Court File No. CV-19-00615270-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

BETWEEN:

ROYAL BANK OF CANADA

Applicant

- and -

DISTINCT INFRASTRUCTURE GROUP INC., DISTINCT INFRASTRUCTURE GROUP WEST INC., DISTINCTTECH INC., IVAC SERVICES INC., IVAC SERVICES WEST INC., and CROWN UTILITIES LTD.

Respondents

BOOK OF AUTHORITIES OF THE APPLICANT

December 11, 2019

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Tab 1

2001 CarswellOnt 1019
Ontario Court of Appeal

Ma, Re

2001 CarswellOnt 1019, [2001] O.J. No. 1189, 104 A.C.W.S. (3d) 261, 143 O.A.C. 52, 24 C.B.R. (4th) 68

In the Matter of the Bankruptcy of James Hoi-Pang Ma, of the City of Mississauga, in the Regional Municipality of Peel, in the Province of Ontario

James Hoi-Pang Ma (Bankrupt (Appellant)) and Toronto Dominion Bank (Applicant (Respondent))

Abella, Charron, Sharpe JJ.A.

Judgment: March 23, 2001
Judgment: April 4, 2001 (Written Reasons)
Docket: CA C34958

Proceedings: affirming (2000), 20 C.B.R. (4th) 267 (Ont. Bktcy.); affirming (2000), 19 C.B.R. (4th) 117 (Ont. Bktcy.)

Counsel: *Chi-Kun Shi*, for Appellant
Bruce S. Batist, for Respondent
William J. Meyer, *Q.C.*, for Trustee in Bankruptcy

Subject: Insolvency; Civil Practice and Procedure
Related Abridgment Classifications
Bankruptcy and insolvency
XVI Effect of bankruptcy on other proceedings
XVI.1 Proceedings against bankrupt
XVI.1.a Before discharge of trustee
XVI.1.a.ii Granting of leave
Bankruptcy and insolvency
XVII Practice and procedure in courts
XVII.4 Stay of proceedings
Bankruptcy and insolvency
XVII Practice and procedure in courts
XVII.6 Discovery and examinations
XVII.6.d Evidentiary issues
XVII.6.d.i General principles

Headnote
Bankruptcy --- Effect of bankruptcy on other proceedings — Proceedings against bankrupt — Before discharge of trustee — Granting of leave
Creditor of undischarged bankrupt brought motion for order lifting stay of proceedings to permit creditor to commence and continue fraudulent misrepresentation action against bankrupt — Creditor's motion was granted — Deputy registrar held creditor's proposed action was type of claim that should be allowed to proceed — Deputy registrar held examination of merits of claim was not appropriate — Bankrupt's appeal was dismissed — Presence in proposed action of defendants other than bankrupt was sufficient prejudice to justify lifting stay — Bankrupt appealed — Appeal dismissed — Reviewing judge correctly concluded deputy registrar was correct in finding sufficient prejudice to creditor to justify lifting stay — No requirement existed to establish prima facie case — Onus was on creditor to establish basis for order lifting automatic stay under s. 69.4 of Bankruptcy

and Insolvency Act — Deputy registrar's finding accorded with s. 69.4 of Act and was supported by record — Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 69.4.

Table of Authorities

Cases considered:

Arrojo Investments v. Cardamone (1995), 33 C.B.R. (3d) 46 (Ont. Gen. Div.) — referred to

Bowles v. Barber (1985), 36 Man. R. (2d) 209, 60 C.B.R. (N.S.) 311 (Man. C.A.) — not followed

Francisco, Re (1995), 19 C.L.R. (2d) 146, 32 C.B.R. (3d) 29 (Ont. Bktcy.) — applied

Francisco, Re (1996), 40 C.B.R. (3d) 77 (Ont. C.A.) — referred to

Statutes considered:

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

s. 69.4 [rep. & sub. 1997, c. 12, s. 65(1)] — considered

APPEAL by bankrupt from order lifting stay of proceedings against bankrupt, 2000 CarswellOnt 4416, 20 C.B.R. (4th) 267 (Ont. Bktcy.).

Endorsement. *Per curiam*:

1 The appellant argues that when considering an application to lift a stay under s. 69.4 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c.B-3, the applicant is required to establish a *prima facie* case for the proposed action. *Bowles v. Barber* (1985), 60 C.B.R. (N.S.) 311 (Man. C.A.) is cited in support of this proposition. It is argued that to the extent Ontario cases such as *Arrojo Investments v. Cardamone* (1995), 33 C.B.R. (3d) 46 (Ont. Gen. Div.) apply a more lenient standard, they are inconsistent with decisions from other provinces.

2 In our view there is no requirement to establish a *prima facie* case and no inconsistency in the case law. We do not agree that *Bowles v. Barber* imposes a *prima facie* case requirement. More importantly, that requirement is not imposed by the statute. Under s. 69.4 the court may make a declaration lifting the automatic stay if it is satisfied (a) that the creditor is "likely to be materially prejudiced by [its] continued operation" or (b) "that it is equitable on other grounds to make such a declaration." The approach to be taken on s. 69.4 application was considered by Adams J. in *Re Francisco* (1995), 32 C.B.R. (3d) 29 (Ont. Bktcy.), at 29-30, a decision affirmed by this court (1996), 40 C.B.R. (3d) 77 (Ont. C.A.):

> In considering an application for leave, the function of a bankruptcy court is not to inquire into the merits of the action sought to be commenced or continued. Instead, the role is one of ensuring that sound reasons, consistent with the scheme of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c.B-3, exist for relieving against the otherwise automatic stay of proceedings.

3 As this passage makes clear, lifting the automatic stay is far from a routine matter. There is an onus on the applicant to establish a basis for the order within the meaning of s. 69.4. As stated in *Re Francisco*, the role of the court is to ensure that there are "sound reasons, consistent with the scheme of the *Bankruptcy and Insolvency Act*" to relieve against the automatic stay. While the test is not whether there is a *prima facie* case, that does not, in our view, preclude any consideration of the merits of the proposed action where relevant to the issue of whether there are "sound reasons" for lifting the stay. For example, if it were apparent that the proposed action had little prospect of success, it would be difficult to find that there were sound reasons for lifting the stay.

4 In the case before us, Justice Lane found that the Deputy Registrar was correct in finding that the applicant would suffer sufficient prejudice to justify an order lifting the stay. This finding accords with s. 69.4 and is supported by the record. We see no basis for interfering with his conclusion. The appeal is therefore dismissed with costs.

