Court File No.: CV-12-9545-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

BETWEEN:

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF 3113736 CANADA LTD. 4362063 CANADA LTD., and A-Z SPONGE & FOAM PRODUCTS LTD.

BRIEF OF AUTHORITIES OF THE MOVING PERSON DOMFOAM INC.

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B E T W E E N:

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Chi-Chun Liu, Chiun Li Biotechnology (BVI) Inc., Then-Trai Liu and Bau Shan Biotechnology Corp., Plaintiffs/Respondents v. Daniel Executive (Canada) Holdings Corp., Cheng-Shing, Chen and Shu-Chen Liu, Defendants/Appellants

H.J. Wilton-Siegel J.

Heard: January 22, 2010
Judgment: April 12, 2010
Docket: 06-CL-6248

Proceedings: affirming *Liu v. Daniel Executive (Canada) Holdings Corp.* (2009), 2009 CarswellOnt 5942 (Ont. Master); Leave to appeal refused *Liu v. Daniel Executive (Canada) Holdings Corp.* (2011), 2011 CarswellOnt 432, 2011 ONSC 379 (Ont. Div. Ct.)

Counsel: David E. Greenwood, for Plaintiffs / Respondents
Ford W. Poon, Brendan Walker, for Defendants / Appellants

Subject: Civil Practice and Procedure

Headnote

Civil practice and procedure --- Costs — Security for costs — Default in giving security — Extension of time after default
Plaintiffs brought unspecified action against defendants — Defendants brought counterclaim against at least one plaintiff — Defendants successfully brought motion for security for costs to be posted within ten days — Plaintiffs' solicitor was removed from record and he failed to provide plaintiffs with copy of order — Plaintiffs received copy of order from defendants after deadline expired — Defendants successfully brought motion without notice for order dismissing plaintiffs' action for non-compliance with order — Plaintiffs retained new solicitor and immediately gave notice of intention to set aside dismissal order — Plaintiffs brought successful motion for order setting aside dismissal order — Plaintiffs were given further seven days to post security — Jurisdiction to set aside dismissal order arose under R. 37.14(1)(a) of Rules of Civil Procedure since dismissal order was made without notice — Master held that fact that order for security for costs permitted motion for dismissal to be brought without notice was not relevant — Plaintiffs had not been notified about security for costs order prior to expiration of deadline — Master held that plaintiffs had actively participated in proceeding and had complied with prior orders — Plaintiffs were awarded $25,000 for costs plus $1,706.22 for disbursements — Defendants appealed — Appeal dismissed — Master was correct in finding that dismissal order fell within R. 37.14(1)(a) — Result was not unfair to non-defaulting party nor did it render without notice order meaningless — Such orders should be granted sparingly — If party had not abandoned action and there is dispute as to compliance with earlier order with respect to which defaulting party seeks to introduce responding materials, dispute regarding significance of alleged non-compliance should be resolved on motion back before Master rather than on appeal — There was no direct evidence that defendants received notice of dismissal motion in accordance with Rules prior to hearing of motion — Master did not misapprehend evidence before him with respect to findings of fact — As basis for his finding that defendants believed they satisfied security for costs order by having property available as security for costs pursuant to earlier order of Master, master could reasonably rely on L's statement that he told his former solicitor to inform court that hey had already put up enough security — Issue was L's statement of mind not whether he was correct — Master reasonably concluded that defendants did not receive notice of dismissal motion prior to hearing of motion on March 25, 2009 — Defendants failed to demonstrate prejudice.

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Civil practice and procedure --- Judgments and orders — Setting aside — Jurisdiction to set aside
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Cases considered by *H.J. Wilton-Siegel J.*:

Beneficial Investment (1990) Inc. v. Hong Kong Bank of Canada (2006), 2006 CarswellOnt 1853 (Ont. Master) — distinguished

John Wheelwright Ltd. (Trustee of) v. Central Transport Inc. (1996), 1996 CarswellOnt 3274, 6 C.P.C. (4th) 251 (Ont. Div. Ct.) — referred to

Rolling Stone Haulage Ltd. v. Wilkinson, Tyrell, McKay Insurance Brokers & Consultants Ltd. (1997), 16 C.P.C. (4th) 189, 1997 CarswellOnt 5371 (Ont. Div. Ct.) — considered

Royal Bank v. 1552680 Ontario Inc. (2005), [2005] O.T.C. 578, 2005 CarswellOnt 2889, 18 C.P.C. (6th) 276 (Ont. S.C.J.) — considered

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Wellwood v. Ontario Provincial Police (2009), 2009 CarswellOnt 260, 66 C.P.C. (6th) 48, 246 O.A.C. 71 (Ont. Div. Ct.) — referred to

Zeitoun v. Economical Insurance Group (2008), 236 O.A.C. 76, 64 C.C.L.I. (4th) 52, 2008 CarswellOnt 2576, 53 C.P.C. (6th) 308, 292 D.L.R. (4th) 313, 91 O.R. (3d) 131 (Ont. Div. Ct.) — followed

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Rules considered:

Rules of Civil Procedure, R.R.O. 1990, Reg. 194
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R. 37.07(6) — considered

R. 37.14 — considered

R. 37.14(1) — considered

R. 37.14(1)(a) — considered

APPEAL by defendants from judgment reported at *Liu v. Daniel Executive (Canada) Holdings Corp.* (2009), 2009 CarswellOnt 5942 (Ont. Master), setting aside earlier dismissal order and reinstating action of plaintiffs.

H.J. Wilton-Siegel J.:

1 The appellants appeal an order of Master Glustein dated September 25, 2009 (the "Reinstatement Order"), which set aside the Master's earlier order of March 25, 2009 (the "Dismissal Order") and reinstated the action of the respondents.

The Endorsement of Master Glustein

2 Master Glustein's reasons are set out in his endorsement dated September 25, 2009 (the "Endorsement"). In his Endorsement Master Glustein found that the motion for dismissal of the respondents' action heard on March 25, 2009 (the "Dismissal Motion") was made without notice and, therefore, that he had jurisdiction to set aside the Dismissal Order under Rule 37.14(1)(a). He then exercised his discretion to set aside the Dismissal Order based on eight factors, after expressing the issue as whether the "draconian consequences" of striking the pleading were justified in light of the breach of the underlying court order of February 25, 2009 requiring the posting of security for costs (the "Security for Costs Order"), bearing in mind the policy of the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194 as amended, to facilitate the expeditious resolution of every civil dispute on its merits. Master Glustein also held that, even if he had concluded that the respondents had knowledge of the Dismissal Motion, a dismissal order would not have been appropriate because he did not find the respondents' conduct in this litigation to have been so egregious as to warrant such action.

Standard of Review

3 The standard of review of a master's order, as set out in *Zeitoun v. Economical Insurance Group* (2008), 91 O.R. (3d) 131 (Ont. Div. Ct.) at paras. 41 and 43 , aff'd [2009] O.J. No. 2003 (Ont. C.A.), is that a master's order will not be interfered with unless an appellant can demonstrate that the master erred in law, exercised his discretion based on wrong principles, or misapprehended the evidence such that there is a palpable and overriding error.

Was the Dismissal Motion a Motion Made Without Notice?

4 The Master proceeded on the basis that the Dismissal Order was a "without notice" order and therefore he had jurisdiction to set it aside under Rule 37.14(1)(a). The appellants argue that, because the Security for Costs Order permitted a dismissal motion to be obtained without notice in the event of non-compliance, the Dismissal Order was not an order contemplated by Rule 37.14(1)(a). Therefore, they say that the Master erred in law.

5 I agree with the Master that the Dismissal Order fell within Rule 37.14(1)(a) for the reasons set out in the Endorsement.

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6 Under the *Rules*, a party may challenge an *ex parte* order in two ways. If the party does not seek to introduce its own responding materials with respect to the *ex parte* motion, it will typically appeal the order. If, however, a party wishes to introduce responding materials and it can satisfy the requirements of Rule 37.14(1), that Rule provides that the party may proceed by way of a hearing before a judge of this Court to set aside the earlier order. Such a hearing would involve a new decision at first instance.

7 I see no distinction between an order granted on an *ex parte* basis and an order granted on a "without notice" motion. If a party affected by a "without notice" order issued on such a motion wishes to challenge the order by introducing responding materials addressing its noncompliance, the proper proceeding is, therefore, a Rule 37.14 motion, for which the party must satisfy the requirements of such Rule.

8 I also agree with Master Glustein that it would be illogical for the legal position of a party affected by such an order to depend upon whether there was compliance or partial compliance with the underlying order as the appellants argue based on *Warger v. Nudel*, [1989] O.J. No. 1880 (Ont. Master), aff'd (1990), 49 C.P.C. (2d) 126 (Ont. Div. Ct.). As the present proceeding and several of the cases cited to the Court demonstrate, even if there were no compliance, it is possible that the reasons for such non-compliance would be a relevant consideration for the motions judge in refusing to exercise the Court's discretion to grant the requested relief — for example, if the failure to post security were due to an unanticipated medical emergency that prevented compliance or a temporary computer problem at the Court presenting acceptance of new security deposits. In my opinion, justice and practical common sense compel the simple rule articulated above.

9 I do not agree with the appellants that such a result is unfair to the non-defaulting party and renders a "without notice" order meaningless, although I agree with Matlow J. in *Rolling Stone Haulage Ltd. v. Wilkinson, Tyrell, McKay Insurance Brokers & Consultants Ltd.*, [1997] O.J. No. 4018 (Ont. Div. Ct.), that such orders should be granted sparingly. "Without notice" orders are of value in circumstances in which there is no likelihood that the defaulting party will comply with the prior order because it has abandoned the action. On the other hand, for the reason set out above, if il transpires that a party has not abandoned an action and there is a dispute as to compliance with an earlier order with respect to which the defaulting party seeks to introduce responding materials, the dispute regarding the significance of the alleged non-compliance should be resolved on a motion back before the Master rather than on an appeal.

The Master's Finding Regarding the Absence of Notice

10 The Master also found that the Dismissal Order was made without notice so as to engage Rule 37.14(1)(a). The appellant argues that Master Glustein misapprehended the evidence and thereby made a palpable error in reaching this conclusion.

11 Rule 37.07(6) provided at the time that, where a motion was made on notice, the notice of motion was to be served at least four days before the date on which the motion was to be heard. In the present proceedings, while there is a dispute as to when the respondents received a copy of the Security for Costs Order, there is no dispute regarding the facts pertaining to delivery of the notice of the Dismissal Motion.

12 The appellants did not send a motion record to the respondents until March 19, 2009. On that date, the appellants sent a copy of the motion materials in English by express post and regular mail. However, the motion materials did not arrive until sometime during the following week. The notice of motion set out a return date of March 19, 2009, the date of transmittal. The motion record was also sent to two e-mail addresses but there is no evidence that the respondents received notice by this means prior to the hearing of the motion which, for unexplained reasons, was adjourned to March 25, 2009. On March 24, 2009, the appellants also sent a letter by e-mail to these two addresses advising of the revised date of the motion.

13 There is, therefore, no direct evidence that the respondents received notice of the Dismissal Motion in accordance with the *Rules* prior to the hearing of the motion on March 25, 2009. The appellants do not suggest there is such evidence. Instead, they say the Master should have inferred receipt based upon a complicated argument regarding the e-mail addresses used by Keelson Liu's assistants, which the appellants say demonstrates that Keelson Liu is not credible.

14 There is, however, insufficient evidence in the transcript of the cross-examination of Keelson Liu to support such an inference. On the evidence before the Master, he could reasonably conclude that it was more probable than not that the

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respondents did not receive the notice of the Dismissal Motion that was e-mailed to them on or about March 19, 2009 before March 25, 2009. Accordingly, Master Glustein could reasonably find that the respondents did not receive notice of the Dismissal Motion for the purposes of Rule 37.14(1)(a)

The Master's Decision to Set Aside the Dismissal Order

The Standard Applied By the Master

15 The Master correctly stated that, once the requirements of Rule 37. 4(1)(a) are satisfied, the matter is discretionary and requires the balancing of the interests of the parties involved: *John Wheelwright Ltd. (Trustee of) v. Central Transport Inc.*, 1996 CarswellOnt 3274 (Ont. Div. Ct.) at para. 4 . In this connection, the Master properly addressed whether the "draconian consequences" of striking the respondents' pleadings were justified in light of the breach of the Security for Costs Order.

The Master's Findings of Fact

16 As mentioned, the Master exercised his discretion in reliance on eight factors enumerated in his Endorsement.

17 In their factum, the appellants say that the Master erred in misapprehending the evidence in respect of four of such factors:

1. his conclusion that the respondents believed they had satisfied the Security for Costs Order;

2. his conclusion that the respondents sought and obtained new counsel shortly after they learned of the Security for Costs Order;

3. his conclusion that the respondents have shown a willingness by past conduct to abide by orders made by the Court; and

4. his conclusion that the respondents did not know about the Dismissal Motion until after it was heard.

18 On the evidence before the Court, however, I find that the Master did not misapprehend the evidence before him with respect to such findings of fact and could reasonably make all eight of the findings of fact upon which he relied in reaching his decision. I will address in particular the Master's findings of fact in respect of the four factors set out above.

19 First, as the basis for his finding that the respondents believed they had satisfied the Security for Costs Order by having the British Columbia property available as security for costs pursuant to an earlier order of the Master, the Master could reasonably rely on Keelson Liu's statement that he told his former solicitor to inform the court that he had already put up enough security. The appellants say the Master disregarded the fact that the respondents' former solicitor told or advised Keelson Liu by e-mail and telephone to pay the $300,000 into Court. These two pieces of evidence are not inconsistent. The issue is Keelson Lie's state of mind, not whether he was correct in his belief. He did not act in an unreasonable manner by continuing to assert his position after he engaged new counsel. The Master was entitled to make this finding of fact.

20 As a related matter, the appellants also submit that the Master erred in finding and relying upon the fact that the respondents did not understand the orders dated February 25, 2009 including, in particular, the Security for Costs Order. In particular, they say that the Master should have found that Keelson Liu understood the orders based on evidence of sufficient proficiency in English to comprehend the Security for Costs Order. They also suggest that the Court should disbelieve the respondents or, alternatively, should find that the respondents' behavior in asserting that they did not understand the orders dated February 25, 2009 was an abuse of process, in light of their previous attempt to set aside an earlier order on the same grounds.

21 I do not see an explicit finding in the Endorsement to the effect that Keelson Liu did not understand the orders of February 25, 2009 when it was brought to his attention. Instead, the Master's principal finding regarding Keelson Liu's state

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of mind was that Keelson Liu believed he had complied with the Security for Costs Order when it was explained to him. Such a finding presupposes some understanding of the Security for Costs Order and renders irrelevant the issue raised by the appellants. Even if the Master had made an implicit finding to the effect alleged by the appellants, the evidence before the Court could reasonably support the conclusion that, at least, initially. Keelson Liu did not understand the Security for Costs Order and for this reason sought counsel. Such a finding would be fully consistent with the Master's decision to set aside the Dismissal Order.

22 Second, the evidence amply demonstrates that the respondents sought and obtained new counsel after learning of the Security for Costs Order. The appellants position is that the respondents' evidence is contradictory. Any inconsistencies, however, do not vitiate the Master's conclusion. Two of the statements identified by the appellants indicate that the respondents began looking for new counsel sometime between the hearing on the Security for Costs Order and the hearing of the Dismissal Motion. A further statement that suggests a later date is clearly an error as the appellants themselves point out. It is inconsistent with the timing of the engagement of Pei Shing Wang. The last statement put the commencement after learning of the Dismissal Order. This is not inconsistent with the Master's finding.

23 Third, the Master has been the case management master for substantially all of this proceeding. He was therefore in a position to assess the respondents' conduct in its entirety. The appellants submit that the Master erred in finding that the respondents have shown a willingness by past conduct to abide by the orders made by the Court. The appellants dispute this by a bald statement and a further statement that, in their view, the six versions of the statement of claim demonstrate that the respondents' claim has no merit. The former statement is insufficient to displace the Master's finding given his familiarity with the proceeding. The latter is, of course, irrelevant as well as unproven.

24 Fourth, as mentioned, the Master could reasonably conclude that the respondents did not receive notice of the Dismissal Motion prior to the hearing of the motion on March 25, 2009. There is also no evidence that the respondents were aware of the hearing of the Dismissal Motion even if they were not served with the motion materials for such hearing. On this basis, the Master could reasonably conclude that the respondents did not know about the Dismissal Motion until after it was heard.

The Relevance of the Factors Considered by the Master

25 The appellants also argue that the Master exercised his discretion on the basis of wrong principles insofar as he took into consideration the eight factors set out in his Endorsement.

Background to the Security for Costs Order

26 The appellants sought the Security for Costs Order to replace a negative pledge given by a corporation owned by Keelson Liu and his wife in respect of a property in British Columbia owned by the corporation. The appellants had previously relied on this negative pledge as a form of security. However, for the negative pledge to provide effective security to the appellants, the assistance of the respondents' counsel given by way of a solicitor's undertaking was required. Such protection would disappear upon the removal of the respondents' former solicitor as their solicitor of record, which was also the subject of a motion on February 25, 2009.

27 Critically, the Security for Costs Order required payment of security for costs in the amount of $300,000 within ten days of the date of that order. There is no evidence as to how it was reasonable to expect the respondents to be able to satisfy an order of this magnitude in such a short period of time. It was not contemplated that the security would take the form of a mortgage on the British Columbia property and there is no suggestion that the property was in the process of being sold.

28 Instead, it appears that the appellants believed that the respondents' actions in the months leading up to the hearing on February 25, 2009, including their decision to discharge their counsel, indicated that the respondents had decided to abandon the action and would therefore not be posting any security for costs. Given that they did not expect the respondents to post security, it was not unreasonable for the appellants to seek an order for security for costs having a very short compliance period. To the extent that they thought the respondents had abandoned the action, it would also have been reasonable for them to obtain an uncontested dismissal of the action relatively quickly in reliance on the terms of the Security for Costs

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Order. There is nothing objectionable about this manner of proceeding provided that the underlying assumption, that the respondents did not intend to continue the proceeding, was correct.

The Basis of the Master's Conclusions

29 I think it is clear that, at the hearing of the motion for the Security for Costs Order, the Master proceeded on the tacit assumption that the respondents did not intend to continue their action. As the respondents were not represented at the subsequent Dismissal Motion, he approached that motion on the same basis. Indeed, he was encouraged to do so by language in the appellants' motion materials for the Dismissal Motion. This assumption is *also* implicit in the Master's choice of the factors upon which he relied in deciding to set aside the Dismissal Order, as is addressed below.

30 The Master's consideration of the eight factors must be reviewed against the backdrop of the two principal conclusions upon which he based his decision in the Endorsement.

31 First, the Master concluded, I think quite reasonably, that the evidence regarding the respondents' actions after receiving the Security for Costs Order, which was not before the Court on the hearing of the Dismissal Motion, demonstrated that, contrary to expectations, the respondents had not decided to abandon the action. In reaching this conclusion, the Master also implicitly rejected the appellants' argument addressed below regarding the nature and motivation of the respondents' actions after the motion for the Security for Costs Order was heard.

32 Second, the Master also found that the appellants would be not prejudiced if the Dismissal Order were set aside whereas the respondents would suffer significant prejudice. The Master had ample grounds for reaching this conclusion.

33 Most significantly, the appellants were unable to demonstrate any prejudice to them in the action given the short period of time between the Dismissal Order and the date of the letter of the respondents' present legal counsel advising that the respondents intended to move to set aside the Dismissal Order and were prepared to post the required security. The only prejudice the appellants assert is prejudice flowing from continuation of the litigation after the limitation date for commencement of a new action has passed. This is not legitimate prejudice in the present circumstances: see *Wellwood v. Ontario Provincial Police*, [2009] O.J. No. 235 (Ont. Div. Ct.) per Ferrier J.

34 To this argument, the appellants add the submission that the respondents' claim has no merit and therefore they are suffering prejudice from the mere continuation of the litigation. That may well be the case. However, on the record before him, the Master was not in a position to decide that issue on the motion for the Reinstatement Order nor is the Court able to do so on this motion. Moreover, as the case management master for this action, the Master was in the best position to assess whether the respondents' action was devoid of merit and he chose not to express any such conclusion.

35 In short, the appellants have failed to demonstrate prejudice, not even prejudice that is compensable by a payment of costs.

36 Accordingly, faced with the respondents' manifest intention to continue the action as evidenced by, among other things, the expressed willingness to post the security required under the Security for Costs Order, the Master concluded that it would be unjust not to set aside the Dismissal Order. In these circumstances, it was reasonable to conclude that the "draconian consequences" of dismissal of the respondents' action outweighed any prejudice to the appellants.

37 I therefore see no basis for setting aside the Master's exercise of this discretion on this basis. As mentioned, he applied the correct standard in exercising his discretion. The eight factors enumerated in the Endorsement are relevant to, and support, the two principal conclusions upon which the Master based the exercise of his discretion.

