COURT OF APPEAL FOR BRITISH COLUMBIA

Citation: *Contech Enterprises Ltd. v. Vegherb, LLC,* 2015 BCCA 99

Date: 20150306
Docket: CA042532

In the Matter of the Proposal of Contech Enterprises Inc.

Between:

Contech Enterprises Inc. and Deloitte Restructuring Inc.

Respondents
(Applicants)

And

Vegherb, LLC

Appellant
(Respondent)

Before: The Honourable Madam Justice Newbury
The Honourable Madam Justice Saunders
The Honourable Mr. Justice Willcock

On appeal from: An order of the Supreme Court of British Columbia, dated January 26, 2015 (*Contech Enterprises Inc. (Re)*, 2015 BCSC 129, Vancouver Docket No. B150025).

Counsel for the Appellant:	G.N. Harney
Counsel for the Respondents:	K. Jackson D. Toigo
Place and Date of Hearing:	Vancouver, British Columbia February 19, 2015
Written Submissions Received:	March 2 and 5, 2015
Place and Date of Judgment:	Vancouver, British Columbia March 6, 2015

Written Reasons by:
The Honourable Madam Justice Newbury

Concurred in by:
The Honourable Madam Justice Saunders
The Honourable Mr. Justice Willcock

Summary:

Appellant sold assets to Respondent ("Contech") and executed a license agreement allowing Contech to use its intellectual property ("IP"). Under the license agreement, Contech would acquire title in the IP once it had made all payments under the asset purchase agreement. Contech also granted a GSA to Appellant, which was later subordinated to the GSAs of two other creditors. All the GSAs were perfected by registration in the PPS Registry. Contech defaulted on payment to Appellant, which purported to terminate the license agreement. Contech applied for approval of a proposal in bankruptcy that would extinguish the claims (including ownership or title) of all "Affected Secured Creditors", including the Appellant, in exchange for shares in Contech.

Chambers judge approved the proposal over Appellant's objections. She held that Appellant could not reclaim the IP simply by terminating the license agreement since it was a "security agreement", and thus subject to the Personal Property Security Act; that Contech was entitled to a declaration that Appellant's title to the IP was "extinguished" by operation of the Bankruptcy and Insolvency Act, as the IP formed part of Contech's "basket of assets"; that Appellant should be put in the same class as other Affected Secured Creditors under the proposal; and that the proposal was otherwise fair and reasonable. Re Giffen [1998] 1 S.C.R. 91 was held to apply such that Appellant's title to the IP was extinguished. Appellant alleges that chambers judge erred in each of these conclusions and that the proposal was "confiscatory" and should not have been approved as fair.

***Held**: **Appeal allowed**. Chambers judge did not err in concluding that the license agreement created a security interest under the PPSA and that Appellant could not reclaim the IP simply by terminating the license. However, she did err in relying on Re Giffen in support of her finding that Appellant's ownership of the IP was extinguished. That case is distinguishable because this is merely a <u>proposal</u> in bankruptcy; because Appellant perfected its security interest in the IP; and because Appellant's security interest was a purchase-money security instrument ("PMSI") and thus entitled to a "super priority" under s. 22(1) and 34(1). Chambers judge also erred in concluding Appellant had a "commonality of interest" with other Affected Secured Creditors, all of whom (unlike Appellant) had already agreed to receive shares prior to the proposal. On this basis, and because it purported to extinguish Appellant's title to the IP, the proposal was not reasonable.*

Reasons for Judgment of the Honourable Madam Justice Newbury:

[1] Since at least 1998, when the Supreme Court of Canada issued its reasons in *Re Giffen* [1998] 1 S.C.R. 91, it has been clear that the trustee in bankruptcy of a debtor may acquire a "higher interest in [collateral] than that enjoyed by the bankrupt through the operation of the [*Personal Property Security Act*]*"*. (At 101.) The central issue raised by this appeal is whether a similar result obtains in a somewhat different context.

[2] The chambers judge below found that *Re Giffen* did apply to 'extinguish' the proprietary interest of the secured creditor in this case and that the collateral – here, a license to use certain intellectual property (the "IP") of significance to both the creditor and the debtor – passed, together with the creditor's 'ownership' interest therein, to the debtor in accordance with the terms of its proposal under the *Bankruptcy and Insolvency Act,* R.S.C. 1985, c. B-3 (the "*BIA*"). Based in part on this premise, she approved the proposal as reasonable, rejecting the creditor's argument that it was intended to effect, and does effect, a "confiscation" of the IP. Following the filing of the creditor's notice of appeal, a stay was automatically granted pursuant to s. 195 of the *BIA*, suspending the order of the chambers judge pending the disposition of the appeal.

[3] For the reasons that follow, it is my view that although the licence by its terms created a security interest for purposes of the *Personal Property Security Act*, R.S.B.C. 1996, c. 369 ("*PPSA*"), *Re Giffen* does not apply to make the security interest "ineffective" against the trustee of the proposal, and that indeed the interest is a purchase money security interest ("PMSI") as defined in the *Act*, entitled to a 'super priority' in most circumstances. It is also my view that the classification of the secured creditor under the proposal is unfair, as is a term of the proposal that would extinguish the creditor's retention of ownership of the IP, and that the chambers judge therefore erred in approving it as reasonable within the meaning of s. 59(2) of the *BIA*.

Factual Background

[4] At paras. 39-54 of her reasons, the chambers judge described the dealings between the respondent/debtor Contech Enterprises Inc. ("Contech") and the appellant/creditor, Vegherb LLC ("Vegherb"), which gave rise to this proceeding. In summary form, the relevant facts are as follows:

- At some point prior to February 2013, Contech granted general security agreements ("GSAs") in favour of various persons, including HSBC Bank Canada ("HSBC") and First West Credit Union ("FWCU"). These lenders registered financing statements in the Personal Property Security Registry.

- On February 22, 2013 Contech entered into an Asset Purchase Agreement ("APA") with Vegherb to buy all the latter's assets for $4,438,750. The APA defined the term "Purchased Assets" to mean all the assets of Vegherb except the IP, which was the subject of a separate License Agreement. Under the APA, $857,100 of the purchase price was paid by Contech on closing; $2,301,650 was to be paid over time commencing on June 15, 2013 and ending in late 2018, as evidenced by a promissory note (the "Note") delivered to Vegherb at closing; and the balance was paid by the issuance of 4,000,000 shares of Contech to Vegherb at $.32 per share.

- As part of and at the time of the closing of the APA, the parties executed the License Agreement. It recited that in exchange for "$1.00 and other good and valuable consideration", Vegherb granted to Contech a "right and license [the "License"] under any and all of the Intellectual Property during the term of this Agreement to use, disclose, reproduce, … sell, offer for sale, advertise, market, distribute, supply, import, use, adapt, prepare derivative works of and otherwise exploit the Intellectual Property." The Agreement contemplated that if either party became aware of any unauthorized use or infringement of the proprietary rights granted to Contech, that party would immediately notify the other. The parties would

confer "to determine the course of action to be taken with respect to such unauthorized use or infringement." In the event Vegherb did not take reasonable steps within 60 days, Contech would be entitled to do so. Any damages recovered in such proceeding would be payable to Contech.

