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CALGARY, ALBERTA

Court of Queen's Bench of Alberta

Citation: Alberta Energy Regulator v Lexin Resources Ltd, 2018 ABQB 590

Date:
Docket: 1701 03460
Registry: Calgary

Between:

Alberta Energy Regulator

Applicant

- and -

Lexin Resources Ltd., 1051393 B.C. Ltd., 0989 Resource Partnership, LR Processing Ltd., and LR Processing Partnership

Respondents

Decision
of the
Honourable Madam Justice B.E. Romaine

I. Introduction

[1] This is an application by the Receiver of Lexin Resources Ltd, 1051393 BC Ltd, 0989 Resource Partnership, LR Processing Ltd and LR Processing Partnership (the Lexin Group) seeking advice and direction respecting the characterization of funds indirectly advanced by MFC Energy Finance Inc to the 0989 partnership, a member of the Lexin Group, on June 30, 2015. The original amount of the advance was $37,570,500 (the Finance Advance). Finance advances a secured claim in the receivership against 0989 in the amount of $15,058,116.08, which it alleges is the remaining amount of the Finance Advance.

[2] For the reasons set out in this decision, I find that the Finance Advance is more properly characterized as equity rather than debt. In the alternative, I find that the Finance Advance should be postponed to the claims of other creditors pursuant to section 137 of *the Bankruptcy and Insolvency Act*, RSC 1985, C. B-3, as it is not a proper transaction.

II. Facts

[3] The relevant facts are as follows:

[4] MFC Bancorp Ltd (Bancorp) is a merchant banking company that invests in distressed businesses. In 2012, a subsidiary of Bancorp acquired the shares of Lexin Resources Inc, and in effect assumed or paid down Lexin's existing debt. At the time it did so, another of Bancorp's subsidiaries, MFC Energy Holding Austria Gmbh (MFC Austria) entered into two loan facility agreements with Austrian banks.

[5] Debt under these facilities was incurred in order to aid in the restructuring of Lexin, and used by the subsidiary to acquire a TD bank loan facility that had been used by Lexin's predecessor. The subsidiary and Lexin were then amalgamated, thus extinguishing Lexin's debt.

[6] While Finance submits that the intention was that the facility loans would be repaid from Lexin's cash flow, no loan agreement or other debt obligation has ever been put in place between MFC Austria and Lexin. Any payments by Lexin to MFC Austria have been made by way of a return of share capital.

[7] In 2013, Lexin's assets were transferred to the 0989 partnership, in which Lexin and Bancorp are partners. Again, there is no loan agreement between MFC Austria and 0989. The outstanding balance of the Finance Advance was reduced from time to time, and Finance now submits that the current balance is $15,058,116.08.

[8] In June, 2015, approximately $10.2 million in payments under the Austrian facilities became due.

[9] At this point in time, Bancorp held 100% of the shares of M Financial Corp (M Financial) and MFC Austria, which was wholly-owned by Bancorp, owned all the shares of Lexin. Lexin and Bancorp were partners of 0989, Lexin as to 66 2/3% and Bancorp as to 33.68%.

[10] Finance was incorporated on June 26, 2015 as a wholly-owned subsidiary of M Financial. Thus, each of Finance, M Financial, MFC Austria and Lexin were wholly –owned subsidiaries of Bancorp.

[11] Michael Smith was a director of Bancorp, M Financial, Finance, MFC Austria and Lexin and a member of the management committee of 0989.

[12] The following transactions all occurred on the same day, June 30, 2015:

(a) the directors of Finance resolved to issue 37,570,500 shares in Finance to M Financial for consideration of $37,570,500 and to grant a loan to 0989 in the same amount. Mr. Smith and Samuel Morrow, a director of Finance, MFC Austria and Bancorp, signed the directors' resolution. At the time, Finance had no other business or assets;
(b) 0989 received a wire transfer of $37,570,500 directly from M Financial;

[13] Finance and 0989 entered into a demand loan agreement dated June 30, 2015 which states that Finance was providing a loan to 0989 in the amount of $37,570,500. As security for the loan, 0989 and Lexin executed a general security agreement and 0989 executed a demand promissory note payable to Finance in the amount of the advance, all dated June 30, 2015. Before this, neither 0989 nor Lexin had any debt.

