2022 01G 1964
IN THE SUPREME COURT OF NEWFOUNDLAND AND LABRADOR
IN BANKRUPTCY AND INSOLVENCY

IN THE MATTER OF the *Companies Creditors Arrangement Act* R.S.C., 1985 c. C-36 as Amended (the "**CCAA**"); and

AND IN THE MATTER OF an application of Edward Collins Contracting Ltd., Classic Security Limited, FGC Holdings Limited, 51037 Newfoundland and Labrador Inc. and H&E Designs Ltd. (collectively, "**ECC**" or the "**Company**").

MEMORANDUM OF AUTHORITIES

SUMMARY OF CURRENT DOCUMENT

Court File Number(s):	2022 01G 1964
Date of Filing of Document:	12 September 2022
Name of Party Filing or Person:	ECC (or "**Applicant**") (as defined below)
Application to which Document being filed relates:	Interlocutory Application (*Inter Partes*) filed by the Applicant
Statement of Purpose in filing:	Interlocutory Application seeking appointment of Grant Thornton Limited as Monitor of the Company pursuant to the CCAA
Court Sub-File Number, if any	N/A

To: The Service List attached hereto as Schedule "A".

O'KEEFE & COMPANY
Solicitor for the Applicant
Whose address for service is:
84 Airport Road, St. John's, NL
A1C 4Y3
Attn: Darren D. O'Keefe

Memorandum of Authorities:

1. *Rules of the Supreme Court*, 1986, c-42, Rule 25
2. *Meridian v. Okje Cho & Family Enterprise Ltd.*, 2021 ONSC 3755
3. *Affinity Credit Union 2013 v. Vortex Drilling Ltd.* 2017 SKQB 228
4. *BCIMC Construction Fund Corporation et al. v. The Clover on Yonge Inc.*, 2020 ONSC 1953
5. *Romspen Investment Corporation v. 6711162 Canada Inc.*, 2014 ONSC 2781
6. Dr. Janis Sarra in "La bonne foi est une considération de base – Requiring Nothing Less than Good Faith in Insolvency Law Proceedings", Annual Review of Insolvency Law, eds Janis Sarra & Barbara Romaine, Toronto: Thomson Reuters Canada, 2014:

DATED at the City of St. John's, in the Province of Newfoundland and Labrador, this 13th day of September, 2022.

O'KEEFE & COMPANY

Darren D. O'Keefe
Solicitor for the Applicant
Whose address for service is:
84 Airport Road, St. John's, NL
A1C 4Y3

TO: **Supreme Court of Newfoundland & Labrador**
General Division (In Bankruptcy)
P.O. Box 937
313 Duckworth Street
St. John's, NL A1C 5M3

AND TO: **The Service List attached as Schedule "A"**

TAB 1

This is an official version.

Table of Regulations | Main Site | How current is this regulation?

RULE 25
RECEIVERS

Analysis

RULE 25
RECEIVERS

Back to Top

Application for receiver and injunction

25.01. (1) The Court may appoint a receiver in any proceeding in which it appears to be just or convenient, and the appointment may be made either unconditionally or upon such terms and conditions as the Court thinks just.

(2) When appointing a receiver, the Court may grant an injunction restraining the party beneficially entitled to any interest in the property of which a receiver is sought, from assigning, charging or otherwise dealing with that property until after the hearing of the application for the appointment of the receiver.

(3) Where an applicant wishes to apply for the immediate grant of an injunction, the applicant may do so *ex parte*.

(4) Where on a hearing of an application for the appointment of a receiver, it appears that the matter in dispute should be dealt with by an early trial, the Court may order accordingly and fix the place and mode of trial, and make such other order as is just.

1986 c42 Sch D rule 25.01

Back to Top

Giving of security by receiver

25.02. (1) Unless the Court otherwise orders or a statute otherwise provides a receiver shall give security approved by the Court to account for any property received by the receiver, as receiver, and the receiver shall deal with the property as the Court directs.

(2) The security shall be filed with the Court.

1986 c42 Sch D rule 25.02; 36/14 s29

Back to Top

Remuneration of receiver

25.03. A receiver shall be allowed such proper remuneration, if any, as may be fixed by the Court.

1986 c42 Sch D rule 25.03

Back to Top

Receiver's accounts

25.04. A receiver shall submit the accounts, verified by affidavit, to the Court, annually or at such intervals as the Court may order, for approval and when approved the accounts shall be filed and any balance disbursed in accordance with the order.

1986 c42 Sch D rule 25.04

Back to Top

Default by receiver

25.05. Where a receiver fails to attend on the passing of any account, submit an account, make an affidavit, or do any other thing that the receiver is required to do, the receiver and any party or person may be required to attend in chambers to show cause for the failure, and the Court may make such order as is just, including ordering the discharge of the receiver and the appointment of another, the disallowance of any remuneration claimed by the receiver or any part thereof, and the payment of such interest and costs by the receiver or any party or person as is just.

1986 c42 Sch D rule 25.05

TAB 2

CITATION: Meridian v. Okje Cho & Family Enterprise Ltd., 2021 ONSC 3755
COURT FILE NO.: CV-21-00660390-00CL
DATE: 20210525

SUPERIOR COURT OF JUSTICE – ONTARIO

COMMERCIAL LIST

RE: MERIDIAN CREDIT UNION LIMITED, Applicant

AND:

OKJE CHO & FAMILY ENTERPRISE LTD. and 2341567 ONTARIO LTD., Respondents

BEFORE: L.A. Pattillo J.

COUNSEL: *Ian Klaiman* and *Jason Spetter*, for the Applicant

Robert Choi and *Adam Beyhum*, for the Respondents

HEARD: May 21, 2021

ENDORSEMENT

[1] The applicant, Meridian Credit Union Limited ("Meridian") seeks an order pursuant to s. 243(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (BIA) and s. 10 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43 ("CJA"), appointing BDO Canada Limited ("BDO") as receiver and manager over all property, assets and undertaking of the respondents, Okje Cho & Family Enterprise Ltd. ("Okje") and 2341567 Ontario Ltd. ("234").

[2] 234 operates as franchisee a Hampton Inn by Hilton at 40 McPherson Drive in Napanee, Ontario (the "Property") which is owned by Okje. Paul OJ Cho and his wife Choon Bum Cho are the principals and the officers and directors of both Okje and 234.

[3] Pursuant to a Credit Agreement dated September 20, 2018, Meridian authorized a non-revolving loan to Okje to a maximum of $7,200,000, payable on demand. That agreement was superseded by a Credit Agreement dated November 4, 2019 pursuant to which Meridian authorized the following credit facilities, payable on demand:

a) A non-revolving loan to a maximum of $6,995,000 (Credit Facility 1); and

b) An installment loan to a maximum of $700,000 (Credit Facility 2).

[4] In the spring of 2020, as a result COVID-19 and the government restrictions, Okje requested payment relief from its obligations under the 2019 Credit Agreement. Pursuant to amending agreements dated April 8, 2020 and July 14, 2020, Meridian agreed to defer Okje's monthly principal and interest payments for three months and then a further two months. The July 14, 2020 amending agreement also authorized a further credit facility to Okje, payable on demand, to a maximum of $102,000 to capitalize the interest accrued pursuant to the April 8, 2020 amending agreement (Credit Facility 3).

[5] Okje's indebtedness under the Credit Facilities is secured by:

a) Personal guarantees and postponement of claims from the Chos of the loans under Credit Facilities 1 & 2;

b) Guarantee and postponement of claim of Okje's liabilities by 234;

c) General Security Agreements from both Okje and 234, registered under the *Personal Property Security Act*;

d) A collateral mortgage granted by Okje in favour of Meridian for $8,000,000 registered against the Property (the "Mortgage");

[6] Okje is in default under the Credit Facilities. It has made no payments under Credit Facility 1 since December 1, 2020; made no payments on Credit Facility 2 since January 1, 2021 and failed to repay Credit Facility 3 by its maturity date, October 31, 2020.

[7] In addition, Okje and 234 were also in default under the Credit Agreement in respect of the following arrears: property taxes for the Property totaling $135,350.18 as at October 6, 2020; non-resident tax of $102,386.14 as of July 29, 2020; GST/HST arrears for Okje of $8,904.29 as at June 30, 2020; GST/HST arrears for 234 of $115,183.91 as at December 31, 2019.

[8] In October 2020, Okje made an application for a $1.4 million loan under the EDC Business Credit Availability Program ("BCAP Loan") through Meridian. The application was declined by Meridian on December 8, 2020. Subsequently, Meridian and Okje attempted to address the respondents' defaults.

[9] On February 26, 2021, after a payment by Okje of past due amounts under Credit Facility 2 was returned due to "insufficient funds", Meridian made a demand for payment upon Okje, 234 and the personal guarantors of the entire amount of the indebtedness under the Credit Facilities, which at that date was $7,770,121.39. The indebtedness remains outstanding.

[10] The application was commenced on April 13, 2021 and returnable April 22, 2021 at which time it was put over to May 11, 2021 to permit the respondents to file responding materials. On May 11, 2021 it came before me. As part of their responding material, the respondents filed an affidavit from Mr. Maneet Singh Gadhok (also known as Monty Singh), in which he deposed that he had entered into an Agreement of Purchase and Sale with Okje dated April 8, 2021, amended April 16, 2021, to purchase the Property for $8,000,000.00 (the "Agreement"). The Agreement was conditional on, among other things, the approval of the

terms of the Agreement by Mr. Singh's solicitor and assumption by him of the Mortgage. As a result of the amendment, the date for satisfying the conditions was May 17, 2021 and the closing date was June 1, 2021.

[11] Meridian's position was that it was not prepared to consent to Mr. Singh assuming the Mortgage. Further, and even if the Agreement as produced was completed, there would likely still be money owing to it and to Okje and 234's other creditors, some of whom have priority over the Mortgage. In response, Okje and 234 took issue with the statement Meridian would not assume the Mortgage and stated the Chos' including their son, have indicated that they were prepared to or have already listed their homes in Toronto for sale and there is sufficient equity to pay off both Meridian and the outstanding creditors.

[12] In the circumstances, I granted a short adjournment to May 21, 2021 to enable Okje and 234 to firm up their plan to resolve their obligations. In so doing, I stated that prior to the return date, the respondents must provide evidence concerning the status of the Agreement and specifically whether the conditions in the Agreement had been fulfilled or waived such that the Agreement was firm as well as evidence of the status of both the Chos and their son's proposed sales of their Toronto properties including whether the properties have been listed; the listing price; the total amount of mortgages and other encumbrances on the properties and the expected "net" proceeds that will be available.

[13] I further advised the parties that if I was satisfied on the return date that based on the evidence, there was a realistic possibility that the respondents and the Chos could resolve their obligations to Meridian and their other creditors, I would further adjourn the application for a reasonable period to let that happen. For that to happen, however, the respondents must have a concrete plan including a firm agreement of purchase and sale.

[14] Prior to the return on May 21, 2021, both parties filed further evidence concerning events subsequent to May 11, 2021. Mr. Cho advised that the Agreement was "alive" and that it had been further amended to reduce the purchase price of the Property to $7 million. The amended Agreement contained a clause that the buyer agreed to lend $2 million to the seller for closing the deal. Both parties agreed to "register this money" on the Chos' personal residence. The amended Agreement still contained the buyer's lawyer's approval condition but not the assumption of the Mortgage. Finally, the time to satisfy conditions was extended to June 15, 2021 and the closing date to June 30, 2021.

[15] Mr. Cho further deposed that the $9 million (the new purchase price together with the $2 million loan) would be sufficient to pay off all the respondents' liabilities. He further stated that Okje had become aware of and submitted a loan application for $1 million to the Regional Relief and Recovery Fund, a Federal programme to help small businesses and he anticipated that funding would be distributed in 6 to 9 weeks-time. Finally, he provided evidence of listings of both his personal residence ($6,990,000) and his son's residence ($3.289 million).

[16] Meridian filed a further affidavit of Amber Waheed, a Commercial Credit Specialist and the person responsible for managing the respondents' loans. On May 18, 2021, Ms. Waheed had a telephone discussion with Mr. Singh during which he advised he had not yet retained legal

counsel; the removal of the condition requiring the assumption of Meridian's mortgage was an error and that he still required the condition to be included; although he'd been in touch with the franchisor, he had not received its approval to take over the hotel; his understanding was that Okje currently owed the franchisor between a $100,000 and $150,000 in outstanding franchise fees; in respect of the $2 million loan, he said Meridian would receive approximately $1 million and the balance would be used for priority and trade payables although he could not provide any details of the timing or the amounts owing.

[17] Following the above discussion with Mr. Singh, he retained a lawyer and discussions took place between Mr. Singh and Meridian, but no agreement was reached.

[18] Mr. Cho filed a further brief affidavit taking issue with Ms. Waheed's statement that Mr. Singh had said that the deletion of the condition requiring the assumption of the Meridian mortgage was an "error". Mr. Cho said that the condition was specifically discussed and deleted, and that Mr. Singh communicated to him that he could finance the acquisition of the hotel.

[19] Both s. 243(1) of the BIA and s. 101 of the CJA provide that the court may appoint a receiver if it considers it to be just or convenient to do so.

[20] In determining whether it is just or convenient, the court must have regard to all of the circumstances of the case including the nature of the property, the rights and interests of the parties to the property, whether the lender's security is at risk of deteriorating, whether there is a need to stabilize and preserve the business, whether there is a loss of confidence in the debtor's management and the positions and interests of other creditors. See: *Confederation Life Insurance Co. v. Double Y Holdings Inc.*, 1991 CarswellOnt 1511 (Ont. S.C.J. (Commercial List) at para. 20; *BCIMC Construction Fund Corporation et al. v. The Clover on Yonge Inc.*, 2020 ONSC 1953.

[21] Further, while the appointment of a receiver is considered an extraordinary remedy, in circumstances such as in this case, where the Credit Agreement, the Okje and 234 General Security Agreements and the Mortgage all provide that Meridian is entitled to appoint a receiver and manager in the event of a default, as Meridian's right to the appointment of a receiver is derived from a private contract, the appointment of a receiver cannot be considered an extraordinary remedy. See: *Business Development Bank of Canada v. 2197333 Ontario Inc.*, 2012 ONSC 965; *BCIMC Construction Fund*, at para. 43.

[22] Meridian submits that is just and convenient to appoint a receiver in this case. The respondents are clearly in default of the Credit Agreement. They are insolvent and have presented no clear path to resolve their obligations. There is no assurance the Agreement will be completed and even if it is, the respondents, by their actions, concede that more money will be required to pay out Meridian and the other ranking creditors, the source of which is also tenuous. Meanwhile, the longer the delay, the more its security is in jeopardy and at risk of eroding. Meridian has lost confidence in Okje's management and the appointment of a receiver will bring stability to the business and permit an orderly resolution of the issues.

[23] The respondents submit that a receivership would not be just or convenient. It would result in a substantial reduction in the value of the hotel and add substantial unnecessary expense to the process of finding a purchaser. It would also lead to the termination of 234's franchise pursuant to the franchise agreement. The respondents submit that they ought to be provided a fair opportunity to rectify any defaults and to sell their assets in an orderly manner.

[24] The respondents also raise issues of misrepresentation and bad faith conduct on the part of Meridian in relation to its handling of Okje's application for BCAP Loan in October 2020 and Meridian's subsequent decline of the application. They have commenced an action against Meridian and submit, given the factual issues in dispute, the application should be converted to an action.

[25] Finally, the respondents rely on the Agreement together with their actions in attempting to liquidate their assets to demonstrate that they have a plan which they are executing to enable them to pay off Meridian and their other creditors. They also point to their recent application for $1 million in funding to the Regional Relief and Recovery Fund.

[26] In my view, based on all the evidence, I am satisfied the appointment of a receiver is justified in this case.

[27] There is no issue that the loans are in default and have been for some time. The amount involved is substantial. The respondents essentially seek an opportunity to either bring the loans into good standing or sell the Property and business and repay Meridian and their other creditors. The evidence of how they intend to do that however does not in my view establish that to be a realistic possibility.

[28] The Agreement, which has been amended twice, is far from firm. There is also evidence that the parties may have a disagreement over whether there is a condition regarding Mr. Singh's assumption of the Mortgage. The further $2 million loan from Mr. Singh and/or the sale of the residences are also far from firm. The former is not documented and is to be secured by a mortgage on the Chos' residence which is for sale. Nor is there evidence of the encumbrances on the residences or what the net proceeds from the proposed sales would be should they occur.

[29] There is also no evidence that Okje's recent application for funding from Regional Relief and Recovery Fund will solve the respondents' issues. Even if approved, funding is still 6-9 weeks away and will not resolve their issues with Meridian or with the other creditors.

[30] There is also no evidence on the financial status of the hotel, including its recent cash flow and liabilities. As part of its disclosure for the BCAP Loan in the fall of 2020, Okje noted cash shortfalls of $622,593 for 2020 and projected $923,437 for 2021. That was before the province wide stay at home order in March of this year which has impacted all small businesses. Mr. Singh's information that there are substantial franchise fees in arrears is also troubling. In my view, in the circumstances, a receiver is required to stabilize and preserve the business.

[31] I also not satisfied that the application should be converted to an action or that Meridian's actions in respect of declining the BCAP Loan should impact on this application. The documentary evidence does not come close to establishing that Meridian made any

misrepresentations to the respondents concerning the availability of the BCAP Loan or its actions in declining it. The respondents were aware at all times that approval of the loan was subject to the approval of Meridian's credit department, which was not forthcoming for reasons which were communicated to the respondents.

[32] For the above reasons, BDO is appointed as receiver and manager over all property, assets and undertaking of Okje and 234.

[33] I am not prepared at this stage to authorize BDO to assign the respondents into bankruptcy. Such a request is premature in my view.

[34] Nor do I consider that the Agreement should be sealed. There is no evidence that it was obtained based on a formal sale process or that the proposed purchase price has any relation to the actual market value of the Property. In the circumstances, it should have no impact on the value of the Property.

[35] A receivership order, substantially in the form of the Commercial List order shall issue.

L.A. Pattillo J.

Released: May 25, 2021.

TAB 3

QUEEN'S BENCH FOR SASKATCHEWAN

Citation: **2017 SKQB 228**

Date: **2017 07 24**
Docket: QBG 783 of 2017
Judicial Centre: Saskatoon

COURT OF QUEEN'S BENCH FOR SASKATCHEWAN
IN BANKRUPTCY AND INSOLVENCY

BETWEEN:

AFFINITY CREDIT UNION 2013

PLAINTIFF

- and –

VORTEX DRILLING LTD.

DEFENDANT

Docket: QBG 1030 of 2017
Judicial Centre: Saskatoon

BETWEEN:

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, RSC 1985, c C-36, AS AMENDED

- and -

IN THE MATTER OF *THE* SASKATCHEWAN *BUSINESS CORPORATIONS ACT*, RSS 1978, c B-10

IN THE MATTER OF A PROPOSED PLAN OF COMPROMISE OR ARRANGEMENT OF VORTEX DRILLING LTD.

Counsel:

Jeffrey M. Lee, Q.C., and Paul D. Olfert	for the Affinity Credit Union and Radius Credit Union
Mary I.A. Buttery and Jared Enns	for Vortex Drilling
Ian A. Sutherland and Jordan F. Richards	for the Receiver
Brent Warga	Representative of Interim Receiver (via phone)
P. Koliaskis	for the Proposed Monitor (via phone)

DECISION — SCHERMAN J.
July 24, 2017

Introduction

[1] Affinity Credit Union 2013 [Affinity], a secured lender to Vortex Drilling Ltd. [Vortex], is owed in excess of $8,350,000 and has applied for the appointment of a Receiver of all of the assets and properties of Vortex under s. 243 of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 [*BIA*] and s. 64 of *The Personal Property Security Act, 1993*, SS 1993, c P-6.2 [*PPSA*].

[2] Vortex has applied under s. 11.02(a) of the *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 [*CCAA*], for an initial order granting various relief including a stay of all proceedings against Vortex for a period of time to permit it to pursue a successful arrangement or reorganization.

[3] Vortex is insolvent. The other statutory requirements to permit Affinity to pursue the appointment of a Receiver under the *BIA* and for Vortex to seek an initial order and stay under the *CCAA* have been met or established.

[4] Affinity has since early 2015 accommodated financial difficulties being faced by Vortex and agreed, under the terms of various agreements, to interest only

payments for periods of time in return for various undertakings of Vortex. It says Vortex has breached those undertakings, has ceased making even interest payments and since April of 2017 has been in default under the terms of its credit agreements. Affinity has demanded payment in full of the indebtedness owed to it, and Vortex has failed to pay what it is contractually obligated to pay.

[5] Vortex is in the business of drilling oil wells. It says that its financial difficulties are the direct result of the significant drop in the price of oil that occurred in 2014 and has continued to date. This has caused a related reduction in the demand for drilling rigs to drill new wells. Oil prices peaked well in excess of $100 U.S. per barrel and since 2014 have fallen to $50 U.S. or less per barrel.

[6] Vortex argues the economic climate in the Western Canadian oil industry is improving, it is expecting a substantial improvement in its cash flow, Affinity is fully secured for the indebtedness owed and the initial *CCAA* order it seeks should be granted so as to give it an opportunity to seek refinancing from other lenders or to facilitate the making of a compromise or arrangements with its existing creditors so as to permit it to be able to continue in business.

[7] The issue to be decided in the context of the competing applications is whether the appropriate order to make is to grant an initial order and stay of proceedings under the *CCAA* or to grant Affinity's application for the appointment of a Receiver.

Background Facts

[8] Vortex was created in November of 2010 and subsequently purchased and/or constructed three drilling rigs largely utilizing borrowed funds. Under the

terms of an August 12, 2013 Offer to Finance from Affinity [Credit Agreement] accepted and agreed to by Vortex, Affinity advanced Vortex, under three separate loan facilities, a total of $14,910,711 to pay out existing loans in respect of two rigs and to finance the construction of a third drilling rig. The individual loan facilities were each payable on demand, but before demand were to be paid by combined monthly principal and interest payments totalling $325,257. The Credit Agreement expressly provided that any material change in risk or adverse change in the financial condition of Vortex or failure to comply with any condition of the Offer to Finance would constitute an event of default entitling Affinity to demand payment of all sums owing and to realize on the security taken for the loan.

[9] As required by the Credit Agreement, Vortex granted to Affinity, under the terms of a general security agreement registered in the personal property registries of each of Manitoba, Saskatchewan and Alberta [GSA], a security interest in all of its present and after acquired property. The terms of the GSA included the right of Affinity, upon the occurrence of an event of default as therein defined, to seize and sell any of Vortex's property or to appoint a Receiver (see paragraphs 9 to 13 of the GSA). Events of default were widely defined and include the insolvency of Vortex.

[10] With the collapse of oil prices and the resulting downturn in the oil industry Vortex was unable to make the monthly payments contemplated by the Credit Agreement and sought accommodations from Affinity. By a series of agreements Affinity provided principal repayment deferrals to Vortex, which resulted in Vortex paying only interest for most of the months of 2016. Vortex failed to fulfil its commitments to make balloon principal payments and to resume principal and interest payments by dates and in amounts contemplated by these accommodations or deferral agreements.

[11] As of January 2017 regular monthly principal and interest payments of $325,257 were again to resume but Vortex failed to make such payments. In March of 2017 Vortex informed Affinity that it could only afford to make monthly payments of $100,000 rather than the $325,257 per month then required by the Credit Agreement. Affinity prepared an amendment to the Credit Agreement which would have permitted such reduced payments on condition that Vortex approach its shareholders to obtain an injection of equity capital to finance its business operations and reduce the indebtedness owing to Affinity. Vortex did not sign that amending agreement, has not made the required monthly payments, nor remedied the defaults that have occurred under the Credit Agreement, as amended from time to time.

[12] By letter of May 1, 2017 Affinity gave Vortex notice of intention to enforce its security pursuant to s. 244(1) of the *BIA* and demanded that the full outstanding obligations (stated to be $8,422,061.01 as at April 28, 2017) be repaid within 30 days, failing which Affinity would proceed to avail itself of its legal remedies including enforcing its security. On June 6, 2017 Affinity filed with this Court its notice of application, returnable June 9, 2017, seeking the appointment of a receiver. By agreement between counsel for Affinity and Vortex this application was adjourned to June 23, 2017.

[13] During this adjournment negotiations continued between the parties with Vortex seeking continuing accommodations or forbearance on the part of Affinity. Vortex was representing it had prospects to refinance the indebtedness with other lenders.

[14] Affinity takes that position that these negotiations resulted in a concluded agreement under which Affinity was to provide an additional two-week period of forbearance so as to give Vortex additional time to pursue refinancing and

would fund current payroll obligations of Vortex, in return for which Vortex would consent to the appointment of a receiver should its refinancing efforts fail. Vortex takes the position that no such agreement was ever concluded.

[15] Affinity's application for the appointment of a receiver came before me on June 23, 2017. Vortex sought an adjournment of that application, advancing the position that it needed time to respond to the affidavits filed by Affinity and to bring its own application for *CCAA* relief. In the circumstances I ordered the appointment of an interim receiver for a period ending July 23, 2017 under which the interim receiver could investigate, monitor and facilitate Vortex's continuing operation so as to give Vortex an opportunity to file opposition affidavits and make its *CCAA* application.

[16] That application and the affidavit evidence of both Vortex and Affinity on both applications are before me. As stated above, Vortex is insolvent, in the sense of being unable to pay its debts as they become due. The issue to be decided is whether in the circumstances the appointment of a Receiver or an initial order under the *CCAA* is most appropriate in the circumstances.

The Law Respecting *CCAA* Applications

[17] Jurisprudence establishes that the following principles are applicable to *CCAA* applications:

a. The legislative purpose of the *CCAA* is to permit qualifying debtors to carry on business and where possible avoid the social and economic costs of liquidating its assets: See *Century Services Inc. v Canada (Attorney General)*, 2010 SCC 60 at para 15, [2010] 3 SCR 379 [*Century*].

b. The remedial purpose of the *CCAA* is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors to the end that the company is able to continue in business: See *Chef Ready Foods Ltd. v Hongkong Bank of Canada* [1991] 2 WWR 136.

c. The requirements of appropriateness, good faith and due diligence are baseline considerations that a court should always bear in mind when exercising *CCAA* jurisdiction: *Century* at para 70.

d. Appropriateness is assessed by inquiring whether the order sought advances the remedial purpose of the *CCAA*: *Century* at para 70

e. Section 11.02(3)(a) of the *CCAA* states that the court shall not grant a stay of proceedings unless:

> (a) the applicant satisfies the court that circumstances exist that make the order appropriate…

[18] I proceed on the basis that a *CCAA* applicant bears the burden of establishing each of the requirements of appropriateness, good faith and due diligence.

The Law Respecting Receivership Applications

[19] In a previous unreported decision in *Golden Opportunities Fund Inc. v Phenomenome Discoveries Inc.* (25 February 2016) Saskatoon, QB 1639 of 2015 (Sask QB), I summarized jurisprudence with respect to applications to appoint a receiver under s. 243 of the *BIA*. I repeat here that summary, which I view as remaining accurate:

5. Under s. 243(1) of the *BIA* this court can, on application of a secured creditor, appoint a receiver where it considers it just and convenient to do so. Instructive decisions on the factors relevant to the court's determination of whether it is "just and convenient" include *Bank of Montreal v. Carnival National Leasing Ltd.* 2011 ONSC 1007 *and Kasten Energy Inc. v. Shamrock Oil & Gas Ltd.* 2013 ABQB 63.

6. In Carnival the court said the following regarding the just and convenient criteria at para 24 of its reason:

> In *Bank of Nova Scotia v. Freure Village on Clair Creek* (1996), 40 C.B.R. (3d) 274 (Ont. Gen. Div. [Commercial List]), Blair J. (as he then was) dealt with a similar situation in which the bank held security that permitted the appointment of a private receiver or an application to court to have a court appointed receiver. He summarized the legal principles involved as follows:
>
>> 10 The Court has the power to appoint a receiver or receiver and manager where it is "just or convenient" to do so: the Courts of Justice Act, R.S.O. 1990, c. 43, s. 101. In deciding whether or not to do so, it must have regard to all of the circumstances but in particular the nature of the property and the rights and interests of all parties in relation thereto. The fact that the moving party has a right under its security to appoint a receiver is an important factor to be considered but so, in such circumstances, is the question of whether or not an appointment by the Court is necessary to enable the receiver-manager to carry out its work and duties more efficiently; see generally *Third Generation Realty Ltd. v. Twigg* (1991) 6 C.P.C. (3d) 366 at pages 372-374;*Confederation Trust Co. v. Dentbram Developments Ltd.* (1992), 9 C.P.C. (3d) 399; *Royal Trust Corp. of Canada v. D.Q. Plaza Holdings Ltd.* (1984), 54 C.B.R. (N.S.) 18 at page 21. It is not essential that the moving party, a secured creditor, establish that it will suffer irreparable harm if a receiver-manager is not appointed: *Swiss Bank Corp. (Canada) v. Odyssey Industries Inc.*(1995), 30 C.B.R. (3d) 49.

7. In *Kasten* the court said the following:

> 13 Both parties agree that the factors that may be considered in making a determination whether it is just and convenient to appoint a Receiver are listed in a non-

exhaustive manner in *Paragon Capital Corp. v. Merchants & Traders Assurance Co.*, 2002 ABQB 430 (Alta. Q.B.) at para 27, (2002), 316 A.R. 128 (Alta. Q.B.) [Paragon Capital], citing from Frank Bennett, Bennett on Receiverships, 2nd ed (Toronto: Thompson Canada Ltd, 1995) at 130] to include:

a) whether irreparable harm might be caused if no order were made, although it is not essential for a creditor to establish irreparable harm if a receiver is not appointed, particularly where the appointment of a receiver is authorized by the security documentation;

b) the risk to the security holder taking into consideration the size of the debtor's equity in the assets and the need for protection or safeguarding of the assets while litigation takes place;

c) the nature of the property;

d) the apprehended or actual waste of the debtor's assets;

e) the preservation and protection of the property pending judicial resolution;

f) the balance of convenience to the parties;

g) the fact that the creditor has the right to appoint a receiver under the documentation provided for the loan;

h) the enforcement of rights under a security instrument where the security-holder encounters or expects to encounter difficulty with the debtor and others;

i) the principle that the appointment of a receiver is extraordinary relief which should be granted cautiously and sparingly;

j) the consideration of whether a court appointment is necessary to enable the receiver to carry out its' duties more efficiently;

k) the effect of the order upon the parties;

l) the conduct of the parties;

> m) the length of time that a receiver may be in place;
>
> n) the cost to the parties;
>
> o) the likelihood of maximizing return to the parties;
>
> p) the goal of facilitating the duties of the receiver.
>
> See also, *Lindsey Estate v. Strategic Metals Corp.*, 2010 ABQB 242 (Alta. Q.B.) at para 32, aff'd 2010 ABCA 191 (Alta. C.A.); and *Romspen Investment Corp. v. Hargate Properties Inc.*, 2011 ABQB 759 (Alta. Q.B.) at para 20.

[20] Consistent with my view that a *CCAA* applicant bears the burden of establishing each of the requirements of appropriateness, good faith and due diligence, I am of the view that an applicant under s. 243 of the *BIA* bears the burden of satisfying the Court that it would be just and convenient to appoint a receiver in the circumstances.

