

ONTARIO
SUPERIOR COURT OF JUSTICE
(Commercial List)

**IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT,
R.S.C. 1995, c. C-36, AS AMENDED**

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF First Leaside Wealth Management Inc., First Leaside Finance Inc., First Leaside Securities Inc., FL Securities Inc., First Leaside Management Inc., First Leaside Accounting and Tax Services Inc., First Leaside Holdings Inc., 2086056 Ontario Inc., First Leaside Realty Inc., First Leaside Capital Inc., First Leaside Realty II Inc., First Leaside Investments Inc., 965010 Ontario Inc., 1045517 Ontario Inc., 1024919 Ontario Inc., 1031628 Ontario Inc., 1056971 Ontario Inc., 1376095 Ontario Inc., 1437290 Ontario Ltd., 1244428 Ontario Ltd., PrestonOne Development (Canada) Inc., PrestonTwo Development (Canada) Inc., PrestonThree Development (Canada) Inc., PrestonFour Development (Canada) Inc., 2088543 Ontario Inc., 2088544 Ontario Inc., 2088545 Ontario Inc., 1331607 Ontario Inc., Queenston Manor General Partner Inc., 1408927 Ontario Ltd., 2107738 Ontario Inc., 1418361 Ontario Ltd., 2128054 Ontario Inc., 2069212 Ontario Inc., 1132413 Ontario Inc., 2067171 Ontario Inc., 2085306 Ontario Inc., 2059035 Ontario Inc., 2086218 Ontario Inc., 2085438 Ontario Inc., First Leaside Visions Management Inc., 1049015 Ontario Inc., 1048016 Ontario Inc., 2007804 Ontario Inc., 2019418 Ontario Inc., FL Research Management Inc., 970877 Ontario Inc., 1031628 Ontario Inc., 1045516 Ontario Inc., 2004516 Inc. (the "Applicants")

FACTUM OF THE MOVING PARTY,
STRUCTFORM INTERNATIONAL LIMITED
(Returnable June 13, 2012)

June 5, 2012

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ONTARIO
SUPERIOR COURT OF JUSTICE
(Commercial List)

**IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT,
R.S.C. 1995, c. C-36, AS AMENDED**

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF First Leaside Wealth Management Inc., First Leaside Finance Inc., First Leaside Securities Inc., FL Securities Inc., First Leaside Management Inc., First Leaside Accounting and Tax Services Inc., First Leaside Holdings Inc., 2086056 Ontario Inc., First Leaside Realty Inc., First Leaside Capital Inc., First Leaside Realty II Inc., First Leaside Investments Inc., 965010 Ontario Inc., 1045517 Ontario Inc., 1024919 Ontario Inc., 1031628 Ontario Inc., 1056971 Ontario Inc., 1376095 Ontario Inc., 1437290 Ontario Ltd., 1244428 Ontario Ltd., PrestonOne Development (Canada) Inc., PrestonTwo Development (Canada) Inc., PrestonThree Development (Canada) Inc., PrestonFour Development (Canada) Inc., 2088543 Ontario Inc., 2088544 Ontario Inc., 2088545 Ontario Inc., 1331607 Ontario Inc., Queenston Manor General Partner Inc., 1408927 Ontario Ltd., 2107738 Ontario Inc., 1418361 Ontario Ltd., 2128054 Ontario Inc., 2069212 Ontario Inc., 1132413 Ontario Inc., 2067171 Ontario Inc., 2085306 Ontario Inc., 2059035 Ontario Inc., 2086218 Ontario Inc., 2085438 Ontario Inc., First Leaside Visions Management Inc., 1049015 Ontario Inc., 1048016 Ontario Inc., 2007804 Ontario Inc., 2019418 Ontario Inc., FL Research Management Inc., 970877 Ontario Inc., 1031628 Ontario Inc., 1045516 Ontario Inc., 2004516 Inc. (the "Applicants")

FACTUM OF THE MOVING PARTY,
STRUCTFORM INTERNATIONAL LIMITED
(Returnable June 13, 2012)

PART 1 - INTRODUCTION

1. Structform International Limited ("Structform"), a lien claimant, brings this motion seeking:
 - (a) an order, if necessary, abridging the time for, validating the manner of and/or dispensing with the service of this Notice of Motion and supporting affidavit;
 - (b) an order varying or amending the Initial Order of Justice David M. Brown in this

matter dated February 23, 2012, to add a paragraph 10A as follows:

“THIS COURT ORDERS that any funds held by First Leaside Expansion Limited Partnership (“FLEX”) in its bank account as of February 23, 2012, be kept aside and not be used in any way, including as a part of the Central Cash Management System, until further order of this court; and that if such funds have been used or removed by FLEX or anyone, including the Monitor and the CRO, in the time since February 23, 2012, such funds be restored to the bank accounts of FLEX forthwith, to be kept there until further order of this court.”

- (c) an order amending paragraph 56 of the Initial Order in these proceedings to read as follows:

56. THIS COURT ORDERS that the CRO fees and the professional fees of the Monitor, counsel to the Monitor, First Leaside’s counsel and Representative counsel paid or incurred in accordance with this Order and any amounts paid to indemnify directors and officers shall be allocated by First Leaside with the assistance of the Monitor to the various business units pursuant to a protocol to be proposed by First Leaside with the assistance of the Monitor, which protocol shall be approved upon motion to this Court. First Leaside and the Monitor shall endeavour to make recommendations in respect of a protocol on or before March 30, 2012.

- (d) a declaration that all funds being held by FLEX in its bank accounts are subject to a trust for the benefit of Structform to the full extent of its proven outstanding payment certificates pursuant to section 7(2) of the *Construction Lien Act*, R.S.O 1990, c.C.30 (“the *CLA*”);
- (e) a declaration that all funds being held by FLEX in its bank accounts are subject to a trust for the benefit of Structform to the full extent of its proven outstanding

payment certificates or, alternatively, at least to the extent of \$647,555.14, pursuant to section 7(1) of the *CLA*; and

- (f) if necessary, an order lifting the stay imposed by the Initial Order to the extent of allowing Structform to bring this motion.

PART II - THE FACTS

2. During the period from June 2011 to December 2011, Structform performed concrete forming work on lands in Uxbridge, Ontario (the "Lands") under its contract (the "Contract") with First Leaside Expansion Limited Partnership ("FLEX") and made six applications for payment for work done to the Construction Manager, Kenaidan Contracting Ltd. ("Kenaidan") as the payment certifier in accordance with the Contract.

Supplementary affidavit of James Greig sworn April 25, 2012 (Greig Supplementary Affidavit), Structform Supplementary Motion Record ("SMR"), Tab 2, paragraph 2.

- 3.. Structform received payment for the applications for payment for the work done during the months of July, August and September, but the applications for payment for October, November and December were not paid even though certificates of payment were issued in accordance with the Contract.

Greig Supplementary Affidavit, SMR, Tab 2, paragraph 3.

4. In accordance with Section 5.3.1.3 of the Contract, payment is due on or before 20 calendar days after the later of: receipt by the Construction Manager of the application for payment,

or the last day of the monthly payment period for which application was made. Accordingly, payment of the October and November applications were overdue in January, 2012.

Payment of the December application, which was received by the Construction Manager on or before December 15, 2011, was due, at the latest, on or before January 27, 2012, being 20 business days after December 31, 2011.

Greig Supplementary Affidavit, SMR, Tab 2, paragraph 5.

5. During the course of a conference telephone call with Joan L Wilson, a representative of FLEX, held on December 14, 2012, Structform was advised that about \$600,000.00 to \$700,000.00 was being held by FLEX for the purpose of constructing the Head Office.

Affidavit of James Greig sworn March 16, 2012 ("Greig Affidavit"), Structform Motion Record ("MR"), Tab 2, paragraph 7.

6. On or about December 16, 2011, counsel for Structform wrote a letter to FLEX advising that "we understand from discussions held between our client, your organization and others that there are funds which have been received by you to be used in the financing of this project which pursuant to section 7(1) of the Construction Lien Act of Ontario are trust funds to be held for the benefit of our client"

Letter from E. Alan Garbe to 2067171 Ontario Inc. and FLEX dated December 26, 2012, Grieg Affidavit, Exhibit B, MR, Tab B.

7. On or about January 3, 2012, Structform received an email from the construction manager advising that the writer was to meet with Mr. MacLeod and Ms. Wilson the following day to review Mr. MacLeod's current plan. In this email reference is made to the desire of FLEX

to protect the holdbacks of approximately \$600,000.00.

Greig Affidavit, MR, Tab 2, paragraph 11.

8. On or about January 16, 2012, Structform caused a Claim for Lien to be registered against the Lands in the amount of \$1,723,754.66 and subsequently registered a certificate of action perfecting its lien.

Greig Affidavit, MR, Tab 2, paragraph 14.

9. In the affidavit of Gregory MacLeod, sworn May 2, 2012 in response to Structforms's motion, Mr. Macleod identifies a TD Canada Trust account which contains funds of FLEX referred it in the affidavit of Mr. Greig and that the amount in this account is \$647,555.14, which amount has remained unchanged to date.

Affidavit of Gregory MacLeod sworn May 2, 2012 ("MacLeod Affidavit"), paragraphs 3 and 4.

10. By order of the Honourable Mr. Justice Brown, made February 23, 2012, (the "Initial Order") First Leaside Wealth Management Inc. and other applicants (the "First Leaside Group") were granted protection from their creditors under the *Companies Creditors Arrangement Act* R.S.C. 1985 c. C-36 ("CCAA").

Affidavit of Gregory MacLeod sworn April 23, 2012, SMR, Tab K, paragraph 2.

11. The Initial Order created a charge for the benefit of the directors and officers of the First Leaside Group in the amount of \$250,000.00, referred to in the Initial Order as the "Directors Charge."

Initial Order, SMR, tab L, paragraph 31.

12. The Initial Order also created a charge for the benefit of the Monitor, First Leaside Group's counsel and Representative Counsel (as defined in the Initial Order) in the amount of \$1,000,000.00, referred to in the Initial Order as the "Administration Charge"

Initial Order, SMR, Tab L, paragraph 41.

13. The Initial Order provides for the Chief Restructuring Officer's fees and the professional fees of the Monitor, counsel to the Monitor, First Leaside Group's counsel and Representative Counsel paid or incurred in accordance with the Initial Order shall be allocated by First Leaside Group with the assistance of the Monitor to the various business units pursuant to a protocol to be proposed by First Leaside with the assistance of the Monitor, which protocol shall be approved upon motion to this Court.

Initial Order, SMR, Tab L, paragraph 56.

14. In his reasons for decision, Mr. Justice Brown, at paragraph 57, in referring to the Administration Charge and the Directors Charge collectively as the "priority charges", stated, "the Applicant and Monitor will develop an allocation methodology for the priority charges for later consideration by this Court." His Honour also stated that "the secured creditors will be able to make submissions on any proposed allocation of the priority charges"

Initial Order, SMR, Tab M, paragraph 57.

PART III - THE ISSUES

15. The issues in this motion are the following:
- (a) If necessary, should an order be given lifting the stay imposed by the Initial Order to facilitate this motion?
 - (b) Are the funds in FLEX's bank accounts subject to a trust pursuant to *CLA* section 7(2), and, if so, to what extent?
 - (c) Are the funds in FLEX's bank accounts subject to a trust pursuant to *CLA* section 7(1), and, if so, to what extent?
 - (d) Can these funds be used in any way to pay the expenses that are the subject matter of the Administration Charge and the Directors' Charge until an allocation protocol for those charges has been court approved?
 - (e) Can these funds be used to pay any other expenses, such as overhead expenses for the maintenance of the Lands?
 - (f) Should paragraph 56 of the Initial Order be amended to include reference to the expenses that are the subject matter of the Directors' Charge?

PART IV - LAW AND ARGUMENT

- a) **If necessary, should an order be given lifting the stay imposed by the Initial Order to facilitate this motion?**

16. If the Structform motion amounts to a violation of the stay imposed by the Initial Order, and extended by subsequent order, Structform submits that the court should grant a lifting of the stay to allow Structform to bring this motion.
17. In considering whether to lift a stay, the court should balance the potential damage being inflicted on the applicant by the stay against the prejudice a lifting of the stay would cause to the debtor company and other creditors and the objectives of the *CCAA* order in question.

Re Canwest Global Communications Corp. (2009), 2009 CarswellOnt 7882 (Ont. S.C.J. [Commercial List]), Tab A(1), at paragraphs 32 and 33.

18. In this case, if the funds in question are found to be trust funds being held for the benefit of Structform, there is a real risk that without this motion, the trust nature of those funds will be lost on account of the funds being commingled with non-trust funds in the Cash Management System mandated by the Initial Order. On the other hand, there is no evidence before the court that this motion will prejudice the debtor company, other creditors or any plan of liquidation of First Leaside assets.

- b) **Are the funds in FLEX's bank accounts subject to a trust pursuant to *CLA* section 7(2), and, if so, to what extent?**

19. Section 7(2) of the *Construction Lien Act* states that, where an amount becomes payable under a contract to a contractor by an owner under a certificate of a payment certifier, an amount that is equal to an amount so certified that is in the owner's hands or received by the owner at any time thereafter constitutes a trust fund for the benefit of the contractor.

Construction Lien Act, R.S.O. 1990, c.C.30, section 7(2), Tab B

20. It does not matter what the source, nature or purpose of the funds are that are in the possession of the owner. Under section 7(2), all that matters is that the owner receives or has in its possession the funds that are equivalent to the amount of the unpaid payment certificates.

***Structural Contracting Ltd. v. Westcola Holdings Inc.* [2000] O.J. 2131 (Ont.C.A.), Tab A(2), at paragraphs 21 and 22.**

***Elmford Construction Co. v. South Winston Properties Inc.* 2002 CarswellOnt 1117 (Ont. Div. Ct.), Tab A (3), at paragraph 4.**

21. Structform submits that it has established on the evidence that the funds in FLEX's bank accounts at the time of the Initial Order were trust funds pursuant to *CLA* section 7(2) being held for the benefit of Structform to the full extent of the Structform outstanding payment certificates.

c) Are the funds in FLEX's bank accounts subject to a trust pursuant to *CLA* section 7(1), and, if so, to what extent?

22. Where monies are received by an owner for the purpose of financing an improvement, those monies are trust monies for the benefit of the contractor, pursuant to *CLA* section 7(1).

Construction Lien Act, R.S.O. 1990, c.C.30, section 7(2), Tab B

23. Structform also submits that it has established on the evidence that the funds in FLEX's bank accounts at the time of the Initial Order were trust funds pursuant to the section 7(1) of the *CLA*, at least to the extent of \$647,555.14.

d) Can these trust funds be used in any way to pay the expenses that are the subject matter of the Administration Charge and the Directors' Charge until an allocation protocol for those charges has been court approved?

24. Paragraph 56 of the Initial Order makes it clear that the allocation of the expenses that are the subject matter of the Administration Charge and Directors' Charge "to the various business units" of the debtor is to be done in accordance with a protocol that "shall be approved upon motion to this Court." This motion and approval have not taken place. Therefore, there is no jurisdiction whereby the Monitor, or anyone, can use the trust funds to pay expenses that are the subject matter of these Charges until such an approval order has been obtained.

Order of Justice David M. Brown dated February 23, 2012, SMR, Tab L, paragraph 56.

e) Can these funds be used to pay any other expenses, such as overheads for the maintenance of the improved lands?