[14] All of the documentation with respect to the Finance Advance was signed or co-signed by Mr. Smith on behalf of both Finance and 0989.

[15] The loan agreement between Finance and 0989, provides, among other things, that:

(a) the Finance Advance is to be payable by 0989 only upon demand of Finance. There is no schedule for repayment;
(b) interest will only accrue if 0989 commits an event of default;
(c) 0989 is prohibited from selling assets of a value of more than $100,000 in any 12 month period, other than usual course sales of assets;
(d) 0989 may only make a payment on account of redemption or a distribution or return of capital if Finance consents to such a payment; and
(e) Finance is free to assign its rights and obligations under the agreement.

[16] Prior to the receivership of 0989 and Lexin, only two variable payments were made by 06989 to Finance, and no interest was ever charged.

[17] 0989 did not record receiving $37,570,500 in its accounting records in June, 2015 or any other date, but instead recorded an account payable of $37,570,500 to M Financial and a corresponding reduction in the share capital account of 0989 and Lexin.

[18] On the same day, June 30, 2015, the management committee of the 0989 partnership resolved to issue distributions to its two partners, Lexin and Bancorp, in the total amount of $37,570,500. At the time the Finance Advance was made, Finance was aware of this resolution.

[19] 0989's bank records show that on June 30, 2015, $12,653.744.40 was transferred to Bancorp and $24,916,755.60 was transferred to Lexin, resulting in no net change in 0989's bank accounts. Again on the same day, Lexin transferred the $24,916,755.60 to MFC Austria, resulting in no net change in Lexin's bank accounts. Given the over lapping nature of Finance and Lexin's directors, it is reasonable to infer that Finance was aware of these transfers.

[20] On June 30, 2015, MFC Austria paid down the Austrian bank facilities in the amount of $10,200,000 and transferred the remaining approximately $15,000,000 back to M Financial, the originator of the funds, as repayment for a 2013 loan made by the M Financial to MFC Austria.

[21] In summary, the Finance Advance was received by 0989, not from Finance but from M Financial directly, on June 30, 2015, and the whole advance was withdrawn from 0989's account on the same day and transferred to each of Lexin and Bancorp. Bancorp received and kept $12,653,744.40. On the same day, Lexin transferred the entirety of the amounts it had received to MFC Austria, MFC Austria then paid part of the amount to reduce bank debt and the rest, about $15 million, to M Financial, the originator of the funds for the Finance Advance. 0989 and Lexin only served as conduits though which the money flowed.

[22] In December, 2015, Finance transferred a portion of Lexin and 0989's assets to itself in partial settlement of the Finance Advance, at a time when Lexin's liabilities to creditors had started to accrue.

III. Position of the Parties

[23] Finance submits that the Finance Advance is a debt incurred for purposes of recapitalizing Lexin Resources Ltd. and 0989 with some additional "local" leverage to reduce their costs of capital.

[24] The Receiver, however, submits that, when considering the Finance Advance in light of all the surrounding circumstances at the time it was advanced, including the economic reality of 0989 and Lexin and the manner in which the advance was used, the Finance Advance should properly be characterized as an equity contribution made by Finance to 0989. Thus, the Receiver seeks an order declaring that 0989 is not indebted to Finance by reason of the Finance Advance, and that any claim that Finance has against 0989 or Lexin as a result of the Finance Advance is an "equity claim" as that term is defined under the *BIA*.

[25] In the alternative, if the Finance Advance is determined to be debt, the Receiver submits it is appropriate to postpone the Finance Advance to the claims of all of Lexin and 0989's other creditors pursuant to section 137 of the *BIA*, as an improper transaction between the debtors and a non-arm's length party. Further in the alternative, the Receiver submits that the Finance Advance should be postponed pursuant to the doctrine of equitable subordination.