Appeal dismissed.

End of Document

Tab 2

2011 ONCA 34
Ontario Court of Appeal

C.I.F. Furniture Ltd., Re

2011 CarswellOnt 155, 2011 ONCA 34, 17 P.P.S.A.C. (3d) 47, 215 A.C.W.S. (3d) 1002, 273 O.A.C. 172, 348 D.L.R. (4th) 660, 73 C.B.R. (5th) 238

In the Matter of the Proposal of C.I.F. Furniture Limited

John Laskin, Robert P. Armstrong, R.G. Juriansz JJ.A.

Heard: October 28, 2010
Judgment: January 18, 2011
Docket: CA C51633

Proceedings: affirming *C.I.F. Furniture Ltd., Re* (2010), 63 C.B.R. (5th) 141, 2010 CarswellOnt 257, 2010 ONSC 505, 16 P.P.S.A.C. (3d) 9 (Ont. S.C.J. [Commercial List])

Counsel: David R. Byers, Maria Konyukhova, for Appellant, Kari Holdings Inc.
Steven L. Graff, for Respondents, VenGrowth Traditional Industries Fund Inc., VenGrowth II Investment Fund Inc.

Subject: Insolvency; Corporate and Commercial
Related Abridgment Classifications
Bankruptcy and insolvency
X Priorities of claims
X.1 Secured claims
X.1.b Forms of secured interests
X.1.b.xii Miscellaneous
Personal property security
IV Priority of security interest
IV.5 Subordination and postponement
Headnote
Bankruptcy and insolvency --- Priorities of claims — Secured claims — Forms of secured interests — Miscellaneous
Business and purchaser amalgamated — Vendor's holding company K Inc. provided vendor takeback financing secured by registered general security agreement — Bank became senior operating lender, guaranteed by two companies related to purchaser, VGT Inc. and VGI Inc. — VG Inc. provided funding through debentures registered by security interest, and other funding subordinate to K Inc. — Inter-creditor agreement made debenture agreement priority over K Inc.'s interest — Bank financing agreement gave K Inc.'s interest priority over bank, which had priority over VG Inc.'s interest — Business became insolvent and gained Bankruptcy and Insolvency Act protection — Hearing was held regarding priority — Motion judge held that VG Inc.'s security interest ranked in priority to K Inc.'s to extent of principal owing under debenture — VG Inc. did not sign any document ceding priority to K Inc. — Circular priority existed — Motion judge found that inter-creditor agreement subordinated K Inc.'s interest to VG Inc.'s interest, which did not change with agreement with bank — K Inc. appealed — Appeal dismissed — It would have been unreasonable to find that VG Inc. intended complete subordination, by 2008 K Inc.'s financing had already been spent and bank was providing new financing — As VG Inc. had big investment in corporation, it made sense for it to subordinate its interest to bank, but made no sense for it to subordinate its interest to K Inc. — Motion judge was correct in finding that complete subordination would confer windfall on K Inc., going from second to first priority.
Personal property security --- Priority of security interest — Subordination and postponement
Business and purchaser amalgamated — Vendor's holding company K Inc. provided vendor takeback financing secured by registered general security agreement — Bank became senior operating lender, guaranteed by two companies related to

purchaser, VGT Inc. and VGI Inc. — VG Inc. provided funding through debentures registered by security interest, and other funding subordinate to K Inc. — Inter-creditor agreement made debenture agreement priority over K Inc.'s interest — Bank financing agreement gave K Inc.'s interest priority over bank, which had priority over VG Inc.'s interest — Business became insolvent and gained Bankruptcy and Insolvency Act protection — Hearing was held regarding priority — Motion judge held that VG Inc.'s security interest ranked in priority to K Inc.'s to extent of principal owing under debenture — Section 38 of Personal Property Security Act states that secured party may subordinate its interest in manner which can be enforced by third party, but only where secured creditor explicitly subordinated its interests against third party — Documentation did not show agreement of subordination between VG Inc. and bank in favour of K Inc. — Inter-creditor agreement could only have impact on determining extent to which money paid to business pursuant to senior debentures should be paid in favour of bank, and did not burden or benefit K — Complete subordination in favour of K Inc. had not occurred — K Inc. appealed — Appeal dismissed — Nothing in 2008 inter-creditor agreement showed intention on VG Inc.'s part to go to bottom of queue.

Table of Authorities

Statutes considered:

Personal Property Security Act, R.S.O. 1990, c. P.10

Generally — referred to

s. 38 — considered

APPEAL by creditor from judgment reported at *C.I.F. Furniture Ltd., Re* (2010), 63 C.B.R. (5th) 141, 2010 CarswellOnt 257, 2010 ONSC 505, 16 P.P.S.A.C. (3d) 9 (Ont. S.C.J. [Commercial List]), finding that creditor's interest had been subordinated.

***John Laskin J.A.*:**

A. Introduction

1 This appeal concerns a priorities dispute between two secured creditors of an insolvent corporation. The insolvent corporation is C.I.F. Furniture Limited. The sale of its assets in a receivership did not generate enough money to satisfy its secured creditors. The two competing secured creditors are Kari Holdings, the holding company of the corporation's founders, Hans and Elizabeth Kamin, and The VenGrowth group of investment funds, which financed the purchase of Kari's shares in 2004.

2 Kari claims priority for a $1 million secured note received as vendor take back financing on the sale of its shares. VenGrowth claims priority for a $4.35 million senior subordinated debenture, used to finance the share purchase.

3 The case turns on whether a theory of complete subordination or a theory of partial subordination should be used to resolve the dispute. Under the complete subordination theory, Kari succeeds; under the partial subordination theory, VenGrowth succeeds.

4 The motion judge, Morawetz J., applied a partial subordination theory and so found in favour of VenGrowth. On its appeal, Kari submits that the motion judge erred in two ways. First, having regard to the factual and contractual matrix, the motion judge erred by not applying a complete subordination theory. Second, the motion judge erred in his application of s. 38 of the *Personal Property Security Act* (PPSA).

5 I agree with Morawetz J.'s reasons, which I have appended to this judgment. I add brief reasons of my own to address the arguments made in this court. I will first briefly review the financing agreements that led to this dispute, then the two competing theories, and finally why I agree with the motion judge and reject Kari's submissions.