Appellants' Arguments that the Master Took into Account Irrelevant Considerations

38 The appellants submit, however, that the Masters exercise of his discretion was flawed in four respects.

39 First, they say that the Master should not have taken the four factors set out above into consideration because there was

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no reasonable basis for making the findings upon which such factors are based. Had the four factors been excluded, the Master's conclusion that the respondents had not abandoned the action would have been significantly weaker or unsupportable. I have, however, addressed this issue above in finding that the Master did not err in making the impugned findings of fact.

40 For the sake of completeness, I would add that, to the extent that the appellants may be arguing that these factors are also irrelevant considerations, I do not agree. Each of these factors is relevant to the Master's conclusion that the expectation that the respondents intended to abandon the action was incorrect and that the respondents intended throughout the relevant period to maintain the action notwithstanding their decision to discharge their counsel and their non-attendance at the hearing of the Dismissal Motion.

41 Second, the appellants submit that the Master erred in taking the following four factors into consideration:

1. that the respondents did not receive notice of the Security for Costs Order until after the deadline for posting security had expired (because the respondent Keelson Liu thought he had ten days to post security from the date of receipt of the Security for Costs Order and still did not pay it)

2. that immediately upon being retained, the respondents' current counsel advised that the respondents would seek to set aside the Dismissal Order;

3. that the respondents have participated in the litigation for almost four years; and

4. that the appellants' continuing counterclaim against the respondent Keelson Liu raises the same issues as those raised in the respondents' claim.

For clarity, I understand the appellants do not dispute the reasonableness of these determinations on the evidence but, instead, argue that they are irrelevant considerations on a motion brought under Rule 37.14(1)(a).

42 I do not agree that these factors are irrelevant and should not have been taken into consideration. The first and second factors are relevant as part of the factual matrix pertaining to the respondents' reaction to learning of the Security for Costs Order and the Dismissal Order. The two remaining factors are relevant to the issue of relative prejudice to the appellants and the respondents.

43 Third, the appellants argue that the Master should have refused to exercise his discretion on a purely technical reading of the Security for Costs Order. They say the Master should not have granted the Reinstatement Order because the respondents failed to comply within ten days of the Security for Costs Order or, alternatively, within ten days of receiving the order. As mentioned, they argue that the respondents understood the Security for Costs Order to require compliance within ten days of receipt and that, even if they did not receive the Security for Costs Order until March 12, 2009, the respondents had failed to comply with the Security for Costs Order by the date of the hearing of the Dismissal Motion. In short, they say there was noncompliance that entitled them to the Dismissal Order.

44 The crux of this argument is that the Master erred in taking into consideration the respondents' intention to continue their action and the prejudice to them given that intention. The appellants are essentially asking the Court to disregard the very basis upon which they obtained the Dismissal Order from the Master — their expectation that the respondents had abandoned the action and therefore, as a practical matter, any issue of fairness or practicality regarding the respondents' ability to understand and implement the order within 10 days of receipt was purely hypothetical.

45 For the reasons set out above, I do not think that the Master erred in exercising his discretion to set aside the Dismissal Order given the evidence before the Master regarding the respondents' intentions and the absence of prejudice to the appellants.

46 Lastly, the appellants submit that the evidence demonstrates that the respondents initially decided to abandon the action after receiving a copy of the Security for Costs Order on March 12, 2009 and that they reversed their decision only when they realized that they would lose their interest in the British Columbia property. Accordingly, they say that the Master erred in concluding that the discretion of the Court should be exercised in the respondents' favour. They say that the

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circumstances of this proceeding are similar to those in *Beneficial Investment (1990) Inc. v. Hong Kong Bank of Canada*, [2006] O.J. No. 1225 (Ont. Master), a decision of Master Dash. The appellants argue that the Court should hold the respondents to their earlier decision as it would be an abuse of the court system to permit them to change their decision. I would observe that, although this argument has been framed in terms of an error in prine ple in the taking into consideration of an irrelevant factor, it is principally an argument that the Master misapprehended the facts in refusing to find that the respondents acted in the manner alleged by the appellants.

47 I accept that such a finding could be a legitimate reason for refusing to set aside a dismissal order. This would be particularly persuasive in circumstances in which the non-defaulting party could establish a pattern of behaviour on the part of the defaulting party that suggested an intentional disregard for the judicial process, an absence of a real willingness to proceed with an action, or material prejudice to the non-defaulting party.

48 This is not, however, the case in the present action. I am not persuaded that the Master misapprehended the evidence with respect to the respondents' intentions after they received a copy of the Security for Costs Order. I am also not persuaded on the evidence before the Court that the Master erred in concluding that Keelson Liu's conduct in the litigation has not been so egregious as to warrant dismissal of the action.

49 Reading the transcript of the cross-examination of Keelson Liu in its entirety together with Ms affidavit in the motion materials for the motion heard on September 25, 2009, I conclude that the evidence fails to establish the appellants' position on a balance of probabilities. Instead, the evidence simply points to initial confusion on the part of Keelson Liu regarding the nature and import of the proceedings, followed by the engagement of new counsel with instructions, evidenced in the correspondence of such counsel, to seek an order setting aside the Dismissal Order. In particular, there is no evidence that the respondents failed to react until they received advice that there would be consequences for their interest in the British Columbia property. I would add that, as a consequence, the present circumstances are significantly different from the circumstances in *Beneficial Investment*.

Conclusion

50 For the reasons stated above, the appellants have failed to establish that the Master exercised his discretion on the basis of wrong principles or misapprehended the evidence such that there was a palpable and overriding error in his decision. The appeal of the Reinstatement Order is therefore dismissed.

Cost Award

51 The appellants also submit that the Master erred in awarding costs of $25,000 plus disbursements in favour of the respondents. They say that the Master should have regarded the circumstances as akin to those in *Royal Bank v. 1552680 Ontario Inc.*, [2005] O.J. No. 2884 (Ont. S.C.J.) at para. 34.

52 The award of costs is discretionary. I am not persuaded that the Master exercised his discretion improperly in the present matter. The appellants had previously been awarded their costs of the Dismissal Motion. They incurred no other costs arising therefrom of which I am aware. All of their costs thereafter resulted from a decision to oppose the respondents' motion to set aside the Dismissal Order.

53 I acknowledge that the respondents' motion turned, in part, on a legal issue regarding notice on which there is conflicting authority. Nevertheless, the Master was bound to take into consideration other issues that the appellants refuse to acknowledge because they believe the respondents' action to be entirely unmeritorious. The appellants chose to assert a failure to comply with an order that was never expected to be complied with. When it became apparent that the respondents did intend to continue the action, the appellants put forward an argument that the motion should be dismissed on technical grounds, disregarding the fact that the order was not intended to be complied with as well as the reason for the respondents' non-compliance, or alternatively on factual grounds that cannot be established, being an stileged reversal of a decision to abandon the action. This situation therefore presented several factors additional to those in *Royal Bank v. 1552680 Ontario Inc.*

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54 In these circumstances, while I might not have awarded costs in their entirety in favour of the respondents. I cannot find that the Master erred in the exercise of his discretion in awarding costs in their favour.

Appeal dismissed.

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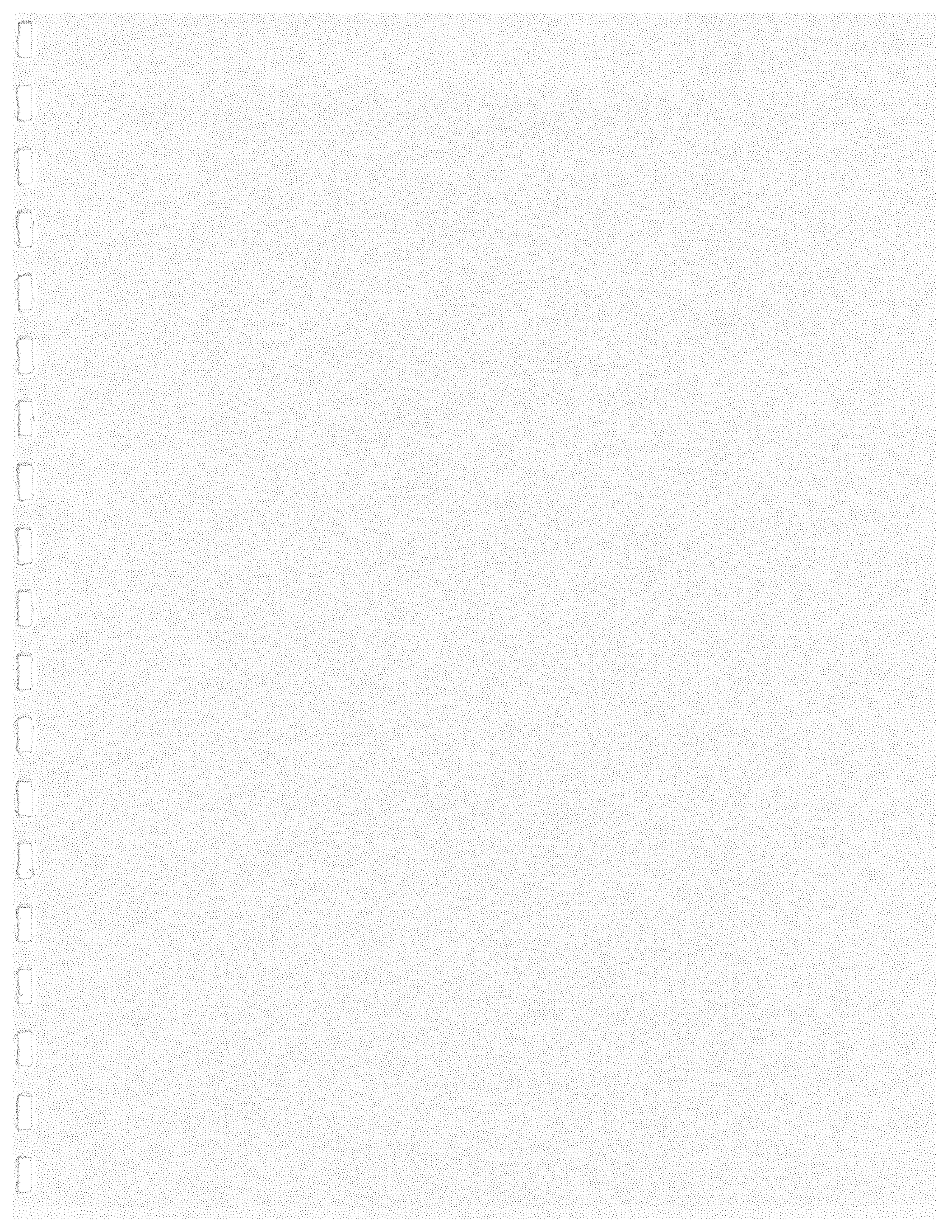

2011 ONSC 379
Ontario Superior Court of Justice (Divisional Court)

Liu v. Daniel Executive (Canada) Holdings Corp.

2011 CarswellOnt 432, 2011 ONSC 379, [2011] O.J. No. 355, 197 A.C.W.S. (3d) 365

Chi-Chun Liu, Chiun Li Biotechnology (BVI) Inc., Tien-Tsai Liu and Bau Shan Biotechnology Corp., Plaintiffs and Daniel Executive (Canada) Holdings Corp., Cheng-Shing Chen, and Shu-Chen Liu, Defendants

Ferrier J.

Heard: January 10, 2011
Judgment: January 24, 2011
Docket: Toronto 450-10

Proceedings: refused leave to appeal *Liu v. Daniel Executive (Canada) Holdings Corp.* (2010) ((Ont. S.C.J.))

Counsel: David Greenwood, for Plaintiffs
Ford W. Wong, for Defendants

Subject: Civil Practice and Procedure

Headnote

Civil practice and procedure --- Practice on appeal — Leave to appeal — Application — General principles

Civil practice and procedure --- Costs — Security for costs — Order for security — Miscellaneous

Table of Authorities

Cases considered by *Ferrier J.*:

Liu v. Daniel Executive (Canada) Holdings Corp. (2009), 2009 CarswellOnt 5942 (Ont. Master) — referred to

Rolling Stone Haulage Ltd. v. Wilkinson, Tyrell, McKay Insurance Brokers & Consultants Ltd. (1997), 16 C.P.C. (4th) 189, 1997 CarswellOnt 5371 (Ont. Div. Ct.) — considered

Vesely v. Dietrich (1998), 39 O.R. (3d) 541, 1998 CarswellOnt 4186 (Ont. Div. Ct.) — considered

Warger v. Nudel (1989), 39 C.P.C. (2d) 290, 1989 CarswellOnt 456 (Ont. Master) — considered

Warger v. Nudel (1990), 49 C.P.C. (2d) 126, 1990 CarswellOnt 434 (Ont. Div. Ct.) — referred to

Rules considered:

Rules of Civil Procedure, R.R.O. 1990, Reg. 194
R. 1.04(1) — considered

R. 1.04(1.1) [en. O. Reg. 438/08] — considered

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R. 37.14 — considered

R. 37.14(1)(a) — considered

R. 59.06(2)(a) — considered

R. 62.02(4)(a) — considered

R. 62.02(4)(b) — considered

Ferrier J.:

1 The Defendants seek leave to appeal the order of Honourable Mr. Justice Wilton-Siegel dated April 12, 2010 which upheld Master Glustein's September 25, 2009 [*Liu v. Daniel Executive (Canada) Holdings Corp.*, 2009 CarswellOnt 5942 (Ont. Master)] order. Master Glustein's September 25th, 2009 order set aside his own March 25, 2009 order dismissing the claims of the plaintiffs, Chi-Chun ("Keelson") Liu's and Chiun Li Biotechnology (BVI) Inc.'s (collectively referred to as the "Keelson plaintiffs").

2 On February 25, 2009, the Keelson plaintiffs' then counsel brought a motion to be removed as solicitor of record. On the same day, the defendants brought a motion for security for costs. The Master ordered the removal of the solicitor and ordered the Keelson plaintiffs to pay $300,000 security for costs within 10 days, failing which the defendants could move without notice to dismiss their action. The Keelson plaintiffs were unrepresented. The Keelson plaintiffs reside in Taiwan.

3 The Keelson plaintiffs did not provide the security and the defendant then moved without notice to dismiss the action. The Master dismissed the action by order dated March 25, 2009.

4 The circumstances following the granting of the order for security, including the significant efforts by the defendants to bring the security order to the attention of the Keelson plaintiffs and to advise them of the pending *ex parte* motion to dismiss, are reviewed in the decisions below.

5 The Keelson plaintiffs retained new counsel and in due course moved before Master Glustein to set aside the dismissal order, which he did by order dated September 24, 2009.

6 The reasons of the master reflect a thorough and careful analysis of the issues. He exercised his discretion and set aside the dismissal order. He did so pursuant to rule 37.14(1)(a). After reviewing the conflicting case law, he preferred the reasoning in *Rolling Stone Haulage Ltd. v. Wilkinson, Tyrell, McKay Insurance Brokers & Consultants Ltd.*, 1997 CarswellOnt 5371 (Ont. Div. Ct.)at para. 10, to that in *Warger v. Nudel*, [1989] O.J. No. 1880 (Ont. Master), *confirmed on appeal* (1990), 49 C.P.C. (2d) 126 (Ont. Div. Ct.), and the cases flowing from them respectively.

7 On appeal to Mr. Justice Wilton-Siegel, the learned judge, in an equally thorough and carefully reasoned decision, dismissed the appeal. He too recognized the conflict in the cases and preferred the *Rolling Stone* line of authority.

8 Thus, the Master clearly exercised his discretion correctly, without error in principle, unless rule 37.14(1)(a) had no application, and on that question there are conflicting decisions.

9 Thus, the first branch of rule 62.02(4)(a) is satisfied, and the question becomes whether it is "desirable that leave to appeal be granted".

10 In my view the answer to that question is no. In the circumstances following the making of the order for security, it is my view that it would be quite unjust to allow the dismissal to stand. That is not to say that the Keelson plaintiffs are without fault in their default and the circumstances as they developed following the security order. They could have been and should have been more diligent in paying attention to their affairs — namely, the substantial lawsuit in which they are involved and

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which they initiated.

11 To be sure, the argument that the conflict in the cases should be cleared up has considerable merit, but in my view this is not the case which should go forward on the issue. The circumstances here are particular to this case — Taiwanese plaintiffs, long distance communication aspects, a solicitor getting off the record immediately before the security order, some difficulty, however slight, in retaining new counsel, and a counterclaim which remains alive, involving many of the same issues in the claim.

12 Concerning rule 62.02(4)(b), notwithstanding the conflicting case law, I am not of the view that the matter is open to serious debate. A "motion without notice" is such whether it is permitted by the rules or by leave granted in an order. I agree with the analyses of the master and the judge below. Furthermore, in *Warger*, *supra*, the motion was brought pursuant to rule 59.06(2)(a) and the comments of Master Sandler concerning rule 37.14 and the *ex parte* motion in that case, would appear to be *obiter*. In *Vesely v. Dietrich*, [1998] O.J. No. 6475 (Ont. Div. Ct.), the court did not take the principle in *Warger*, *supra*, to be correct. The other authorities cited by the plaintiffs and referred to in the decisions below, are clearly distinguishable on their facts.

13 I am reinforced in this view by the provision of rule 1.04(1), that the rules shall be liberally construed to secure the just, most expeditious and least expensive determination of every civil proceeding on its merits. Sub-rule (1.1) specifically directs the court to consider proportionality. The dismissal of an action is quite obviously a very serious event, one which should be relieved against if there is a legitimate basis for the exercise of the court's discretion.

14 Even if I am wrong on the first branch of this sub-rule, for the reasons expressed above — the particular circumstances of this case — I am of the view that this is not the case which will advance the interests of the administration of justice in reference to the issue.

15 Accordingly, the motion for leave to appeal is dismissed.

16 On the question of costs, there was a reasonable argument that could be made in support of the motion for leave, in view of the conflicting cases. In the circumstances, there will be no order as to costs.

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Tab 2

2005 CarswellOnt 2889
Ontario Superior Court of Justice

Royal Bank v. 1552680 Ontario Inc.

2005 CarswellOnt 2889, [2005] O.J. No. 2884, [2005] O.T.C. 578, 140 A.C.W.S. (3d) 660, 18 C.P.C. (6th) 276

Royal Bank of Canada v. 1552680 Ontario Inc.

Quigley J.

Heard: June 2, 2005
Judgment: July 4, 2005
Docket: 01-BN-5253

Counsel: Tracy C. Warne, Q.C. for Debtor / Applicant
Robert J. van Kessel for Creditor / Respondent

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

Headnote

Civil practice and procedure --- Default proceedings — Defences to default proceedings — Error or inadvertence by defaulting party
Company was allegedly a garnishee with respect to third party — Bank obtained judgment against third party — Bank garnered default order against company to recover same amount owed by company to third party — Company did not oppose bank's initial application — Company did not appear, based on advice from third party's trustee that company's presence was not necessary — Company brought motion to set aside default order — Motion granted — Company satisfied test of overturning default judgment — Company did not appear due to mistake, based on reasonable belief at instance of supposedly knowledgeable person — Trustee had indicated to company that trustee had received legal opinion that company did not have to appear — Several triable issues existed for re-hearing.

MOTION by company to set aside default order.

***Quigley J.*:**

1 The issue in this motion is whether to set aside a default order under Rule 37.14(1)(b). That Rule

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permits the Court to set aside or vary an order where the applicant failed to appear on an earlier motion through accident, mistake, or insufficient notice.

2 In this application, 1552680 Ontario Inc., carrying on business as Oxygen Telecard Solutions, and under other trade names, (hereinafter referred to as "Oxygen") seeks to set aside an order of Corbett, J. dated March 1, 2005. That order granted judgment to the respondent (the "Bank") against Oxygen as garnishee for the amount set out in a notice of garnishment, which the Bank had served on Oxygen. Oxygen pleads that it failed to appear on that motion owing to inadvertence and a mistake based on a misunderstanding, and on that basis now requests that Corbett J's order be set aside under Rule 37.14.

3 Oxygen is a garnishee in respect of Tom Vachliotis ("Tom"), against whom the Bank had obtained a judgment under Corbett J.'s order. The Bank obtained a garnishment order against Oxygen for the same amount which was owed to it by Tom, because Oxygen had failed to respond to the Bank's notice of garnishment and failed to appear on the motion.

4 In support of its motion, counsel for Oxygen argues that Rule 37.14(1)(b) was designed to permit a person who mistakenly fails to appear on a motion to move to set aside or vary an order, provided that the notice of motion seeking to set aside, vary or amend the order is served forthwith after the order comes to the person's attention, and provided the moving party names the first available hearing date that is at least three days after service of the notice of motion. Oxygen argues that it meets both of these requirements.

5 Counsel for the Bank argues, however, that it is not open to the court to vary or set aside Justice Corbett's order under Rule 37.14. He says that if Oxygen disputes that order, then the proper procedure would be to appeal that order to the Court of Appeal. He says that Justice Corbett's order is a final order, and that the doctrine of *stare decisis* precludes this court from now granting an order under Rule 37.14 to set aside the order of Corbett J. In the alternative, counsel for the Bank argues that Oxygen is not in compliance with Rule 37.14(1)(b) since the requirement that the Notice of Motion to set aside the earlier order be brought forthwith has not been complied with by Oxygen.