25. Trust funds pursuant to the *Construction Lien Act* cannot be used to pay overheads, even if those overheads pertain to the improved lands.

Dietrich Steel Ltd. v. Shar-Dee Towers (1987) Ltd., 1999 CarswellOnt 266 (Ont.C.A.), Tab A(4), at paragraph 17.

26. Therefore, the Initial Order should be amended to prohibit the use of these trust funds for any purpose other than as authorized by the *CLA* or to pay priority charges once the aforesaid protocol is approved, which prohibition would include a prohibition against using these funds to pay overheads concerning the improved lands.

f) Should paragraph 56 of the Initial Order be amended to include reference to the expenses that are the subject matter of the Directors' Charge?

27. Justice Brown ordered on February 23, 2012 that "the Applicant and Monitor will develop an allocation methodology for the priority charges for later consideration by this Court. . . . The secured creditors will be able to make submissions on any proposed allocation of the priority charges."

Reasons for Decision of Justice D.M. Brown, Supplementary Motion Record, Tab L, paragraph 57.

28. Paragraph 56 of the issued and entered order of Justice Brown makes no reference to the expenses that are the subject matter of the Directors' Charge. Structform submits that this oversight should be corrected by the court.

Rules of Civil Procedure, R.R.O. 1990, Reg. 194, Rule 59.06, Tab B

PART V - ORDER SOUGHT

29. Structform requests that an order as set forth paragraph 1 hereof be granted with costs.

All of which is respectfully submitted this 5th day of June, 2012.



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TAB A

SCHEDULE A

TAB

1. *Re Canwest Global Communications Corp.* (2009), 2009 CarswellOnt 7882, (Ont. S.C.J. [Commercial List]), at paragraphs 32 and 33.
2. *Structural Contracting Ltd. v. Westcola Holdings Inc.* [2000]O.J. 2131 (Ont.C.A.), at paragraphs 21 and 22.
3. *Elmford Construction Co. v. South Winston Properties Inc.* 2002 CarswellOnt 1117, (Ont. Div. Ct.), at paragraph 4.
4. *Dietrich Steel Ltd. v. Shar-Dee Towers (1987) Ltd.*, 1999 CarswellOnt 266 (Ont.C.A.), at paragraph 17.

TAB 1

2009 CarswellOnt 7882, 61 C.B.R. (5th) 200



2009 CarswellOnt 7882, 61 C.B.R. (5th) 200

Canwest Global Communications Corp., Re

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

AND IN THE MATTER OF A PROPOSED PLAN OF COMPROMISE OR ARRANGEMENT OF CANWEST
GLOBAL COMMUNICATIONS CORP. AND THE OTHER APPLICANTS LISTED ON SCHEDULE "A"

Ontario Superior Court of Justice [Commercial List]

Pepall J.

Heard: December 8, 2009
Judgment: December 15, 2009
Docket: CV-09-8241-OOCL

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Benjamin Zarnett, Robert Chadwick for Ad Hoc Committee of Noteholders

K. McElcheran, G. Gray for GS Parties

Hugh O'Reilly, Amanda Darrach for Canwest Retirees and the Canadian Media Guild

Hilary Clarke for Senior Secured Lenders to LP Entities

Steve Weisz for CIT Business Credit Canada Inc.

Subject: Insolvency; Civil Practice and Procedure; Corporate and Commercial

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Initial application — Proceedings subject to
stay — Contractual rights

2009 CarswellOnt 7882, 61 C.B.R. (5th) 200

Business was acquired through acquisition company, C Co. — C Co. was jointly owned by moving parties and 441 Inc., wholly owned subsidiary of insolvent entities — Moving parties, 441 Inc., insolvent entities and C Co. entered into shareholders agreement providing that in event of insolvency of insolvent entities, moving parties could effect sale of their interest in C Co. and require sale of insolvent entities' interest — Shareholders agreement also provided that 441 Inc. could transfer its C Co. shares to insolvent entities at any time — 441 Inc. subsequently transferred shares of C Co. to insolvent entities and was dissolved — Insolvent entities obtained initial order under Companies' Creditors Arrangement Act including stay of proceedings — Moving parties brought motion seeking to set aside transfer of shares to insolvent entities or, in alternative, requiring insolvent entities to perform and not disclaim shareholders agreement as if shares had not been transferred — Insolvent entities brought motion for order that motion of moving parties was stayed — Moving parties brought cross-motion for leave to proceed with their motion — Motion of insolvent entities granted; motion and cross-motion of moving parties dismissed — Substance and subject matter of moving parties' motion were encompassed by stay — Substance of moving parties' motion was "proceeding" that was subject to stay under initial order which prohibited commencement of all proceedings against or in respect of insolvent entities or affecting business or property of insolvent entities — Relief sought would involve exercise of any right or remedy affecting business or property of insolvent entities which was stayed under initial order.

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Initial application — Lifting of stay

Business was acquired through acquisition company, C Co. — C Co. was jointly owned by moving parties and 441 Inc., wholly owned subsidiary of insolvent entities — Moving parties, 441 Inc., insolvent entities and C Co. entered into shareholders agreement providing that in event of insolvency of insolvent entities, moving parties could effect sale of their interest in C Co. and require sale of insolvent entities' interest — Shareholders agreement also provided that 441 Inc. could transfer its C Co. shares to insolvent entities at any time — 441 Inc. subsequently transferred shares of C Co. to insolvent entities and was dissolved — Insolvent entities obtained initial order under Companies' Creditors Arrangement Act including stay of proceedings — Moving parties brought motion seeking to set aside transfer of shares from 441 Inc. to insolvent entities or, in alternative, requiring insolvent entities to perform and not disclaim shareholders agreement as if shares had not been transferred — Insolvent entities brought motion for order that motion of moving parties was stayed — Moving parties brought cross-motion for leave to proceed with their motion — Motion of insolvent entities granted; motion and cross-motion of moving parties dismissed — Stay of proceedings not lifted — Balance of convenience, assessment of relative prejudice and relevant merits favoured position of insolvent entities — There was good arguable case that shareholders agreement, which would inform reasonable expectations of parties, permitted transfer and dissolution of 441 Inc. — Moving parties were in no worse position than any other stakeholder who was precluded from relying on rights that arose upon insolvency default — If stay were lifted, prejudice to insolvent entities would be great and proceedings contemplated by moving parties would be extraordinarily disruptive — Litigating subject matter of motion would undermine objective of protecting insolvent entities while they attempted to restructure — It was premature to address issue of whether insolvent entities could disclaim agreement — Issues surrounding any attempt at disclaimer should be canvassed on basis mandated in s. 32 of Act — Discretion to lift stay on basis of lack of good faith not exercised.

Cases considered by *Pepall J.*:

Campeau v. Olympia & York Developments Ltd. (1992), 14 C.B.R. (3d) 303, 14 C.P.C. (3d) 339, 1992 CarswellOnt 185 (Ont. Gen. Div.) — considered

Canadian Airlines Corp., Re (2000), 19 C.B.R. (4th) 1, 2000 CarswellAlta 622 (Alta. Q.B.) — considered

Hongkong Bank of Canada v. Chef Ready Foods Ltd. (1990), 51 B.C.L.R. (2d) 84, 1990 CarswellBC 394, 4 C.B.R. (3d) 311, (sub nom. *Chef Ready Foods Ltd. v. Hongkong Bank of Canada*) [1991] 2 W.W.R. 136 (B.C. C.A.) — considered

2009 CarswellOnt 7882, 61 C.B.R. (5th) 200

ICR Commercial Real Estate (Regina) Ltd. v. Bricore Land Group Ltd. (2007), 2007 SKCA 72, 2007 CarswellSask 324, [2007] 9 W.W.R. 79, (sub nom. *Bricore Land Group Ltd., Re*) 299 Sask. R. 194, (sub nom. *Bricore Land Group Ltd., Re*) 408 W.A.C. 194, 33 C.B.R. (5th) 50 (Sask. C.A.) — referred to

Lehndorff General Partner Ltd., Re (1993), 17 C.B.R. (3d) 24, 9 B.L.R. (2d) 275, 1993 CarswellOnt 183 (Ont. Gen. Div. [Commercial List]) — referred to

Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd. (1988), 92 A.R. 81, 72 C.B.R. (N.S.) 1, 63 Alta. L.R. (2d) 361, 1988 CarswellAlta 318 (Alta. Q.B.) — considered

San Francisco Gifts Ltd., Re (2004), 5 C.B.R. (5th) 92, 42 Alta. L.R. (4th) 352, 2004 ABQB 705, 2004 CarswellAlta 1241, 359 A.R. 71 (Alta. Q.B.) — considered

Stelco Inc., Re (2005), 253 D.L.R. (4th) 109, 75 O.R. (3d) 5, 2 B.L.R. (4th) 238, 9 C.B.R. (5th) 135, 2005 CarswellOnt 1188, 196 O.A.C. 142 (Ont. C.A.) — referred to

Statutes considered:

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

Generally — referred to

s. 8 — referred to

s. 11 — referred to

s. 11.02(1) [en. 2005, c. 47, s. 128] — considered

s. 11.02(2) [en. 2005, c. 47, s. 128] — considered

s. 32 — considered

Courts of Justice Act, R.S.O. 1990, c. C.43

s. 106 — referred to

Rules considered:

Rules of Civil Procedure, R.R.O. 1990, Reg. 194

R. 25.11(b) — referred to

R. 25.11(c) — referred to

MOTION by moving party to set aside transfer of shares to insolvent entities or, in alternative, requiring insolvent entities to perform and not disclaim shareholders agreement; MOTION by insolvent entities for order that motion by moving party was stayed; CROSS-MOTION by moving party for leave to proceed with its motion.

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Pepall J.:

Relief Requested

1 The CCAA applicants and partnerships (the "CMI Entities") request an order declaring that the relief sought by GS Capital Partners VI Fund L.P., GSCP VI AA One Holding S.ar.l and GS VI AA One Parallel Holding S.ar.l (the "GS Parties") is subject to the stay of proceedings granted in my Initial Order dated October 6, 2009. The GS Parties bring a cross-motion for an order that the stay be lifted so that they may pursue their motion which, among other things, challenges pre-filing conduct of the CMI Entities. The Ad Hoc Committee of Noteholders and the Special Committee of the Board of Directors support the position of the CMI Entities. All of these stakeholders are highly sophisticated. Put differently, no one is a commercial novice. Such is the context of this dispute.

Background Facts

2 Canwest's television broadcast business consists of the CTLP TV business which is comprised of 12 free-to-air television stations and a portfolio of subscription based specialty television channels on the one hand and the Specialty TV Business on the other. The latter consists of 13 specialty television channels that are operated by CMI for the account of CW Investments Co. and its subsidiaries and 4 other specialty television channels in which the CW Investments Co. ownership interest is less than 50%.

3 The Specialty TV Business was acquired jointly with Goldman Sachs from Alliance Atlantis in August, 2007. In January of that year, CMI and Goldman Sachs agreed to acquire the business of Alliance Atlantis through a jointly owned acquisition company which later became CW Investments Co. It is a Nova Scotia Unlimited Liability Corporation ("NSULC").

4 CMI held its shares in CW Investments Co. through its wholly owned subsidiary, 4414616 Canada Inc. ("441"). According to the CMI Entities, the sole purpose of 441 was to insulate CMI from any liabilities of CW Investments Co. As a NSULC, its shareholders may face exposure if the NSULC is liquidated or becomes bankrupt. As such, 441 served as a "blocker" to potential liability. The CMI Entities state that similarly the GS parties served as "blockers" for Goldman Sachs' part of the transaction.

5 According to the GS Parties, the essential elements of the deal were as follows:

- (i) GS would acquire at its own expense and at its own risk, the slower growth businesses;
- (ii) CW Investments Co. would acquire the Specialty TV Business and that company would be owned by 441 and the GS Parties under the terms of a Shareholders Agreement;
- (iii) GS would assist CW Investments Co. in obtaining separate financing for the Specialty TV Business;
- (iv) Eventually Canwest would contribute its conventional TV business on a debt free basis to CW Investments Co. in return for an increased ownership stake in CW Investments Co.

6 The GS Parties also state that but for this arrangement, Canwest had no chance of acquiring control of the Specialty TV Business. That business is subject to regulation by the CRTC. Consistent with policy objectives, the CRTC had to satisfy itself that CW Investments Co. was not controlled either at law or in fact by a non-Canadian.

7 A Shareholders Agreement was entered into by the GS parties, CMI, 441, and CW Investments Co. The GS Parties state that 441 was a critical party to this Agreement. The Agreement reflects the share ownership of each of the

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parties to it: 64.67% held by the GS Parties and 35.33% held by 441. It also provides for control of CW Investments Co. by distribution of voting shares: 33.33% held by the GS Parties and 66.67% held by 441. The Agreement limits certain activities of CW Investments Co. without the affirmative vote of a director nominated to its Board by the GS Parties. The Agreement provides for call and put options that are designed to allow the GS parties to exit from the investment in CW Investments Co. in 2011, 2012, and 2013. Furthermore, in the event of an insolvency of CMI, the GS parties have the ability to effect a sale of their interest in CW Investments Co. and require as well a sale of CMI's interest. This is referred to as the drag-along provision. Specifically, Article 6.10(a) of the Shareholders Agreement states:

Notwithstanding the other provisions of this Article 6, if an Insolvency Event occurs in respect of CanWest and is continuing, the GS Parties shall be entitled to sell all of their Shares to any *bona fide* Arm's Length third party or parties at a price and on other terms and conditions negotiated by GSCP in its discretion provided that such third party or parties acquires all of the Shares held by the CanWest Parties at the same price and on the same terms and conditions, and in such event, the CanWest Parties shall sell their Shares to such third party or parties at such price and on such terms and conditions. The Corporation and the CanWest Parties each agree to cooperate with and assist GSCP with the sale process (including by providing protected purchasers designated by GSCP with confidential information regarding the Corporation (subject to a customary confidentiality agreement) and with access to management).

8 The Agreement also provided that 441 as shareholder could transfer its CW Investments Co. shares to its parent, CMI, at any time, by gift, assignment or otherwise, whether or not for value. While another specified entity could not be dissolved, no prohibition was placed on the dissolution of 441. 441 had certain voting obligations that were to be carried out at the direction of CMI. Furthermore, CMI was responsible for ensuring the performance by 441 of its obligations under the Shareholders Agreement.

9 On October 5, 2009, pursuant to a Dissolution Agreement between 441 and CMI and as part of the winding-up and distribution of its property, 441 transferred all of its property, namely its 352,986 Class A shares and 666 Class B preferred shares of CW Investments Co., to CMI. CMI undertook to pay and discharge all of 441's liabilities and obligations. The material obligations were those contained in the Shareholders Agreement. At the time, 441 and CW Investments Co. were both solvent and CMI was insolvent. 441 was subsequently dissolved.

10 For the purposes of these two motions only, the parties have agreed that the court should assume that the transfer and dissolution of 441 was intended by CMI to provide it with the benefit of all the provisions of the CCAA proceedings in relation to contractual obligations pertaining to those shares. This would presumably include both the stay provisions found in section 11 of the CCAA and the disclaimer provisions in section 32.