B. The Financing Agreements

(i) Background

6 The Kamins started C.I.F. in the 1960s and incorporated their business in 1969. The corporation manufactured and supplied custom laboratory systems for laboratory and educational markets in North America.

7 In 2004, the Kamins retired and sold their shares in Kari. As part of the sale price, Kari took back a $1 million secured note, in turn secured by a general security agreement. The purchase of Kari's shares was financed by VenGrowth funds, which included $4.35 million secured by a senior subordinated debenture.

8 On November 30, 2004 Kari perfected its security interest in the note by registration under the PPSA. Two days later, on December 2, 2004, VenGrowth perfected its security interest in its senior debenture by registering its security interest under the PPSA. However, Kari's priority of registration under the PPSA was superceded by an inter-creditor agreement made at the end of December 2004.

(ii) The inter-creditor agreement, December 31, 2004

9 On December 31, 2004, the Bank of Nova Scotia (C.I.F.'s operating lender), Kari and VenGrowth entered into an inter-creditor agreement. They agreed on the following priorities among them, regardless of the order of registration under the PPSA:

- First, the Bank of Nova Scotia to the extent of its loans to C.I.F. (the bank was paid out in December 2006);
- Second, VenGrowth to the extent of its $4.35 million senior subordinated debenture;
- Third, Kari to the extent of its $1 million secured note;
- Fourth, VenGrowth to the extent of the additional loans it had advanced on the purchase of Kari's shares.

10 Thus, under the inter-creditor agreement, the VenGrowth senior debenture had priority over the Kari note, and the other VenGrowth debt was subordinate to the Kari note. The priority dispute between Kari and VenGrowth arose in 2008 when Comerica Bank agreed to provide secured financing to C.I.F.

(iii) The 2008 financing of C.I.F.

11 In 2008, Comerica Bank agreed to provide secured financing to C.I.F. The financing took the form of a revolving credit facility. To implement the financing, the parties signed several documents of which three are relevant to this appeal: a commitment letter signed by Comerica, a credit agreement between Comerica and C.I.F., and, most important, an inter-creditor agreement between Comerica and VenGrowth.

(a) The commitment letter

12 Comerica committed to provide a revolving credit facility to C.I.F. The commitment letter contains two provisions on which Kari relies in support of its appeal. First, the commitment letter expressly provides that the Kari $1 million note is "to rank ahead of the Bank." This provision reflects Kari's prior registration under the PPSA. Second, the commitment letter also required VenGrowth to provide Comerica with a $1 million guarantee, which would terminate on repayment of the Kari note. VenGrowth delivered this guarantee to Comerica.

(b) The credit agreement between Comerica and C.I.F.

13 Under this agreement, Comerica agreed to loan C.I.F. up to $2.5 million, secured by a general security agreement. Comerica perfected its security interest by registering a financing statement under the PPSA. At April 2009, the balance owing on Comerica's loan was approximately $1.3 million.

14 The credit agreement, like the commitment letter, recognized the Kari $1 million note as a "first priority lien" and Comerica's security interest as a "second priority lien." Moreover, Comerica's obligations under the agreement were conditional on, among other things, delivery to it of the VenGrowth guarantee.

(c) The 2008 inter-creditor agreement between Comerica and VenGrowth

15 Under this agreement, VenGrowth agreed to subordinate its security to Comerica's security.

C. The Dispute and the Two Competing Theories

(i) The dispute

16 The various financing agreements created what has been called a "circularity problem." The problem arises because there is no document in which all three parties -Comerica, Kari and VenGrowth - agreed among themselves on which security interest has priority. Instead, the key agreements were entered into by one or two but not all three parties. The three important agreements are the 2004 inter-creditor agreement to which Comerica was not a party, the 2008 creditor agreement to which neither Kari nor VenGrowth was a party, and the 2008 inter-creditor agreement to which Kari was not a party.

17 Under the 2004 inter-creditor agreement, the VenGrowth $4.35 million senior subordinated debenture has priority over the $1 million Kari note. Under the 2008 creditor agreement (and the 2008 commitment letter) the Kari $1 million note has priority over Comerica's security. Under the 2008 inter-creditor agreement, Comerica's security has priority over VenGrowth's security.

18 In short form, these three agreements provide:

- V ($4.35 million) ranks ahead of K ($1 million) - 2004 inter-creditor agreement
- K ($1 million) ranks ahead of C - 2008 creditor agreement
- C ranks ahead of V - 2008 inter-creditor agreement

19 How then is this priority dispute to be resolved? Both sides accept that it should be resolved by applying either a theory of complete subordination or a theory of partial subordination. The two theories are discussed in the reasons of the motion judge. I will review how the application of each theory affects the priorities among VenGrowth, Kari and Comerica.

(ii) Complete subordination

20 Under complete subordination, VenGrowth gives up its priority to Comerica: in other words, VenGrowth agrees not to assert a claim against the fund generated by the sale of C.I.F.'s assets until Comerica's claim is satisfied. But because Kari's security interest was registered under the PPSA before Comerica's security interest was registered, Comerica's claim cannot be satisfied until Kari's claim is paid. Kari therefore benefits indirectly from the agreement between VenGrowth and Comerica: Kari goes to first priority and VenGrowth falls to last priority. If the theory of complete subordination is applied, the priorities are:

- First, Kari;
- Second, Comerica;
- Third, VenGrowth

(iii) Partial subordination

21 Under partial subordination, VenGrowth gives the benefit of its first priority to Comerica. The amount of VenGrowth's claim - $4.35 million - is set aside out of the fund. That amount is used to satisfy Comerica's claim. If Comerica's claim is less than $4.35 million, it will get all of its claim paid and VenGrowth will get the balance. If Comerica's claim is greater than $4.35 million it will get the entire $4.35 million, but will receive the remainder of its claim only after Kari is paid.

22 Partial subordination has no effect on Kari. It remains in second priority after VenGrowth's first priority to the extent of $4.35 million. While under complete subordination, VenGrowth completely steps aside, under partial subordination VenGrowth steps aside only to the extent of Comerica's claim. Accordingly, if the theory of partial subordination is applied, the priorities are:

- First, Comerica, to a maximum of $4.35 million, and then VenGrowth, to a maximum of $4.35 million less Comerica's claim;

- Second, Kari;

- Third, Comerica for any claim in excess of $4.35 million;

- Fourth, VenGrowth for all of its remaining claims.