IV. Preliminary Issues

A. Procedural Unfairness

[26] Finance complains that the Receiver has acted unfairly in this application, in that contrary to the procedural order, it not only addressed the validity of the Finance Advance, but also its priority. I do not agree that the Receiver was limited in its submissions on these issues by the procedural order or that issues of priory and equitable subordination do not fall within the broad issue of the reasons for the Receiver's denial of the claim, or that the Receiver was not clear in its reasons for its denial of the claim, which were set out in its letter of November 29, 2017. Without agreeing that there was any unfairness, however, I allowed Finance to tender a late affidavit, and a few additional days to respond to the Receiver's submissions on equitable subordination. Finance was also given the opportunity of filing a supplemental brief.

B. Brown v Dunn

[27] Finance submits that, as the Receiver did not comply with ***Brown v Dunn*** by questioning Mr. Morrow on whether it was Finance's intention to create an equity claim, his evidence that the intention was to re-leverage 0989 with some debt should be accepted as contradicted. However, as noted by the Receiver, in the absence of an arm's length relationship, it is not the stated intention of the parties that is determinative of the character of the advance, but rather all of the surrounding circumstances. I agree that the issue is whether the substance of the transaction is different from what the parties expressed it to be: ***Re U.S. Steel Ltd***, 2016 ONSC 569, upheld 2016 ONCA 662m at para 140.

V. Analysis

A. Should the Finance Advance be characterized as an investment of capital in 0989 by Finance or as a loan by Finance to 0989?

[28] If the Finance Advance is characterized as an equity contribution, Finance's secured claim will be subordinated to the claims of all other "creditors by the operation of 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".

1. Onus

[29] In the normal course in an insolvency, the onus is on a creditor to prove its claim.

[30] While Finance concedes that it has the "initial" burden to prove that the Finance Advance is a secured claim in the receivership, it submits that it does not have the burden of disproving that the Finance Advance is equity, or that it ought to be subordinated. By this, Finance means that, once it has proved that there is a contract, pursuant to which one person delivers money, and the other person agrees to repay the borrowed amount. Finance has met its burden and the onus proving that the advance is equity shifts to the Receiver. Finance relies in this respect on comments made by the Court in ***U.S Steel***.

[31] Those comments were made in context of a contest between competing creditors, and not an application by a receiver for advice and directions with respect to its findings on the validity of a claim. The Receiver has made its objections to the claim clear: the transaction bears the characteristics of a claim in equity and not in debt. Thus, the normal rule that the creditor bears the onus of establishing otherwise should apply. In any event, even if the burden shifts to the Receiver, the Receiver has met the burden in this case.

2. Analysis

[32] The issue of: supra particular claim is to be treated as debt or equity is a matter of statutory interpretation: ***supra*** at para 152.

[33] An "equity claim" is defined in the *BIA* as a claim that is in respect of an equity interest, including a claim for a return of capital or a contribution in respect of such a claim. An "equity interest" is defined as a share in the corporation, or another right to acquire a share in the corporation, other than one that is derived from a convertible debt. As noted by Wilton-Seigel, J. in ***U.S. Steel***, this type of situation can be distinguished from the situation in ***Canada Deposit Insurance Corp v Canadian Commercial Bank***, [1992] 3 SCR 558, where the transaction was arm's length.

[34] In ***U.S. Steel***, the Court held at para 155-156 that the definition of "equity claim" can extend to a contribution to capital by a sole shareholder unaccompanied by a further issuance of shares. Further, the reference to "a return of capital" need not be limited to a claim in respect of express contribution to capital, and a transaction can be a contribution of capital in substance even if it is expressed otherwise.

[35] Both the Receiver and Finance rely on the decision of ***U.S. Steel***, as the Court in that case considered the specific circumstances of the characterization of the claim, such as this one, involving wholly-owned subsidiaries engaged in non-arm's length transactions.