The Parties' Positions in Brief

[21] Vortex's position is that on a proper application of the legislative and remedial purposes of the *CCAA* it is appropriate to issue an initial order and grant a stay. It argues that putting Vortex into receivership is going to result in liquidation of its assets and the end of its business with the resulting loss of employment for many individuals as well as the loss of the other economic activity that Vortex generates in its home community.

[22] Vortex says that the economic climate in the Western Canadian oil industry is improving and it is expecting a substantial improvement in its cash flow. It says it expects to soon secure additional business and that it is actively pursuing promising refinancing opportunities. Thus it says it is appropriate that it be given an opportunity to pursue such refinancing or a compromise with its creditors so as to

avoid the social and economic costs of liquidation. It says that the security that Affinity holds has a value significantly beyond the debt owed by it, and there will be no real prejudice to Affinity by granting an initial order and granting a stay.

[23] Affinity says the proper and appropriate order in the circumstances is the receivership order it seeks. It says that Vortex is insolvent, it has the contractual right to appoint a receiver or seize and sell the rigs upon an event of default (which both insolvency and failure to pay the debt owed are), it has already provided Vortex with lengthy and significant accommodations and for good and sufficient cause it has lost trust in Vortex. Affinity says Vortex has repeatedly failed to honour contractual commitments made to Affinity in return for the deferrals granted and that the evidence demonstrates that Vortex has not acted in good faith.

[24] Beyond these factors Affinity's position is that, given the realities of the oil industry and Vortex's financial position, the business is unviable now and into the foreseeable future. Over nearly 2 ½ years Affinity has accepted deferral in payments totalling some $4,500,000, but notwithstanding this accommodation Vortex has been unable to generate cash flow that permitted it to cover its variable operating costs, much less make a contribution to fixed costs. The application made by Vortex does not contain even the germ of a reorganization plan that has any prospect of succeeding. It relies on purported, but unverified, refinancing possibilities. Vortex has had many months' opportunity to obtain refinancing and has not been able to do so.

[25] Affinity says that continuing to operate the rigs without generating revenue sufficient to cover the fixed costs (which includes repayment of the loans) means the rigs will continue to depreciate and Affinity's security position will be eroded.

[26] For all of these reasons it says to issue an initial order and grant a stay of proceedings under the *CCAA* would be inappropriate and that is just and convenient to appoint a receiver.

Analysis of Vortex's Position that *CCAA* Relief is Appropriate

i. Evidentiary Concerns

[27] At paragraphs 20 to 22 of the Vortex Brief of Law counsel argues as follows:

> 20. A stay of proceedings would fulfill the legislative objective of the CCAA by permitting Vortex to carry on its business operations during the reorganization process. The evidence in support of this application clearly demonstrates that such an order is appropriate in these circumstances:
>
> (a) the industry within which Vortex operates is seasonal, and Vortex's Rigs are generally deployed from the month of June onwards (Twietmeyer Affidavit, at para 18);
>
> (b) as the industry itself is seasonal, so too is Vortex's cash flow (Twietmeyer Affidavit, at para 18);
>
> (c) Vortex's assets are worth significantly more than its debts (Twietmeyer Affidavit, at paras 2 and 17);
>
> (d) two of Vortex's three Rigs are currently deployed and operational for the 2017 season, one for Crescent Point Energy Cop. (sic), which is one of Canada's largest light and medium oil producers, and the second Rig is currently in operation for Aldon Oil Ltd. (Twietmeyer Affidavit, at para 19);
>
> (e) Vortex's general manager and sales consultant are currently deploying significant efforts in order to secure a contract in respect of its third Rig. The evidence before this court is that these efforts have successfully generated new business for Vortex, including its most recent contract with Aldon Oil Ltd. Accordingly, and through these ongoing efforts, it is

> believed that it is highly likely that Vortex will secure a contract for its third Rig (Twietmeyer Affidavit, at para 20); and
>
> (f) assuming all of the relief sought in this application is granted, Vortex's cash-flow projections indicate that, if DIP Financing is approved, Vortex will have enough liquidity to meet its cash flow needs through to the end of the 13-week forecast period (Twietmeyer Affidavit, at para 61).

[28] It should be noted that for each of the points in paragraph 20 (a) to (f) counsel references supporting evidence from affidavits of one Tina Twietmeyer. I have concluded that it is not appropriate for me to rely on much of the affidavit evidence of Tina Twietmeyer for the reasons that follow:

a. In paragraph 1 of her affidavit she describes herself as the Administrative Director of Vortex without providing any information or details as to what that job function involves and how it would give her the personal knowledge she claims to have. The evidence establishes she is not and has never been a corporate director of Vortex.

b. Notwithstanding her statement that she has personal knowledge of matters in question, on a close read of her affidavits it is apparent much of her evidence is based on information and belief without the basis for her information and belief being provided.

c. Rule 13-30 of *The Queen's Bench Rules* requires that an affidavit must be confined to facts within the personal knowledge of the person swearing the affidavit except that on an interlocutory application affidavit evidence based on information and belief is permissible provided the basis for the claimed information and belief is disclosed.

d. Applying the test in *Verlaan v Lang Estate*, 2004 SKQB 376, that an application is interlocutory where the decision in respect of it given in one way would finally dispose of the matter but if given in another way would allow the action to go on, I am of the opinion that an application for an initial order and stay of proceedings under the *CCAA* is not an interlocutory application. I fully appreciate that if the initial order is granted a further application approving a restructuring plan would be required. While the current application may lie close to the tipping point between what is a final application and an interlocutory application, it is my conclusion that Vortex's *CCAA* application has more of the characteristics of a final application than of an interlocutory application and thus I find the application to not be an interlocutory application. The result is that affidavit evidence based on information and belief is not admissible and should not be considered.

e. If I am wrong in my conclusion that the application is not interlocutory, then nonetheless, in various instances where Ms. Twietmeyer is giving evidence based upon information and belief for which the basis is not provided, the weight and reliability to be given to much of her evidence cannot be assessed.

f. Beyond these concerns, the Rules applicable to affidavit evidence do not permit opinion, argument, irrelevant matters or hearsay on either an interlocutory or final application. Much of Ms. Twietmeyer's affidavit evidence consists of opinion, argument and hearsay or irrelevant matters and thus should not be considered on those grounds.

g. An example of this is her evidence at paragraph 3 of her referenced affidavit that "the economic climate in the Western Canadian oil industry is improving. As a result, Vortex is experiencing significant growth in its business and is expecting a substantial improvement in its cash flow". This evidence includes inadmissible opinion, speculation and argument.

h. On the basis of all of the evidence, I conclude it is wrong to say that Vortex is experiencing significant growth. Rather it is limping along drilling wells on a "one-off" basis as and when such contracts come available. This work is done at depressed prices that cover the variable costs of operation, if that, and the bulk of its capacity is unused.

i. Ms. Twietmeyer is in no position to provide opinion evidence that the economic climate in the Western Canadian oil industry is improving, and her statement that Vortex is expecting a substantial improvement in its cash flow can at best be viewed as her hope, but in the context of affidavit evidence is inadmissible speculation.

[29] With reference to the points made in paragraph 20 of the Vortex Brief of Law above:

i. The facts stated in paragraphs 20 (a) and (b) that the industry in which Vortex operates and thus its cash flow is seasonal is of no or little relevance. The fact that the oil well drilling industry cash flow is seasonal is simply a fact of the business that should be accommodated in the budgeting. The evidence establishes that over a continuous 2 ½ years this business has been unviable.

ii. The statement at paragraph 20 (c) that Vortex's assets are worth significantly more that its debts is either or both inadmissible hearsay evidence or inadmissible opinion evidence. Paragraph 17 of Ms. Twietmeyer's affidavit indicated that an appraisal of the equipment had been obtained valuing it at $17,146,000, but Vortex has not filed this appraisal claiming confidentiality. This is not an acceptable reason for not filing an appraisal relied upon. Where appropriate, evidence with confidentiality concerns can be filed on a basis that protects the confidentiality.

iii. Opinion evidence can only be given by an individual found to be qualified to give such opinion evidence. To attempt to bootstrap opinion evidence of value into the record in this way is an attempt to introduce hearsay evidence. It denies Affinity any ability to test the opinion evidence or respond. Opinion evidence of value should be provided directly by the person expressing the opinion accompanied by the details of qualifications and the opinion so as to give the party opposite and this Court an opportunity to assess its reliability.

iv. Given no evidence that establishes the expertise of the provider of such appraisal and other evidence that the daily rates for drilling rigs have declined from in excess of $16,000 per day to under $7,000 per day and that only one out of three of Vortex's rigs has been operating on any regular basis gives significant basis to be concerned about the reliability of such evidence.

v. Paragraph 20 (d) of the Vortex brief argues, based on paragraph 19 of the Twietmeyer affidavit, that two of Vortex's three rigs are operational for the 2017 season. This is misleading as to the true state of affairs. The current evidence, as of the date this matter was heard, was that the second rig had drilled one well for Aldon, over a period of approximately one week, and has since been idle. While there may be two rigs which are in operating condition, the relevant fact is that these two rigs are far from fully engaged.

vi. The argument advanced at paragraph 20(e) of the Vortex brief that "it is believed that it is highly likely that Vortex will secure a contract for its third Rig" is based on an expressed "belief" in paragraph 20 of the Twietmeyer affidavit without Twietmeyer having provided any basis for such belief other than reference to efforts on the part of a Messrs. Geysen and Rae. If there is relevant evidence on efforts and prospects for future work it should be given by these individuals rather than in the second-hand, hearsay manner here attempted. Reduced to its essence this is speculation and argument, not evidence.

[30] An applicant seeking relief under the *CCAA* should be placing before the Court the best evidence available. Section 11.02(3) of the *CCAA* requires the applicant to satisfy the Court that circumstances exist that make the order sought appropriate. It is a concern to me that I have a number of affidavits from Ms. Twietmeyer but no affidavit on this application from Mr. Geysen, who is the President and General Manager of Vortex, and thus presumably the responsible person within the company who has the requisite personal knowledge.

[31] Counsel for Vortex argues that I should have similar or enhanced concerns with respect to the affidavit evidence filed on behalf of Affinity and says I need to consider Ms. Spencer's affidavits with great care. I do not find reason for overall concern. While Ms. Spencer has expressed opinions or beliefs with regard to

the impact on the viability of Vortex given Mr. Big Eagle is no longer on the Board or the Chief Executive Officer of Vortex, I have not relied on that evidence for the decisions I have made.

[32] Ms. Spencer's affidavits make it clear that she has had day-to-day responsibility for administration of Affinity's account relating to Vortex and that she has conducted a detailed review of the books, records, files and correspondence of Affinity relating to that account. To the extent to which she provides factual evidence based upon the knowledge of the books, records, files and correspondence of Affinity, I find the factual evidence provided by Ms. Spencer in her affidavits to be appropriate and reliable. To the extent to which she engaged in measures of speculation, argument or providing evidence that she did not have personal knowledge of, I have not relied on such evidence.

ii. Good Faith Considerations in *CCAA* Applications

[33] I find on the basis of the evidence before me that there have been elements of bad faith in Vortex's dealings with Affinity. Vortex had, arising from both the nature of their relationship and by virtue of express contractual provisions, an obligation to provide complete and accurate financial information to Affinity and to not hide or misrepresent matters relevant to their relationship. Good faith of the applicant is a baseline consideration for a Court when considering *CCAA* applications.

[34] As of June 20, 2017, with Affinity's receivership application before this Court, but adjourned while the parties were negotiating a potential forbearance agreement, Vortex represented to Radius Credit Union (a member of the Affinity lending syndicate and independently providing an operating line of credit to Vortex) it had no accounts payable. This it did by writing cheques purporting to pay various

accounts payable, but then holding those cheques totalling some $235,548 and not delivering them to the payees. This accounting fiction that accounts payable had been paid was used by Vortex to access, under the Radius margining formula, some $121,000 in operating credits that would not have been available had the facts been accurately disclosed. I find this to be a breach of Vortex's contractual covenants to Affinity to provide honest and accurate financial information to Affinity notwithstanding that the misrepresentation was made to Radius in the first instance. Given the circumstances and Affinity's concerns with respect to Vortex's financial position, this action was a failure to act in good faith. It only came to light by reason of investigations by the Interim Receiver.

[35] In a June 30, 2016 revision to the Credit Agreement, which allowed Vortex's request to pay interest only from July through November, Vortex agreed that any financial settlement with one Harvey Turcotte would be funded from outside sources and not from Vortex's cash flow. Notwithstanding this agreement, in February of 2017 Vortex made a payment of $525,000 to Harvey Turcotte from its cash flow in breach of this agreement. This fact was not disclosed by Vortex to Affinity and only came to light by reason of investigations by the Interim Receiver. This I find to be a failure on the part of Vortex to act in good faith.

iii. Is *CCAA* Relief Appropriate or the Appointment of a Receiver Just and Convenient?

[36] On the basis of the totality of the evidence before me, I have concluded that it is not appropriate to make an initial order nor grant a stay of proceedings as requested by Vortex in its *CCAA* application. For reasons that overlap, I find it is just

and convenient that a Receiver be appointed. I am assisted in these findings by the information provided in the Interim Receiver's reports. In particular I note the Interim Receiver's statements in his July 18, 2017 report, that:

a. Vortex is not contemplating any debt payment to be made to Affinity during the period July 17, 2017 to September 24, 2017 (para. 39); and

b. "Vortex would not have been able to manage its cash flow needs from ongoing operations without the injection of the July 7, 2017 payroll funded by the Interim Receiver." (para. 41).

[37] Vortex bears the burden of satisfying me that the relief they seek is appropriate in the circumstances. I am fully alive to the consequences that appointing a receiver may have upon Vortex's employees, unsecured creditors, shareholders and business associates. However, the evidence satisfies me that:

a. The prospect of Vortex finding a lender to refinance it, at the level required to satisfy all of the indebtedness to Affinity and other creditors without significant equity injections by the shareholders, is remote or non-existent.

b. The shareholders of Vortex have demonstrated over the last 2 ½ years that they are not prepared to invest further monies in Vortex. While Vortex says it has interest from other lenders in refinancing it, Vortex has chosen not to share with Affinity and the Court the details of such refinancing proposals. In the circumstances I am unable to give weight to suggestions that there are real prospects of refinancing that do not involve either substantial write-off of current indebtedness or the injection of significant additional equity.

c. Vortex has long known that Affinity wanted additional capital injection to the company. Vortex has, given the accommodations Affinity provided over the last two years, had ample opportunity to pursue alternate financing. At a minimum they have since May 1, 2017 had the knowledge that the need for alternate financing was immediate.

d. Two years of financial statements of Vortex establishes that, given the day rates for drilling rigs and the work available, it is unviable at its current debt levels. To the extent Vortex has been able to generate revenue, that revenue has barely covered, and during some periods not covered, the variable costs of operating those rigs, much less making a contribution to fixed costs. Vortex is currently in breach of its statutory obligation to pay employee withholdings to Canada Revenue Agency.

e. While Vortex argues that the economic prospects are improving, there is no credible evidence provided to support that argument. Rather the evidence is that since 2014 the day rate paid for drilling rigs has been reduced to less than one half of their previous levels and even at these rates Vortex is unable to find work that does more than partially utilize its rigs.

f. Oil prices remain below $50.00 per barrel, and Vortex has provided no evidence to support a conclusion that drill utilization rates or daily charges can or will improve beyond the rates experienced over the last 2 ½ years. No statistical evidence has been provided that establishes the number of rigs available in Western Canada and their current utilization rates nor economic forecasts or analysis that demonstrates that those utilization rates or the presently available day rates for such rigs will increase.

g. If alternate or takeout financing is not available, then the only other justification for an initial order and stay would be to provide time to Vortex to negotiate a compromise agreement between Vortex and its creditors, secured and unsecured. Affinity is the only secured creditor, and it has made it clear that it is not prepared to compromise its debts. Affinity cannot be criticized for such a position. Indeed the members of Affinity would have good reason to criticize Affinity management were they to compromise a debt which it has reasonable prospects to fully recover.

h. Affinity's position is that they have lost confidence in and no longer trust Vortex. This position is reasonable given that Vortex has repeatedly over the last two years failed to meet its commitments to make balloon payments or to resume regular payments coupled with the concerns with respect to Vortex's good faith discussed above.

i. While Vortex argues Affinity is not only fully secured, but has a significant cushion of security such that Affinity would suffer no prejudice by permitting Vortex to pursue *CCAA* relief, that argument is but one of many considerations to weigh. It does not weigh heavily given the absence of admissible and credible evidence as to the value of Affinity's security and my common sense conclusion, given the utilization rates and day rates available to Vortex, that the present value of these rigs is a matter of significant uncertainty.

j. Continued operation of the rigs carries with it the consequence that to some greater or lesser extent the value of the rigs will continue to physically depreciate independent from market forces related to the depressed state of the Western Canadian oil industry or that may result from the introduction of new technologies in drilling rigs and practices.

k. If Vortex were granted *CCAA* protection, Affinity would effectively bears the risks and costs associated with that action since, with the exception of the relatively insignificant dollar amount owed to unsecured creditors (some $193,000), Affinity is the only creditor. If Vortex were given *CCAA* protection then, under the usual DIP financing protocols of *CCAA* protection, costs arising from the continuing operation of Vortex that are in excess of its revenue, including the costs of the Monitor and its legal counsel, will effectively be borne by the security Affinity holds. The Pre-Filing Report of the Proposed Monitor contemplates approval of up to $1,000,000 in DIP financing for the proposed 13-week cash flow period which includes $500,000 in professional fees. Such DIP financing would, of course, assume a super priority position over the secured financing of Affinity. Thus the risks associated with *CCAA* protection are effectively borne by Affinity and the unsecured lenders if the security cushion suggested by Vortex turns out not to exist.

[38] The contractual agreement between Affinity and Vortex clearly contemplated loans payable on demand, with specified principal and interest payments before demand. Affinity has provided significant relief from the contractual terms over a two-year period. In a practical sense, Affinity has already effectively provided Vortex with much of the remedial opportunity contemplated by the *CCAA*. Vortex has had the benefit of two years of debt repayment accommodations and forbearance and the opportunity to seek alternate financing. During this period Vortex has failed to honour undertakings it gave in exchange of the deferral relief provided. Affinity is contractually entitled, following its demand, to either seize and sell the rigs or to have a Receiver appointed. Having regard to the relevant factors I outlined in paragraph 19 above, I conclude that it is just and convenient to appoint a Receiver as sought by Affinity.

iv. Other Considerations

[39] Affinity argued that there was a concluded agreement in which Vortex had agreed to consent to the appointment of a Receiver. Vortex disputes that such an agreement was concluded and took exception to evidence Affinity wished to rely on as being without prejudice communications. In light of the conclusions I have reached above, I do not find it necessary to address these arguments and the related argument relating to settlement privilege. My decision is made without regard to the evidence and argument submitted surrounding these issues.

Conclusion

[40] For the reasons set forth above:

a. I dismiss Vortex's application for relief under the *CCAA*.

b. I order that Deloitte Restructuring Inc. be appointed Receiver of Vortex effective immediately.

c. I contemplate that the form of that order will be substantially in the form of the draft order filed by counsel for Affinity on July 6, 2017. However, at the hearing of the applications counsel for Affinity and Vortex asked that the final form of the order not be settled until after counsel had reviewed my decision and had discussion on the final form of order. I ask counsel to consult promptly. If they are able to agree on the form of order they shall file same for my approval. If they cannot agree on the form of the order, a conference call with me shall be arranged to settle this matter.

c. I approve the actions of the Interim Receiver since the date of appointment as Interim Receiver to the termination of that order.

J.
B. SCHERMAN

CITATION: Meridian v. Okje Cho & Family Enterprise Ltd., 2021 ONSC 3755
COURT FILE NO.: CV-21-00660390-00CL
DATE: 20210525

SUPERIOR COURT OF JUSTICE – ONTARIO

COMMERCIAL LIST

RE: MERIDIAN CREDIT UNION LIMITED, Applicant

AND:

OKJE CHO & FAMILY ENTERPRISE LTD. and 2341567 ONTARIO LTD., Respondents

BEFORE: L.A. Pattillo J.

COUNSEL: *Ian Klaiman* and *Jason Spetter*, for the Applicant

Robert Choi and *Adam Beyhum*, for the Respondents

HEARD: May 21, 2021

ENDORSEMENT

[1] The applicant, Meridian Credit Union Limited ("Meridian") seeks an order pursuant to s. 243(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (BIA) and s. 10 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43 ("CJA"), appointing BDO Canada Limited ("BDO") as receiver and manager over all property, assets and undertaking of the respondents, Okje Cho & Family Enterprise Ltd. ("Okje") and 2341567 Ontario Ltd. ("234").

[2] 234 operates as franchisee a Hampton Inn by Hilton at 40 McPherson Drive in Napanee, Ontario (the "Property") which is owned by Okje. Paul OJ Cho and his wife Choon Bum Cho are the principals and the officers and directors of both Okje and 234.

[3] Pursuant to a Credit Agreement dated September 20, 2018, Meridian authorized a non-revolving loan to Okje to a maximum of $7,200,000, payable on demand. That agreement was superseded by a Credit Agreement dated November 4, 2019 pursuant to which Meridian authorized the following credit facilities, payable on demand:

a) A non-revolving loan to a maximum of $6,995,000 (Credit Facility 1); and

b) An installment loan to a maximum of $700,000 (Credit Facility 2).

[4] In the spring of 2020, as a result COVID-19 and the government restrictions, Okje requested payment relief from its obligations under the 2019 Credit Agreement. Pursuant to amending agreements dated April 8, 2020 and July 14, 2020, Meridian agreed to defer Okje's monthly principal and interest payments for three months and then a further two months. The July 14, 2020 amending agreement also authorized a further credit facility to Okje, payable on demand, to a maximum of $102,000 to capitalize the interest accrued pursuant to the April 8, 2020 amending agreement (Credit Facility 3).

[5] Okje's indebtedness under the Credit Facilities is secured by:

a) Personal guarantees and postponement of claims from the Chos of the loans under Credit Facilities 1 & 2;

b) Guarantee and postponement of claim of Okje's liabilities by 234;

c) General Security Agreements from both Okje and 234, registered under the *Personal Property Security Act*;

d) A collateral mortgage granted by Okje in favour of Meridian for $8,000,000 registered against the Property (the "Mortgage");

[6] Okje is in default under the Credit Facilities. It has made no payments under Credit Facility 1 since December 1, 2020; made no payments on Credit Facility 2 since January 1, 2021 and failed to repay Credit Facility 3 by its maturity date, October 31, 2020.

[7] In addition, Okje and 234 were also in default under the Credit Agreement in respect of the following arrears: property taxes for the Property totaling $135,350.18 as at October 6, 2020; non-resident tax of $102,386.14 as of July 29, 2020; GST/HST arrears for Okje of $8,904.29 as at June 30, 2020; GST/HST arrears for 234 of $115,183.91 as at December 31, 2019.

[8] In October 2020, Okje made an application for a $1.4 million loan under the EDC Business Credit Availability Program ("BCAP Loan") through Meridian. The application was declined by Meridian on December 8, 2020. Subsequently, Meridian and Okje attempted to address the respondents' defaults.

[9] On February 26, 2021, after a payment by Okje of past due amounts under Credit Facility 2 was returned due to "insufficient funds", Meridian made a demand for payment upon Okje, 234 and the personal guarantors of the entire amount of the indebtedness under the Credit Facilities, which at that date was $7,770,121.39. The indebtedness remains outstanding.

[10] The application was commenced on April 13, 2021 and returnable April 22, 2021 at which time it was put over to May 11, 2021 to permit the respondents to file responding materials. On May 11, 2021 it came before me. As part of their responding material, the respondents filed an affidavit from Mr. Maneet Singh Gadhok (also known as Monty Singh), in which he deposed that he had entered into an Agreement of Purchase and Sale with Okje dated April 8, 2021, amended April 16, 2021, to purchase the Property for $8,000,000.00 (the "Agreement"). The Agreement was conditional on, among other things, the approval of the

terms of the Agreement by Mr. Singh's solicitor and assumption by him of the Mortgage. As a result of the amendment, the date for satisfying the conditions was May 17, 2021 and the closing date was June 1, 2021.

[11] Meridian's position was that it was not prepared to consent to Mr. Singh assuming the Mortgage. Further, and even if the Agreement as produced was completed, there would likely still be money owing to it and to Okje and 234's other creditors, some of whom have priority over the Mortgage. In response, Okje and 234 took issue with the statement Meridian would not assume the Mortgage and stated the Chos' including their son, have indicated that they were prepared to or have already listed their homes in Toronto for sale and there is sufficient equity to pay off both Meridian and the outstanding creditors.

[12] In the circumstances, I granted a short adjournment to May 21, 2021 to enable Okje and 234 to firm up their plan to resolve their obligations. In so doing, I stated that prior to the return date, the respondents must provide evidence concerning the status of the Agreement and specifically whether the conditions in the Agreement had been fulfilled or waived such that the Agreement was firm as well as evidence of the status of both the Chos and their son's proposed sales of their Toronto properties including whether the properties have been listed; the listing price; the total amount of mortgages and other encumbrances on the properties and the expected "net" proceeds that will be available.

[13] I further advised the parties that if I was satisfied on the return date that based on the evidence, there was a realistic possibility that the respondents and the Chos could resolve their obligations to Meridian and their other creditors, I would further adjourn the application for a reasonable period to let that happen. For that to happen, however, the respondents must have a concrete plan including a firm agreement of purchase and sale.

[14] Prior to the return on May 21, 2021, both parties filed further evidence concerning events subsequent to May 11, 2021. Mr. Cho advised that the Agreement was "alive" and that it had been further amended to reduce the purchase price of the Property to $7 million. The amended Agreement contained a clause that the buyer agreed to lend $2 million to the seller for closing the deal. Both parties agreed to "register this money" on the Chos' personal residence. The amended Agreement still contained the buyer's lawyer's approval condition but not the assumption of the Mortgage. Finally, the time to satisfy conditions was extended to June 15, 2021 and the closing date to June 30, 2021.

[15] Mr. Cho further deposed that the $9 million (the new purchase price together with the $2 million loan) would be sufficient to pay off all the respondents' liabilities. He further stated that Okje had become aware of and submitted a loan application for $1 million to the Regional Relief and Recovery Fund, a Federal programme to help small businesses and he anticipated that funding would be distributed in 6 to 9 weeks-time. Finally, he provided evidence of listings of both his personal residence ($6,990,000) and his son's residence ($3.289 million).

[16] Meridian filed a further affidavit of Amber Waheed, a Commercial Credit Specialist and the person responsible for managing the respondents' loans. On May 18, 2021, Ms. Waheed had a telephone discussion with Mr. Singh during which he advised he had not yet retained legal

counsel; the removal of the condition requiring the assumption of Meridian's mortgage was an error and that he still required the condition to be included; although he'd been in touch with the franchisor, he had not received its approval to take over the hotel; his understanding was that Okje currently owed the franchisor between a $100,000 and $150,000 in outstanding franchise fees; in respect of the $2 million loan, he said Meridian would receive approximately $1 million and the balance would be used for priority and trade payables although he could not provide any details of the timing or the amounts owing.

[17] Following the above discussion with Mr. Singh, he retained a lawyer and discussions took place between Mr. Singh and Meridian, but no agreement was reached.

[18] Mr. Cho filed a further brief affidavit taking issue with Ms. Waheed's statement that Mr. Singh had said that the deletion of the condition requiring the assumption of the Meridian mortgage was an "error". Mr. Cho said that the condition was specifically discussed and deleted, and that Mr. Singh communicated to him that he could finance the acquisition of the hotel.

[19] Both s. 243(1) of the BIA and s. 101 of the CJA provide that the court may appoint a receiver if it considers it to be just or convenient to do so.

[20] In determining whether it is just or convenient, the court must have regard to all of the circumstances of the case including the nature of the property, the rights and interests of the parties to the property, whether the lender's security is at risk of deteriorating, whether there is a need to stabilize and preserve the business, whether there is a loss of confidence in the debtor's management and the positions and interests of other creditors. See: *Confederation Life Insurance Co. v. Double Y Holdings Inc.*, 1991 CarswellOnt 1511 (Ont. S.C.J. (Commercial List) at para. 20; *BCIMC Construction Fund Corporation et al. v. The Clover on Yonge Inc.*, 2020 ONSC 1953.

[21] Further, while the appointment of a receiver is considered an extraordinary remedy, in circumstances such as in this case, where the Credit Agreement, the Okje and 234 General Security Agreements and the Mortgage all provide that Meridian is entitled to appoint a receiver and manager in the event of a default, as Meridian's right to the appointment of a receiver is derived from a private contract, the appointment of a receiver cannot be considered an extraordinary remedy. See: *Business Development Bank of Canada v. 2197333 Ontario Inc.*, 2012 ONSC 965; *BCIMC Construction Fund*, at para. 43.

[22] Meridian submits that is just and convenient to appoint a receiver in this case. The respondents are clearly in default of the Credit Agreement. They are insolvent and have presented no clear path to resolve their obligations. There is no assurance the Agreement will be completed and even if it is, the respondents, by their actions, concede that more money will be required to pay out Meridian and the other ranking creditors, the source of which is also tenuous. Meanwhile, the longer the delay, the more its security is in jeopardy and at risk of eroding. Meridian has lost confidence in Okje's management and the appointment of a receiver will bring stability to the business and permit an orderly resolution of the issues.

[23] The respondents submit that a receivership would not be just or convenient. It would result in a substantial reduction in the value of the hotel and add substantial unnecessary expense to the process of finding a purchaser. It would also lead to the termination of 234's franchise pursuant to the franchise agreement. The respondents submit that they ought to be provided a fair opportunity to rectify any defaults and to sell their assets in an orderly manner.

[24] The respondents also raise issues of misrepresentation and bad faith conduct on the part of Meridian in relation to its handling of Okje's application for BCAP Loan in October 2020 and Meridian's subsequent decline of the application. They have commenced an action against Meridian and submit, given the factual issues in dispute, the application should be converted to an action.

[25] Finally, the respondents rely on the Agreement together with their actions in attempting to liquidate their assets to demonstrate that they have a plan which they are executing to enable them to pay off Meridian and their other creditors. They also point to their recent application for $1 million in funding to the Regional Relief and Recovery Fund.

[26] In my view, based on all the evidence, I am satisfied the appointment of a receiver is justified in this case.

[27] There is no issue that the loans are in default and have been for some time. The amount involved is substantial. The respondents essentially seek an opportunity to either bring the loans into good standing or sell the Property and business and repay Meridian and their other creditors. The evidence of how they intend to do that however does not in my view establish that to be a realistic possibility.

[28] The Agreement, which has been amended twice, is far from firm. There is also evidence that the parties may have a disagreement over whether there is a condition regarding Mr. Singh's assumption of the Mortgage. The further $2 million loan from Mr. Singh and/or the sale of the residences are also far from firm. The former is not documented and is to be secured by a mortgage on the Chos' residence which is for sale. Nor is there evidence of the encumbrances on the residences or what the net proceeds from the proposed sales would be should they occur.