D. Discussion

23 The motion judge applied a theory of partial subordination for two main reasons. First, partial subordination produced an equitable result because it meant "Kari is neither burdened nor benefited by the 2008 Inter-Creditor Agreement," whereas complete subordination "would result in a windfall benefit to Kari at the expense of VenGrowth." Second, complete subordination could be justified only if supported by "clear and explicit language," and "such clear and explicit language is not found in the documents": see paras. 50-51 of the motion judge's reasons.

24 I turn to Kari's two submissions.

1. Having regard to the factual and contractual matrix, did the motion judge err by not applying complete subordination?

25 Whether complete or partial subordination should be applied turns on VenGrowth's intention, as disclosed by the various agreements. Do the agreements show that VenGrowth intended to wholly step aside and go to the bottom of the queue, or do they show that VenGrowth intended to step aside only to the extent of Comerica's interest?

26 Kari submits that the agreements, and the factual context in which they were signed, show that VenGrowth intended to go to the bottom of the queue. In making this submission, Kari relies mainly on five contractual provisions: the negative covenant in s. 8.2(b) of the Kari note, repeated in Kari's general security agreement; sections 4(d) and 11 of the 2004 inter-creditor agreement between Kari and VenGrowth; the 2008 credit agreement between Comerica and C.I.F.; the VenGrowth $1 million guarantee; and article 4 of the 2008 inter-creditor agreement between VenGrowth and Comerica. I do not think that singularly or collectively these five contractual provisions support Kari's position.

27 Section 8.2(b) of the Kari note contains a negative covenant precluding C.I.F. from granting additional encumbrances without Kari's consent. Kari says that the 2008 Comerica financing was done without its knowledge and thus breaches s. 8.2(b). Whether the 2008 financing amounts to a breach of this covenant need not be decided on this appeal. The important point is that VenGrowth was not a party to the note or to the financing in 2008. They therefore do not speak to VenGrowth's intentions; nor can they affect its priority position. Kari's corollary argument that VenGrowth arranged the financing is not supported in the record.

28 Sections 4(d) and 11 of the 2004 inter-creditor agreement stipulate that nothing in that agreement shall be construed as conferring any rights on a third party. Comerica is a third party, and therefore Kari argues that these provisions precluded Comerica from taking the benefit of VenGrowth's priority. In my opinion, these provisions do not assist Kari. The priority given to Comerica was conferred not in this 2004 agreement, but in the 2008 inter-creditor agreement.

29 Nor does the 2008 credit agreement or the commitment letter assist Kari. As VenGrowth was not a party to this agreement, or to the commitment letter, their terms cannot demonstrate any intention on VenGrowth's part to go to the bottom of the queue. These documents do no more than acknowledge that the Kari note ranks ahead of Comerica's security interest. They do not establish any agreement between Kari and VenGrowth or between VenGrowth and Comerica that puts Kari in first priority.

30 Kari's strongest argument rests on the $1 million guarantee given by VenGrowth in connection with the Comerica financing. The guarantee stipulated that it would terminate on payment of the Kari note. Kari contends that this guarantee and its termination provision make no sense under partial subordination. Kari says that Comerica insisted on this guarantee because it did not have a subordination agreement with Kari. Functionally, Kari says that the guarantee puts it in first priority until it is paid.

31 I do not accept Kari's contention. The record is silent on why Comerica insisted on this guarantee. I agree with VenGrowth that banks ask for many pieces of security, some they need and some they may not need, to protect their position. It is just as plausible that Comerica asked for this guarantee because the guarantee made its interest more secure. Perhaps more important, there is no term in the guarantee from which one can say that by giving it VenGrowth intended to entirely cede its priority to Kari.

32 Finally, Kari relies on article 4 of the 2008 inter-creditor agreement between Comerica and VenGrowth. Article 4 states:

> **Priorities of Indebtedness; Subordination of Junior Creditor Indebtedness**
>
> Junior Creditor hereby subordinates, to the extent and in the manner provided in this Agreement, all of its rights of payment of all of the Junior Creditor Indebtedness to the full and final payment of all of the Senior Creditor Indebtedness and the termination of all financing arrangements and commitments between the Debtor, the Guarantor and the Senior Creditor.
>
> [Comerica is the Senior Creditor and VenGrowth is the Junior Creditor.]

33 Kari submits that article 4 means VenGrowth is not to be paid until Comerica is paid in full. However, because Kari's security interest was registered before Comerica's security interest, Comerica cannot be paid until Kari is paid. So, implicitly, by article 4, VenGrowth agreed to step aside completely.

34 Kari's submission does not give effect to the qualifying phrase in article 4, "to the extent and in the manner provided in this Agreement". Other provisions of the agreement show that VenGrowth did not intend to subordinate its entire priority position to Kari. For example, articles 2 and 3 state that no third party - and Kari is a third party under this agreement - may benefit from anything contained in the agreement. Article 7a explicitly recognizes that VenGrowth agrees to step aside only to the extent of Comerica's interest:

> Under any circumstances ... the Collateral shall be applied first to the Senior Creditor Indebtedness until all of the Senior Creditor Indebtedness has been fully and finally paid and all of the financing arrangements and commitments between the Debtor, the Guarantor and Senior Creditor have been terminated, and then to the Junior Creditor Indebtedness.

35 For these reasons, I do not agree that the various contractual provisions on which Kari relies argue for complete subordination. Moreover, there are several compelling reasons to apply partial subordination.

36 First, it would be unreasonable to find that VenGrowth intended complete subordination. By 2008, Kari's financing had already been spent. Comerica was providing new financing to keep the corporation afloat. As VenGrowth had a big investment in the corporation, it made sense for VenGrowth to subordinate its interest to Comerica's interest. By contrast, it would have made no sense for VenGrowth to subordinate its interest to Kari's interest.

37 Second, as the motion judge pointed out, complete subordination would confer a windfall on Kari. It would go from second to first priority. Partial subordination leaves Kari in second position. It gets exactly what it bargained for in 2004.

38 Third, there is no document where VenGrowth agreed to subordinate its interest to Kari's interest. Thus, to give effect to Kari's position, one would have to infer that VenGrowth intended to go to the bottom of the queue. To draw that inference, one would expect some clear and unequivocal language in one of the documents, or at the very least, an exchange of correspondence between VenGrowth and Kari. Nothing of that sort exists.

