[14] In October, 2014 D&S agreed to sell substantially all of its assets to Maynards. The sale was conducted without notice to Trisura and the proceeds of sale were distributed to numerous parties to the exclusion of Trisura.

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[13] Receiver's M.R., Part 1, Tab 1, p.50, para. 28
[14] Ibid, Part 1, Tab 2, p.157

31. As noted in paragraph 9 of the CRA factum, certain of the sale proceeds were transferred to D&S. From those proceeds Sandra paid approximately $205,000 to each of herself and Darrell. Sandra transferred the balance of $190,669 to her lawyers (DLPC), purportedly to be held for the payment of the tax obligations of D&S and Ebersole. In fact the funds were set aside to protect Sandra's personal liability for those tax obligations.

32. CRA claims that the latter funds – i.e. the $190,669 – constituted an express trust in favour of CRA which is enforceable notwithstanding the receivership and subsequent bankruptcy of D&S and Ebersole. CRA says that Sandra was the "settlor" of an express trust in favour of CRA because she intentionally "set aside" the funds to meet the tax liabilities. CRA argues that as a result the 3 "certainties" required of an express trust were established.[15]

33. While it may be true that Sandra as the settlor may have had the required certainty of intention, there are a number of fundamental reasons why her actions should not give rise to an express trust in the circumstances of this case:

(1) For a true express trust to be effected the settlor must set aside his, her or its own money. The proceeds of sale, which formed the *corpus* of the purported trust, were not Sandra's to give. The proceeds were subject to Trisura's security and Trisura did not consent to the transaction.

[15] CRA factum, para.18

(2) The sale proceeds were paid to D&S at a time when Trisura's security still attached. There was no legal basis or authority for the company to transfer the funds to Sandra who subsequently purported to transfer them to her lawyers.

(3) To the extent that the purported trust was to cover Ebersole's tax liabilities, Sandra had no authority to use D&S' funds (i.e. the proceeds of the sale to Maynards) to create a trust to cover Ebersole's liabilities.

34. Trusts are creatures of equity. It would be inequitable to recognize an express trust in the circumstances set forth above. The purported "settlor" used other peoples' money in a transparent attempt to avoid her and her spouse's personal tax liabilities. Sandra's actions constitute a fraud upon Trisura and the attempted express trust should not be recognized or enforced as a result.

35. As CRA points out in paragraph 26 of its factum, the Crown is entitled to take the benefit of a purported trust "so long as monies held in trust for the Crown conform with the ordinary principles of trust law. For the reasons set forth above, Sandra's purported express trust did not conform with the ordinary principles of trust law.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 1st day of May, 2015.

John Marshall

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Lawyers for Trisura Guarantee Insurance Company

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