QUEEN'S BENCH FOR SASKATCHEWAN

Citation: **2021 SKQB 47**

Date: **2021 02 18**
Docket: QBG 1337 of 2020
Judicial Centre: Saskatoon

IN THE MATTER OF THE RECEIVERSHIP OF TYLER SMITH AND PAMELA SMITH, SMITH NORTHERN RANCHING AND 101197829 SASKATCHEWAN LTD.

BETWEEN:

BANK OF MONTREAL

PLAINTIFF

- and -

TYLER SMITH, PAMELA SMITH, SMITH NORTHERN RANCHING and 101197829 SASKATCHEWAN LTD.

DEFENDANTS

Counsel:

Paul D. Olfert	for Deloitte Restructuring
Janine L. Lavoie-Harding	for Farm Credit Canada
David G. Gerecke, Q.C.	for the Bank of Montreal
James P. Kroczynski	for Richardson Pioneer Ltd.
Peter V. Abrametz	for the defendants

FIAT
February 18, 2021

SCHERMAN J.

Introduction

[1] By Order of Smith J., made December 1, 2020 [Order], pursuant to s. 243(1) of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3, s. 65(1) of *The Queen's Bench Act, 1998*, SS 1998, c Q-1.01, and s. 64(8) of *The Personal Property Security Act, 1993*, SS 1993, c P-6.2, Deloitte Restructuring Inc. [Receiver] was appointed the Receiver of the Debtors Tyler Smith, Pamela Smith, Smith Northern Ranching and 101197829 Saskatchewan Ltd. [Debtors]. Paragraph 3(c) of the Order stipulated, *inter alia*, that the Receiver was authorized to "cease to perform any contracts of the Debtors". The Receiver has now applied for an order authorizing it to cease to perform purchase contracts between Tyler Smith and Richardson Pioneer Limited [Richardson].

Background Facts

[2] Smith Northern Ranching is a partnership created by Tyler Smith, Pamela Smith and 101197829 Saskatchewan Ltd. to carry on the business of a farming enterprise commencing January 1, 2012. As of March 16, 2012 Smith Northern Ranching was registered with the Saskatchewan Corporate Registry as a business name for the partnership. 101197829 Saskatchewan Ltd. is a corporation whose shares are owned by and is controlled by Tyler and Pamela Smith.

[3] Bank of Montreal [BMO] has been a lender to Smith Northern Ranching and the Debtors since the partnership was established in 2012 and was a lender to the individual debtors previous to that. BMO's loans and lines of credit to Smith Northern Ranching were guaranteed by Tyler Smith, Pamela Smith and 101197829 Saskatchewan Ltd. The BMO loans to the partnership and the related guarantee obligations were all secured by registered s. 427 *Bank Act*, SC 1991, c 46, security and General Security Agreements granted by the Debtors over all their assets.

[4] In January of 2018 BMO made demands for payment of all monies due based upon defaults by the Debtors of their loan covenants. Following negotiations a Forbearance Agreement was entered into on July 16, 2018. Breaches of the Forbearance Agreement occurred resulting in demands for payment in full being made on February 13, 2019. On March 11, 2019 BMO served the Debtors with Notices of Intention to Enforce Security under s. 244 of the *Bankruptcy and Insolvency Act* and Notice of Intent to Realize on Security under s. 21 of the *Farm Debt Mediation Act*, SC 1997, c 21. Unsuccessful negotiations followed.

[5] In August of 2020 counsel for BMO advised the Debtors' counsel that if satisfactory responses were not received by August 11, 2020 steps would be started to have a receiver appointed. Following this the Debtors applied for a stay of proceedings under the *Farm Debt Mediation Act* which was granted. No resolution was achieved at mediation and the stay imposed was lifted effective November 9, 2020 at 24:00 hours.

[6] On November 10, 2020 BMO commenced action seeking judgment and appointment of a receiver. On November 12, 2020 BMO had a bailiff seize the Debtors' grain and canola and filed its application seeking the appointment of a receiver.