Article 3 of the License Agreement referred to the Note granted by Contech at closing to evidence the $2,301,650 portion of the purchase price payable over time. Article 3 stated:

> 3.1 The term of this Agreement commences on the date hereof and will terminate on the earlier of:
>
> 3.1.1 the Licensee fulfilling its obligations in favour of the Licensor with respect to the payments evidenced by the Promissory note dated of even date herewith and delivered at Closing pursuant to the APA (the "Payments"); or
>
> 3.1.2 the Licensee defaulting on its obligations in favour of the Licensor to make the Payments.
>
> 3.2 Effect of Termination**.**
>
> 3.2.1 Upon the termination of this Agreement in accordance with Section 3.1.1, the Licensor shall transfer to the Licensee the Intellectual Property pursuant to the terms of an Assignment Agreement of even date herewith.
>
> 3.2.2 Upon the termination of this Agreement in accordance with Section 3.1.2, the Licensee may continue to exercise the rights granted to it under Section 2.1 in connection with any products made in conjunction with the Intellectual Property that have been manufactured, included in work in process or are called for pursuant to contracts or purchase orders from existing customers of the Licensee as of the date of such termination. [Emphasis added.]

In accordance with Article 3.2.1, the parties also signed an assignment agreement to be used in respect of the IP "as and when such assignment is to occur."

It seems to be common ground that although the IP was the subject of a separate agreement, it was an important part of the transaction and that the $4,438,750 purchase price included the value of the IP. Vegherb made various representations and warranties in the APA concerning the IP and trademarks relating thereto.

- In accordance with the foregoing documents, Contech also executed and delivered the Note in the amount of $2,301,650 (said to be in U.S. funds) in favour of Vegherb, setting forth the same schedule of payments contemplated by the APA. In addition, Contech signed a General Security Agreement in favour of Vegherb, granting a security interest in "all of the Debtor's present and after-acquired personal property, including all inventory, equipment and fixtures … and other intangibles" to secure payment of the balance of the purchase price as defined in the APA.

- On or about February 22, Vegherb registered a financing statement in respect of its GSA in the PPS Registry. The collateral was described as:

  > All of the debtor's present and after–acquired personal property, including without limitation fixtures (and terms used herein that are defined in the *Personal Property Security Act* of British Columbia or the regulations made thereunder have those defined meanings appear).

  At around the same time, Vegherb also entered into a Subordination and Standstill Agreement with FWCU in which it subordinated its security to that of the credit union to the extent of $1,450,000; and under a second such agreement, subordinated its security to that of HSBC "in all respects".

- On March 7, 2014 Contech and certain of its lenders entered into an "Amended and Restated Loan Agreement" contemplating further loans by them of up to $3 million, to be evidenced by "Secured Convertible Debentures" the holders of which could elect to convert their loans into shares in Contech. The agreement provided as well that on September 7, 2015, the outstanding amount of the loans <u>would</u> be converted to shares "without any further action on the part of any one or more of the Lenders". Contech's obligations under this agreement were secured by yet another GSA, which would cease to have effect upon the payment of the loans or their conversion into shares.

- On October 30, 2014 Contech defaulted in paying an instalment due on the Note to Vegherb. The default continued for five business days, entitling Vegherb to accelerate the entire amount of the debt. Contech attempted to cure its default by paying Vegherb $300,000 "on or around" November 6, but since this payment was regarded as a breach of terms of Vegherb's subordination agreements with HSBC and FWCU, the $300,000 was ultimately returned to Contech. It remains in default. At present, approximately $1.5 million (U.S.) principal amount remains owing to Vegherb on account of the $4.438 million purchase price under the APA.

- On December 23, 2014 Contech made a proposal (the "Proposal") in bankruptcy under the *BIA*. The respondent Deloitte Restructuring Inc. was appointed as trustee.

[5] At the hearing below on January 20, 2015, the chambers judge had before her an application by Contech for the approval of the Proposal. I will return to it below, but it is noteworthy at this point that it provides for the release by all "Affected Secured Creditors" (a class defined to include Vegherb) of all claims, including any right of ownership or title, they had against Contech as of the date of filing of the Proposal.

The judge below also had before her two other applications, described in her reasons as follows:

> 1. Contech seeks an order declaring that on fulfillment of the Proposal, it will be owner of certain intellectual property (the "IP") which was part of a past transaction whereby Contech purchased the assets of Vegherb. Vegherb opposes the application.
> 2. Vegherb seeks an order in the alternative that if the Proposal is approved, Vegherb be permitted to amend its proof of claim to change its position from that of a secured creditor to that of an unsecured creditor. Contech opposes the application.

[6] The chambers judge approved the Proposal as fair and reasonable "in respect of the whole body of Contech creditors." She also granted Contech a declaratory order that upon the extinguishment of Vegherb's Claim to "title" to the IP

"by operation of the *BIA*", property in the IP would "reside entirely in Contech subject to any secured interests of other parties that have not been released." (Para. 99.) Last, she dismissed Vegherb's application to amend its proof of claim.

The Chambers Judge's Reasons

Security Agreement?

[7] The first and most important issue before the chambers judge was taken to be whether the License Agreement constituted a "security agreement" for purposes of the *PPSA.* (Attached to these reasons is a schedule reproducing the relevant statutory provisions.) As required by s. 2(1), the chambers judge considered the "substance" of the Agreement and found that it was analogous to a conditional sale agreement for the sale of the IP, in that it contemplated that Vegherb would "temporarily retain title to the IP merely as a means to secure payment of the purchase price being paid for all of the assets." (Para. 69.) The judge continued:

> The License Agreement was not a means for Vegherb to keep ownership of the IP beyond the date of payment of the purchase price, nor was it a means for Vegherb to receive ongoing benefits in relation to that ownership. Payment by Contech to Vegherb under the License Agreement was not based on royalties for revenues earned by use of the IP; it was not based on any performance milestones to be met by Contech in using the IP; and there were no restrictions on Contech's use of the IP geographically or temporally.
>
> It was clear that the intention of the parties was for Vegherb to sell the IP to Contech as part of the sale of Vegherb assets to Contech. The only specific consideration mentioned under the Assignment Agreement for transfer of the IP, after the conditions of making the Promissory Note payments were met, was payment of $1 which had already been made. If that was the only value of the IP the parties would not be bringing these arguments to court. Clearly the value of the IP was part of the value attributed to "goodwill and other intangibles" which was part of the purchase price for the total assets of Vegherb.
>
> <u>The structure of the entire transaction was that the purchase price of all of the assets of Vegherb, including the IP, was secured by Vegherb seeking to retain title of the IP until the entire payments due under the Promissory Note were paid</u>.
>
> There were no other conditions under the License Agreement that had to be met by Contech in order to effect transfer of title to the IP from Vegherb to Contech other than payment of the installment payments secured by the Promissory Note in relation to the sale of the total asset package.
> [Paras. 70-3; emphasis added.]