39 I would not give effect to Kari's main ground of appeal.

2. Did the Motion Judge Err in His Application of s. 38 of the PPSA?

40 Section 38 of the PPSA states:

> A secured party may, in the security agreement or otherwise, subordinate the secured party's security interest to any other security interest and such subordination is effective according to its terms.

41 Section 38 recognizes that a secured party can, by agreement, subordinate its interest to other security interests in the same collateral, and a third party, not privy to that agreement, can rely on and enforce that subordination.

42 Kari argues that as a third party, it can rely on section 38 to enforce what it claims is the priority given to it by the 2008 credit agreement between Comerica and C.I.F., and the 2008 inter-creditor agreement between Comerica and VenGrowth. This argument simply recasts in the context of s. 38 of the PPSA, the main argument Kari advanced on this appeal, which I have already rejected. The motion judge did not give effect to Kari's argument under s. 38 and I would not do so either.

43 VenGrowth was not a party to the 2008 credit agreement, and therefore the parties to that agreement - Comerica and C.I.F. - could not by themselves subordinate the priority interest of the VenGrowth senior debenture to the Kari note. Further, as I have already discussed, nothing in the 2008 inter-creditor agreement shows an intention on VenGrowth's part to go to the bottom of the queue. I would not give effect to this ground of appeal.

E. Conclusion

44 The motion judge was correct in applying the theory of partial subordination to resolve the priority dispute between Kari and VenGrowth. I would therefore dismiss Kari's appeal, with costs fixed in the agreed upon amount of $17,500, inclusive of disbursements and applicable taxes.

***Robert P. Armstrong J.A.*:**

I agree.

***R.G. Juriansz J.A.*:**

I agree.

Appeal dismissed.

Appendix A

CITATION: C.I.F. Furniture Limited (Bankruptcy of), 2010 ONSC 505 **COURT FILE NO.:** 31-1194593 **DATE:** 20100121

SUPERIOR COURT OF JUSTICE - ONTARIO

(**COMMERCIAL LIST - BANKRUPTCY AND INSOLVENCY) RE:** IN THE MATTER OF THE PROPOSAL OF C.I.F. Furniture Limited, Applicants **BEFORE:** MORAWETZ J.

COUNSEL: Steven L. Graff and Sandra A. Vitorovich, for The VenGrowth Traditional

Industries Fund Inc. and the VenGrowth II Investment Fund Inc.

Paul G. Macdonald and Myriam M. Seers, for Kari Holdings Inc.

Endorsement

[1] This matter involves a priority dispute arising from the sale of assets of C.I.F. Furniture Limited ("CIF") for proceeds that are insufficient to satisfy the security interests of certain secured creditors. The dispute is between Kari Holdings Inc. ("Kari") and The VenGrowth Traditional Industries Fund Inc. ("VenGrowth Traditional") and The VenGrowth II Investment Fund Inc. ("VenGrowth Investment") and together with VenGrowth Traditional, ("VenGrowth").

[2] The parties are in agreement that a secondary issue, namely, whether the VenGrowth Security Interest only covered the principal amount owing to VenGrowth and does not include any payments of interest is moot and consequently need not be determined.

Summary of Facts

[3] CIF carried on business for the manufacture and supply of custom laboratory systems for markets across Canada and the United States.

[4] The business was established in the early 1960's by Mr. Hans J. Kamin and his spouse, Mrs. Elizabeth M. Kamin. In 1969, the Kamins incorporated CIF to continue the business.

[5] Upon retiring in 2004, the Kamins sold CIF to an affiliate of VenGrowth (the "Purchaser") pursuant to a share purchase agreement dated November 23, 2004. On the closing date (December 7, 2004), the Purchaser and CIF amalgamated and continued as CIF. The purchase price was $7,057,060. At the time of closing, VenGrowth indirectly held 53% of the issued and outstanding shares in CIF. At the time of the motion, VenGrowth was CIF's 95% majority shareholder and a substantial secured creditor.

[6] As part of the share purchase, Kari (the holding company of Mr. and Mrs. Kamin) provided the Purchaser with $1,000,000 in vendor take-back ("VTB") financing (the "Kari Note"), secured by a general security agreement dated December 1, 2004 (the "Kari GSA"), for which a financing statement was registered under the *Personal Property Security Act (Ontario)* ("PPSA") on November 30, 2004 (the "Kari Security Interest").

[7] VenGrowth also financed the share purchase by advancing the Purchaser the principal amount of $4,350,000, secured by a senior subordinated debenture dated December 2, 2004 (the "VenGrowth Senior Debenture") for which a financing statement was registered under the PPSA by VenGrowth on December 2, 2004 (the "VenGrowth Security Interest").

[8] VenGrowth also advanced significant additional capital to CIF on a junior and/or subordinated basis to Kari, with certain of these additional advances being made in December 2004 to finance the share purchase.

[9] Following the share purchase, Bank of Nova Scotia ("BNS") agreed to be the operating lender of CIF. All parties funding the share purchase recognized and agreed that BNS was in priority to all other secured creditors. CIF repaid its obligations to BNS in December 2006.

[10] Subsequently, Comerica Bank ("Comerica") became the operating lender. Pursuant to a credit agreement between Comerica and CIF dated November 28, 2008 (the "Comerica Credit Agreement"), Comerica provided CIF with a revolving credit facility to a maximum of $2,500,000. The facility granted pursuant to the Comerica Credit Agreement was secured by a security agreement dated November 28, 2008 (the "Comerica Security"), for which a financing statement was registered under the PPSA on November 13, 2008 (the "Comerica Security Interest").

[11] Both VenGrowth Traditional and VenGrowth Investment guaranteed a portion of the Comerica facility pursuant to the following guarantees (the "VenGrowth Guarantees"):

(a) a guarantee dated November 28, 2008 granted by VenGrowth Traditional in favour of Comerica and limited to $462,571; and

(b) a guarantee dated November 28, 2008 granted by VenGrowth Investment in favour of Comerica limited to $537,429.

[12] VenGrowth submits that the guarantee of VenGrowth Traditional was amended and restated by a guarantee dated April 29, 2009 limited to $601,342 and that the guarantee of VenGrowth Investment was amended and restated by a guarantee also dated April 23, 2009 limited to $698,658.

[13] The PPSA registrations are filed in the following order of priority:

(i) Kari - November 30, 2004;

(ii) VenGrowth - December 2, 2004;

(iii) Comerica - November 13, 2008.