[29] There is also no evidence that Okje's recent application for funding from Regional Relief and Recovery Fund will solve the respondents' issues. Even if approved, funding is still 6-9 weeks away and will not resolve their issues with Meridian or with the other creditors.

[30] There is also no evidence on the financial status of the hotel, including its recent cash flow and liabilities. As part of its disclosure for the BCAP Loan in the fall of 2020, Okje noted cash shortfalls of $622,593 for 2020 and projected $923,437 for 2021. That was before the province wide stay at home order in March of this year which has impacted all small businesses. Mr. Singh's information that there are substantial franchise fees in arrears is also troubling. In my view, in the circumstances, a receiver is required to stabilize and preserve the business.

[31] I also not satisfied that the application should be converted to an action or that Meridian's actions in respect of declining the BCAP Loan should impact on this application. The documentary evidence does not come close to establishing that Meridian made any

misrepresentations to the respondents concerning the availability of the BCAP Loan or its actions in declining it. The respondents were aware at all times that approval of the loan was subject to the approval of Meridian's credit department, which was not forthcoming for reasons which were communicated to the respondents.

[32] For the above reasons, BDO is appointed as receiver and manager over all property, assets and undertaking of Okje and 234.

[33] I am not prepared at this stage to authorize BDO to assign the respondents into bankruptcy. Such a request is premature in my view.

[34] Nor do I consider that the Agreement should be sealed. There is no evidence that it was obtained based on a formal sale process or that the proposed purchase price has any relation to the actual market value of the Property. In the circumstances, it should have no impact on the value of the Property.

[35] A receivership order, substantially in the form of the Commercial List order shall issue.

L.A. Pattillo J.

Released: May 25, 2021.

TAB 4

CITATION: BCIMC Construction Fund Corporation et al. v. The Clover on Yonge Inc. 2020 ONSC 1953

COURT FILE NO.: CV-20-00637301-00CL & CV-20-00637297-00CL

DATE: 2020-03-30

ONTARIO

SUPERIOR COURT OF JUSTICE

[Commercial List]

BETWEEN:	
BCIMC CONSTRUCTION FUND CORPORATION AND BCIMC SPECIALTY FUND CORPORATION	*David Bish, Adam M. Slavens, Jeremy Opolsky* Counsel for the Applicants
Applicants	
– and –	
THE CLOVER ON YONGE INC., THE CLOVER ON YONGE LIMITED PARTNERSHIP, 480 YONGE STREET INC. AND 480 YONGE STREET LIMITED PARTNERSHIP	*Steven Graff, Ian Aversa, Jeremy Nemers* for the Respondents
Respondents	
AND BEWTWEEN	
BCIMC CONSTRUCTION FUND CORPORATION AND OTERA CAPITAL INC.	*David Bish, Adam M. Slavens, Jeremy Opolsky* Counsel for BCIMC Construction Fund Corporation
Applicants	*Virginie Gauthier, Allan Merskey and Peter Tae-Min Choi* counsel for Otera Capital Inc.
- **and -**	

33 YORKVILLE RESIDENCES INC. AND 33 YORKVILLE RESIDENCES LIMITED PARTNERSHIP	)))	*Steven Graff, Ian Aversa, Jeremy Nemers* for the Respondents
Respondents	)	See Schedule A for complete list of counsel

Heard: March 27, 2020

KOEHNEN J.

Overview

[1] This proceeding involves competing applications for the appointment of a receiver and manager pursuant to subsection 243(1) the *Bankruptcy and Insolvency Act,* R.S.C. 1985, c. B-3, as amended and section 101 of the *Courts of Justice Act*, R.S.O. 1990, c. C-43, as amended and an application for protection under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended.

[2] The hearing was held by telephone conference call due to the COVID-19 emergency on Friday, March 27, 2020. The hearing was held in accordance with: (a) the Notice to the Profession issued by Chief Justice Morawetz on March 15, 2020; and (b) the "Changes to Commercial List operations in light of COVID-19" developed by the Commercial List judges in consultation with the Commercial List Users Committee. The teleconference line was one provided by the Ontario Superior Court of Justice. Materials were sent to me by email before the hearing.

[3] At the end of the hearing I advised counsel that I would dismiss the CCAA application and grant the receivership application with reasons to follow. These are my reasons. I have issued two sets of reasons, a sealed confidential set of reasons and a public set of reasons. The public reasons contains all of the information in the confidential reasons except certain figures which have been redacted.

[4] In short, after considering the various factors that all sides brought to my attention, it struck me that a receivership was clearly the preferable route to take. Secured creditors with a blocking position to any plan objected to a CCAA proceeding. They had valid grounds for doing so. They had first mortgages in land, there was no concrete proposal at hand to have them paid out. The mortgagees had made demand on February 20. Demand was prompted by findings of financial irregularity within the debtors. The debtors had agreed to give the mortgagees receivership rights in the lending agreements they signed. Approving a CCAA proceeding would force lenders to continue to be bound to debtors in whom they no longer had any confidence by reason of the debtors' absence of transparency and forthrightness in its dealings with the lender. There was no evidence that a CCAA proceeding would have a material impact

on safeguarding jobs nor was there any evidence that it would materially safeguard the interests of other creditors more so than a receivership would.

A. The Parties

[5] The Receivership Applicants, BCIMC Construction Fund Corporation and BCIMC Specialty Fund Corporation are affiliates of the British Columbia Investment Management Corporation and help manage the pensions of over 500,000 British Columbia public servants.

[6] The receivership applicant Otera Capital Inc. is a subsidiary of the Caisse de Dépôt et Placement du Québec and is one of Canada's largest real estate lenders. For ease of reference I will refer to all three applicants as the Receivership Applicants.

[7] The Receivership Applicants asked me to appoint PricewaterhouseCoopers Inc. as receiver and manager over all of the undertakings, properties and assets of three residential condominium construction projects known as The Clover, Halo and 33 Yorkville.

[8] The BCIMC parties have advanced loans on all three projects. Otera has advanced loans only on 33 Yorkville where it has shared advances equally with the BCIMC parties.

[9] The Debtors are special-purpose, project-level entities for the development of each of the three projects.

[10] Each of the three projects is affiliated with The Cresford Group, which owns each project through individual, single asset, special purpose corporations. Cresford is a significant developer and builder of residential condominiums in the Toronto area.

[11] Clover and Halo object to the receivership application and have brought their own application to seek protection under the CCAA. The Yorkville project seeks to adjourn the receivership application in respect of it. The parties in the proceeding of each project are the corporate general partner and the corporate limited partnership entity.

(a) The Clover Project

[12] The Clover project is located at 595 Yonge St., north of Wellesley St. in Toronto. It is comprised of two towers; one 44 storeys, the other 18 storeys containing a total of 522 residential units. The Clover project is the most advanced of the three projects. Construction is well underway with the higher floors now under construction.

[13] The Clover Commitment Letter from the Receivership Applicants provides for two non-revolving construction loans in amounts of $172,616,007 and $37,450,668 and a non-revolving letter of credit facility of up to $3,000,000.

[14] As of March 2, 2020, the Receivership Applicants had advanced $107,668,017.82 under the Clover Facilities. In addition, $3,000,000 in letters of credit have been extended. The

Receivership Applicants also extended a mezzanine mortgage on Clover, with $34,035,878.69 in principal outstanding.

[15] The obligations are secured by, among other things, a first-ranking security interest in substantially all of the property, assets and undertaking of the Clover Debtors, and by registered first-ranking and third-ranking charges/mortgages in respect of real property.

[16] There are 499 purchasers of units in Clover who have paid a total of approximately $49 million in deposits.

(b) The Halo Project

[17] The Halo project is located at 480 Yonge St. south of Wellesley St. in Toronto. It calls for a 39-storey tower with 413 residential units set-back from the street to accommodate a historic clock tower. Halo is in early stages of construction.

[18] The Halo Commitment Letter provides for two non-revolving construction loans in amounts of $156,850,7747 and $29,292,804, respectively, and a non-revolving letter of credit facility in the amount of up to $2,000,000.

[19] As of March 2, 2020, the Receivership Applicants have advanced $47,429,211.83 in principal. In addition, $1,500,000 in letters of credit have been extended. The Receivership Applicants have also extended a mezzanine mortgage on the Halo project, with $25,725,159.27 in principal outstanding.

[20] The obligations are secured by, among other things, a first-ranking security interest in substantially all of the property, assets and undertaking of the Halo Debtors, and by registered first-ranking and third-ranking charges/mortgages in respect of real property.

[21] There are 388 purchasers of units in Halo who have paid a total of approximately $43 million in deposits.

(c) The Yorkville Project

[22] The Yorkville project is located at 33 Yorkville Ave between Bay and Yonge Streets in Toronto. Current plans call for one 43 and one 69 storey tower with 1,079 residential units and an eight storey podium. Excavation began in 2019 but no construction of the towers has begun.

[23] The Yorkville Commitment Letter provides for a non-revolving construction loan and a non-revolving letter of credit in amounts of up to $571,300,000 and $83,000,000, respectively.

[24] As of March 2, 2020, the Receivership Applicants had advanced $122,432,764.85 under the Facilities. In addition, $79,592,744.24 in letters of credit have been extended.

[25] The obligations are secured by, among other things, a first-ranking security interest in substantially all of the property, assets and undertaking of the Yorkville Debtors, and by registered first-ranking charges/mortgages in respect of real property.

[26] There are 918 purchasers of units in Yorkville who have paid a total of approximately $160 million in deposits.

[27] There are three other major secured creditors on the projects. Aviva Insurance Company of Canada has second and fourth priority mortgages. KingSett Capital Inc. has third ranking mortgages. Construction lien holders have liens of approximately $38,000,000 registered against the properties.

B. Deterioration of the Relationship

[28] In January 2020, the Receivership Applicants became aware of a statement of claim issued by Maria Athanasoulis against the Cresford Group. Ms. Athanasoulis was a former officer of Cresford who made allegations of financial irregularities within the Debtors. As a result, the Receivership Applicants appointed PWC and Altus Group Limited to investigate. Altus is a well-known quantity surveyor and cost consultant. The results of the investigation raised three issues showing a lack of transparency and forthrightness by the Debtors which led the Receivership Applicants to lose all confidence in the Debtors and which led the Receivership Applicants to conclude they no longer wanted anything to do with the projects.

[29] First, at the outset of the lending relationship, Cresford was required to inject equity into each project. It was important for the Receivership Applicants that Cresford had "skin in the game" in order to align Cresford's interests with those of the lenders.

[30] Instead of injecting its own funds, Cresford borrowed money at over 16% interest from a third party and used that loan as "equity" in the project. Cresford then used advances from the Receivership Applicants to pay for the 16% interest on its "equity". Approximately $10.668 million of the lenders' funds have been diverted from the three projects to service the interest on Cresford's "equity".

[31] Second, the projects have maintained two sets of books. A first set of accounting records shows costs that were consistent with the construction budget which had been presented to the lenders. Those records were used to obtain continued advances on the lending facilities. A second set of books records increases over the approved construction budgets. Approximately $ X of increased costs were hidden in this manner.

[32] In furtherance of the two sets of books, the Debtors had certain suppliers issue two invoices for the same supply. The first invoice was consistent with the approved construction budget. It was recorded in the accounting records that were available to the lenders and which showed costs in accordance with the budget. The second invoice from the supplier was for the amount by which the supply exceeded the construction budget. The second invoice was

recorded on the second accounting ledger kept for each project and was not disclosed to the lenders.

[33] Third, to help further hide increased costs, the Debtors sold units to suppliers at substantial discounts to their listing prices. Over $ X in discounted sales fall into this category.

[34] The agreements between the Receivership Applicants and the Debtors require the Debtors to inform the Receivership Applicants of any cost overruns, seek consent for material changes, always maintain sufficient financing to complete the projects and to fund any cost overruns with equity. The Debtors failed to do so.

[35] Cost overruns on the three projects come to more than $ X above the lender approved budget. The average rate of increase on each of the three projects is X %. Of those increases, approximately $ X were construction costs that were hidden from the lenders. The amount hidden on Clover was $ X; on Halo $ X and on 33 Yorkville, $ X.

[36] Although the Debtors dispute the precise amounts by which the projects are overbudget and take issue with what they say is an overly conservative approach by PWC, the Debtors' numbers would not change the economic viability of the projects. By way of example, PWC says 33 Yorkville is $ X over budget. The Debtors say PWC's number is overstated by $ X. Even if I assume the Debtors are correct, it would mean the Yorkville Project is over budget by $ X. All three Debtors agree that their projects are economically unviable. The only way to make the projects viable is to disclaim all of the agreements of purchase and sale for the condominium units and to sell the units anew at prices higher than those at which they were originally sold.

[37] In addition to the foregoing breaches, approximately $3.5 million in interest payments to the Receivership Applicants are overdue.

[38] On February 20, 2020, the Applicants made demand on the Debtors and sent notices under section 244 of the BIA giving notice of the Receivership Applicants' intention to enforce against security.

[39] The receivership application first came before me on March 2, 2020. The Debtors asked me to adjourn to enable them to respond to the allegations. At the time, Debtors' counsel suggested the allegations were questionable because the Receivership Applicants had attached the Athanasoulis statement of claim but had not attached the Cresford statement of defence. I adjourned the hearing to March 27, 2020 but indicated that the new hearing date was peremptory.

[40] Although the Debtors have had more than three weeks to respond to the allegations of the improper financial practices that led the Receivership Applicants to lose confidence in them, the Debtors have failed to do so. The Debtors do not deny the allegations. They do not explain them. They do not suggest they were the conduct of a rogue employee. They do not state that the irregularities were unknown to senior management. They remain completely silent about the

allegations. In these circumstances I can only assume that the allegations are true and were, at all material times, known to and accepted by senior management.

[41] In referring here to allegations of financial irregularity I am not referring to the allegations contained in Ms. Athanasoulis' statement of claim. I have not even read the statement of claim because it is of no evidentiary worth. Instead, I rely on the affidavits filed by the Receivership Applicants and on the pre-filing reports of PWC. Those materials have evidentiary value and have not been refuted. The allegations in Ms. Athanasoulis' statement of claim form the subject of a separate proceeding. Nothing in these reasons is intended to make any evidentiary findings in that action. The purpose of these reasons is solely to choose between a receivership or a CCAA proceeding based on the evidence before me on these applications.

C. The Prima Facie Right to a Receivership

[42] A receiver may be appointed where it is just and convenient equitable to do so.

[43] Although receivership is generally considered to be an extraordinary remedy, there is ample authority for the proposition that its extraordinary nature is significantly reduced when dealing with a secured creditor who has the right to a receivership under its security arrangements. See for example: *RMB Australia Holdings Limited v. Seafield Resources Ltd.*, 2014 ONSC 5205 (Commercial List), paras. 28-29; *Elleway Acquisitions Ltd. v. Cruise Professionals Ltd.*, 2013 ONSC 6866 at para. 27.

[44] The relief becomes even less extraordinary when dealing with a default under a mortgage: *Confederation Life Insurance Co. v. Double Y Holdings Inc.*, 1991 CarswellOnt 1511 (Ont. S.C.J.(Commercial List) at para. 20.

[45] In *Confederation Life*, at paras. 19-24 Farley J. set out four additional factors the court may consider in determining whether it is just and convenient to appoint a receiver:

(a) The lenders' security is at risk of deteriorating;

(b) There is a need to stabilize and preserve the debtors' business;

(c) Loss of confidence in the debtors' management;

(d) Positions and interests of other creditors.

[46] All four factors apply here.

[47] **Security at risk of deteriorating**: There is no doubt that the lenders' security is at risk of deteriorating. All three projects are overbudget. The Debtors acknowledge that the projects are economically unviable in light of the proceeds generated by the agreements of purchase and sale. Work has stopped on the projects. Trades are not being paid. Over $38,000,000 in construction liens have been registered since March 2. $3.5 million of interest is overdue. The

lenders are concerned about the risk of further deterioration as a result of liquidity problems that they fear may arise because of the Covid 19 emergency. These various factors make it necessary to gain control of the projects quickly.

[48] **The need to stabilize the business**: The Debtors agree that there is a need to stabilize the business. The only difference in this regard is whether it should be stabilized through a receivership or a CCAA proceeding.

[49] **Loss of confidence in management**: Given the length of time during which the financial irregularities have persisted, the deliberate, proactive nature of those irregularities and the deliberate efforts to hide the irregularities, the Receivership Applicants have a legitimate basis for a lack of confidence in management.

[50] **Position and interests of other creditors**: No other creditor has opposed the receivership application. Kingsett supports the receivership. Aviva has no preference between receivership or CCAA. Two lawyers appeared for limited partners in Yorkville. Mr. Mattalo supported the CCAA application. Ms. Roy was agnostic between the two but submitted that more time should be allowed for a transaction to materialize on the Yorkville project.

[51] In the circumstances, the Receivership Applicants have established *a prima facie* right to a receivership. The issue is which of a receivership or a CCAA proceeding is preferable.

D. The Debtors' Proposal

[52] The Debtors ask me to afford Clover and Halo CCAA protection and to adjourn the receivership application with respect to 33 Yorkville.

[53] The Debtors propose to sell the shares in the special purpose corporations that own the Clover and Halo projects to Concord Group Developments, one of Canada's leading developers of residential condominiums. It has developed over 150 condominium towers with over 39,000 units in Canada. It currently has more than 50 development projects in various stages of planning and development in Canada, the United States and the United Kingdom.

[54] The share sale to Concord would close on payment of one dollar. An additional $38,000,000 would be paid to a Cresford related person or entity upon completion of the following:

(a) Court approval of CCAA protection for Clover and Halo.

(b) Court approval of the disclaimer of existing condominium unit purchase contracts for Clover and Halo

(c) Completion of construction financing either with the existing lenders or new lenders.

[55] As part of the CCAA process Concord states that it will

(a) provide $20,000,000 of debtor-in-possession financing at a rate of 5%. $7,000,000 would be advanced during the first 10 days.

(b) Negotiate the resolution of creditors' claims.

(c) Offer unit purchasers a right of first refusal to re-purchase their units at "a discount to current market value."

[56] The Receivership Applicants oppose the CCAA application. They have indicated that they will not provide construction financing to Concord. They simply want their money paid and want nothing further to do with the project.

[57] With respect to Yorkville, the Debtor concedes there is nothing as far as advanced there is with Clover and Halo but points to a letter of intent for the purchase of the Yorkville property.

[58] Counsel for the purchaser under the letter of intent appeared on the application and produced a letter it had sent to the Debtor indicating that the letter of intent had expired on its terms but that the purchaser remains interested in pursuing a transaction. That purchaser is indifferent about whether they pursue the transaction through a receivership or a CCAA proceeding.

[59] I decline to grant the adjournment with respect to the Yorkville project. I indicated on March 2 that the March 27 date would be peremptory. I have been given no reason to depart from that direction. Even if there were a CCAA application with respect to the Yorkville project similar to the one for Clover and Halo, I would nevertheless appoint a receiver manager for the same reasons that I have decided to appoint a receiver manager for Clover and Halo.

E. Receivership or CCAA?

[60] In choosing between a receivership or a CCAA process, I must balance the competing interests of the various stakeholders to determine which process is more appropriate: *Romspen Investment Corp. v. 6711162 Canada Inc.*, 2014 ONSC 2781 at para. 61.

[61] The factors addressed in argument relevant to this exercise were as follows:

(a) Payment of the Receivership Applicants

(b) Reputational damage

(c) Preservation of employment

(d) Speed of the process

(e) Protection of all stakeholders

(f) Cost

(g) Nature of the business

(a) Payment of the Receivership Applicants

[62] During the adjournment hearing on March 2, 2020 there was discussion about the desirability of ending the entire dispute by having the Receivership Applicants paid out. The Debtors submit that their proposal does so and is equivalent to having "Pulled a rabbit out of the hat." Unfortunately, I cannot agree.

[63] It was abundantly clear as of February 20, 2020 that the Debtors needed new financing when the Receivership Applicants demanded payment on their loans. As a practical matter it was clear before February 20 that the Debtors needed new financing. As soon as allegations of financial wrongdoing arose, the Debtors would have known that they had engaged in conduct that would likely lead a lender to terminate its relationship with them.

[64] Despite the assertion that the Debtors have "pulled a rabbit out of the hat," the CCAA proposal does not address the Receivership Applicants' concerns. The Receivership Applicants want their money back. What is currently on the table is a purchase agreement with Concord that is close to completion. The Debtors and Concord say it should have been completed on March 26, 2020 but was delayed because of a number of what they describe as "technical issues". Regardless of what the issues are, there is no enforceable agreement on the table although there may be in the near future.

[65] Even if that enforceable agreement materializes, it would not give the Receivership Applicants what they want. There is still no financing in place. Concord admits that it needs construction financing from either the existing lenders or new lenders. The Receivership Applicants will not provide financing.

[66] The Debtors point to a comfort letter from HSBC dated March 25, 2020 as evidence that Concord can obtain financing without difficulty. A closer read of that letter provides little comfort. On the one hand the letter states:

> We wish to confirm that Concord possesses significant capital, liquidity and credit lines, and is considered highly credit worthy, with consistent access to debt capital markets in order to facilitate large asset acquisitions and development projects.

[67] As the applicants point out however, Concord is not prepared to make any of its "significant capital liquidity and credit lines" available to pay out the Receivership Applicants.

Concord is not the buyer of the two projects. The existing sole purpose entities remain the owner of the projects. Concord is simply the new shareholder. It assumes no other liabilities.

[68] Finally, the HSBC letter goes on to state:

> In light of current market and economic conditions surrounding the COVID-19 health crisis, we are unable to comment specifically on financing aspects regarding the subject development projects at this time.

[69] From the perspective of the Receivership Applicants, this is the very problem. Far from pulling a rabbit out of the hat, the Debtors proposal would keep the Receivership Applicants in projects that, at least on the face of the HSBC letter, are currently not capable of obtaining new financing. In those circumstances one can readily expect that any new financing may well be conditional on the Receivership Applicants taking a discount on their debt or being forced to continue financing to avoid such a discount. Concord has not undertaken that the Receivership Applicants will be paid out without discount in any new financing.

[70] I intend no criticism of Concord by these comments. I would not expect them to make their own capital or liquidity available to the project. The whole point of financing through project specific entities is to insulate the assets of a larger group from the risks of a particular project. It is readily understandable and commercially reasonable that Concord would pursue that objective.

[71] At the same time, however, the Receivership Applicants should not necessarily be compelled to remain in the project either permanently or temporarily while they wait for a project specific company to obtain new financing without the Receivership Applicants having any control of the process. Forcing the Receivership Applicants to remain without control of the process is even more unfair when the contracts to which the Debtors agreed give the Receivership Applicants a right to control the process through a receivership.

(b) Reputational Damage

[72] The Debtors submit that a CCAA process is preferable to a receivership because it would cause less reputational damage to Cresford. In the circumstances of this case, that is irrelevant. Any reputational damage to Cresford is of its own making.

[73] One may well have sympathy for a debtor who is caught up in a cycle of increasing construction costs in Toronto's heated construction market. One has less sympathy for a debtor who hides those costs from lenders instead of being transparent and searching for a solution. One has even less sympathy for a debtor who from the outset of the relationship has misled a lender about the nature of the debtor's equity injection and one who uses $10.6 million of the lender's money to fund the interest on the debtor's equity injection. The Receivership Applicants lent money for construction costs. They did not lend money to finance the Debtor's equity injection.

[74] This is a situation where a debtor has acted in a manner which charitably would be described as lacking in transparency from the inception of its relationship with the creditor. The Debtors took a series of proactive steps to hide information from a creditor over a prolonged period.

[75] In those circumstances any reputational damage is of the Debtors' own making. The lenders should not now be required to incur even more risk in order to protect the Debtors' reputation.

[76] The Debtors note that there are many examples of CCAA applications involving Debtors who have engaged in wrongdoing such as Hollinger, YBM, Phillips Services and Enron. I am in no way suggesting that the presence of wrongdoing within a corporation automatically precludes a CCAA application. In many cases it is the presence of wrongdoing that demands and justifies a CCAA application. Whether wrongdoing affects the decision to afford CCAA protection depends on balancing the circumstances before the court in each case.

(c) Preservation of Employment

[77] The Debtors submit that a CCAA process will preserve jobs. They note that Cresford employs approximately 75 people. While CCAA proceedings often preserve jobs, the evidence before me does not support that assertion in this case.

[78] There is no evidence before me about how many of Cresford's 75 employees are devoted exclusively to the projects in issue nor is there any evidence about how many, if any, of those employees will lose their jobs as a result of a receivership. The CCAA proposal is one in which two of the three projects will be owned by Concord. Concord presumably has its own employees who would run the projects. As a result, any job losses within Cresford as a result of a receivership would likely also follow as a result of any sale in the CCAA proceeding. If, on the other hand, that is not the case because there is an arrangement with Concord to continue to use Cresford management, that would only exacerbate the problem from the perspective of the Receivership Applicants. It would mean that their debt remains in place for the foreseeable future and that the project would continue to be administered by the very people who engaged in the financial wrongdoing that created the problem in the first place.

[79] The situation with Yorkville is similar. While the Yorkville project is not being acquired by Concord, there are efforts underway to sell it as well.

[80] The vast majority of the jobs associated with the three projects are construction jobs. Construction personnel are not employed by the Debtors or Cresford but are employed by arms-length contractors that the Debtors have retained to build the projects. Construction contractors will be needed to complete the projects whether a new owner acquires through a receivership or through a CCAA proceeding. At the moment, construction on the projects is halted in any event because of the Covid 19 emergency and lack of financing.

[81] As a result of the foregoing, I do not see any marked difference between a receivership and a CCAA proceeding with respect to either immediate or long term employment.

(d) Speed of the Process

[82] The Debtors submit that the CCAA is faster than a receivership.

[83] During argument, the Debtor's and Concord's counsel described the steps in a CCAA proceeding. They struck me as fairly long and involved.

[84] In all likelihood, the first step in a CCAA proceeding would be to disclaim the sales of condominium units and to re-sell the units. This is the case because any construction financer would probably want to see a certain percentage of units sold before committing to financing.

[85] It will also require a process to negotiate with over 1800 purchasers (887 in the Clover and Halo projects) for new agreements or a process to sell the units to new purchasers. Each of the disclaimer and the approval of new agreements of purchase and sale will require a hearing and a court order. Even if there are no appeals from such orders, that process will take time.

[86] If Cresford and Concord can make arrangements to address the interests of secured creditors more quickly than the receivership takes, it can apply to the court to end the receivership.

(e) Protection of all Stakeholders

[87] The Debtors submit that their CCAA application will protect all stakeholders. The only stakeholder that I see being protected in the CCAA proceeding is Cresford as an equity stakeholder. It will receive $38,000,000 in a transaction beyond the scrutiny of the court. The condominium purchasers will lose their contracts. The employees will be replaced by Concord employees. The construction employees will not have jobs until new financing has been arranged. The creditors will be left to negotiate the best outcome they can in a CCAA proceeding. The only difference is that in a receivership Cresford will not necessarily receive $38,000,000 in cash.

[88] There has been no explanation in the materials before me to justify the receipt of $38,000,000 in cash by an equity holder when creditors like unitholders are certain to have to compromise their rights.

[89] In my view, it would be preferable to have a receiver acting as an officer of the court who can act without being hamstrung by closing a transaction that favours equity over creditors. This is all the more so because a receivership does not preclude the Concord transaction provided the Debtors and Concord can deal with secured creditors in a manner that is satisfactory to them or is at a minimum reasonable in the eyes of the court. If such a transaction is available, the Debtors and Concord can come before me at any time to present it. That transaction must however be concrete, not aspirational.

[90] Although the Debtors and Concord submit that their CCAA proposal would, after the agreements of purchase and sale have been disclaimed, allow former purchasers the opportunity to repurchase the units at a discount to current market value, that is a fairly vague commitment. Both the concepts of "discount" and of "current market value" are subject to considerable elasticity. They are not sufficiently concrete to lead me to prefer a CCAA proceeding over a receivership.

(f) Costs

[91] The Debtors submit that a CCAA proceeding will be less expensive than a receivership because Concord can manage the project less expensively than can PWC. PWC will incur significant fees that will prime other interests. While not stated explicitly, the implicit suggestion is that Concord will not charge fees. There is, however, a significant risk that Concord will charge internal management fees. There is no undertaking from Concord not to do so. Charging management and administration fees is a common way for developers to ensure that they get some of their expenses repaid early on. I accept that even if Concord charges fees, they are likely to be less than PWC's fees. Regardless of whether Concord does or does not charge fees, the risk of PWC's fees provides additional incentive to Cresford and Concord to present a transaction that sees secured creditors paid out quickly.

[92] The costs of financing a receivership or a CCAA proceeding are similar. Concord has offered a DIP loan of $20,000,000 at 5% interest. The Receivership Applicants have offered a loan of $29,000,000 at 5% interest.

[93] CCAA proceedings are inherently expensive. They require regular court attendances, probably with greater frequency than a receivership does. Both the proposed monitor, Ernst & Young and the proposed receiver, PWC and their counsel can be expected to have similar rates. In addition, PWC's work to date is fully recoverable pursuant to the security documents of the Receivership Applicants. In its work to date, PWC has acquired significant knowledge of the affairs of the Debtors, the advantage of which would be lost in a CCAA proceeding.

[94] Even if I accept that a CCAA proceeding will be less expensive than a receivership, that does not outweigh the equitable interests that the creditors have in a receivership by virtue of their lending agreements, the conduct of the Debtors, a CCAA transaction that would put $38,000,000 into the hands of equity holders before giving anything to creditors and the absence of other compelling stakeholder interests.

(g) Nature of the Business

[95] During the hearing before me there was considerable debate about the degree to which a CCAA proceeding was even available for a single-purpose land development company. There was some suggestion that there was a *prima facie* rule or inclination on the part of courts to the effect that CCAA proceedings were not appropriate for such businesses.

[96] In my view, the case law does not demonstrate a rule or an inclination one way or the other. Rather, the nature of the business and its particular circumstances are factors to take into account in every case when considering whether a CCAA proceeding is appropriate.

[97] More particularly, the cases that are sometimes used to suggest that courts are inclined against using CCAA proceedings for single-purpose land development companies do not turn on the issue of land development. Rather, they turn on the nature of the security and the position of security holders with respect to a CCAA proceeding. Even those factors, however, are not determinative. Rather, they are factors to weigh when determining the best avenue to pursue.

[98] In a much quoted paragraph from *Cliffs Over Maple Bay Investments Ltd. v. Fisgard Capital Corp.*, 2008 BCCA 327 the British Columbia Court of Appeal stated at paragraph 36:

> Although the CCAA can apply to companies whose sole business is a single land development as long as the requirements set out in the CCAA are met, it may be that, in view of the nature of its business and financing arrangements, such companies would have difficulty proposing an arrangement or compromise that was more advantageous than the remedies available to its creditors. The priorities of the security against the land development are often straightforward, and there may be little incentive for the creditors having senior priority to agree to an arrangement or compromise that involves money being paid to more junior creditors before the senior creditors are paid in full. If the developer is insolvent and not able to complete the development without further funding, the secured creditors may feel that they will be in a better position by exerting their remedies rather than by letting the developer remain in control of the failed development while attempting to rescue it by means of obtaining refinancing, capital injection by a new partner or DIP financing.

[99] Although the paragraph refers to the nature of the business, the real thrust of the analysis turns on the nature of the security and the attitudes of the secured creditors.