[7] Following the appointment of the Receiver on December 1, 2020 the Receiver took possession of Debtor assets, which included some 96,000 bushels of canola that had been in the possession of the Debtors but seized by BMO's bailiff on November 12, 2020.

[8] On July 27, 2020 Tyler Smith had entered into three separate "deferred delivery contracts" with Richardson for the future delivery of some of 165,345 bushels of canola to Richardson. The contract prices were between $10.30 and $10.45 per

bushel. Prior to BMO's seizure of assets and the appointment of the Receiver Tyler Smith had delivered approximately 65,000 bushels of canola to Richardson.

[9] By January of 2021 prices for February/March delivery of canola were in the order of $14.70 per bushel. There followed discussions between the Receiver and Richardson with respect to the canola now in the possession of the Receiver. Richardson's position was that the Receiver should honour the contracts entered into by Tyler Smith. The Receiver's position was that it was in the best interests of all stakeholders to disclaim the contracts since the 96,000 bushels would generate approximately $413,000 more for the stakeholders in the receivership than selling the canola to Richardson under the contracts Tyler Smith had entered into. Further the Receiver questions the validity and enforceability of the contracts entered into by Tyler Smith as against Smith Northern Ranching.

[10] The Receiver is of the opinion that there is a net benefit to the receivership estate of approximately $413,000.00 if it disclaims the contracts Tyler Smith entered into with Richardson and has applied to the court for an order authorizing it to disclaim the Richardson contracts. Richardson opposes the application and asks the court to dismiss the application with costs to it.

Issues

[11] The issues to be decided on the Receiver's application are:

a. The court's jurisdiction to hear the application;

b. The legal principles with respect to a court-appointed Receiver's right to disclaim contracts; and

c. Whether this Court should exercise its discretion to approve the Receiver's disclaimer of the Richardson contracts.

The Court's Jurisdiction

[12] The application for appointment of a receiver was made, *inter alia*, under 243(1) of the *Bankruptcy and Insolvency Act.* This section provides the court with the authority to give the receiver the authority to take any action the court considers advisable. The Order appointing the Receiver specifically provides in paragraph 3(c) that the Receiver is empowered and authorized, among others, to "cease to perform any contracts of the Debtors". This power is commonly granted and is a standard clause in the Saskatchewan Template Receivership Orders.

[13] It is well established in law that court-appointed receivers do have the right to cease to perform or disclaim contracts, subject to the limitations or parameters discussed below. The jurisdiction of the court to hear and decide the application made is clear.

The legal principles with respect to a receiver disclaiming a contract

[14] While it is common practice for receivers to disclaim contracts or choose not to honour contracts entered into by subject debtors, there is a paucity of judicial decisions addressing the application of the relevant legal principles. The applicable legal principles and the underlying decisions are summarized in Frank Bennett, *Bennett on Receiverships*, 3d ed (Toronto: Thomson Reuters, 2011) at 433 to 436 under the headings "5. Contracts, (a) Existing Contract with Debtor". There the learned author states in part as follows:

> At the commencement of any receivership, the receiver reviews the terms of any on-going or executory contracts at the time of the

appointment or order with a view to determining whether the receiver should perform or disclaim them. Where the *Bankruptcy and Insolvency Act* applies to the receivership, subsection 14.06(1.2) provides that a trustee, including a receiver, is not liable for claims arising prior to the appointment of the receiver. If the receiver completes the contract, the receiver may be conferring a preference on a creditor who would otherwise be unsecured. In cases where the contract is almost complete, such as in the case where the debtor had sold goods but had not delivered them, the court examines the terms of the contract, the intention of the parties, and the debtor's conduct. If the debtor intended that title to the goods passes to the purchaser and separated the goods from its other inventory, the court will enforce the contract in favour of the purchaser or in the case of real property where equitable title has passed, direct the receiver to perform the contract. ...

