Date: 20060407
Docket: CI 05-01-43350
(Winnipeg Centre)
Indexed as: Manitoba Securities Commission
v. Crocus Investment Fund
Cited as: 2006 MBQB 87

COURT OF QUEEN'S BENCH OF MANITOBA

BETWEEN:	)	David G. Hill
	)	for Deloitte & Touche Inc.
	)	Receiver and Manager of
	)	Crocus Investment Fund
	)	
	)	Kenneth A. Filkow, Q.C.
	)	and Diane M. Stasiuk
	)	for Lea Baturin, Albert Beal,
	)	Diane Beresford, Charles E.
	)	Curtis, Sylvia Farley, Peter
THE MANITOBA SECURITIES COMMISSION,	)	Olfert, Robert Ziegler, Wally
	)	Fox-Decent, Hugh Eliason,
Applicant,	)	Ron Waugh, Robert Hilliard
	)	and John Clarkson
- and -	)	
	)	Kenneth A. Filkow, Q.C. also
CROCUS INVESTMENT FUND,	)	appeared as agent for:
	)	G. Patrick S. Riley,
Respondent.	)	Counsel for Sherman Kreiner
	)	and Jane Hawkins
	)	and as agent for:
	)	Robert A. Tapper, Q.C.,
	)	Counsel for James Umlah
	)	
	)	Martin G. Tadman
	)	for Robert Hilliard
	)	
	)	Douglas G. Ward
	)	for the Manitoba Federation
	)	of Labour
	)	

) John Fabello/Andrew Gray
) for BMO Nesbitt Burns Inc.
)
) Jonathan B. Kroft
) and Pearl J. Reimer
) for Wellington West
) Capital Inc.
)
) David Klein, Jay C. Prober
) and J.R. Norman Boudreau
) for Bernard Bellan et al in
) Q.B. Suit No. CI 05-01-42765
)
) Kieran E. Siddal
) for David Friesen
)
) Jack T. McJannet, Q.C.
) for Crocus Investment
) Association
)
) Judgment delivered:
) April 7, 2006

McCAWLEY, J. (ORALLY)

[1] Deloitte & Touche Inc., as Receiver and Manager of Crocus Investment Fund, brings a motion seeking the advice and direction of the court with respect to Receiver's Report #6. Specifically, the court is being asked whether the Receiver may consider making a distribution to the shareholders of Crocus in the face of a proposed class action filed on behalf of Bernard W. Bellan et al in Queen's Bench Suit No. CI 05-01-42765 (the "Bellan action").

[2] Since the Receiver's plan for the gradual sale of the assets of Crocus over a reasonable period of time was approved in October 2005, events have

continued to unfold apace. This is evident from the first quarterly report of the Receiver for the period ending December 31, 2005 outlining its activities since its appointment in June of that year.

[3] Additionally, evidence filed in the within motion discloses a continuing interest in Crocus by GrowthWorks Canadian Fund Ltd. (a Vancouver based venture capital fund which earlier had made a proposal to purchase the assets of Crocus) and efforts on the part of certain Crocus shareholders to hold a shareholders' meeting to consider any GrowthWorks proposal. The court was advised that discussions involving the Receiver, GrowthWorks and some of the Crocus investee companies had taken place as recently as the previous evening.

[4] A further development is that, as a result of a court order, new counsel have been retained in the Bellan action. It is their intention to seek an amendment to the statement of claim expanding the proposed class to include all Crocus shareholders, not only those who purchased their shares on or after October 1, 2000. No defences have been filed and the action is yet to be certified.

[5] To set the context against which these events have occurred, it is useful to refer to the Receiver's first quarterly report which, among other things, notes the following:

- as at June 28, 2005 there were 46 individual investee companies within the Crocus portfolio with a gross carrying value of $64.1M;

- Crocus investments are comprised of both debt and equity with the majority being minority equity positions;
- as at December 31, 2005 there remain 39 investee companies with a gross carrying value of approximately $61.5M;
- since its appointment, in addition to receiving approximately $2.4M for investment with a book value of $2.5M, the Receiver has eliminated exposure on approximately $1.7M in guarantees;
- the net assets as of December 31, 2005 have a book value of approximately $85M consisting of the aforementioned $64.1M plus approximately $20M in unencumbered short-term investments.