[8] The Court found that the terms of the License Agreement dealing with the rights and duties of the parties in the event of a third party's unauthorized use or infringement of the IP were consistent with a conditional sale agreement, as was the fact that Contech's right to sublicense or assign the License was restricted to an assignment in favour of a wholly-owned subsidiary unless Vegherb's consent was obtained. Finally, the Court found no business purpose for the License "other than to function as a form of security for Vegherb to secure the payment of the purchase price on the sale of the total package of Vegherb's assets …". It followed that the License Agreement was a security agreement that created a security interest under the *PPSA*. (Para. 85.)

[9] Elaborating on the implications of this conclusion, the chambers judge reasoned that both Vegherb and Contech had "some proprietary interest in the IP" under the License Agreement until the purchase price for Vegherb's assets (i.e., the outstanding balance of the Note) was paid. Thus, she reasoned, Contech's rights in the IP formed part of its "basket of assets" to which the security interests of other existing secured creditors could attach. (Para. 88.) On this point, the judge cited *Haibeck v. No. 40 Taurus Ventures Ltd.* (1991) 59 B.C.L.R. (2d) 229 (S.C.), where it was held that although the purchaser of chattels under a conditional sales contract had not made any payments thereunder, it did have a security interest in the chattels in question. Since that contract and a debenture previously granted, were perfected by registration, priority was determined according to s. 35(1) of the *PPSA*, not according to where "title" lay. (Para. 89.). Similarly, in the case at bar, the chambers judge reasoned:

> The License Agreement provided an extra form of security to Vegherb (which also had a general security agreement). However, because it fits within the definition of security agreement under the *PPSA*, once there is a contest amongst secured creditors, Vegherb's rights under the License Agreement as between it and other secured creditors are treated just like other security interests under the *PPSA*.
>
> This means that in a bankruptcy of Contech, Vegherb's secured claim in relation to the IP will be subject to the priorities of other secured creditors; and any realization of Contech's assets for the benefit of creditors will include realization of Contech's rights to the IP. The Trustee has already concluded that Vegherb would recover nothing in the event of a bankruptcy, after liquidation of Contech's assets. [Paras. 91-2.]

[10] Likewise, she reasoned, in circumstances falling short of bankruptcy, such as in a proposal under the *BIA*, Contech's "rights in relation to the IP" would form part of its "basket of assets." But, since Article 2.4 of the Proposal contemplated that on the "Conversion Date" (as defined) all Affected Secured Creditors (a term defined to include Vegherb) would release Contech and its directors from all claims (defined to include any "right of ownership or title") that arose prior to the filing date regardless of the date of crystallization, Vegherb's claim to "title" in respect of the IP was now simply a "secured claim which [could] be extinguished by operation of the *BIA* just like what can happen to other secured claims against Contech's property". Accordingly, the judge continued, "once Vegherb's claim is extinguished then the property in the IP will reside entirely in Contech subject to any secured interests of other parties that have not been released." (Para. 99.) It is this part of the chambers judge's reasoning that lies at the heart of Vegherb's appeal.

[11] At paras. 100-118, the chambers judge considered Vegherb's argument that Contech's default under the Note (and License Agreement) automatically terminated the License, as Vegherb's counsel had asserted in a letter to counsel for Contech on October 31, 2014. In this letter, Vegherb demanded that Contech cease and desist from using the IP. The chambers judge rejected the notion of termination, finding "no evidence that Contech agreed to Vegherb's position that the License Agreement was terminated due to default or that Contech no longer had any rights to the IP". (Para. 102.) She continued:

> I cannot accept Vegherb's argument that because of either the default in payment or Vegherb's unilateral notice of termination, all of Contech's rights to the IP would then be taken out from under the umbrella of the *PPSA* and *BIA*. That argument suggests that Vegherb could unilaterally "opt-out" of the legislation governing security interests, the *PPSA*, and thereby take priority over an asset of the debtor for itself despite competing creditors. This would undermine one of the important purposes of the *PPSA*, which is to provide certainty amongst competing creditors as to how their interests in personal property will be ranked.
>
> The potential default of the debtor was the very reason for the security agreement which took the form of the License Agreement, and the very reason it is to be governed by the *PPSA*, rather than by terms which seek to give preference to Vegherb to these assets as against other creditors. [Paras. 104-5; emphasis added.]

[12] An argument made by Vegherb based on *DaimlerChrysler Financial Services (debis) Canada Inc. v. Mega Pets Ltd.* 2002 BCCA 242 was found to be of no assistance to the creditor because the *PPSA* had been found not to apply in that instance. Instead, the chambers judge found the case at bar to be analogous to that in *Re Giffen*, where the Supreme Court had stated:

> … the lessor's security interest remained vulnerable to the claims of third parties who obtain an interest in the car through the lessee including, trustees in bankruptcy. In order to protect its security interest from such claims, the lessor must therefore perfect its interest through registration of its interest (s. 25), or repossession of the collateral (s. 24). The lessor did not have possession of the car, and it did not register its security interest. Thus, prior to the bankruptcy, the lessor held an unperfected security interest in the car. This brings us to the *BIA*.
>
> D. *The Bankrupt's Interest in the Car Vests in the Trustee*
>
> Section 71(2) of the *BIA* provides that, upon an assignment into bankruptcy, the bankrupt's "property . . . shall, subject to this Act and to the rights of secured creditors, forthwith pass to and vest in the trustee". Section 2 of the *BIA* defines "property" very broadly to include "every description of estate, interest and profit, present or future, vested or contingent, in, arising out of or incident to property".
>
> In my opinion, the bankrupt's right to use and possession of the car constitutes "property" for the purposes of the *BIA* and the trustee, by virtue of s. 71(2) of the *BIA*, succeeds to this proprietary right. [Para. 115; emphasis added.]

[13] The chambers judge found that the same analysis applied in this case: under the terms of the Proposal, Contech had acquired the proprietary right to use the IP under the License Agreement, as well as the right to receive “legal title” upon payment of the Note. This was said to be part of “Contech’s personal property to which claims of secured creditors of Contech attached (that is, those creditors who registered security interests against all of Contech’s personal property). Mere default by Contech does [sic; does not?] simply result in that property becoming the sole property of Vegherb.” (Para. 118.)

[14] As already noted, the chambers judge then granted a declaration to the effect that upon implementation of the Proposal, including Vegherb’s receipt of certain shares of Contech, Vegherb’s right in respect of the IP would be “extinguished” and Contech would be permitted to take all necessary steps to register the IP in Contech’s name. (Para. 123.) (No argument was advanced to the effect that a

security interest in intellectual property does not, because of the federal jurisdiction over trademarks and patents, fall under the *PPSA*. On this point, see R.C. Cuming and R.J. Wood, *British Columbia Personal Property Security Act Handbook* (1998) at s. 2[7].)

Classes of Creditors

[15] The second major conclusion of the chambers judge that is relevant to this appeal concerns Vegherb's being included in the class of "Affected Secured Creditors" under the Proposal. The Proposal defines this class to mean "creditors having a security interest in any assets of Contech ranking subordinate to the security interests of FWCU" and the Secured Debenture Holders and Vegherb specifically. Vegherb asserted that it should be in its own class as a secured creditor because the other members of the class were "all debentureholders who always expected to ultimately receive equity in Contech". (Para. 131.) In contrast, Vegherb had sold all its assets to Contech and was still waiting to be paid.