[100] The proposition articulated in *Cliffs Over Maple Bay* has been widely accepted. See for example: *Romspen* at para. 61; *Dondeb Inc., Re*, 2012 ONSC 6087 (Commercial List), at para.16; *Octagon Properties Group Ltd.*, [2009] A.J. No. 936, 2009 CarswellAlta 1325 (Q.B.), at para. 17.

[101] The factors that the British Columbia Court of Appeal articulated in *Cliffs Over Maple Bay* are apposite here. The Receivership Applicants have a blocking position to any CCAA plan. They have expressed the view that they have no intention of compromising their debt within a CCAA proceeding. Their priorities are straightforward and there is little incentive on them to

compromise. They believe they will be in a better position by exerting their receivership remedies than by letting the Debtors remain in control and trying to refinance.

[102] As Justice Kent pointed out in *Octagon,* as para 17,

> ...if I granted CCAA relief, it would be these same mortgagees who would be paying the cost to permit Octagon to buy some time. Second, there is no other reason for CCAA relief such as the existence of a large number of employees or significant unsecured debt in relation to the secured debt. I balance those reasons against the fact that even if the first mortgagees commence or continue in their foreclosure proceedings that process is also supervised by the court and to the extent that Octagon has reasonable arguments to obtain relief under the foreclosure process, it will likely obtain that relief.

[103] Once again it is the nature of the security and the secured creditor's attitude towards a CCAA proceeding that are the factors to consider in arriving at an equitable result.

[104] Here, the Receivership Applicants have indicated that they want nothing to do with the projects. They have a reasonable basis for coming to that view. I underscore, however, that the nature of the security and the secured creditor's views are not determinative. It may well be appropriate for a court to approve CCAA protection in the face of a first ranking secured creditor who expresses no desire to negotiate a compromise depending on the circumstances.

[105] In the case at hand where the breakdown in the relationship is caused by persistent and deliberate wrongdoing by the debtor, where there are no significant differences to the outcome for other stakeholders between a receivership or a CCAA proceeding and where there are no material employment concerns, there is no reason to restrain the exercise of the Receivership Applicants' contractual rights.

[106] The Debtors submit that cases in which receiverships have been preferred over CCAA proceedings in the context of land development companies are distinguishable.

[107] By way of example, the Debtors note that *Romspen* involved only one piece of development land, no operating business, no significant progress on development like there is with Clover and Halo and few employees. In addition, they point out that in *Romspen* there was no plan, no purchaser and no financing. Instead, the existing debtor just wanted to carry on.

[108] In my view that is not materially different from what we have here. There is no purchaser of the property and there is no financing. The same single purpose entity that owns the project now will continue to own the project. While the shareholder of the project specific entity might be different, the new shareholder does not have financing. Nor does the new shareholder have a plan. Instead, they have the conceptual outline of a plan that they would like to pursue. As noted earlier, I am not persuaded by the issue of employees for the reasons set out earlier.

Similarly, the state of development is moot because construction is frozen pending financing and the resolution of the Covid 19 emergency. Approval of the CCAA application will not allow construction to resume.

[109] More importantly, while different cases may help in identifying the range of factors to consider when deciding whether to afford CCAA protection, the actual conclusion of courts in different cases is of significantly less assistance unless those cases are pretty much identical to the one at hand. This is because factors assume different degrees of importance depending on the circumstances of each case.

[110] The Debtors also point to *Re 2607380 Ontario Inc.,* a recent unreported endorsement of Justice Conway dated March 6, 2020. The Debtors submit that *260* is relevant because it deals with a development project in which secured creditors preferred a receivership to a CCAA proceeding but one in which the court nevertheless granted CCAA protection. In addition, the Debtors say the case demonstrates that concerns about the debtor remaining in possession, can be addressed through enhanced monitor's powers including prohibitions on any expenditures above a certain threshold without the monitor's approval.

[111] In my view *Re 2607380 Ontario Inc.* does not assist the Debtors. In that case Conway J recognized that the choice between a receivership and a CCAA application is discretionary and requires the judge to balance competing interests of the various stakeholders to determine which process is more appropriate. In *Re 2607380 Ontario Inc.,* two of the three first ranking secured creditors supported the CCAA procedure. Only the third objected. Moreover, the applicant in that case had a concrete plan with specific timelines and development budget. That is not the case before me.

[112] With respect to the ability to give the monitor enhanced powers, that too depends on the circumstances of the case. If one is dealing with a relatively small operation, giving the monitor enhanced powers to approve low threshold expenditures may be appropriate. Where one is dealing with a large operation with many expenditures and there are significant concerns about how expenditures have been recorded and hidden in the past, enhanced monitor's powers will afford limited protection and be very expensive.

[113] For the reasons already set out above, the circumstances in this case render a receivership preferable to a CCAA procedure.

[114] For the reasons set out above an order will go appointing PWC as a receiver and manager of each of the Clover Halo and Yorkville projects.

Koehnen J.

Released: March 30, 2020

SCHEDULE A – COUNSEL SLIP

David Bish, Adam Slavens, Jeremy Opolsky, for the Applicants, BCIMC Construction Fund Corporation and BCIMC Specialty Fund Corporation

Alan Mersky, Virginie Gauthier, Peter Choi, for the Applicants, Otéra Capital Inc.

Steven L. Graff, Ian Aversa, Jeremy Nemers for the Respondents

Geoff Hall, Heather Meredith, and Alex Steele for PricewaterhouseCoopers Inc.

Sean Zweig and Danish Afroz for KingSett Mortgage Corporation

Jonathan Rosenstein for Aviva Insurance Company of Canada and Westmount Guarantee Services Inc.

Haddon Murray for Tarion Warranty Corporation

David Gruber for Concord Group

Christopher J. Henderson and Diane Zimmer for City of Toronto and Toronto Parking Authority

Shara N. Roy, Aaron Grossman and Sahara Tailibi for 2504670 Ontario Inc., Pine Point International Inc., 2638006 Ontario Inc., Linda Yee Han Chan, Eric Yin Win Chan, 8451761 Canada Inc. and 2595683 Ontario Inc.

Shara N. Roy, Aaron Grossman and Sahara Tailibi for Homelife New World Realty Inc,, Paul Lam, Homelife Landmark Realty Inc., TradeWorld Realty Inc., Landpower Real Estate Ltd., Master's Choice Realty Inc., formerly known as Re/Max Master's Choice Realty Inc. and Michael Chen

Brandon Mattalo for certain limited partnership interests

Mark Dunn and Carlie Fox for Maria AthAthanasoulis

Bryan Hanna for 2379646 Ontario Inc.

Brandon Mattale for certain limited partnership investors

Matthew Gottlieb for KingSett Real Estate Growth LP 4

George Benchetrit for Ernst & Young as proposed Monitor

Maria Konyukhova for PJD Developments

DJ Miller for investors in YSL

CITATION: BCIMC Construction Fund Corporation et al. v. The Clover on Yonge Inc.
2020 ONSC 1953
COURT FILE NO.: CV-20-00637301-00CL & CV-20-00637297-00CL
DATE: 2020-03-30

ONTARIO

SUPERIOR COURT OF JUSTICE

BETWEEN:

BCIMC CONSTRUCTION FUND CORPORATION AND BCIMC SPECIALTY FUND CORPORATION

Applicants

– and –

THE CLOVER ON YONGE INC., THE CLOVER ON YONGE LIMITED PARTNERSHIP, 480 YONGE STREET INC. AND 480 YONGE STREET LIMITED PARTNERSHIP

Respondents

AND BEWTWEEN

BCIMC CONSTRUCTION FUND CORPORATION AND OTERA CAPITAL INC.

Applicants

- **and -**

33 YORKVILLE RESIDENCES INC. AND 33 YORKVILLE RESIDENCES LIMITED PARTNERSHIP

Respondents

REASONS FOR JUDGMENT

Koehnen, J.

Released: March 30, 2020

TAB 5

CITATION: Romspen Investment Corporation v. 6711162 Canada Inc., 2014 ONSC 2781
COURT FILES NOS.: CV-14-10470-00CL and CV-14-10529-00CL
DATE: 20140505

SUPERIOR COURT OF JUSTICE – ONTARIO

COMMERCIAL LIST

COURT FILE NO. CV-14-10470-00CL

RE: Romspen Investment Corporation, Applicant

AND:

6711162 Canada Inc., 1794247 Ontario Inc., 1387267 Ontario Inc., 1564168 Ontario Inc., 2033387 Ontario Inc., Hugel Lofts Ltd., Altaf Soorty and Zoran Cocov, Respondents

AND:

COURT FILE NO. CV-14-10529-00CL

RE: IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF 6711162 CANADA INC., AND THOSE OTHER COMPANIES LISTED IN SCHEDULE "A" HERETO

BEFORE: D. M. Brown J.

COUNSEL: S. Jackson, for the Romspen Investment Corporation

D. Magisano and S. Puddister, for 6711162 Canada Inc., 1794247 Ontario Inc., 1387267 Ontario Inc., 1564168 Ontario Inc., 2033387 Ontario Inc., Hugel Lofts Ltd. and Casino R.V. Resorts Inc., respondents/CCAA Applicants

A. Bouchelev, for Altaf Soorty and Zoran Cocov

E. Tingley, for Pezzack Financial Services Inc.

HEARD: May 2, 2014

REASONS FOR DECISION

I. Competing applications for the appointment of a receiver and the making of an initial order under the *Companies' Creditors Arrangement Act*

[1] Romspen Investment Corporation ("Romspen") lent money to 6711162 Canada Inc. ("671") and certain related companies. That loan has matured and has not been repaid. Romspen applies for the appointment of a receiver under section 243(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, together with the appointment of a construction lien trustee pursuant to section 68 of the *Construction Lien Act*, R.S.O. 1990, c. C.30.

[2] 6711162 Canada Inc. and certain related companies opposed the appointment of a receiver and, instead, they have applied for an initial order under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36. Romspen opposed the making of a *CCAA* initial order.

[3] The key business issue at stake in these competing applications is who gets to control the development and/or realization of a partially-completed residential condominium project in Midland, Ontario – a court-appointed receiver or the current owners and management of one of the CCAA Applicants, Hugel Lofts Limited?

[4] For the reasons set out below, I grant the application for the appointment of a receiver and construction lien trustee, and I dismiss the application for an initial order under the *CCAA*.

II. Evidence about the debt and secured assets

[5] Romspen is a commercial mortgage lender. The respondents, Altaf Soorty and Zoran Cocov, are the principals of a group of property holding and development companies which own parcels of land in Midland, Cambridge and Ramara, Ontario and to which Romspen lent money.

A. The Loan and the demands

[6] By Commitment Letter dated July 18, 2011, Romspen agreed to provide 671162 Canada Inc. ("671") and 1794247 Ontario Inc. ("179") with a $16 million loan facility for a two year term expiring August 1, 2013. The Commitment Letter stated:

> The Loan shall be funded by way of advances, the amount(s) and timing of such advances(s) to be in the absolute discretion of Lender.

[7] The funds were to be used "for general corporate purposes…to retire existing mortgage indebtedness [on two properties]…to pay fees and transaction costs, to set up an interest reserve, and up to $10,000,000 for the acquisition of additional real property, to be secured by mortgage(s) and other security satisfactory to Lender in its sole discretion."

[8] The Loan was secured by first mortgages on three properties in Ramara, as well as by a second mortgage on a fourth. Three of the properties were owned by 671 and 179; the fourth was owned by Soorty and Cocov. The Commitment Letter stated that the Borrower had represented that the cumulative value of the four properties was $28.1 million. The Loan was also secured by general security agreements.

[9] A year later, on June 12, 2012, the parties amended the Commitment Letter in several respects (the "First Supplement"). First, another company controlled by Soorty and Cocov, Casino R.V. Resorts Inc., was added as a "Borrower". Second, an additional advance of $470,000 was made, secured by two other properties. The parties agreed that this advance was transitional in nature and ultimately was taken out by replacement financing.

[10] However, the principals of the CCAA Applicants made some very serious allegations about the validity of the First Supplement. Soorty, in his April 17, 2014 affidavit, deposed:

> I did not sign the said document and verily believe that it is a forgery. Unlike all other documents signed between Romspen Investment Corporation and myself, the pages of the First Supplement are not initialed and the signatures not witnessed, even though space for witnessess' signatures is provided.

Soorty so deposed evidently to support his contention that he had never agreed to make Casino R.V. a "Borrower" under the Loan, which on its face was one of the effects of the First Supplement. In his April 17 affidavit Cocov also alleged that his signature on the First Supplement was a forgery.

[11] Romspen adduced evidence which showed that slightly over 15 other documents were signed as part of the additional $470,000 loan put in place by the First Supplement. Soorty signed many of those on behalf of Casino R.V. One of the documents was an opinion by corporate counsel for Casino R.V. dated June 14, 2012 which stated that the "Loan and Security Documents have been duly and validly executed and delivered by the Company and create valid and legally binding obligations of the Company enforceable against the Company in accordance with the term thereof".

[12] After Romspen filed that evidence Soorty swore a further affidavit (April 23) in which he backpedalled from his forgery allegation, now contending that:

> I have no recollection of ever signing [the First Supplement]. If I ever did sign it, it was without understanding and appreciation of the nature and legal consequences of the document that was put in front of me.

Then, in his affidavit in support of the *CCAA* application, Soorty deposed that "even a cursory review of the First Amendment shows that it was put together in a rather hap-hazard fashion". Finally, in his second affidavit in support of the *CCAA* application, Soorty simply stated that the First Supplement "was placed in front of me with little time to obtain meaningful legal advice".

[13] Yet, as will be discussed in detail shortly, on June 7, 2013, one year after the First Supplement, both Soorty and Cocov signed a forbearance letter with Romspen, including Soorty signing the letter on behalf of Casino R.V. Resorts Inc. Why, one might ask, if the First Supplement which added Casino R.V. as a Borrower was a "forgery" or was based on a lack of "understanding and appreciation", would Soorty proceed to sign, one year later, the forbearance letter on behalf of Casino? In my view the answer is clear – there is absolutely no basis to support the allegations of Soorty and Cocov that the First Supplement was a forgery or that they

did not understand it. Their allegations of forgery can only be described as falsehoods, and such falsehoods severely undermine the credibility of the *CCAA* application given that Soorty and Cocov are the principals of the CCAA Applicants.

[14] To continue with the technical narrative, a further amendment was made to the Commitment Letter on August 15, 2012 (the "Second Supplement"). Four entities were added as "Borrowers": Hugel Lofts Limited, 20333387 Ontario Inc., 1564168 Ontario Inc., and 1387267 Ontario Inc. The use of the loaned funds provision was amended so that the next advances under the Loan could be used by the Borrowers to refinance a condominium project in Midland and "to provide funds to assist in completion of construction on [the Midland Condo Project] on a cost to complete basis in accordance with a project budget to be approved by Lender (including contingency allowance satisfactory to Lender)(approximately $7,000,000) and to pay further fee and transaction costs."

[15] Also, the Second Supplement increased the security provided by the Borrowers to include three Midland properties, including the lands upon which the Midland Condo Project was being built, as well as three properties in Cambridge. Romspen took first and second mortgages on the Midland lands, a first mortgage on one Cambridge property, and second mortgages on two other Cambridge properties which were behind mortgages held by Pezzack Financial Services Inc.

[16] The mortgage security taken by Romspen contained a standard provision enabling it to appoint a receiver upon an event of default, and the chargor also agreed to consent to a court order appointing a receiver.

[17] The Second Supplement also amended the Commitment Letter by adding, as a schedule, Romspen's Standard Construction Conditions. Section 4 of those Conditions stated:

> **4. Cost to Complete**
>
> The Lender shall not be required to make any advance unless prior to making such advance, the Lender is satisfied that the unadvanced portion of the Loan will be sufficient to pay the cost to complete the Project. Where insufficient unadvanced funds remain, the Borrower shall be required to pay such additional funds to the Lender so as to make the unadvanced portion of the Loan equal to the cost to complete.

[18] According to Wesley Roitman, a Managing General Partner of Romspen, in the months following the execution of the Second Supplement Romspen became concerned that the costs to complete the Midland Condo Project would exceed the budgeted $7 million and that a funding gap of about $3.1 million would arise. On June 7, 2013, the parties entered into a forbearance agreement. After reciting the language of the Commitment Letter's Section 4 "Cost to Complete", the forbearance letter went on to state:

> At this time, the amount required to be invested by you to comply with Section 4 above, is $3,180,994.00. You have advised that you have been and are currently unable to fund this amount. *Your failure to fund this amount constitutes an act of default under the loan and the security granted in connection therewith.* (emphasis added)

[19] Notwithstanding putting the Borrowers on notice that they had committed an act of default, in the forbearance letter Romspen stated that it agreed to forbear from exercising its available rights and remedies with respect to the act of default and would make the current advance requested by the Borrowers under the Loan "to fund continuing construction with respect to the condominium development at 151 Marina Park Avenue, Midland, Ontario".

[20] The Borrowers did not invest the $3,180,994.00 stipulated in the forbearance agreement. The record showed that at most they invested a further $270,000 on June 20, 2013 and paid a supplier's $89,383 invoice on June 14, 2013.

[21] Rompsen stopped making any further advances under the Loan in October, 2013.

[22] In December, 2013, suppliers to the Midland Condo Project registered liens totaling about $2.248 million.

[23] On January 3, 2014, Romspen sent to all of the Borrowers, except Casino, a demand letter and *BIA* s. 244(1) Notice of Intention to Enforce Security. The demand stated that as of January 3, 2014, the sum of $11.996 million was owed under the Loan. Payment was demanded by January 17, 2014. None was made.

[24] On March 28, 2014, Romspen sent to Casino R.V. Resorts a demand letter and *BIA* s. 244(1) Notice of Intention to Enforce Security which stated that as of March 28, 2014 the amount due under the Loan was $12.284 million.

[25] On March 4, 2014 Romspen commenced its application to appoint a receiver, subsequently amending its notice of application on April 3. A schedule for the hearing of Romspen's receivership application was set by the Court on April 11, 2014.

[26] Then, on April 28, 2014, 671, 179, 1387267 Ontario Inc., 1564168 Ontario Inc., 2033387 Ontario Inc. and Hugel Lofts Ltd. (the "CCAA Applicants"), issued their notice of application seeking an initial order under the *CCAA*.

B. The businesses of the *CCAA* Applicants

[27] Five of the CCAA Applicants own vacant land: 671 and 179 own the properties in Ramara, and 138, 156 and 203 own the Cambridge properties. At the present point of time, those CCAA Applicants operate simply as land holding companies; they have no employees.

[28] The other CCAA Applicant, Hugel Lofts, owns the land on which the Midland Condo Project is located, together with two undeveloped parcels of land in Midland.

C. The Midland Condo Project and other Midland properties

[29] The Midland Condo Project involves a partially constructed 4-storey residential building with 53 units. Construction is either about 50% or two-thirds completed, depending on which evidence one consults. The project has had a difficult development history, with Hugel Lofts

acquiring the already-started project in power of sale proceedings in June, 2012 for $4 million, with a mortgage back for $3.1 million.

[30] Between December 11 and December 20, 2013, trades registered six construction liens against the Midland Condo Project, with certificates of action registered this past January and February. In early April Hugel Lofts filed notices of intent to defend those lien actions. Construction has ceased on the Project.

[31] There was a dispute in the evidence about the fair market value of the three properties in Midland. The CCAA Applicants pointed to an October 3, 2013 "short narrative appraisal" prepared by Real Estate Appraisers and Consulting Limited which appraised the properties at $18 million (the "RE Appraisal"). That appraisal consisted of an "as is" appraisal of the one parcel on which the Midland Condo Project is located (151 Marina Park Ave.), which the appraiser arrived at by deducting the costs to complete from an appraised "as if complete" sellout value for the 53 condo units. The RE Appraisal also contained "as if" appraisals of the other two Midland parcels assuming "all approvals for the proposed development are in place and the subdivisions registered" (Vindon and Victoria Streets).

[32] The RE Appraisal recounted the following history of the Midland Condo Project as obtained from the current property owner – i.e. Hugel Lofts:

> Based on the information available, the structure was erected a few years ago by the previous owner. Due to finance and other difficulties, the construction work was (sic) for several years. This property in conjunction with the remaining undeveloped lands was sold under power of sale in 2012. Our client (the new owner) reported that the construction work was resumed in summer 2013.
>
> …
>
> The building as of the date of appraisal is described as about 50% completed.
>
> It is also reported that all units were completely presold by the previous owner for about $275 per sq ft. These sales were however void after liquidation of the previous owner.
>
> Per our client, that marketing of the new project will be launched in Spring 2014 and the new price range will be between $300 and $325 per sq ft. *Our client reported that many of the previous buyers show strong interest of coming back.* (emphasis added)

Photographs of the Midland Condo Project taken by the appraiser in October, 2013 showed significant completion of the exterior work on the building, but the need for extensive interior work.

[33] The RE Appraisal used a "cost to complete" for the Midland Condo Project of $6.591 million based upon a payment schedule dated September 15, 2013 provided by the general contractor, Sierra Construction. Sierra's schedule recorded a total value for its construction contract of $7.452 million, with the value of work done to that date of $1.145 million.

[34] Hugel Lofts proposes to build on the two undeveloped parcels (Vindon and Victoria Streets) 68 condo apartment units, 39 senior apartment units, 66 bungalows, 62 townhouse units and 80,000 sq. ft. of commercial space. The RE Appraisal assigned an "as is" value to 151 Marina Park of $10.6 million, and a "hypothetical" "as if" value of $7.4 million to the other two parcels.

[35] Romspen's internal valuations placed the worth of the Midland properties at far less than $18 million.

D. The Ramara properties

[36] The CCAA Applicants contended that the four Ramara Properties – 5781 Rama Road, 5819 Rama Road, 4243 Hopkins Bay Road and 4285 Hopkins Bay Road – were worth about $27 million on a built-out basis. An August 11, 2010 narrative appraisal of the vacant, unserviced development land prepared by Schaufler Realty Advisors for 671 provided a "hypothetical value of the subject site as fully serviced sites approved for the contemplated commercial and residential development" as of October 6, 2012 of $27.1 million.

[37] The Schaufler Appraisal noted that the four properties had been acquired for $4.4 million.

[38] A November 21, 2013 "draft" appraisal prepared by Schaufler also used a $27.1 million hypothetical value.

[39] Romspen's internal valuations placed the "as is" worth of the Ramara properties at far, far less than $27.1 million.

E. The Cambridge Properties

[40] 138, 156 and 203 own six parcels of vacant land in Cambridge, some of which are "brown-field" lands which will require remediation for environmental reasons. Romspen holds first mortgages over the Cambridge properties owned by 138, and second mortgages over those owned by 156 and 203, with Pezzack Financial Services and TD Canada Trust holding $300,000 in first mortgages on those properties.

III. Evidence about the owners' approach should the Court grant a *CCAA* initial order

[41] Soorty deposed that the CCAA Applicants intend to complete the Midland Condo Project without any further financial support from Romspen and he believed that the proceeds from condo units sales would be "sufficient to repay Romspen, resolve any lien claims and make a proposal to creditors using the remaining properties as the basis for that proposal":

> The Applicants simply want to complete the Condo Project with funds that will likely be supplied by Zoran and I (from our own resources) and repay Romspen the funds they did advance once the Condo Project is complete.

Soorty deposed elsewhere:

> … I believe that Zoran and I should have the opportunity to restructure the Applicants' affairs, repay Romspen on its loan, pay remaining creditors and keep control of our real estate development projects. As shown above, there is more than enough value in the Applicants' assets to repay Romspen in full.

A. Proposed sources of funds

A.1 Principals of CCAA Applicants mortgage other assets under their control

Harbour Mortgage

[42] As to the sources of those funds, Soorty deposed that a related company, 1026517 Ontario Limited, owned lands in Mississauga which secured a collateral mortgage in favour of Harbour Mortgage Corp. in the amount of $8 million. He deposed that Harbour Mortgage had "agreed to increase the loan amount to $11,250,000, thereby providing 1026517 Ontario Limited with an additional $3,250,000. I intend to use these funds to finish the construction at the Midland Property".

[43] The April 2, 2014 term sheet signed by Harbour Mortgage had not been signed and accepted by Soorty on behalf of 1026517 Ontario. The "loan amount" of $11.25 million was "not to exceed 65% of the appraised value and/or value as determined by the Lender" of the Mississauga properties. No evidence of their value was placed in evidence. The term sheet offered a loan with a 12-month term, and described the "use of funds" as follows:

> The proceeds of the Loan shall be used to refinance existing debt and to repatriate Borrower equity for planned future development.

The term sheet made no reference to a permitted use of funds for the Midland Condo Project.

National Bank

[44] Cocov deposed that he was the President of Harmony Homes Oshawa Ltd., a recently completed townhome condominium project in Oshawa, and that the National Bank had agreed to provide Harmony Homes with a mortgage for $4.8 million: "I intend to use these funds to complete construction at 151 Marina Park Avenue, Midland, Ontario."

[45] Cocov attached to his affidavit an April 11, 2014 "Discussion Paper" from National Bank which stated: "This Discussion Paper is an outline of proposed terms for purpose of considering your application only and is not: (i) a commitment letter; nor (ii) an agreement to provide financing". The Discussion Paper only referenced the Oshawa property, and it described the "purpose of proposed loan" as "refinancing", with the "type of facility" as "first rank conventional mortgage financing". The Discussion Paper made no reference to the Midland Condo Project, and I infer from its terms that the bank simply envisaged that its loan would replace the existing financing for the Oshawa property.

[46] Harmony Home signed the Discussion Paper on April 17, 2014. This motion was heard on May 2. No detailed evidence was provided concerning what discussions, if any, had ensued between Harmony Home and National Bank between April 17 and May 2.

[47] The Projected Statement of Cash Flows for the period May 2 through to June 6, 2014 filed by the CCAA Applicants did not make any reference to cash receipts from financings from either Harbour Mortgage or National Bank.

A.2 Proposed DIP Financing

[48] Soorty deposed that the CCAA Applicants would require $250,000 to complete four model suites, together with $50,000 in soft costs to begin pre-sales. Soorty and Cocov would finance those costs using their personal funds to make available up to $300,000 in "drip" financing, provided their financing was given a DIP Priority Charge.

[49] The filed CCAA Cash Flow statement contemplated using $150,000 of the DIP financing during the initial 30-day period.

A.3 HST Refund

[50] Soorty deposed that in early April, 2014, Cocov had contacted the CRA which had advised that it had approved an HST refund to Hugel Lofts of about $254,000. The filed CCAA Cash Flow statement contemplated receipt of the HST Tax refund during the week of May 23, 2014. The CCAA Applicants did not adduce any written communications from CRA which confirmed the entitlement to the HST Refund or the expected date of refund issuance.

B. Costs to complete the Midland Condo Project

[51] As to the costs to complete the Midland Condo Project, Soorty initially deposed that the Project's general contractor, Sierra Construction (Woodstock) Limited:

> [I]s prepared to complete the Condo Project for $5.5 million plus H.S.T. (the "Project Completion Costs"). In fact, they have guaranteed to complete the Condo Project for no more than then Project Completion Costs.

The April 23, 2014 Sierra Construction letter which Soorty filed in support of that evidence did not support Soorty's assertion. Sierra Construction did write that "the all in number to complete should be $5,500,000.00 (HST is not included)". However, it continued:

> Sierra, the project trades and their respective suppliers have suffer and continue to suffer damages as a result of non-funding. Collectively and in the interest of the Lien holders, we request the project/developer not be placed in receivership and the courts allow the project to be completed. Our summary would indicate the costs spent to date and the costs to complete weighted against the projected revenues, support the request for the project to continue to completion. We look forward in assisting you in completing this project.

Sierra's letter contained no "guarantee" that it would complete construction for $5.5 million.

[52] In a subsequent affidavit Soorty attached a further, April 28, 2014 letter from Sierra which stated, in part:

> The outstanding Construction Liens cumulative balance is $1,378,605.02 per our understanding you intend to vacate the liens. Some contractor Liens are in dispute, the true Lien value is $957,949.00. The remaining cost to complete the construction portion of the project plus consulting fees, Tarion Warranty inspections, Models suite upgrades, the all in number to complete should be $5,500,000.00 (HST is not included). Based on earlier submission/correspondence Sierra is prepared to enter into a fix price contract for the remainder of the project work.
>
> Collectively and in the interest of the Lien holders, we request the project/developer not be placed in receivership and the courts allow the project to be completed. We look forward in assisting you in completing this project.

[53] The CCAA Applicants did not file a detailed statement from Sierra which identified the work needed to complete the Midland Condo Project, similar to the one attached as Appendix "E" to the October, 2013 RE Appraisers report, nor did they file any explanation about why Sierra, which in that October, 2013 statement valued the work remaining to be done at $6.3 million, would be prepared to commit to complete the work for the significantly lesser amount of $5.5 million.

[54] Also, Sierra's April 28 letter suggested that it would not be prepared to resume work unless its lien was vacated. The CCAA Applicants did not address where the funds would come from to either pay off or bond off Sierra's lien, let alone those of other lien claimants, apart from their evidence about dealings with Harbour Mortgage and National Bank.

[55] Romspen filed its own internal calculations which placed all of the costs to complete – both "hard" and "soft" – several million dollars higher than the $5.5 million referred to by Sierra.

C. Summary

[56] In sum, the evidence filed by the CCAA Applicants disclosed that, if granted CCAA protection, they would look to the future sale of the units from the Midland Condo Project to "repay the Romspen Indebtedness in full and provide funds for resolving lien claims". The evidence of projected unit sales revenue of $17.579 million filed by the CCAA Applicants consisted of a short email (which contained no date) from Mr. Jonathan Weizel, who described himself as a sales representative at Royal LePage Terrequity Realty in Thornhill. Soorty deposed that Weizel had been responsible for selling out the Midland Condo Project before the previous owners were placed into a receivership.

[57] Soorty also deposed that the CCAA Applicants proposed "…leaving the balance of the Applicants' assets as a basis for a proposal to the Applicants' remaining creditors". In terms of the amounts due to those "remaining creditors", Crowe Soberman Inc., in its April 30, 2014 Pre-

Filing Report in its capacity as the proposed Monitor, estimated the amounts owed by Hugel Lofts at $15.98 million, consisting of $12 million due to Romspen, $958,000 due to lien claimants, and $3 million due to unsecured creditors, including related parties. Soorty deposed:

> The most significant unsecured creditors are Zoran and I with respect to shareholder loans we have made to facilitate completion of the Condo Project.

[58] Soorty, in his *CCAA* affidavit, deposed that save for Hugel Lofts, the other CCAA Applicants have "nominal financial obligations", and Crowe Soberman made no mention of any other liabilities concerning the CCAA Applicants, from which I infer that such liabilities are limited to the amounts contained in the charges registered against the Ramara and Cambridge properties owned by the CCAA Applicants.