In a court-appointed receivership, the receiver is not bound by existing contracts made by the debtor nor is the receiver personally liable for the performance of those contracts entered into before receivership unless the receiver continues to perform them. However, that does not mean the receiver can arbitrarily break a contract. The receiver must exercise proper discretion in doing so since ultimately the receiver may face the allegation that it could have realized more by performing the contract rather than terminating it or that the receiver breached its standard of care by dissipating the debtor's assets. If the receiver operates the business, the receiver has a duty to preserve the goodwill and the assets of the business. Consequently, the receiver should not disregard executory contracts where they are beneficial to the stakeholders. Thus, if the receiver chooses to break a material contract, the receiver should seek leave of the court where the receiver does not have the power to do so under the initial order. *[Bank of Montreal v Probe Exploration Inc. (2000), 33 CBR (4th) 173, 2000 Carswell Alta. 1659, [2000] AJ No 1752 (Alta QB), appeal dismissed (2000), 33 CBR (4th) 182, 2000 CarswellAlta 1621, [2000] AJ No 1751(Alta CA) where the court refused to allow the receiver to terminate a contract essentially on the basis that the receiver is bound to act in an equitable manner, must be fair and equitable to all, and must not prefer one creditor over another.]* The debtor remains liable for any damages as a result of the breach. *[Cited in Bank of Montreal v Scaffold Connection Corp. (2002), 36 CBR (4th) 13, 2002 ABQB 706 (CanLII), 2002 CarswellAlta 932 (Alta QB) and in New Skeena Products Inc. v. Kitwanga Lumber Co. (2005), 39 BCLR (4th) 327, 251 DLR (4th) 328, 9 CBR (5th) 267 (BC CA), affirming (2004), 19 CBR (5th) 45, 2004 BCSC 1818 (CanLII), 2004 CarswellBC 3540 (BC SC) where the court concluded that the receiver had the power in the initial order to apply for a vesting order to convey assets free and clear of security including executory contracts. The court went on to discuss and conclude that trustees in bankruptcy have a common law right to disclaim contracts. See also Re Pope & Talbot Ltd. (2009), 50 CBR*

(5th) 99, 2009 BCSC 17 (CanLII), 2009 CarswellBC 88 (BC SC). See also bcIMC Construction Fund Corp. v Chandler Homer Street Ventures Ltd. (2008), 86 BCLR (4th) 114, 44 CBR (5th) 171 at para 58, 72 RPR (4th) 68 (BC SC) where the court reviews the case law on the right of the receiver to terminate existing contracts and summarizes the effects; namely, (a) the receiver is not bound by existing contract entered into before the receivership unless it decides to be bound by them; (b) the receiver should seek leave of the court before disclaiming contracts; (c) the debtor remains liable for any damages if the receiver disclaims the contracts; (d) the receiver owes a duty of care to preserve the goodwill to the debtor, not to the creditors; (e) the receiver can disclaim the contract with a third party even if the third party has an equitable interest; and (f) if the receiver decides to perform the contract entered into by the debtor before the receivership, then the receiver is liable for the performance. Referred to in 2155489 Ontario Inc. v SMK Speedy International Inc. (2009), 2009 CanLII 4847, 2009 CarswellOnt 668 (Ont SCJ [Commercial List]). See also Royal Bank of Canada v Penex Metropolis Ltd. (2009), 2009 CanLII 45848, 2009 CarswellOnt 5202, [2009] OJO No 3645 (Ont SCJ), where the court granted the receiver power to disclaim contracts in the initial order. In this case, the court re-iterated that as long as the receiver's decision to terminate a contract is commercially reasonable or "within the broad bounds of reasonableness", the court will not interfere.]

... Whether the receiver disclaims the contract unilaterally or applies to the court for an order to do so, the receiver must act reasonably and exercise good business sense. The receiver should review the contract in some detail, make appropriate investigations and inquiries including conferring with the principals of the debtor, and others in the industry to see if there is any merit in performing the contract for all the stakeholders since, if the contract is terminated, the other party has a claim in damages against the debtor.