[6] Of particular interest with respect to this motion are the known contingent liabilities as at December 31, 2005 listed in the report. They include:

- the proposed class action filed July 21, 2005 claiming $150M in damages for oppression and negligence and $50M for punitive and exemplary damages;
- indemnifications claimed by the former officers and directors of Crocus with respect to proceedings before the Manitoba Securities Commission and an investigation of the Office of the Auditor General of Manitoba, and the defendants in the proposed class action which also include the lead brokers of Crocus;

- guarantees by Crocus of advances to investee companies from other lenders which exposure has been reduced from $4.0M to $1.6M as at December 31, 2005;
- severance claims and potential pension plan contributions with respect to two former employees of Crocus who were not paid prior to the receivership;
- a claim by a former employee of Crocus for $30M filed in the U.S. which the Receiver believes to be frivolous and which will be vigorously defended;
- a potential claim by the Government of Canada - Western Economic Diversification with respect to a $2M contribution made to Crocus between 1994 and 1996, a portion of which was repayable on an annual basis by Crocus depending on profitability levels;
- an estimated liability for trailer fees of approximately $1.5M which is based on a share price of $6.00 but which amount will ultimately be based on the amount of repayment to shareholders;
- two indemnities provided by Crocus of which the trustee became aware after its appointment.

[7] It is important to note the following statement by the Receiver in relation to the list of contingent liabilities:

> ... The Receiver however cannot provide any assurance that all contingent liabilities of the Fund have been identified. (p. 11)

[8] At p. 15 of the report, addressing the issue of share value, the Receiver also had this to say:

> The ultimate realizable value of the shares will be dependent on future events which will determine the realizable value of the portfolio. As well, the amounts that Crocus will have to pay in order to settle known and contingent liabilities, including payment on various indemnities, may have a material effect on the unit value which is ultimately available for distribution to Crocus unit holders. The Receiver continues to believe that these amounts may be significant in light of the current investigations and the Class Action lawsuit against the Fund and other parties that are claiming Crocus' indemnification.... (emphasis added)

[9] The Receiver now says that, in the normal course of its operations, it does not need to retain all the short-term investments in its possession during the wind down period. In its opinion it could distribute $14.2M as an interim distribution to shareholders and still have sufficient funds to finance the ongoing operations of Crocus including paying its current creditors. The sticking point is the proposed class action which the Receiver identifies as an impediment to any distribution given its current inability to assess the outcome or place a value upon the class action. As the Receiver observed:

> ... It may be that at some point, the effect of the Class Action will be a judgment in an amount so significant that it renders the company insolvent. However, at the present time, it is the Receiver's opinion that that is not the case, and indeed may never be the case. (p. 3, para. 7)

[10] Accordingly, the Receiver comes to court for advice and direction and asks for authorization to consider an interim distribution of $14.2M. One of the grounds initially advanced in support of such authorization was that, if the proposed class action were ultimately successful, those shareholders who were not part of the class would be prejudiced. Obviously this justification disappears

if the proposed class action is expanded to include all shareholders. When counsel for the Receiver was asked about this, he suggested that the interim distribution could be treated as an "advance" or "set off" against any future finding of liability and noted this would be consistent with the goal of maximizing the realization available to the shareholders.

[11] Counsel for the Bellan action, in supporting the notion of an interim distribution, described the situation if the class were expanded as a "perfect match" which should alleviate any concern the court might have. Since any defendants claiming indemnification would not be entitled to it until they have been found liable to the shareholders, whatever was paid to the shareholders by way of an interim distribution could be set off against the defendants' liability to them. In any event, it was his opinion that the claims for indemnification were unlikely to succeed. This position was supported by counsel for the Crocus Investment Association.

[12] Not surprisingly, counsel for the former officers and directors of Crocus, its agents and lead broker were opposed to any consideration of an interim distribution at this time. Their position that such consideration was premature was also shared by counsel for the Manitoba Federation of Labour.