[16] The chambers judge reviewed the seminal Canadian case of *Re Canadian Airlines* (2000) 19 C.B.R. (4th) 12 (Alta. Q.B.) in which classification issues were considered. Paperny J. noted *Sovereign Life Assurance Co. v. Dodd* [1892] 2 Q.B. 575 (C.A.), where Bowen L.J. observed:

> The word class is vague and to find out what is meant by it, we must look at the scope of the section which is a section enabling, the court to order a meeting of a class of creditors to be called. It seems plain that we must give such a meaning to the term 'class' as will prevent the section, being so worked as to result in confiscation and injustice, and that it must be confined to those persons, whose rights are not so dissimilar as to make it impossible for them to consult together with the view to their common interest. [Para. 17; emphasis added.]

The Court in *Canadian Airlines* went on to reason:

> This test has been described as the "commonality of interest" test. All counsel agree that this is the test to apply to classification of claims under the C.C.A.A. However, there is a dispute on the types of interests that are to be considered in determining commonality.
>
> Generally, the cases hold that classification is a fact-driven determination unique to the circumstances of every case, upon which the court should be loathe to impose rules for universal application, particularly in light of the

> flexible, and remedial jurisdiction involved: see, for example, *Re Fairview Industries Ltd.* (1991) 11 C.B.R. (3d) 71 (N.S.T.D.)
>
> The majority of the cases presented to me, held that commonality of the interest is to be determined by the rights the creditor has a vis-vis the debtor. Courts have also found it helpful to consider the context of the proposed plan and treatment of creditors under a liquidation scenario. In the absence of bad faith, motivation for supporting or rejecting a plan is not a classification issue in the authorities. [Paras. 17-9; emphasis added.]

[17] In the case at bar, the chambers judge reasoned that the class of Affected Secured Creditors had a "commonality of interest because they are unlikely to recover anything if Contech goes bankrupt. They all have general security agreements. Thus the rights of the members of this class vis-à-vis Contech are similar." (Para. 134.) She concluded that Vegherb's inclusion in the class was appropriate.

[18] Beginning at para. 150 of her reasons, the judge then considered the reasonableness of the Proposal as a whole and in particular, Vegherb's argument that the Proposal was "designed by its structure to 'confiscate' the IP of Vegherb." She did not accept that this was a "motive" underlying the Proposal. In her words:

> I find that the Proposal is designed as an attempt by Contech to restructure its debt and obtain new financing to enable it to continue its operations. If it is ultimately successful, under the Proposal the creditors affected by the Proposal will be better off than they would have been if Contech was simply to go bankrupt now.
>
> The fact that the Affected Creditors approve the Proposal by a large majority is a sign that they must have considered it fair and reasonable, and is entitled to considerable weight.
>
> Vegherb argues that the fact it is going to lose the IP without receiving ongoing payments for its use is unfair. Again, I do not agree that this is because of the structure of the Proposal. It is because of the terms of the License Agreement which is not a true license agreement.
>
> Vegherb complains that the structure of the Proposal essentially requires secured creditors to accept shares in Contech, not payment, in satisfaction of amounts owed. Vegherb argues that it may be subsequently difficult to redeem the shares since Contech is not publicly traded.
>
> I am not satisfied that the share component of the Proposal makes it unfair, and again I point to the fact that the majority of Affected Secured Creditors have voted in favour of it. [Paras. 154-8; emphasis added.]

[19] Finally for our purposes, the chambers judge dismissed Vegherb's application to be permitted to amend its proof of claim to change its position from that of a

secured creditor to Unsecured Creditor under ss. 50.1 and 132.1 of the *BIA*. The Court found that the Proposal had not contained a "proposed assessed value" for its claim. The result was that s. 50.1(1) applied, but ss. 50.1(2) and (3) did not; nor did s. 132(1). On this point, the judge cited *Re WorkGroup Designs Inc*. (2008) 40 C.B.R. (5th) 1 (Ont. C.A.).

On Appeal

[20] In this court, Vegherb asserted the following errors in judgment:

> I. The Chambers Judge erred in fact and law in finding the License Agreement to be a security agreement.
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> II. The Chambers Judge erred in fact and law in finding the License Agreement did not validly terminate.
>
> III. In the alternative, the Chambers Judge erred in fact and law in finding that on default of payment, the IP remained the property of Contech.
>
> IV. The Chambers Judge erred in fact and law in approving the Proposal.
>
> V. The Chambers Judge erred in fact and law in dismissing Vegherb's application to amend its proof of claim.

License as Security Agreement

[21] Mr. Harney for Vegherb argued strenuously on appeal that the License Agreement was a "true license" and not a security agreement. In his submission, none of the parties intended to create a security agreement for *PPSA* purposes, and the parties' intentions is one of the factors relevant to determining the substance of a transaction: see *Manning Jamison Ltd. v. Registrar of Travel Services* 1999 BCCA 185 at para. 26. Counsel challenged the notion that any particular terms – e.g., a geographical or temporal restriction, "performance milestones" or the payment of royalties in relation to revenues – are required for a "true" license agreement, and noted other characteristics – restrictions on the assignment of the license that are normally indicative of a license, for example – which the chambers judge found to be equivocal.

[22] I am not sure that a "true" license agreement cannot also be a security agreement, and in this case, it seems to me the Licence Agreement <u>was</u> a security agreement regardless of whether it was a "true" license. As the chambers judge

noted, Vegherb's reservation of ownership of the IP until such time as the Note was discharged, means that "in substance" the Agreement "provide[d] for a security interest" within the meaning of the definition of "security agreement" at s. 1 of the *PPSA*.

[23] It is worth emphasizing, however, that this security interest was perfected under the *PPSA* by the registration of a financing statement in respect of the GSA in February 2013. There was no necessity for the License Agreement to be the subject of a separate filing: s. 43(5) confirms that a registration "may relate to one or more security agreements." Thus Professors R.C. Cuming, R.J. Wood et al. observe in *Personal Property Security Law* (2nd ed., 2012):

> The PPR registration process does not require a registrant to submit the security documentation; instead, the registrant submits a separate "financing statement" containing only minimal information about the transaction to which it relates. It follows that there is no reason to insist on a one-to-one relationship between each registration and each security agreement. Accordingly, the PPSA confirms that a single registration is effective to perfect a security interest arising under multiple agreements, regardless of whether the agreements are related to one another or represent separate and distinct transactions. [at 329; emphasis added.]

(See also *674921 B.C. Ltd. v. New Solutions Financial Corporation* 2006 BCCA 49 at para. 33.) It follows that Vegherb's GSA perfected its security interest in the assets which it had sold to Contech in February 2013, including the rights that were granted under the License Agreement.

[24] The chambers judge seemed to recognize the fact of perfection by registration at para. 91 of her reasons. There she stated:

> The License Agreement provided an extra form of security to Vegherb (which also had a general security agreement). However, because it fits within the definition of security agreement under the *PPSA*, once there is a contest amongst secured creditors, Vegherb's rights under the License Agreement as between it and other secured creditors are treated just like other security interests under the *PPSA*.