11 The CMI Entities state that CMI's interest in the Specialty TV Business is critical to the restructuring and recapitalization prospects of the CMI Entities and that if the GS parties were able to effect a sale of CW Investments Co. at this time, and on terms that suit them, it would be disastrous to the CMI Entities and their stakeholders. Even the overhanging threat of such a sale is adversely affecting the negotiation of a successful restructuring or recapitalization of the CMI Entities.

12 On October 6, 2009, I granted an Initial Order in these proceedings. CW Investments Co. was not an applicant. The CMI Entities requested a stay of proceedings to allow them to proceed to develop a plan of arrangement or compromise to implement a consensual "pre-packaged" recapitalization transaction. The CMI Entities and the Ad Hoc Committee of 8% Noteholders had agreed on terms of such a transaction that were reflected in a support agreement and term sheet. Those noteholders who support the term sheet have agreed to vote in favour of the plan subject to certain conditions one of which is a requirement that the Shareholders Agreement be amended.

13 The Initial Order included the typical stay of proceedings provisions that are found in the standard form order

promulgated by the Commercial List Users Committee. Specifically, the order stated:

15. THIS COURT ORDERS that until and including November 5, 2009, or such later date as this Court may order (the "Stay Period"), no proceeding or enforcement process in any court or tribunal (each, a "Proceeding") shall be commenced or continued against or in respect of the CMI Entities, the Monitor or the CMI CRA or affecting the CMI Business or the CMI Property, except with the written consent of the applicable CMI Entity, the Monitor and the CMI CRA (in respect of Proceedings affecting the CMI Entities, the CMI Property or the CMI Business), the CMI CRA (in respect of Proceedings affecting the CMI Entities, the CMI Property or the CMI Business), the CMI CRA (in respect of Proceedings affecting the CMI CRA), or with leave of this Court, and any and all Proceedings currently under way against or in respect of the CMI Entities or the CMI CRA or affecting the CMI Business or the CMI Property are hereby stayed and suspended pending further Order of this Court. In the case of the CMI CRA, no Proceeding shall be commenced against the CMI CRA or its directors and officers without prior leave of this Court on seven (7) days notice to Stonecrest Capital Inc.

16. THIS COURT ORDERS that during the Stay Period, all rights and remedies of any individual, firm, corporation, governmental body or agency, or any other entities (all of the foregoing, collectively being "Persons" and each being a "Person") against or in respect of the CMI Entities, the Monitor and/or the CMI CRA, or affecting the CMI Business or the CMI Property, are hereby stayed and suspended except with the written consent of the applicable CMI Entity, the Monitor and the CMI CRA (in respect of rights and remedies affecting the CMI Entities, the CMI Property or the CMI Business), the CMI CRA (in respect of rights or remedies affecting the CMI CRA), or leave of this Court, provided that nothing in this Order shall (i) empower the CMI Entities to carry on any business which the CMI Entities are not lawfully entitled to carry on, (ii) exempt the CMI Entities from compliance with statutory or regulatory provisions relating to health, safety or the environment, (iii) prevent the filing of any registration to preserve or perfect a security interest, or (iv) prevent the registration of a claim for lien.

14 The GS parties were not given notice of the CCAA application. On November 2, 2009, they brought a motion that, among other things, seeks to set aside the transfer of the shares from 441 to CMI or, in the alternative, require CMI to perform and not disclaim the Shareholders Agreement as if the shares had not been transferred. On November 10, 2009 the GS parties purported to revive 441 by filing Articles of Revival with the Director of the CBCA. The CMI Entities were not notified nor was any leave of the court sought in this regard. In an amended notice of motion dated November 19, 2009 (the "main motion"), the GS Parties request an order:

- (a) Setting aside and declaring void the transfer of the shares from 441 to CMI;
- (b) declaring that the rights and remedies of the GS Parties in respect of the obligations of 441 under the Shareholders Agreement are not affected by these CCAA proceedings in any way whatsoever;
- (c) in the alternative to (a) and (b), an order directing CMI to perform all of the obligations that bound 441 immediately prior to the transfer;
- (d) in the alternative to (a) and (b), an order declaring that the obligations that bound 441 immediately prior to the transfer, may not be disclaimed by CMI pursuant to section 32 of the CCAA or otherwise; and
- (e) if necessary, a trial of the issues arising from the foregoing.

15 They also requested an order amending paragraph 59 of the Initial Order but that issue has now been resolved and I am satisfied with the amendment proposed.

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16 The CMI Entities then brought a motion on November 24, 2009 for an order that the GS motion is stayed. As in a game of chess, on December 3, 2009, the GS Parties served a cross-motion in which, if required, they seek leave to proceed with their motion.

17 In furtherance of their main motion, the GS Parties have expressed a desire to examine 4 of the 5 members of the Special Committee of the Board of Directors of Canwest. That Committee was constituted, among other things, to oversee the restructuring. The GS Parties have also demanded an extensive list of documentary production. They also seek to impose significant discovery demands upon the senior management of CanWest.

Issues

18 The issues to be determined on these motions are whether the relief requested by the GS Parties in their main motion is stayed based on the Initial Order and if so, whether the stay should be lifted. In addition, should the relief sought in paragraph 1(e) of the main motion be struck.

Positions of Parties

19 In brief, the parties' positions are as follows. The CMI Entities submit that the GS Parties' motion is a "proceeding" that is subject to the stay under paragraph 15 of the Initial Order. In addition, the relief sought by them involves "the exercise of any right or remedy affecting the CMI Business or the CMI Property" which is stayed under paragraph 16 of the Initial Order. The stay is consistent with the purpose of the CCAA. They submit that the subject matter of the motion should be caught so as to prevent the GS parties from gaining an unfair advantage over other stakeholders of the CMI Entities and to ensure that the resources of the CMI Entities are devoted to developing a viable restructuring plan for the benefit of all stakeholders. They also state that CMI's interest in CW Investments Co. is a significant portion of its enterprise value. They state further that their actions were not in breach of the Shareholders Agreement and in any event, debtor companies are able to organize their affairs in order to benefit from the CCAA stay. Furthermore, any loss suffered by the GS Parties can be quantified.

20 In paragraph 1(e) of the main motion, the GS parties seek to prevent CMI from disclaiming the obligations of 441 that existed immediately prior to the transfer of the shares to CMI. If this relief is not stayed, the CMI Entities submit that it should be struck out pursuant to Rule 25.11(b) and (c) as premature and improper. They also argue that section 32 of the CCAA provides a procedure for disclaimer of agreements which the GS Parties improperly seek to circumvent.

21 Lastly, the CMI Entities state that the bases on which a CCAA stay should be lifted are very limited. Most of the grounds set forth in *Canadian Airlines Corp., Re*[FN1] which support the lifting of a stay are manifestly inapplicable. As to prejudice, the GS parties are in no worse position than any other stakeholder who is precluded from relying on rights that arise on an insolvency default. In contrast, the prejudice to the CMI Entities would be debilitating and their resources need to be devoted to their restructuring. The GS Parties' rights would not be lost by the passage of time. The GS Parties' motion is all about leverage and a desire to improve the GS Parties' negotiating position submits counsel for the CMI Entities.

22 The Ad Hoc Committee of Noteholders, as mentioned, supports the CMI Entities' position. In examining the context of the dispute, they submit that the Shareholders Agreement permitted and did not prohibit the transfer of 441's shares. Furthermore, the operative obligations in that agreement are obligations of CMI, not 441. It is the substance of the GS Parties' claims and not the form that should govern their ability to pursue them and it is clearly encompassed by the stay. The Committee relies on *Hongkong Bank of Canada v. Chef Ready Foods Ltd.*[FN2] in support of their position on timing.

23 The Special Committee also supports the CMI Entities. It submits that the primary relief sought by the GS

parties is a declaration that their contracts to and with CW Investments cannot or should not be disclaimed. The debate as to whether 441 could properly be assimilated into CMI is no more than an alternate argument as to why such disclaimer can or cannot occur. They state that the subject matter of the GS Parties' motion is premature.

24 The GS Parties submit that the stay does not prevent parties affected by the CCAA proceedings from bringing motions within the CCAA proceedings themselves. The use of CCAA powers and the scope of the stay provided in the Initial Order and whether it applies to the GS Parties' motion are proper questions for the court charged with supervising the CCAA process. They also argue that the motion would facilitate negotiation between key parties, raises the important preliminary issue of the proper scope and application of section 32 of the CCAA, and avoids putting the Monitor in the impossible position of having to draw legal conclusions as to the scope of CMI's power to disclaim. The court should be concerned with pre-filing conduct including the reason for the share transfer, the timing, and CMI's intentions.

25 Even if the stay is applicable, the GS parties submit that it should be lifted. In this regard, the court should consider the balance of convenience, the relative prejudice to parties, and where relevant, the merits of the proposed action. The court should also consider whether the debtor company has acted and is acting in good faith. The GS Parties were the medium by which the Specialty TV Business became part of Canwest. Here, all that is being sought is a reversal of the false and highly prejudicial start to these restructuring proceedings. It is necessary to take steps now to protect a right that could be lost by the passage of time. The transfer of the shares exhibited bad faith on the part of Canwest. 441 insulated CW Investments Co. and the Specialty TV Business from the insolvency of CMI and thereby protected the contractual rights of the GS Parties. The manifest harm to the GS Parties that invited the motion should be given weight in the court's balancing of prejudices. Concerns as to disruption of the restructuring process could be met by imposing conditions on the lifting of a stay as, for example, the establishment of a timetable.

Discussion

(a) Legal Principles

26 First I will address the legal principles applicable to the granting and lifting of a CCAA stay.

27 The stay provisions in the CCAA are discretionary and are extraordinarily broad. Section 11.02 (1) and (2) states:

11.02 (1) A court may, on an initial application in respect of a debtor company, make an order on any terms that it may impose, effective for the period that the court considers necessary, which period may not be more than 30 days,

(a) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under the Bankruptcy and Insolvency Act or the Winding-up and Restructuring Act;

(b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(c) prohibiting, until otherwise ordered by the court, the commencement of any action, suit or proceeding against the company.

(2) A court may, on an application in respect of a debtor company other than an initial application, make an order, on any terms that it may impose,

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- (a) staying until otherwise ordered by the court, for any period that the court considers necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in paragraph (1)(a);
- (b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and
- (c) prohibiting, until otherwise ordered by the court, the commencement of any action, suit or proceeding against the company.

28 The underlying purpose of the court's power to stay proceedings has frequently been described in the case law. It is the engine that drives the broad and flexible statutory scheme of the CCAA: *Stelco Inc., Re* [FN3] and the key element of the CCAA process: *Canadian Airlines Corp., Re* [FN4]. The power to grant the stay is to be interpreted broadly in order to permit the CCAA to accomplish its legislative purpose. As noted in *Lehndorff General Partner Ltd., Re* [FN5], the power to grant a stay extends to effect the position of a company's secured and unsecured creditors as well as other parties who could potentially jeopardize the success of the restructuring plan and the continuance of the company. As stated by Farley J. in that case,

"It has been held that the intention of the CCAA is to prevent any manoeuvres for positioning among the creditors during the period required to develop a plan and obtain approval of creditors. Such manoeuvres could give an aggressive creditor an advantage to the prejudice of others who are less aggressive and would undermine the company's financial position making it even less likely that the plan will succeed....The possibility that one or more creditors may be prejudiced should not affect the court's exercise of its authority to grant a stay of proceedings under the CCAA because this affect is offset by the benefit to all creditors and to the company of facilitating a reorganization. The court's primary concerns under the CCAA must be for the debtor and *all* of the creditors." [FN6] (Citations omitted)

29 The all encompassing scope of the CCAA is underscored by section 8 of the Act which precludes parties from contracting out of the statute. See *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* [FN7] in this regard.

30 Two cases dealing with stays merit specific attention. *Campeau v. Olympia & York Developments Ltd.* [FN8] was a decision granted in the early stages of the evolution of the CCAA. In that case, the plaintiffs brought an action for damages including the loss of share value and loss of opportunity both against a company under CCAA protection and a bank. The statement of claim had been served before the company's CCAA filing. The plaintiff sought to lift the stay to proceed with its action. The bank sought an order staying the action against it pending the disposition of the CCAA proceedings. Blair J. examined the stay power described in the CCAA, section 106 of the Courts of Justice Act [FN9] and the court's inherent jurisdiction. He refused to lift the stay and granted the stay in favour of the bank until the expiration of the CCAA stay period. Blair J. stated that the plaintiff's claims may be addressed more expeditiously in the CCAA proceeding itself. [FN10] Presumably this meant through a claims process and a compromise of claims. The CCAA stay precludes the litigating of claims comparable to the plaintiff's in *Campeau*. If it were otherwise, the stay would have no meaningful impact.

31 The decision of *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* is also germane to the case before me. There, the Bank demanded payment from the debtor company and thereafter the debtor company issued instant trust deeds to qualify for protection under the CCAA. The bank commenced proceedings on debenture security and the next day the company sought relief under the CCAA. The court stayed the bank's enforcement proceedings. The bank appealed the order and asked the appellate court to set aside the stay order insofar as it restrained the bank from exercising its rights under its security. The B.C. Court of Appeal refused to do so having regard to the broad public policy objectives of the CCAA.

32 As with the imposition of a stay, the lifting of a stay is discretionary. There are no statutory guidelines contained in the Act. According to Professor R.H. McLaren in his book "Canadian Commercial Reorganization: Preventing Bankruptcy"[FN11], an opposing party faces a very heavy onus if it wishes to apply to the court for an order lifting the stay. In determining whether to lift the stay, the court should consider whether there are sound reasons for doing so consistent with the objectives of the CCAA, including a consideration of the balance of convenience, the relative prejudice to parties, and where relevant, the merits of the proposed action: *ICR Commercial Real Estate (Regina) Ltd. v. Bricore Land Group Ltd.*[FN12]. That decision also indicated that the judge should consider the good faith and due diligence of the debtor company.[FN13]

33 Professor McLaren enumerates situations in which courts will lift a stay order. The first six were cited by Paperny J. in 2000 in *Canadian Airlines Corp., Re*[FN14] and Professor McLaren has added three more since then. They are:

1. When the plan is likely to fail.
2. The applicant shows hardship (the hardship must be caused by the stay itself and be independent of any pre-existing condition of the applicant creditor).
3. The applicant shows necessity for payment (where the creditors' financial problems are created by the order or where the failure to pay the creditor would cause it to close and thus jeopardize the debtor's company's existence).
4. The applicant would be significantly prejudiced by refusal to lift the stay and there would be no resulting prejudice to the debtor company or the positions of creditors.
5. It is necessary to permit the applicant to take steps to protect a right which could be lost by the passing of time.
6. After the lapse of a significant time period, the insolvent is no closer to a proposal than at the commencement of the stay period.
7. There is a real risk that a creditor's loan will become unsecured during the stay period.
8. It is necessary to allow the applicant to perfect a right that existed prior to the commencement of the stay period.
9. It is in the interests of justice to do so.

(b) Application

34 Turning then to an application of all of these legal principles to the facts of the case before me, I will first consider whether the subject matter of the main motion of the GS Parties is captured by the stay and then will address whether the stay should be lifted.

35 In analyzing the applicability of the stay, I must examine the substance of the main motion of the GS Parties and the language of the stay found in paragraphs 15 and 16 of my Initial Order.

36 In essence, the GS Parties' motion seeks to:

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(i) undo the transfer of the CW Investments Co. shares from 441 to CMI or

(ii) require CMI to perform and not disclaim the Shareholders Agreement as though the shares had not been transferred.