[36] As noted at para 154 of ***U.S. Steel***:

> In the circumstances of a sole shareholder, there is no practical difference...... between a shareholding of a single share and a shareholding of multiple shares. Accordingly, for the purposes of the definition of an "equity claim", there should be no difference between a payment to a debtor company on account of the issuance of new shares and a payment to a debtor company by way of a contribution to capital in respect of the existing shares.

[37] Thus, as was the case in ***U.S. Steel,*** the determination of whether Finance's claim is to be treated as debt or equity must address, not just the expressed intentions of the parties as reflected in the transaction documentation but also the manner in which the transaction was implemented and the economic reality of the surrounding circumstances. The form of the documentation is merely the "point of departure": ***supra*** at para 149.

[38] The issue in situations where the parties are not arm's length is not what the parties say they intended regarding the substance of the transaction but the "underlying substantive reality of the transaction": ***supra*** para 167. As actually implemented, is the substance of the transaction different from what was expressed in the transaction documentation?

[39] It is not as simple as submitted by Finance. The approach to characterization is not merely a narrow "rubber-stamping" of the form of transaction chosen by the sole shareholder: ***supra*** para 168.

[40] While the characterization of the claim must be analyzed at the date of advance, subsequent behavior, rather than subsequent stated intention, may be relevant if it illuminates the intentions of the parties at the date of advance although it cannot on its own justify a re-characterization of such advance: ***U.S. Steel*** at para 195; ***Canadian Deposit Insurance*** at para 52. The determination is not based on inequitable behaviour, but on the underlying substantive reality of the transaction.

[41] ***U.S. Steel*** sets out a helpful two-part test in to be followed in situations involving parent-subsidiary relationships at paras 186-190:

(a) subjectively, did the alleged lender actually expect to be repaid the principle amount of the loan with interest out of the cashflows of the alleged borrower; and
(b) objectively, was the expectation reasonable under the circumstances?

[42] The Court in ***U.S. Steel*** referred to various factors used by American courts to aid in determining appropriate characterization, including the following:

(a) the names given to the instruments, if any, evidencing the indebtedness;
(b) the presence or absence of a fixed maturity date and schedule of payments. The American cases suggest that the absence of a fixed maturity date and a fixed obligation to repay is an indication that the advances were capital contributions and not loans;
(c) the presence or absence of a fixed rate of interest and interest payments. Again, it is suggested that the absence of a fixed rate of interest and interest payments is a strong indication that the advances were capital contributions rather than loans;

(d) the source of repayments. If the expectation of repayment depends solely on the success of the borrower's business, the cases suggest that the transaction has the appearance of a capital contribution;
(e) the adequacy or inadequacy of capitalization. Thin or inadequate capitalization is strong evidence that the advances are capital contributions rather than loans;
(f) the identity of interest between the creditor and the shareholder. If shareholders make advances in proportion to their respective stock ownership, an equity contribution is indicated;
(g) the security, if any, for advances;
(h) the corporation's ability to obtain financing from outside lending institutions. When there is no evidence of other outside financing, some cases indicate that the fact no reasonable creditor would have acted in the same manner is strong evidence that the advances were capital contributions rather than loans;
(i) the extent to which the advances were subordinated to the claims of outside creditors;
(j) the extent to which the advances were used to acquire capital assets. The use of the advance to meet the daily operating needs for the corporation, rather than to purchase capital assets, is arguably indicative of bona fide indebtedness; and
(k) the presence or absence of a sinking fund to provide repayments.

[43] However, these and other factors are no more than an aid in determining substantive reality and should not be used in a "score-card" manner: supra para 181.

[44] However, the Receiver submits that these factors overwhelmingly point to the Finance Advance being in reality equity and not debt, particular factors b), c), e), f) and j).

[45] While there is formal documentation in this case, it does not include a schedule for repayment and there is no obligation to pay interest until default. Since it is characterized as a demand loan, there is no fixed maturity date. Thus, it would be possible, and in fact has been the case, that no demand for repayment has been made. Although there is evidence indicating the commencement of enforcement proceedings by various creditors, and thus default, Finance has issued no formal notice of default and no interest is alleged to be payable.