In the situation where the receiver applies to the court and if the receiver is permitted to disclaim such a contract between the debtor and a third party, the third party has a claim for damages and can claim set-off against any moneys that it owes to the debtor. If the court-appointed receiver can demonstrate that the breach of existing contracts does not adversely affect the debtor's goodwill, the court may order the receiver not to perform the contract even if the breach would render the debtor liable in damages. On the other hand, if the assets of the debtor are likely to be sufficient to meet the debt to the security holder, the court may not permit the receiver to break a contract since, by doing so, the debtor would be exposed to a claim for damages. If the receiver chooses to adopt the debtor's contract, the receiver becomes personally liable for that performance unless it disclaims liability.

[Bracketed and italicized text is the insertion of footnotes from the Bennett text.]

Should the Court exercise its discretion to approve the Receiver's disclaimer of the Richardson contracts?

[15] Richardson does not take the position that it is either a secured or unsecured creditor of the Debtors. On hearing of the application counsel for Richardson took the position that it was present in its capacity as a purchaser of the canola "nothing more nothing less" and opposed any order disclaiming the contracts. There is no claim that Richardson has a security interest in the canola in question. Its position is simply that the contracts it has should be honoured.

[16] Richardson's position is that in reliance on the contracts with Tyler Smith, it in turn sold that quantity of canola for future delivery at the then market price. Should the Tyler Smith contracts not be honoured it says it will suffer a significant financial loss since it will then have to purchase equivalent amounts of canola at current market prices so as to perform its contractual obligations under its resale contracts. Thus it says that in fairness and on equitable considerations the Receiver should not be permitted to disclaim the contracts. In support of its position Richardson relies on the *Bank of Montreal v Probe Exploration Inc.* (2000), 33 CBR (4th) 173 (Alta QB) [*Probe*]. This decision is noted in the footnotes to *Bennett on Receivership* quoted above.

[17] The position of the Receiver and Bank of Montreal is that:

a. The Receiver has an obligation to maximize the recovery from the assets of the Debtors' estate for the benefit of all stakeholders;

b. To maximize the value of the estate the Receiver needs to sell the canola inventory at the current market price;

c. The Receiver has the right to disclaim contracts which are not for the benefit of the estate and it is in the best interests of the estate to disclaim the Richardson contracts;

d. BMO has a first and prior security interest in the canola which it is entitled to have enforced against any claim of Richardson. BMO had seized the canola and whatever rights Richardson may have under its contracts cannot defeat the rights BMO has to realize on its security, whether directly or through the actions of the Receiver;

e. When fairness and equity considerations are considered, the interests of BMO as a secured creditor and the interests of other creditors of the Debtors (secured and unsecured) outweigh any equities in favour of Richardson arising under its executory contracts;

f. Richardson's contracts with respect to the canola are executory only in nature and with respect to non-unique goods, thus the *Forjay Management Ltd. v 0981478 B.C. Ltd.*, 2018 BCCA 215, 62 CBR (6th) 180 [*Forjay*] and *Probe* decisions relied upon by Richardson are distinguishable and not applicable; and

g. In any event, the canola in question was the property of Smith Northern Ranching, the partnership, which Tyler Smith had no authority to sell in his personal name and so the contracts are unenforceable against the partnership.

[18] Counsel for the Debtors advised the court that their position is that the position advanced by the Receiver is the correct position in law and in equity and the Receiver should be permitted to disclaim the contracts.

[19] When a receiver assesses whether or not to disclaim a contract the receiver is obligated to assess all equitable interests or equities in the disclaimer exercise. See *New Skeena Forest Products Inc. v Kitwanga Lumber Co. Ltd.*, 2004 BCSC 1818 at para 22, 19 CBR (5th) 45.