37 It seems to me that the first issue is caught by the stay of proceedings and the second issue is properly addressed if and when CMI seeks to disclaim the Shareholders Agreement.

38 The substance of the GS Parties' motion is a "proceeding" that is subject to the stay under paragraph 15 of the Initial Order which prohibits the commencement of all proceedings against or in respect of the CMI Entities, or affecting the CMI Business or the CMI Property. The relief sought would also involve "the exercise of any right or remedy affecting the CMI Business or the CMI Property" which is stayed under paragraph 16 of the Initial Order.

39 When one examines the relief requested in detail, the application of the stay is clear. The GS Parties ask first for an order setting aside and declaring void the transfer of the shares from 441. As the shares have been transferred to the CMI Entities presumably pursuant to section 6.5(a) of the Shareholders Agreement, this is relief "affecting the CMI Property". Secondly, the GS Parties ask for a declaration that the rights and remedies of the GS Parties in respect of the obligations of 441 are not affected by the CCAA proceedings. This relief would permit the GS Parties to require CMI to tender the shares for sale pursuant to section 6.10 of the Shareholders Agreement. This too is relief affecting the CMI Entities and the CMI Property. Thirdly, they ask for an order directing CMI to perform all of the obligations that bound 441 prior to the transfer. This represents the exercise of a right or remedy against CMI and would affect the CMI Business and CMI Property in violation of paragraph 16 of the Initial Order. This is also stayed by virtue of paragraph 15. Fourthly, the GS Parties seek an order declaring that the obligations that bound 441 prior to the transfer may not be disclaimed. This both violates paragraph 16 of the Initial Order and also seeks to avoid the express provisions contained in the recent amendments to the CCAA that address disclaimer.

40 Accordingly, the substance and subject matter of the GS Parties' motion are certainly encompassed by the stay. As Mr. Barnes for the CMI Entities submitted, had CMI taken the steps it did six months ago and the GS Parties commenced a lawsuit, the action would have been stayed. Certainly to the extent that the GS Parties are seeking the freedom to exercise their drag along rights, these rights should be captured by the stay.

41 The real question, it seems to me, is whether the stay should be lifted in this case. In considering the request to lift the stay, it is helpful to consider the context and the provisions of the Shareholders Agreement. In his affidavit sworn November 24, 2009, Mr. Strike, the President of Corporate Development & Strategy Implementation of Canwest Global and its Recapitalization Officer, states that the joint acquisition from Alliance Atlantis was intensely and very carefully negotiated by the parties and that the negotiation was extremely complex and difficult. "Every aspect of the deal was carefully scrutinized, including the form, substance and precise terms of the Initial Shareholders Agreement." The Shareholders Agreement was finalized following the CRTC approval hearing. Among other things:

- Article 2.2 (b) provides that CMI is responsible for ensuring the performance by 441 of its obligations under the Shareholders Agreement.
- Article 6.1 contains a restriction on the transfer of shares.
- Article 6.5 addresses permitted transfers. Subsection (a) expressly permits each shareholder to transfer shares to a parent of the shareholder. CMI was the parent of the shareholder, 441.
- Article 6.10 provides that notwithstanding the other provisions of Article 6, if an insolvency event occurs (which includes the commencement of a CCAA proceeding), the GS Parties may sell their shares and cause the Canwest parties to sell their shares on the same terms. This is the drag along provision.

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- Article 6.13 prohibits the liquidation or dissolution of another company[FN15] without the prior written consent of one of the GS Parties[FN16].

42 The recital of these provisions and the absence of any prohibition against the dissolution of 441 indicate that there is a good arguable case that the Shareholders Agreement, which would inform the reasonable expectations of the parties, permitted the transfer and dissolution.

43 The GS Parties are in no worse position than any other stakeholder who is precluded from relying on rights that arise upon an insolvency default. As stated in *San Francisco Gifts Ltd., Re*[FN17] :

"The Initial Order enjoined all of San Francisco's landlords from enforcing contractual insolvency clauses. This is a common prohibition designed, at least in part, to avoid a creditor frustrating the restructuring by relying on a contractual breach occasioned by the very insolvency that gave rise to proceedings in the first place." [FN18]

44 Similarly, in *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.*[FN19] , one of the debtor's joint venture partners in certain petroleum operations was unable to rely on an insolvency clause in an agreement that provided for the immediate replacement of the operator if it became bankrupt or insolvent.

45 If the stay were lifted, the prejudice to CMI would be great and the proceedings contemplated by the GS Parties would be extraordinarily disruptive. The GS Parties have asked to examine 4 of the 5 members of the Special Committee. The Special Committee is a committee of the Board of Directors of Canwest. Its mandate includes, among other things, responsibility for overseeing the implementation of a restructuring with respect to all, or part of the business and/or capital structure of Canwest. The GS Parties have also requested an extensive list of documentary production including all documents considered by the Special Committee and any member of that Committee relating to the matters at issue; all documents considered by the Board of Directors and any member of the Board of Directors relating to the matters at issue; all documents evidencing the deliberations, discussions and decisions of the Special Committee and the Board of Directors relating to the matters at issue; all documents relating to the matters at issue sent to or received by Leonard Asper, Derek Burney, David Drybrough, David Kerr, Richard Leipsic, John Maguire, Margot Micillef, Thomas Strike, and Hap Stephen, the Chief Restructuring Advisor appointed by the court. As stated by Mr. Strike in his affidavit sworn November 24, 2009,

The witnesses that the GS Parties propose to examine include the most senior executives of the CMI Entities; those who are most intensely involved in the enormously complex process of achieving a successful going concern restructuring or recapitalization of the CMI Entities. Myself, Mr. Stephen, Mr. Maguire and the others are all working flat out on trying to achieve a successful restructuring or recapitalization of the CMI Entities. Frankly, the last thing we should be doing at this point is preparing for a forensic examination, in minute detail, over events that have taken place over the past several months. At this point in the restructuring/recapitalization process, the proposed examination would be an enormous distraction and would significantly prejudice the CMI Entities' restructuring and recapitalization efforts.

46 While Mr. McElcheran for the GS Parties submits that the examinations and the scope of the examinations could be managed, in my view, the litigating of the subject matter of the motion would undermine the objective of protecting the CMI Entities while they attempt to restructure. The GS Parties continue to own their shares in CW Investments Co. as does CMI. CMI continues to operate the Specialty TV Business. Furthermore, CMI cannot sell the shares without the involvement of the Monitor and the court. None of these facts have changed. The drag along rights are stayed (although as Mr. McElcheran said, it is the cancellation of those rights that the GS Parties are concerned about.)

47 A key issue will be whether the CMI Parties can then disclaim that Agreement or whether they should be

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required to perform the obligations which previously bound 441. This issue will no doubt arise if and when the CMI Entities seek to disclaim the Shareholders Agreement. It is premature to address that issue now. Furthermore, section 32 of the CCAA now provides a detailed process for disclaimer. It states:

32.(1) Subject to subsections (2) and (3), a debtor company may — on notice given in the prescribed form and manner to the other parties to the agreement and the monitor — disclaim or resiliate any agreement to which the company is a party on the day on which proceedings commence under this Act. The company may not give notice unless the monitor approves the proposed disclaimer or resiliation.

(2) Within 15 days after the day on which the company gives notice under subsection (1), a party to the agreement may, on notice to the other parties to the agreement and the monitor, apply to a court for an order that the agreement is not to be disclaimed or resiliated.

(3) If the monitor does not approve the proposed disclaimer or resiliation, the company may, on notice to the other parties to the agreement and the monitor, apply to a court for an order that the agreement be disclaimed or resiliated.

(4) In deciding whether to make the order, the court is to consider, among other things,

(a) whether the monitor approved the proposed disclaimer or resiliation;

(b) whether the disclaimer or resiliation would enhance the prospects of a viable compromise or arrangement being made in respect of the company; and

(c) whether the disclaimer or resiliation would likely cause significant financial hardship to a party to the agreement.

48 Section 32, therefore, provides the scheme and machinery for the disclaimer of an agreement. If the monitor approves the disclaimer, another party may contest it. If the monitor does not approve the disclaimer, permission of the court must be obtained. It seems to me that the issues surrounding any attempt at disclaimer in this case should be canvassed on the basis mandated by Parliament in section 32 of the amended Act.

49 In my view, the balance of convenience, the assessment of relative prejudice and the relevant merits favour the position of the CMI Entities on this lift stay motion. As to the issue of good faith, the question is whether, absent more, one can infer a lack of good faith based on the facts outlined in the materials filed including the agreed upon admission by the CMI Entities. The onus to lift the stay is on the moving party. I decline to exercise my discretion to lift the stay on this basis.

50 Turning then to the factors listed by Professor McLaren, again I am not persuaded that based on the current state of affairs, any of the factors are such that the stay should be lifted. In light of this determination, there is no need to address the motion to strike paragraph 1(e) of the GS Parties' main motion.

51 The stay of proceedings in this case is performing the essential function of keeping stakeholders at bay in order to give the CMI Entities a reasonable opportunity to develop a restructuring plan. The motions of the GS Parties are dismissed (with the exception of that portion dealing with paragraph 59 of the Initial Order which is on consent) and the motion of the CMI Entities is granted with the exception of the strike portion which is moot.

52 The Monitor, reasonably in my view, did not take a position on these motions. Its counsel, Mr. Byers, advised the court that the Monitor was of the view that a commercial resolution was the best way to resolve the GS Parties'

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issues. It is difficult to disagree with that assessment.

Insolvent entities' motion granted; motion and cross-motion of moving party dismissed.

[FN1 \(2000\), 19 C.B.R. \(4th\) 1](#) (Alta. Q.B.).

[FN2](#) (B.C. C.A.) at p. 4.

[FN3 \(2005\), 75 O.R. \(3d\) 5](#) (Ont. C.A.) at para. 36.

[FN4 \(2000\), 19 C.B.R. \(4th\) 1](#) (Alta. Q.B.).

[FN5 \(1993\), 17 C.B.R. \(3d\) 24](#) (Ont. Gen. Div. [Commercial List]).

[FN6](#) Ibid, at p. 32.

[FN7](#) Supra, note 2

[FN8 \(1992\), 14 C.B.R. \(3d\) 303](#) (Ont. Gen. Div.).

[FN9](#) R.S.O. 1990, c.C.43.

[FN10](#) Supra, note 6 at paras. 24 and 25.

[FN11](#) (Aurora: Canada Law Book, looseleaf) at para. 3.3400.

[FN12 \(2007\), 33 C.B.R. \(5th\) 50](#) (Sask. C.A.) at para. 68.

[FN13](#) Ibid, at para. 68.

[FN14](#) Supra, note 3.

[FN15](#) This was 4414641 Canada Inc. but not 4414616 Canada Inc., the company in issue before me.

[FN16](#) Specifically, GS Capital Partners VI Fund, L.P.

[FN17 \(2004\), 5 C.B.R. \(5th\) 92](#) (Alta. Q.B.) at para.37.

[FN18](#) Ibid, at para. 37.

[FN19 \(1988\), 72 C.B.R. \(N.S.\) 1](#) (Alta. Q.B.).

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TAB 2

2000 CarswellOnt 2018, 48 O.R. (3d) 417, 2 C.L.R. (3d) 165, 35 R.P.R. (3d) 1, 132 O.A.C. 381, 187 D.L.R. (4th) 407



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Structural Contracting Ltd. v. Westcola Holdings Inc.

Structural Contracting Ltd., Plaintiff (Respondent) and **Westcola Holdings Inc.** and Frank Colatosti, Defendants
(Appellants)

Ontario Court of Appeal

Austin, Moldaver, Borins JJ.A.

Heard: May 17, 2000
Judgment: June 12, 2000
Docket: CA C32949

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Counsel: *Duncan W. Glaholt*, for defendants/appellants.

Gregory N. Hemsworth, for plaintiff/respondent.

Subject: Contracts; Corporate and Commercial; Estates and Trusts; Insolvency

Construction law --- Construction and builders' liens — Trust fund — Breach of statutory trust

Contractor contracted with commercial landlord to renovate underground parking garage of building — After certification of substantial completion, landlord received rent from building tenants and deposited rent in its bank account to pay for services and expenses involved in continued operation of building — Part of contractor's account remained unpaid — Contractor brought action against landlord and its sole principal to recover unpaid portion of account — Landlord admitted liability on basis of contract — Trial judge found both landlord and principal liable on basis of breach of trust — Landlord and principal appealed finding of breach of trust on which principal's personal liability was based — Appeal dismissed — Application of s. 7(3) of Construction Lien Act is not restricted to profits in hands of owner — All money coming into hands of landlord was subject to trust, under s. 7(3), up to amount owing to contractor — Commercial rent in this case was subject to trust under s. 7 of Act — Principal assented to or acquiesced in conduct that he knew or reasonably ought to have known amounted to breach of trust — Principal was sole officer, director, controlling mind, and signing officer of landlord — Principal could not be relieved of personal liability under s. 35 of Trustee Act — Principal did not act reasonably, and breach of trust could not be described as technical — Construction Lien Act, R.S.O. 1990, c. C.30, ss. 7, 7(3) — Trustee Act, R.S.O. 1990, c. T.23, s. 35.

Cases considered by *Austin J.A.*:

Dietrich Steel Ltd. v. Shar-Dee Towers (1987) Ltd. [\(1999\)](#), 170 D.L.R. (4th) 475, 42 O.R. (3d) 749, 119 O.A.C. 69,

2000 CarswellOnt 2018, 48 O.R. (3d) 417, 2 C.L.R. (3d) 165, 35 R.P.R. (3d) 1, 132 O.A.C. 381, 187 D.L.R. (4th) 407

[45 C.L.R. \(2d\) 178](#) (Ont. C.A.) — applied

Rudco Insulation Ltd. v. Toronto Sanitary Inc. [\(1998\), 41 C.L.R. \(2d\) 1, 114 O.A.C. 272, 167 D.L.R. \(4th\) 121, 42 O.R. \(3d\) 292](#) (Ont. C.A.) — referred to

Tam-Kal Ltd. v. Stock Mechanical Inc. [\(1998\), 43 C.L.R. \(2d\) 94](#) (Ont. Gen. Div.) — considered

Tam-Kal Ltd. v. Stock Mechanical Inc. [\(1999\), 127 O.A.C. 56, 50 C.L.R. \(2d\) 224](#) (Ont. C.A.) — considered

Statutes considered:

Construction Lien Act, R.S.O. 1990, c. C.30

Pt. II — considered

s. 7 — considered

s. 7(2) — considered

s. 7(3) — considered

s. 7(4) — considered

s. 8 — considered

s. 8(2) — considered

s. 9 — considered

s. 9(2) — considered

s. 10 — considered

s. 11 — considered

s. 11(2) — considered

s. 12 — considered

s. 13 — considered

s. 13(1) — considered

s. 66 — considered

Courts of Justice Act, R.S.O. 1990, c. C.43

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s. 128 — referred to

Trustee Act, R.S.O. 1990, c. T.23

s. 35 — considered

APPEAL by landlord and principal from decision allowing contractor's action to recover amount owing on account.

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

1 This appeal considers whether rents received by a commercial landlord are trust funds and remain so by reason of s. 7(2) and (3) of the *Construction Lien Act*, R.S.O. 1990, c. C.30 ("the Act"), until a contractor working on the property is paid.