Summary of Facts

6 Tom was indebted to the Bank. The Bank had obtained judgment against Tom in the sum of $68,543.39. The relationship between Tom and Oxygen is not entirely clear. The applicant relies on the affidavit evidence of Tom, Howard Cramer ("Howard"), and Mikki Fish ("Mikki") to support its contention that Tom was associated with but was not an "employee" of Oxygen. They say Tom was not receiving a salary, commission or other form of compensation from Oxygen that would be the subject of garnishment to satisfy Tom's debt to the Bank. Instead, Oxygen states that the intent when Oxygen was incorporated was that Tom would contribute so-called "sweat equity" in the hope that ultimately he would obtain an equity interest in the company, a salary and potential bonuses.

7 While it is acknowledged that Oxygen did make advances to Tom, Oxygen asserts that as of the date of the garnishment, and the date of this application, Tom did not have an interest in the company and he had not received any salary. As a result, Oxygen takes the position that it owed no monies or

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debts of any kind to Tom and thus is not an appropriate garnishee in respect of the judgment obtained by the Bank against Tom.

8 Not surprisingly, counsel for the Bank, presents a different view of the facts. He relies upon the same affidavits, but he draws contrasts between the evidence of the three deponents, Tom, Howard and Mikki given at different times in the proceedings and in cross-examinations on those affidavits, to show inconsistencies in Tom's evidence. He observes that at the time that Tom was examined in aid of execution on the judgment on October 4, 2004, he testified, contrary to earlier assertions, that he was the president and C.E.O. of Oxygen. At that time, Tom testified that he owned a significant shareholding position in Oxygen, that there were other shareholders, that two of the other employees were shareholders like him, and that his share of Oxygen was worth some $60,000 to $80,000. He indicated that he had been drawing "advances" from Oxygen on a basis that would be the equivalent of $50,000 per year.

9 Further, counsel for the Bank points out that Oxygen was paying certain of Tom's expenses, including his monthly car lease, and that Tom had contributed furniture from a prior failed business to Oxygen, in lieu of an investment of money. Thus, the Bank asserts that this evidence shows that there were and are amounts presently due to Tom from Oxygen that would justify and could be subjected to a garnishment order. It asserts that Oxygen wouldn't be paying any monies to Tom if he hadn't provided services, and that these were not mere advances

10 Based upon this evidence, the Bank served a Notice of Garnishment on Oxygen on or about November 23, 2004, to pay to the Sheriff the sum of $68,543.39 and also served a garnishee statement on Oxygen. During this period, communications between counsel for the Bank and the principals of Oxygen were not particularly co-operative, a point referenced in Corbett J's order of March 1, 2005. Counsel for the Bank indicates that he wrote to Oxygen on a couple of occasions in late 2004 and early 2005 requiring it to deliver a garnishee statement but that Oxygen did not comply. Finally, on the 1st of February, 2005, Oxygen faxed a response to counsel for the Bank indicating that Tom was not on the payroll of Oxygen. This was a one-line response provided by Oxygen to the letter sent by the Bank's counsel demanding completion of a garnishee statement. Corbett J. ruled that since the statement from Oxygen was expressed in the present tense, rather than referring to its prior relationship with Tom to which a garnishment order would relate, the statement was not substantively compliant with the Rules of Civil Procedure.

11 The next event of importance took place on February 3, 2005. On that date Tom advised the Bank that he had filed a proposal under the *Bankruptcy and Insolvency Act*. As a result of his bankruptcy proposal, Tom was advised by the Trustee in Bankruptcy that an automatic stay of proceedings arose.

12 One of the other principals, who was a minority shareholder and the general manager and director of operations of Oxygen, was under the same belief. He wrote to counsel for the Bank on February 24, 2005, enclosing with that letter a copy of the Summary Administration Notice of Stay of Proceedings issued by the Trustee. The Notice of Stay of Proceedings clearly refers to the action by the Bank against Tom. There is little doubt from the materials filed with the Court that Oxygen and its principals believed that the proceedings were stayed as against them as a result of the proceedings being stayed as against Tom. They believed that a stay of proceedings as against Tom also operated as a stay of proceedings

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against Oxygen, as potential garnishee. Whether right or wrong, there was a reasonable foundation for their belief insofar as the Trustee had written a letter attaching a copy of the court order in the bankruptcy action, and which contained reference to a legal opinion that she had obtained that the stay of proceedings had the effect of staying all proceedings relative to Tom. Clearly the Trustee was also of the belief that this included the garnishment proceedings brought against Oxygen relating to Tom's debt to the Bank.

13 Nevertheless, in correspondence with Oxygen, counsel for the Bank made it clear that he intended to proceed with his motion on the 1st of March. In response, having regard to the Trustee's communication, Oxygen provided Bank's counsel with a copy of the Stay of Proceedings in Tom's proposal proceedings, and advised in its reply letter that Oxygen would act accordingly and would not respond to the Bank's motion for garnishment, returnable March 1, 2005 based on that information.

14 Had the assumption, which had been communicated to it by the Trustee, and upon which Oxygen was relying, been correct, then it would have not been necessary for them to respond to the Bank's motion.

15 Regrettably for Oxygen, and as Bank's counsel succeeded in arguing on the motion, the Trustee appears to have been mistaken in its belief about the effect of the Stay of Proceedings owing to Tom's bankruptcy on the quite separate garnishment proceedings against Oxygen,. Consequently the advice that had been provided to the principals of Oxygen was also mistaken. Tom's bankruptcy did not give rise to a Stay of Proceedings with respect to the garnishment, but rather, only with respect to Tom. Up until this time, neither Oxygen nor its principals had retained counsel or received any legal advice with respect to their position.

16 The Bank proceeded with its motion on March 1, 2005. On that date, Justice Corbett gave the following endorsement:

> Mr. van Kessel, provided the Court with a notice from Oxygen Tele-Card indicating that the judgment debtor Tom Vachliotis has made a proposal under the Bankruptcy and Insolvency Act. Mr. van Kessel is prepared to accept that this statement, in a fax from the garnishee, is correct for the purposes of this motion.
>
> The notice of garnishment was served on November 23, 2004 and no proper response has been received to it. The one sentence letter dated February 1, 2005 speaks in the present tense, is inconsistent with prior sworn evidence from the debtor (a principal of the garnishee) and is not a complete and forthcoming response to the notice of garnishment. I decline to accept it as substantially compliant with the Rules of Civil Procedure.
>
> Finally, I note that the garnishee has had notice of this proceeding today and has elected not to attend apparently in the mistaken belief that this proceeding has been stayed by the proposal of Mr. Vachliotis.
>
> This is not a proceeding against Mr. Vachliotis. It is against the garnishee. It is not stayed and there is no reason to give the garnishee the benefit of the doubt, given its pathetic record of communication in this case. Further, the proceeding was commenced in the name provided by Mr.

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Vachliotis, a registered business style of 1552680 Ontario Inc. (among other business styles used by this company).

> 1. An order shall go amending the title to this proceeding to change the name of the garnishee to the corporation referred to in paragraph 1 of the order referenced in paragraph 2 of this endorsement; and
>
> 2. An order shall go in the form of the draft provided by counsel, which I have signed.

17 Following the issuance of Justice Corbett's orders, the Bank sought to enforce those orders by registering writs of seizure and sale and garnishing Oxygen's bank, the Bank of Montréal. However, Oxygen only became aware of the garnishment when it was served with the notice of garnishment on April 13, 2005, a full six weeks after Justice Corbett's orders were issued. The evidence shows that Oxygen immediately retained counsel, who immediately contacted counsel for the Bank to find out what had happened on the first of March. He was advised that Justice Corbett had concluded that the bankruptcy proposal did not stay proceedings respecting Oxygen, and had issued a garnishment order against it. Thereafter, on May 4, 2005, Oxygen served this Notice of Motion on the Bank seeking to vacate Justice Corbett's orders under Rule 37.14.

Analysis

18 Rule 37.14(1) provides that a person who fails to appear on a motion through accident, mistake or insufficient notice, may move to set aside or vary the order by a motion that is served forthwith after the order comes to the person's attention and which names the first available hearing date that is at least three days after service of the notice of motion. The position of counsel for Oxygen is quite straightforward. He argues that an innocent party should not be prejudiced by an inadvertent mistake, where that mistake was based on an understandable and legitimate belief, such as in the present case, that the action had been stayed. Further, he argues that as soon as the issuance of the order of garnishment came to the attention of Oxygen, it retained counsel and took steps to defend its rights by seeking a reversal of Justice Corbett's order. Finally, he argues that the second part of the test in Rule 37.14(1)(b) has also been met, in that he did commence this motion forthwith upon learning of the issuance of the order sought to be vacated.

19 As noted above, the Bank's counsel takes the position that the rule of *stare decisis* prevents this court from now vacating Justice Corbett's order under rule 37.14. He relies for this proposition on several authorities, including a decision of O'Connell J. of this court in *Zsoldos v. Assn. of Architects (Ontario)*, [2003] O.J. No. 2394 (Ont. S.C.J.). There, O'Connell J. referred to the admonition of the Court of Appeal that "attempts, whatever their form, to reopen matters which are the subject of a final judgment must be carefully scrutinized." (see *Tsaoussis (Litigation Guardian of) v. Baetz* (1998), 165 D.L.R. (4th) 268 (Ont. C.A.), at 277 and continued:

> Upon a motion to vary or set aside a Superior Court judge's final order, it is not within the motion court's jurisdiction to determine whether the judge erred in law on the merits or in the exercise of

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his discretion in proceeding in the absence of a party. It is also not within the court's purview, on motion to determine whether any bias against a party (or reasonable apprehension thereof) was evident in the conduct of the presiding judge. To obtain such relief, the plaintiff would have to exercise whatever rights he might have in the Court of Appeal under section 6(1)(b) of the *Courts of Justice Act*.

20 With great respect for the submissions of counsel for the Bank, and while I agree that the plaintiff's motion must be carefully scrutinized, in my view, the principle of *stare decisis* does not apply in the present case. First, as I read the principles enunciated by the Court of Appeal in *Delta Acceptance Corp. v. Redman*, [1966] 2 O.R. 37 (Ont. C.A.), the decision of Corbett J. does not establish a substantive rule of law. Corbett J. did not lay down any new principle, but merely decided a question based on the facts before him within the framework of an existing rule of law.

21 Further, this is not a case where the conclusion reached by Corbett J. is being argued to be wrong on its merits, having regard to the facts which were before him, but is instead an application under a Rule specifically designed for the purpose to vacate an order granted in circumstances where the failure of a party to appear is claimed to be attributable to a mistake. It does not challenge the order itself or the reasons for which it was given. It would be hard to conceive that Rule 37.14 could ever be operative to achieve its desired purpose of permitting an order to be vacated if the route which litigants were required to follow, faced with the circumstances which the Rule contemplates and in the face of a final order previously issued, were instead always to proceed to the Court of Appeal. As Clark J. stated in *Waites v. Alltemp Products Co.* [1987 CarswellOnt 442 (Ont. Dist. Ct.)], after adopting the approach of Borins J, as he then was, in *Strazisar v. Canadian Universal Insurance Co.* (1981), 21 C.P.C. 51 (Ont. Co. Ct.),

> A motion to rescind is not an appeal, but a substantive motion. The question is not alone whether the order should have been made initially but, whether having been made, it should be set aside.

22 I agree with Clark J. If this were not so, it is difficult to see that the potential relief provided to litigants under Rule 37.14 could ever be made available. Further, the approach adopted by Borins J. in *Strazisar* seems to me, to clearly favour Oxygen when applied to the facts of the present case. It is acknowledged that communications between the parties were difficult, and even though there were inconsistencies in Tom's evidence, the evidence supports Oxygen's position that it chose not to appear on the March 1st motion because of the advice it was given by Tom's Trustee, that his proposal in bankruptcy had eliminated the need for Oxygen to appear. Indeed, this conclusion appears not to have been without some legal support, since the Trustee itself indicated that it had received a legal opinion to the effect that Tom's proposal resulted in a stay of proceedings not only as against him, but also as against Oxygen as potential garnishee.

23 As such, in my view, Oxygen has satisfied the test in Rule 37.14(b) of establishing that its failure to attend on March 1, 2005 was attributable to mistake or inadvertence, based upon a reasonable belief at the instance of a supposedly knowledgeable person, the Trustee, that the proposal filed by Tom served as well to stay the garnishment proceedings against Oxygen. Further, I accept the explanation of Oxygen's counsel for the time frame within which he took steps to bring this motion and find that he did bring the motion "forthwith." As such, Oxygen's motion under Rule 37.14(b) for an order vacating the

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March 1, 2005 order of Corbett J. is granted.

24 I would emphasize, that in granting Oxygen's motion, the Court is specifically not commenting on the merits of the garnishment proceedings themselves. Clearly there is at least one, if not more, triable issues. These include the status of Tom within the Oxygen organization, whether he was an employee and whether amounts paid by Oxygen to Tom as "advances" should instead be regarded as remuneration or other amounts due to Tom, which could properly be the subject of the garnishment order, as distinct from advances, which being in the nature of a loan, could not.

Terms and Costs

25 It remains to impose terms, respecting the granting of this order, and to address the issue of costs. Both counsel were invited to and made written submissions on both points.

26 Counsel for the Bank requests an order for a payment into court of the judgment amount, amongst other terms, including that the Writ of Seizure and Sale registered by the Bank shall remain in place, but be stayed pending further order of the court. He seeks payment of the order for costs made by Justice Corbett in the sum of $2000, and delivery to the Bank at Oxygen's expense of copies of all of its financial records and its minute books within 21 days.

27 As to costs of this motion, counsel for the Bank requests its costs on a partial indemnity scale. The Bank's counsel notes that on a motion to set aside a default judgment, the usual disposition would be for the moving party to pay the costs of the motion and the costs thrown away, and submits, by analogy, that this should be the disposition in this case. He observes that these costs might have been avoided by Oxygen, simply by serving a garnishee statement in response to any of the Bank's three requests made between November of 2004 and February of 2005. He therefore requests, costs of the motion and costs thrown away in the sum of $11,416.09 in accordance with a Bill of Costs attached to his submission.

28 For its part, Oxygen submits that an order requiring the payment of any amount of money into court is a completely inappropriate term. He takes this position, based on the evidence of the witnesses for Oxygen that Tom was not on the payroll and was not owed monies by Oxygen. The evidence of Tom and Mikki, was that amounts paid to Tom were in the nature of "advances". Counsel argues that advances, at law, are loans against monies to be earned. In other words, in receiving advances from Oxygen, Tom is simply obtaining loans against future earnings. Loans could not be the subject matter of the garnishment order.

29 Further, counsel for Oxygen argues that even if the Bank is successful on the ultimate motion, it can only be successful in requiring Oxygen to pay to the Bank, or indeed to pay into Court, the monies it otherwise should have paid to the Bank from the date of service of the original Notice of Garnishment on November 23, 2004 until the Order of Mr. Justice Corbett, on March 1, 2005. Based upon Tom's evidence, if the $50,000 a year advance amount that he claimed to be receiving was found by the Court to be salary, and was prorated for a three-month amount, and multiplied by 20%, (being the percentage stipulated under the *Wages Act* as the maximum amount claimable by the Bank against Oxygen under a

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garnishment order), plus three months of lease payments on the car, then the amount would total $2,920. Instead, counsel for Oxygen suggests that the only appropriate term that should be imposed is a requirement that Oxygen give an appropriate response to the garnishee within 21 days.

30 As to the request that the Court order the payment of the $2000 amount for the March 1st costs, which was ordered by Corbett J. having regard to Oxygen's failure to attend on that date, Oxygen is agreeable to paying that amount. Further, Oxygen agrees to present its financial records and Minute Books for the inspection of the Bank within 21 days, as requested by counsel for the Bank.

31 With respect to costs, counsel for Oxygen argues that costs follow the event, and therefore claims costs on a substantial indemnity basis for a full day's motion as the successful party. He takes the position that the Bank and its counsel should have an consented to an Order setting aside Justice Corbett's order as soon as they were put on notice that a motion would be brought, instead of vehemently opposing the application and conducting vigorous cross-examination.

32 Having heard from both parties as to terms, the Court concludes that any payment into Court is inappropriate under the circumstances and that the Writ of Seizure and Sale cannot remain in place. The fact is that the status of payments made by Oxygen to Tom is central to the dispute between the parties. If the amounts payable by Oxygen to Tom constitute salary, wages or other amounts due to him, then a garnishment order against Oxygen would be appropriate. However, if there is no employee relationship, such that the amounts paid and payable by Oxygen to Tom do merely constitute "advances" against future earnings, then no garnishment order would be appropriate. The status of these payments, and Tom's entitlements is the principal issue between the parties, which will need to be resolved upon a further argument of the garnishment motion itself. As such, it is inappropriate in my view to require a payment into court of the sum in issue as a sort of secured amount when entitlement to that sum is the central issue requiring determination.

33 As such, the terms upon which the Order will go, include that no money shall be paid into Court until the Court is satisfied on the subsequent argument of the motion that Oxygen did indeed owe money to Tom which could be the subject matter of a garnishment order. However Oxygen shall be required to give an appropriate response to the garnishee within 21 days. Further, Oxygen shall pay the $2000 in costs ordered by Corbett J., because of its failure to attend on the March 1st motion date. Finally, Oxygen shall provide its financial records and Minute Books to the Bank for inspection within 21 days of the date of this order.

34 As far as the costs of this motion to set aside are concerned, however, and while costs typically follow the cause, in my view, this would be quite inappropriate in this case. Oxygen argues that the Bank should have consented to an order vacating the order of Corbett J. I do not agree. There was a reasonable position put forward by the Bank, which had a reasonable legal argument behind it. Had Oxygen taken the step of retaining counsel at an earlier time, perhaps all of this cost could have been avoided. In my view, Oxygen is responsible for the costs incurred on this motion to vacate, and notwithstanding that the order sought by Oxygen is being granted, I see no reasonable basis to reward them for their conduct. In the *Strazisar* case referred to above, Borins J awarded costs to the defendant even though it was the unsuccessful party on the motion. In that case, he observed that the defendant's position was far from hopeless, and that the defendant clearly had an arguable case. I think the same can

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be said in this instance, and accordingly, the Bank shall have its costs of the motion and costs thrown away in the sum set forth in a Bill of Costs presented by the Bank to the Court totaling $11,416.09.

Motion granted.

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Tab 3

IN THE COURT OF APPEAL OF NEW ZEALAND

CA553/2011
[2013] NZCA 357

BETWEEN	STRATEGIC FINANCE LIMITED (IN RECEIVERSHIP & IN LIQUIDATION) AND STRATEGIC NOMINEES LIMITED (IN RECEIVERSHIP) Appellants
AND	DAVID JOHN BRIDGMAN AND CRAIG ALEXANDER SANSON First Respondents
AND	COMMISSIONER OF INLAND REVENUE Second Respondent

Hearing:	27 March 2013
Court:	Arnold, Stevens and White JJ
Counsel:	M J Tingey and T B Fitzgerald for Appellants No appearance for First Respondents P W O'Regan and N M H Whittington for Second Respondent
Judgment:	9 August 2013 at 10.30 am

JUDGMENT OF THE COURT

A The application by the appellants for leave to adduce further evidence is declined.

B The appeal is allowed in respect of the engineering and construction bonds of $3,000 which are payable to the appellants, but in all other respects the appeal is dismissed.

C The appellants are to pay the second respondent's costs for a standard appeal on a band A basis and usual disbursements. We certify for two counsel.

REASONS OF THE COURT

(Given by White J)

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Introduction

[1] This appeal involves a dispute between the appellants, Strategic Finance Ltd (in rec and in liq) and Strategic Nominees Ltd (in rec), (Strategic), the only remaining secured creditors in the liquidation of Takapuna Procurement Ltd (Takapuna), and the second respondent, the Commissioner of Inland Revenue, (the Commissioner), the only remaining preferential creditor in the liquidation. The dispute relates to various categories of funds totalling $782,108.18 plus accrued interest held by the first respondents, David Bridgman and Craig Sanson (the liquidators of Takapuna) who abide the Court's decision.

[2] Strategic claim that their general security agreement (GSA) over Takapuna's personal property entitles them to all the funds held by the liquidators essentially because under the relevant provisions of the Companies Act 1993 the Commissioner's claim as a preferential creditor is limited to "book debts" and therefore does not include most of the categories of funds at issue. Strategic also claim on the basis of other legal principles that one of the categories, namely a GST refund of $169,349.86, released by the Commissioner to Takapuna "in error" after the liquidation, should not in any event be repaid to the Commissioner.[1]

[3] In the High Court Associate Judge Gendall rejected Strategic's claims and ordered that all the funds be paid to the Commissioner.[2] The grounds for his decision were:

(a) it would be unfair and unconscionable for the GST refund of $169,349.86 to be retained by the liquidators;[3]

(b) the expression "accounts receivable" in sch 7, cl 2(2) of the Companies Act is not limited to book debts;[4] and

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1 Restitution and the rule in *Re Condon, ex parte James* (1874) LR 9 Ch App 609 (CA).
2 *Burns v Commissioner of Inland Revenue* (2011) 10 NZCLC 264,885 [the High Court decision].
3 At [45].
4 At [101].