[46] Payments made under the Finance Advance were sporadic and the first payment made was in the form of an actual transfer of assets to Finance and its subsidiaries. Two variable cash repayments were made in 2016.

[47] It is relevant that the Finance Advance was not available for use by 0989 for daily operations or the acquisition of assets, but was immediately flowed through to its partners as distributions.

[48] It is also relevant that Bancorp was a guarantor of the Austrian bank debt, and that the transaction allowed that debt to be paid down, to the advantage of the parent company.

[49] The Receiver submits that this series of transactions was a plan to save the consolidated Bancorp enterprise at the expense of Lexin, 0989 and their stakeholders and, in effect, to secure ties to equity distributions for themselves against the Lexin Group's assets. Thus, it submits, referring back to the first part of the two-part test, there was no subjective intention for the Finance Advance to have ever been repaid.

[50] As noted at para 257 of ***U.S. Steel***:

> As a polar case, I accept that there may be circumstances in which a parent corporation is expectation from the outset is that it will sacrifice a subsidiary's profitability over the long-term for the benefit of the consolidated enterprise. In such circumstances, a court could find that the parent corporation had no intentions of causing the subsidiary to repay with interest any financing extended to the subsidiary or, more precisely, no expectation that the subsidiary would generate sufficient cash flow to enable it to make such payments based on the parent's anticipated business plan for it. In such circumstances, a court could also find that the entire amount of the financing extended by the parent corporation to the subsidiary was, in reality, an equity contribution.

[51] Finance submits that there are valid responses to all of these factors. It submits that the fact that the Finance Advance is a demand loan is responsive to the lack of maturity date. As noted in ***U.S. Steel*** ,a lack of maturity date and the absence of a schedule for the principal payment may only indicate the desire for flexibility to align payments of principal with 0989's economic performance against the back drop of a cyclical industry: ***supra*** at para 224.

[52] Despite submissions by both parties, I am unable on the basis of the evidence before me to determine whether undercapitalization is an issue.

[53] However, for Finance, the lack of any interest provision except on default is more problematic. Mr. Morrow alleges that withholding tax issues are the reasons for the advance being non-interest bearing. While there is nothing improper about this, this lacks of interest implies equity disguised as debt. Business choices on structure, while otherwise entirely proper, can have consequences for characterization.

[54] The Receiver submits that the restructuring of 0989 and Lexin as of June 30, 2015 with additional debt at a time when these entities had no debt does not make commercial sense. I accept the Receiver's view, particularly as none of the funds remained with 0989 or Lexin, and $15 million went full-circle back to M Financial, as Finance was clearly aware was the plan.

[55] Finance states that the commercial propose of the Finance Advance was (i) to fund the repayment of the MFC Austria loans, and (ii) to recapitalize Lexin and 0989 with some additional leverage, with one advantage being to add a "modest amount of local leverage to reduce Lexin and 0989's cost of capital".

[56] However, there was no debt obligation between MCF Austria and Lexin or 0989 at any point in time.

[57] In addition, the explanation that a modest amount of local leverage would reduce 0989 and Lexin's costs of capital is inconsistent with the fact that, as early as December, 2014, Bancorp was pursing the disposition of some of the Lexin properties. The commercially unusual aspects of the Finance Advance, including its nature as a demand loan, the fact that it was payable only upon default and that it included restrictions on redemption, distribution and return of capital without Finance's consent, could hardly be considered to be attractive to a prospective purchaser, even if the loan did not bear interest until default. If a cash and debt offer was more attractive to a purchaser, it could be negotiated at the time of the sale.

[58] However, I am not able to decide the issue of the credibility of Mr. Morrow's assertions with respect to Finance's subjective expectations despite these contradictory indicators without the benefit of viva voce evidence. Thus, given the circumstances in which this application was heard, I must accept that Finance has met the first part of the two-part test.

[59] However, was that expectation reasonable in the circumstances? The surrounding economic circumstances provide context to this question.