[14] In 2004, CIF, Kari and VenGrowth entered into the following priorities agreements:

(a) an inter-creditor agreement dated December 3, 2004 (the "2004 Inter-Creditor Agreement");

(b) a subordination agreement dated December 7, 2004 (the "2004 Subordination Agreement"); and

(c) separate postponement and subordination agreements in favour of Kari from each of VenGrowth Traditional, VenGrowth Investment, as well as various other CIF creditors, namely, Cinitel Corp., Fallbrook Holdings Limited ("Fallbrook"), Mr. Bruce Andrew, Mr. Stephen Dulong and 1639662 Ontario Inc. ("Holdco").

[15] The 2004 Inter-Creditor Agreement granted the VenGrowth Security Interest, to the extent of the debt under the VenGrowth Senior Debenture, priority over the Kari Security Interest.

[16] Under the 2004 Subordination Agreement, VenGrowth Investment and VenGrowth Traditional agreed to postpone and subordinate their security interests, pursuant to their respective security, to the Kari Security Interest, except that neither of VenGrowth Investment or VenGrowth Traditional postponed or subordinated the VenGrowth Security Interest. As stated by counsel to VenGrowth, "in other words, all advances made by VenGrowth, other than the VenGrowth Senior Debenture, were subordinated to Kari".

[17] Comerica was not a party to the 2004 Inter-Creditor Agreement.

[18] In 2008, CIF secured financing from Comerica. The terms of the financing were set out in a commitment letter dated June 5, 2008 pursuant to which Comerica committed to provide a $2.5 million revolving credit facility to CIF (the "Commitment Letter").

[19] The Commitment Letter expressly states that the Kari Security Interest will rank in priority to the Comerica Security Interest and that the VenGrowth Security Interest will be subordinated to the Comerica Security Interest.

[20] The Comerica Credit Agreement recognizes the Kari Security Interest as a first priority lien and that the Comerica Security Interest as a second priority lien.

[21] The Comerica Credit Agreement included the Kari Note as a "Permitted Debt", the Kari Security Interest as a "Permitted Lien" and required a subordination of the VenGrowth Security Interest but not the Kari Security Interest to the Comerica Security Interest.

[22] VenGrowth was not a party to either the Commitment Letter or the Comerica Credit Agreement.

[23] Also, on November 28, 2008, CIF provided Comerica with the Comerica Security Agreement.

[24] The Comerica Security Interest also provides that each of the VenGrowth Guarantees will terminate upon the payment in full of the Kari Note.

[25] On November 28, 2008, VenGrowth and Comerica entered into an inter-creditor agreement whereby VenGrowth agreed to fully subordinate the VenGrowth Security Interest to the Comerica Security Interest (the "2008 Inter-Creditor Agreement").

[26] Kari did not know about the Comerica Security Interest until CIF served it with motion materials in these proceedings on April 21, 2009.

[27] CIF is insolvent and on April 21, 2009 it filed a Notice of Intention to Make a Proposal under the *Bankruptcy and Insolvency Act* (the "BIA").

[28] On April 29, 2009, A. Farber & Partners Inc. (the "Interim Receiver") was appointed interim receiver of CIF and by order dated May 15, 2009, the Interim Receiver was authorized to market and sell the assets.

[29] There is no inter-creditor agreement to which Comerica, VenGrowth and Kari are all parties that set out the priorities among them. There is no inter-creditor agreement or subordination agreement in which VenGrowth subordinates or postpones the VenGrowth Security Interest to the Kari Security Interest.

[30] Kari and Comerica have not entered into any agreement between themselves which governs the relative priorities of the Kari Security Interest and the Comerica Security Interest.

Analysis

[31] Kari submits that the Kari Security Interest ranks in priority to the Comerica Security Interest and the VenGrowth Security Interest by operation of the Commitment Letter, the Comerica Credit Agreement, the Comerica Security Agreement, the Comerica Security Interest and the 2008 Inter-Creditor Agreement (collectively the "Comerica Agreements") and s. 38 of the PPSA.

[32] Counsel to Kari submits that an objective interpretation of the relevant documents demonstrates that both VenGrowth and Comerica intended that, as a result of the Comerica Agreements, the Kari Security Interest would rank in priority to the Comerica Security Interest and, therefore, the VenGrowth Security Interest. Counsel to Kari submits that this position is supported by the repeated references in the Commitment Letter and the Comerica Credit Agreement to the first priority position of the Kari Security Interest and VenGrowth's voluntary agreement to step out of the priority queue and back in behind Comerica.

[33] There is, in my view, a fundamental weakness in this argument. VenGrowth is not party to either the Commitment Letter or the Comerica Credit Agreement. These are contractual agreements between CIF and Comerica. Although VenGrowth is the substantial controlling shareholder of CIF, this does not mean that the contractual agreements of CIF are agreements that bind VenGrowth. There is no stated intention in any document that establishes that VenGrowth intended to cede its priority position in all respects to the Kari Security Interest.

[34] When read together, the 2004 Inter-Creditor Agreement and the 2008 Inter-Creditor Agreement create a circularity issue as between Kari, VenGrowth and Comerica.

[35] Professor Wood commented on this issue in "*Circular Priorities in Secured Transactions Law*" at pages 7 - 8:

> The real controversy concerns the proper interpretation of the subordination agreement. In the United States, the issue is framed as whether SP1 intended a complete subordination of its claim or only a partial subordination. A **complete subordination** occurs if the subordination agreement is interpreted as an agreement by SP1 not to assert its claim against the collateral until SP3's claim is satisfied. It does not involve an agreement by SP1 to turn over the benefit of its priority to SP3. Rather, it is essentially an agreement by SP1 to step aside and not assert its claim until SP3's claim has been satisfied. On this view, the competition is resolved by giving first priority

> to SP2, second priority to SP3, and third priority to SP1. SP2 is the indirect beneficiary of the subordination agreement because SP3 cannot satisfy its claim until the claim of SP2 is fully satisfied.
>
> Under the competing **partial subordination theory**, a subordination agreement is interpreted as an agreement under which SP1 agrees to turn over the benefit of its priority to SP3. The priorities are therefore resolved in the following manner. First, the amount of SP1's claim is set aside out of the fund. Second, the fund is used to satisfy SP3's claim. If there is anything left over, it is paid to SP1. Third, SP2's claim is satisfied out of the fund. Fourth, any remaining balance is distributed to SP3 and then to SP1.