(c) the funds held by the liquidators of Takapuna are "accounts receivable" and therefore payable to the Commissioner as the only preferential creditor.[5]

[4] Strategic challenge each of these grounds, but advance their appeal first through grounds (b) and (c). Ground (a) arises only if Strategic are successful in their challenge to grounds (b) and (c). A central question for our determination is the meaning of the term "accounts receivable" for the purposes of the regime established under the Personal Property Securities Act 1999 (the PPSA). As the assets of Takapuna are insufficient to meet the Commissioner's preferential claim without recourse to the personal property the subject of Strategic's GSA, the question is whether the funds of $782,108.18 held by the liquidators are available to meet the Commissioner's claim in priority to Strategic's security interest.

[5] We first set out the background to the appeal, which is largely undisputed, before addressing the issues raised by Strategic.

Background

[6] Takapuna was a property developer whose business included a development in Takapuna called Shoalhaven. Strategic provided Takapuna with a loan facility of up to $10,988,000 plus capitalised interest and fees for the development which was secured by the GSA, dated 20 May 2003, and a second mortgage registered over the Shoalhaven property. The GSA, which gave Strategic security over all of Takapuna's "present and after-acquired personal property, and all of [Takapuna's] present and future rights in relation to any personal property", was registered on the Personal Property Securities Register.[6]

[7] On 21 November 2008 the High Court at Auckland put Takapuna into liquidation on the application of the Commissioner.[7] Messrs Grant Burns and

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[5] At [108]–[109] and [113].

[6] On 22 May 2003 and re-registered on 4 April 2008.

[7] *Commissioner of Inland Revenue v Takapuna Procurement Ltd* HC Auckland CIV-2008-404-4659, 21 November 2008.

Richard Agnew of PricewaterhouseCoopers (PwC) were appointed as liquidators, but they were subsequently replaced by the first respondents.[8]

[8] In the course of the liquidation of Takapuna the liquidators received proofs of debt from:

(a) Strategic claiming $7,056,000 under their securities; and

(b) the Commissioner claiming $3,625,493.51 as a preferential creditor for GST arrears plus interest and costs.

[9] The liquidators have collected funds totalling $782,108.18 plus accrued interest comprising the following four different categories:

(a) refunds to Takapuna from the North Shore City Council (the NSSC) of:

(i) development contributions paid earlier by Takapuna to the Council ($451,176.94);

(ii) bonds paid earlier by Takapuna to the Council ($3,000);

(b) the GST refund of $169,349.86 released by the Commissioner of Inland Revenue to Takapuna "in error"; and

(c) various funds held by Takapuna's solicitors ($158,581.38).

Development contribution refunds ($451,176.94)

[10] These funds, which were received by the liquidators from the NSCC, were refunds of development contributions paid by Takapuna to the NSCC prior to the liquidation. The contributions were required from developers on development project approvals under NSCC 2004 and 2006 development contributions policies.

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8 *Strategic Finance Ltd (in rec) v Bridgman* CA553/2011, 19 March 2012.

[11] In March 2007 the High Court decided in judicial review proceedings not involving Takapuna that the NSCC had made a number of errors of law in adopting its development contribution policies.[9] The Court did not, however, address matters of relief or remedy and no declaration of invalidity was made.[10] Instead it was left to the parties to negotiate those matters in light of the principles in the judgment.

[12] There is no evidence before this Court of any negotiations between the parties to the judicial review proceeding as to relief or remedy. Nor is there any evidence of any decision having been made by the NSCC to make any refunds to Takapuna prior to its liquidation on 21 November 2008.

[13] The evidence establishes, however, that after the liquidation of Takapuna the following steps were taken by the NSCC:

(a) on 29 January 2009 the NSCC refunded to the liquidators overpaid development contributions of $2,297.50;

(b) on 1 July 2009 the NSCC reassessed the development contributions paid under the 2004 and 2006 policies and resolved to pay the difference between the amounts paid by Takapuna and the amounts payable under the reassessed policies (plus interest); and

(c) on 7 August 2009 the NSCC refunded the development contributions of $448,879.08 to the liquidators.

Engineering and construction bonds ($3,000)

[14] Prior to the liquidation, Takapuna paid engineering and construction bonds to the NSCC in connection with the Shoalhaven development. In accordance with standard practice, the bonds were refunded after the NSCC concluded that the development was compliant with the council development code. This occurred on 15 January and 16 April 2009, that is, after the liquidation of Takapuna.

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9 *Neil Construction Ltd v North Shore City Council* [2008] NZRMA 275 (HC) at [289]–[291].
10 See at [2] and [294].

GST refund ($169,349.86)

[15] On 3 December 2008, shortly after Takapuna was put into liquidation, the Commissioner repaid $169,349.86 in respect of claimed GST overpayments that Takapuna had made in the period before its liquidation.

[16] Although Takapuna was put into liquidation on 21 November 2008, one of its directors filed Takapuna's GST return for the period ending 31 October 2008 on 28 November 2008. The return showed that Takapuna was entitled to a refund of $169,349.86 in respect of GST overpayments in the period before its liquidation.

[17] Notwithstanding the fact that at that time Takapuna's GST payment arrears exceeded $3,600,000, the Inland Revenue Department employee who reviewed Takapuna's GST return of 28 November 2008 arranged for the refund of $169,349.86 to be paid.

[18] The Commissioner's position is that, even if the refund is not, as the High Court concluded, an "account receivable", the refund was paid by mistake and that she therefore has a proper claim to the money under restitution principles or alternatively the liquidators should be directed to return the funds under the rule in *Re Condon*.[11]

[19] Strategic take issue with the Commissioner's position and the findings of the Associate Judge. Strategic also seek to rely on a PwC file note dated 10 December 2008 recording a telephone conversation between an employee of PwC and an employee of the Inland Revenue Department relating to the GST refund, a copy of which was provided to this Court by counsel. The Commissioner strongly opposes this Court admitting the file note in evidence or giving any weight to it as it was not in evidence in the High Court and was not the subject of an application to this Court for leave to adduce further evidence.[12] At the hearing of the appeal we indicated that we would receive the file note on a de bene esse basis and rule on its admissibility in

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11 *Re Condon*, above n 1.

12 Under the Court of Appeal (Civil) Rules 2005 [the Rules], r 45(1).

our judgment. We address this issue and the factual background to this ground of appeal later.[13]

Carter Atmore funds ($158,581.38)

[20] These funds were held by Carter Atmore, Takapuna's former solicitors, in their trust account on behalf of Takapuna and comprised:

(a) body corporate levies of $28,021.88 refunded to Carter Atmore on behalf of Takapuna (in liquidation) on 4 December 2008 by the body corporate managers for the Shoalhaven development;

(b) deposits paid for the purchase of units in the Shoalhaven development prior to the liquidation: two by purchasers whose deposits were forfeited when their contract was cancelled and one by a purchaser whose contract was amended and whose deposit was applied to the purchase price of a property from Takapuna;

(c) rental payments paid by Quinovic Property Management Ltd before the liquidation for rental properties managed for Takapuna;[14]

(d) sourcing fees totalling $10,187.38 reimbursed from Investors Forum NZ Ltd and settlement funds in relation to another Shoalhaven unit, both paid to Carter Atmore prior to liquidation; and

(e) "miscellaneous funds" consisting of refunds for overpayment of general rates, water charges and legal fees.

[21] The case for Strategic is that none of the four categories of funds (the development contribution funds, the engineering and construction bonds, the GST refund and the Carter Atmore funds) constituted "accounts receivable" by Takapuna as at the date of its liquidation. They are therefore not available for the Commissioner as a preferential creditor under s 312 of the Companies Act and

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13 Below at [117]–[118].
14 High Court decision, above n 2, at [112].

remain subject to Strategic's GSA. Nor is the GST refund recoverable by the Commissioner on the basis of restitution principles or the decision in *Re Condon*.

[22] As the issues raised on the appeal arise in the context of Strategic's GSA and the preferential creditor regime, it is convenient to describe the nature and scope of the GSA and the preferential creditor regime before turning to the interpretation of the relevant statutory provisions.

Strategic's GSA

[23] Strategic's GSA was designed to provide Strategic with the broadest possible security for their loan facility over Takapuna's personal property. Strategic, which made the advance to Takapuna (a development company) through Strategic Nominees Ltd, their finance company, were concerned to ensure that in the event of Takapuna being unable to meet its loan repayment obligations they had access to all of Takapuna's personal property. The GSA was therefore in standard form, creating a security interest under the PPSA over both Takapuna's "present and after-acquired personal property" and all of Takapuna's "present and future rights in relation to any personal property".[15]

[24] The GSA contains the broad PPSA definition of "personal property" as including chattel paper, documents of title, goods, intangibles, investment securities, money, and negotiable instruments.[16] As the inclusive nature of this definition[17] and the further definitions of each of the included items[18] indicate, the scope of the expression "personal property" is broad.[19] For present purposes we note that it encompasses, but is clearly not limited to, "accounts receivable". As Mr Tingey

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15 Personal Property Securities Act [PPSA], s 17.

16 Clause 2(j) of the general security agreement [the GSA]; PPSA, s 16.

17 JF Burrows and RI Carter *Statute Law in New Zealand* (4th ed, LexisNexis, Wellington, 2009) at 417–421.

18 Section 16: the PPSA provides for three broad classes of collateral which are intended to be mutually exclusive and comprehensive of all personal property not otherwise excluded from the PPSA by the operation of s 23: "goods", which consist of the sub-categories of "consumer goods", "inventory" and "equipment"; five classes of "documentary" or "quasi-intangible" securities: "chattel paper", "documents of title", "negotiable instruments", "investment securities" and "money"; and "intangibles" – the residual category which includes "accounts receivable".

19 Linda Widdup *Personal Property Securities Act: A Conceptual Approach* (3rd ed, LexisNexis, Wellington, 2013) at 71. For a discussion of the limits of "personal property" and "questionable" personal property, see Widdup at 11–19.

submitted, "accounts receivable" is a sub-category of "intangibles" which is in turn a category of "personal property" under the PPSA.[20]

[25] The GSA does not contain a definition of "after-acquired personal property". The PPSA definition of "after-acquired property" as meaning personal property acquired by a debtor after the security agreement is made will therefore be applicable.[21] It was assumed in the High Court,[22] and by the parties on appeal, that the liquidation of Takapuna did not prevent Strategic's GSA from attaching to such property. As the assumption is consistent with both the PPSA requirements relating to attachment,[23] and the scheme of Part 16 of the Companies Act,[24] we proceed on the same basis.[25]

[26] Neither the GSA nor the PPSA contains a definition of the expression "present and future rights in relation to any personal property".[26] The expression is clearly intended to widen the scope of Strategic's security and would include at least all "interests" in personal property within the broad meaning of the term "security interest" under the PPSA. The term is defined in s 17(1)(a) as meaning:

> ... an interest in personal property created or provided for by a transaction that in substance secures payment or performance of an obligation, without regard to—
>
> (i) the form of the transaction; and
>
> (ii) the identity of the person who has title to the collateral ...

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20 Section 16.

21 Section 16. See also ss 43–44.

22 High Court decision, above n 2, at [3].

23 PPSA, s 40(1)(b).

24 Companies Act, ss 248(2), 312 and 313; *Dunphy v Sleepyhead Manufacturing Co Ltd* [2007] NZCA 241, [2007] 3 NZLR 602 at [43].

25 Under the old regime the crystalisation of a floating charge did not prevent a floating charge which covered future assets from applying to assets acquired after the charge crystallised: *N W Robbie & Co Ltd v Witney Waterhouse Co Ltd* [1963] 1 WLR 1324 (CA); *Ferrier v Bottomer* (1972) 126 CLR 597; and *Elders Pastoral Ltd v TAS Enterprises Ltd* HC Hamilton CP39/86, 11 June 1987. Such a charge would not, however, extend to monies recovered by a liquidator pursuant to provisions proscribing preferences: *Re Yagerphone Ltd* [1935] Ch 392 (CA); *NA Kratzman Pty Ltd (in liq) v Tucker (No 2)* (1968) 123 CLR 295; and *Re Hibiscus Coast Marine Centre Ltd (in liq)* (1986) 3 NZCLC 99,615 (HC) (the justification for this exception has, however, been questioned: Michael Gedye "What is an 'Account Receivable'?" (2009) 15 NZBLQ 168 at 176).

26 Although the Law Commission anticipated the use of security agreements which: "provide simply that the debtor grants a security interest in 'all present and after-acquired property'": Law Commission *A Personal Property Securities Act for New Zealand* (NZLC R8, 1989) at 111.

[27] The broad scope of the meaning of "security interest" is reinforced by the provisions in the PPSA relating to security interests in after-acquired property[27] and the proceeds of personal property.[28] A security interest in collateral that is dealt with or otherwise gives rise to "proceeds" continues in the collateral,[29] unless the secured party expressly or impliedly authorised the dealing, and extends to the proceeds.[30]

[28] The question whether the reference in the GSA to "present and future *rights*" (emphasis added), as distinct from "interests", extends the scope of the GSA further does not arise in this case and was not argued. If it had arisen, it might have been necessary to consider the scope of the PPSA and whether, notwithstanding the PPSA, it was open to the parties to extend their agreement beyond the scope of the Act.[31] While, as permitted by the PPSA,[32] Strategic and Takapuna contracted out of the enforcement provisions of the PPSA,[33] it is at least doubtful whether they could either contract out of, or effectively extend, the scope of other provisions of the Act.[34] We do not, however, need to decide these questions.

[29] Applying the relevant definition provisions of the GSA and the PPSA, we have little difficulty in concluding that all of the funds in dispute in this case constituted after-acquired personal property or the proceeds of such property over which Strategic's GSA provided a security interest. The development contribution refunds, the engineering and construction bonds and the GST refund were all the personal property of Takapuna received by the liquidators of Takapuna after the liquidation of Takapuna. The Carter Atmore funds were also the personal property of Takapuna held by Carter Atmore in their trust account prior to the liquidation.

[30] On this basis under the terms of Strategic's GSA and the relevant provisions of the PPSA Strategic have a security interest in all of the disputed funds entitling them as the remaining secured creditors of Takapuna to receive the funds from the

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27 Sections 43–44.
28 Sections 45–47.
29 Section 16: "identifiable or traceable personal property".
30 Section 45.
31 Section 23. See also *Saulnier v Royal Bank of Canada* 2008 SCC 58, [2008] 3 SCR 166.
32 Section 107.
33 GSA, cl 25.
34 Section 35 provides as a starting point that the parties' agreement will be effective in its own terms, unless it is inconsistent with statute.

liquidators unless their rights as secured creditors are defeated by the Commissioner as the remaining preferential creditor or, in the case of the GST refund, the Commissioner's other claims.

[31] The Commissioner did not really challenge the view that Strategic would be entitled to receive the funds if the Associate Judge's decision is not upheld. Mr O'Regan did submit that if the funds were not "accounts receivable" as claimed by Strategic, then Strategic would not be entitled to them under the GSA, but this submission was made in the context of responding to Strategic's submissions on the interpretation of the term "accounts receivable" and not in the context of the interpretation and application of the GSA and PPSA to the categories of personal property held by the liquidators after the liquidation of Takapuna.

[32] The crucial issues on this appeal therefore relate to the nature and scope of the preferential creditor regime and the Commissioner's claims in respect of the GST refund. Is Strategic's entitlement as the remaining secured creditor defeated?

The preferential creditor regime

[33] Statutory regimes conferring preferential creditor status on various categories of creditors in the bankruptcy of individuals and the receivership or liquidation of companies have been in place in New Zealand for many years.[35] The categories of preferential creditor have included the Official Assignee, receivers and liquidators in respect of their costs and expenses, employees in respect of their wages and the Commissioner in respect of unpaid tax, including GST. While there have been

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[35] Initially legislation granted preferential creditors priority over other unsecured creditors, but the development of the floating charge – first recognised in *Re Panama, New Zealand and Australian Royal Mail Co* (1870) 5 LR Ch App 318 (CA) – which enabled a company to grant a charge over substantially the whole of its assets led to legislation for the priority for the payment of preferential debts from the proceeds of a floating charge. In respect of personal insolvency see: Bankruptcy Act 1867, ss 216–217; Bankruptcy Act 1883, s 137; Bankruptcy Act 1892, s 120; Bankruptcy Act 1908, s 120; Insolvency Act 1967, s 104; Insolvency Act 2006, s 274–275. In respect of companies: Companies Act 1882, s 172; Companies Amendment Act 1890; Companies Act 1903, s 260; Companies Act 1908, s 260, Companies Amendment Act 1928, s 2; Companies Act 1933, s 159; Companies Act 1955, ss 205, 209P(c), 229(5) and 286 and sch 8C; and Companies Act 1993 ss 234, 312 and sch 7.

suggestions that the Commissioner's preferential status should not be retained,[36] these views have not been accepted by Parliament.[37]

[34] In the case of a company receivership or liquidation, amounts owed to preferential creditors are given priority in two different situations:

(a) If the assets of the company are sufficient to meet the claims of preferential creditors without recourse to any personal property of the company the subject of a security interest under the PPSA, the preferential creditors will be paid ahead of all unsecured creditors.[38]

(b) But, if the assets are insufficient to meet the claims, they will rank ahead of secured creditors with security interests in respect of certain prescribed categories of personal property.[39]

[35] Prior to the amendment of the Companies Act to bring it into line with the PPSA, the prescribed categories of personal property comprised the assets which were the subject of "a floating charge" and included a charge that conferred a floating security at the time of its creation but had since become a fixed or specific charge.[40] A floating charge provided a lender with security over a debtor company's personal property, including its inventory, bank accounts and deposits, book debts

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36 Law Commission *Priority Debts in the Distribution of Insolvent Estates Advisory Report to the Ministry of Commerce* (NZLC SP2, 1999) at [248].

37 Current categories of preferential creditors a liquidation consist of: (1) claims by employees for unpaid wages and salaries, holiday pay, redundancy compensation and outstanding deductions for reimbursement of lost wages and employee Kiwisaver contributions; (2) claims by layby sale creditors and holders of liens over company documents and costs related to creditors' compromise meetings; and (3) Crown claims for GST, PAYE, withholding tax and customs duties, see Liesle Theron "The Liquidation Process" in Paul Heath and Michael Whale (eds) *Insolvency Law in New Zealand* (LexisNexis, Wellington, 2011) 397 at [16.36].

38 The preferential creditor regime is contained in sch 7 of the Companies Act.

39 Sub-clauses 2(1)(b)(i)(B) and (C) of sch 7 (and their iterations under related legislation) recognise that under the pre-PPSA law some interests in inventory (such as retention of title clauses) and accounts receivable (such as assignments of single accounts receivable) took priority over preferential creditors. The PPSA approximations of those interests (purchase money security interests and transfers of a single account receivable) replicate, as far as possible, the earlier position. No such interests arise in this case.

40 Companies Act, sch 7, cl 9 (as it then was); Companies Amendment Act 1999; and Personal Property Securities Amendment Act 2001.

and other debts.[41] The charge was described as "floating" because the debtor company was left free to deal with its "circulating assets" until some future event such as default on the debt secured or liquidation.[42]

[36] It was the "long-troubling" distinction between fixed and floating charges,[43] particularly in the context of disputes between secured and preferential creditors, that led to the enactment of the PPSA and the accompanying amendment of the Companies Act. A new preferential creditor regime thereby replaced the reference to assets secured by "a floating charge" with the reference to "accounts receivable and inventory".[44] This amendment had the consequence of narrowing the scope of the assets available for preferential creditors from all aspects of personal property the subject of a floating charge to the two specific categories of "accounts receivable" and "inventory". Other categories of personal property, such as "chattel paper", "investment securities" and "negotiable instruments", are not included.

[37] The new regime also abrogated the floating/fixed charge distinction, at least within the confines of the registration and priority regime regulating security interests in personal property.[45] Security distinctions are now based on the economic substance of a transaction. The new focus is on the type of property secured, not the type of security.[46] As the Supreme Court has made clear, principles and concepts developed prior to the PPSA have limited relevance now.[47] This means that we do not accept Mr Tingey's submission that much assistance is still to be obtained from

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41 Peter Blanchard and Michael Gedye *Private Receivers of Companies in New Zealand* (LexisNexis, Wellington, 2008) at [1.03]; Rizwaan Mokal "Liquidation Expenses and Floating Charges – the Separate Funds Fallacy" [2004] LMCLQ 387 and for example *Commissioner of Inland Revenue v Agnew* [2000] 1 NZLR 223 (CA) at [3]; affirmed by the Privy Council: *Commissioner of Inland Revenue v Agnew* [2002] 1 NZLR 30 (PC).