[60] While Finance asserts that the Austrian bank loans were intended to be repaid from Lexin's cash flow, in 2013, when the loans were made, Finance provided funds to MFC Austria to repay the principal and interest installments due under the loans, as neither 0989 nor Lexin generated sufficient returns to make equity distributions.

[61] In 2014, Lexin did make payments to MFC Austria, but it was by way of a return of capital. Finance states that MFC Austria used these funds to reduce the MFC Austria loans and to partially repay M Financial for the amounts it had advanced to MFC Austria in 2013.

[62] The funds distributed to Lexin and Bancorp by 0989 on June 30, 2015 are characterized by Finance as distributions to 0989's partners. The funds distributed by Lexin to MFC Austria the same day are characterized by Finance as a return of capital to Lexin's sole shareholder, MFC Austria, by way of a reduction of share capital pursuant to Section 74 of the British Columbia *Business Corporations Act*, SBC 2002 c 57. This raises the issue of why the flow-through of funds to 0989 was structured as a loan.

[63] Finance's answer is that the benefit of this leverage was in reducing 0989 and Lexin's cost of capital. However, Finance also submits that purpose of the loan was to facilitate a future sale.

[64] Finance's counsel included in its brief a hypothetical example that purported to demonstrate this increased saleability. However, the hypothetical example did not adequately take into account the effect of the Finance Loan. The Receiver revised the example, incorporating both the advance and actual data from the June 30, 2015 Lexin financial statements. This revision shows that the result would be the opposite of what Finance suggested would be increased saleability and that the advance would make a sale less attractive. As noted previously, the uncommon aspects of the debt would more likely make the existence of the Finance Advance a negative, rather than a positive, despite the lack of interest prior to default.

[65] Between July and September of 2015, the Bancorp board approved a plan to sell all of Lexin's assets, and in Bancorp's consolidated financial statements dated December 31, 2015, Bancorp referred to declining prices for oil and gas beginning in December 2014 and further declining by September 2015, leading to impairment assessments on its hydrocarbon properties in each of 2013 and 2014. In those financial statements, Bancorp indicates that on December 30th, 2015, it sold a 95 percent interest in certain hydrocarbon assets to a third party for nominal and contingent consideration, and that the contingent consideration was valued at nil.

[66] Even though the June 30, 2015 transactions occurred prior to these financial statements, and thus, some of these records are dated after the date of the Finance Advance, subsequent events are sometimes relevant to the extent they illuminate the intentions of the parties at the time of the advance. In this case, the subsequent events followed within weeks and months of the advance. In any event, Bancorp knew of declining commodity prices in 2013 and 2014, thus, it

cannot have had any objectively reasonable expectation that 0989 would be able to pay the principle amount of the Finance Advance out of cashflow, even without interest.

[67] The Receiver submits that it is clear that 0989 and Lexin were underperforming at the time of the Finance Advance, but Mr. Morrow alleges that Lexin was profitable, and that he was not aware of any creditor that was outstanding as of June 30, 2015 or the rest of 2015 that was not paid in full. However, affidavits filed by the municipalities of Willow Creek and Vulcan indicate that Lexin had failed to pay property taxes levied by the counties since 2015, resulting in liens and seizures beginning in November, 2015. Mr. Morrow also relied on the GLG reserve reports for the period, but failed to mention that the report assumes that the company would have to incur costs of development much higher than expected cash flowed in 2017 in order to earn such cash flows. The unaudited consolidated financial statements, without notes, do not aid in the determination of whether the expectation of repayment was objectively reasonable.

[68] In conclusion, I find that the expectation that the Finance Advance would be repaid by the borrower from cashflow was not objectively reasonable, and that the Finance Advance is properly characterized as an equity contribution.

[69] In the event I am wrong in this determination, I have considered whether it is appropriate to postpone the Finance Advance to all of Lexin and 0989's other creditors.