[13] As has been observed by many, this is not a "typical" receivership and the issues are varied and complex. Although Crocus is not currently insolvent, the known contingent liabilities far exceed the assets. Whether they, and particularly

the proposed class action, will ultimately result in payments and if so how much is the multi-million dollar question.

[14] The fact that the present circumstances are out of the ordinary can provide an opportunity for creative solutions. On the other hand, it is not an excuse to throw caution to the wind. Whereas one has considerable sympathy for the thousands of shareholders who invested in good faith in Crocus and who are understandably concerned about the return on their investment, such sentiments cannot obscure the court's obligation to apply the law to the facts in accordance with established legal and equitable principles.

[15] In my reasons for decision of October 27, 2005, I noted certain general principles which bear repeating here. One is that creditors have priority over shareholders. Another is that whereas the goal is to maximize the realization available to shareholders, the general rule is that such realization does not occur until after the liabilities of a company are determined and paid. One can conceive of a situation where it might be appropriate to make a distribution after all liabilities have been determined but not yet paid (for example, where sufficient funds have been reserved for that purpose), but that is not the case here.

[16] It should also be remembered that one of the justifications in support of the Receiver's plan to gradually dispose of the assets of Crocus was the corporation's inability to raise and distribute funds in the face of the proposed class action, particularly because the extent of and liabilities of Crocus could not

be ascertained. There is nothing in the evidence before me to suggest they are any better known.

[17] In my view, for the purpose of this motion, it is not necessary to consider the relative priority of shareholders' claims and creditors' claims beyond what has already been said. No one has argued that the shareholders should be considered as anything other than shareholders for the purpose of a potential interim distribution. Neither was it suggested that this was a dividend or indeed anything other than a distribution of part of the Crocus assets. The difference is that, as one counsel aptly observed, this is about a distribution of the Crocus assets rather than a distribution of the remaining assets after liabilities have been determined and paid. It is an important distinction.

[18] Noticeably absent is any legal authority to support any right or entitlement of the shareholders to an interim distribution such as the Receiver wishes to consider.

[19] Counsel for the Receiver argues that consideration of an interim distribution to shareholders at this time would strike the necessary balance between the shareholders of Crocus who are desirous of receiving a distribution and those who have potential claims against the assets of Crocus. But the fact remains that if such a distribution were permitted, the effect would be to prefer the interests of the shareholders over those of the creditors at a time when the liabilities of Crocus are as yet unknown.

[20] Although it is recognized that the presence of a contingent claim does not necessarily preclude a company from making a distribution, there is an obligation to assess the strength of the claim. As noted in the brief of the Receiver:

> Ordinarily the directors of a corporation would evaluate a contingent claim, and consider whether they have a reasonable belief that the company has sufficient assets to cover its probable liabilities. That responsibility now rests with the Receiver. (p. 6, para. 21)

[21] At the same time, the Receiver has acknowledged that there is insufficient evidence upon which to properly evaluate the proposed class action. As was stated at pp. 4-5, para. 13 of the Receiver's brief:

> ... It is difficult if not impossible for the Receiver to assess the likelihood of any recovery to the plaintiffs or the potential value of the claim. Such an assessment would require some consideration as to the facts relied upon by the Plaintiffs and by the Defendants, and could not realistically be made at this stage of the proceedings....

[22] In so stating, the Receiver has effectively answered its own question. Certainly the court is in no better position to conduct such an evaluation at this time. Even ignoring the other contingent liabilities, I am satisfied that it is premature for any consideration to be given to the possibility of an interim distribution to the shareholders of Crocus in the face of the proposed class action. The time, effort and associated costs do not warrant such an undertaking. I do not, however, preclude the possibility from arising in the future.

[23] I am mindful that I have not directly addressed all of the arguments raised by counsel at the hearing of this motion. Although I have considered them, I am satisfied that the uncertainties about what the future portends for

Crocus in the face of the proposed class action overwhelmingly point to the conclusion reached for the reasons stated.

N.J. McEwen J.