42 *Re Spectrum Plus* [2005] UKHL 41, [2005] 2 AC 680 at [107]; John Walsh (ed) *Insolvency Law and Practice* (online looseleaf ed, Brookers) at [CA312.03]. The floating charge became ubiquitous in Commonwealth jurisdictions prior to the enactment of personal property securities legislation: Michael Gedye "The Structure of New Zealand's 'New' Priority Debts Regime" (2003) 9 NZBLQ 220 at 223 and 226; Mokal, above n 41; *Buchler v Talbot* [2004] UKHL 9, [2004] 2 AC 298; and Blanchard and Gedye at [1.12]–[1.13].

43 *Commissioner of Inland Revenue v Agnew*, above n 41, at [1].

44 See below at [73]–[74].

45 The use of the terms "fixed charge" and "floating charge" are not abolished as such. Post-PPSA, the language of the traditional floating charge can still be used. The PPSA continues to recognise all forms of security interest that existed prior to the Act. The continued existence of the floating charge is expressly confirmed by s 17(3). However, there is no need to fit post-PPSA security interests into the old forms.

46 PPSA, s 17(1).

47 *Stiassny v Commissioner of Inland Revenue* [2012] NZSC 106, [2013] 1 NZLR 453 at [49].

consideration of the "floating charge" concept and the decision in *Buchler v Talbot*,[48] which is now in large part only of historical interest.

[38] The parties did not dispute that the crucial date for determining whether the funds at issue in fact constituted accounts receivable or inventory will be the date of the appointment of the receiver or liquidator. We refer to this point further below.[49]

[39] Against this background, we now turn to address the specific question of statutory interpretation relating to the meaning of the term "accounts receivable".

The meaning of "accounts receivable"

[40] There is also no dispute that, by virtue of s 312 and sch 7, cl 1(5)(a) of the Companies Act, the Commissioner has a preferential claim on Takapuna in liquidation for the GST arrears of $3,625,493.51 as a general priority payment. Whether the Commissioner is entitled to all or any of the $782,108.18 held by the liquidators depends first on whether those funds constitute "accounts receivable" under sch 7, cl 2(1) of the Companies Act which provides:

> **2 Conditions to priority of payments to preferential creditors**
>
> (1) The claims listed in each of subclauses (2), (3), (4), and (5) of clause 1—
>
> (a) rank equally among themselves and, subject to any maximum payment level specified in any Act or regulations, must be paid in full, unless the assets of the company are insufficient to meet them, in which case they abate in equal proportions; and
>
> (b) in so far as the assets of the company available for payment of those claims are insufficient to meet them,—
>
> (i) have priority over the claims of any person under a security interest to the extent that the security interest—
>
> (A) is over all or any part of the company's **accounts receivable** and inventory or all or any part of either of them; and

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48 *Buchler v Talbot*, above n 42.
49 At [61] and [86].

(B) is not a purchase money security interest that has been perfected at the time specified in section 74 of the Personal Property Securities Act 1999; and

(C) is not a security interest that has been perfected under the Personal Property Securities Act 1999 at the commencement of the liquidation and that arises from the transfer of an **account receivable** for which new value is provided by the transferee for the acquisition of that **account receivable** (whether or not the transfer of the **account receivable** secures payment or performance of an obligation); and

(ii) must be paid accordingly out of any **accounts receivable** or inventory subject to that security interest (or their proceeds).

(Emphasis added.)

[41] Clause 2(2) then provides:

> For the purposes of subclause (1)(b), the terms **account receivable, inventory**, **new value**, **proceeds**, **purchase money security**, and **security interest** have the same meaning as the Personal Property Securities Act 1999.[50]

[42] The term "account receivable" is defined in s 16 of the PPSA as:

> a monetary obligation that is not evidenced by chattel paper, an investment security, or by a negotiable instrument, whether or not that obligation has been earned by performance.

High Court decision

[43] Associate Judge Gendall concluded that the term "accounts receivable" was not limited to book debts. He first discussed the position under the PPSA,[51] then considered the relevant legislative history[52] and the High Court decision in *Commissioner of Inland Revenue v Northshore Taverns Ltd (in liq)*,[53] where

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[50] Regarding the use of "account" and "accounts", we note the rule that the singular includes the plural: Interpretation Act 1999, s 33.

[51] High Court decision, above n 2, at [50]–[59].

[52] At [60]–[69].

[53] *Commissioner of Inland Revenue v Northshore Taverns Ltd (in liq)* (2008) 23 NZTC 22,074 (HC).

Associate Judge Hole held that "accounts receivable" was limited to "book debts",[54] before turning to analyse the expression itself in the context of well-established principles of statutory interpretation and the submissions for the parties.[55]

Submissions for Strategic

[44] For Strategic, Mr Tingey submits that principles of statutory interpretation and the legislative history support the view that "accounts receivable" means "book debts" rather than literally any obligation quantifiable in money. Mr Tingey relies in particular on the history of the preferential creditor regime in both England and New Zealand, the nature of the changes required by the introduction of the PPSA, the purpose of the Companies Act and the legislative history of sch 7. He submits that the Associate Judge's approach is contrary to the clear intention of the drafters and represents a significant change in the law which would be arbitrary, commercially severe and deprive owners of property of valuable rights.

[45] Mr Tingey submits that, consistent with the language, policy and legislative history of sch 7, "accounts receivable" means "book debts". He refers in particular to the ordinary meanings of "accounts receivable" and "monetary obligations", Parliament's intentions and the approach of the High Court in other cases.[56] He suggests that the "book debts" definition does not face any of the problems posed by the Associate Judge's approach. Finally, he submits that Strategic's proposed definition does not create any complications for the PPSA and that the Associate Judge erred in attempting to define the term in the Companies Act by reference to the meaning the term might have in the PPSA context.

Our approach

[46] We recognise, as Associate Judge Gendall did,[57] that the meaning of "accounts receivable" depends on the text of the relevant provisions read in light of

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54 High Court decision at [70]–[78].
55 At [79]–[101].
56 *Commissioner of Inland Revenue v Northshore Taverns Ltd (in liq)*; *Eagle v Petterson* HC Auckland CIV-2011-404-7387, 16 December 2011; and *Petterson v Gotland (No 3)* [2012] NZHC 666 at [5].
57 High Court decision at [79]–[80].

their purpose, the objects of the legislation and their context, interpreted in a realistic and practical manner in order to enable them to work.[58] The latter requirement is particularly important in the context of this legislation which must be applied by busy receivers and liquidators. We therefore start with the text of the relevant provisions before considering their purpose and legislative history and the decisions and principles of statutory interpretation relied on by Mr Tingey.

Text

[47] Parliament has decided that "for the purposes of subclause (1)(b)" of cl 2 the terms "**accounts receivable, inventory, new value, proceeds, purchase money security interest**, and **security interest**" in sch 7, cl 2(2) of the Companies Act are to have "the same meanings" as in the PPSA.[59] We agree with Mr O'Regan that this provision could not be clearer. It expressly adopts the PPSA definitions of those terms for the purposes of sch 7, cl (2)(1)(b) of the Companies Act. They are to have "the same meaning" in both statutes.

[48] As the Associate Judge held,[60] and Mr O'Regan submits, the interpretation principle of "referential definition" rather than the different principle of "incorporation by reference" has been adopted by Parliament in this case.[61] The latter principle and its supporting authorities relied on by Mr Tingey are simply not applicable.[62]

[49] This also means that, contrary to Associate Judge Hole's decision in *Northshore Taverns*,[63] and Mr Tingey's submissions, the meanings given to the defined terms in the PPSA are incorporated into the Companies Act. How the words are used in the context of the PPSA is not only the starting point but also the end

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58 Interpretation Act, s 5, *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36, [2007] 3 NZLR 767 at [22] and *Northland Milk Vendors Assoc Inc v Northern Milk Ltd* [1988] 1 NZLR 530 (CA) 538; and Burrows and Carter, above n 17, at 205.

59 Companies Act, sch 7, cl 2(2).

60 High Court decision at [101].

61 Burrows and Carter at 423; FAR Bennion *Bennion on Statutory Interpretation* (5th ed, LexisNexis, London, 2008) at 572 and 758–759.

62 *Re Wood's Estate* (1886) 31 Ch D 607 (CA); *Down v R* [2012] NZSC 21, [2012] 2 NZLR 585 at [23].

63 *Commissioner of Inland Revenue v Northshore Taverns Ltd (in liq)*, above n 56, at [29]–[35].

point.[64] The terms are not to be given a different meaning in the context of the Companies Act.

[50] We do not, however, agree with Mr O'Regan that in this case the referential definition does not import the exclusions to that definition from other parts of the PPSA. Here the referential definition refers not simply to the definitions in s 16 of the PPSA but to the meanings of the terms in the Act itself. This means that the meanings are to be ascertained from the PPSA read as a whole.

[51] Considering the text of the definition of "account receivable" in the context of cl 2(1)(b) of sch 7 of the Companies Act, the short answer is that the term has the meaning given to it in s 16 of the PPSA which we have already set out.[65]

[52] The text of the definition in s 16 makes it plain that "accounts receivable" are not limited simply to "book debts", especially as "book debts" are usually considered to be a subset of receivables.[66] If Parliament had intended to limit "accounts receivable" to "book debts", it would have done so expressly. The fact that Parliament has not done so is particularly significant given that the operative parts of sch 7 of the Companies Act are, as already noted, replicated in a number of statutes dealing with formal insolvency processes or quasi-insolvency processes.[67]

[53] In determining the meaning of the term "accounts receivable" in the Companies Act it is therefore necessary to consider the meaning of the definition in s 16 of the PPSA. Three features of the text of the definition in s 16 are to be noted:

(a) there must be "a monetary obligation";

(b) but not one "evidenced by chattel paper, an investment security, or by a negotiable instrument"; and

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64 *Mayor of Portsmouth v Smith* (1885) 10 App Cas 364 (HL) at 371.

65 Above at [42].

66 Fidelis Oditah *Legal Aspects of Receivables Financing* (Sweet & Maxwell, London, 1991) at 20–32; Gedye, above n 25, at 173.

67 For example, Property Law Act 2007, s 153; Receiverships Act 1993, s 30; and Insolvency Act 2006, ss 274–275.

(c) the obligation need not have been earned by performance.

[54] Putting aside obligations evidenced by chattel paper, an investment security or a negotiable instrument, each of which is separately defined in the PPSA and none of which is relevant in this case, we consider that "monetary obligation" in the context of the PPSA means an existing obligation imposed on, or assumed by, one party to pay a certain sum of money to the other party on a specific or ascertainable future date. An obligation of this nature will involve an existing liability on the part of the first party which is legally enforceable by the second party. Each of the essential elements of the term "monetary obligation" is supported by reference to relevant dictionary definitions and legal texts.

[55] The use of the adjective "monetary", which means relating to money or currency,[68] excludes non-monetary obligations such as an obligation for specific performance or an obligation to deliver or restore property. As pointed out in *Mann on the Legal Aspect of Money*,[69] monetary obligations primarily exist where the debtor is bound to pay a fixed, certain, specific or liquidated sum of money. A liquidated obligation generally includes both debts in the classical sense and executory obligations of a monetary character, such as an obligation to pay the price of goods not yet delivered.[70]

[56] The need for an existing liability to pay and a matching legally enforceable right to recover the payment is recognised by the relevant accounting standards which state that:[71]

> ... one party's contractual right to receive (or obligation to pay) cash is matched by the other party's corresponding obligation to pay (or right to receive).

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68 John Simpson and others (eds) *Oxford Dictionary* (online ed, Oxford University Press). Section 16 of the PPSA defines money for the purposes of the PPSA as "currency authorised as a medium of exchange by the law of New Zealand or of any other country".

69 Charles Proctor (ed) *Mann on the Legal Aspect of Money* (7th ed, Oxford University Press, Oxford, 2012) at [3.03].

70 *Webb v Stanton* (1883) 11 QBD 518; *Sturdy Components Pty Ltd v Burositzmobelfabrik Friedrich W Dauphin GmbH* [1999] NSWSC 595.

71 *International Accounting Standard 32 Financial Instruments: Presentation* (International Accounting Standards Board, IAS 32, 1 January 1996) Appendix, AG4.

[57] When "monetary" and "obligation" are read together, it is also clear that the liability must be to pay an identifiable sum on an ascertainable date. This will include a claim of that nature based on debt statute or money had and received.[72] A possible liability to pay an unidentifiable sum at an unascertainable future date will not suffice.[73]

[58] The fact that in terms of the definition the monetary obligation "need not have been earned by performance" confirms that existing monetary obligations that are not earned by performance under a contract are within the definition. Such obligations will include those that exist under deed, statute or by virtue of a court order, independently of any need for performance.

[59] Recognition of obligations which are not dependent on the need for performance does not mean, however, that an obligation that requires performance in order to come into existence will be recognised. The absence of performance in that case will simply mean that there is no obligation in existence.

[60] We therefore do not accept Mr Tingey's submission that the definition includes wholly executory contracts under which monetary obligations have not yet been earned by performance. An executory contract exists when the parties have exchanged promises to perform certain obligations in the future but have not yet performed them.[74] No monetary obligation arises until performance by which the other party earns the right to be paid occurs. For an amount to be "receivable", it must be currently owed to a party who is entitled to expect its payment without undertaking further performance. In the absence of any obligation being earned, there will be no existing obligation and therefore no account receivable.

[61] The adjective "receivable" and the express provision that the obligation need not already have been earned also reinforce the need to focus on the existence of the obligation at the relevant time, that is, in this case, the date of liquidation. An

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72 *OPC Managed Rehab Ltd v Accident Compensation Corporation* [2006] 1 NZLR 778 (CA) at [40]–[51].

73 Compare *Marren (Inspector of Taxes) v Ingles* [1981] 1 WLR 983 (HL) and *New Zealand Venue and Event Management Ltd v Worldwide NZ LCC* [2013] NZCA 130.

74 John Burrows, Jeremy Finn and Stephen Todd *Law of Contract in New Zealand* (4th ed, LexisNexis, Wellington, 2012) at [4.2.1].

obligation that may arise in the future when there is performance in terms of the contract will not be included because once a company is in liquidation (or a person is insolvent) there may be no prospect of performance justifying payment.

[62] In the event of liquidation or insolvency, performance may become impossible. An executory obligation will therefore not suffice in this context. This distinction is recognised in *Goode on Payment Obligations in Commercial and Financial Transactions* where it is noted that the difference between existing and contingent rights and obligations may be material.[75] Typically, an existing right to payment is one which is definite, even if maturing in the future, whereas a contingent claim is one which may not materialise.[76] The latter does not therefore constitute an existing monetary obligation. There is no existing liability to pay and no matching legally enforceable right to receive.

[63] Accordingly we do not accept Mr O'Regan's submission that "monetary obligation" includes an existing right to claim damages in tort or equity. In the absence of a judgment of the court, such claims do not involve an existing liability to pay with a matching legally enforceable right to receive. The existence of a claim against a director of a company for reckless trading or misappropriating company property, which Mr O'Regan suggested might also fall within the definition, does not mean that the director is under an existing monetary obligation to pay.

[64] We recognise that claims for money had and received may be in a different category because such claims involve recovery of a debt due which may constitute an existing monetary obligation.[77] We do not, however, need to decide this issue as there is no suggestion that Takapuna had any relevant claim of this nature. Thus we do not need to consider the effect of s 23(e)(vii), which excludes transfers of claims for tort damages from the scope of the PPSA, and the view of William Young J in *Waller v New Zealand Bloodstock Ltd* relied on by Mr O'Regan.[78] As Professor

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75 Charles Proctor (ed) *Goode on Payment Obligations in Commercial and Financial Transactions* (2nd ed, Thompson Reuters, London, 2009) at 26–29.
76 At 26.
77 *OPC Managed Rehab Ltd v Accident Compensation Corporation*, above n 72.
78 *Waller v New Zealand Bloodstock Ltd* [2006] 3 NZLR 629 (CA) at [125]–[127].

Gedye has pointed out, s 23(e)(vii) appears to have been included in the PPSA out of an abundance of caution.[79]

Purpose

[65] In this case the clearest indication of the purpose of the definition of "accounts receivable" in the Companies Act is the language used by Parliament in the statutory provisions.[80] By adopting a definition from the PPSA, a new statute with a totally new regime for personal property securities,[81] and by eschewing any reference in the definition to "book debts", Parliament has made it clear that, for the purpose of the liquidation and preferential creditor provisions of the Companies Act, the term "accounts receivable" is to be given the same meaning in both statutes and that the meaning is not limited to "book debts".[82]

[66] Our approach to the interpretation of the definition of "accounts receivable" in s 16 of the PPSA is consistent with and supported by the purpose of that definition in the PPSA. The focus is on the substance or existence of the underlying monetary obligation, which is the subject of the security interest rather than on the previous "floating" nature of the form of the interest.[83]

Scheme of PPSA

[67] Our approach to the interpretation of accounts receivable is also consistent with other provisions of the PPSA. The wide interpretation we prefer is consistent with the proper operation of other aspects of the PPSA, such as the perfection of a creditor's interest in the proceeds of original collateral, and s 17 which provides that transfers of accounts receivable are deemed security interests. It would be anomalous if transfers of monetary obligations that were not book debts did not constitute security interests under the PPSA.

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[79] Gedye, above n 25, at n 13.
[80] *Stiassny v Commissioner of Inland Revenue,* above n 47, at [23].
[81] PPSA, s 4; Widdup, above n 19, at 1–4.
[82] Gedye, above n 25, at 172–175.
[83] At 173–174; Michael Gedye, Ronald C C Cuming and Roderick J Wood *Personal Property Securities in New Zealand* (Brookers, Wellington, 2009) at 10–13; Widdup, above n 19, at 8.

Legislative history

[68] The meaning of the term "accounts receivable" based on its text and purpose is supported by its legislative history. First, it is the legislative history of the PPSA rather than the Companies Act which is primarily relevant.

[69] Second, the PPSA, which is modelled on Canadian provincial legislation,[84] was enacted to rationalise New Zealand's law relating to securities over personal property. It constituted a significant commercial law reform.[85] Principles and concepts developed prior to the PPSA have limited relevance now.[86] Provisions in the Companies Act with counterparts in the PPSA should be interpreted consistently with the PPSA.[87]

[70] Strategic relies on the following passage from the Law Commission's report as evidence that accounts receivable are restricted to the scope of book debts:[88]

> Account receivable describes, for example, the right to payment which a supplier of goods becomes entitled upon performance. The term is the equivalent of the New Zealand expression "book debt." Computerised record keeping has made the adjective "book" misleading. "Receivable" more accurately describes the direction of the entitlement than does the term "debt"...

[71] As Professor Gedye has noted, however, the context of this passage indicates that it should not be read over-literally as indicating that the Commission considered that the two terms were synonymous.[89] In stating that the term "book debt" had been replaced by the term "account receivable", the meaning, in context, was that the historic term book debt had been subsumed into the modern term account

[84] The New Zealand Law Commission used as a model the then Personal Property Security Bill of British Columbia (subsequently the Personal Property Security Act RSBC 1996 c 359): Law Commission *A Personal Property Securities Act for New Zealand*, above n 26, at 9. The Commerce Select Committee indicated it considered the PPSA was based mainly on the Saskatchewan Personal Property Security Act 1993 SS c P-6.2: Personal Property Securities Bill 1998 (251-2) (select committee report) at ii.

[85] Gedye, Cuming and Wood at 1.

[86] *Stiassny v Commissioner of Inland Revenue*, above n 47, at [49].

[87] *Dunphy v Sleepyhead Manufacturing Co Ltd*, above n 24, at [36]–[37].

[88] Law Commission *A Personal Property Securities Act for New Zealand* at 80.

[89] Gedye, above n 25, at 172–173.

receivable.[90] This is implicit in the final sentence of the extract from the Law Commission report.

[72] Third, to the extent that the legislative history of the Companies Act is relevant, the history and purpose of the preferential creditor regime does not require a narrowing of the definition.

[73] With the PPSA's abolition of the concepts of "fixed" and "floating" charges in favour of a single definition of "security interest", it became necessary to amend sch 7 to remove the reference to "floating charge". We agree with Associate Judge Gendall that the language of the amendments was changed to reverse the decision of the High Court in *Re Brumark Investments Ltd (in rec)*,[91] which dealt with issues relating to fixed and floating charges.[92] The High Court had held that it was possible to create a fixed charge over both existing book debts and future choses in action. As a result of that decision, the rights of the debenture holder to the book debts in question prevailed over the rights of preferential creditors in that case. The current wording was enacted to ensure that the availability of "accounts receivable" for preferential creditors would not be dependent on the wording of the particular instrument which creates the security interest.

[74] The changes were explained by the responsible Ministers in Parliament during the enactment of the respective amendments.[93] They emphasised that there was no intention to alter "the priority rankings" and that the intention was to preserve "the status quo" so that employees and other preferential creditors were not put in any position that was different from where they were under the old regime. The select committee report on the Personal Property Securities Bill stated that the intention of the new Act was to retain the order of distribution on insolvency.[94]

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90 Gedye, Cumming and Wood at 52.