B. Should the Finance Advance be postponed pursuant to section 137 of the *BIA*?

[70] Section 137 of the *BIA* provides that a non-arm's length creditor that entered into a transaction with the debtor before bankruptcy is not entitled to payment of its claim arising from that transaction "until all claims of the other creditors have been satisfied, unless the transaction was in the opinion of the...court a proper transaction."

[71] It is clear that the Finance Advance was a transaction entered into with a non-arm's length party before bankruptcy. Thus, section 137 would postpone Finance's claim to the claims of other creditors unless this Court finds that the Finance Advance was a "proper transaction".

1. Onus

[72] When a debt claim is being advanced by a non-arm's length party, the claimant has the onus of proving that the transaction is a proper claim if it hopes to avoid having the claim subordinated pursuant to section 137 of the *BIA*: ***Re Tudor Sales Ltd***, 2017 BCSC 119 at para 48. However, even if I am wrong in this regard, the Receiver has satisfied the onus of establishing that the Finance Advance is not a proper transaction for the purpose of section 137.

2. Analysis

[73] Finance submits that, if the Finance Advance is debt, the Court cannot find that it is not a proper transaction under s. 137, relying on ***Stone Mountain Resource Holdings Ltd v Stone Mountain Resources Ltd***, 2012 ABQ 534. That is not what the Court in ***Stone Mountain*** establishes. Kent, J, found that the transaction in that case was for a proper purpose because a) there was no preference, and b) there was an injection of new money from an arm's length creditor to the debtor's parent company, and a subsequent loan of that money to the debtor subsidiary as a direct contribution to the debtor company's working capital, in accordance with a development plan: ***supra*** paras 31, 39-43.

[74] The facts in this case are different from those in ***Stone Mountain***. In this case, the funds advanced were flowed through 0989 as distributions to its partners, leaving 0989 without additional operating funds or working capital but only debt.

[75] In addition, there is nothing in the plain language of section 137 that would prevent it from applying to a transaction that is structured as debt. Indeed, the postponement created by the section would not be necessary if it applied merely to equity.

[76] The Receiver references ***Tudor Sales*** as a case that considered issues similar to the ones that arise here.

[77] In ***Tudor***, the applicant was an unsecured creditor of the bankrupt Tudor, seeking an order under section 135(5) of the *BIA* that the claim of a shareholder of Tudor with respect to shareholder loans be expunged or subordinated to the claims of other creditors.

[78] There was no written documentation of the shareholder loans, no fixed interest rate and no schedule for repayment. The advances were secured by a GSA. The interest rate that the company paid to the shareholder each year fluctuated with the fortunes of the company.

[79] The Court first considered whether the shareholder loans should be characterized a debt or equity, and found them to be equity, not because of the lack of a schedule for repayment or the absence of loan documentation, but because of the variable nature of the interest payments and the circumstances surrounding the advances at the time they were made. The Court considered events that took place shortly after the dates of the advances, noting that the "very close proximity in time" between the advances and these subsequent events "strongly implies that [the] advances were in substance consideration paid for [the shareholder's] ownership stake." Saunders, J. thus found the purported shareholder loans to be equity claims. The Court also considered whether the claim would fail by reason of section 137(1), and was satisfied that there was "simply no justification for allowing [the shareholder] the luxury of securing his investment in [another venture] through the mechanism of the GSA... and thereby defeating the legitimate interests of creditors": para 47.

[80] The Receiver submits that the Finance Advance was not made for the purpose of Lexin or 0989's ongoing operating expenses, or for their benefit at all, rather it was made for the sole purpose of enabling 0989 to issue partnership distributions which were ultimately return to Bancorp, MFC Austria and M Financial the originator of the funds, on the same day they were received.

[81] As previously noted, Finance claims that the purpose underlying the Finance Advance was to "recapitalize Lexin and 0989 with some additional leverage" and "reduce Lexin and 0989's costs of capital. This assertions is inconsistent with certain of Finance's other evidence, including the fact that at the time the Finance Advance was made, neither Lexin or 0989 had any debt. I accept that the substantive reality of the transactions was that, through the Finance Advance, Bancorp and its subsidiaries, including Finance, made equity distributions to themselves with their own funds, and secured such distributions against the assets of Lexin and 0989, both of whom previously had no debt.