[36] The duelling approaches were also the subject of commentary by Professors Cumming, Walsh and Wood in *Personal Property Security Law* where the authors explained as follows:

> The priority competition is resolved by setting aside the amount of SP1's claim. From this fund, SP3's claim is satisfied. If a surplus remains after SP3's claim is satisfied, it is paid over to SP1. SP2's claim would next be satisfied from the remaining funds. If there is anything left, it is then distributed to SP3, then SP1. In other words, the subordination agreement between SP1 and SP3 is effective only as between those parties, and has no effect on the relative priority of SP2.
>
> Most subordination agreements provide for a postponement of the subordinating creditor's claim. Under a "step-aside" agreement, a secured party may instead agree that it will not make a claim in respect of a subordinated debt until the benefiting creditor is paid in full. If this form of agreement is used, there is a greater likelihood that it will have the effect of elevating the priority of an intervening party. In the above scenario, SP1 would renounced its claim until SP3 is paid in full. This would seem to have the effect of placing SP1 at the end of the queue, with the result that SP2 would obtain first priority followed by SP3.

[37] At issue is whether the circularity problem should be resolved in favour of VenGrowth or Kari. A resolution in favour of VenGrowth would require the application of the partial subordination theory. A resolution in favour of Kari would require the application of the complete subordination theory.

[38] In considering which of these two approaches should be applied in these circumstances, in my view, it is necessary to consider the impact of agreements to which VenGrowth, Kari and Comerica are parties.

[39] As a result of the 2004 Inter-Creditor Agreement, the Kari Security Interest is subordinate to the VenGrowth Security Interest. The issue is whether this situation changed as a result of the Comerica Agreements. In my view, it has not.

[40] VenGrowth entered into the 2008 Inter-Creditor Agreement with Comerica, the result of which is that VenGrowth subordinated payment under the VenGrowth Senior Debenture to Comerica. It does not follow that VenGrowth intended that its entire priority position would be subordinated to that of Kari.

[41] The Commitment Letter states that the VTB from Kari in the amount of $1,000,000 is to rank ahead of Comerica. This statement, at most, provides the understanding on the part of Comerica that Kari's interest ranks ahead of Comerica's position, but there is no agreement or acknowledgement by VenGrowth that the Kari Security Interest ranks ahead of the VenGrowth Security Interest.

[42] Further, the Comerica Credit Agreement does not recognize or state that the Kari Security Interest shall constitute a priority claim to the VenGrowth Security Interest.

[43] Section 38 of the PPSA provides that a secured party may, in the security agreement or otherwise, subordinate its security interest to any other security interest and the subordination is effective according to its terms and a third party who is not privy to the security agreement or other agreement which contains the subordination clause can enforce it.

[44] Counsel to VenGrowth submits that s. 38 applies only in instances where the secured creditor itself subordinates, explicitly or implicitly, its security interest vis-à-vis a third party. Counsel cites *Sun Life Assurance Co. of Canada v. Royal Bank*, 37 C.B.R. (4th) 169 in support of this submission. I agree with this position.

[45] In this case, the Commitment Letter and the Comerica Credit Agreement are the documents that Kari submits evidences the intention of VenGrowth to subordinate the VenGrowth Security Interest to the Kari Security Interest. I am in agreement with the submission of counsel to VenGrowth that evidence of an understanding involving Comerica and CIF in respect of the priority between Kari and Comerica does not establish a subordination agreement as between VenGrowth and Comerica in favour of Kari.

[46] The only documents in the Comerica Agreement to which VenGrowth is a party are the 2008 Inter-Creditor and the VenGrowth Guarantees. These documents, do not, in my view, result either clearly or explicitly, in a subordination of the VenGrowth Security Interest to the Kari Security Interest.

[47] Counsel to VenGrowth submits that the effect of the 2008 Inter-Creditor Agreement is to provide that a portion of any fund paid by CIF to VenGrowth under the VenGrowth Senior Debenture would be paid by VenGrowth to Comerica and any funds available for payment by CIF after repayment of the amount owing under the VenGrowth Senior Debenture would be paid to Kari next in satisfaction of the indebtedness under the Kari Note. A proper interpretation is that under the 2008 Inter-Creditor Agreement, any payments received by VenGrowth from CIF pursuant to the VenGrowth Senior Debenture (up to a maximum of the VenGrowth Indebtedness) would be shared as between VenGrowth and Comerica as follows:

> (a) first, payment would be made to Comerica in satisfaction of the Comerica indebtedness; and
>
> (b) secondly, the remaining funds, of the total of the VenGrowth Senior Debenture (inclusive of amounts paid in sub (a)), would be payable to VenGrowth in satisfaction of the VenGrowth indebtedness. The total distributed under both sub (a) and sub (b) would not be greater than the VenGrowth indebtedness.

[48] Counsel to VenGrowth submits that this interpretation is consistent with the analysis set out by Grant Gilmore in *Security Interests in Personal Property*, where he discusses a situation with three creditors, A, B, and C where A and C enter into a subordination agreement, the secured assets are sold and there are insufficient funds to satisfy the claims of all three creditors. The ensuing distribution was explained by Gilmore as follows:

> There is a comforting unanimity, among courts and commentators, on the proper distribution of funds:
>
> 1. Set aside from the fund the amount of A' claim.
>
> 2. Pay the amount set aside to
>
> a) C, to the amount of his claim;
>
> b) A, to the extent of any balance remaining after C's claim is satisfied.
>
> 3. Pay B the amount of the fund remaining after A's claim has been set aside.
>
> 4. If any balance remains in the fund after A's claim has been set aside and B's claim has been satisfied, distribute the balance to
>
> a) C,
>
> b) A.

> Thus C, by virtue of the subordination agreement, is paid first, but only to the amount of A's claim, to which B was in any event junior. B receives what he had expected to receive: the fund less A's prior claim. If A's claim is smaller than C's, C will collect the balance of his claim in his own right, only after B has been paid in full. A, the subordinator, receives nothing until B and C have been paid except to the extent that his claim, entitled to first priority, exceeds the amount of C's claim, which under his agreement, is to be paid first.