91 *Re Brumark Investments Ltd (in rec)* (1999) 19 NZTC 15,159 (HC); *Agnew v Commissioner of Inland Revenue* [2000] 1 NZLR 233 (CA); and *Agnew v Commissioner of Inland Revenue* [2002] 1 NZLR 30 (PC).

92 Personal Property Securities Amendment Act 2001, above n 40; High Court decision, above n 2, at [60]–[66].

93 (8 December 1998) 574 NZPD 14425–14426; (4 April 2001) 591 NZPD 8756.

94 Personal Property Securities Bill 1998 (251-2) (select committee report) at ix.

[75] Mr Tingey relied strongly on the Ministers' speeches in support of his submission that Parliament intended to replicate the existing law as closely as possible by ensuring that preferential creditors maintained their priority "in respect only of circulating assets typically covered by a floating charge, namely accounts receivable and inventory".

[76] We agree with Mr O'Regan that Mr Tingey's submission draws too much from the Ministers' speeches which related to priority rankings of security interests rather than to the identification of the assets to be available for preferred creditors in the event of there being insufficient funds available in a liquidation. The Ministers were not asserting that preferential creditors would be paid out of assets identical to those from which they were paid under the previous legislation.

Unintended adverse consequences?

[77] We do not agree with Mr Tingey that the Associate Judge's interpretation is wrong because it leads to unintended adverse consequences.

[78] First, for the reasons we have already given, we do not consider that a claim against a director of a company for misappropriating company property constitutes an "account receivable". In the absence of a judgment against the director, there will be no existing enforceable monetary obligation. Mr Tingey's concern on this count is therefore misplaced.

[79] Second, we do not consider it to be of concern that, if a company agreed to sell the entirety of its business for value immediately before liquidation, the proceeds of sale would be an "account receivable" as the purchaser would be under an existing enforceable obligation to pay. In practical terms it is unlikely that a sale of the whole business would have occurred in the ordinary course of the seller's business and without the lender's consent.[95] If such a sale had occurred with the lender's consent, then there is no reason why the proceeds of sale should not be viewed as "accounts receivable" in the same way as they would previously have been the subject of a

[95] PPSA, s 53; *Stockco Ltd v Gibson* [2012] NZCA 330, (2012) 10 NZBLC 99-709 at [48].

floating charge over the seller's assets and thus available for preferential creditors in the absence of sufficient funds available on a liquidation.

[80] We are not satisfied that adopting the PPSA definition of "account receivable" results in an arbitrary change in the law or is commercially severe and deprives owners of property of valuable rights. The purpose of the preferential creditor regime is to restrict the rights of secured creditors in relation to preferential creditors in the manner mandated by the statute.

Academic commentary

[81] Finally, on this issue, we note that the interpretation favoured by the Associate Judge in this case, rather than the approach adopted in *Northshore Taverns*, is supported by academic commentary.[96]

Summary

[82] Accordingly, in our view, the term "accounts receivable" in sch 7, cl 2(1) of the Companies Act has the same meaning as given in s 16 of the PPSA, namely "a monetary obligation that is not evidenced by chattel paper, an investment security, or by a negotiable instrument, whether or not that obligation has been earned by performance".

[83] Under this definition any "monetary obligation" that is not expressly excluded is included. In this context a "monetary obligation" is an existing legal obligation on another party to pay an identifiable monetary sum to the company on an ascertainable date. The obligation must be legally enforceable by the company (at the date of the receivership or liquidation) on the basis that the other party has an existing liability to make the payment.

[84] The definition includes, but is not limited to, debts or "book debts". Also included are other legally enforceable rights under deeds, statutes and court

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[96] Widdup, above n 19, at 77–80; Michael Whale "Personal Property Securities Act Issues" (paper presented to Auckland District Law Society Corporate Insolvency Update Intensive Conference, February 2011); Gedye above n 25.

judgments whether or not earned by performance. Money held in a bank account will be an "account receivable" because the bank will be under a legally enforceable obligation to pay the money to the account holder.[97]

[85] A mere right to claim will not be included within the definition until it is converted into a legally enforceable obligation by a judgment of a court.

Application of definition to the funds

[86] This definition may be applied to the funds at issue on the undisputed basis that the crucial date for determining whether the funds constituted "accounts receivable" is the date on which Takapuna was placed into liquidation, namely 21 November 2008. While the PPSA does not explicitly specify the date, the date on which a receiver or liquidator is appointed is generally adopted as the relevant date in relevant legislation,[98] and has been accepted in other cases,[99] and by the authors of the New Zealand text on receivership.[100] We agree with that approach.

Development contribution refunds

[87] As at 21 November 2008 the High Court had decided that the NSCC had made errors of law in adopting its 2004 development contributions policy (carried-over into its 2006 policy) under which Takapuna had previously paid its development contributions. While the High Court had not invalidated the policies or granted any relief or remedy, there is no doubt that the errors of law identified by the High Court meant that the contributions had been wrongly paid and were refundable to Takapuna.

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97 *Re Bank of Credit and Commerce International SA (in liq) (No 8)* [1998] AC 214 (HL); *Flexi-Coil Ltd v Kindersley District Credit Union Ltd* (1993) 107 DLR (4th) 148 (SKCA); *Foley v Hill* (1848) 2 HLC 28, 9 ER 1002 (HL); Thomas Gault (ed) *Commercial Law* (online looseleaf ed, Brookers) at [8A.2.08(1)(a)]; Gedye, above n 25, at 171; Gedye, Cumming and Wood, above n 83, at [16.1.28] and [17.8]; and Oditah, above n 66, at 23–24.

98 Companies Act, sch 7, cl 6; Goods and Services Tax Act 1985, s 42(2)(a) and (b). Tax Administration Act 1994, s 167.

99 *Gibbston Downs Wines Ltd v Perpetual Trust Ltd* [2012] NZHC 1022; *Sperry Inc v Canadian Imperial Bank of Commerce* (1985) 17 DLR (4th) 236 (ONCA); *Canadian Imperial Bank of Commerce v Melnitzer (Trustee of)* (1993) 23 CBR (3d) 161 (ONCJ).

100 Blanchard and Gedye above n 41, at [7.06].

[88] On the basis of the principle of law established by the majority decision of the House of Lords in *Woolwich Equitable Building Society v Inland Revenue Commissioners*,[101] which is part of the law of New Zealand,[102] the contributions were refundable by NSCC to Takapuna as of right. As Lord Goff said in *Woolwich*:[103]

> ... money paid by a citizen to a public authority in the form of taxes or other levies paid pursuant to an ultra vires demand by the authority is prima facie recoverable by the citizen as of right.

And Lord Slynn said:[104]

> Accordingly I consider that Glidewell and Butler-Sloss LJJ [in the Court of Appeal] were right to conclude that money paid to the revenue pursuant to a demand which was ultra vires can be recovered as money had and received. The money was repayable immediately it was paid.

[89] Applying this principle means that from at least the time of the High Court decision on 21 March 2007 Takapuna was entitled to recover the unlawful development contributions paid to the NSCC. Consequently, as at the date of Takapuna's liquidation, there was an existing legal obligation on the NSCC to refund the contributions to Takapuna. The refunds were an identifiable monetary sum and were already repayable. Takapuna was legally entitled to enforce the NSCC's obligation on the basis that the NSCC had an existing liability to make the refunds.

[90] Contrary to the submission for Strategic, the fact that the NSCC did not "reassess" Takapuna's development obligations and make the refunds until after the liquidation does not alter the application of the *Woolwich* principle. The contributions were refundable because as a result of the High Court decision they were unlawful, not because the NSCC decided to refund them. They were refundable at least from the date of the High Court decision.

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[101] *Woolwich Equitable Building Society v Inland Revenue Commissioners (No 2)* [1993] AC 70 (HL); see also *Kleinwort Benson Ltd v Lincoln City Council* [1999] 2 AC 349 (HL); and *Deutsche Morgan Grenfell Group plc v Inland Revenue Commissioners* [2007] 1 AC 558 (HL).

[102] *Laws of New Zealand* Restitution (online ed) at [63]; *Waikato Regional Airport Ltd v Attorney-General* [2003] UKPC 50, [2004] 3 NZLR 1; *Stiassny v Commissioner of Inland Revenue*, above n 47, at [67].

[103] At 177.

[104] At 204.

[91] The refunds of the development contributions therefore constituted monetary obligations within the definition of "accounts receivable" and should be paid to the Commissioner as the remaining preferential creditor.

Engineering and construction bonds

[92] Unlike the development contributions, the engineering and construction bonds of $3,000 were not paid by Takapuna to the NSCC on the basis of a policy subsequently held to be unlawful. The bonds were lawfully received by the NSCC to secure the performance of resource consents and were not refundable to Takapuna unless and until the NSCC was satisfied that the Shoalhaven development complied with the NSCC standards.[105]

[93] As the NSCC was not satisfied that the development complied with its standards until after the liquidation of Takapuna, the bonds were not repaid until then. Prior to that time the bonds were not refundable.

[94] As at the date of the liquidation of Takapuna, they were therefore not an existing monetary obligation of the NSCC. Takapuna had no legally enforceable right to recover the bonds on that date and the NSCC had no liability to repay the bonds. Furthermore, in the event that the NSCC was ultimately not satisfied that the development complied with its standards, the bonds would not be refundable at all.

[95] Contrary to the submissions for the Commissioner, we do not accept that the bonds were within the definition on the contended basis that:

(a) Takapuna had treated them in its balance sheet as an asset;[106] and

(b) conditional obligations are covered.

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105 Resource Management Act 1991, ss 108(2)(b) and 108A.

106 The Associate Judge noted the Commissioner's submission to the same effect: High Court decision, above n 2, at [109].

[96] The fact that Takapuna may have treated the bonds as an asset in its balance sheet does not in law impose an existing enforceable obligation on the NSCC to repay the bonds prior to being satisfied that is conditions were met.

[97] Accordingly, we consider that the bonds were not existing monetary obligations within the definition of "accounts receivable". When they were subsequently paid by the NSCC to the liquidators of Takapuna the preferential creditor priority did not extend to them and they remained subject to Strategic's GSA.

GST refund

[98] As at the date of the liquidation of Takapuna, the Commissioner was under no obligation to pay a GST refund to Takapuna. On the contrary, as at that date Takapuna's GST arrears exceeded $3,600,000. The Commissioner had a statutory right of set-off in respect of any GST refund claim under s 46(6) of the Goods and Services Tax Act 1985 which provides:

> (6) If, but for this subsection, a registered person would be entitled to an amount as a refund under section 19C(8) or 20(5) or 45 or 78B(5)(c) or under the Tax Administration Act 1994, or as a payment of interest under Part 7 of the Tax Administration Act 1994, the Commissioner may apply the amount, in accordance with a request under section 173T of the Tax Administration Act 1994 or in the absence of a request in such order or manner as the Commissioner may determine, in payment of—
>
> (a) tax that is payable by the person:
>
> (b) an amount that is payable by the person under another Inland Revenue Act.

[99] The fact that after the liquidation of Takapuna the Inland Revenue Department received a GST return from Takapuna seeking a GST refund and, overlooking the statutory right of set-off, paid the refund to the liquidators in accordance with s 20(5) and s 46(1) of the Goods and Services Tax Act does not mean that there was a retrospective obligation to do so.[107] The existence of the GST arrears and the right of set-off meant that the Commissioner was not under a legally

[107] In particular s 46(1) did not require the Commissioner to make the refund at the date of liquidation.

enforceable obligation to make the GST refund payment. Takapuna had no right to recover that refund.

[100] Accordingly, the GST refund was not an existing monetary obligation within the definition of "accounts receivable". This conclusion does not mean, however, that the GST refund paid in error to the liquidators is irrecoverable by the Commissioner on other grounds. We consider those grounds later.[108]

Carter Atmore funds

[101] Strategic do not dispute that as at the date of the liquidation of Takapuna the funds were in the trust account of Carter Atmore who were Takapuna's lawyers.[109] Nor do they dispute that the funds referred to above at [20(a)] were due to Takapuna on that date, even though they were not received until shortly after the liquidation. In terms of s 110(1) of the Lawyers and Conveyancers Act 2006, Carter Atmore therefore held these funds in its trust bank account on behalf, of and at the direction of, Takapuna.

[102] We agree with Mr O'Regan that these funds are therefore no different in concept to funds held by a bank in a bank account or a deposit account for a company.

[103] As already discussed,[110] money in the Carter Atmore trust account will be an "account receivable" because Carter Atmore, like a bank, will be under a legally enforceable obligation to pay the money to the company.[111]

[104] Contrary to Mr Tingey's submission, the fact that Takapuna was already the beneficial owner of the funds makes no difference. The fact that the PPSA does not provide for any form of collateral in this context other than money and accounts receivable is instructive. As submitted by the Commissioner, the fact that the funds may have been beneficially owned by Takapuna does not alter the legal state of

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108 Below at [108].
109 Above at [20(b)], [20(c)], [20(d)] and [20(e)].
110 Above at [84].
111 *Fletcher v Eden Refuge Trust* [2012] NZCA 124, [2012] 2 NZLR 227 at [73]–[88]. None of the exceptions indicated in that case apply.

affairs. If it did, solicitors' trust accounts could become a haven for funds which an insolvent company sought to keep from preferential creditors.

[105] The conclusion of Associate Judge Hole in *Northshore Taverns* that funds in a solicitor's trust account were not accounts receivable at the date of liquidation was therefore wrong.[112]

Summary

[106] For the reasons we have given, we conclude that the development contribution refunds and the Carter Atmore funds were accounts receivable on 21 November 2008 when Takapuna was put into liquidation, but that the engineering and construction bond and GST refund were not. We therefore turn to address the Commissioner's other arguments justifying repayment of the GST refund.

Recovery of the GST refund

[107] The Associate Judge decided that the GST refund paid by the Inland Revenue Department to Takapuna "in error" was recoverable on the basis of the rule in *Re Condon*[113] and therefore did not address the Commissioner's argument that the refund was also recoverable under restitution principles. As already noted, the Commissioner relies on both arguments on appeal.[114] We therefore propose to consider them both.

Re Condon

[108] It is common ground between the parties that under the rule in *Re Condon* liquidators appointed under Court order, who are officers of the Court and obliged to act in a manner consistent with the highest principles, are not permitted to take advantage of the strict legal rights available to them if to do so would mean that they were acting unjustly, inequitably, or unfairly.[115]

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112 See above at [49] and [82].
113 *Re Condon*, above n 1.
114 Above at [18].
115 See also *Re Cider (New Zealand) Ltd (in liq)* [1936] NZLR 374 (SC) and John Farrar and Susan Watson (eds) *Company and Securities Law* (online looseleaf ed, Brookers) at [CA260.04].

[109] As Mr O'Regan points out, the rule has been applied to cases involving payments made to trustees in insolvency situations as a result of mistakes of law and mistakes of fact.[116] It has also been applied in such cases in New Zealand.[117]

[110] The Associate Judge held that applying this rule in the present case required the liquidators of Takapuna to repay the GST refund.[118] It would have been unfair for the creditor to obtain a benefit just because the Commissioner's mistake was the result of a "mere clerical error" and the facts of the case were therefore analogous to the decision in *Re Thomas Horton*.[119]

[111] Strategic challenge the application of the rule in this case on three alternative grounds:

(a) *Re Condon* cannot apply to the GST refund because it was subject to Strategic's security interest. The liquidators' duties to the Court cannot affect Strategic's existing proprietary interest in the property.

(b) As the Commissioner has elected to prove for her debt in the liquidation, she cannot now rely on *Re Condon*.[120]

(c) As the High Court erred in finding that the Commissioner made a relevant "mistake", it would not be inequitable to insist on the strict legal position. In respect of this ground Strategic also relies on the PwC file note of 10 December 2008.

[112] For the following reasons, we do not accept Strategic's challenges to the Associate Judge's decision on any of these grounds.

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[116] *Re Tyler, ex parte the Official Receiver* [1907] 1 KB 865 (CA); *Re Thellusson, ex parte Abdy* [1919] 2 KB 735 (CA).

[117] *Re Thomas Horton* [1925] NZLR 739 (SC); *Re Buyers, ex parte Davies* [1965] NZLR 774 (SC); and *Official Assignee v Westpac Banking Corporation* (1993) 4 NZBLC 102,939 (HC).

[118] High Court decision, above n 2, at [26]–[44].

[119] *Re Thomas Horton*.

[120] *Re Clark (A Bankrupt), ex parte the Trustee v Texaco Ltd* [1975] 1 WLR 559 (Ch D); *Re Modern Terrazzo (in liq)* [1998] 1 NZLR 160 (HC) at 188.

[113] First, the existence of Strategic's security interest does not prevent the rule in *Re Condon* from applying. The rule applies to Takapuna's liquidators as officers of the Court and impacts on their duty to distribute funds collected. As Strategic permitted the liquidators to realise any assets subject to its GSA as its agents,[121] Strategic's conscience is necessarily similarly affected and it would be inappropriate in those circumstances for Strategic to obtain a windfall of $169,349.86. If the Commissioner had exercised the set-off, the money would never have passed to Takapuna.

[114] Second, the fact that the Commissioner has proved for the entirety of her debt in the liquidation of Takapuna does not constitute an election preventing the Commissioner from relying on *Re Condon*. It is not a question of the Commissioner seeking to upset the pari passu distribution required when the liquidation estate is to be divided amongst unsecured creditors, as occurred in *Re Cider*,[122] *Re Modern Terrazzo*,[123] and *Re Gozzett*.[124] Here the Commissioner is not receiving a preference in terms of sch 7, cl 2(1)(b), she is only receiving what she would ordinarily have got but for this mistake. Again, if the rule is not applied, Strategic would receive a windfall.

[115] Third, the Associate Judge did not err in finding that the Commissioner made a "mistake" that justifies the application of the rule. We agree with the Commissioner that there is no evidence of any reckless conduct in making the refund that should disentitle her from relief. The unchallenged evidence for the Commissioner establishes that the relevant Inland Revenue Department employee merely overlooked the fact that Takapuna had a significant GST debt with the unfortunate result that the $169,349.86 was mistakenly paid out. We consider that it is not now open to Strategic to suggest that the conduct was reckless in the absence of any cross-examination of the employee.[125]

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121 *Dunphy v Sleepyhead Manufacturing Co Ltd*, above n 24.
122 *Re Cider*, above n 115.
123 *Re Modern Terrazzo (in liq)*.
124 *Re Gozzett* [1936] 1 All ER 79 (CA).
125 Evidence Act 2006, s 92.

[116] In particular, we do not accept that the PwC file note should be admitted in evidence on appeal or that, if it were, it would alter our conclusion on this issue. The file note does not meet the requirements for admissibility on appeal as it is not fresh or cogent evidence.[126] The file note was available at the time of the hearing in the High Court, but was not adduced in evidence by the then counsel for Strategic. A letter from the liquidators to the Commissioner, also provided to this Court by counsel for Strategic, states that the note was made available to both parties and discussed at the time of the High Court hearing. No adequate explanation was given as to why Strategic chose not to produce the note in the High Court.

[117] The file note purports to record a conversation between an employee of PwC and an employee of the Inland Revenue Department (not the one who made the refund decision) in which the latter, on being informed of the receipt of the GST refund cheque, is recorded as having said "Oh, you are rich! Go ahead and bank it". Even assuming that the file note is an accurate and complete record of the conversation, we do not consider that it converts the employee's error in making the refund into a "reckless" one.

[118] It is also relevant in this context that the GST refund claim was made after the liquidation of Takapuna by one of its directors and not by the liquidators. It is unlikely that the liquidators would have made the claim at all once they discovered the total GST arrears. Indeed in the letter the liquidators suggest that the conversation recorded in the note is inconsistent with Strategic's contention that its conscience was not engaged when it received the refund. Further, if the liquidators had made the claim the Inland Revenue Department would have been on notice of the liquidation and the employee would have been unlikely to have made the error.

[119] Although it has not been necessary to decide the restitution issue in this case, far from demonstrating that the consciences of the liquidators were unengaged, their agents' perfunctory investigation, which was noted but not taken any further, appears

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[126] Rules, r 45(1); *Paper Reclaim Ltd v Aotearoa International Ltd* [2006] NZSC 59, [2007] 2 NZLR 1; *Erceg v Balenia Ltd* [2009] NZCA 48, [2009] NZCCLR 32; *Airwork (NZ) Ltd v Vertical Flight Management Ltd* [1999] 1 NZLR 641 (CA); *Rae v International Insurance Brokers (Nelson Marlborough) Ltd* [1998] 3 NZLR 190 (CA).

to indicate an awareness of the Commissioner's mistake and a less than forthcoming response to it.[127]

[120] For these reasons we agree with the Associate Judge that the liquidators are obliged by the rule in *Re Condon* to pay the mistaken GST refund of $169,349.86 to the Commissioner.