IV. Analysis

A. A summary of the applicable legal principles

[59] Romspen seeks the appointment of SF Partners Inc. as receiver and construction lien trustee over the respondents under *BIA* s. 243(1), section 101 of the *Courts of Justice Act* and section 68 of the *Construction Lien Act*. In *Bank of Nova Scotia v. Freure Village on Clair Creek*, the court reviewed the factors to be taken into account in considering a request to appoint a receiver:

> The Court has the power to appoint a receiver or receiver and manager where it is "just or convenient" to do so: the *Courts of Justice Act*, R.S.O. 1990, c. 43, s. 101. In deciding whether or not to do so, it must have regard to all of the circumstances but in particular the nature of the property and the rights and interests of all parties in relation thereto. The fact that the moving party has a right under its security to appoint a receiver is an important factor to be considered but so, in such circumstances, is the question of whether or not an appointment by the Court is necessary to enable the receiver-manager to carry out its work and duties more efficiently...It is not essential that the moving party, a secured creditor, establish that it will suffer irreparable harm if a receiver-manager is not appointed....
>
> While I accept the general notion that the appointment of a receiver is an extraordinary remedy, it seems to me that where the security instrument permits the appointment of a private receiver - and even contemplates, as this one does, the secured creditor seeking a court appointed receiver - and where the circumstances of default justify the appointment of a private receiver, the "extraordinary" nature of the remedy sought is less essential to the inquiry. Rather, the "just or convenient" question becomes one of the Court determining, in the exercise of its discretion, whether it is more in the interests of all concerned to have the receiver appointed by the Court or not. This, of course, involves an

> examination of all the circumstances which I have outlined earlier in this endorsement, including the potential costs, the relationship between the debtor and the creditors, the likelihood of maximizing the return on and preserving the subject property and the best way of facilitating the work and duties of the receiver-manager. [1]

[60] The CCAA Applicants seek the making of an initial order under *CCAA* s. 11.02. In broad terms, the purpose of the *CCAA* is to permit a debtor to continue to carry on business and, where possible, avoid the social and economic costs of liquidating its assets. As pointed out by the Supreme Court of Canada in *Century Services Inc. v. Canada (Attorney General)*:

> There are three ways of exiting *CCAA* proceedings. The best outcome is achieved when the stay of proceedings provides the debtor with some breathing space during which solvency is restored and the *CCAA* process terminates without reorganization being needed. The second most desirable outcome occurs when the debtor's compromise or arrangement is accepted by its creditors and the reorganized company emerges from the *CCAA* proceedings as a going concern. Lastly, if the compromise or arrangement fails, either the company or its creditors usually seek to have the debtor's assets liquidated under the applicable provisions of the *BIA* or to place the debtor into receivership.[2]

[61] Both an order appointing a receiver and an initial order under the *CCAA* are highly discretionary in nature, requiring a court to consider and balance the competing interests of the various economic stakeholders. As a result, the specific factors taken into account by a court are very circumstance-oriented. In the case of land development companies, some courts have identified several of the factors which might influence a decision about whether to grant an initial order under the *CCAA*. For example, in *Cliffs over Maple Bay Investments Ltd. v. Fisgard Captial Corp.*, the British Columbia Court of Appeal stated:

> Although the *CCAA* can apply to companies whose sole business is a single land development as long as the requirements set out in the *CCAA* are met, it may be that, in view of the nature of its business and financing arrangements, such companies would have difficulty proposing an arrangement or compromise that was more advantageous than the remedies available to its creditors. The priorities of the security against the land development are often straightforward, and there may be little incentive for the creditors having senior priority to agree to an arrangement or compromise that involves money being paid to more junior creditors before the senior creditors are paid in full. If the developer is insolvent and not able to complete the development without further funding, the secured creditors may feel that they will be in a better position by exercising their remedies rather than by letting the developer remain in control of the failed development

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[1] (1996), 40 C.B.R. (3d) 274 (Ont. Gen. Div.), paras. 10 and 12.
[2] [2010] 3 S.C.R. 379, para. 14.

while attempting to rescue it by means of obtaining refinancing, capital injection by a new partner or DIP financing.[3]

[62] More recently, C. Campbell J., in *Re Dondeb Inc.*, after quoting the above passage from *Cliffs over Maple Bay*, stated:

> Similarly, in *Octagon Properties Group Ltd.*, [2009] A.J. No. 936, 2009 CarswellAlta 1325 (Q.B.), paragraph 17, Kent, J. made the following comments:
>
> > This is not a case where it is appropriate to grant relief under the CCAA. First, I accept the position of the majority of first mortgagees who say that it is highly unlikely that any compromise or arrangement proposed by Octagon would be acceptable to them. That position makes sense given the fact that if they are permitted to proceed with foreclosure procedures and taking into account the current estimates of value, for most mortgagees on most of their properties they will emerge reasonably unscathed. There is no incentive for them to agree to a compromise. On the other hand if I granted CCAA relief, it would be these same mortgagees who would be paying the cost to permit Octagon to buy some time. Second, there is no other reason for CCAA relief such as the existence of a large number of employees or significant unsecured debt in relation to the secured debt. I balance those reasons against the fact that even if the first mortgagees commence or continue in their foreclosure proceedings that process is also supervised by the court and to the extent that Octagon has reasonable arguments to obtain relief under the foreclosure process, it will likely obtain that relief.
>
> A similar result occurred in *Shire International Real Estate Investments Ltd.*, [2010] A.J. No. 143, 2010 CarswellAlta 234, even after an initial order had been granted.
>
> In *Edgeworth*, dealing with the specifics of that case I noted:
>
> > Were it not for the numerous individual investors (UDIs, MICs) and others who claim to have any interest in various of the lands as opposed to being general creditors of the Edgeworth companies, I doubt I could have been persuaded to grant the Initial CCAA Order.
>
> ...
>
> [In the present case] the request for an Initial Order under the *CCAA* was dismissed for the simple reason that I was not satisfied that a successful plan could be developed that would receive approval in any meaningful fashion from the creditors. To a large extent,

[3] 2008 BCCA 327, para. 36.

> Mr. Dandy is the author of his own misfortune not just for the liquidity crisis in the first place but also for a failure to engage with creditors as a whole at an early date.
>
> In his last affidavit filed Mr. Dandy explained why certain properties were transferred into individual corporations to allow additional financing that would permit the new creditors access to those properties in the event of default. To a certain extent this was perceived by creditors as "robbing Peter to pay Paul" and led to the distrust and lack of confidence the vast majority of creditors exhibit. Had there been full and timely communication both the creditors and the court may have concluded that a *CCAA* plan could be developed.
>
> ...
>
> Following further submissions on behalf of the debtor I advised the parties that in my view the conditions necessary for approval of an Initial *CCAA* Order were not met but that a comprehensive Receivership Order should achieve an orderly liquidation of most of the properties and protect the revenue from the operating properties with the hope of potential of some recovery of the debtor's equity.[4]

B. Applying the legal principles to the evidence

[63] The evidence adduced by Romspen established the indebtedness of the Borrowers under the Loan, the maturing of the Loan facility in September, 2013, the demands for payment, the failure of the Borrowers to repay the amount demanded and the validity of the security held by Romspen on the Ramara, Midland and Cambridge properties. The Borrowers did not dispute the amount owed, and the security documents contained a clear contractual right of Romspen to appoint a receiver upon an act of default and required the Borrowers, in such circumstances, to consent to an order appointing a receiver. An active development was underway on only one of the properties securing the Loan – the Midland Condo Project – the other lands being vacant and undeveloped. The other creditors who hold security against the Cambridge lands did not oppose the appointment of a receiver. Pezzack Financial simply submitted that in the event a receiver were appointed, the receiver should not enjoy priority over Pezzack Financial for its fees and expenses on those properties where Pezzack Financial held the first mortgages. The lien claimants against the Midland Condo Project did not appear on the return of the application, although served with the court materials. Sierra Construction provided the Borrowers with a letter of support, but did not formally appear in the proceeding.

[64] In the usual course of affairs those circumstances would point towards the appropriateness of granting the requested order appointing a receiver, as well as a construction lien trustee. However, the Borrowers opposed the making of such an order on two main grounds. First, they argued that by its conduct Rompsen had caused the Borrowers to default

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[4] 2012 ONSC 6087, paras. 19-21, 25, 26 and 31.

under the Loan and Romspen should not be allowed to take advantage of such conduct. Second, they contended that the plan advanced by the CCAA Applicants offered a fairer way to balance the competing economic interests at play and any consideration of the appointment of a receiver should be deferred until the CCAA Applicants had been afforded an opportunity to complete the Midland Condo Project. Let me deal with each argument in turn.

[65] First, Soorty, in his affidavit in support of the CCAA application, and the CCAA Applicants in their written submissions to the Court, contended that their default on the Loan was caused by Romspen's wrongful failure to advance the full amount of the Loan as it was contractually required to do, leading to the trades to lien the Midland Condo Project. The CCAA Applicants argued that a lender was not entitled to take advantage of, or seek relief in respect of, a default which its own wrongful conduct had created.

[66] While the authorities certainly contemplate that a court may refuse to appoint a receiver where the lender's conduct has placed the debtor in default of its borrowing obligations,[5] that is not this case. When the Loan facility was amended to permit the use of funds for the continued construction of the Midland Condo Project, the Second Supplement, by incorporating Section 4 of Romspen's Standard Construction Conditions, made quite express the circumstances under which Rompsen was required to advance further funds for that project:

> The Lender shall not be required to make any advance unless prior to making such advance, the Lender is satisfied that the unadvanced portion of the Loan will be sufficient to pay the cost to complete the Project. Where insufficient unadvanced funds remain, the Borrower shall be required to pay such additional funds to the Lender so as to make the unadvanced portion of the Loan equal to the cost to complete.

[67] The June, 2013 Forbearance Letter contained an acknowledgement by the Borrowers of their failure to have advanced their own funds towards the Midland Condo Project:

> At this time, the amount required to be invested by you to comply with Section 4 above, is $3,180,994.00. You have advised that you have been and are currently unable to fund this amount. *Your failure to fund this amount constitutes an act of default under the loan and the security granted in connection therewith.*

[68] In sum, the evidence established that it was the failure of the Borrowers to abide by the terms of the Commitment Letter, as amended by the Second Supplement and the Forbearance Letter, which led to them to commit acts of default.

[69] The CCAA Applicants also strongly intimated in their evidence that throughout the earlier part of this year Romspen had misled them into thinking that the difficulties with the Loan could be worked out. In support of that submission they pointed to language in an April 4, 2014

[5] *Royal Bank of Canada v. Chongsim Investments Ltd.* (1997), 456 C.B.R. (3d) 267 (Ont. Gen. Div.)

email from Roitman to them which talked about the completion of the Midland Condo Project as "clearly…the best outcome for all of us". That was not an accurate characterization of the email by the CCAA Applicants, as can be seen when one reads the email in full:

> Al, these emails are not really very useful. As we have discussed at length, Romspen's lawyers need to push our case forward as forcefully as they can. This does not prevent us from changing course later on. When you and Zoran have your affairs arranged to the point where you can move the project forward again, we will be glad to discuss terms for reinstating the loan and completing the project. Clearly this would be the best outcome for all of us, *but we have waited about one year already for you guys to work things out between each other and to find the funding to cover the cost, and we just can't wait forever*. (emphasis added)

[70] The last phrase in Roitman's email most likely suggests the real reason for the default of the CCAA Applicants under the Loan – internal disagreements between Soorty and Cocov about how much each of them should contribute to the continued construction of the Midland Condo Project. The June 7, 2013 forbearance agreement signed by both hinted at this problem, with its reference to Soorty and Cocov having advised "that you have been and are currently unable to fund this amount" (i.e. $3.18 million). Soorty expressly referred to the internal problems in paragraph 55 of his *CCAA* initial affidavit when he deposed: "As a sign of our good faith, I was prepared to put $2 million towards the Condo Project immediately, however, Zoran required additional time to finalize similar financing".

[71] Turning to the second argument advanced by the Borrowers/CCAA Applicants, does their proposed approach to complete the construction of the Midland Condo Project offer a better, more practical alternative to Romspen's proposed appointment of a receiver?

[72] At a high level, a certain unfairness characterizes the plan of the CCAA Applicants. Under their plan, they would see the development of the Midland Condo Project to its end and use the unit sales proceeds to pay off Romspen in full and, evidently, to pay most of the amounts sought by the lien claimants. They would then develop out the other secured properties to propose a plan to the other unsecured creditors, but according to Soorty most of the unsecured debt consists of shareholders loans from Cocov and himself. Reduced to its essence, the plan seems to be no more than asking the court to impose on Romspen an extension of the term of the Loan beyond its 2-year term and to allow management to continue operating as they have in the past. In other words, the CCAA Applicants do not propose the compromise of debt or the liquidation of part of their businesses – they want to carry on just as they have in the past.

[73] I accept the evidence of Romspen about the unfairness of such an approach. Romspen stated that it had "absolutely no confidence" in the ability of Soorty and Cocov to manage the affairs of the CCAA Applicants during any stay period, pointing to them letting the first general contractor on the Midland Condo Project, Dineen, place liens on it, and allowing subsequent contractors to do so as well. Roitman also deposed about Soorty and Cocov:

> They have evidently been unable to manage their mutual partnership relationship. Moreover, notwithstanding their purported ability according to the Soorty affidavit to refinance their obligations to Romspen with other assets they control, they have had over 12 months to make those arrangements and have failed to do so. Had they done so, Romspen would have extended the facility.
>
> There is no plan acceptable to Romspen short of immediate payment in full. The plan proposed by the Debtors, apart from the priming of Rompsen's security and the multi-layered professional expenses associated with a CCAA, in circumstances where there is no operating business, amounts to little more than what Messrs. Soorty and Cocov have been unable to do over the past 12 months.

[74] Two other questions arise as part of this higher level analysis. First, the RE Appraisal recited that management had told the appraiser that "all units were completely presold by the previous owner" and "many of the previous buyers show strong interest in coming back". If that in fact was the case, why have Soorty and Cocov been unable to attract replacement financing for the Midland Condo Project? Second, the CCAA Applicants emphasized the significant equity available in the other Midland properties, as well as the Ramara and Cambridge properties, arguing that Romspen should hang in for the duration of the Midland Condo Project because it was fully secured. Perhaps the more appropriate question to pose is why the CCAA Applicants are not prepared to realize on some of the equity in those other properties to pay out Romspen now, given that the Loan matured well over half a year ago? The answer appears to be that they want the *CCAA* initial order to secure for them a compelled extension of the term of the Romspen Loan at minimal cost. I do not regard that as a proper use of the *CCAA* process in the circumstances.

[75] Other questions arise when one turns to the specifics of the general plan proposed by the CCAA Applicants. It is apparent that the proposed DIP financing would be wholly inadequate to complete the construction of the Midland Condo Project. Where will the other funds come from? The suggestion by the CCAA Applicants that National Bank and Harbour Mortgage may serve as sources for such financing simply is not borne out by the specifics contained in the respective Discussion Paper and Term Sheet. Put another way, I see no credible evidence before the Court to suggest that that the CCAA Applicants are anywhere close to finding sources to fund the costs to complete the construction of the Midland Condo Project, let alone to resolve the existing lien claims which one would expect would be one of the necessary first steps to get this project back up and running.

[76] Further, the 30-day Cash Flow statement filed in support of the short-term plan to build model suites rested heavily on the receipt of the HST Refund, yet the CCAA Applicants placed no evidence before the Court from CRA which would indicate that such a refund would be received within the next 30 days.

[77] Finally, I would have very strong reservations about leaving the court-supervised completion of the Midland Condo Project in the hands of Soorty and Cocov, even with a Monitor present. As I mentioned earlier, their allegations that their signatures had been forged on the

First Supplement were without foundation and most seriously undermined their credibility. Also, Soorty exaggerated his evidence on other important issues, such as the actual purposes of the funds being sought from National Bank and Harbour Mortgage, as well as his initial characterization of Sierra Construction having offered a "guaranteed" cost to complete.

[78] For these reasons, I dismiss the application by the CCAA Applicants for an initial order under the *CCAA*, and I grant the application of Romspen for the appointment of SF Partners Inc. as receiver and construction lien trustee.

C. The scope of the appointment

[79] Romspen holds security, by way of mortgages and general security agreements, over the companies which own the Ramara Properties – 6711162 Canada Inc. and 1794247 Ontario Inc. – the companies which own the Cambridge Properties – 1387267 Ontario Inc., 1564168 Ontario Inc. and 2033387 Ontario Inc. – and the company which owns the Midland Properties – Hugel Lofts Ltd. A receiver is appointed over those companies and those properties.

[80] One of the Ramara Properties – 4271-4275 Hopkins Bay Road, Rama – is owned by Altaf Soorty and Zoran Cocov. At the hearing I had questioned Romspen's counsel about why his client was seeking the appointment of a receiver over Soorty and Cocov. He responded by pointing to GSAs given by both individuals to Romspen. After further discussion counsel advised that he had received instructions to withdraw the request for a receiver over Soorty and Cocov. I had not been able to read most of the application records prior to the hearing. I now see that Romspen obtained a charge from Soorty and Cocov over the Hopkins Bay Road properties owned by them. My queries about the need to appoint a receiver over the individual respondents were not focused on that property, but on whatever other assets the two individuals possessed. Consequently, I consider it most appropriate to appoint a receiver over the property owned by Soorty and Cocov at 4271-4275 Hopkins Bay Road, Rama.

[81] Much ink was spilt by both sides over the appointment of a receiver over Casino R.V. Resorts Inc. That issue can be dealt with quickly. Romspen loaned money to Casino and received a package of security in return, part of which included the addition of Casino as a "Borrower" under the Commitment Letter pursuant to the First Supplement. All parties agreed that that loan was repaid in full. On July 16, 2012, Romspen wrote that upon receipt of the amount to pay out the loan to Casino, it would provide its signed authorization to register its assignment of its *PPSA* registrations in respect of the loan, as well as a release of its interest. The loan was repaid, but apparently Romspen did not provide those documents. It contended it was never asked to do so.

[82] Be that as it may, while I am prepared to grant Romspen's request to add Casino R.V. Resorts Inc. as a party to the receivership application, I am not prepared to appoint a receiver over Casino or any properties it previously provided as security. The appointment of a receiver is an equitable remedy. Casino repaid the loan and Romspen agreed to release its interest. Under those circumstances, it is neither fair nor reasonable for Romspen to seek the appointment of a receiver over Casino.

[83] Counsel for Romspen circulated a draft appointment order at the hearing. On behalf of Pezzack Financial Services Inc., Mr. Tingley submitted that the receiver's charge should not enjoy priority over his client's first mortgages on Cambridge Properties because the receivership really concerned a dispute involving the Midland Condo Project. That was a reasonable request in the circumstances, and I order that in respect of the Cambridge Properties the charge granted to the receiver shall stand subordinate to any first charges registered against those properties by any person other than Romspen.

[84] A sealing order shall issue in respect of the Confidential Exhibits to the Affidavit of Wesley Roitman in order to preserve the integrity of any sales and marketing process undertaken by the Receiver. Counsel can submit a revised draft appointment order to my attention through the Commercial List Office for issuance.

V. Costs

[85] I would encourage the parties to try to settle the costs of these applications. If they cannot, Rompsen may serve and file with my office written cost submissions, together with a Bill of Costs, by May 16, 2014. Any party against whom costs are sought may serve and file with my office responding written cost submissions by May 29, 2014. The costs submissions shall not exceed three pages in length, excluding the Bill of Costs.

[86] Any responding cost submissions should include a Bill of Costs setting out the costs which that party would have claimed on a full, substantial, and partial indemnity basis. If a party opposing a cost request fails to file its own Bill of Costs, I shall take that failure into account as one factor when considering the objections made by the party to the costs sought by any other party. As Winkler J., as he then was, observed in *Risorto v. State Farm Mutual Automobile Insurance Co.*, an attack on the quantum of costs where the court did not have before it the bill of costs of the unsuccessful party "is no more than an attack in the air".[6]

D. M. Brown J.

Date: May 5, 2014

[6] (2003), 64 O.R. (3d) 135 (S.C.J.), para. 10, quoted with approval by the Divisional Court in *United States of America v. Yemec*, [2007] O.J. No. 2066 (Div. Ct.), para. 54.

TAB 6

ANNUAL REVIEW

OF

INSOLVENCY LAW

2014

JANIS P. SARRA

AND

JUSTICE BARBARA ROMAINE

Editors

CARSWELL

La bonne foi est une considération de base — Requiring Nothing Less than Good Faith in Insolvency Law Proceedings

*Janis Sarra**

I. INTRODUCTION

It is hard to believe that anyone would argue for the corollary of good faith in insolvency proceedings, *i.e.* "bad faith" in the conduct of the creditors and others. Yet, amazingly, there is a critical mass of practitioners who argue strenuously that good faith should not be a requirement imposed on creditors in Canadian insolvency proceedings. It may be that they do not appreciate that the Supreme Court of Canada has already weighed in on this issue, calling good faith one of the baseline considerations of the court when it is determining whether or not to exercise its authority in insolvency proceedings.[1] Based on this reasoning, and a recent Supreme Court of Canada judgment advancing the Canadian law doctrine of good faith in contractual relations,[2] the obligation already exists.

Yet there is anecdotal evidence that suggests that parties in some instances are increasingly failing to deal honestly, candidly, forthrightly or reasonably with other stakeholders in insolvency proceedings; or are acting in a way that undermines the interests of others or of the proceeding itself; and/or are acting contrary to the objectives of the insolvency

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1 *Century Services Inc v Canada (Attorney General)*, 2010 SCC 60, [2010] 3 SCR 379 [*Century Services*].

2 *Bhasin v Hrynew*, 2014 SCC 71.

legislation; all hallmarks of a failure to act in good faith, as recognized by the Supreme Court.[3]

Hence, an important question is whether there should be a statutorily codified obligation to act in good faith enshrined in the *Bankruptcy and Insolvency Act (BIA)*[4] and the *Companies' Creditors Arrangement Act (CCAA)*,[5] as there is in the *Civil Code of Québec (Civil Code)*[6] and the United States *Bankruptcy Code*.[7] This article suggests that such a duty either needs to be codified or the courts need to make clearer to parties that a standard of good faith conduct is a minimum requirement for parties in insolvency proceedings and that the court is prepared to act when conduct is brought to its attention that does not meet this standard. The fact that some creditors already implicated in insolvency law proceedings and their professionals do not understand that this duty exists speaks volumes as to the need for enhancing the duty so that its requirements are clarified for those involved in proceedings.[8]

Canadian insolvency legislation already imposes an affirmative duty to act in good faith on the debtor company.[9] To receive a recognition and stay order on an initial

3 The "anecdotal evidence" comes from interviews with some insolvency professionals and parties to proceedings, but no one was prepared to go on record for purposes of this article, which in itself is indicative of the need for a candid public policy discussion.

4 *Bankruptcy and Insolvency Act*, RSC 1985, c B-3, as amended *(BIA)*.

5 *Companies' Creditors Arrangement Act*, RSC 1985 c C-36, as amended *(CCAA)*.

6 *Civil Code of Québec*, SQ 1991, c 64. Technically, the *Civil Code* is not a statute; it was adopted in a statute by the National Assembly, but comprises a body of rules laying down the *jus commune*, and is considered the foundation of all other laws: *Civil Code of Québec*, preliminary provisions.

7 United States *Bankruptcy Code*, 11 USC, as amended.

8 See *supra* note 3. One US practitioner who has appeared recently in two Canadian proceedings observed that he was accustomed to the good faith obligation under the US *Bankruptcy Code*, but was unaware that creditors had any such obligation under Canadian legislation.

9 *CCAA*, ss. 11.02(3) and 33(3); *BIA*, ss. 50(12), 50.4(9), 50.4(11) and 65.12(2).

application, the burden is on the applicant, usually the debtor company, to satisfy the court that the order is appropriate in the circumstances and that the applicant has been acting in good faith and with due diligence.[10] The court also needs to be satisfied that the debtor continues in act in good faith before it will grant any extensions of the stay order. In Canada, directors' actions are also assessed on a basis of good faith. For example, the Supreme Court of Canada has held that "Canadian courts tend to accord deference to business decisions of directors taken in good faith and in the performance of the functions they were elected to perform by shareholders."[11] In the context of approving a plan of arrangement under s. 192 of the *Canadian Business Corporations Act*, the Court has held: "s. 192 review requires a court approving a plan of arrangement to be satisfied that: (1) the statutory procedures have been met; (2) the application has been put forth in good faith; and (3) the arrangement is fair and reasonable."[12]

There is also a good faith obligation on unions that represent employees in insolvency proceedings, given that good faith is explicitly required as a condition of being able to collectively bargain on behalf of employees under Canadian and provincial labour relations legislation.[13] Both the union and the debtor company also have a statutory duty to bargain in good faith with a view to reaching a collective agreement. Trustees and monitors are also required to act in good faith if they are to receive liability protection for their actions in insolvency proceedings.[14]

10 *CCAA*, ss. 11.02(3). See also *Century Services, supra* note 1 at para 69.

11 *BCE Inc v 1976 Debentureholders*, [2008] 3 SCR 560.

12 *Ibid.* at 46.

13 See for example, *Canada Labour Code*, RSC 1985, c L-2 and Ontario *Labour Relations Act, 1995*, SO 1995, c 1.

14 See for example, *BIA* ss. 50(9) and 50.4(5); *CCAA* s. 23(2). See also, *Re Braich* (2003), 2 CBR (5th) 75 (BCSC [In Chambers]); *Re Hover* (2000), 21 CBR (4th) 263 (QB); *Re Katz* (1991), 6 CBR (3d) 211 (Ont Bktcy).

That leaves creditors more generally without an express statutory obligation to act in good faith. Should Canadian insolvency legislation expressly impose a duty of good faith on creditors in insolvency proceedings, and if so, what should be the contours of such an obligation? If not, what principles should guide Canadian courts in their deliberations, so that the good faith baseline requirement observed by the Supreme Court has meaning on the ground?

Let's deal with the arguments against codification up front. One argument is that Canadian courts already have broad statutory authority under the *BIA* and *CCAA*. That observation is correct, as observed by the Supreme Court of Canada in *Century Services v Canada (Attorney General)*.[15] However, it has not prevented bad faith dealing, particularly by foreign bondholders and other creditors that have limited or no relational ties to the debtor company or to the communities in which the debtor operates. Express language would be helpful, particularly for these parties, primarily US based, who have recently tested the scope of acceptable behaviour in insolvency proceedings.

Second, the argument is that Canadian commercial law generally, with the notable exception of the *Civil Code*,[16] does not impose a duty of good faith, and so, why should insolvency legislation? Historically, this view was somewhat accurate, but as is evident in the discussion below on general obligations of good faith, the Supreme Court of Canada has recently clarified the law and heightened the existing good faith obligation in contract law. Given that contract law governs much of the relationship between debtors and creditors outside of insolvency law, arguably statutory codification or enhanced recognition of the obligation by the courts could assist with greater certainty and consistency in treatment of the law both in and outside of insolvency.

15 *Century Services, supra* note 1.

16 *Civil Code, supra* note 6, articles 6, 7 and 1375. These provisions are discussed in greater detail in part III of this article.

An important counter-argument to the objectors to good faith obligations is that access to the court-supervised procedure must carry with it responsibilities for creditors, just as it does for debtors. Creditors, having received the benefits of the statutory framework and the supervision of the court, are no longer purely private contracting parties. Arguably, with the benefit of the stay that prohibits a race to the assets, protection of the hierarchy of claims and other protections of insolvency legislation come responsibilities. The baseline good faith requirement should be more fulsomely recognized and given meaning, an argument for codification. Creditors' conduct should be explicitly required to be in good faith if they expect the full benefit of remedies under insolvency law and contract law to which they may entitled.

This article suggests that the existing requirement of good faith in insolvency proceedings needs considerable bolstering, either through express direction of the court or through an express statutory obligation of good faith on all stakeholders involved in insolvency proceedings. Either strategy would add transparency, accountability and certainty to insolvency proceedings. The article offers some starting principles for assessing good faith that could be imposed by the courts under the current legislation and common law, or which could inform the thinking underlying an express statutory obligation.

Part II of the article examines recent developments in Supreme Court of Canada jurisprudence on good faith generally. Part III explores the contours of the obligation under the Québec *Civil Code*, which imposes an express requirement of good faith. Part IV examines the statutory obligation of good faith on creditors, debtors and others under the US *Bankruptcy Code*, including the issues the courts have had to determine in respect of this obligation. Part V then offers baseline principles and considerations that the courts should apply in assessing good faith conduct of parties in insolvency proceedings.

II. THE SUPREME COURT OF CANADA HAS ALREADY RECOGNIZED GOOD FAITH AS A BASELINE REQUIREMENT IN INSOLVENCY LAW

The Supreme Court of Canada in *Century Services v Canada (Attorney General)* held that good faith is a baseline requirement that the court will consider in making determinations under Canadian insolvency legislation.[17] To quote:

> [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.

The Court grounds this authority in its broad statutory jurisdiction:

> [65] I agree with Justice Georgina R. Jackson and Professor Janis Sarra that the most appropriate approach is a hierarchical one in which courts rely first on an interpretation of the provisions of the *CCAA* text before turning to inherent or equitable jurisdiction to anchor measures taken in a *CCAA* proceeding (see G. R. Jackson and J. Sarra, "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters", in J. P. Sarra, ed., *Annual Review of Insolvency Law 2007* (2008), 41, at p. 42). The authors conclude that when given an appropriately purposive and liberal interpretation, the *CCAA* will be sufficient in most instances to ground measures necessary to achieve its objectives (p. 94).
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> [66] Having examined the pertinent parts of the *CCAA* and the recent history of the legislation, I accept that in most instances the issuance of an order during *CCAA* proceedings should be considered an exercise in statutory interpretation. Particularly noteworthy in this regard is the expansive interpretation the language of the statute at issue is capable of supporting.
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> [67] The initial grant of authority under the *CCAA* empowered a court "where an application is made under this Act in respect of a company . . . on the application of any person interested in the matter, . . . subject to this Act, [to] make an order under this section" (*CCAA*, s. 11(1)). The plain language of the statute was very broad.
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> [68] In this regard, though not strictly applicable to the case at bar, I note that Parliament has in recent amendments changed the wording contained in s. 11(1), making explicit the discretionary authority of the court under the *CCAA*. Thus, in s. 11 of the *CCAA* as currently enacted, a court may, "subject to the restrictions set out in this Act,...make any order that it considers appropriate in the circumstances" (S.C. 2005, c. 47, s. 128). Parliament appears to have endorsed the broad reading of the *CCAA*.

Hence, the Supreme Court's finding that good faith is a baseline consideration in insolvency law arises out of its broad statutory authority, and the court can consider the good faith actions of all parties to a *CCAA* and *BIA* proceeding. As the Court held, the court should assess whether the order sought *and the means it employs* advance the policy objectives and remedial purpose of the *CCAA*, which is to avoid the social and economic losses resulting from liquidation of an insolvent company.[18] The Court observes that the chances for successful reorganizations are enhanced where all stakeholders are treated as advantageously and fairly as the circumstances permit.[19]

This broad authority clearly mandates Canadian courts to assess the good faith conduct of the parties in insolvency proceedings; yet there are only rare instances in which such an assessment has been undertaken. There are numerous possible reasons. First, without an express requirement, non-repeat[20]

17 *Century Services, supra* note 1 at para 70.

18 *Ibid.*

19 *Ibid.* at para 70.