As will be seen below, however, she assumed that *Re Giffen* applied to 'extinguish' all of Vegherb's rights to the IP – a consequence that does not necessarily follow. I will return to this point in due course.

[25] It is also apparent that to the extent the security interest reserved by Vegherb secured payment of all or part of the purchase price for Vegherb's assets, including the IP, the GSA is a purchase money security interest ("PMSI") for purposes of the *Act*. Contech acknowledged this in written submissions we requested on the point.

Termination of License?

[26] It will be recalled that the chambers judge rejected Vegherb's submission that the License had been validly terminated (and all interests in the IP presumably reverted to Vegherb), on the basis that there was "no evidence" Contech had agreed to Vegherb's position that it had terminated. Vegherb challenges this reasoning, arguing that no such agreement or acquiescence was required by the terms of the License Agreement or any other agreement to which Contech and Vegherb were parties. I agree that whether Contech agreed or not to the termination of the License is irrelevant to whether it was effectively terminated.

[27] Section 9 of the *PPSA* provides that subject to any enactment, a security agreement is "effective according to its terms". However, as Mr. Jackson contended, when the security interest in the IP was taken (or more properly, retained) by Vegherb, the existing secured creditors of Contech effectively acquired certain statutory rights as against Vegherb. (Mr. Jackson described these rights as amounting to a proprietary interest in the IP, but I need not decide if that is a correct characterization.) In any event, to allow a creditor to "opt out" of the *PPSA* by unilaterally terminating its security agreement would, as the chambers judge stated, undermine one of the important purposes of the *PPSA*, i.e., to "provide certainty among competing creditors as to how their interests in personal property will be ranked". (Para. 104.) The *PPSA* regulates the taking (or re-taking) of possession of collateral by secured creditors. Section 61 requires that notice of a proposal to do so be given to other secured parties and allows the court to hear their objections. Section 62 deals with "rights of redemption and reinstatement" and s. 61 deals with "voluntary foreclosure", i.e., situations in which a secured party proposes to take and retain the collateral in satisfaction of the obligation secured by it. There is no argument that any of these provisions was invoked or complied with by Vegherb in this case.

Re Giffen

[28] This brings us to the chambers judge's analysis of *Re Giffen*, which Contech relies on not only for the proposition that its existing secured creditors effectively acquired an interest in the Licence but also for the proposition that Vegherb's interest, including its reservation of title to the IP itself, was effectively eliminated. In *Re Giffen*, a lessor ("TLC") had leased a car to B.C. Telephone Co. It in turn subleased the car to one of its employees, "B". Since the lease had a term of more than one year, it was required to be registered under the *PPSA*. However, neither B.C. Telephone Co. nor TLC filed financing statements in respect of their security interests by the time B became bankrupt. B's trustee in bankruptcy obtained an order in the trial court (see (1994) 90 B.C.L.R. (2d) 326) that it was entitled to the proceeds of sale of the car by virtue of s. 20(b)(i) of the *PPSA*. As we noted in *Re Perimeter Transportation Ltd.* 2010 BCCA 509, this Court in *Giffen*, *per* Finch, J.A., as he then was, reversed that order on three bases – that under s. 71(2) of the *BIA*, it was only "property of the bankrupt" that vested in the trustee; that the lessee did not have a proprietary interest in the car; and that allowing the trustee a greater claim to the vehicle than the bankrupt had would "overlook fundamental concepts of bankruptcy law".

[29] The Supreme Court of Canada disagreed and allowed the appeal, restoring the order of the trial court. Again as this court noted in *Perimeter Transportation*:

> The Supreme Court of Canada allowed the trustee's appeal and restored Hood J.'s order. Iacobucci J. for the Court stated that the primary issue on the appeal was whether s. 20(b)(i) of the *PPSA* could extinguish the lessor's (i.e., TLC's) right to the car in favour of the trustee's interest, or whether the operation of s. 20(b)(i) was "limited by certain provisions of the *BIA*". The issue could be resolved, he said, by a "normal reading of the relevant provisions of both the *PPSA* and *BIA*, buttressed by the policy considerations supporting these provisions." (Para. 24.) The Court of Appeal was found to have erred in focusing on the *locus* of title in the car and in holding that the lessor's common law ownership interests prevailed despite the clear meaning of s. 20(b)(i). It had not recognized that in enacting the *PPSA*, the Legislature had "set aside the traditional concepts of title and ownership to a certain extent." The Supreme Court quoted with approval a passage from *International Harvester Credit Corp. of Canada v. Bell's Dairy Ltd*. (1986) 30 D.L.R. (4th) 387, 34 B.L.R. 76 (Sask. C.A.), in which it was recognized that the *PPSA* regime "does not turn on title to the collateral":

> There is nothing in the language of the section [s. 20 of the Saskatchewan and British Columbia *PPSA*s], or its relationship with other sections, or indeed in the overall scheme of the Act to suggest, for example, that an unperfected security interest, because it is rooted in and attached to the title of particular goods in the possession of a debtor, should be treated as superior to the more generally derived and broadly attached interest which an execution creditor comes to have in a debtor's goods. Indeed, the very opposite is suggested not only by the language of the section, but by the overall thrust of the Act. [At 396.]

Thus in Iacobucci J.'s analysis, the dispute could not properly be resolved by determining who had title to the car, because the dispute was "one of priority to the car and not ownership in it." [At para. 20; emphasis added.]

[30] With respect to s. 20(b)(i) of the *PPSA*, the Supreme Court in *Re Giffen* noted that a person with an interest "rooted in title to property" in the possession of another is vulnerable if the interest is not perfected under the *PPSA*. In the analysis of Iacobucci J.:

> ... Public disclosure of the security interest is required to prevent innocent third parties from granting credit to the debtor or otherwise acquiring an interest in the collateral. However, public disclosure of the security interest does not seem to be required to protect a trustee who is not in the position of an innocent third party; rather, the trustee succeeds to the interests of the bankrupt. In one authority's opinion, trustees are given the capacity to defeat unperfected security interests because of the "representative capacity of the trustee and the effect of bankruptcy on the enforcement rights of unsecured creditors" (R. C. C. Cuming, "Canadian Bankruptcy Law: A Secured Creditor's Heaven" (1994), 24 *Can. Bus. L.J*. 17, at pp. 27-28).
>
> Prior to a bankruptcy, unsecured creditors can make claims against the debtor through provincial judgment enforcement measures. Successful claims will rank prior to unperfected security interests pursuant to s. 20. Once a bankruptcy occurs, however, all claims are frozen and the unsecured creditors must look to the trustee in bankruptcy to assert their claims. Cuming describes the purpose of s. 20(b)(i) (at p. 29):
>
> > In effect, the judgment enforcement rights of unsecured creditors are merged in the bankruptcy proceedings and the trustee is now the representative of creditors who can no longer bring their claims to a "perfected" status under provincial law. As the repository of enforcement rights, the trustee has status under s. 20(b)(i) of the BCPPSA to attack the unperfected security interest.
>
> The purpose behind granting a trustee in bankruptcy the power to defeat unperfected security interests was recognized by the Saskatchewan Court of Appeal in *International Harvester* [*International Harvester Credit Corp. of Canada Ltd. v. Bell's Dairy Ltd. (Trustee of)* (1986) 61 C.B.R. (N.S.) 193] (at p. 206):
>
> > Indeed, the fact that a trustee in bankruptcy is a representative of creditors serves to shed light on more than one aspect of the issue. It