[20] This Court must similarly assess all equitable interests or equities when being asked to approve a disclaimer proposed by a Receiver. It is my conclusion that in the circumstances of this case the equitable interests or equities support approving a disclaimer by the Receiver of the Tyler Smith contracts with Richardson.

[21] The overarching legal and equitable consideration is that BMO has a first security interest in the canola in question that it is entitled to enforce. The Receiver is obligated to give effect to existing security interests and their relative priorities when marshalling assets of the estate for all stakeholders.

[22] Apart from the question of whether Tyler Smith's contracts are enforceable against Smith Northern Ranching, the contracts are executory in nature; i.e. there are continuing obligations to perform on both sides. The canola is in the possession of the Receiver, it has not been delivered to Richardson and Richardson has not paid for it.

[23] No property in the canola had passed. The contracts contemplated delivery in the future and payment upon delivery. Had the canola been delivered and Richardson paid for it then Richardson would have an argument that property had passed and the security interest of BMO attached only to the proceeds paid. That is not the situation here.

[24] While the Richardson contracts (Condition 8 thereof) purport to have the seller, Tyler Smith, grant to the buyer, Richardson, a general and continuing security interest in the canola to be purchased "for all present and future indebtedness of the Seller to the Buyer", at the date of the Receivership there was no indebtedness of Tyler Smith to Richardson to secure. Even if Tyler Smith could grant Richardson a security interest in canola of the Partnership, in respect of potential future indebtedness, that security interest was clearly subordinate to the prior security interest of BMO in the canola.

[25] Had a receiver not been appointed, there is no question but that BMO would have been entitled to seize and sell the canola in question pursuant to its registered prior security interests in the canola. Richardson would not in such a situation have been able to validly claim, by virtue of its contracts with Tyler Smith, that it had either a prior legal right or equities that somehow defeated the legal rights of BMO.

[26] The Receiver is obliged within the receivership to give full credence to the legal rights flowing from security interests held by creditors. With limited exceptions vested legal interests prevail over equitable interests. One exception is that of the *bona fide* purchaser for value without notice of a prior existing legal interest. This exception does not exist here. By virtue of BMO's registration of its security interest in the assets of all of the Debtors, Richardson had notice of BMO's security interests. Further, Richardson does not have the status of a *bona fide* purchaser for value because it has not given value for and purchased the canola in question.

[27] Counsel for Richardson argues that other security BMO holds, without the additional some $413,000 that would be realized by selling the canola at current market value, will be sufficient to cover the indebtedness to BMO and thus the contracts

should not be disclaimed. Apart from the fact that I do not have clear evidence this is so, this argument is a *non sequitur.*

[28] Under the doctrine or principles respecting marshalling of assets BMO as a secured creditor, and the Receiver in its role as receiver, has the obligation to satisfy the debt to BMO and other ranking secured creditors first from assets which may not be available to other secured creditors and to unsecured creditors. This ensures that all creditors and stakeholders are treated fairly by requiring that all available assets are realized upon for the benefit of the stakeholders generally.

[29] The order of liquidity applied within the doctrine of marshalling of assets contemplates that the highest liquid asset is placed first and the least liquid asset is placed last. Goodwill is the least liquid asset and thus placed last. Clearly the canola is a very liquid asset. Thus, given the first secured position of BMO and the doctrine of marshalling of assets, it follows that the full value of the canola must be accessed to ensure those ranking lower in priority or unsecured are not treated unfairly. The Receiver's responsibility is to maximize the value of the estate for the benefit of all creditors and other stakeholders.

[30] In my opinion the equitable considerations engaged by the doctrine respecting marshalling of assets militates heavily in favour of the Receiver disclaiming the Richardson contracts for the benefit of all stakeholders in the receivership. The availability of this asset for the benefit of the estate as a whole is maximized by the Receiver disclaiming the contracts.