[82] Mr. Morrow's evidence is that the purpose of the Finance Advance was to "facilitate a potential sale of the company at some point in the future through a deal that could include as part of the consideration an acquisitions of debt as opposed to a purely cash sale." Finance submits that this is evidence of a legitimate business purpose, and a benefit to 0989 and Lexin. As noted previously, a cash and debt sale could also be accomplished thought negotiation at the time of sale, and the hypothetical submitted through on Finances behalf does not support this theory.

[83] Finance also suggests that a benefit accrued to 0989 and Lexin in that MFC Austria used the proceeds of the MFC Austria loans to satisfy Lexin's pre-acquisition secured debt. However, 0989 and Lexin have no liability for that debt.

[84] Finance submits that, by retiring the debt, it freed up Lexin's cash flow but it is clear that in 2013 and 2014, cash flow was insufficient to warrant distributions sufficient to cover the Austrian loan. The Finance Advance occurred two and a half years after the alleged benefit, after numerous inter-corporate distributions, and in a climate of acknowledged declines in commodity prices. I find that there was no appreciable benefit to 0989 and Lexin in imposing debt as part of the 2015 transactions.

[85] I agree that the purpose and result of the Finance Advance was to leverage 0989 and Lexin for the benefit of Bancorp, which was at risk as a guarantor of the MFC Austria loan, and to benefit MFC Austria.

[86] As noted in ***U.S. Steel*** at para 257, there may be circumstances in which a parent corporation will sacrifice a subsidiary's profitability over the long-term for the benefit of the consolidated enterprise. This is that type of case. It does not fall within the exception set out in section 37 as a proper transaction.

C. Should the Finance Advance be postponed pursuant to the doctrine of equitable subordination?

[87] It is not necessary in this case to resort to the doctrine of equitable subordination, given that I have found the Finance Advance to be in substance equity rather than debt, and, in the alternative, debt that must be subordinated claims of the other creditors under s. 137 of the *BIA*.

[88] Application of the doctrine by the courts in Canada has been inconsistent. Most recently, the Ontario Court of Appeal in ***Re U.S. Steel***, 2016 ONCA 662 declined to grant a declaration that the *CCAA* contains no restrictions within the meaning of s. 11 on the court's ability to apply the doctrine of equitable subordination, noting that "this is the wrong inquiry": para 100. The Court instead declined to grant the relief sought because there was no specific authority within the *CCAA* to apply the doctrine, and the appellant had not identified how the doctrine would further the remedial purpose of the *CCAA*: para 102.

[89] The Receiver describes the elements of the American doctrine in the terms set out by the Supreme Court in Canada in the 1992 case of ***Canada Deposit Insurance***. However, as noted in ***Re Blue Range Resource Corp***, 2000 ABQB 4 at para 50, and in ***Re I. Waxman & Sons Limited***, [2008] OJ No 885 at para 29, the doctrine as interpreted in American cases is not static, and appears to have evolved over time to the point that it no longer requires inequitable conduct by the creditors but rather depends on considerations of fairness on a case-by-case basis. This illustrates the danger of "taking a doctrine divorced from its legal home and applying it to Canada's statutory bankruptcy regime unencumbered with deep knowledge of the origin, development and legal system from which it originated": ***Waxman*** at para 33.

[90] At any rate, this case does not require consideration of the doctrine of equitable subordination; since the provisions set out in the *BIA* at sections 140.1and 137 are sufficient to determine the issue.

Dated at the City of Calgary, Alberta this 08th day of August, 2018.

B.E. Romaine
J.C.Q.B.A.

Appearances:

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Keely R. Cameron
for the Alberta Energy Regulator

Chris D. Simard
for Exxon Mobil Energy Canada

Gregory C. Plester and Megan Van Huizen
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Mary Buttery
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Richard Billington, Q.C.
for Young Energy Services Inc.

Karen Fellows
for MNP Ltd.

David Girard
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