> explains – or at least assists in the explanation of – why a trustee in bankruptcy is included in s. 20, as well as why a trustee is not necessarily confined to the interest of the bankrupt.
>
> The Saskatchewan Court of Appeal again acknowledged the representative role of the trustee in bankruptcy in *Paccar Financial Services* [*Ltd. v. Sinco Trucking Ltd. (Trustee of*) [1989] 3 W.W.R. 481], which also involved a priority contest between a trustee and the unperfected security interest of a lessor. The court stated that the trustee, after bankruptcy, acts as the representative of the unsecured creditors of the bankrupt and asserts "the claim of the unsecured creditors to the goods and possessions of the bankrupt pursuant to the priorities established for competing perfected and unperfected security interests. It is simply a contest as between an unsecured creditor and the holder of an unperfected security interest" (p. 490).
>
> The Court of Appeal [of British Columbia] erred, in my view, in not recognizing that the purpose of s. 20(b)(i) is, at least in part, to permit the unsecured creditors to maintain, through the person of the trustee, the same status vis-à-vis secured creditors who have not perfected their security interests which they enjoyed prior to the bankruptcy of the debtor. [At paras. 38-42; emphasis added.]

[31] Thus the Supreme Court found that on an application of s. 20(b)(i) of the *PPSA,* the common law rule of *nemo dat quod non habet* was supplanted by a "policy choice of the Legislature". The trustee in bankruptcy was found to be entitled to the proceeds of sale of the car and could pass title to the car to a purchaser as a result of the operation of both s. 20(b)(i) of the *PPSA* and s. 81(2) of the *BI*A on the bankruptcy. (At 116-7; see also paras. 23-4 of *Perimeter Transportation*.) In the words of Iacobucci J., "on a plain reading of s. 20(b)(i), the lessor's interest in the car [was] ineffective against the trustee." (At 117.)

[32] The chambers judge found at para. 118 of her reasons that the same analysis applied in the case at bar. With respect, however, a "plain reading" of s. 20(b)(i) shows that this is not so. Section 20(b)(i) provides:

> 20 A security interest
>
> …
>
> (b) in collateral is not effective against
>
> (i) a trustee in bankruptcy if the security interest is unperfected at the date of the bankruptcy, … [Emphasis added.]

[33] Section 20(b)(i) is not applicable in this instance for at least two reasons. First, it states that an unperfected interest is ineffective against a trustee in

bankruptcy, but does not refer to a trustee appointed under a proposal in bankruptcy. There is case law that suggests the two are not the same in form or in substance: see *Re PSINet Ltd.* (2002) 30 C.B.R. (4th) 226 (Ont. S.C.J.), *per* Farley J., *aff'd* (2002) 32 C.B.R. (4th) 102, regarding a monitor under the *Companies' Creditors Arrangement Act,* R.S.C. 1985, c. C-36; *Re TRG Services Inc.* (2006) 26 C.B.R. (5th) 203 (Ont. S.C.); *Re Mercantile Steel Products Ltd.* (1978) 20 O.R. (2d) 237 (Ont. S.C.), regarding a trustee under a (commercial) *BIA* proposal; Anthony Duggan, "The Status of Unperfected Security Interests in Insolvency Proceedings", (2008) 24 *B.F.L.R*. 103 at 106-111; and *Re Hupfer* (2003) 41 C.B.R. (4th) 187 (Alta Q.B.).

[34] More importantly, s. 20(b)(i) of the *PPSA* has no application because Vegherb's security interest was perfected, by registration, prior to the date of the Proposal. Indeed, since the License Agreement (and the APA generally) created a PMSI perfected by registration, s. 22(1)(b) of the *PPSA* operates to give Vegherb's GSA priority over the interests of the persons referred to in s. 20(b). It follows that the reasoning in *Re Giffen* and the policy underlying it are not applicable.

[35] In summary, this case must be distinguished from *Re Giffen* on several grounds – the fact that the security interest with which we are concerned was, unlike the conditional sale agreement in *Re Giffen*, perfected by registration; the fact that the collateral in this case is an intangible; the fact that the creditor's security interest is a PMSI; and the fact that this case does not involve a bankruptcy, but a proposal in bankruptcy (which of course is intended to avoid a bankruptcy), so that on its face s. 20(b)(i) is not applicable.

[36] The remaining question is what priorities apply as between Vegherb's registered PMSI (i.e., Vegherb's GSA) and the earlier GSAs in favour of HSBC and FWCU – which interests were also perfected under the *Act*. Section 34(1) of the *PPSA* states that a PMSI in an intangible that is perfected not later than 15 days after the day on which the security interest attached, has "priority over any other security interest in the same collateral given by the same debtor". (My emphasis.)

This is consistent with the policy of the *PPSA* to provide a so-called "super priority" for PMSIs. Cuming, Wood and Walsh, *supra*, explain this policy as follows:

> The rationale for the purchase money security interest super priority is very much bound up with the approach to security interests in after-acquired property adopted by the *PPSA*. The *PPSA* greatly facilitated the ability of parties to take security interests in after-acquired property. The security interest attaches to the new property without the requirements of any new act of transfer. The parties may execute a single security agreement that will automatically attach to new inventory that is acquired or new accounts that are generated without the need to execute new security agreements ...
>
> The effectiveness of an after-acquired property clause when combined with a first-in-time priority rule gives the first secured party a competitive advantage over later secured parties. The first secured party enjoys a situational monopoly over later entrants. The purchase money security interest priority is introduced into the *PPSA* in order to blunt this situational monopoly and permit the debtor to obtain future loans from secured parties on competitive terms. This is not seen as unfair to the first secured party, since a new asset would not have been obtained by the debtor but for the new credit provided by the purchase money security interest financier. …
>
> Recognition of the purchase money security interest priority means that a debtor who is given a broadly based security interest on present and after – acquired property to one creditor will be able to raise additional secured financing from a different creditor on the basis of new assets so long as the additional financing is used to acquire the new assets. [At 439-40; emphasis added.]

[37] In the case at bar, of course, Vegherb subordinated its position to that of HSBC and FWCU, the latter to a limited extent. As far as other secured creditors are concerned, however, Vegherb's PMSI ranks in priority under the *PPSA* regime by virtue of s. 34(1)(b). Even given the priority agreements, it is not correct to say that Vegherb's security interest is "extinguished". As a PMSI, it is entitled to the "super priority" granted by s.34(1)(b) of the *PPSA*. Its proprietary interest in the IP and the other assets it agreed to sell to Contech in February 2013, is subordinate only to those of HSBC and FWCU, the latter to the extent of $1,450,000. As against all other secured (and unsecured) creditors, Vegherb remains in a position of priority. Nothing in the *PPSA* makes its security interest "ineffective" as against the trustee of the Proposal or other creditors. Indeed, the *BIA* generally recognizes and preserves the priorities of secured creditors in the scheme of distribution established by s. 136 on a bankruptcy. (In particular, s. 136 begins with the phrase "subject to the rights of secured creditors".)