[31] Disclaiming the contracts by the Receiver does not leave Richardson without a remedy. Such disclaimer simply means the Receiver does not acknowledge or accept responsibility for the contract. Richardson will have the ability to pursue a

claim for breach of contract and consequential damages against Tyler Smith. If successful in such a claim it will be an unsecured creditor of Tyler Smith and would participate rateably with other unsecured creditors of Tyler Smith in realization from the assets of Tyler Smith. However, at this point in time Richardson is not yet an unsecured creditor. Its status is simply that of being a party to an executory contract with Tyler Smith.

[32] The following authorities support this analysis and conclusion:

- *Forjay*, aff'd on appeal 2018 BCCA 251, 11 BCLR (6th) 429;
- *bcIMC Construction Fund Corp. v Chandler Homer Street Ventures Ltd.*, 2008 BCSC 897, 44 CBR 171 [*bcIMC Construction Fund*]; and
- *Golden Opportunities Fund Inc. v Phenomenome Laboratory Services Inc.*, (19 July 2016) Saskatoon, QBG 1639/16 (Sask QB) [*Phenomenome*], a fiat of Meschishnick J.

[33] In *Forjay* a condo developer entered into 40 pre-sale contracts of condo units. Later the condo developer was placed into receivership by secured lenders holding mortgages over the development. The receiver applied to the court for approval to disclaim the 40 pre-sale contracts in circumstances where the market price for the condos had risen significantly above the pre-sale prices. The court granted the approval to disclaim stating that if not disclaimed the receiver would in effect be granting the pre-sale purchasers priority over the condo developer's secured creditors. At paragraph 93 the court said the following:

> 93 I also have no difficulty concluding that a failure to disclaim here would result in the purchasers receiving a preference in respect of value that would otherwise accrue to the mortgagees under their prior

> ranking security. In order to permit the pre-sale contracts to complete, the Court would need to order the discharge of the mortgages in circumstances where the mortgagees would not receive payment of the amounts they bargained to accept in exchange for a discharge. This would be an exceptional result and I know of no authority to order it in these circumstances. I agree with the mortgagees that it would have the effect of elevating the claims of the purchasers above the legal priority and security of the mortgagees: *bcIMC* at para. 96; *Penex* at para. 27 [2009 CanLII 45848].

[34] In *bcIMC Construction Fund* the court held at paragraph 96 that a receiver should be permitted to disclaim an agreement if continuing the agreement would create a significant preference in favour of the contracting party. Requiring the Receiver to here honour the contracts entered into by Tyler Smith would have the effect of granting a significant preference to Richardson beyond what it would in all likelihood receive as an unsecured creditor of Tyler Smith or Smith Northern Ranching based on a damage judgment as an unsecured creditor.

[35] In *Phenomenome* Meschisnick J. distinguished the decision in *Probe* relied upon by Richardson and said the following:

> 8. As detailed in the Second Report, the disclaimer of the Contracts will result in a net benefit of approximately $412,800.00 for division among the Debtors' creditors, in accordance with their respective priorities. Conversely, if the Contracts are not disclaimed, Richardson Pioneer will realize the full quantum of that net benefit, to the exclusion of the Debtor's other creditors.
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> 9. Paragraph 3(c) of the Receivership Order entitles the Receiver to disclaim contracts without leave of the Court; however, Courts and commentators have noted that, where a Receiver seeks to disclaim a *material* contract, it should seek leave of the Court to do so.
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> 10. Accordingly, given the significance of the Contracts in the context of this receivership, the Receiver has applied for this Honourable Court's advice and direction on how the Receiver should exercise its authority under paragraph 3(c) of the Receivership Order.

Conclusion

[36] For the reasons stated above I approve the application of the Receiver for approval of its decisions to disclaim the subject contracts between Tyler Smith and Richardson. The decision shall not operate to prevent Richardson from taking action against Tyler Smith and/or Smith Northern Ranching for breach of contract. This decision makes no finding as to whether or not such causes of action have merit or what, if any, damages might be awarded.

[37] The Receiver shall have costs of this application to be taxed on the basis of Column 2 of the tariff.

J.

B.J. SCHERMAN