2 Westcola Holdings Inc. ("Westcola") is a commercial landlord. It owns a commercial building in Toronto and leases parts of it to various tenants. Frank Colatosti ("Colatosti") is the sole principal of Westcola.

3 Structural Contracting Limited ("Structural") is a construction company. In April 1997 Structural contracted with Westcola to renovate the underground parking garage of Westcola's building. The final price agreed upon was \$215,000.

4 The work was completed by September 29, 1997. The contract provided that the progress of the work was to be certified by Westcola's consultant Trow Consulting Engineers Ltd. ("Trow"). Trow certified substantial completion of the work on October 23, 1997, and published the Certificate of Substantial Completion on October 28, 1997.

5 Westcola did not undertake any financing specifically for the work contracted. Instead, in so far as it made payments to Structural, they were paid out of general revenue. Approximately \$90,000 remained unpaid and Structural commenced this action to recover that money.

6 After the certification of substantial completion, Westcola received rents on a regular basis from the tenants of the building. These were deposited in Westcola's bank account. From that account, payments were made with respect to various services and expenses necessary for the continued operation of the building. These included heat, hydro, janitorial, maintenance, property taxes, goods and services tax, and mortgage payments. The total amount of the payments exceeds the amount claimed by Structural.

7 Following the production of documents and the examination for discovery of Colatosti, Structural moved for summary judgment. Westcola admitted liability on the basis of the contract. On September 1, 1999, Pitt J. found both defendants liable on the basis of breach of trust. That basis is reflected in the formal judgment; the admitted liability of Westcola in contract is not so reflected in the formal judgment. To that extent, the formal judgment is deficient although no claim to correct it was raised by Structural on this appeal.

8 Both defendants purport to appeal against the judgment as pronounced. Westcola's appeal is moot in the sense that whatever might happen on its appeal, it should remain liable in contract. It is not moot in the sense that by reason of the opening words of s. 13(1) of the *Act*, Colatosti's liability in trust is dependent upon Westcola first being found liable for breach of trust under s. 7(3). Accordingly, it is necessary to deal with the liability of both Westcola and Colatosti in considering Colatosti's appeal.

9 The claim for damages for breach of trust is based upon the *Act*, ss. 7 and 13. Those provisions as are follows:

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Trust Provisions

7.-(1) All amounts received by an owner, other than the Crown or a municipality, that are to be used in the financing of the improvement, including any amount that is to be used in the payment of the purchase price of the land and the payment of prior encumbrances, constitute, subject to the payment of the purchase price of the land and prior encumbrances, a trust fund for the benefit of the contractor.

(2) Where amounts become payable under a contract to a contractor by the owner on a certificate of a payment certifier, an amount that is equal to an amount so certified that is in the owner's hands or received by the owner at any time thereafter constitutes a trust fund for the benefit of the contractor.

(3) Where the substantial performance of a contract has been certified, or has been declared by the court, an amount that is equal to the unpaid price of the substantially performed portion of the contract that is in the owner's hands or is received by the owner at any time thereafter constitutes a trust fund for the benefit of the contractor.

(4) The owner is the trustee of the trust fund created by subsection (1), (2) or (3), and the owner shall not appropriate or convert any part of a fund to the owner's own use or to any use inconsistent with the trust *until the contractor is paid all amounts related to the improvement owed to the contractor by the owner*. 1983, c. 6, s. 7. [Emphasis added.]

.....

13.(1) In addition to the persons who are otherwise liable in an action for breach of trust under this Part,

(a) every director or officer of a corporation; and

(b) any person, including an employee or agent of the corporation, who has effective control of a corporation or its relevant activities,

who assents to, or acquiesces in, conduct that he or she knows or reasonably ought to know amounts to breach of trust by the corporation is liable for the breach of trust.

(2) The question of whether a person has effective control of a corporation or its relevant activities is one of fact and in determining this the court may disregard the form of any transaction and the separate corporate existence of any participant.

(3) Where more than one person is found liable or has admitted liability for a particular breach of trust under this Part, those persons are jointly and severally liable.

(4) A person who is found liable, or who has admitted liability, for a particular breach of a trust under this Part is entitled to recover contribution from any other person also liable for the breach in such amount as will result in equal contribution by all parties liable for the breach unless the court considers such apportionment would not be fair and, in that case, the court may direct such contribution or indemnity as the court considers appropriate in the circumstances. 1983, c. 6, s. 13.

10 Structural's position is straightforward and simple and may be stated as follows:

(a) Part II of the Act creates trusts designed to protect persons engaged in the construction industry. Specifically, s. 7 creates trusts binding the owner and s. 8 creates trusts binding the contractor.

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(b) In this case ss. 7(3) and (4) apply.

(c) Rents and other money in excess of \$90,000 came into Westcola's hands after the certification of substantial completion and was paid out without Structural being paid in full.

(d) The monies paid to Westcola were impressed with a trust by reason of the non-payment of Structural when money was due to it.

(e) The only beneficiary of the trust was Structural.

(f) When Westcola paid the trust money out to anyone other than Structural, contrary to s. 7(4), it breached the trust and is thus liable to Structural for the full amount of its claim.

(g) Colatosti is also liable for breach of the trust by reason of the application of s. 13 and by reason of the fact that he is the sole officer, director, signing officer and controlling mind of Westcola and the person who signed all the cheques by which funds were paid out of the corporation.

11 Colatosti raised three defences:

(a) Section 7(3) of the Act does not apply to money received as rent and paid out for overhead expenses and mortgages.

(b) In order for s. 13 to apply, it must be shown in evidence that Colatosti assented to or acquiesced in conduct that he knew or reasonably ought to have known amounted to a breach of trust. Only a trial can establish this knowledge.

(c) Section 35 of the *Trustee Act* provides relief for persons such as Colatosti in these circumstances.

12 In my respectful opinion, none of these defences is applicable to the facts of this case.

(A)

13 The first defence requires the interpretation of s. 7(3). In oral argument counsel for Colatosti advanced a proposition even broader than as set out in paragraph 11(a) of these reasons. Counsel's position was that in order for there to be any business at all, the trust in s. 7(3) had to be limited to the amount of the profit in the owner's hands. The owner was free to pay, and would have to pay, in order to keep the business functioning, heat, light, gas, other utilities, municipal taxes and mortgage expenses. If he did not, the business would fail and no one would be paid. Counsel was candid in admitting that there was no jurisprudence which directly supported his proposition; there simply were no cases on this issue.

14 Counsel went on to raise obvious difficulties. What about tenants' rent deposits? What if the owner had a cheque in the mail en route to a mortgagee when the certificate of a certifier was received? What is the owner to do, stop payment on the cheque to the mortgagee? It was not suggested that any of these specific situations actually existed in the instant case. They were just illustrations of the problems that would inevitably arise if s. 7(3) were to be interpreted as decided by Pitt J.

15 It is therefore not necessary to deal with these questions as there is no evidentiary support for them in the instant case. It may be the case, however, that tenants' deposits are subject to a separate trust and, therefore, not

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available to Structural. Section 66 of the Act provides ready access to the court for directions in such circumstances. It provides as follows:

66. Where a person is in possession of an amount that may be subject to a trust under Part II, the person may apply to the court for direction and the court may give any direction or make any order that the court considers appropriate in the circumstances. 1983, c. 6, s.68.

No application was brought by either Westcola or Colatosti for directions.

16 In so far as mortgage payments are concerned, mortgagees have their own remedies, as do mortgagors. The concern in this appeal is not the protection of mortgagees, but the protection of contractors and subcontractors.

17 The Act provides no support for the argument of the owner. Section 7(3) deals with cases where substantial performance is certified. That is the instant case. The subsection provides that "an amount that is equal to the unpaid price . . . that . . . is received by the owner . . . constitutes a trust fund for the benefit of the contractor." Section 7(2) provides for cases where amounts become payable by an owner to a contractor by virtue of certificates; the relevant language is identical to that of s. 7(3). Section 7(4) prohibits the use of any such funds by the owner until the contractor has been paid. It may be that some payments coming into the hands of, or paid out of the funds of, an owner such as Westcola are not subject to the trust imposed by s. 7(3). None were drawn to the court's attention in the instant case.

18 As noted earlier, s. 8 of the Act deals with circumstances in which a trust is imposed upon a contractor or subcontractor. Sections 9, 10, 11 and 12 set out circumstances in which the amount of trust in either section 7 or 8 may be reduced. Sections 8, 9, 10, 11 and 12 provide as follows:

8.(1) All amounts,

(a) owing to a contractor or subcontractor, whether or not due or payable; or

(b) received by a contractor or subcontractor,

on account of the contract or subcontract price of an improvement constitute a trust fund for the benefit of the subcontractors and other persons who have supplied services or materials to the improvement who are owed amounts by the contractor or subcontractor.

(2) The contractor or subcontractor is the trustee of the trust fund created by subsection (1) and the contractor or subcontractor shall not appropriate or convert any part of the fund to the contractor's or subcontractor's own use or to any use inconsistent with the trust until all subcontractors and other persons who supply services or materials to the improvement are paid all amounts related to the improvement owed to them by the contractor or subcontractor. 1983, c. 6, s. 8.

9.(1) When the owner's interest in a premises is sold by the owner, an amount equal to,

(a) the value of the consideration received by the owner as a result of the sale,

less,

(b) the reasonable expenses arising from the sale and the amount, if any, paid by the vendor to discharge any existing mortgage indebtedness on the premises,

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constitutes a trust fund for the benefit of the contractor.

(2) The former owner is the trustee of the trust created by subsection (1), and shall not appropriate or convert any part of the trust property to the former owner's use or to any use inconsistent with the trust until the contractor is paid all amounts owed to the contractor that relate to the improvement.

10. Subject to Part IV (holdbacks), every payment by a trustee to a person the trustee is liable to pay for services or materials supplied to the improvement discharges the trust of the trustee making the payment and the trustee's obligations and liability as trustee to all beneficiaries of the trust to the extent of the payment made by the trustee. 1983, c. 6, s. 10.

11.(1) Subject to Part IV, a trustee who pays in whole or in part for the supply of services or materials to an improvement out of money that is not subject to a trust under this Part may retain from trust funds an amount equal to that paid by the trustee without being in breach of the trust.

(2) Subject to Part IV, where a trustee pays in whole or in part for the supply of services or materials to an improvement out of money that is loaned to the trustee, trust funds may be applied to discharge the loan to the extent that the lender's money was so used by the trustee, and the application of trust money does not constitute a breach of the trust. 1983, c. 6, s. 11.

12. Subject to Part IV, a trustee may, without being in breach of trust, retain from trust funds an amount that, as between the trustee and the person the trustee is liable to pay under a contract or subcontract related to the improvement, is equal to the balance in the trustee's favour of all outstanding debts, claims or damages, whether or not related to the improvement. 1983, c. 6, s. 12.

19 Sections 9, 10, 11 and 12 demonstrate that the Legislature considered the question of reducing the amount of a trust fund, but the Act contains no exceptions of the kind suggested by the appellants. The strictures of a trust apply to any and all money coming in to the hands of the owner, up to the amount owing to the contractor, in this case approximately \$90,000. As a practical matter, the limitation on the application of s. 7(3) proposed by counsel for the defendants, namely, restricting the trust to profits in the hands of the owner, would turn actions to enforce the trust sections of the Act into accounting exercises. Nothing in the Act suggests that that was the intention of the Legislature in passing s. 7(3). Indeed, the italicized portion of s. 7(4), which is set out in para. [9], which conforms with ss. 8(2), 9(2) and 11(2) illustrates the contrary.

20 The appellant's factum draws a distinction between ss. 7 and 8 of the Act. As noted earlier, s. 8 imposes a trust upon certain funds received by the contractor while s. 7 imposes a trust on the owner. A line of cases has decided that the contractor is not entitled to pay overhead from those funds at the expense of subcontractors. (See, for example, *Rudco Insulation Ltd. v. Toronto Sanitary Inc.* (1998), 42 O.R. (3d) 292 (Ont. C.A.).)

21 The appellants argue that the same considerations do not apply to s. 7, particularly where the funds are received on account of rent, without which the owner would be unable to provide the services required by its lease obligations. I do not see how this submission can prevail given the language of s. 7(4).

22 That argument must be rejected. Westcola is essentially a landlord. Rent is not an incidental matter to it. Rent is its lifeblood, its *raison d'être*. To exclude rent from the trust in the case of a landlord would be to exclude Westcola from the application of s. 7. No justification has been suggested for such a step.

23 The appellant's first defence must therefore fail.

(B)

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24 The second defence is raised on behalf of Colatosti only. He relies on s. 13 of the Act. For liability to attach to him, it must be shown in evidence that he assented to or acquiesced in conduct that he knew or reasonably ought to have known amounted to a breach of trust. He argues that those conclusions cannot be drawn by inference and that only a trial can establish the necessary knowledge. I disagree.

25 Colatosti swore that he was a licensed real estate broker, that he was not involved in the construction industry, that he was not familiar with the provisions of the Act, that he was not aware of the publication of the Certificate of Substantial Completion and that it never occurred to him, nor was it ever suggested to him, that the rent payments received by the corporation might be viewed as trust funds.

26 Although it was a s. 8 case, a similar situation occurred in *Tam-Kal Ltd. v. Stock Mechanical Inc.* (1998), 43 C.L.R. (2d) 94 (Ont. Gen. Div.), aff'd (1999), 50 C.L.R. (2d) 224 (Ont. C.A.). There the issue was whether one Michael Cannone was personally liable for the breaches of trust. In concluding that he was, Ground J. said at p. 116:

[54] Counsel for Mr. Cannone submitted that the test must be subjective and that there is no evidence before this court that Mr. Cannone actually knew or should have known that certain of the payments made by Stock were not proper trust fund payments. I reject such submission. The test in the statute is disjunctive i.e. "knows or reasonably ought to know". It seems to me that the second wing of the test must necessarily depend upon an objective analysis as to what a reasonable person ought to know in the circumstances. It is particularly significant in our case that Mr. Cannone was the chief executive officer of Stock and presumably the person responsible for making decisions as to payments to suppliers and others. In *Andrea Schmidt Construction Ltd. v. Glatt* (1979), 25 O.R. (2d) 567 (Ont. H.C.), Saunders J. stated:

In my opinion, the participation by Burnac was of such a degree as to at least put Burnac on inquiry as to whether there was a breach of trust committed by the diversion. There were circumstances that would indicate to a reasonable person that such a diversion might constitute a breach of trust and if a reasonable inquiry had been made, the failure to pay Schmidt would, in all probability, have been revealed.

And in *G.V.B.S. Inc. v. Hydro Guard Inc.* (1998), 40 C.L.R. (2d) 272 (Ont. Gen. Div.), Somers J. stated at para. 58:

In my view, it is no defence that if a corporation's conduct constituted a breach of the trust the person sought to be held responsible was apparently acting mistakenly or pursuant to what he believed to be the true situation.

[55] I must conclude that a person in the position of Mr. Cannone with his years of experience in the construction industry and being the chief executive officer of Stock, on any reasonable person test, ought to have known that the payments referred to above, which I have disallowed as payments to trust funds beneficiaries, were improper payments out of trust funds and that accordingly Mr. Cannone has personal liability for breach of trust pursuant to ss. 13(1) of the C.L.A. to the extent of the amount paid by Stock which were improper applications of trust funds.