[38] In the result, I would not accede to Vegherb's first ground of appeal, but I would set aside the declaration granted by the chambers judge at para. 123 of her reasons. On the other hand, I agree with counsel for Contech that it was not open to Vegherb to remove itself from the *PPSA* priority system simply by purporting to terminate the License Agreement. Since Vegherb did not attempt to follow any of the procedures established by the *PPSA* for repossession, redemption, reinstatement or "voluntary foreclosure", its purported termination is now of little consequence, even though the termination may be effective as against Contech as a matter of contract and s. 9 of the *PPSA*.

Approval of the Proposal

[39] I turn next to Vegherb's assertion that the chambers judge erred in approving the Proposal and in particular, in ruling that Vegherb had a "commonality of interest" with other members of the "Affected Secured Creditors" class, such that there is no justification for placing Vegherb in a different class.

[40] The Proposal states that its purpose is to:

> … permit [Contech] to settle payment of its liabilities as at the Filing Date and to compromise indebtedness owed to Affected Creditors of [Contech] on a fair and equitable equal basis so as to enable [Contech] to carry on business in the ordinary course.

It contemplates the following classes of creditors:

- Priority Creditors – holders of Crown claims and claims of employees under ss. 60(1.3) and 136(1d) of the *BIA,* which would have priority if Contech became bankrupt.

- Unaffected Creditors – post-filing creditors, equipment lenders, and those creditors having security interests in any assets of Contech ranking even with or in priority to FWCU's interest. Unaffected Creditors are listed in Schedule A to the proposal and include HSBC and FWCU.

- Affected Secured Creditors – creditors having security interests which rank subordinate to FWCU's security interest, plus the Secured Debenture

Holders (which term is defined to include parties to the amended and Restated Loan Agreement dated March 7, 2014 described earlier in these reasons, and Vegherb).

- Equity Election Creditors – unsecured creditors with claims equal to or greater than $30,000 who elect to receive common shares of Contech at a conversion rate of one share for every $.12 of proven claims.

- Convenience Creditors – creditors with proven claims of $1,500 or less, who are to be paid in full.

- Unsecured Creditors – creditors who have proven claims but who did not have a security interest under relevant provincial legislation (including the *PPSA*) at the date of filing of the Proposal. They are to receive $.30 for every $1 of proven claims.

[41] As their name suggests, Unaffected Creditors are not intended to be affected by the Proposal "and will be paid in accordance with existing agreements between such creditors and [Contech] or in accordance with alternative arrangements to be negotiated concurrently with the filing and implementation" of the Proposal. (Art. 2.3.)

[42] Affected Secured Creditors such as Vegherb are to receive common shares in Contech at the rate of one share for every $0.08 of their proven claims. Upon the issuance of shares to them and to the Equity Election Creditors (who are subject to a different conversion rate), the Proposal would operate to:

> a. Release [Contech] from all Claims that arose before the Filing Date and that relate to the obligations of [Contech] prior to the Filing Date, regardless of the date of crystallization of such Claims; and
>
> b. Release the directors and officers of [Contech] from all Claims that arose before the Filing Date and that relate to the obligations of [Contech] prior to the Filing Date, regardless of the date of crystallization of such Claims, where the directors or officers are, by law, liable in their capacity as directors or officers. [Art. 2.4; emphasis added.]

Again, the Proposal defines "Claim" to include any right of ownership or title.

[43] As we have seen, the chambers judge correctly instructed herself that the Court could refuse to approve the Proposal pursuant to s. 59(2) of the *BIA* if it was of the opinion "that the terms of the [Proposal] are not reasonable or are not calculated to benefit the general body of creditors". The judge also referred to relevant case law, including *Re Kitchener Frame Ltd.* 2012 ONSC 234 and *(Re) Magnus One Energy Corp. (Re)* 2009 ABQB 200. She accepted that a court is not bound to accept a proposal even if it is approved by creditors and recommended by a trustee, citing *Magnus* at para. 11. (See para. 128.)

[44] Vegherb objected both to the Proposal itself and to the classification of Vegherb as an Affected Security Creditor. In the words of the chambers judge:

> One of Vegherb's strong objections to the form of the Proposal is the fact that it groups it into a class of Affected Secured Creditors. Vegherb asserts it should be in its own class as a secured creditor because the other creditors in its class are all debenture holders who always expected to ultimately receive equity in Contech. In contrast, Vegherb says that it is the seller of assets to Contech waiting to get paid for those assets. [Para. 131; emphasis added.]

The Court noted ss. 50(1.4) and (1.5) of the *BIA*, which are worth reproducing here:

> (1.4) Secured claims may be included in the same class if the interests or rights of the creditors holding those claims are sufficiently similar to give them a commonality of interest, taking into account
>
> (*a*) the nature of the debts giving rise to the claims;
>
> (*b*) the nature and rank of the security in respect of the claims;
>
> (*c*) the remedies available to the creditors in the absence of the proposal, and the extent to which the creditors would recover their claims by exercising those remedies;
>
> (*d*) the treatment of the claims under the proposal, and the extent to which the claims would be paid under the proposal; and
>
> (*e*) such further criteria, consistent with those set out in paragraphs (*a*) to (*d*), as are prescribed.
>
> (1.5) The court may, on application made at any time after a notice of intention or a proposal is filed, determine, in accordance with subsection (1.4), the classes of secured claims appropriate to a proposal, and the class into which any particular secured claim falls. [Emphasis added; para. 132.]

[45] As we have also seen, the judge quoted a passage from *Re Canadian Airlines*, in which the Court cited the well-known English case of *Sovereign Life*

Assurance Co. v. Dodd [1892] 2 Q.B. 573 (C.A.). Subsequent Canadian cases have refined the reasoning in *Canadian Airlines*. This "evolution" in the law is helpfully described in the judgment of Blair J.A. in *Re Stelco Inc.* [2005] O.J. No. 4883 (Ont. C.A.), where he observed that in addition to being concerned with commonality of interest, a court dealing with a classification of creditors issue should also be concerned "about the confiscation of legal rights and about avoiding what the parties have referred to as 'a tyranny of the minority.'" (See, for example, *Elan Corp. v. Comiskey* (1990) 1 O.R. (3d) 289 (C.A.), *Re Wellington Building Corp.* (1934) 16 C.B.R. 48 (Ont. H.C.J.), *Sklar-Pepler Furniture Corp. v. Bank of Nova Scotia* (1991) 86 D.L.R. (4th) 621 (Ont. Gen. Div.) and *Re Campeau Corp.* (1990) 10 C.B.R. (3d) 100 (Ont. Gen. Div.)).