20 By "non-repeat" creditors, I mean smaller, less sophisticated creditors that are not repeat players in the Canadian insolvency law regime.

and vulnerable creditors may be unaware that counter-parties to the proceedings have such obligations; thus, the lack of transparency about such an obligation may encourage certain behaviours in the negotiations for a workout, a part of the proceeding that the court does not see or hear about unless an express issue is brought before it.

Second, the vast majority of participants may be assuming good faith on the part of all participants, and a lack of good faith may be difficult to detect unless it is suspected and evidence of it sought. Even then, it may be very difficult to ascertain and demonstrate, which would be a prerequisite to court intervention to censure reprehensible conduct.

Third, some parties lack the resources to bring complaints about parties failing to act in good faith. Insolvency proceedings, particularly under the *CCAA*, are already very expensive, and most creditors that are likely to be at the receiving end of conduct that fails to fulfill the good faith obligation are often at the vulnerable end of the spectrum of creditor power. Courts must be alert to this risk in their determination of issues. Whatever the reasons for the rarity of good faith complaints, parties have received a wake-up call in a recent Supreme Court decision.

In November 2014, the Supreme Court of Canada in *Bhasin v Hrynew* held that good faith is an organizing principle in Canadian commercial relations.[21] It held that it is appropriate to recognize a general organizing principle of good faith, which is a common law duty that requires parties to be honest in their dealings with one another; and that parties generally must perform their contractual duties honestly and reasonably and not capriciously or arbitrarily. The Supreme Court held that good faith, as a basic level of honest conduct, is necessary to the proper functioning of commerce. To quote Cromwell J writing for a unanimous Court:

> [32] The notion of good faith has deep roots in contract law and permeates many of its rules. Nonetheless, Anglo-Canadian common law has resisted acknowledging any generalized and independent doctrine of good faith performance of contracts. The result is an "unsettled and incoherent body of law" that has developed "piecemeal" and which is "difficult to analyze": Ontario Law Reform Commission ("OLRC"), *Report on Amendment of the Law of Contract* (1987), at p. 169. This approach is out of step with the civil law of Québec and most jurisdictions in the United States and produces results that are not consistent with the reasonable expectations of commercial parties.
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> [33] In my view, it is time to take two incremental steps in order to make the common law less unsettled and piecemeal, more coherent and more just. The first step is to acknowledge that good faith contractual performance is a general organizing principle of the common law of contract which underpins and informs the various rules in which the common law, in various situations and types of relationships, recognizes obligations of good faith contractual performance. The second is to recognize, as a further manifestation of this organizing principle of good faith, that there is a common law duty which applies to all contracts to act honestly in the performance of contractual obligations.
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> [34] In my view, taking these two steps is perfectly consistent with the Court's responsibility to make incremental changes in the common law when appropriate. Doing so will put in place a duty that is just, that accords with the reasonable expectations of commercial parties and that is sufficiently precise that it will enhance rather than detract from commercial certainty.

The Supreme Court noted that the doctrine of good faith traces its history to Roman law and found acceptance in earlier English contract law, the courts finding that in contracts of all kinds, it is of the highest importance that courts of law should compel the observance of honesty and good faith.[22] However, the Court noted that such broad pronouncements were

21 *Bhasin v Hrynew*, *supra* note 2.

Ibid. at para 35, citing Lord Kenyon in *Mellish v Motteux* (1792), Peake 156, 170 ER 113 (KB) at 157. The Court also held: "For example, Lord Northington wrote in *Aleyn v Belchier* (1758), 1 Eden 132, 28 ER 634, at 138, cited in *Mills v Mills* (1938), 60 CLR 150 (HCA), at 185, that '[n]o point is better established than that, a person having a power, must execute it *bona fide* for the end designed, otherwise it is corrupt and void.'... In *Carter v Boehm* (1766), 3 Burr 1905, 97 ER 1162, at 1910, Lord Mansfield stated that good faith is a principle applicable to all contracts: see also *Herbert v Mercantile Fire Ins Co* (1878), 43 UCQB 384 (Ont); R Powell, "Good Faith in Contracts" (1956), 9 *Curr Legal Probs* 16."

restricted over the years to specific types of contracts and relationships, leaving unclear the role of the broader principle of good faith in the modern Anglo-Canadian law of contracts.[23]

The Supreme Court further held:

> [60] Commercial parties reasonably expect a basic level of honesty and good faith in contractual dealings. While they remain at arm's length and are not subject to the duties of a fiduciary, a basic level of honest conduct is necessary to the proper functioning of commerce. The growth of longer term, relational contracts that depend on an element of trust and cooperation clearly call for a basic element of honesty in performance, but, even in transactional exchanges, misleading or deceitful conduct will fly in the face of the expectations of the parties...
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> [63] The first step is to recognize that there is an organizing principle of good faith that underlies and manifests itself in various more specific doctrines governing contractual performance. That organizing principle is simply that parties generally must perform their contractual duties honestly and reasonably and not capriciously or arbitrarily.
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> [64] As the Court has recognized, an organizing principle states in general terms a requirement of justice from which more specific legal doctrines may be derived. An organizing principle therefore is not a free-standing rule, but rather a standard that underpins and is manifested in more specific legal doctrines and may be given different weight in different situations: see, e.g., *R. v. Jones*, 1994 CanLII 85 (SCC), [1994] 2 S.C.R. 229, at p. 249; *R. v. Hart*, 2014 SCC 52 (CanLII), [2014] 2 S.C.R. 544, at para. 124; R. M. Dworkin, "Is Law a System of Rules?", in R. M. Dworkin, ed., The Philosophy of Law (1977), 38, at p. 47. It is a standard that helps to understand and develop the law in a coherent and principled way...
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> [65] The organizing principle of good faith exemplifies the notion that, in carrying out his or her own performance of the contract, a contracting party should have appropriate regard to the legitimate contractual interests of the contracting partner. While "appropriate regard" for the other party's interests will vary depending on the context of the contractual relationship, it does not require acting to serve those interests in all cases. It merely requires that a party not seek to undermine those interests in bad faith. This general principle has strong conceptual differences from the much higher obligations of a fiduciary. Unlike fiduciary duties, good faith performance does not engage duties of loyalty to the other contracting party or a duty to put the interests of the other contracting party first.
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> [66] This organizing principle of good faith manifests itself through the existing doctrines about the types of situations and relationships in which the law requires, in certain respects, honest, candid, forthright or reasonable contractual performance. Generally, claims of good faith will not succeed if they do not fall within these existing doctrines. But we should also recognize that this list is not closed. The application of the organizing principle of good faith to particular situations should be developed where the existing law is found to be wanting and where the development may occur incrementally in a way that is consistent with the structure of the common law of contract and gives due weight to the importance of private ordering and certainty in commercial affairs.[24]

As noted in the excerpt above, the Court held that, unlike fiduciary duties, good faith performance does not engage duties of loyalty to the other contracting party or a duty to put the interests of the other contracting party first. It also made clear that the existing doctrinal requirements of candidness, honesty, forthrightness and reasonableness that are necessary to good faith are not a closed list.

The Court in *Bhasin v Hrynew* recognized that there are limits to good faith as an organizing principle:

> [69] The approach of recognizing an overarching organizing principle but accepting the existing law as the primary guide to future development is appropriate in the development of the doctrine of good faith. Good faith may be invoked in widely varying contexts and this calls for a highly context-specific understanding of what honesty and reasonableness in performance require so as to give appropriate consideration to the legitimate interests of both contracting parties. For example, the general organizing principle of good faith would likely have different implications in the context of a long-term contract of mutual cooperation than it would in a more transactional exchange: Swan and Adamski, at § 1.24; B. Dixon, "Common law obligations of good faith in Australian commercial contracts — a relational recipe" (2005), 33 A.B.L.R. 87.
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> [70] The principle of good faith must be applied in a manner that is consistent with the fundamental commitments of the common law of contract which generally places great weight on the freedom of contracting parties to pursue their individual self-interest. In commerce, a party may sometimes cause loss to another — even intentionally — in

23 *Bhasin v Hrynew*, *ibid.* at para 36.

24 *Ibid.* at paras 60-66.

the legitimate pursuit of economic self-interest: *A.I. Enterprises Ltd. v. Bram Enterprises Ltd.*, 2014 SCC 12 (CanLII), [2014] 1 S.C.R. 177, at para. 31. Doing so is not necessarily contrary to good faith and in some cases has actually been encouraged by the courts on the basis of economic efficiency: *Bank of America Canada v. Mutual Trust Co.*, 2002 SCC 43 (CanLII), [2002] 2 S.C.R. 601, at para. 31. The development of the principle of good faith must be clear not to veer into a form of *ad hoc* judicial moralism or "palm tree" justice. In particular, the organizing principle of good faith should not be used as a pretext for scrutinizing the motives of contracting parties.

[71] Tying the organizing principle to the existing law mitigates the concern that any general notion of good faith in contract law will undermine certainty in commercial contracts. In my view, this approach strikes the correct balance between predictability and flexibility.

[72] ...The key question before the Court, therefore, is whether we ought to create a new common law duty under the broad umbrella of the organizing principle of good faith performance of contracts.

[73] In my view, we should. I would hold that there is a general duty of honesty in contractual performance. This means simply that parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract. This does not impose a duty of loyalty or of disclosure or require a party to forego advantages flowing from the contract; it is a simple requirement not to lie or mislead the other party about one's contractual performance. Recognizing a duty of honest performance flowing directly from the common law organizing principle of good faith is a modest, incremental step. The requirement to act honestly is one of the most widely recognized aspects of the organizing principle of good faith.

.....

[80] Recognizing a duty of honesty in contract performance poses no risk to commercial certainty in the law of contract. A reasonable commercial person would expect, at least, that the other party to a contract would not be dishonest about his or her performance. The duty is also clear and easy to apply. Moreover, one commentator points out that given the uncertainty that has prevailed in this area, cautious solicitors have long advised clients to take account of the requirements of good faith...

The Supreme Court of Canada summarized the principles as follows: (1) there is a general organizing principle of good faith that underlies many facets of contract law; (2) in general, the

particular implications of the broad principle for particular cases are determined by resorting to the body of doctrine that has developed, which gives effect to aspects of that principle in particular types of situations and relationships; and (3) it is appropriate to recognize a new common law duty that applies to all contracts as a manifestation of the general organizing principle of good faith: a duty of honest performance, which requires the parties to be honest with each other in relation to the performance of their contractual obligations.[25]

Although decided in a non-insolvency context, the Supreme Court's reasoning in *Bhasin v Hrynew* regarding a general organizing principle of good faith has direct application to insolvency matters. Parties to insolvency proceedings should act honestly, candidly and reasonably and not capriciously or arbitrarily.[26] Parties must not lie or otherwise knowingly mislead each other about matters related to the insolvency proceeding. Moreover, stakeholders in insolvency proceedings should have appropriate regard for the legitimate interests of the other creditors and stakeholders, "appropriate regard" requiring that, while self-interest in pursuing their claims is valid, the parties should not seek to undermine the interests of others in bad faith.[27]

The Court's reasoning aligns with ordinary definitions of good faith. For example, the Oxford Dictionary defines good faith as: "honesty or sincerity of intention" and bad faith as "intent to deceive".[28] In both instances, there is an element of intention driving the conduct, which, in law, can usually only be discerned through the conduct of parties. The Black's Law Dictionary defines good faith as encompassing, among other things, "an honest belief, the absence of malice and the absence of design to defraud or seek an unconscionable advantage" and "an

25 *Ibid.* at para 93.
26 *Ibid.* at para 66.
27 *Ibid.* at paras 63-65.
28 Oxford Dictionary, 2014, online: http://www.oxforddictionaries.-com/us/definition/american_english/good-faith?q = good + faith&-searchDictCode = all.

honest intention to abstain from taking any unconscientious advantage of another", even though technicalities of law might dictate a different result.[29] It defines bad faith as a "design to mislead or deceive another, or a neglect or refusal to fulfill some duty or some contractual obligation", or "conscious doing of a wrong because of dishonest purpose or moral obliquity", contemplating a "state of mind affirmatively operating with furtive design or ill will".[30]

Claire Moore Dickerson locates the good faith obligation and fiduciary duty on a single continuum; in her view, the appropriate level of good faith is determined on the basis of the relationship of power and conflict.[31] Dickerson suggests that analysis of good faith has systematically favoured the stronger party in the contractual or organizational relationship, failing to consider the harm inflicted on the weaker party.[32] Her work, engaged with commercial contracting outside of insolvency, suggests that a positive way to approach the minimum mandatory standard of good faith in the business-commercial context is to think of the good faith norm as part of the commons; that the good faith norm is non-renewable, and thus, abuse by one party has the effect of imposing costs on all others, and that its destruction harms all participants in the business arena.[33] This notion that good faith standards facilitate commercial bargaining and that destruction of such standards in one case has implications for its value across the system is an important consideration in the discussion below.

One challenge for thinking about the reasoning in *Bhasin v Hrynew* in the insolvency context is the scope of the good faith obligation. If one considers the stages of contractual relationships: negotiation, execution of contract, performance

29 *Black's Law Dictionary*, 5th ed (Minn: West Publishing) at 623.
30 *Ibid.* at 127.
31 Claire Moore Dickerson, "From Behind the Looking Glass: Good Faith, Fiduciary Duty and Permitted Harm", 1995 22 *Fla St U L Rev* 955.
32 *Ibid.*
33 Claire Moore Dickerson, "Cycles and Pendulums: Good Faith, Norms, and the Commons", 1997 54 *Wash & Lee L Rev* 399.

and enforcement, the question is, at which stages of the insolvency workout does the good faith duty apply? *Bhasin v Hrynew* only addresses contract performance, without direction on the other stages, although it makes clear that the list is not closed in terms of how the general underlying principle of good faith may be applied in the future as the law develops.[34]

As will be evident in the next part, under the *Civil Code*, the good faith obligation is much more fulsome, applying to negotiations and other dealings between the parties. Given that in *BIA* proposal and *CCAA* proceedings, the creditors are negotiating with the debtor and each other to effect a proposal or a plan of arrangement and/or compromise that will ultimately be a contract or similar binding document, it is important to be very clear that good faith covers the workout negotiations. It is particularly important, given the different levels of vulnerability and sophistication of the parties to the workout. Moreover, numerous players new to the proceedings, such as distressed debt purchasers, interim financiers and plan sponsors, should have clear notice of the standard of conduct expected of them. As noted in the introduction, in receiving the benefits of the statutory framework, it is incumbent on creditors to act in a manner that advances the objectives of the legislation and to act in good faith. As also noted by the Supreme Court, the question of appropriate regard for the other parties' interests will depend on the context of the relationship, and in insolvency proceedings, there is a very specific context, the objective of facilitating a workout to reduce the social and economic losses resulting from a firm's insolvency.[35]

34 For another example of good faith in performance, see the recent judgment in *SCM Insurance Services Inc v Medisys Corporation Health LP*, 2014 ONSC 2632, which in the context of an agreement to right of first negotiation, the Court held that there was an obligation to negotiate in good faith, good faith referring to refraining from acting in a manner that would have the result that the plaintiffs did not have a reasonable opportunity to acquire the business. On the facts, the Court found no violation of good faith.
35 *Century Services*, *supra* note 1 at para 70.

III. THE OBLIGATION OF GOOD FAITH UNDER THE QUÉBEC *CIVIL CODE*

The *Civil Code of Québec* has had a codified obligation to act in good faith for more than twenty years.[36] The *Civil Code* comprises a body of rules that "lays down the *jus commune*, expressly or by implication"; it is the foundation of all other laws, although other laws may complement the *Code* or make exceptions to it,[37] and it operates in harmony with the *Charter of human rights and freedoms*.[38] It sets out the general principles of law, and governs relations between persons, and persons and property.[39] The *Civil Code* specifies a broad duty of good faith in the exercise of civil rights, which extends to the formation, performance and termination of a contract and includes the notion of abuse of contractual rights.[40]

The good faith obligation includes the duty to negotiate in good faith, the duty to cooperate, the duty to disclose applicable information, the duty to be honest and not misinform, the duty to act as a reasonable and prudent person consistent with the rules of fair play, also referred to as the prohibition against abuse of right, and good faith as the basis for interpretation of contracts.[41] A contracting party must perform his or her obligations or exercise his or her rights conferred by the agreement in a manner consistent with justice, equity and fair play, and so as not to injure the other party.[42]

36 *Civil Code of Québec, supra* note 6.
37 *Ibid.*, preliminary provision.
38 Québec *Charter of human rights and freedoms*, SQ c C-12.
39 *Civil Code of Québec, supra* note 6, preliminary provision.
40 *Ibid*, see arts. 6, 7 and 1375. See also the observations of the Supreme Court of Canada in *Bhasin v Hrynew, supra*, note 2 at para 83; and C M Mélanges, *Enquête de justice et d'équité*, ed Yvon Blais, 2003, at 497.
41 *Banque nationale du Canada c Houle*, [1990] 3 SCR 122, 1990 CarswellQue 37.
42 *Ibid.* at para 148, finding also that the courts wish to avoid one party using a right conferred on him or her by the contract maliciously against the other party, negligently or for a purpose completely unrelated to that which the legislature or the parties had in mind in creating that right. On the facts, the Court held that in

Parties are to act in the prudent and diligent manner of a reasonable individual and within the confines of fair play.[43] Prior to the enactment of the *Civil Code*, although there was no express provision of good faith in the *Civil Code of Lower Canada*, the Supreme Court of Canada found such a general duty from more specific provisions of the former code.[44] That duty of good faith was subsequently enshrined in the revisions leading to the enactment of the *Civil Code of Québec*, and together, articles 6, 7 and 1375 create a general duty to act good faith.

Specifically, the *Civil Code* expressly imposes the following requirements in book one, title one, dealing with persons and the exercise of civil rights:

> Art. 6: Every person is bound to exercise his civil rights in good faith.
>
> Art. 7: No right may be exercised with the intent of injuring another or in an excessive and unreasonable manner, and therefore contrary to the requirements of good faith.

The *Civil Code* expressly imposes the following requirements in book five, title one, dealing with obligations in general:

> Art.1375: The parties shall conduct themselves in good faith both at the time the obligation arises and at the time it is performed or extinguished.

There are approximately 100 provisions that refer to good faith obligations, including almost 30 references to bad faith in the *Civil Code*, many of which are not directly relevant to the insolvency context. Given that there are more than 200

accordance with the agreement entered into by the parties and with the applicable law, the bank had the right to call in the loan on demand and to realize its security without notice. The calling of the loan was not, in itself, an abuse by the bank of its contractual rights; however, the quick liquidation of the company's assets did amount to an abuse of rights because, in so doing, the bank effectively prevented any chance of the company meeting its obligations. The bank acted in an impulsive and detrimental manner, which constituted an abuse of contractual rights. *Ibid.*
43 *Ibid.*
44 See *National Bank of Canada v Soucisse*, [1981] 2 SCR 339; *Banque Nationale du Canada c Houle*, [1990] 3 SCR 122; *Bank of Montreal v Bail ltée*, [1992] 2 SCR 554.

judgments on the contours of the good faith obligation under the Québec *Civil Code*, in insolvency and non-insolvency cases, the discussion here is not intended to be a review of the case law. Rather, there are a number of important principles that can be drawn from the judgments, many of which align with the recent pronouncements of the Supreme Court of Canada.

Good faith obligations in Québec apply to contractual relations between parties, from negotiation, to contract execution, to completion or end of the contract.[45] The Court has held that failure to negotiate in good faith will result in a remedy.[46] A party will be considered to be in bad faith if it makes no attempt to seriously negotiate or if it does not address the legitimate demands of the other party.[47]

The good faith obligation under the *Civil Code* applies to any contracts made under private law, including commercial contracts and insolvency related contracts.[48] The art. 6

45 *Caisse Desjardins de St-Paulin c Bombardier inc*, 2008 CarswellQue 7877, 2008 QCCS 3725, EYB 2008-146023, JE 2008-1838, citing art. 1375, "La bonne foi doit gouverner la conduite des parties, tant au moment de la naissance de l'obligation qu'à celui de son exécution ou de son extinction." See also *Thalasso PDG Inc c Laboratoires Aeterna Inc*, 1997 CarswellQue 346 (CS Que).

46 *Desjardins Sécurité financière v Bergeron*, 2011 QCCS 2204, in which the Québec Superior Court examined the duty to negotiate in good faith where a lessee had the option to renew his lease according to the terms of the contract and the lessor suggested a lease agreement under different conditions, including an excessive rent increase. The Court found that the lessor had acted in bad faith in neglecting to send documents justifying the rent increase to the lessee. Because the negotiations for the renewal of the lease were not carried out in good faith, the lessee was permitted to continue to rent the premises under the conditions of the first renewal agreement.

47 *Garderie à moi mes enfants inc c Importations de chaussures Vulcano ltée*, 2012 QCCS 1833. See also *Friedman v Ruby*, 2012 QCCS 1778, where the Court held that the duty to negotiate in good faith also carries with it the duty not to break off negotiations without a valid reason.

48 See for example, *Développements industriels & commerciaux de Montréal inc c A L Van Houtte ltée*, 2010 QCCA 1970, 2010 CarswellQue 11575; *Groupe Cliffton inc c Solutions réseau d'affaires*

requirement that every person is bound to exercise his, her or its civil rights in good faith creates a presumption of good faith, including in the interpretation of contracts and other commercial dealings.[49] Good faith includes honesty.[50]

The Supreme Court of Canada has observed that the good faith obligation under the *Civil Code* has two main aspects.[51] The "first is the subjective aspect, which is concerned with the state of mind of the actor, and addresses conduct that is, for example, malicious or intentional. The second is the objective aspect, which is concerned with whether the conduct is unacceptable according to the standards of reasonable people."[52] A person can be acting without malicious intent, the subjective obligation, yet his or her conduct may nevertheless be contrary to the requirements of good faith in that it violates objective standards of conduct that are generally accepted in society.[53]

Article 7 of the *Civil Code* requires that no right may be exercised with the intent of injuring another or in an excessive and unreasonable manner, as it is contrary to the requirements of good faith.[54] Violations of this principle have been referred to as *abus de droit*.[55] The Court, recognizing principles of equity, has held that there is no need to prove malicious or excessive conduct of a party, unreasonable conduct is enough to establish a violation of the good faith obligation.[56] The

Meta-4 inc, 2003 CarswellQue 2246, JE 2003-1954; *Re 6676561 Canada inc*, 2013 QCCS 297, 2013 CarswellQue 557.

49 See for example *Grant v Dion*, 2007 QCCS 4833 at paras 37-51, where the Court held that where there is an abuse of right or of power by the majority, the court has both the power and the duty to intervene to correct the situation. See also *Gestion Segi ltd c 82773436 Canada inc*, 2014 QCCS 4113.

50 *Re Gaumond*, 2013 QCCA 2076.

51 *Bhasin v Hrynew*, *supra*, note 2 at para 83.

52 *Ibid.*

53 *Ibid.*

54 See *Banque Canadienne Nationale c Houle*, [1990] 3 SCR 122 at 155-158.

55 *Ibid.*

56 See also *Vachon c Lachance*, [1994] RJQ 2576, 1994 CarswellQue 2159.

Court has also held that a person cannot hide behind a company to protect him or herself from liability if he or she has acted in bad faith, and in such instances, the corporate veil will be drawn aside to hold the person liable.[57] The *Civil Code* good faith provisions have also been used to evaluate the fraudulent behaviour of a debtor.[58] The Court has also pulled aside the corporate veil to make a bankrupt liable for acts of the corporation where the bankrupt was the sole directing mind of the company in its efforts to defraud, and the bankrupt was found to be in violation of the good faith provisions in the *Civil Code*.[59]

In analyzing art. 1375 of the *Civil Code,* the courts have held that good faith has a very broad meaning and contains the equivalent of the common law notion of equity.[60] The contractual obligation of good faith is required between co-contracting parties, and is even incumbent on the vulnerable

57 *9158-0340 Québec inc. v Chase Paymentech Solutions*, 2008 QCCS 4470; *Sigma Constructions inc c Ievers*, 1995 CanLII 4787 (CA Que). See also *Thalasso PDG Inc c Laboratoires Aeterna Inc*, 1997 CarswellQue 346 (CS Que), where the Court held that the purpose of the *Civil Code* articles is to allow the judge to mitigate the effect and scope of a legal or contractual obligation when a party has acted in bad faith, at para 46.

58 *9142-6502 Québec inc c 9079-4850 Québec inc*, 2014 CarswellQue 7338, 2014 QCCS 3444, EYB 2014-240125, 243 ACWS (3d) 66 at paras 60, 117.

59 *Maritime-Ontario Freight Lines Ltd v 9106-1200 Québec inc*, 2011 CarswellQue 12575, 2011 QCCS 6071, JE 2012-127, citing art. 1451. The Québec Superior Court held that Singh was the *alter ego* of the company as he was its sole director and shareholder and had, in ignoring the fact that the company was being overpaid, participated in a concerted effort to defraud, and had failed to act in good faith, at paras 108-111. The Court held that he was solidarily liable with the company for the repayment of the sum to the company that overpaid the debtor. Damages were sufficiently quantifiable, and there was a direct causal link between the fault and the damages, at para 116. In light of the foregoing, the Court held that Singh should not to be released from liability on bankruptcy discharge.

60 *Re Location Bristar Idealease inc*, 2012 CarswellQue 751, 2012 QCCS 211 at para 77; *Boless inc c Residence Denis Marcotte*, 1995 JE 95-1890; *Re Groupe Sutton-Royal inc*, 2013 CarswellQue 12212, 2013 QCCS 5934.

party.[61] Good faith includes an obligation to inform during th negotiations for, and the performance of, the contract.[6 Silence has been viewed as a violation of the good faitl obligation.[63]

The Québec courts have also found a violation of good faitl by creditors in the context of *CCAA* proceedings. In *Minco Division Construction Inc v 9170-6929 Québec Inc*, Justic Tingley of the Québec Superior Court held that there was n justification for abandoning a game plan at a time when matter had reached a critical stage in a *CCAA* proceeding, affecting no

61 *Backman v Canadian Imperial Bank of Canada*, 2003 CanLII 3315 (CS Que).

62 *Cadieux c St A Photo Corporation*, 1997 CarswellQue 4040 (C Que), appeal filed closed 2007 QCCA 1667; where the Court hel that good faith is the foundation of any contract and failure t disclose the realities underlying the subject of the contract wa sufficient to warrant cancellation of the contract. See als *Automobiles Jalbert c BMW Canada*, 2006 CarswellQue 7963 (C Que), where the Court held that arts. 7 and 1375 concern the pre contractual stage, and impose a duty of loyalty requiring the part drafting the contract to not abuse its dominant situation, at 232 *Diotte c Collège CDI*, 2014 QCCQ 858, 2014 CarswellQue 2607 which held that the requirement of "cooperation" implies that " party must cooperate with the other party to allow the contract t produce its full effect, and that other party to achieve its legitimat and reasonable goals", at para 63. See also *3216438 Canada inc Dagan*, 2008 QCCS 5508, affirmed 2009 QCCA 692, leave to appea to SCC refused 2009 CarswellQue 11010, which held that th mutual obligation of good faith attending the formation and performance of contracts under art. 1375 of even marginal complexity entitles a party to ask for advance notice of what it is the other party is prepared to sign and expects him (or her) to sign, if for nothing else than to allow for his (or her) enlightened consent and so as to avoid the waste of devoting further time and resources to advancing the transaction if the proposal does not conform to the parties' prior agreement, at para 117.

63 *Intérim capital inc c Monette*, 2014 CarswellQue 6909, EYB 2014-239612, 2014 QCCS 3290, 243 ACWS (3d) 68, in which the applicant did not inform the defendant that it had acquired the assets of the company with the intention of selling them to third parties. His silence in this respect was contrary to the obligation to act in good faith, particularly considering the agreements binding on the parties, at para 79.

only a white knight and its shareholders, but also all the other creditors of the debtors who had a stake in the plan they had been invited to vote on.[64] He concluded that the conduct prejudiced other creditors. The Court held that "threatening to hijack the project and frustrate a plan intended to bring a measure of relief to many creditors, including the purchasers of units, does not square with the good faith conduct required of contracting parties by article 1375 *CCQ*. Rather, such behaviour in the context of this case is abusive and tramples on the rights and expectations of others."[65]

64 *Minco-Division Construction Inc v 9170-6929 Québec Inc*, 2007 CarswellQue 420, JE 2007-724, 29 CBR (5th) 165, 2007 QCCS 236 at para 35. The debtors were established to acquire a commercial building site in Montréal and to convert it to residential condominium units in three phases. When the project was delayed and seriously over budget, unpaid suppliers and trade creditors registered their claims against site, triggering defaults under the secured loans. The debtors applied to the court for *CCAA* protection to make arrangement with their creditors to continue and complete the project. In this context, the debtors obtained interim financing from 9170-6929 Québec Inc ("9170" or the "white knight") a company in which the shareholders of the debtors held a minority shareholders' position, and a new investor held the majority of the shares. The white knight became the main secured creditor by purchasing secured claims from the debtors' secured creditors at a discount. A dispute arose among the members of the various groups of shareholders of 9170, and the white knight became rogue and sought to take over the project by virtue of its security. The intervenants (shareholders of the debtors and minority shareholders of 9170), brought a motion to prevent 9170 (the *mis en cause*) from taking any action to realize on the secured claims against the debtors until the court had valued these claims and sought a declaration that the value of claims amounted to what the company paid for them, which was substantially below the face value of the claims, as they had been purchased at a discount. The motion was granted. The Court found the conduct of the rogue white knight improper, and decided to decrease the claim to the amount actually paid by the rogue white knight, plus legal fees relating to the purchase of the claims from the secured creditors and lien claimants, plus interest on the amounts paid, at the rates agreed in the acquired claims (or at the legal rates, if there was no agreed rate).

65 *Ibid.* at para 37.

In *Re Stanford International Bank Ltd*, the Québec Superior Court held that international cooperation does not mean that one court must cede its authority and jurisdiction over its own process, and that under the principles of equity and the *Civil Code*, the party seeking discretionary measures from the court must act in good faith and come with clean hands.[66] The Court held that a party seeking a discretionary order from the court must have acted in good faith and have nothing to be reproached about in relation to the object of its request or fulfillment of its role.[67] Here, the evidence showed that an Antiguan liquidator had failed to inform the Québec Autorité des marchés financiers of its activities at the debtor's Montréal office or of *ex parte* proceedings it had initiated. Regardless of a judgment from the court in Antigua, the liquidator was subject to the laws of Canada and Québec; and it had demonstrated an absence of good faith and respect for the Canadian court and the public interests represented by the securities regulator, the Autorité des marchés financiers.[68]

In *Re Société en commandite Avestor*, the Québec Court of Appeal allowed an appeal from a Superior Court judgment that ordered a respondent trustee in bankruptcy for the estate of the debtor to pay a respondent company,[69] rather than the

66 *Re Stanford International Bank Ltd*, 2009 CarswellQue 9211, EYB 2009-163753, 2009 QCCS 4106, JE 2009-1791, 65 CBR (5th) 33, 18[illegible] ACWS (3d) 300, [2009] RJQ 2544. The debtor international banking group experienced financial difficulties and a receiver was appointed in the US and a liquidator was appointed in Antigua. The Antiguan liquidator took steps to close the debtor group's office in Montréal and the Autorité des marchés financiers ("AMF") wrote to the Antiguan liquidator and requested information and documents regarding the Montréal office. The Antiguan liquidator informed AMF that the Montréal office was closed but, unbeknownst to AMF, electronic data was recovered at that office and a copy was sent to Antiguan liquidator, who subsequently deleted the content of the group's servers in the Montréal office. The liquidator refused to send AMF a list of investors unless ordered to do so by the court in Antigua, as provided in a judgment of that court.