Restitution principles

[121] In view of our conclusion as to the application of the rule in *Re Condon* it is strictly speaking unnecessary for us to consider the Commissioner's alternative argument based on restitution principles. But having heard submissions from the parties we do address the argument briefly.

[122] The Commissioner referred to older English authorities for the proposition that where one party receives a mistaken payment from another, in some circumstances the payer has a proprietary remedy because a constructive trust is created.[128] The existence of such a remedy is a matter of unresolved controversy in New Zealand. New Zealand courts have in the past indicated a preparedness to make the remedy available.[129] This Court in *Fortex Group (in rec and in liq) v MacIntosh* has, however, put the future of the "so-called remedial constructive trust" remedy in doubt.[130]

[123] This Court declined to make any final decision as to whether the remedy formed a part of the law of New Zealand or whether the distinction between remedial

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[127] We note for completeness that no estoppel would be raised on the alleged facts: see Piers Feltham, Daniel Hochberg and Tom Leech *Spencer Bower on Estoppel by Representation* (4th ed, LexisNexis, London, 2004) at 211–213; and James Every Palmer "Equitable Estoppel" in Andrew Butler (ed) *Equity in Trusts in New Zealand* (2nd ed, Thompson Reuters, Wellington, 2009) 601 at [19.2–19.5].

[128] *Chase Manhattan Bank NA v Israel-British Bank (London) Ltd* [1981] Ch 105 (CA); *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669 (CA) (although the latter case is arguably explicable on other grounds).

[129] *Elders Pastoral Ltd v Bank of New Zealand* [1989] 2 NZLR 180 (CA); *Liggett v Kensington* [1993] 1 NZLR 257 (CA) in which Gault and McKay JJ considered the remedy available) not doubted on appeal: *Re Goldcorp Exchange Ltd (in rec)* [1994] NZLR 358 (PC).

[130] *Fortex Group (in rec and in liq) v MacIntosh* [1998] 3 NZLR 171 (CA) at 172–173.

and institutional constructive trusts is significant. It did, however, confirm that unconscionability would be the underlying principle for the remedy in any case.[131]

[124] The chief objection to the restitutionary proprietary remedy is that the juristic basis of the remedy of unconscionability is too open-ended and offends against settled insolvency rules on too loose a basis by according priority via constructive trust.[132] This discretion to vary proprietary rights may be undesirable. It has been suggested that it is proper that "[t]he insolvency road is blocked off to remedial constructive trusts, at least when judge driven in a vehicle of discretion".[133]

[125] In *Fortex Group* it was noted that the question of the place of the remedial constructive trust in New Zealand should be "left to another day" with the warning that caution should be exercised "in proceeding to do anything which would disturb the settled pattern of distribution in an insolvency".[134] That day will be one in which the issue is of central importance to a decision of this Court, rather than peripheral as in the present case.

[126] For these reasons we prefer not to determine this issue in this case when it is unnecessary for us to do so.

Result

[127] The appeal is allowed in respect of the engineering and construction bonds of $3,000 which are payable to Strategic, but in all other respects the appeal is dismissed.

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131 At 175–177.

132 At 176 per Gault, Keith and Tipping JJ.

133 *Re Polly Peck (No 2)* [1998] 3 All ER 812 (CA); Peter Watts "Restitution" [1995] NZ L Rev 395 at 396. It has been suggested that the existence of the established restitutionary claim recognises that the mistaken windfall is unconscionable, but that there is not sufficient unconscionability to "justify the payer's extraction from the 'fly-paper' of insolvency" (that is, the general pool of creditors). Arguably, the plaintiff payer's position is no more invidious than that of unsecured tort, contract or other claimants.

134 *Fortex Group* at 182 per Blanchard J.

[128] In view of the minor level of Strategic's success, Strategic are to pay the Commissioner's costs for a standard appeal on a band A basis and usual disbursements.

Solicitors:
Bell Gully, Auckland for Appellants
Crown Solicitor, Auckland for Second Respondents

Tab 4

Most Negative Treatment: Application/Notice of Appeal
Most Recent Application/Notice of Appeal: Soboczynski v. Beauchamp | 2015 CarswellOnt 10763 | (S.C.C., Jun 19, 2015)

2015 ONCA 282
Ontario Court of Appeal

Soboczynski v. Beauchamp

2015 CarswellOnt 5577, 2015 ONCA 282, [2015] O.J. No. 2055, 125 O.R. (3d) 241, 251 A.C.W.S. (3d) 701, 333 O.A.C. 353, 385 D.L.R. (4th) 148, 42 B.L.R. (5th) 171, 52 R.P.R. (5th) 175

Adam Soboczynski and Olga Soboczynski, Respondents and Don Beauchamp and Louise Beauchamp, Appellants

Alexandra Hoy A.C.J.O., Gloria Epstein, C.W. Hourigan JJ.A.

Heard: November 4, 2014
Judgment: April 23, 2015
Docket: CA C58106

Counsel: Benjamin G. Blay, for Appellants
W. Scott Gallagher, for Respondents

Subject: Contracts; Corporate and Commercial; Property; Torts

Headnote

Real property --- Sale of land — Agreement of purchase and sale — Interpretation of contract — Miscellaneous

Parties entered into agreement of purchase and sale (APS), which contained entire agreement clause — Vendors signed seller property information statement (SPIS), in which they stated that property was not subject to flooding and that they would inform purchasers of any "important changes" prior to closing — Vendors did not disclose subsequent flood in basement — After transaction closed, basement flooded again — Purchasers brought successful action against vendors for damages based on negligent misrepresentation — Vendors appealed — Appeal allowed — Given that entire agreement clause operated retrospectively, not prospectively, representations made in SPIS were actionable because SPIS was completed after APS had been signed — However, evidence did not support finding that purchasers relied on representations that formed basis of their claim.

Torts --- Fraud and misrepresentation — Negligent misrepresentation (Hedley Byrne principle) — Particular relationships — Sale of land

Parties entered into agreement of purchase and sale (APS), which contained entire agreement clause — Vendors signed seller property information statement (SPIS), in which they stated that property was not subject to flooding and that they would inform purchasers of any "important changes" prior to closing — Vendors did not disclose subsequent flood in basement — After transaction closed, basement flooded again — Purchasers brought successful action against vendors for damages based on negligent misrepresentation — Vendors appealed — Appeal allowed — Evidence did not support finding that purchasers relied on representations that formed basis of their claim.

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Hedley Byrne & Co. v. Heller & Partners Ltd. (1963), 107 Sol. Jo. 454, [1963] 3 W.L.R. 101, [1964] A.C. 465, [1963] 1 Lloyd's Rep. 485, [1963] 2 All E.R. 575 (U.K. H.L.) — referred to

Inntrepreneur Pub. Co. v. East Crown Ltd. (2000), [2000] N.P.C. 93, [2000] 3 E.G.L.R. 31, [2000] 2 Lloyd's Rep. 611, [2000] 41 E.G. 209 (Eng. Ch. Div.) — considered

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APPEAL by vendors from decision allowing purchasers' action for damages based on negligent misrepresentation.

Gloria Epstein J.A.:

I. Overview

1 The appellants, Don and Louise Beauchamp, sold their home to the respondents, Adam and Olga Soboczynski.

2 The issue at the centre of this appeal is the legal effect of an entire agreement clause in an agreement of purchase and sale. Specifically, does the clause preclude a purchaser's action in negligent misrepresentation against a vendor for non-contractual representations made subsequent to entering into the agreement but before closing?

3 The appellants and respondents entered into the agreement of purchase and sale (the "APS") on November 21, 2007. The purchase price was $290,000. Following the execution of the agreement, but before the transaction closed, the appellants, at the respondents' request, completed and signed a Seller Property Information Statement (the "SPIS"). In the SPIS, the appellants stated that the property was not subject to flooding. They also undertook to inform the respondents of any "important changes" to the information contained in the SPIS based on events, if any, that took place prior to closing.

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4 On January 9, 2008, the basement of the house flooded, causing relatively minor damage. The appellants fixed the damage but did not disclose the incident to the respondents. The transaction closed as scheduled on January 18, 2008.

5 On February 6, 2008, the basement flooded again. After learning of the pre-closing flood, the respondents sued the appellants for damages based on negligent misrepresentation, arguing that the SPIS required the appellants to disclose the January 9 flood to them.

6 The trial judge concluded that the entire agreement clause in the APS acted as a bar to the respondents' action. Notwithstanding this conclusion, the trial judge proceeded to assess damages. He found that if the respondents had been successful, they would have been entitled to $25,000 in damages for negligent misrepresentation.

7 The Divisional Court disagreed with the trial judge's conclusion that the entire agreement clause precluded the respondents' tort action. The SPIS required the appellants to tell the respondents about the pre-closing flood. They failed to do so. And the other elements of the tort of negligent misrepresentation had been made out. Therefore, the Court awarded damages to the respondents in the amount assessed by the trial judge.

8 The appellants appeal on two main grounds. First, the Divisional Court erred in finding that the entire agreement clause in the APS does not preclude a claim based on representations made in the SPIS. Second, the court erred in holding that the tort of negligent misrepresentation had been made out.

9 I would allow the appeal. I agree with the Divisional Court that the representations the appellants made in the SPIS are actionable notwithstanding the entire agreement clause in the APS. However, in my view, the evidence does not support a finding that the respondents relied on the representations that form the basis of their claim for negligent misrepresentation. In the absence of reliance, the respondents' claim must fail.

II. Factual Background

(i) The APS and the SPIS

10 The APS was subject to two conditions — satisfactory financing, and a satisfactory home inspection. The APS also contained an entire agreement clause. It read:

> [The APS] including any Schedule attached hereto, shall constitute the entire Agreement between Buyer and Seller. There is no representation, warranty, collateral agreement or condition, which affects [the APS] other than as expressed herein.

11 On November 22, 2007, the day after the APS was signed, Mr. Soboczynski gave the appellants the SPIS to fill out. After consulting their lawyer, the appellants completed and signed the SPIS. In the document, the appellants indicated that: (i) the property was not subject to flooding, (ii) they were not aware of any moisture or water problems, and (iii) they were not aware of any damage due to wind, fire, water, insects, termites, rodents, pets or wood rot. The SPIS concluded with the following statement:

> Any important changes to this information known to the sellers will be disclosed by the sellers prior to closing.

12 As previously noted, the APS was conditional on the "[r]esults of an inspection from an inspector of [the respondents'] choice". On November 28, 2007, the respondents obtained a satisfactory home inspection from their chosen inspector. As Mr. Soboczynski testified, "We received the inspection report. There was nothing significant there to be concerned about that we thought. My wife saw the inspection report as well and I took it home to her." Having obtained a satisfactory home inspection, the respondents waived the home inspection condition. They also secured financing and waived the financing condition. As of November 28, 2008, the APS was no longer conditional.

13 The SPIS was not incorporated into the terms of, or otherwise referenced in, the APS.

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(ii) The Two Floods

14 On January 9, 2008, the basement of the house flooded after a period of heavy rainfall and melting snow. Water entered the basement through the window wells. The carpet was saturated with water. The appellants repaired the damage by drying out the rug and replacing the under pad. The repairs cost $1,648.59.

15 The appellants consulted their lawyer about the flood but did not inform the respondents of the incident. The appellants' evidence was that they believed the flood was an isolated occurrence and was not an "important change" requiring them to give notice to the respondents under the terms of the SPIS.

16 The sale closed on January 18, 2008. The respondents were unaware of the January 9 flood. On February 6, 2008, after another period of heavy rainfall, the basement flooded again. The respondents repaired the damage and took steps to prevent further flooding. The respondents hired an expert and discovered that the backyard was ponding and the window wells were lower than the surrounding land. The remedial steps the respondents took cost $22,598.17.

17 The respondents eventually found out about the January 9 flood. By statement of claim dated November 17, 2009, they commenced this action against the appellants. The respondents sued only in tort. They claimed damages based on alleged fraudulent or negligent misrepresentations made in the SPIS.

III. Decisions Below

(i) Superior Court of Justice

18 The trial judge dismissed the respondents' claim.

19 He was not satisfied that the respondents had demonstrated that the property had been subjected to any flooding prior to the January 9 flood. He found that the cause of the flood was not clearly established but reasoned that after a period of heavy rainfall and melting snow, water had entered through the window wells. He further found that the appellants made a conscious decision not to disclose the January 9 flood to the respondents because they thought it was a "one off occurrence".

20 Citing *Krawchuk v. Scherbak*, 2011 ONCA 352, 106 O.R. (3d) 598 (Ont. C.A.), leave to appeal to S.C.C. refused, [2011] S.C.C.A. No. 319 (S.C.C.), the trial judge reasoned that statements in an SPIS can amount to non-contractual representations and can give rise to the tort of negligent misrepresentation. However, here, the SPIS was not part of or otherwise connected with the APS. The trial judge concluded that, as a result, the entire agreement clause in the APS "prevails to exclude" the representations in the SPIS. The respondents could therefore not rely on them.

21 The trial judge expressed some reluctance about whether the tort would be made out if he had reached a different conclusion about the effect of the entire agreement clause. At para. 62, he wrote:

> [I]t is doubtful that the incident, which I find the Beauchamps believed to have been a one off incident, was an "important change to the information" requiring disclosure to the purchasers as per the wording of the S.P.I.S.

22 Notwithstanding this reluctance, the trial judge dealt with the respondents' damages. He assessed them at $25,000 — an amount that included $22,598.17 for the costs of fixing the damage and preventing further flooding. The balance was intended to compensate the respondents for mental distress and loss of enjoyment. The amount of damages was not in issue before the Divisional Court and is not in issue before this court.

23 The trial judge died shortly after releasing his decision in this matter but before deciding the issue of costs. The appellants suggested that costs be referred to another judge of the Superior Court or be determined by the Divisional Court. The respondents suggested that costs be determined by the Divisional Court.

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(ii) Divisional Court

24 The Divisional Court allowed the respondents' appeal.

25 First, I note that at the conclusion of the hearing before the Divisional Court, counsel were asked the following question. If the Court determined that the trial judge had erred by reviewing the appellants' conduct on a subjective rather than an objective standard, were the parties content that the Court make findings of fact on the correct standard rather than send the matter back to trial? Both counsel agreed with the Divisional Court's proposal.

The Entire Agreement Clause and an Action in Tort

26 The Divisional Court held, at para. 40, that "the trial judge erred in law when he concluded that the [respondents] could not rely on the representation in the SPIS because of the entire agreement clause in the [APS]". The Court reasoned that the entire agreement clause in the APS did not interfere with the respondents' claim based on a negligent misrepresentation made in the SPIS, even though it was signed after the APS was entered into but before closing.

27 In coming to this conclusion, Herman J., writing for the Court, noted that in *Dzourelov v. T.B. Bryk Management & Development Ltd.* (2004), 190 O.A.C. 321 (Ont. Div. Ct.), Dawson J. interpreted the first sentence of a comparable entire agreement clause as "deal[ing] with the situation at the time the agreement was signed. It has the effect of excluding the possibility of any representation, warranty or collateral agreement at that time, that was not included in the written agreement": para. 13. [1] Justice Dawson concluded that the entire agreement clause did not preclude a claim arising out of the formation of a subsequent oral agreement.

28 The Court also pointed to several decisions in which courts have held that representations in an SPIS can give rise to an action in tort for negligent misrepresentation. [2] The Court noted, however, that in each case the completed SPIS was provided to the purchaser before the agreement of purchase and sale was entered into.

Was the Tort Made Out?

29 The Divisional Court then proceeded to determine whether the respondents had established a claim for negligent misrepresentation on the basis of the appellants' failure to advise them of the pre-closing flood.

30 After concluding that the appellants owed the respondents a duty of care, the Court found that the January 9 flood constituted an "important change" and, under the terms of the SPIS, the appellants were required to notify the respondents of the occurrence. Their failure to do so constituted an untruth.

31 The Court then held that the trial judge erred in law by applying a subjective test to the appellants' obligations under the SPIS by focusing on their honest belief that the incident did not amount to an "important change". In keeping with the approach set out in *Krawchuk*, an objective standard must be applied. The question is whether a reasonable person in the circumstances would have disclosed the flood.

32 The Court found that it was not reasonable for the appellants to not advise the respondents of the change. Therefore, the appellants "acted negligently in not disclosing the change in the situation": para. 59.

33 In considering the issue of reliance, the Court started with the proposition that purchasers are entitled to rely on representations in an SPIS. The Court then wrote, at para. 61:

> Had the [respondents] known about the flood, they might well have retained their own expert to investigate the situation to determine the cause of the problem. If it was determined that the problem was significant and was more than a one-time event, the contractual options of rescission or abatement might have been available to them.

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34 In concluding its analysis of the tort of negligent misrepresentation, the Divisional Court found that the respondents sustained damage as a result of the misrepresentation and gave judgment to the respondents in the unchallenged amount of $25,000.

Costs Award

35 After considering written costs submissions, the Divisional Court rejected the appellants' argument that costs should be reduced because the respondents had pleaded but did not establish fraud. The Court found that the fraud allegations had not been actively pursued at trial. The central issue at trial was negligent misrepresentation.

36 The Court awarded the respondents their trial costs fixed in the amount of $15,000, plus $10,171.69 in disbursements. The Court also awarded the respondents costs of the appeal in the amount of $7,500.

IV. Issues on Appeal

37 The appellants advance three main grounds of appeal. They submit that the Divisional Court erred:

1. by finding that the entire agreement clause in the APS did not preclude a claim in tort based on an alleged negligent misrepresentation made in the SPIS;

2. by concluding that the respondents had made out a claim for damages based on negligent misrepresentation; and

3. in its trial costs award to the respondents.

V. Analysis

(i) Did the Divisional Court err by finding that the entire agreement clause in the APS did not preclude a claim in tort based on an alleged negligent misrepresentation made in the SPIS?

38 The appellants submit that the entire agreement clause, which expressly stated that there are no representations affecting their agreement other than as expressed in the APS, precludes the respondents from advancing a claim in tort based on representations in the SPIS. The appellants point out that the respondents could have avoided the consequences of the entire agreement clause by incorporating the SPIS into the APS, but did not do so.

39 It is well-settled that contract and tort duties may arise concurrently. In *BG Checo International Ltd. v. British Columbia Hydro & Power Authority*, [1993] 1 S.C.R. 12 (S.C.C.), the Supreme Court wrote, at p. 26, "where a given wrong *prima facie* supports an action in contract and in tort, the party may sue in either or both, except where the contract indicates that the parties intended to limit or negative the right to sue in tort." The Court continued, at p. 27, "In so far as the tort duty is not contradicted by the contract, it remains intact and may be sued upon."

40 Accordingly, the key question is whether the entire agreement clause in the APS negatives the respondents' right to sue in tort based on misrepresentations made in the SPIS — a document completed after the APS was entered into.

41 In my view, the answer to the question is that, in the circumstances of this case, any consequences flowing from representations made in the SPIS were outside the reach of the entire agreement clause. The entire agreement clause in the APS operates retrospectively, not prospectively. In other words, the application of the clause is restricted to limit representations, warranties, collateral agreements, and conditions made *prior to or during* the negotiations leading up to the signing of the APS. When the appellants made representations in the SPIS, a document completed *after* the APS had been signed by all parties, the entire agreement clause was spent.

42 This conclusion is supported by the general purpose of entire agreement clauses, jurisprudence from this court, the plain meaning of the entire agreement clause at issue in this case, and the post-contractual conduct of the parties.

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General Purpose of Entire Agreement Clauses

43 An entire agreement clause is generally intended to lift and distill the parties' bargain from the muck of the negotiations. In limiting the expression of the parties' intentions to the written form, the clause attempts to provide certainty and clarity.

44 In *Inntrepreneur Pub. Co. v. East Crown Ltd.*, [2000] 41 E.G. 209 (Eng. Ch. Div.), Lightman J. colourfully described the purpose of an entire agreement clause as follows:

> The purpose of an entire agreement clause is to preclude a party to a written agreement threshing the undergrowth and finding in the course of negotiations some (chance) remark or statement (often long forgotten or difficult to recall or explain) on which to found a claim such as the present to the existence of a collateral warranty... For such a clause constitutes a binding agreement between the parties that the full contractual terms are to be found in the document containing the clause and not elsewhere.
>
> [Emphasis added.]

45 Legal commentators appear to be united in their view that entire agreement clauses are, generally speaking, retrospective in nature. According to Angela Swan, "An "entire agreement" clause deals only with what was done or said *before* the agreement was made and seeks to exclude those statements and acts from muddying the interpretation of the agreement; it is a contractual invocation of the parol evidence rule": *Canadian Contract Law*, 3d ed. (Markham: LexisNexis Canada, 2012), at p. 600 (emphasis in original); see also John D. McCamus, *The Law of Contracts*, 2d ed. (Toronto: Irwin Law Inc., 2012), at p. 733.