[46] Blair J.A. went on to agree with those authorities, including *Canadian Airlines*, which stipulate that the "classification of creditors is determined by their legal right in relation to the debtor company, as opposed to their rights as creditors in relation to each other." (Para. 30.) This factor is of course the first listed at s. 50(1.4) of the *BIA,* which came into force in 1992 and was amended in 2004 to refer to creditors' rights as well as interests. (See also the judgments of Trainor J. in *Re Northland Properties Ltd.* (1988) 31 B.C.L.R. (2d) 35 and 73 C.B.R. (N.S.) 175, both upheld by this court: see (1988) 32 B.C.L.R. (2d) 309 and (1989) 34 B.C.L.R. (2d) 122, cited by Blair J.A. at para. 24.)

[47] The chambers judge declined to give effect to Vegherb's objection to its inclusion in the class of Affected Secured Creditors on the basis that all the parties in this class were unlikely to recover anything if Contech became bankrupt and that there was "no evidence suggesting that the interest secured by [the License Agreement] ranks ahead of any of the interests secured by the general security agreements." (Para. 135.) In so concluding, the judge in my respectful view erred in law and failed to consider that the GSA granted a favour of Vegherb created a PMSI which, under the *PPSA* priority regime, would be entitled to "priority over any other security interest in the same collateral given by the same debtor" (*PPSA*, s. 34(1)(b)). Of course, Vegherb subordinated its GSA to the GSAs of HSBC and FWCU.

[48] As for the conclusion of the court below that Vegherb should be equated with the holders of the Convertible Debentures, this seems to ignore the fact that the holders of such Debentures had agreed that their loan positions would by September 2015 be converted into shares – this was not just an option. While it is true that Vegherb had accepted some shares of Contech as part of its consideration for the sale of its assets under the APA, it was not obliged to accept additional shares under the terms of any agreement to which we have been referred. As well, as we have seen, Vegherb was, unlike holders of the Debentures, entitled to a 'super-priority' over other secured interests.

[49] Given the foregoing, it seems to me highly doubtful that Vegherb and the other Affected Secured Creditors had a commonality of interest. The Affected Secured Creditors other than Vegherb had only an expectation of receiving shares; Vegherb on the other hand had a PMSI and was entitled to "super priority" subject only to its voluntary subordination to HSBC and FWCU. Under the Proposal, however, Vegherb would be required to release Contech from all claims whatsoever – including claims aimed at enforcing Vegherb's proprietary interest in the IP. As noted by Vegherb in its factum, other members of the Affected Secured Creditors can expect to receive "substantially the same remedy under the Proposal as they would have faced otherwise, including substantially the same remedy for which they originally contracted"– shares in Contech in proportion to the money they lent to Contech. Vegherb on the other hand stands to lose all its assets to Contech, including its right of "ownership" of the IP. Lord Bowen's stricture against a "confiscatory" classification method resonates in these circumstances.

Disposition

[50] At the end of the day, I agree with Vegherb that its classification as an Affected Secured Creditor along with the holders of the Convertible Debentures is unfair and that because of this classification in combination with Article 2.4 of the Proposal (see para. 42 above), the Proposal would operate unfairly to Vegherb. Court approval of the Proposal would in my view not preserve the integrity of the bankruptcy process or comply with the requirements of commercial morality: see *Re*

Gardner (1921) 1 C.B.R. 424 (Ont. S.C.). On this basis, I conclude that the chambers judge fell into error in ruling that the Proposal was reasonable.

[51] I would allow the appeal, set aside the Order of the chambers judge and dismiss the respondents' application.

"The Honourable Madam Justice Newbury"

I AGREE:

"The Honourable Madam Justice Saunders"

I AGREE:

"The Honourable Mr. Justice Willcock"

Schedule

Personal Property Security Act, R.S.B.C. 1996, c. 359

Definitions and interpretation

1 (1) In this Act:

[…]

"purchase money security interest" means

(a) a security interest taken in collateral, other than investment property, to the extent that it secures payment of all or part of its purchase price,

(b) a security interest taken in collateral, other than investment property, by a person who gives value for the purpose of enabling the debtor to acquire rights in the collateral, to the extent that the value is applied to acquire the rights,

(c) the interest of a lessor of goods under a lease for a term of more than one year, and

(d) the interest of a person who delivers goods to another person under a commercial consignment,

but does not include a transaction of sale by and lease back to the seller and, for the purposes of this definition, "purchase price" and "value" include credit charges or interest payable for the purchase or loan credit;

[…]

"security agreement" means an agreement that creates or provides for a security interest and, if the context permits, includes

(a) an agreement that provides for a prior security interest, and

(b) writing that evidences a security agreement;

[…]

"security interest" means

(a) an interest in goods, chattel paper, investment property, a document of title, an instrument, money or an intangible that secures payment or performance of an obligation, but does not include the interest of a seller who has shipped goods to a buyer under a negotiable bill of lading or its equivalent to the order of the seller or to the order of an agent of the seller, unless the parties have otherwise evidenced an intention to create or provide for a security interest in the goods, and

(b) the interest of

(i) a transferee arising from the transfer of an account or a transfer of chattel paper,

(ii) a person who delivers goods to another person under a commercial consignment, and

(iii) a lessor under a lease for a term of more than one year,

whether or not the interest secures payment or performance of an obligation;

Scope of Act: security interests

2 (1) Subject to section 4, this Act applies

(a) to every transaction that in substance creates a security interest, without regard to its form and without regard to the person who has title to the collateral, and

(b) without limiting paragraph (a), to a chattel mortgage, a conditional sale, a floating charge, a pledge, a trust indenture, a trust receipt, an assignment, a consignment, a lease, a trust, and a transfer of chattel paper if they secure payment or performance of an obligation.

Effectiveness of a security agreement

9 Subject to this and any other enactment, a security agreement is effective according to its terms.

Subordination of unperfected security interests

20 A security interest […]

(b) in collateral is not effective against

(i) a trustee in bankruptcy if the security interest is unperfected at the date of the bankruptcy, or

(ii) a liquidator appointed under the *Winding-up and Restructuring Act* (Canada) if the security interest is unperfected at the date that the winding-up order is made…]

Perfection of purchase money security interests

22 (1) A purchase money security interest in […]

(b) an intangible that is perfected not later than 15 days after the day the security interest attaches,

has priority over the interests of persons referred to in section 20 (a) and (b).

Purchase money security interests

34 (1) Subject to section 28, a purchase money security interest in

(a) collateral or its proceeds, other than intangibles or inventory, that is perfected not later than 15 days after the day the debtor, or another person at the request of the debtor, obtains possession of the collateral, whichever is earlier, or

(b) an intangible or its proceeds that is perfected not later than 15 days after the day the security interest in the intangible attaches,

has priority over any other security interest in the same collateral given by the same debtor.

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3

Registration of financing statements

43 […]

(5) A registration may relate to one or more than one security agreement.

Who may make a proposal

50 […]

(1.5) The court may, on application made at any time after a notice of intention or a proposal is filed, determine, in accordance with subsection (1.4), the classes of secured claims appropriate to a proposal, and the class into which any particular secured claim falls.

(1.6) Subject to section 50.1 as regards included secured creditors, any creditor may respond to the proposal as made to the creditors generally, by filing with the trustee a proof of claim in the manner provided for in

(*a*) sections 124 to 126, in the case of unsecured creditors; or

(b) sections 124 to 134, in the case of secured creditors.