67 *Ibid.* at para 9.

68 *Ibid.* at para 61.

69 *Re Société en commandite Avestor*, 2011 CarswellQue 15228, JE

appellant, the amount of a claim against the debtor.[70] The Court held that a corporation may be regarded as the *alter ego* of another corporation when there is such a close relationship between them that what apparently concerns one actually pertains to the activities of the other, the Court noting that a large number of factors can be identified to determine the existence of such a relationship, but the most explicit and most likely to cover all aspects of the concept is control.[71] In such a context of an *alter ego* relationship, there is a presumption that the one corporation knows the contractual obligations of the other, and an *alter ego* cannot argue in good faith that it is a third party.[72] Here, the evidence was not of a nature to support a conclusion of fraud, abuse of rights or a breach of public order to allow drawing aside the corporate veil or to apply the principle of *fin de non-recevoir* (estoppel) or good faith in contract.[73]

Insolvency professionals have also been found to have good faith obligations under the *Civil Code*, whether or not they are court-appointed.[74] A trustee is to act in good faith, reasonably and impartially.[75] The Québec Superior Court found no breach

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2011-625, 2011 QCCA 587, EYB 2011-188457, 201 ACWS (3d) 21; the Court of Appeal allowed an appeal from a judgment of the Superior Court, District of Montréal rendered on 13 January 2009.

70 *Ibid.*

71 *Ibid.* at para 124.

72 *Ibid.* at para 125. The Court held: "[134] ...SandJ cannot now argue that it exercised in good faith hypothecary rights that were to be discharged. [135] To act in that way would be contrary to the requirements of articles 7 and 1375 *CCQ*: 7. No right may be exercised with the intent of injuring another or in an excessive and unreasonable manner which is contrary to the requirements of good faith; and the parties shall conduct themselves in good faith both at the time the obligation is created and at the time it is performed or extinguished", at paras 134-35.

73 *Ibid.* at para 93.

74 *Re Bédard*, 2005 CarswellQue 3728, EYB 2005-91487, JE 2005-1233, 22 CBR (5th) 68, 152 ACWS (3d) 569, [2005] RJQ 1732.

75 *Ibid.* In *Bédard*, a trustee was found to have acted not in good faith; having learned of a counter-letter before assignment, the trustee did not act with the impartiality and neutrality required of an officer of the court, and the Court held that the good faith for value purchaser should be recognized. The trustee's motion sought to disguise

of the good faith requirement where the proceeds of a "kiting scheme" were found to constitute part of the property of a bankrupt that vested in the trustee, the Court finding that the trustee had not breached its duty of good faith.[76] The Court held that the application of the principles of good faith, fairness and equity are always relative to the context and the court will assess the reasonableness of the conduct of the trustee in the circumstances.[77] The Court held that the application of the principles of good faith and equity are also often a question for the exercise of judicial discretion where the tribunal finds itself faced with a "shocking situation" if the law is strictly applied.[78] The exercise of judicial discretion must yield to the application of statutory provisions of the *BIA*, and in this instance, when

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reality, and create unjust enrichment for the bankrupt and creditors; yet creditors' rights over the property of the bankrupt could not be broader than before bankruptcy. The trustee attempted to exercise rights in a manner that was excessive, unreasonable and inconsistent with natural justice.

76 *Re Location Bristar Idealease inc, supra* note 60. The case involved a series of suspicious banking transactions involving three major banks, made by two debtors. Once fraud was discovered, the trustee brought a motion before the Superior Court seeking a declaration that funds held by one bank were property of the bankrupts and should be transferred to the trustee. The motion was granted; the expert evidence revealed that the transactions in question were part of a system of "kiting", a form of cheque fraud, whereby the balance of a chequing account is inflated in order to allow cheques that would otherwise bounce to clear. Considering the ongoing bankruptcy proceedings, the Court found that the *Bank Act* did not confer any real right or right to follow funds; the funds were not traceable because funds were fungible property and there was no constructive trust. The debtors' claim to the funds in the bank accounts was part of their patrimony (property of the bankrupt within the meaning of the *BIA*) at the date of bankruptcy, and to exclude the funds from the debtors' patrimony would give the banks an unfair advantage over other creditors.

77 *Ibid.* at para 106.

78 "L'application des principes de bonne foi et d'équité est aussi souvent une question de discrétion judiciaire lorsque le tribunal se retrouve devant une situation choquante si le droit strict est appliqué. Ce n'est pas le cas à l'examen des faits de l'instance." *Ibid.* at para 107.

the very purpose of the statute is to settle situations of insolvency, the Court held that the value accruing to the body of creditors was fully justified pursuant to the *BIA*.[79]

The Québec Court has also held that whether one is in civil law or the law relating to insolvency and bankruptcy, agreements between parties are subject to the obligations of good faith both in their negotiation of their contract and its implementation.[80] Where parties were aware of the insolvency and all parties knew that the secured creditor intended, within a relatively short time, to implement its guarantees and proceed with the sale of land, buildings and equipment, but the debtor signed a lease and transfer of assets, the debtor had breached its good faith obligation.[81]

Parties are obliged under art. 1375 of the *Civil Code* to exercise their rights and to behave according to the rules of good faith in contractual matters, and a creditor lacking flexibility in the use of its right of retention can be found in breach of the good faith obligation.[82]

79 *Ibid.* at paras 103, 107.

80 *Re 6676561 Canada inc*, 2013 CarswellQue 557, EYB 2013-217407, 2013 QCCS 297, 237 ACWS (3d) 32, at para 20: "Que l'on soit en matière de droit civil ou de droit relatif à l'insolvabilité et la faillite, les ententes conclues entre parties sont soumises à des obligations de bonne foi tant au niveau de leur négociation que de leur mise en application (art. 6, 7 et 1375 du *Code civil du Québec*)."

81 *Ibid.* at para 21. The secured creditor, because of the offer made to it for part of the property on which it held collateral, agreed to grant time to the debtor, at paras 22-24. The Court held that when the lease and contracts were concluded, both the debtor and applicant knew that the secured creditor had not agreed to be bound by them and that the debtor had, at most, been granted a deadline until the end of December for some assets. Still, the Court allowed the application in part, because the negotiations were held with the secured creditor's knowledge, and the secured creditor had agreed to grant access to the debtor to some assets for a time. The Court held that the secured creditor had to honour that obligation to allow continued occupancy for a time, even if the right had been assigned. Because of the rights that had been granted to the debtor, it was to be given 30 days' notice should a sale of the buildings to a third party intervene.

82 *Re Scierie Gauthie*, 2012 CarswellQue 2401, 2012 QCCS 1054, EYB 2012-204016, 219 ACWS (3d) 502 at para 37.

The Supreme Court of Canada has observed that experience in Québec indicates that even very broad conceptions of the duty of good faith have not impeded contractual activity or contractual stability.[83]

Canada is bi-juridical, and now that the Supreme Court has said that good faith is part of the common law, we should be trying to harmonize the obligations across Canada. Québec has a fulsome history of judicial decisions and if we are going to depart from this standard of good faith conduct, there needs to be good reason.

IV. GOOD FAITH REQUIREMENTS IN THE UNITED STATES

In the United States, as in Québec, judicial developments preceded legislative action in codifying good faith. US courts had recognized the existence of a general duty of good faith before the promulgation of the Uniform Commercial Code (UCC).[84] The good faith obligation is also codified in the US *Bankruptcy Code* and is an obligation on debtors, creditors and the trustee.[85]

The Court has held that US bankruptcy courts are courts of equity and apply the principles and rules of equity in their determinations of good faith.[86] The court's general grant of equitable powers must be exercised within the parameters of the *Bankruptcy Code* itself.[87] The good faith inquiry is undertaken at several different stages of the bankruptcy proceeding, and a finding of good faith at the time a bankruptcy petition is filed

83 *Bhasin v Hrynew*, *supra* note 2 at para 85.

84 See for example, *Kirke La Shelle Co v Armstrong Co*, 263 NY 79 (1933). Uniform Commercial Code (UCC), online: http://www.law.cornell.edu/ucc.

85 US *Bankruptcy Code*, *supra* note 7, § 1126 and § 1129. The good faith inquiry is directed at all parties supporting the plan.

86 *Pepper v Litton*, 308 US 295, 60 S Ct 238 (1939); *In re American Capital Equipment LLC and Skinner Engine Companies*, 2011 688 F 3d 145, US LEXIS 15333 (US Court of Appeals for the Third District) at para 16 [*In re American Capital Equipment*].

87 *In re American Capital Equipment*, *ibid.* at para 20.

does not preclude a later inquiry into whether the plan proposed has been proposed in good faith.[88]

The US courts rely on both the UCC and the provisions of the *Bankruptcy Code* to assess good faith conduct in US bankruptcy proceedings.[89] Section 1-304 of the UCC, which has been enacted in all 50 states, provides that "Every contract or duty within the Uniform Commercial Code imposes an obligation of good faith in its performance and enforcement."[90] The general definition of good faith in the UCC is quite broad, encompassing honesty and adherence to reasonable commercial standards, including honesty in performance.[91] Significantly, the "obligations of good faith, diligence, reasonableness and care" may not be disclaimed by agreement.[92] There is no contracting out of the good faith duty, although parties can define the contours of the obligation if they are not manifestly unreasonable.[93]

Chapter 11 of the US *Bankruptcy Code* sets out good faith obligations for the debtor company and other parties in the reorganization process. The Court has held that the good faith inquiry at the time of filing includes an inquiry as part of judicial doctrine, distinct from the statutory good faith requirement for confirmation of a plan.[94] That doctrine inquires into the

88 *Ibid.* at para 14.

89 The term "bankruptcy" under US legislation refers to both insolvency and bankruptcy.

90 *Bhasin v Hrynew*, *supra* note 2 at para 84. While the provisions of the UCC apply only to commercial contracts, the 1981 Second Restatement of Contracts provides for a general duty of good faith in all contracts, a provision that has been followed by courts in the vast majority of states, § 205 of the Restatement (Second) of Contracts (1981).

91 UCC, § 1-201(b)(20). Honesty in performance is also a key component of good faith under the Restatement, UCC, § 205. A D Miller and R Perry, "Good Faith Performance" (2013), 98 *Iowa L Rev* 689, at 719-20.

92 *Ibid.*

93 UCC, § 1-302(b). The parties, by agreement, may determine the standards by which the performance of those obligations is to be measured if those standards are not manifestly unreasonable.

94 *In re American Capital Equipment*, *supra* note 86 at para 14; *In re Combustion Eng'g*, 391 F 3d at 247 (2004).

motivation for the proceeding, requiring an examination of all the facts and circumstances.[95]

A good faith assessment is also made at the time of approval of a reorganization plan under Chapter 11. Section 1129(a) of the US *Bankruptcy Code* specifies that the court shall confirm a plan only if the plan has been proposed in good faith and not by any means forbidden by law.[96] Chapter 11 further sets out good faith obligations on parties who solicit acceptance or rejection of a plan.[97] Pursuant to § 1126, which specifies "On request of a party in interest, and after notice and a hearing, the court may designate any entity whose acceptance or rejection of such plan was not in good faith, or was not solicited or procured in good faith or in accordance with the provisions of this title", the court can disallow a creditor's vote on a plan of reorganization for failure to act in good faith.

The *Code* does not define the term good faith, but the courts have held that good faith, for purposes of approval of the plan, is a narrower inquiry than the overarching good faith requirement in bankruptcy proceedings;[98] good faith is assessed on the basis of whether a plan is reasonably likely to achieve its goals and whether those goals are consistent with the purpose of the US *Bankruptcy Code*, that is, the plan is feasible, practical and would enable the company to continue its business and pays its debts in accordance with the plan's provisions.[99] A plan is proposed in

95 *In re American Capital Equipment*, *ibid.* at para 14; *In re Integrated Telecom Express Inc*, 384 F 3d 108 at 121 (2004).

96 11 USC § 1129, ss. (a)(3).

97 11 USC § 1125, ss. (e): "A person that solicits acceptance or rejection of a plan, in good faith and in compliance with the applicable provisions of this title, or that participates, in good faith and in compliance with the applicable provisions of this title, in the offer, issuance, sale, or purchase of a security, offered or sold under the plan, of the debtor, of an affiliate participating in a joint plan with the debtor, or of a newly organized successor to the debtor under the plan, is not liable, on account of such solicitation or participation, for violation of any applicable law, rule, or regulation governing solicitation of acceptance or rejection of a plan or the offer, issuance, sale, or purchase of securities."

98 *In re American Capital Equipment*, *supra* note 86 at para 14.

99 *In re Steve Zimmer Paige et al*, 685 F 3d 1160; 2012 US App LEXIS

good faith only if it will *fairly* achieve a result consistent with the objectives and purposes of the US *Bankruptcy Code*.[100] To be in good faith, a plan of reorganization must have a true purpose and fact-based hope of either "preserving a going concern" or "maximizing property available to satisfy creditors".[101]

The US Bankruptcy Court found a good faith violation where the debtor's CEO had a interest in one of the debtor's largest creditors.[102] The US Bankruptcy Court also denied approval of a reorganization plan on the grounds that it had not been proposed in good faith where the objective of the filing was to avoid tax liability.[103] In finding a lack of good faith, the court will look to see if the debtor or other party proposing the plan intended to abuse the judicial process and the purposes of the *Code*'s reorganization provisions; the court will refuse to sanction the plan where there is no realistic possibility of an effective reorganization and/or there is evidence that the applicant seeks merely to delay or frustrate the legitimate efforts of creditors to enforce their rights.[104] Where a proposed plan was designed to reward its proponent, "an individual whose inequitable conduct was the cause of the debtor's financial distress", the Court refused to sanction the plan as it failed to meet the standard of good faith.[105]

14552 (US Court of Appeals for the Tenth Circuit 2012) at 42-45 (*In re Steve Zimmer Paige*). See also *In re Pikes Peak Water Co*, 779 F 2d 1456 (Tenth Circuit 1985).

100 *In re American Capital Equipment*, *supra* note 86 at para 16; *In re Combustion Eng'g*, *supra* note 94.

101 *In re American Capital Equipment*, *ibid.* at para 13; *Bank of America National Trust & Savings Ass'n v 203 North LaSalle Street Partnership*, 526 US 434, 453, 119 S Ct 1411, 143 L Ed 2d 607 (1999); *In re Madison Hotel Associates*, 749 F 2d 410, 425 (7th Cir 1984); *In re South Beach Securities Inc*, 606 F 3d 366, 2010 US App LEXIS 10175, 2010-1 US Tax Cas (CCH) P50, 421, 105 AFTR 2d (RIA) 2390; Bankr L Rep (CCH) P81, 771, 53 Bankr Ct Dec 47 (US Court of Appeals for the Seventh Circuit 2010)

102 *In re Coram Healthcare*, 271 BR 228 at 234-5 (Bankr D Del 2001).

103 *In re South Beach Securities Inc*, *supra* note 101 at para 21.

104 *In re Steve Zimmer Paige*, *supra* note 99 at 42.

105 *In re Unichem Corp*, 72 BR 95, 100 (Bank ND Ill 1987), at 100, affirmed 80 BR 448 (ND Ill). See also *In re Coram Healthcare Corp*,

The US Court of Appeals for the Second Circuit found that a creditor had violated the good faith obligation under the *Code*.[106] The case dealt with two significant issues. First, Sprint, a creditor of the debtor DBSD North America Inc and its subsidiaries ("the debtor"), alleged that a shareholder had received property in the form of shares and warrants under the plan in priority to its unsecured debt claim.[107] The Court of Appeals agreed and reversed the bankruptcy court, remanding the case for further hearing.[108] The second issue was a bad faith allegation brought by the debtors against DISH, which was not a creditor at commencement of the proceedings, but purchased the claims of various creditors to give it a strong bargaining position during the proceedings. DISH was both a direct and indirect competitor of the debtor.[109] Shortly after the debtor filed its plan disclosure, DISH then purchased all of the first lien debt at its full face value of $40 million, with the agreement that the sellers would make objections to the plan that DISH would adopt after the sale. At first instant, the Bankruptcy Court designated DISH's vote and disregarded DISH's wholly-owned class of first lien debt for the purposes of determining plan acceptance, finding that DISH had violated the good faith obligation under the *Code* in that it was voting against the plan not as a traditional creditor seeking to maximize return on the debt it held, but to establish control over a strategic asset.[110] The District Court affirmed.[111]

On further appeal, the Court of Appeals held that § 1126 and §1129 allow the bankruptcy court to designate, which means to disallow, the votes of any creditor whose acceptance or

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271 BR 228, 240 (Bank D Del 2001), where the continuous conflict of interest of a CEO of the debtor precluded the debtor from proposing a plan in good faith under § 1129(a)(3).

106 *In re DBSD North America Inc*, 634 F 3d 79, 2010 US App LEXIS 27007 (2010) at para 3.

107 *Ibid.* at paras 13-14.

108 *Ibid.* at para 37.

109 *Ibid.* at para 9.

110 *In re DBSD North America Inc*, 421 BR 137.

111 *In re DBSD North America Inc*, WL 1223109 (2010).

rejection of a plan was not in good faith.[112] The Court held that §1126(e) should be employed as an exception, not the rule, and a party seeking to designate (disallow) another's vote has the burden of proving that it was not cast in good faith.[113] The Court held that § 1126(e) comes into play when creditors venture beyond mere self-interested promotion of their claims and protection of their interests, and are instead attempting to obtain some benefit to which they are not entitled.[114] The Court observed that the US Supreme Court has noted that the clear purpose of § 1126(e) is to bar creditors from a vote where they are not acting in good faith.[115] The Court found that DISH had bought a blocking position with the intention to use its status as creditor to bend the bankruptcy process towards its own strategic objective of acquiring an asset of the debtor (its spectrum rights), not towards protecting its claim.[116] As a consequence, it held that the bankruptcy court permissibly designated DISH's votes.

The court has found bad faith where a party bought a blocking position in several classes after the debtor proposed a plan of reorganization and then sought to defeat that plan and proposed its own to give it control over the debtor.[117] The Bankruptcy Court also designated the votes of parties affiliated with a competitor who bought their claims in an effort to block the debtor's reorganization in order to further the interests of their own business.[118]

112 *In re DBSD North America Inc*, *supra* note 106 at para 51, citing § 1126(e).
113 *Ibid.* at para 52. See also *In re Adelphia Communications Corp*, 359 BR 54 (Bank SDNY 2006) at 61.
114 *In re DBSD North America Inc*, *ibid.* at para 52. The Court of Appeals discusses a case from 1936 that sparked the US Congress to amend the legislation to require good faith in voting claims, at para 56. See also *In re Figter*, 118 F 3d 635 at 638 (9th Cir 1997).
115 *In re DBSD North America Inc*, *ibid.* at para 55.
116 *Ibid.* at para 59.
117 *In re Allegheny International Inc*, 118 BR 282 at 289-90 (Bankr WD Pa 1990).
118 *In re MacLeod Co*, 63 BR 654 (Bankr SD Ohio 1986) at 655-6.

The Court has held that a bankruptcy court has an independent duty to ascertain that a reorganization plan complies with the good faith requirements of § 1129(a).[119] A Chapter 11 petition is subject to dismissal for "cause" under 11 U.S.C. § 1112(b) unless it is filed in good faith.[120] The Court has held that lack of good faith or conduct that is bad faith is cause to dismiss under § 1112(b).[121] The court will dismiss an application under § 1307(c), where the debtor has acted in bad faith or abused the bankruptcy process.[122] The US court has read "for cause" in § 1307(c) to authorize dismissal based on bad faith, even though Chapter 13 contains no explicit good faith requirement.[123]

In *Marrama*, the US Supreme Court made clear that bad faith is pertinent in all chapters of the *Bankruptcy Code*, regardless of whether a provision contains an explicit good faith requirement.[124] The courts will consider the totality of all

119 *In re Hoosier Hi-Reach, Inc*, 64 BR 34 (Bankr SD Ind 1986); *In re Wallace*, 61 BR 54 (Bankr WD Ark 1986); *In re Unichem Corp*, 72 BR 95, 100 (Bank ND Ill 1987), at 100, affirmed 80 BR 448 (ND Ill).
120 *In re SGL Carbon Corp*, 200 F 3d 154, 162 (3d Cir 1999).
121 *C-TC 9th Ave P'ship v Norton Co (In re C-TC 9th Ave P'ship)*, 113 F 3d 1304, 1309-12 (2d Cir 1997). See also *Marsch v Marsch (In re Marsch)*, 36 F 3d 825, 828 (9th Cir 1994), interpreting "for cause" in § 1112(b) as permitting dismissal for "a lack of good faith in filing a Chapter 11 petition" even though § 1112(b) "does not explicitly require that cases be filed in good faith".
122 *Jacobsen v Moser (In re Jacobsen)*, 609 F 3d 647, 660 (5th Cir 2010).
123 *In re Lilley*, 91 F 3d 491, 496 (3d Cir 1996); *Molitor v Eidson (In re Molitor)*, 76 F 3d 218, 220-21 (8th Cir 1996); *Eisen v. Curry (In re Eisen)*, 14 F 3d 469, 470 (9th Cir 1994); *Gier v Farmers State Bank of Lucas, Kan (In re Gier)*, 986 F 2d 1326, 1329-30 (10th Cir 1993); *Carolin Corp v Miller*, 886 F 2d 693, 698 (4th Cir 1989); *In re Smith*, 848 F 2d 813, 816 n3 (7th Cir 1988); *In re Madison Hotel Assocs*, 749 F 2d 410, 426 (7th Cir 1984); *Sullivan v Solimini (In re Sullivan)*, 326 BR 204, 211 (BAP 1st Cir 2005).
124 *Marrama v Citizens Bank of Mass*, 549 US 365, 373, 127 S Ct 1105, 1111, 166 L Ed 2d 956 (2007); see also *Rosson v Fitzgerald (In re Rosson)*, 545 F 3d 764, 773 n12 (9th Cir 2008), citing *Marrama* for the proposition that "even otherwise unqualified rights in the debtor are subject to limitation by the bankruptcy court's power under § 105(a) to police bad faith and abuse of process".

the circumstances in determining bad faith of parties to a proceeding, including atypical conduct that falls short of the "honest and forthright invocation of the *Bankruptcy Code's* protections".[125] Under this inquiry, bad faith is ultimately "evidenced by the debtor's deliberate acts or omissions that constitute a misuse or abuse of the provisions, purpose, or spirit of the *Bankruptcy Code*".[126] The Court has held that among other considerations that might indicate bad faith are a debtor's or creditors' "intent to abuse the judicial process",[127] or a debtor's intentional efforts "to delay or frustrate" legitimate creditors.[128]

A court's finding with respect to the good faith requirement imposed under § 1129(a)(3) is subject to review on the grounds of clear error.[129] In addition, but beyond the scope of the discussion in this article, Chapter 11 also imposes a good faith obligation on the trustee and the debtor, when going to court to

125 *Marrama, ibid.*; *Kestell v Kestell (In re Kestell)*, 99 F 3d 146 at 149 (Court of Appeals Fourth Circuit 1996).

126 *McDow v Smith*, 295 BR 69 at 74 (ED Va 2003); see also *Tamecki v Frank (In re Tamecki)*, 229 F 3d 205 at 207 (Court of Appeals Third Circuit 2000).

127 *In re Albany Partners, Ltd*, 749 F 2d 670 at 674 (Court of Appeals Eleventh Circuit 1984).

128 *Ibid.*

129 *John Behrmann et al*, 663 F 3d 704, 2011 US App LEXIS 24454, Bankr L Rep (CCH) P82,124, 66 Collier Bankr Cas 2d (MB) 1282, 55 Bankr Ct Dec. 221 (US Court of Appeals for the Fourth Circuit 2011), where the bankruptcy court's specific findings of good faith were not disturbed, but the appellate court held that to have found specific provisions were essential to implementing the plan conferred a material benefit on the debtor, the estate and the creditors, was meaningless absent specific factual findings explaining why it found good faith. The judgment was vacated and remanded to the bankruptcy court for further proceedings. See also *In re Loop, 76 LLC*, 2014 US App LEXIS 10759 (US Court of Appeals for Ninth Circuit); *In re PWS Holding Corp*, 228 F 3d 224, 242 (3d Cir 2000); *In re Schwarzmann*, No 95-2512, 1996 US App LEXIS 31262, 1996 WL 698072, at 4 (4th Cir 6 December 1996), which held that the factual findings of the bankruptcy court, including a finding of good faith under § 1129(a)(3), are subject to a "clearly erroneous" standard of review. See also *In re Steve Zimmer Paige*, *supra* note 99.

present a proposal not agreed to with the union, relating to a collective bargaining agreement and/or retiree benefits; they are required to "confer in good faith in attempting to reach mutually satisfactory modifications of such an agreement".[130] The provisions are aimed at ensuring that "well-informed and good faith negotiations occur in the market place".[131] In *Delta*, the Court held that the words "fairly and equitably", "good faith", "balance of the equities" admit of no precise meaning, and that every fact and circumstance is relative to determining what is necessary, fair and equitable, good faith, and the balance of the equities.[132] The courts have held that to satisfy the requirement of negotiating in good faith, parties cannot approach negotiations with a "take it or leave it" mentality.[133]

The US court may convert a Chapter 11 case to a liquidation case under Chapter 7 of the *Bankruptcy Code*, or dismiss a case under Chapter 11 for a number of causes, including breach of good faith obligations by the debtor company. The US bankruptcy court can dismiss a Chapter 7 bankruptcy petition for bad faith under § 707(a) of the *Bankruptcy Code*.[134] The Court of Appeals for the Eleventh Circuit has held that based on

130 US *Bankruptcy Code*, § 1113 (b). See also *In re AMR Corporation*, 477 BR 384, 2012 Bankr LEXIS 3756 (US Bankr Crt SDNY 2012). There are a number of other factors, such as the balance of equities, necessity and fair and equitable treatment, which the court must consider under this provision, beyond the scope of this short article. Here, the Court held that the debtor had established that significant changes were necessary to the collective agreement; however, the Court concluded that two of the proposed changes were inconsistent with the § 1113 concept of necessity and denied the motion without prejudice to seek relief under a new proposal in the future, *ibid.* at para 7.

131 *Ibid.* at para 41.

132 *In re Delta Air Lines*, 342 BR 685, 691 (Bankr SDNY 2006).

133 *In re AMR Corporation, supra* note 130 at 52; *Delta, ibid.* 342 BR at 697, addressing the debtor's conduct.

134 *In re Craig Piazza*, 719 F3d 1253, 2013 US App LEXIS 13072, 69 Collier Bankr Cas 2d (MB) 1779, 58 Bankr Ct Dec 37, 24 Fla L Weekly Fed C 384 (US Court of Appeals for the Eleventh Circuit 2013), where, using this reasoning, the Court of Appeals for the Eleventh Circuit found that the bankruptcy court's finding of bad faith was erroneous.

the ordinary meaning of the statutory language and relevant principles of statutory construction, the power to dismiss "for cause" in § 707(a) includes the power to involuntarily dismiss a Chapter 7 case based on prepetition bad faith.[135]

Hence, the obligation in the US *Bankruptcy Code* is a good faith obligation on all parties to the proceeding, reinforced by the good faith requirements of the UCC, both of which set a benchmark against which to assess conduct in the proceedings. It is interesting, therefore, that some of the most aggressive parties in Canadian insolvency proceedings are precisely the market players that are subject to good faith conduct requirements in their home jurisdiction. It speaks to the need to either codify the good faith standard in Canada or to significantly increase the court's direction on this obligation.

Outside of Canada and the US, many countries impose good faith obligations in insolvency proceedings. For example, the United Kingdom *Insolvency Act 1986* imposes good faith obligations on the debtor company and other relevant parties in insolvency restructuring proceedings.[136] Japan's *Corporate Reorganization Act* requires that the petition for commencement of reorganization proceedings by debtors or creditors be filed in good faith; and the court will not grant a reorganization order if the petition is filed for an unjustifiable purpose or it is not filed in good faith.[137] The significance of the good faith obligation has been expressly recognized in the voluntary codes of conduct on sovereign debt restructuring, where good faith is imposed on all parties in the restructuring process.[138]

135 *Ibid.* at para 9, and the cases cited therein. The Court held that bad faith bankruptcy filings significantly burden the legal system in general and bankruptcy courts in particular, at a time when, in 2012, there were approximately 1.2 million bankruptcy filings in the United States, at para 13.

136 United Kingdom *Insolvency Act 1986*, c 45. For example, section 238(5) of the *Act* requires a person dealing with the administrator to act in good faith.

137 The *Corporate Reorganization Act* of Japan, article 41(1).

138 Institute of International Finance, "Key Principles Agreed to Strengthen Emerging Markets Finance" (22 December 2004) online: IIF http://www.iif.com/press/press+3.php. The "Principles for Stable Capital Flows and Fair Debt Restructuring", a voluntary code of conduct between the sovereign debt issuers and their private sector creditors. Since October 2010, the application of the principles has been broadened to include all sovereign issuers as well as non-sovereign debt restructuring in which the state plays a major role in influencing the key parameters of debt restructuring. Principles Consultative Group, "Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets Report on Implementation 2012" (October 2012) at 3, online: http://www.iif.-com/emp/principles/. In October 2012, the Principles Consultative Group ("PCG"), a group of finance and central banks officials and private sector representatives, reported on implementation of principles: "Good-faith negotiations remain the most effective framework for reaching voluntary debt restructuring agreements among sovereign debtors and their diversified private creditor community, particularly in the complex cases of mature market issuers that are members of currency unions."

V. BASELINE PRINCIPLES OF GOOD FAITH IN INSOLVENCY PROCEEDINGS

As is evident from the above discussion, both statutory language and the common law are moving towards a heightened standard of good faith in Canadian and foreign commercial contracts and commercial relationships. Moreover, the Supreme Court of Canada has made clear that good faith conduct is a baseline requirement for the court to take into account in exercising its authority under Canadian insolvency legislation.

During the research and writing of this article, I was somewhat agnostic as to whether statutory codification of the good faith requirement is necessary, given that the current statutory language is broad enough to have the courts exercise their authority where conduct fails to meet a good faith standard. However, I am now persuaded that a clear good faith standard enshrined in the *CCAA* and *BIA* would bring greater transparency and certainty to the proceedings, making clear that there are remedies for failure to comply with this baseline standard of conduct. The standard could be as straightforward as "the parties to the proceeding are required to act in good faith", which would be a helpful amendment in the expected reform to Canadian insolvency legislation in 2015. A codified standard would also greatly assist proposal proceedings under the *BIA*, as parties are frequently not before the court until the proposal approval hearing, and the good faith standard would be a guide to parties from the commencement of the proposal process.

In the interim, there is an immediate need to make the requirement of good faith conduct more transparent and enforceable. The Supreme Court of Canada has called good faith a baseline requirement in insolvency proceedings. What should enforcement of that baseline look like? Below are some preliminary suggestions for principles and best practices that the court should make clear, and which could be backstopped by a clear statement of the principle of good faith conduct in the insolvency legislation.