27 In its endorsement dismissing the appeal from Ground J., this court said at paragraph 16: "In our opinion, Ground J. did not err in his application of this [s. 13] section to the facts of this case."

28 As Ground J. pointed out, the test in s. 13(1) of the Act is disjunctive. As a result, one of the tests is "reasonably ought to know." Unlike Michael Cannone, Colatosti was the only person involved. He was the sole officer, director, controlling mind and signing officer of the corporation and the person who signed all of the cheques in question. Whether or not he knew he was committing a breach of trust, it is beyond argument that he reasonably ought to have known as he had effective control of the activities of the corporation. Accordingly, the defence based upon s. 13 of the

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Act must fail.

(C)

29 Colatosti's third defence is s. 35 of the *Trustee Act*, R.S.O. 1990, c. T.23. It reads as follows:

Technical Breaches of Trust

35. If in any proceeding affecting a trustee or trust property it appears to the court that a trustee, or that any person who may be held to be fiduciarily responsible as a trustee, is or may be personally liable for any breach of trust whenever the transaction alleged or found to be a breach of trust occurred, but has acted honestly and reasonably, and ought fairly to be excused for the breach of trust, and for omitting to obtain the directions of the court in the matter in which the trustee committed the breach, the court may relieve the trustee either wholly or partly from personal liability for the same. R.S.O. 1980, c. 512, s. 35.

30 In *Dietrich Steel Ltd. v. Shar-Dee Towers (1987) Ltd.* (1999), 45 C.L.R. (2d) 178 (Ont. C.A.), a personal defendant appealed the finding of a trial judge that he was personally liable for the breach of s. 8 of the Act. Before dealing with the question of personal liability, the Court of Appeal had to deal with the liability of the company which had defaulted at trial. In dealing with that issue, the argument was raised whether s. 35 could apply to a breach of a specific statutory trust. McKinlay J.A., speaking for the court, said at pp. 8.359 and 8.360:

Assuming, without deciding the question, that s. 35 could apply to a breach of a specific statutory trust, I have difficulty in seeing how the provisions of s. 35 could apply to give relief to a contractor who becomes a trustee by virtue of the provisions of s. 8 of the *Construction Lien Act*. The whole purpose of the Act is to protect persons supplying services and materials to an "improvement" to real property, and s. 8(2) sets out specific duties of a trustee. The trustee must not appropriate funds to its own use or to a use inconsistent with the trust until all amounts owed money by the trustee for services or materials supplied to the improvement are paid. If we assume that a trustee passes the test of honesty required by s. 35, I do not see how the trustee could pass the test of reasonableness if it has acted contrary to the specific provisions of s. 8(2). To say that the trustee's actions could be reasonable in such a situation would be to subvert the whole *raison d'être* of the Act.

31 McKinlay J.A. went on to relieve the personal defendant of liability, but applying her words referable to the company to Colatosti, I conclude that s. 35 is simply not available to him. Following the reasoning of McKinlay J.A. and, assuming without finding that Colatosti acted honestly, it is beyond argument that he did not act reasonably. Nor can what happened here be described as a "technical breach of trust." No evidence has been tendered to suggest that he "ought fairly to be excused for the breach of trust." Fairness in these circumstances raises the question who should bear the loss — Colatosti or Structural? There can be only one answer to that question.

32 None of the defences raised can succeed. Colatosti raised, in addition, a question respecting the rate of prejudgment interest awarded against him. The contract between Structural and Westcola specified interest at the rate of 15% per annum on overdue payments. The trial judge awarded this amount as against both Westcola and Colatosti. The latter argues that he was not a party to the contract and that if judgment is to be awarded against him, it is not for breach of contract and accordingly the rate should be that specified by the *Courts of Justice Act*, R.S.O. 1990, c. C.43, s. 128. I agree and paragraph 1 of the judgment should be varied to reflect that the prejudgment rate of interest awarded against Westcola is 15 percent and, as against Colatosti, is to be calculated according to the *Courts of Justice Act*. If counsel are unable to agree on this rate, it may be addressed by correspondence to the court.

33 In all other respects, I would dismiss the appeal with costs.

Appeal dismissed.

2000 CarswellOnt 2018, 48 O.R. (3d) 417, 2 C.L.R. (3d) 165, 35 R.P.R. (3d) 1, 132 O.A.C. 381, 187 D.L.R. (4th) 407

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TAB 3

2002 CarswellOnt 1117, 158 O.A.C. 373, 59 O.R. (3d) 107, 20 C.L.R. (3d) 302

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2002 CarswellOnt 1117, 158 O.A.C. 373, 59 O.R. (3d) 107, 20 C.L.R. (3d) 302

Elmford Construction Co. v. South Winston Properties Inc.

Elmford Construction Company Limited, Appellant and **South Winston Properties Inc.**, Torkin, Manes, Cohen & Arbus and **Purple Knights Development Inc.**, Respondents

Ontario Superior Court of Justice (Divisional Court)

Blair R.S.J., Farley J., McCombs J.

Heard: March 5, 2002

Judgment: March 25, 2002

Docket: 523-01

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Proceedings: reversing (), [2001 CarswellOnt 2657, 12 C.L.R. \(3d\) 95 \(Ont. S.C.J.\)](#)

Counsel: *David A. Taub*, for Appellant, Elmford Construction Company Limited

Mark S. Shapiro, for Respondent, Purple Knights Development Inc.

Subject: Contracts; Corporate and Commercial; Estates and Trusts

Construction law --- Construction and builders' liens — Trust fund — Distribution of fund

Property owner S Inc. entered into cost sharing agreement with owners of lots in development for costs of roads and services — Owner T agreed to pay share of costs to S Inc. in event that lot was sold — Contractor made certified claim against S Inc. and obtained judgment in amount of \$383,700 — When T's lot was sold, judgment creditor P Inc. attempted to garnish monies owed by T to S Inc. — Notwithstanding contractor's notice to sheriff, sheriff paid \$44,630 of funds received to P Inc. — Contractor's application for recovery of funds paid to P Inc. was dismissed — Motions judge held that, as contractor proceeded by way of garnishment proceedings, contractor could not rely on status as trust fund beneficiary — Motions judge held, as judgment creditor, contractor was subject to Creditors' Relief Act which provided in s. 2 that no priority existed among creditors by execution or garnishment — Contractor appealed — Appeal allowed — Any money "received" by S Inc. constituted trust fund for benefit of contractor, and was not exempt from application of s. 7(2) of Construction Lien Act — Trust attached to general funds of owner, irrespective of whether funds had any connection with improvement — Contractor, as beneficiary of trust funds under Construction Lien Act, was not affected by any scheme of distribution of property of debtor by sheriff pursuant to Creditors' Relief Act — Construction Lien Act, R.S.O. 1990, c. C.30, s. 7(2) — Creditors' Relief Act, R.S.O. 1990, c. C.45, s. 2.

2002 CarswellOnt 1117, 158 O.A.C. 373, 59 O.R. (3d) 107, 20 C.L.R. (3d) 302

Creditors and debtors --- Garnishment by creditor — Priorities — Between garnishor and other creditors — General

Property owner S Inc. entered into cost sharing agreement with owners of lots in development for costs of roads and services — Owner T agreed to pay share of costs to S Inc. in event that lot was sold — Contractor made certified claim against S Inc. and obtained judgment in amount of \$383,700 — When T's lot was sold, judgment creditor P Inc. attempted to garnish monies owed by T to S Inc. — Notwithstanding contractor's notice to sheriff, sheriff paid \$44,630 of funds received to P Inc. — Contractor's application for recovery of funds paid to P Inc. was dismissed — Motions judge held that, as contractor proceeded by way of garnishment proceedings, contractor could not rely on status as trust fund beneficiary — Motions judge held, as judgment creditor, contractor was subject to Creditors' Relief Act which provided in s. 2 that no priority existed among creditors by execution or garnishment — Contractor appealed — Appeal allowed — Any money "received" by S Inc. constituted trust fund for benefit of contractor, and was not exempt from application of s. 7(2) of Construction Lien Act — Trust attached to general funds of owner, irrespective of whether funds had any connection with improvement — Contractor, as beneficiary of trust funds under Construction Lien Act, was not affected by any scheme of distribution of property of debtor by sheriff pursuant to Creditors' Relief Act — Construction Lien Act, R.S.O. 1990, c. C.30, s. 7(2) — Creditors' Relief Act, R.S.O. 1990, c. C.45, s. 2.

Cases considered:

Structural Contracting Ltd. v. Westcola Holdings Inc., [2000 CarswellOnt 2018](#), 48 O.R. (3d) 417, 2 C.L.R. (3d) 165, 187 D.L.R. (4th) 407, 35 R.P.R. (3d) 1, 132 O.A.C. 381 (Ont. C.A.) — considered

Structural Contracting Ltd. v. Westcola Holdings Inc., [2001 CarswellOnt 709](#), [2001 CarswellOnt 710](#), 268 N.R. 199 (note), 147 O.A.C. 399 (note), 195 D.L.R. (4th) vii (S.C.C.) — referred to

Van Arnhem v. Lornewood Tanning Salon Inc., [11 C.L.R. \(2d\) 54](#), [1993 CarswellOnt 818](#) (Ont. Gen. Div.) — referred to

Statutes considered:

Construction Lien Act, R.S.O. 1990, c. C.30

Generally — referred to

s. 7(1) — considered

s. 7(2) — considered

s. 7(3) — considered

Creditors' Relief Act, R.S.O. 1990, c. C.45

Generally — referred to

s. 32 — referred to

Words and phrases considered

received

2002 CarswellOnt 1117, 158 O.A.C. 373, 59 O.R. (3d) 107, 20 C.L.R. (3d) 302

[E]ven if [the owner] did not come into physical possession of the monies from the escrow fund, we are of the view that these are appropriate circumstances to interpret the word "received" [in s. 7(2) of the *Construction Lien Act*, R.S.O. 1990, c. C.30] as including receivable or payable.

APPEAL by contractor from judgment reported at [2001 CarswellOnt 2657](#), 12 C.L.R. (3d) 95 (Ont. S.C.J.), dismissing claim under trust provisions of *Construction Lien Act*.

By The Court:

1 Elmford appealed the judgment of Hawkins J. dismissing its claim under the trust provisions of the *Construction Lien Act* (*Lien Act*) on the basis that the Sheriff had properly distributed the claimed funds to Elmford and to Purple Knights pursuant to the *Creditors' Relief Act* (*Relief Act*). The Sheriff had received \$193,367.07 from Torkin Manes (which was acting as escrow agent for South Winston and other owners) as a result of garnishments by Elmford and Purple Knights. Elmford, a contractor, did work on South Winston's land. This work was certified by the payment certifier, with a judgment for Elmford in the amount of \$383,700.05. Purple Knights was not a contractor but pursuant to a judgment was owed \$143,688.06 by South Winston. Elmford asserted that it was entitled to the whole \$193,367.07 pursuant to those monies being trust funds by virtue of s. 7(2) of the *Lien Act* and that it was not required to share those monies with Purple Knights pursuant to the distribution scheme of s. 32 of the *Relief Act*. Elmford had notified the Sheriff and Purple Knights prior to the Sheriff preparing a distribution list that the monies which the Sheriff was holding were trust funds to which Elmford was entitled. Elmford did not contest the scheme of the Sheriff's proposed distribution. The Sheriff then distributed \$148,555.52 to Elmford and \$44,630.85 to Purple Knights (which latter amount Elmford seeks to recover from Purple Knights).

2 S. 7(2) of the *Lien Act* provides:

Where amounts become payable under a contract to a contractor by the owner on a certificate of a payment certifier, an amount that is equal to the amount so certified that is in the owner's hands or received by the owner at any time thereafter constitutes a trust fund for the benefit of the contractor.

3 We are of the view that the fact that South Winston did not take physical possession of the monies released from escrow by Torkin Manes does not prevent them from "being in the owner's hands or received by the owner." Torkin Manes as escrow agent did not own the monies which it held, rather they were owned by the various owners, including South Winston, who were collaborating in the overall project. The funds in question were released by Torkin Manes to South Winston as owner once South Winston's share was calculated; the fact that the monies were detoured by the garnishment to the Sheriff did not change their character. In any event, even if South Winston did not come into physical possession of the monies from the escrow fund, we are of the view that these are appropriate circumstances to interpret the word "received" as including receivable or payable. See *Van Arnhem v. Lornewood Tanning Salon Inc.*, [1993 CarswellOnt 818](#), 11 C.L.R. (2d) 54 (Ont. Gen. Div.) at paras. 19, 20, 23, 28.

4 Does the fact that the funds released from escrow had no direct connection with Elmford's work have any bearing on their ability to become trust funds pursuant to s. 7(2) of the *Lien Act*? We are of the view that that factor does not prevent the funds from becoming trust funds. S. 7(2) is very broadly worded; it should be contrasted with the more restrictive provisions in s. 7(1) which is limited to "all amounts received by an owner ... that are to be used in the financing of the improvement." See *Structural Contracting Ltd. v. Westcola Holdings Inc.* (2000), 48 O.R. (3d) 417 (Ont. C.A.), leave to appeal to S.C.C. refused (2001), 195 D.L.R. (4th) vii (S.C.C.), where the court held that rents received by the owner were impressed with the construction trust. After identifying that s. 7(3) and s. 7(2) contained identical relevant language, Austin J.A. for the Court observed at para. 17:

It may be that some payments coming into the hands of, or paid out of the funds of, an owner such as Westcola

2002 CarswellOnt 1117, 158 O.A.C. 373, 59 O.R. (3d) 107, 20 C.L.R. (3d) 302

are not subject to the trust imposed by s. 7(3). None were drawn to the court's attention in the instant case.

We do not see that Purple Knights has made out a case to exempt the funds in question from the general application of s. 7(2). Austin J.A. went on at para. 19 to state:

...The strictures of a trust apply to any and all money coming in to the hands of the owner, up to the amount owing to the contractor, in this case approximately \$90,000. As a practical matter, the limitation on the application of s. 7(3) proposed by counsel for the defendants, namely restricting the trust to profits in the hands of the owner, would turn actions to enforce the trust sections of the Act into accounting exercises. Nothing in the Act suggests that that was the intention of the legislature in passing s. 7(3)...

It should be kept in mind that s. 7(2) does not deal with the source of the funds; rather s. 7(2) designates that funds attributable to the owner are designated trust funds for the benefit of a contractor who has had its work certified.

5 In his article *Trust Obligations Under the Construction Lien Act* (1994), 15 C.L.R. (2d) 208, Kevin McGuinness at pp. 219-20 raises fairness and economically beneficial questions as to "the type of arbitrary preference that ss. 7(2) and 7(3) of the CLA envisage" but he has no doubt that: "The sections 7(2) and 7(3) trusts attach to the general funds of the owner, irrespective of whether those funds have any connection with the improvement."

6 We are therefore of the view that the monies released from escrow for the benefit of South Winston were trust funds pursuant to s. 7(2) as to which Elmford was entitled to receive. As trust funds, they were no longer the property of South Winston. Only when paid over to Elmford as beneficiary of the trust funds will the debt be extinguished between South Winston and Elmford; in that limited respect does Elmford continue to be a creditor of South Winston.