46 Justice P.M. Perell agrees. He says that "[t]he parol evidence rule then directs that the written contract may not be contradicted by evidence of the oral and written statements made by the parties before the signing of the contract. The entire agreement clause is essentially a codification of the parol evidence rule": "A Riddle Inside an Enigma: The Entire Agreement Clause" (1998) The Advocates' Q. 287 at 290-91 (emphasis added).

47 And according to Professor M.H. Ogilvie, entire agreement clauses are "patently not applicable... where the representation postdates the contract": "Entire Agreement Clauses: Neither Riddle Nor Enigma" (2009) 87 The Canadian Bar Review at 642 (emphasis added).

Jurisprudence From This Court

48 While there appears to be little jurisprudence on the effect of an entire agreement clause on representations made *after* the contract containing the clause is entered into, some assistance can be found in this court's decision in *Shelanu Inc. v. Print Three Franchising Corp.* (2003), 64 O.R. (3d) 533 (Ont. C.A.), subsequent proceedings, (2006), 19 B.L.R. (4th) 19 (Ont. C.A.).

49 *Shelanu* involved a contractual dispute in which the question was whether an entire agreement clause in a written agreement rendered unenforceable a subsequent oral agreement between the parties. Justice Weiler, writing for the court, concluded it did not.

50 *Shelanu* clarified certain points about entire agreement clauses.

51 First, an entire agreement clause does not prevent the parties from amending the terms of their agreement. In other words, post-contract events can affect both the enforceability of the obligations in the agreement and add new obligations to those imposed by its terms.

52 Second, and relatedly, entire agreement clauses do not apply prospectively unless the wording expressly so provides. In the words of Weiler J.A., at paras. 49-50:

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> [A]n exception to the parol evidence rule is the existence of any subsequent oral agreement to rescind or modify a written contract provided that the agreement is not invalid under the Statute of Frauds: *Ellis v. Abell* (1884), 10 O.A.R. 226 (Ont. C.A.) at para. 85.
>
> > Clauses such as the entire agreement clause in issue here are normally used to try to exclude representations made prior to the signing of the written agreement. See P.M. Perell, "A Riddle Inside an Enigma: The Entire Agreement Clause" (1998) *The Advocates' Q.* 287. Nothing in [the entire agreement clause] suggests that an oral agreement to surrender the franchise several years later would be of no effect. It cannot be said the entire agreement clause was clearly intended to cover any and all future contractual relations between Shelanu and Print Three.
> >
> > [Emphasis added.]

53 Both the general purpose of entire agreement clauses set out above and the approach to their application evident in this court's decision in *Shelanu* support the conclusion that, subject to express wording to the contrary, these clauses do not apply to agreements or representations that post-date the contract in which the clause is found.

54 I now turn to the specific circumstances in this case.

Specific Words Used in the Entire Agreement Clause in the APS

55 A consideration of the precise words the parties used to record their bargain is central to the interpretation of the entire agreement clause in the APS. For convenience, I again set out the text of the entire agreement clause in issue:

> This Agreement including any Schedule attached hereto, shall constitute the entire Agreement between Buyer and Seller. There is no representation, warranty, collateral agreement or condition, which affects this Agreement other than as expressed herein.

56 The clause is worded in the present tense — "[t]here is no representation" affecting the APS (emphasis added). On their face, the words of the clause do not preclude an action for negligent misrepresentation based on a representation made post-contract. The words that reflect the parties' bargain are therefore consistent with the general legal principles animating entire agreement clauses.

57 This interpretation of the clause is also consistent with the Divisional Court's analysis in *Dzourelov* — a case relied upon by the Divisional Court in this case. In *Dzourelov*, the entire agreement clause was very similar to the one in this case. It read: "The parties acknowledge that there is no representation, warranty, collateral agreement or condition, affecting the Agreement except as contained in this agreement. This agreement may not be amended other than in writing" (emphasis added). In interpreting this clause, Dawson J. wrote:

> The exclusive agreement clause in question consists of two sentences. I agree with the appellant's submission that the first sentence deals with the situation at the time the agreement was signed. It has the effect of excluding the possibility of any representation, warranty or collateral agreement at that time, that was not included in the written agreement.
>
> [Emphasis added.]

58 Thus, *Dzourelov* confirms that entire agreement clauses drafted in the present tense look backwards, not forwards.

59 The entire agreement clause in this case is saying, "These are the terms of our agreement and nothing that was said beforehand is relevant. You have no basis for relying on anything other than the terms of the agreement. The agreement stands on its own".

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Post-Contractual Conduct of the Parties

60 Finally, Canadian courts often look to the post-contractual conduct of the parties to shed light on what they intended the words enshrined in their written agreement to mean. The trend in Canada toward analyzing the subsequent actions of the parties is captured by G.H.L. Fridman in *The Law of Contract in Canada*, 6th ed. (Toronto: Carswell, 2011), at pp. 450-51:

> Canadian courts have adopted the view that subsequent conduct can be a useful guide to the interpretation of a written contract... In one case, concerned with whether a restrictive covenant in a contract was personal to the parties or went with the land, Thomson J. of the Supreme Court of Saskatchewan, said that in cases involving an ambiguity in an agreement, "there is no better way of determining what the parties intended than to look to what they did under it [*Bank of Montreal v. Univ. of Saskatchewan* (1953), 9 W.W.R. (N.S.) 193 (Sask. Q.B.), at 199]. There is much to be said for this approach, as many Canadian judges since 1970, have declared. In Canada it seems clear that the subsequent actions of the parties may be admissible to explain the true meaning and intent of their agreement. [Citations omitted.]

61 An examination of the conduct of the parties to the APS after they entered into their agreement supports the conclusion that they intended that the appellants' obligations under the SPIS would be enforceable.

62 It was not necessary for the appellants to complete the SPIS. If one contracting party asks, post contract, for a representation or warranty, the other does not have to give it: he or she can say, "No, the contract expresses the limit of my obligations". But that is not what transpired in this case. The fact that the appellants completed the SPIS, after consulting their lawyer, provides insight into their intentions in relation to the entire agreement clause. It reveals that the appellants considered the SPIS seriously.

63 Moreover, in the SPIS, the appellants undertook to inform the respondents of any "important changes" to the information they provided in the document. This ongoing obligation to which the appellants committed themselves indicates that all parties considered the SPIS as affecting their relationship.

64 For these reasons, I agree with the Divisional Court that the entire agreement clause, properly interpreted, does not preclude the respondents' claim for damages based on negligent misrepresentation. In my view, the appellants should be held to any consequences that flow, in law, from the representations they made in the SPIS. To conclude otherwise would render the entire SPIS exchange meaningless.

The Doctrine of Caveat Emptor

65 Before proceeding, I pause to briefly address the doctrine of *caveat emptor* ("let the buyer beware").

66 The appellants submit that circumventing the parties' intentions as expressed by the entire agreement clause in the APS erodes the doctrine of *caveat emptor*. I disagree with the premise of this submission. Having concluded that the entire agreement clause in this case operates retrospectively, not prospectively, it cannot be said that the respondents' claim for negligent misrepresentation has the effect of circumventing the parties' intentions or the entire agreement clause.

67 At para. 38 of its reasons, the Divisional Court quoted from Killeen J.'s decision in *Kaufmann*, at para. 119, for the proposition that, "once a vendor "breaks his silence" by signing the SPIS, the doctrine of *caveat emptor* falls away as a defence mechanism and the vendor must speak truthfully and completely about the matters raised in the unambiguous questions at issue". Although the SPIS at issue in *Kaufmann* was expressly incorporated into the agreement of purchase and sale, I agree with the thrust of Killeen J.'s remarks. So long as a purchaser's action is not precluded by the agreement of purchase and sale, the vendor cannot hide behind the doctrine of *caveat emptor* if he or she breaks the silence by signing a SPIS.

68 I would not give effect to this argument.

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(ii) Did the Divisional Court err by concluding that the respondents had made out a claim for damages based on negligent misrepresentation?

69 Despite my conclusion that the entire agreement clause does not prevent the respondents from advancing a claim in negligent misrepresentation, in my view, their claim still fails because they have not established the fourth element of negligent misrepresentation — reasonable reliance.

70 The tort of negligent misrepresentation has five elements: *Hedley Byrne & Co. v. Heller & Partners Ltd.*, [1964] A.C. 465 (U.K. H.L.); *Queen v. Cognos Inc.*, [1993] 1 S.C.R. 87 (S.C.C.), at p. 110. These elements are: (1) a duty of care based upon a special relationship between the plaintiff and defendant; (2) an untrue, inaccurate or misleading statement by the defendant; (3) negligence on the part of the defendant in making the statement; (4) reasonable reliance by the plaintiff on the statement; and (5) damage suffered by the plaintiff as a result.

71 On appeal, the parties made no written or oral submissions on the first element, the duty of care. My analysis proceeds on the assumption that the appellants owed the respondents a duty of care in these circumstances. I accept the Divisional Court's finding that the appellants were negligent in failing to advise the respondents of the pre-closing flood.

72 Reasonable reliance is fundamental to the tort of negligent misrepresentation. The reasonable reliance element "states a factual test for causation": Allen Linden and Bruce Feldthusen, *Canadian Tort Law*, 9th ed. (Canada: LexisNexis Canada Inc., 2011), at p. 473.

73 In *Farmer v. H.H. Chambers Ltd.* (1972), [1973] 1 O.R. 355 (Ont. C.A.), McGillvary J.A. wrote, at p. 357: "To recover under the rationale of the *Hedley Byrne* case, representation must not only be made but it has to be such as to cause the plaintiff, as a result, to do some act to his detriment." Although reliance can be inferred in certain circumstances, such an inference must be supported by the facts and evidence: *Strand v. Emerging Equities Inc.*, 2008 ABCA 23, 37 B.L.R. (4th) 44 (Alta. C.A.), at para. 6

74 The problem here is that it is far from clear that the respondents would have had a remedy even if the January 9 water incident had been disclosed prior to closing. Put another way, the misrepresentation did not cause the respondents to "do some act to [their] detriment": *Farmer*, at p. 357.

75 As noted above, the respondents sued in tort. They claim damages for negligent misrepresentation. However, there is no allegation of reliance in their statement of claim.

76 Notwithstanding the state of the respondents' pleading, in their closing submissions at trial, the respondents advanced two arguments on the reliance issue. They argued that they relied on the misrepresentation in the SPIS because they waived the home inspection condition after receiving the SPIS. The respondents also argued that they relied on the misrepresentation in the SPIS because they were deprived of the opportunity to seek remedies available to them under the APS.

77 I address each submission in turn.

78 There are two difficulties with the respondents' submission that they relied on the SPIS in waiving the home inspection condition in the APS. First, when the respondents waived the home inspection condition, there was nothing for the appellants to disclose. They waived the condition prior to the January 9 water incident. Second, and more significantly, there is no evidence that the inspector who performed the home inspection on behalf of the respondents relied on the SPIS in conducting his home inspection or even knew that it existed. Further, the trial judge rejected Mr. Soboczynski's testimony that the SPIS was "part of the property inspection" process. He also expressly found, at para. 30, that the SPIS "was unrelated to the results of an inspection." In the light of these findings, I would not give effect to this submission.

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79 This takes me to the respondents' argument that had the appellants advised them of the January 9 flood they would have taken advantage of remedies available to them under the APS. In terms of the available remedies, the respondents turn to s. 14 of the APS, which provided:

> **INSURANCE**: All buildings on the property and all other things being purchased shall be and remain until completion at the risk of Seller. Pending completion, Seller shall hold all insurance policies, if any, and the proceeds thereof in trust for the parties as their interests may appear and in the event of substantial damage, Buyer may either terminate this Agreement and have all monies paid returned without interest or deduction or else take the proceeds of any insurance and complete the purchase. No insurance shall be transferred on completion. If Seller is taking back a Charge/Mortgage, or Buyer is assuming a Charge/Mortgage, Buyer shall supply Seller with reasonable evidence of adequate insurance to protect Seller's or other mortgagee's interest on completion.
>
> [Emphasis added.]

80 The APS does not define "substantial damage".

81 The respondents' argument is problematic as it is unclear what rights would have been available to them under this provision. And the Divisional Court's somewhat conclusory statement, at para. 61, that "the contractual options of rescission and abatement might have been available to [the respondents]" does little to clarify the situation.

82 The respondents' access to the remedies available under s. 14 depended on a finding of "substantial damage". The difficulty the respondents face is that no finding was made as to whether the property sustained substantial damage as a result of the January 9 flood. In my view, on this record, the trial judge would likely have concluded that the January 9 flood did not constitute "substantial damage" in the light of the observation he made, at para. 62 of his reasons reproduced above, that "it is doubtful" the January 9 flood was an "important change" as contemplated by the SPIS. The point is, however, that no finding was made.

83 In any event, at the time the property changed hands on January 18, 2008, the $1,648.59 worth of damage caused by the January 9 flood had been repaired. There was no damage to speak of, substantial or otherwise.

84 A consideration of the role damages play in tort cases illuminates why the respondents did not rely on the appellants' negligent misrepresentations. In *Rainbow Industrial Caterers Ltd. v. Canadian National Railway*, [1991] 3 S.C.R. 3 (S.C.C.), at p. 14, the Supreme Court outlined how to assess damages in a negligent misrepresentation action: "The plaintiff seeking damages in an action for negligent misrepresentation is entitled to be put in the position he or she would have been in if the misrepresentation had not been made."

85 Here, had the appellants told the respondents of the January 9 flood, the respondents' position in relation to their obligations under the APS would not have changed. The respondents would have been obliged to complete the transaction under the terms of the APS. The fact that the respondents did not suffer any damage compensable in tort solidifies their inability to prove reliance.

86 To prove reasonable reliance, it was incumbent on the respondents to adduce evidence sufficient for the court to conclude that the misrepresentation somehow caused them to act to their detriment. This they did not do. Although reasonable reliance can be inferred from the circumstances, there is not, in my view, sufficient evidence upon which to base such an inference.

87 I conclude the respondents have not established the fourth element of negligent misrepresentation. Their tort claim must therefore fail.

(iii) Did the Divisional Court err in its trial costs award?

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88 The appellants argue that the Divisional Court erred in assessing the trial costs instead of referring them to the Superior Court. They say that proceeding in this fashion deprived them of a right of appeal.

89 They also contend that the Court erred in assessing costs on the basis that the respondents' allegation against them in fraud was not actively pursued. They say the unsuccessful allegation of fraud was pursued through to the end of trial and that the costs award should reflect the extent to which these allegations increased trial costs.

90 The appellants seek costs payable by the respondents on a substantial indemnity basis. The appellants argue that even if they are unsuccessful in this appeal, they should still be entitled to substantial indemnity costs of the action because the respondents made completely unsubstantiated accusations of fraud against them. Unproven allegations of fraud attract this kind of costs award because they go to the root of a person's integrity.

91 In my view, in the light of the trial judge's death, and the parties' submissions set out above, the Divisional Court was fully entitled to assess costs. The Divisional Court found as a fact that the plaintiffs did not actively pursue the fraud allegation at trial. The trial was about negligence, not fraud. The appellants were not entitled to substantial indemnity costs.

92 I see no reason to interfere with the Court's decision regarding the costs of the trial. The Court's assessment of the trial costs is entitled to deference.

VI. Disposition

93 For these reasons, I would allow the appeal, set aside the decision of the Divisional Court, and restore the decision of the trial judge dismissing the action.

94 I would award the appellants their costs of this appeal in the agreed-upon amount of $5,000, including disbursements and applicable taxes.

Alexandra Hoy A.C.J.O.:

I agree

C.W. Hourigan J.A.:

I agree

Appeal allowed.

Footnotes

1 The entire agreement clause at issue in *Dzourelov* stated: "The parties acknowledge that there is no representation, warranty, collateral agreement or condition, affecting the Agreement except as contained in this agreement. This agreement may not be amended other than in writing."

2 The Divisional Court cited the following three cases for this proposition: *Krawchuk*; *Kaufmann v. Gibson* (2007), 59 R.P.R. (4th) 293 (Ont. S.C.J.); and *Usenik v. Sidorowicz*, [2008] O.J. No. 1049 (Ont. S.C.J.).

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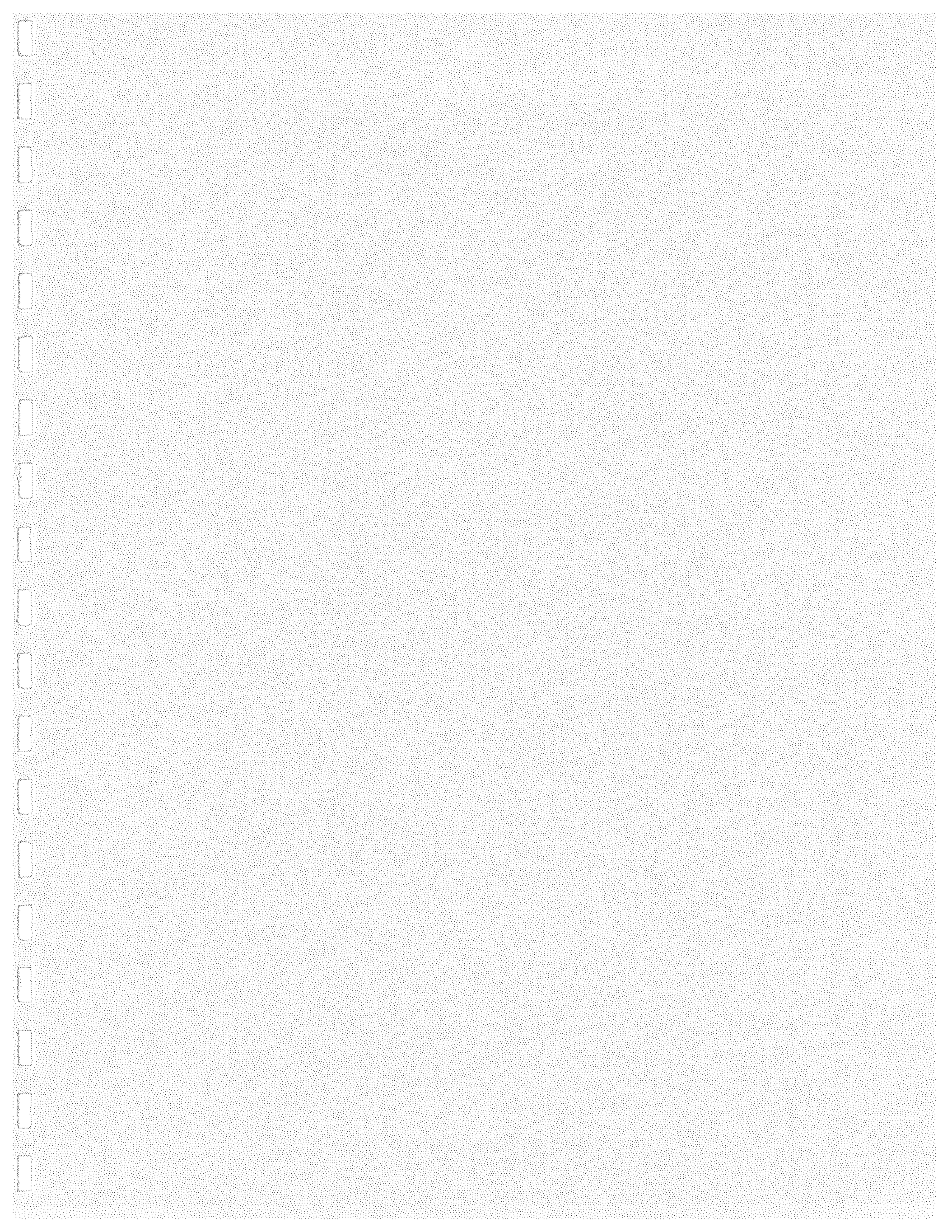

2015 CarswellOnt 17704
Supreme Court of Canada

Soboczynski v. Beauchamp

2015 CarswellOnt 17704, 2015 CarswellOnt 17705, [2015] S.C.C.A. No. 243

Adam Soboczynski and Olga Soboczynski v. Don Beauchamp and Louise Beauchamp

Abella J., Karakatsanis J., Brown J.

Judgment: November 19, 2015
Docket: 36489

Proceedings: Leave to appeal refused, 2015 CarswellOnt 5577, 251 A.C.W.S. (3d) 701, 385 D.L.R. (4th) 148, 333 O.A.C. 353, [2015] O.J. No. 2055, 125 O.R. (3d) 241, 2015 ONCA 282, 52 R.P.R. (5th) 175 (Ont. C.A.)

Counsel: Counsel — not provided

Subject: Contracts; Corporate and Commercial; Property; Torts
Headnote
Real property
Torts

Per curiam:

1 The application for leave to appeal from the judgment of the Court of Appeal for Ontario, Number C58106, 2015 ONCA 282, dated April 23, 2015, is dismissed with costs.

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Court File No. CV-12-9545-00CL

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF 3113736 CANADA LTD. 4362063 CANADA LTD., and A-Z SPONGE & FOAM PRODUCTS LTD.

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

Proceeding Commenced at Toronto

BRIEF OF AUTHORITIES OF THE MOVING PERSON DOMFOAM INC.

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