Suggested principles and best practices:

- The requirement to act in good faith in insolvency proceedings is an obligation of all parties and their professionals, and is an obligation that cannot be contracted out of. The good faith standard also applies to government regulators, interim financiers, plan sponsors, and all other stakeholders involved in the proceeding.
- At the outset of the proceeding, the court should remind parties of the obligation to act in good faith.[139]

139 One reviewer of this article suggested that the judge could, at the outset, get confirmation that if anyone intends to act other than in good faith, they would advise everyone, including the court. Although not expressly relating to good faith, a similar assurance was given in the Air Canada proceeding, when the supervising judge, Mr Justice Farley of the Ontario Superior Court, at one point in the process where more than 100 lawyers were arguing various points, asked all the parties to sign whether they were in support of a *CCAA* plan being negotiated or not. The failure of Air Canada would have caused huge disruption in Canadian air service and opened Canadian airways to foreign competitor airlines. The court clerk handed out a sheet of paper for counsel to fill out: to "crater" or "not crater" the debtor, communicating the court's instructions for them to indicate their client's preference. It came back clean on the crater side. It was a reminder to counsel and the parties of what was at stake in the proceedings and helped focus them on resolution.

- In determining any request for an order, the court will consider whether the order sought *and the means it employs* advance the policy objectives and remedial purpose of the *CCAA*, which is to avoid the social dislocation and economic losses resulting from liquidation of an insolvent company.[140]
- In determining good faith, the court will determine if the debtor, creditors, other stakeholders and their professionals have acted candidly, honestly, forthrightly and reasonably in their dealings with one another and the court. Dealings in this respect would include dealings from the commencement of the proceedings to final resolution, including negotiation for, and implementation of, a proposal or plan under the *BIA* or *CCAA*.
- All stakeholders in insolvency proceedings should have appropriate regard for the legitimate interests of the other creditors and stakeholders, "appropriate regard" requiring that the parties not seek to undermine the interests of others in bad faith.[141]

140 *Century Services, supra* note 1.

141 *Ibid.* at paras 63-65. While not a good faith case, the Privy Council in *British America Nickel Corp v MJ O'Brien Ltd*, 1927 CarswellOnt 42, [1927] 1 WWR 869, [1927] 1 DLR 1121, [1927] AC 369, on appeal from the Ontario Court of Appeal, articulated a standard of conduct expected of parties, finding that where a power is conferred on a majority of a class of debenture-holders enabling them to modify the rights of the entire class, it must be exercised for the purpose of benefiting the class as a whole and not merely individual members only. To quote: "To give a power to modify the terms on which debentures in a company are secured is not uncommon in practice. The business interests of the company may render such a power

- The good faith obligation includes a duty on creditors and other stakeholders to disclose all of their real economic interests in the insolvency proceedings.

- Approval of a proposal or plan of arrangement and compromise or a liquidation should be contingent on the court expressly assessing and finding good faith conduct of the parties, which would require the court being satisfied, on the basis of some evidence, of such good faith conduct.

- The good faith obligation extends to the debtor, creditors and their professionals in the design and execution of a sale of assets in a restructuring proceeding.

- Just as "come back orders" are aimed at encouraging parties with concerns about the initial order under the *CCAA* to come before the court, model initial orders could contain a provision that expressly reminds parties of their obligation to act in good faith in the proceedings, and encourages parties who are concerned about compliance with this standard to come before the court.

- Good faith should generally be a process obligation, but the court may have recourse to assessing the substantive positions of parties in assessing their good faith conduct.

expedient, even in the interests of the class of debenture-holders as a whole. The provision is usually made in the form of a power, conferred by the instrument constituting the debenture security, upon the majority of the class of holders. It often enables them to modify, by resolution properly passed, the security itself.... There is, however, this restriction of such powers, when conferred on a majority of a special class in order to enable that majority to bind a minority. They must be exercised subject to a general principle, which is applicable to all authorities conferred on majorities of classes enabling them to bind minorities. It is that the power given must be exercised for the purpose of benefiting the class as a whole, and not merely individual members only." at para 3.

- The court will find bad faith conduct where a debtor, creditor or their professionals fail to meet the requirements to act candidly, honestly, forthrightly and reasonably in their dealings with one another and the court; where parties act capriciously or arbitrarily;[142] or where they lie or otherwise knowingly mislead each other about matters related to the insolvency proceeding.[143]

There also needs to be an articulation of principles that the court will apply in enforcing the obligation to act in good faith. For example, will the lack of good faith by a debt purchaser result in an order eliminating its voting rights, as occurs under the US *Bankruptcy Code*? These questions are difficult, but necessary to answer. There need to be meaningful remedies to bad faith conduct, the court weighing the equities in all the circumstances, and it may be that codification of the good faith standard is necessary if the court is to exercise its authority to grant meaningful remedies. While the majority of stakeholders act with good faith in insolvency proceedings, the current deterioration in conduct by some parties may be as a result of there being no downside risk. Meaningful remedies address those situations where the conduct of parties is not in good faith, and should act as both "carrot" and "stick" in guiding parties in their workout discussions and their positions before the court.

In summary, the requirement of good faith conduct is part of the existing common law and civil law; insolvency is not some special situation in which different standards of commercial conduct should apply, and really, the question is whether to incorporate it into the statutes or rely on the courts' exercise of their authority. With the increasing number of creditors and financiers from outside Canada, it argues for creating an express requirement that parties act in good faith enshrined in the *CCAA* and *BIA*, as such creditors may interpret the absence

142 *Bhasin v Hrynew, supra* note 2 at paras 63, 66.
143 *Ibid.*

of a statutory provision as a signal that a different standard applies.

Governance in Times of Insolvency: Should We Be Concerned? La gouvernance en période d'insolvabilité: devrions-nous nous en inquiéter?

*The Honourable Marie Deschamps**

I. INTRODUCTION

There is a wave of scholarly writing on corporate governance. It has been the talk of the day for years now amongst businesspersons. A number of best practices have become standard, either because they have been imposed by regulators, or because they have been adopted under the pressure of activists. These practices range from independence of directors sitting on audit committees, to training requirements, gender diversity, and disclosure of remuneration. Everyone seems to have wakened up to governance. This awakening is not the product of a sudden corporate motivation to do good. It has been prompted by a series of electroshocks: Enron, Madoff and the implosion of the tech bubble, to mention just a few. Why is it that governance in times of insolvency does not attract the same interests? Are we waiting for some insolvency practices to make the front page of the Globe and Mail? There are some trends that are worrisome, and I would like to share my concerns with you.

There are two parts to my presentation. First, I discuss current governance in the ordinary course of business, and then I will focus on governance in times of insolvency.

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* The Honourable Marie Deschamps, former Supreme Court of Canada Justice, remarks to the Annual IIC Conference, 2014, Québec City.

Arrangement respecting 9186-9297 Québec inc., 2022 QCCS 1707 (CanLII)

Date: 2022-03-30
File Number: 500-11-060843-220
Reference: Arrangement Respecting 9186-9297 Québec inc., 2022 QCCS 1707 (CanLII), <https://canlii.ca/t/jp6k1>, accessed 2022-09-13

Arrangement relating to 9186-9297 Québec inc. **2022 QCCS 1707**

SUPERIOR COURT

CANADA
PROVINCE OF QUEBEC
DISTRICT OF MONTREAL

N°: 500-11-060843-220

DATE: March 30, 2022

UNDER THE CHAIRMANSHIP OF THE HONOURABLE PHILIPPE BÉLANGER, J.C.S.

IN THE CASE OF *THE COMPANIES' CREDITORS ARRANGEMENT ACT:*
9186-9297 QUÉBEC INC.
Applicant / Secured Creditor
c.
10542113 CANADA INC.
Debtor
and
LIMITED PARTNERSHIP FLORA 1
Respondent
and
RAYMOND CHABOT INC.
Proposed controller
and
ROMSPEN INVESTMENT CORPORATION
Secured creditor/Applicant for the appointment of a receiver
and
MNP LTD.
Proposed Receiver

JUDGEMENT

-

GLIMPSE

[1] The real estate development project (the "**Project**") initiated in 2019 by Société en commandite Flora 1 ("**Flora**") in the borough of Lachine has only been partially completed and suspended since the fall of 2021.

[2] In recent months, several of Flora's creditors, including the plaintiff, 9186-9297 Québec inc. ("**Upbrella**") and Romspen Investment Corporation ("**Romspen**"), which is financing the Project to the tune of almost $22,000,000, have become impatient and proceed with the exercise of their mortgage remedies in order to cause the Project to be sold under judicial control. [1]

[3] Upbrella, whose claim is vigorously contested by Flora, is requesting the issuance of an initial order under the CCAA so that the proposed controller (Raymond Chabot Inc., Jean Gagnon) can proceed without delay to a process of solicitation of offers and processing of claims. Upbrella is also proposing that a temporary financing of $2,000,000 be made available to Flora by HRM Project Villanova ("**HRM**") to meet its liquidity needs until the fall of 2022.

[4] Both Flora and Romspen are challenging Upbrella's application for an initial order under the LAAC; Rompsen instead proposes the appointment of a Receiver (MNP LTD, Sheri Aberback) who would be vested with the necessary powers to proceed with the sale of the Project. Romspen is also proposing to provide Flora with $850,000 in temporary financing to cover Flora's cash flow needs during the sale process.

[5] The Tribunal is therefore seized of what are commonly referred to as "*competing applications*" for the sale of the Project's assets for the benefit of creditors and other interested parties.

[6] The application for upbrella's initial order was originally filed on March 16, 2022. In view of the request for remission made by both Flora and Romspen and the absence of any particular urgency, the Tribunal postponed the hearing of the application to 28 March 2022, the date on which it was agreed that the application should be submitted for a period of 2 months rather than for the maximum period of 10 days provided for in Article 11.02 CCAA.

[7] Before approaching the analysis of these requests, it seems necessary to summarize briefly the progress of the Project and Flora's debt structure.

THE STATUS OF THE PROJECT

[8] The Project began in June 2019 on a vacant lot located in the borough of Lachine acquired by Flora from Développement Lachine-Est ("DLE") for development[2]. At that time, Flora and Upbrella signed a contract construction contract under which Upbrella agreed as general contractor to complete the Project as designed for $47,500,000.[3]

[9] It is then envisaged that it will proceed to the construction of three towers of residential condominium units also including commercial units and underground garages, namely:

1. Tower A with an area of 44,918^{ft2} with 40 residential units;
2. Tower B with an area of 61,568^{ft2} with 66 residential units;
3. Tower C with an area of 70,976^{ft2} with 75 residential units.

[10] The Project is funded by Romspen through an initial funding offer of $36,000,000 which will subsequently be increased to $52,325,000[4]. The repayment of this financing is secured by a movable and immovable hypothec encumbering the universality of Flora's property[5].

[11] Originally, it was envisaged that the delivery of units would begin as of December 2020 but various events and disputes will lead to significant delays and the suspension of work in the fall of 2021. Although it is difficult at this stage to determine the exact causes of Flora's insolvency and the failure of the Project, at a high level, it appears that they are attributable in whole or in part to the following reasons:

- A significant dispute arose between Flora and Upbrella and led in April 2021 to the termination of the contract construction contract and the replacement of Upbrella by Les Entreprises QMD inc. ("**QMD**") as general contractor. In July 2021, Flora brought an action against Upbrella under which she accused it of being responsible for the delays incurred and of having falsely represented the progress of the work[6]. Flora is claiming more than $13,000,000 from Upbrella, arguing that she is likely not owed anything, and is seeking the cancellation of her legal construction hypothec.

- HRM, which initially owed 50% of Flora until the sale of its units in September 2021[7], contends that Romspen's unjustified refusal to make the progressive disbursements in good time and its abusive behaviour towards Flora led to the complete suspension of work between April and September 2021. On March 24, HRM filed an action for damages against Romspen under which it and its shareholder Philip Kerub claimed more than $13,000,000 for the loss in value of their investment and the loss of anticipated profits.
- The pandemic and the government decree of March 2020 that orders the temporary closure of all non-essential businesses leads to the closure of the construction site from March to May 2020;
- The significant increase in construction costs and supply difficulties during the pandemic would also have changed the initial financial parameters of the Project.

[12] In any event, the Project would currently be approximately 45% complete according to the proposed Controller[8]; Tower A is at its final height with an almost completed envelope, the first floors of Tower B have been completed while Tower C remains to be built.

[13] Flora has also entered into 155 preliminary contracts for the sale of condominium units with various promisor-buyers who have made deposits in support of their bids, which are guaranteed by Aviva to the tune of $6,100,000. Flora represents that it has already terminated, in a consensual manner, 70 offers to purchase so that the promisor-buyers can initiate the necessary steps to recover their deposits.

[14] As for Flora's debts, they are essentially divided between the amounts owed to Romspen, which it estimates at $21,682,685 as at December 31, 2021, and those owed to Upbrella, the subsequent general contractor QMD and the various subcontractors selected as part of the Project. It seems difficult at this time to quantify Flora's exact indebtedness to Upbrella, QMD and the subcontractors, not only because Flora disputes Upbrella's claim (which it estimates at $11,675,210) but also because Flora has settled, with romspen's assistance, many of the subcontractors' claims in recent months. At his sworn declaration, Paolo Catania, President of Flora represents having settled by discharge debts of subcontractors (and the related legal hypothecs) totalling $5,092,676[9]. These amounts are likely to be charged as a reduction to the amounts claimed by Upbrella. Moreover, it is common in this industry for there to be duplication between the amounts claimed by the general contractor and those also claimed by its subcontractors, so that the amount reflected in the published legal construction hypothecs does not reflect the true indebtedness of the client.

[15] To these claims are added Aviva's deposit guarantee ($6,100,000) itself secured by a universal mortgage granted by Flora[10] and the balance of sale due to HRM ($7,000,000), the repayment of which is also secured by a universal mortgage encumbering the Project's assets[11].

[16] It is important to mention that there are few or no unsecured debts given the nature of Flora's business, which has no employees, nor suppliers of goods or services that do not benefit from legal hypothecs.

ANALYSE

Preliminary remarks

[17] Before turning to the analysis of the applications submitted by Upbrella and Romspen, it should be mentioned at once that it does not appear that a third avenue can be considered in order to maximize the value of the Project for the benefit of all interested parties.

[18] Flora acknowledges that she is insolvent and has not been able to enter into a new financing agreement with Romspen or another lender that would allow the Project to be finalized and avoid the appointment of a receiver or the issuance of an initial order under the CCAA. Both Romspen (who recalled his advances) and the general contractors and subcontractors retained by Flora demand to be paid as quickly as possible so that the *status quo* is no longer a viable alternative in the current context. All creditors present at the hearing agree that a process for the sale of the Project's assets must be put in place without delay with a view to concluding a transaction for the best price that can be obtained in the current market.

[19] It remains to be determined who of the proposed Receiver or Controller will lead this process.

[20] It should also be noted that both the application for sequestration of Romspen and the application for the issuance of an initial order of Upbrella meet the eligibility conditions set out in the BIA and the CCAA.

[21] With regard to the application for receivership, Romspen issued its opinion under Article 244 BIA[12] in May 2021 and its notice of exercise of a mortgage remedy for the sale of Flora's property under

judicial supervision in June 2021[13]. Since the time limits set out therein have expired, it is for the Tribunal to determine whether, under Article 243 of the BIA, it is "just and expedient" to appoint NPM as receiver of Flora's property.

[22] With respect to an application for an initial order, although it is rarer for it to be made by a creditor rather than the debtor, it is well established that such a request may be made by a creditor in respect of an insolvent debtor.[14]

[23] Both Romspen and Flora urged the Tribunal to dismiss Upbrella's claim in light of the challenge to its claim and the fact that a process under the CCAA would be more costly but not more efficient than a receiver.

[24] The chargeability and the exact amount of Upbrella's claim are certainly factors which must be considered, but they cannot, in themselves, justify the rejection of Upbrella's claim for at least two reasons: first, because the Court cannot, for the time being, rule on the amount of Upbrella's claim, if there is one, nor as to the merits of the many reproaches formulated by Flora. The analytical framework therefore differs from that which applies in the context of bankruptcy under the BIA, which requires the creditor to demonstrate an unsecured claim of at least $1,000[15].[

[25] On the other hand, because beyond the identity of the creditor requesting the issuance of an initial order, it is first and foremost necessary to consider and retain the process which, in the interest of all creditors, maximizes the value of Flora's assets. In other words, the identity of the plaintiff and the apparent weaknesses of his claim should not in themselves lead to the dismissal of an application for an initial order that would otherwise be in the interest of creditors.

[26] That said, in the light of the foregoing remarks, the two key issues that emerge are, in the Tribunal's view, the following:

1. Which of the two claims is likely to promote best implementation for the benefit of creditors and other interested parties?
2. Which of the two offers of temporary financing should be selected in order to provide Flora with the liquidity required to complete the proposed solicitation and sale process?

[27] For the reasons detailed below, the Tribunal concludes that it is appropriate to appoint MNP as receiver pursuant to the draft order proposed by Romspen and to accept the offer of temporary financing put forward by Romspen.

<u>1. Which of the two claims is likely to promote best implementation for the benefit of creditors and other interested parties?</u>

[28] The Tribunal concludes that in the particular circumstances of this case, which concerns an unfinished real estate development project, it seems just and appropriate to give preference to the appointment of a receiver under Article 243 BIA.

[29] This conclusion is based on the following considerations.

[30] On the one hand, it is the mechanism favoured by both Flora and the vast majority of its creditors. At the hearing, Flora confirmed that she did not contest Romspen's request for receivership and preferred this scenario to that of the original order because of the lower costs envisaged in connection with the appointment of MNP as receiver.

[31] Similarly, when questioned by the Tribunal as to the process they prefer, almost all subcontractors express, through their lawyer, their desire for the appointment of the proposed receiver[16]. Only LMT Group Inc. and Aviva rely on the discretion of the Tribunal.

[32] Thus, Romspen and the vast majority of creditors holding legal hypothecs (with the exception of Upbrella, of course) invite the Court to act on their wishes in this regard.

[33] It seems difficult, to say the least, to rule out the path of sequestration that is supported not only by creditors holding legal construction hypothecs, but also by Flora and Romspen. Indeed, given the priority of the mortgage rights of creditors holding legal construction hypothecs[17], it is Romspen, the lower-ranking creditors and subsequently Flora's client who will see their realization reduced if the sale process to be conducted by the Receiver does not generate the expected proceeds of sale or if the costs to be incurred exceed those currently budgeted.

[34] On the other hand, Upbrella does not convince the Tribunal that the restructuring tools and the high flexibility provided for in the CCAA are essential in this case in order to maximize the value of the Project

to be sold in the short term, whether by a receiver or by a controller with expanded powers. It should be borne in mind that Flora is a "*single purpose entity*" that holds only the assets of the Project; there can be no question of trying to maintain its current operations since it has no employees, its company consisting in developing the Project through workers in the field of construction. Again, no one argues that Flora's debt should be restructured through a plan of arrangement or allowed, through an initial order, to find solutions so that she can complete the Project herself and thus generate the potential equity she sees in it.[18]

[35] As soon as it becomes unavoidable that the Project must be put up for sale, it is necessary to prioritize, as courts very frequently do in the context of unfinished real estate projects[19], the appointment of a receiver to an initial order under the CCAA.

[36] In a study recently conducted by the authors Opolsky, Babad and Noel[20],, the latter conclude from their analysis of files involving unfinished real estate projects that it is appropriate to promote, in the vast majority of cases, the appointment of a receiver:

> *In most real estate cases, all of these factors point toward a receivership.*
>
> *There are two forms of prejudice that largely explain the courts' proclivity to grant receiverships over CCAA orders in the context of real property development: (1)* ***secured creditors' funds being unrecoverable, and put at risk, during the pendency of the CCAA****; AND (2)* ***secured creditors' collateral being primed by the costs of the CCAA.*** *A CCAA stay will be unacceptably prejudicial if it requires a secured creditor to "sit on its hands" for an extended period of time with its capital tied up.*

[37] They summarize the specific circumstances that may warrant prioritizing CCAA mechanisms over receivership:

> *[...] In the real estate cases surveyed for this article,* ***courts were only willing to grant a CCAA and dismiss a receivership application in situations where (1) a CCAA proposal was already well-developed by the time of the contested application and (2) the debtor presented evidence showing the plan was highly likely to succeed... The authors did not find any instances in which a court was willing to grant a CCAA in the real estate context without at least some compelling evidence of a developed plan, whereas receivership orders were granted upon, or as a result of, less developed foundations...*** *This underlying commercial reality principle extends to the* ***real estate context, which is often characterized by a relatively simple hierarchy of creditor priorities. Where a senior secured creditor or secured creditors of sufficient value to block a plan indicate that they prefer a receivership to a CCAA because it promises a fuller or faster recovery, there may be little that can be done to convince a court that a CCAA proceeding is viable. There simply is no incentive to agree to a compromise...*** [...]

[38] However, we are not here in a context where it seems realistic that a plan of arrangement should be presented in the near future that would be "*highly likely to succeed*" as required by the courts in such circumstances. Like Romspen and the vast majority of Flora's creditors, the Tribunal considers that the receiver will be able to proceed effectively with the sale of the Project without the need for an initial CCAA order.

[39] The proposed Comptroller submits that it is possible that the continuation of Flora's building permits may eventually justify the issuance of a "*Reverse Vesting Order*" under the CCAA. He may not be wrong, but there is currently no indication that it is essential to use this mechanism for the purpose of selling the Project. It therefore does not seem, at least for the moment, that the sequestration's toolbox is not sufficiently stocked to proceed with this sale.

[40] It should be recalled that under section 243 of the BIA, the Tribunal may authorize the receivership to "take any other measure it considers appropriate"; the Receiver will therefore be free to apply to the Tribunal if it requires additional powers or directives in the performance of its functions.

[41] The Tribunal also notes that Flora and Romspen have already settled the claims of many holders of legal construction hypothecs and that the Receiver will be empowered to deal with claims that have not yet been paid.

[42] Finally, with respect to the identity of the proposed insolvency professionals, the Tribunal can only find that both the Receiver and the proposed Controller are highly competent and able to proceed with the sale of the Project. In many respects, the experience of the proposed Comptroller in similar cases and his involvement as Controller in the restructuring of DLE under the CCAA cannot justify the Tribunal dismissing Romspen's proposed Receivership and replacing it with upbrella's proposed firm.

2. Which of the two offers of temporary financing should be selected in order to provide Flora with the liquidity required to complete the proposed solicitation and sale process?

[43] As mentioned, both Romspen and HRM offer to make temporary funding available to Flora. The main terms of the proposed funding can be summarized as follows:

	ROMSPEN[21]	HRM[22]
Loan amount	$850,000	$2,000,000
Interest rate	8 %	8 %
Fresh	0 %	1% set-up and 2% *standby* fees »
Maturity	September 30, 2022	December 31, 2022
Rank of the load	Priority with the exception of administrative burden and legal construction hypothecs	Priority to all published mortgages (both conventional mortgages and legal construction hypothecs)

[44] The Court concludes that Romspen's offer of temporary financing should be accepted rather than that made by HRM.

[45] This conclusion is based on the following four considerations.

[46] First, on its face, this financing offer seems to reflect more advantageous conditions both for Flora, which favours its acceptance, and for creditors holding legal construction hypothecs. Beyond the fact that the interest rate offered is identical (8%), Romspen's offer does not entail any costs and, above all, the burden by guaranteeing repayment would rank after all creditors holding legal construction hypothecs. Not surprisingly, the latter prefer the implementation of this temporary financing, most probably because they do not have to suffer the risk, perhaps theoretical, that this burden will eventually reduce their realization from the distribution of the sale price.

[47] At the end of the hearing, HRM's counsel notified the Tribunal that he had been instructed to declare that HRM waived the set-up costs (1%) and *the standby* costs (2%) provided for in its Temporary Financing Offer. A few hours after the hearing, HRM's lawyer this time informed the Court and the creditors that HRM accepted that the burden guaranteeing the repayment of its temporary financing would take precedence after the administrative burden and the legal construction hypothecs.

[48] With respect, the Court considers that it is inappropriate for HRM to attempt in this way to improve the conditions of its offer of temporary financing after the hearing. This is not an auction in which HRM has the right to match the conditions offered by Romspen. That said, even in view of the amended terms of HRM's offer of temporary financing, it is necessary to retain that formulated by Romspen since it would nevertheless find itself 'suffering' the priority burden to its rights that HRM requires. On equal financial terms, Romspen should be allowed to provide temporary funding to cover the essential expenses envisaged and thus protect its "*skin in the game*".

[49] Second, the temporary funding proposed by HRM is much higher than that proposed by Romspen ($850,000 vs. $2,000,000) and is primarily intended to cover the professional costs and fees that would be incurred by the proposed Controller and his lawyer as well as those of Upbrella. These fees and expenses, estimated at $1,091,000, are much higher than those budgeted by the Receiver totalling $390,000[23]. Obviously, these are estimates that will necessarily vary according to the evolution of the file. Nevertheless, the costs envisaged by the Receiver and the related priority charge are much lower than those envisaged by the proposed Controller and Upbrella.

[50] Third, the conditions of the temporary financing offered by HRM would have the effect of allowing the priority payment to Romspen of the fees to be incurred by Upbrella which, *a priori,* are not covered by the mortgage guarantee from which it benefits, under articles 2667 and 2762 C.C.Q. Romspen thus finds itself indirectly bearing those fees since they are guaranteed by a priority charge to its mortgage rights.

[51] Finally, it should be recalled that, in principle, section 11.2(1) CCAA[24] allows the "debtor company" and not the creditor to request the establishment of temporary financing. Without ruling on the potential use of Article 11 CCAA[25] as a judicial basis for such an application, it can only be noted that Flora, the debtor company, requires the temporary financing proposed by Romspen and asks the Court to endorse it. In such a context, the wishes expressed by Flora, Romspen and the creditors holding legal construction hypothecs should be acted upon.

CONCLUSION

[52] For the foregoing reasons, Upbrella's application for the issuance of an initial order should be rejected and Rompen's application for the appointment of a receiver of Flora's property should be upheld in accordance with the conclusions sought under the order attached to the present judgment.

[53] In closing, as mentioned at the hearing, the Tribunal invites the Receiver to contact Aviva in order to try to agree on a mechanism for handling the claims of promisor-buyers whose offers to purchase have been or will be terminated, if any, in order to facilitate the recovery of deposits made in support of their offers to purchase. Given Aviva's obligations as security for these deposits, funds that remain held in trust with Notary Burrogano (in the order of $544,000) cannot be disbursed in the absence of an agreement or court order.

FOR THESE REASONS, THE TRIBUNAL:

[54] **REJECTS** the application for the issuance of an initial order and an amended and reformulated initial order made by 9186-9297 Québec inc.

[55] **WELCOMES** the "*Romspen Investment Corporation's Motion to appoint a receiver*" following the findings of the order attached to this judgment;

[56] **NO** legal costs.

__________________________________PHILIPPE BÉLANGER, J.C.S.

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Me Paul Boyer
Lawyer for Groupe DR électrique inc.

Me Jeremy Cuttler
KUGLER KANDESTIN
Lawyer for the proposed Sequestered

Hearing Date: March 28, 2022

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[1] See Upbrella's application for forced abandonment of October 22, 2021, file 500-17-1118728-214 under judicial control of the Project; see also *Originating Application to institute proceedings for forced surrender and sale under judicial authority* of Romspen of 24 January 2022.

[2] This land was acquired by Flora as part of the restructuring under DLE's LAAC overseen by Raymond Chabot Inc. as controller. See the initial order under the LAAC dated January 13, 2018 and the asset devolution order dated January 17, 2018, file 500-11-0518881-171.

[3] See CCDC2 Fixed Contract of 25 June 2019.

[4] See financing offers, Exhibits R-14 and R-15.

[5] See Mortgage Deed of January 21, 202, Exhibits R-16 and R-17.

[6] See Application Initiating Proceedings, Exhibit R-9.

[7] See Agreement of Purchase and Sale of September 29, 2021, Exhibit R-22. The units held by HRM are then sold to the other sponsor, "DLE" for the sum of $7,000,000 payable by DLE forward, no later than March 31, 2023.

[8] See Amended Report of the Proposed Comptroller of 24 March 2022, para. 2.21.

[9] See para. 42-43 of Pablo Catania's sworn declaration of March 25, 2022.

[10] Exhibits R-18, R-19, R-20.

[11] Exhibit R-23.

[12] See Exhibit RIC-5.
[13] See Exhibit RIC-6.
[14] See, for example, *HSBC Bank Canada* v. *Bear Mountain Master Partnership*, 2010 BCSC, 1563, at para. 10; *Anvil Range Mining Corp.* (2001) 2001 CanLII 28449 (ON SC), 25 CBR 4^{th} 1, 34 CBR (4^{th}) 157 (CA); *Arrangement relating to Fortress Global Enterprises Inc.* et al., 500-11-057679-199, Montreal, Initial Order made on December 16, 2019; *Arrangement relating to Taxelco Inc.*, 500-11-0559560-193, Montreal, Original Order made on February 1, 2019; *Arrangement relating to Groupe SMI inc./SMI Group Inc.*, 500-11-055122-184, Montréal, Original Order made on August 24, 2018; *1078385 Ontario Ltd Re (2004)*, 2004 CanLII 55041 (ON CA),, 16 CBR (5th) 152 (Ont CA);.
[15] Art. 43 BIA.
[16] The following creditors have expressed their preference for the appointment of a receiver: Coffrages Martineau inc., MECI inc., Lavallée-Dufour inc., Groupe DR Électrique inc., Maçonnerie Mathieu inc., Aciers Armature 2000 inc., QMD, Coffrages Daniel Campion inc., Sintra inc. and Revêtements Raymond inc.
[17] See Art. 2726-2728 C.C.Q.
[18] In paragraph 62 of his Sworn Declaration of March 25, 2022, Paolo Catania argues that the financial potential of the Project exceeds the liability once the Project is completed.
[19] See *Romspen Investment Corporation* v. *Atlas Healthcare (Richmond Hill) Ltd*, 2018 ONSC 7382, at paras. 74, 82; *Octagon Properties Group Ltd*, 2009 ABQB 500, para. 17; Re Dondeb Inc., 2012 ONSC 6087, para. 25, 34.
[20] "*Receivership vs CCAA in real property Development*," 2020, 18^{th} Annual Review of Insolvency Law, CanLII Docs 3602.
[21] See RIC-13.
[22] See Exhibit P-26.
[23] See Exhibit RIC-9.
[24] **11.2 (1)** At the request of the debtor company, the court may, on notice of the application to secured creditors who are likely to be affected by the charge or security, declare that all or part of the assets of the company are encumbered by an encumbrance or security — in an amount it considers appropriate — in favour of the person named in the order who agrees to lend the company the amount it approves counts taking into account the state of the evolution of the cash and the needs of it. The office or security may only guarantee an obligation subsequent to the making of the order.
[25] **11.** Notwithstanding any provision of the Bankruptcy and Insolvency Act or the Winding-up and Restructuring Act, the court may, in the case of any application under this Act in respect of a debtor company, render, at the request of an interested person, but subject to the restrictions provided for in this Act and with or without notice, any order he considers appropriate.