7 Is Elmford impacted by the provisions of the *Relief Act*? We are of the view that the underpinning of that legislation is that execution or garnishment creditors share *pro rata* (see s. 2) but that sharing is *as to the property of the debtor* held by the Sheriff. Trust funds under the *Lien Act* can no longer be the property of the debtor. Therefore Elmford, as beneficiary of the trust funds pursuant to the *Lien Act*, is not and cannot be affected by any scheme of *distribution of the property of the debtor* by the Sheriff pursuant to the *Relief Act* (except to the extent of its *qua* creditor status which is secondary to its entitlement claim *qua* beneficiary of the trust funds which is of an ownership nature). Since Purple Knights had notice of Elmford's trust claim prior to the distribution by the Sheriff, it is equitable and appropriate that Purple Knights reimburse Elmford the \$44,630.85 which Purple Knights received from the Sheriff.

8 In the result the appeal is allowed.

9 Elmford is to receive its reasonable partial indemnity costs as assessed (if they cannot otherwise be agreed) from Purple Knights both here and before Hawkins J.

Appeal allowed.

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TAB 4

1999 CarswellOnt 266, 170 D.L.R. (4th) 475, 42 O.R. (3d) 749, 119 O.A.C. 69, 45 C.L.R. (2d) 178



1999 CarswellOnt 266, 170 D.L.R. (4th) 475, 42 O.R. (3d) 749, 119 O.A.C. 69, 45 C.L.R. (2d) 178

Dietrich Steel Ltd. v. Shar-Dee Towers (1987) Ltd.

Dietrich Steel Ltd., Plaintiff (Respondent) and Shar-Dee Towers (1987) Ltd., A.M.D. Investments Ltd., Donald Joseph Desrochers, Dianne Chesterman and Bertram Bramwell Sharpe, Defendants (Appellant)

Ontario Court of Appeal

McKinlay, Osborne, Abella JJ.A.

Heard: December 9, 1998

Judgment: February 3, 1999

Docket: CA C24935

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Counsel: *Duncan W. Glaholt*, for the appellant.

M.S. Grossman, for the respondent.

Subject: Corporate and Commercial

Construction law --- Payment of contractors and subcontractors — Entire contract — Miscellaneous issues

Plaintiff subcontractor successfully brought action against defendants for breach of trust — Defendant director was liable as director of contracting company for breaches of statutory trust provisions of Construction Lien Act — Director appealed — Appeal was allowed — Contracting company paid its overhead costs from funds received from owner that should have been held in trust for subcontractors — Persons to whom contracting company made payments on account of its overhead were not subcontractors and therefore not beneficiaries of trust — Contracting company appropriated trust funds for its own use — Payment of overhead costs prior to paying amounts owed to subcontractors was breach of statutory trust — Although contracting company segregated funds in different bank accounts, it was still in breach of trust by misapplying funds — Contracting company did not act honestly and reasonably and ought not in fairness to be excused for breach of trust — Breach of trust by contracting company was not mere technical breach — Although contracting company was liable for breach of trust, director did not have effective control of company nor did he assent or acquiesce to breach of trust — Construction Lien Act, R.S.O. 1990, c. C.30.

Trusts and trustees --- Breach of trust — General

Plaintiff subcontractor successfully brought action against defendants for breach of trust — Defendant director was liable as director of contracting company for breaches of statutory trust provisions of Construction Lien Act — Director appealed — Appeal was allowed — Contracting company paid its overhead costs from funds received from owner that should have been

1999 CarswellOnt 266, 170 D.L.R. (4th) 475, 42 O.R. (3d) 749, 119 O.A.C. 69, 45 C.L.R. (2d) 178

held in trust for subcontractors — Persons to whom contracting company made payments on account of its overhead were not subcontractors and therefore not beneficiaries of trust — Contracting company appropriated trust funds for its own use — Payment of overhead costs prior to paying amounts owed to subcontractors was breach of statutory trust — Although contracting company segregated funds in different bank accounts, it was still in breach of trust by misapplying funds — Contracting company did not act honestly and reasonably and ought not in fairness to be excused for breach of trust — Breach of trust by contracting company was not mere technical breach — Although contracting company was liable for breach of trust, director did not have effective control of company nor did he assent or acquiesce to breach of trust — Construction Lien Act, R.S.O. 1990, c. C.30.

Corporations --- Directors and officers — Liabilities — Miscellaneous issues

Plaintiff subcontractor successfully brought action against defendants for breach of trust — Defendant director was liable as director of contracting company for breaches of statutory trust provisions of Construction Lien Act — Director appealed — Appeal was allowed — Contracting company paid its overhead costs from funds received from owner that should have been held in trust for subcontractors — Persons to whom contracting company made payments on account of its overhead were not subcontractors and therefore not beneficiaries of trust — Contracting company appropriated trust funds for its own use — Payment of overhead costs prior to paying amounts owed to subcontractors was breach of statutory trust — Although contracting company segregated funds in different bank accounts, it was still in breach of trust by misapplying funds — Contracting company did not act honestly and reasonably and ought not in fairness to be excused for breach of trust — Breach of trust by contracting company was not mere technical breach — Although contracting company was liable for breach of trust, director did not have effective control of company nor did he assent or acquiesce to breach of trust — Construction Lien Act, R.S.O. 1990, c. C.30.

Cases considered by *McKinlay J.A.*:

BPCO Inc. v. Deelstra (1994), 19 C.L.R. (2d) 125 (Ont. Gen. Div.) — considered

Crighton v. Roman, [1968] 1 O.R. 769 (Ont. C.A.) — considered

Datasphere Sales Ltd. v. Universal Light & Power Corp. (1991), 48 C.L.R. 25 (Ont. Gen. Div.) — referred to

Emco Supply, division of Emco Ltd. v. Gueguen (1987), 25 C.L.R. 229 (Ont. H.C.) — considered

Guaranty Trust Co. of Canada v. Beaumont (1966), [1967] 1 O.R. 479, 61 D.L.R. (2d) 286 (Ont. C.A.) — considered

Heritage Masonry Ltd. v. Building Team Ltd. (1995), 28 C.L.R. (2d) 101, 5 O.T.C. 53 (Ont. Gen. Div.) — referred to

Home Depot Inc. v. Fieder Painting Inc. (1995), Kirsh's C.L.C.F. 8.30 (Ont. Gen. Div.) — referred to

Rudco Insulation Ltd. v. Toronto Sanitary Inc. (1996), 27 C.L.R. (2d) 71 (Ont. Gen. Div.) — referred to

Rudco Insulation Ltd. v. Toronto Sanitary Inc. (1998), 41 C.L.R. (2d) 1, 114 O.A.C. 272 (Ont. C.A.) — referred to

Statutes considered:

Construction Lien Act, R.S.O. 1990, c. C.30

Generally — considered

1999 CarswellOnt 266, 170 D.L.R. (4th) 475, 42 O.R. (3d) 749, 119 O.A.C. 69, 45 C.L.R. (2d) 178

s. 1(1) "subcontractor" — referred to

s. 7 — referred to

s. 8 — considered

s. 8(1)(b) — considered

s. 8(2) — considered

s. 10 — considered

s. 13 — considered

s. 13(1) — considered

s. 13(1)(b) — considered

s. 13(2) — considered

s. 14 — referred to

s. 14(1) — referred to

Mechanics' Lien Act, R.S.O. 1960, c. 233

Generally — referred to

Mechanics' Lien Act, R.S.O. 1980, c. 261

Generally — considered

s. 3(1) — considered

Trustee Act, R.S.O. 1960, c. 408

s. 35 — referred to

Trustee Act, R.S.O. 1990, c. T.23

s. 35 — considered

APPEAL by defendant director from liability for breach of trust.

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

1 This is an appeal by one of the defendants in this action, Bertram Bramwell Sharpe, from a judgment of the Honour-

1999 CarswellOnt 266, 170 D.L.R. (4th) 475, 42 O.R. (3d) 749, 119 O.A.C. 69, 45 C.L.R. (2d) 178

able Judge E.F. West, requiring the appellant to pay \$55,482.40 plus costs, for breach by the appellant of the trust provisions of the *Construction Lien Act*, R.S.O. 1990, c. C.30 ("the Act").

2 The trial proceeded on an Agreed Statement of Facts, which is quoted below:

1. Dietrich Steel Ltd. ("Dietrich") is a reinforcing steel contractor operating in south-western Ontario.
2. Shar-Dee Towers (1987) Ltd. ("Shar-Dee Towers") and Shar-Dee Contracting Limited ("Shar-Dee Contracting") are private Ontario corporations formerly operating as contractors in Ontario.
3. The personal Defendants Donald Joseph Desrochers ("Desrochers") and Bertram Bramwell Sharpe ("Sharpe") were at all material times officers and directors of Shar-Dee Contracting.
4. A.M.D. Investments Ltd. ("A.M.D.") was the developer of a substantial condominium project in Windsor, Ontario, in the late 1980's called "Waterford Park".
5. The Plaintiff obtained default judgment against A.M.D. and Shar-Dee Towers on June 26, 1990, a copy of which is attached, as Exhibit "A". The judgment is in the full amount of the Plaintiff's claim plus 15% prejudgment interest and costs.
6. Default judgment against the defendants Desrochers and Sharpe were set aside by Orders obtained by these parties.
7. The defendant Dianne Chesterman is no longer a party. This action was dismissed against her by Consent Order dated October 29, 1993.

The Contracts

8. Title in the project was held by a corporation incorporated for that sole purpose, Waterford Park Developments (Windsor) Inc., ("Waterford Park Developments") who, in turn, contracted all development work to A.M.D. A.M.D. contracted the construction portion of Waterford Park to Shar-Dee Contracting.
9. Shar-Dee Contracting entered into sub-contracts with the trades needed to build the project.
10. Shar-Dee Towers entered into a sub-contract with Dietrich Steel on April 18, 1988, for the supply of all necessary labour, materials and equipment to satisfy all reinforcing steel requirements for cast in place concrete work on the project.
11. Shar-Dee Towers never carried on business.
12. Dietrich sent the first 20 of its invoices to "Share-Dee Towers", which invoices were paid by Shar-Dee Contracting.
13. Dietrich sent its last 11 invoices to "Shar-Dee Contracting" and all but the holdback invoice was paid by Shar-Dee Contracting.
14. Waterford Park Developments and A.M.D. ran into financial difficulty on the project in the final stages of completion and sale of the condominium units. Upon application, at the direction of the personal defendants Desrochers and Sharpe, in the name of the title holder Waterford Park Developments, an Order of Justice D. Doherty was made on May 8, 1990, appointing the Windsor law firm of Willson, Barat, Farlam, Millson, as Trustee of the project under the authority of the *Construction Lien Act*.

1999 CarswellOnt 266, 170 D.L.R. (4th) 475, 42 O.R. (3d) 749, 119 O.A.C. 69, 45 C.L.R. (2d) 178

15. The said Court appointed Trustee oversaw the completion of the project, sale of the units and distribution of all funds. His accounts were passed and he was discharged.

16. All of A.M.D.'s construction lien holdbacks from its general contractor, Shar-Dee Contracting, totalling \$991,530.31, were distributed by Order of Master J. Quinn, at Windsor, to those trades of Shar-Dee Contracting that had registered Claims for Lien under the *Construction Lien Act*.

17. The Plaintiff did not register a Lien Claim under the *Construction Lien Act* and, therefore, did not participate in any Court ordered distribution of A.M.D.'s holdbacks.

18. At the time of the discharge of the Court appointed Trustee all project funds had been distributed and there was a shortfall to the principal secured creditor, the first mortgagee, Financial Trust.

Flow of Funds

19. A.M.D. financed this development with a first mortgage from Financial Trust in the amount of \$12,135,000.00.

20. A.M.D.'s contract with Shar-Dee Contracting was on a "cost plus" basis totalling approximately \$8,000,000.00.

21. At the inception of the project, Shar-Dee Contracting opened a segregated bank account at the National Bank of Canada, 263 Queen Street East, Brampton, Ontario, as account no. 00-091-029, for the sole purpose of paying construction expenses related to the project.

22. All funds received by Shar-Dee Contracting from A.M.D. were deposited to National Bank of Canada, 263 Queen Street East, Brampton, Ontario, account no. 00-091-029 and all such funds were used for direct construction costs, either paid to sub-trades such as the Plaintiff, for example, or to direct overhead expenses such as the cost of long distance telephone calls and temporary personnel hired to monitor and administer expenses exclusively for the project.

23. None of the money received by Shar-Dee Contracting from A.M.D. and deposited to National Bank of Canada account no. 00-091-029 was used to cover any internal overhead expense such as, for example, rent or mortgage payments, or for that matter to cover expenses of any other project or activity of Shar-Dee Contracting.

24. Dietrich Steel complains about the following payments by Shar-Dee Contracting:

	PAYEE	AMOUNT
1.	Payments to personnel agencies for accounting clerks working in Shar-Dee Contracting's Mississauga office	\$24,299.30
2.	Bell Canada telephone charges	
	(416) 676-9254 (Mississauga office)	\$7,597.69
	(519) 254-7271 (Windsor office)	\$5,953.20
3.	H.K. Insurance Brokers Ltd., Builder's Risk Coverage	\$9,914.66
4.	Audit Fees - Ward Mallette	\$3,500.00
5.	Corporate Income Taxes	\$3,817.59
6.	H.K. Insurance	\$6,427.00
7.	Shar-Dee Contracting Limited	\$20,000.00
8.	Willowood Personnel for accounting clerks working in Mississauga office	\$20,857.78

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9.	Receiver General	\$5,581.32
10.	Stewart Chev Olds	\$2,612.25
11.	Tony Rea & Co.	\$3,000.00
12.	Holiday Inn	\$1,116.00
13.	N.C.R.	\$1,215.00
14.	R.P.A. Consultants	\$3,600.00
15.	Moore Business Forms	\$2,294.60
16.	Bell Canada	\$3,445.44

3 The trial judge held the appellant liable as a director and officer of the contractor, Shar-Dee Towers (1987) Ltd. ("Shar-Dee Towers"), for breaches by Shar-Dee Towers of the statutory trust provisions of s. 8 of the *Construction Lien Act*.

4 Before commenting on the issues raised by the appellant, I should point out that in his reasons, West J. stated that the sections of the Act particularly relevant to this action are ss. 8, 10, 13(1) and 14(1). I suspect that the inclusion of s. 14(1) was in error since that provision is not referred to elsewhere in the reasons. However, I wish to make it clear that I do not view s. 14 as being of any assistance in resolving the issues in this appeal. Section 14 deals with the creation of a lien under the Act. In this appeal we are not dealing with liens; the respondent failed to file a lien claim. The lien and the trust provisions of the Act are quite distinct, and it is important not to confuse one with the other in dealing with the interpretation of this rather complicated Act.

5 As noted in the agreed facts, default judgment was obtained against the contractor, Shar-Dee Towers, so the question of breach of the s. 8 trust by the contractor was not considered by the court. For personal liability to be found against the appellant, it is first necessary that there be a finding of breach of trust against the contractor.

6 I should point out at this stage that the corporation actually contracting with the owner was Shar-Dee Contracting, but the party contracting with the respondent was Shar-Dee Towers. No issue was raised in this action relating to those facts. Shar-Dee Contracting in fact acted as trustee of funds owing to the respondent.

A. Was there a breach of trust by the contractor?

7 Section 8 of the Act establishes the trust and the obligations of the trustee which are involved in this appeal. That section reads:

8(1) All amounts,

(a) owing to a contractor or subcontractor, whether or not due or payable; or

(b) received by a contractor or subcontractor,

on account of the contract or subcontract price of an improvement constitute a trust fund for the benefit of the subcontractors and other persons who have supplied services or materials to the improvement who are owed amounts by the contract or subcontractor.

(2) The contractor or subcontractor is the trustee of the trust fund created by subsection (1) and the contractor or subcontractor shall not appropriate or convert any part of the fund to the contractor's or subcontractor's own use or to any use inconsistent with the trust until all subcontractors and other persons who supply services or materials to the improvement are paid all amounts related to the improvement owed to them by the contractor or subcontractor.

1999 CarswellOnt 266, 170 D.L.R. (4th) 475, 42 O.R. (3d) 749, 119 O.A.C. 69, 45 C.L.R. (2d) 178

8 The appellant takes the position that the contractor, Shar-Dee Contracting was entitled to pay, out of funds received on account of its contract with the owner, overhead costs directly attributable to the contract involved without, as a result of those payments, being in breach of the s. 8 trust provisions.

9 This question has been addressed in a number of decisions of lower courts: see *Rudco Insulation Ltd. v. Toronto Sanitary Inc.* (1996), 27 C.L.R. (2d) 71 (Ont. Gen. Div.) (affirmed (1998), 41 C.L.R. (2d) 1 (Ont. C.A.)); *Heritage Masonry Ltd. v. Building Team Ltd.* (1995), 28 C.L.R. (2d) 101 (Ont. Gen. Div.); *Home Depot Inc. v. Fieder Painting Inc.* (1995), Kirsh's C.L.C.F. 8.30 (Ont. Gen. Div.); *BPCO Inc. v. Deelstra* (1994), 19 C.L.R. (2d) 125 (Ont. Gen. Div.); *Datasphere Sales Ltd. v. Universal Light & Power Corp.* (1991), 48 C.L.R. 25 (Ont. Gen. Div.); *Emco Supply, division of Emco Ltd. v. Gueguen* (1987), 25 C.L.R. 229 (Ont. H.C.). Only one of those cases, *BPCO Inc. v. Deelstra*, held that payment of overhead costs out of amounts received by the contractors, prior to paying amounts owed to subcontractors, does not amount to a breach of the statutory trust. In so finding, the trial judge cited an annotation to the *Emco Supply, division of Emco Ltd.* case which expressed the view that disallowing such payments, which arise in the normal course of business, was not only unreasonable, but was not within the contemplation of the Act.

10 In my view, the majority of the cases express the correct view. If there were any ambiguity in the terms of the statute, then considerations of reasonableness, and speculation as to what was in the contemplation of the legislators, might be appropriate. However, the provisions of s. 8 are clear and unambiguous. For the purposes of the facts of this case s. 8(1)(b) constitutes all amounts received by the contractor on account of the contract price a trust fund for subcontractors such as the respondent.

11 The appellant presents a number of arguments against this literal construction of the trust provisions of s. 8. First, he argues that if this strict interpretation is correct, then construction lien trusts are unique in requiring the trustee to bear the costs of administration of the trust. The fact is, that construction lien trusts *are* unique. They exist by statute at each level of the contract pyramid for the benefit of those adding value to the land involved. The trust imposed on owner, contractor, and subcontractors is for the benefit of all those on the next level in the pyramid below the trustee. Each trustee will have entered into a contract, oral or written, with the beneficiary of the trust. The statute has super-imposed a trust on each contract. The contractor in this case would be liable in contract to its subcontractor for the full amount of the contract, regardless of the amount of his own overhead costs. I see no reason why the amount of the trust liability should be less. To compare this very specific statutory trust with more usual types of trusts is inappropriate, and does not assist in understanding its unique nature.

12 The appellant's second argument against strict interpretation of s. 8 is that the contractor complied with the policy of the statute by segregating the bank account for this particular project and should, therefore, not be found to have breached the statutory trust provisions. The simple answer to that position is that segregation of accounts does not necessarily preclude a breach of trust. Segregation of accounts is for the purpose of enabling an uncomplicated tracing of funds from the owner to the contractor and from the contractor to its subcontractors. The contractor, although segregating funds, can still be in breach of its trust by applying funds improperly.

13 Third, the appellant argues that it did none of the things which constitute a breach of the trust pursuant to s. 8(2). A breach in this case would require appropriation or conversion of trust funds "to the contractor's ... own use or any use inconsistent with the trust". First, the appellant states that it is conceded by the respondent that no part of the funds were paid to "the contractor's own use", and second, he argues that application of funds to overhead is not a "use inconsistent with the trust".

14 A review of the Agreed Statement of Facts indicates that what was conceded by the respondent was that funds received from the owner and not paid over to subcontractors were used only to pay overhead expenses specifically related to this project. Whether or not such use constitutes appropriation or conversion "to the contractor's own use" is a question of law, and was certainly not conceded by the respondent. Since the contractor is liable to pay its own overhead expenses to whomever provided the materials or services involved, use of trust funds to satisfy these liabilities is, in my view, appropriate.

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tion of trust funds "to the contractor's own use".

15 Dealing with the question of whether the use made of the trust funds was not a "use inconsistent with the trust", I agree with the appellant that those words are broader than those used in the predecessor Act -- the *Mechanics' Lien Act*, R.S.O. 1980, c. 261. Section 3(1) of the *Mechanics' Lien Act* prohibited a trustee from appropriating or converting any part of the trust fund "to his own use or to any use not authorized by the trust". There were in the former Act, and there are in the present Act, uses of trust monies which are specifically "authorized". I agree with the appellant that those authorized uses are not what we are dealing with here. In my view, whether a use is "inconsistent" with the trust depends on the purposes of the trust as set out in the statute. The purpose of the s. 8 trust, as applied to the facts of this case, is to protect the claims of "sub-contractors and other persons" who have provided services or materials to the improvement and who have claims against the contractor, Shar-Dee Contracting. The respondents in this case are clearly subcontractors who have provided services to the improvement, and who are owed money by the contractor. The persons to whom Shar-Dee Contracting made payments on account of its own overhead are not sub-contractors and, therefore, not beneficiaries of the trust in that category.

16 There remains the question of whether they are "other persons" within the meaning of s. 8. "Other persons" must also have provided services or materials to the improvement and be owed money by the contractor, even though they may not come within the statutory definition of "subcontractors". Persons who provided overhead services to the contractor were not providing services or materials to the improvement but, rather, they were providing them to the contractor and are not, therefore, protected by the s.8 trust provisions. Their protection comes through the contractor, as part of its contract price with the owner. The contractor is protected by a separate trust fund provision in s.7 of the Act.

17 Thus, in my view, payment of overhead costs is payment inconsistent with the trust, and any such payments made out of trust funds are made in breach of trust.

18 The appellant's last argument on this issue is that the overhead payments, even if inconsistent with the trust, are, nonetheless, authorized by the Act in s.10, which reads:

10. Subject to Part IV (holdbacks), every payment by a trustee to a person the trustee is liable to pay for services or materials supplied to the improvement discharges the trust of the trustee making the payment and the trustee's obligations and liability as trustee to all beneficiaries of the trust to the extent of the payment made by the trustee.

19 Section 10 merely permits the trustee/contractor to reimburse itself from trust monies for any of its own monies which it has paid over to beneficiaries of the trust. The section in no way creates new beneficiaries.

20 Thus, I consider that all of the overhead payments, including the unexplained cheque for \$20,000 from Shar-Dee Contracting to itself, are payments made in breach of the s. 8 trust, for which the contractor is liable.

B. If there was a breach of trust by the trustee/contractor, was the breach a merely technical one for which the trustee should be granted relief from liability?

21 It is clear that there is no relief from liability provided in the Act for trustees who have committed merely technical breaches of trust. The appellant takes the position, however, that s. 35 of the *Trustee Act*, R.S.O. 1990, c. T.23, should be applied in this situation to provide relief to the trustee. Section 35 reads:

35. If in any proceeding affecting a trustee or trust property it appears to the court that a trustee, or that any person who may be held to be fiduciarily responsible as a trustee, is or may be personally liable for any breach of trust whenever the transaction alleged or found to be a breach of trust occurred, but has acted honestly and reasonably, and ought fairly to be excused for the breach of trust, and for omitting to obtain the directions of the court in the matter in which the trustee committed the breach, the court may relieve the trustee either wholly or partly from personal liability for the same.

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22 The respondent argues first that s.35 has no application in this case, where a specific statutory trust has been breached and, second, that even if s.35 applies, the behaviour of the contractor does not fulfil the three requirements of s.35 that it "has acted honestly and reasonably, and ought fairly to be excused for the breach of the trust".

23 A decision of this court in the case of *Guaranty Trust Co. of Canada v. Beaumont* (1966), [1967] 1 O.R. 479 (Ont. C.A.), was cited by the appellant as a case where the court considered whether it should grant relief under s.35 in a breach of trust situation arising under the *Mechanics' Lien Act*, R.S.O. 1960, c. 233. Actually, that case, although it involved a construction situation, dealt with the duties of a trustee under an assignment by the contractor to a trustee for the benefit of the contractor's creditors. Section 35 was appropriately applied in that situation. The question of its application to a *Mechanics' Lien Act* trust situation was not relevant.

24 In a later decision of this court - *Crighton v. Roman*, [1968] 1 O.R. 769 (Ont. C.A.) - the court considered the application of s.35 to liability of a constructive trustee. Laskin J.A., speaking for the court, held that the words "any person who may be held to be fiduciarily responsible as a trustee" extend the protection of the provision to constructive trustees, although relief from liability was not given on the specific facts of that case.

25 Assuming, without deciding the question, that s.35 could apply to a breach of a specific statutory trust, I have difficulty in seeing how the provisions of s.35 could apply to give relief to a contractor who becomes a trustee by virtue of the provisions of s.8 of the *Construction Lien Act*. The whole purpose of the Act is to protect persons supplying services and materials to an "improvement" to real property, and s. 8(2) sets out specific duties of a trustee. The trustee must not appropriate funds to its own use or to a use inconsistent with the trust until all amounts owed money by the trustee for services or materials supplied to the improvement are paid. If we assume that a trustee passes the test of honesty required by s. 35, I do not see how the trustee could pass the test of reasonableness if it has acted contrary to the specific provisions of s. 8(2). To say that the trustee's actions could be reasonable in such a situation would be to subvert the whole *raison d'être* of the Act.

C. Personal liability of the appellant.

26 Based on my reasons to this point, I agree with West J. that the contractor in this case was liable for a breach of the s.8 trust. However, I have some difficulty with the finding of personal liability against the appellant. Given the breach by Shar-Dee Contracting, the respondent takes the position that the appellant, as a director and officer, is liable for Shar-Dee Contracting's breach pursuant to the provisions of s. 13(1) of the Act. Section 13(1), and s. 13(2), which is also relevant, are reproduced below:

13.(1) In addition to the persons who are otherwise liable in an action for breach of trust under this Part,

(a) every director or officer of a corporation; and

(b) any person, including an employee or agent of the corporation, who has effective control of a corporation or its relevant activities,

who assents to, or acquiesces in, conduct that he or she knows or reasonably ought to know amounts to breach of trust by the corporation is liable for the breach of trust.

(2) The question of whether a person has effective control of a corporation or its relevant activities is one of fact and in determining this the court may disregard the form of any transaction and the separate corporate existence of any participant.

27 The sole reason given by West J. for his finding of personal liability was stated as follows, on p. 8 of his reasons:

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The material before the Court satisfies it that the personal defendants were the persons having effective control of the corporations. A finding against them is therefore warranted.

28 The basic evidence before this court was the Agreed Statement of Facts, and miscellaneous previous court orders which are of little assistance. We were not informed of other evidence which was before West J. From the Agreed Statement of Facts it is not clear that the personal defendants did have "effective control of a corporation [Shar-Dee] or its relevant activities" within the meaning of s. 13(1)(b) of the Act. We do know that both were directors and officers. However, neither being an officer and director, nor being a person with "effective control of a corporation or its relevant activities" is sufficient to satisfy the requirements of s. 13(1). To be liable under that provision, it is also necessary to show that the personal defendant is one "who assents to, or acquiesces in, conduct that he or she knows or reasonably ought to know amounts to breach of trust by the corporation". There were no such facts included in the Agreed Statement of Facts.

29 The respondent argues that the notice of appeal did not set out the appellant's position that there was nothing in the Agreed Statement of Facts which would justify liability of the personal defendants. Given the fact that the totality of the respondent's argument for personal liability was based on s. 13, if the notice of appeal is inadequate in setting out the appellant's position on that provision I would grant leave to amend the notice of appeal as required. The respondent could not have been taken off guard on this issue, which was the only issue remaining after a breach of trust by the contractor was established.

Result

30 I would allow the appeal, set aside the judgment against the appellant, Bertram Bramwell Sharpe, and dismiss the action against him, and allow him his costs below and of the appeal.

Appeal allowed.

END OF DOCUMENT

TAB B

SCHEDULE B

CONSTRUCTION LIEN ACT, R.S.O. 1990, C. C.30, s 7

Owner's trust

Amounts received for financing a trust

7. (1) All amounts received by an owner, other than the Crown or a municipality, that are to be used in the financing of the improvement, including any amount that is to be used in the payment of the purchase price of the land and the payment of prior encumbrances, constitute, subject to the payment of the purchase price of the land and prior encumbrances, a trust fund for the benefit of the contractor. R.S.O. 1990, c. C.30, s. 7 (1).

Amounts certified as payable

(2) Where amounts become payable under a contract to a contractor by the owner on a certificate of a payment certifier, an amount that is equal to an amount so certified that is in the owner's hands or received by the owner at any time thereafter constitutes a trust fund for the benefit of the contractor. R.S.O. 1990, c. C.30, s. 7 (2).

Where substantial performance certified

(3) Where the substantial performance of a contract has been certified, or has been declared by the court, an amount that is equal to the unpaid price of the substantially performed portion of the contract that is in the owner's hands or is received by the owner at any time thereafter constitutes a trust fund for the benefit of the contractor. R.S.O. 1990, c. C.30, s. 7 (3).

Obligations as trustee

(4) The owner is the trustee of the trust fund created by subsection (1), (2) or (3), and the owner shall not appropriate or convert any part of a fund to the owner's own use or to any use inconsistent with the trust until the contractor is paid all amounts related to the improvement owed to the contractor by the owner. R.S.O. 1990, c. C.30, s. 7 (4).

RULES OF CIVIL PROCEDURE, R.R.O. 1990, REG. 194, r. 59.06

AMENDING, SETTING ASIDE OR VARYING ORDER

Amending

59.06 (1) An order that contains an error arising from an accidental slip or omission or requires amendment in any particular on which the court did not adjudicate may be amended on a motion in the proceeding. R.R.O. 1990, Reg. 194, r. 59.06 (1).

Setting Aside or Varying

(2) A party who seeks to,
(a) have an order set aside or varied on the ground of fraud or of facts arising or discovered after it was made;
(b) suspend the operation of an order;
(c) carry an order into operation; or
(d) obtain other relief than that originally awarded,
may make a motion in the proceeding for the relief claimed. R.R.O. 1990, Reg. 194, r. 59.06 (2).

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c c.367, AS AMENDED;
AND IN THE MATTER OF FIRST LEASIDE WEALTH MANAGEMENT INC.

COURT FILE NO. CV-12-9617-00CL

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

Proceedings commenced at Toronto

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