[49] Counsel to VenGrowth also referenced the decision of the Newfoundland and Labrador Court of Appeal in *Hickman Equipment (1985) Ltd., Re*, 2006 CarswellNfld 245, leave to appeal to Supreme Court of Canada refused, [2006] S.C.C.A. No. 462. Counsel to VenGrowth submitted in their factum as follows:

> 42. The Newfoundland and Labrador Supreme Court was recently asked to decide whether by virtue of a subordination agreement between party A and C: (i) C moved up to stand in the place of A and thereby gains priority over B; or (ii) while A ranks in priority behind C, nonetheless B retains priority over C.
>
> 43. Quoting several texts, including the passage from Gilmore above, and Canadian jurisprudence, the Appellant in Hickman argued that "the ranking of the claims and distribution of proceeds is determined apart from the operation of the subordination agreement" with the subordination agreement applying to determine the extent of the share of the distribution that should be paid to the party in whose favour the subordination was granted. Moreover, a creditor in second position (such as Kari) should not receive the benefit of a subordination agreement to which it is not a party and on which the parties to the subordination agreement intended the second position creditor to rely.
>
> 44. The central proposition of the case of the Appellants in *Hickman* [and the position advanced by VenGrowth herein] was:
>
> > Where a subordination is enforced by the benefiting creditor [RBC] for its benefit, the amount secured by the subordinated security interest simply goes toward satisfying in whole or in part two claims as opposed to one: the benefiting creditor's claim [RBC's] and the subordinated creditor's claim [CIBC's]. The benefiting creditor shall receive payment in full of its claim, before the subordinated creditor receives any payment on the subordinated debt. Where there is an intervening security interest [GMAC], the result is equitable, because the intervening creditor will receive what it expected to receive, the fund less the amount secured by the higher ranking subordinated security interest. Otherwise, the intervening creditor receives a windfall and the statutory rights bestowed on the subordinating creditor to subordinate its security interest and the benefiting creditor to enforce the subordination for its benefit are thwarted.
>
> The court, finding the arguments set out by the Appellant persuasive, adopted the Appellant's reasoning.

[50] I am in agreement with the submissions of counsel to VenGrowth. The 2008 Inter-Creditor Agreement can only have an impact on determining the extent to which the monies paid to CIF pursuant to the VenGrowth Senior Debenture should be paid in favour of Comerica. In this manner, Kari is neither burdened nor benefited by the 2008 Inter-Creditor Agreement. On the other hand, the argument put forward by counsel to Kari would result in a windfall benefit to Kari at the expense of VenGrowth. The result preferred by VenGrowth produces, in my view, an equitable result.

[51] It seems to me that the result preferred by Kari, namely, that of a complete subordination, could only be justified if there is clear and explicit language that would result in a complete subordination agreement. Such clear and explicit language is not found in the documents.

Disposition

[52] In this case, in the 2008 Inter-Creditor Agreement, VenGrowth subordinates only to and for the benefit of Comerica, while at the same time preserving its priority position as against third parties. In my view, it is especially telling that s. 2 of the 2008 Inter-Creditor Agreement provides that all agreements and representations are solely for the benefit of the creditors (VenGrowth and Comerica) and that no other parties are intended to be benefited in any way by the 2008 Inter-Creditor Agreement. In the face of such explicit language, it seems to me that it cannot be said that there was the intention on the part of VenGrowth to effect a complete subordination in favour of Kari. Rather, the effect of the 2008 Inter-Creditor Agreement is that, with all the priorities remaining the same, VenGrowth is to set aside a portion of the funds it receives in trust to be paid to Comerica pursuant to the 2008 Inter-Creditor Agreement and that it will not receive its priority payment until Comerica has been paid in full from payments it receives in its position.

[53] In the result, I find that the VenGrowth Security Interest is in priority to the Kari Security Interest to the extent of principal owing under the VenGrowth Senior Debenture. The issue of whether priority extends to interest need not be determined.

[54] VenGrowth is to have its costs of this motion, as agreed, in the amount of $42,500 inclusive of disbursements and GST.

End of Document

Tab 3

Most Negative Treatment: Check subsequent history and related treatments.

2012 ONSC 7319
Ontario Superior Court of Justice [Commercial List]

Peoples Trust Co. v. Rose of Sharon (Ontario) Retirement Community

2012 CarswellOnt 16827, 2012 ONSC 7319, 19 C.L.R. (4th) 1, 224 A.C.W.S. (3d) 323, 97 C.B.R. (5th) 303

Peoples Trust Company (Applicant) and Rose of Sharon (Ontario) Retirement Community (Respondent)

D.M. Brown J.

Heard: December 21, 2012
Judgment: December 27, 2012
Docket: CV-11-9399-00CL

Counsel: C. Prophet, C. Stanek for Receiver, Deloitte & Touche Inc.
R. Jaipargas for Trisura Guarantee Insurance Company

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

Related Abridgment Classifications

Bankruptcy and insolvency
XVII Practice and procedure in courts
XVII.4 Stay of proceedings
Construction law
IV Construction and builders' liens
IV.10 Practice on enforcement of lien
IV.10.n Miscellaneous

Headnote

Bankruptcy and insolvency --- Practice and procedure in courts — Stay of proceedings
Lifting stay — General contractor began proceedings against condominium — Receiver was appointed over condominium and proceedings stayed pursuant to Bankruptcy and Insolvency Act — Default judgment was granted in favour of contractor — Contractor brought motion to set aside stay — Motion granted — Receiver did not object to claim but on condition of setting aside default judgment — Lien claim would expire if stay not lifted — Default judgment was likely made without knowledge of appointment and was in contravention of its terms — Court had authority to determine all matters touching on receivership — Receiver met test for setting aside stay under s. 54(3) of Construction Lien Act, and default and noting in default were set aside.
Construction law --- Construction and builders' liens — Practice on enforcement of lien — Miscellaneous
General contractor began proceedings against condominium — Receiver was appointed over condominium and proceedings stayed pursuant to Bankruptcy and Insolvency Act — Default judgment was granted in favour of contractor — Contractor brought motion to set aside stay — Motion granted — Receiver did not object to claim but on condition of setting aside default judgment — Lien claim would expire if stay not lifted — Default judgment was likely made without knowledge of appointment and was in contravention of its terms — Court had authority to determine all matters touching on receivership — Receiver met test for setting aside stay under s. 54(3) of Construction Lien Act, and default and noting in default were set aside.

Table of Authorities

Cases considered by *D.M. Brown J.*:

A1 Equipment Rental Ltd. v. Borkowski (2008), 2008 CarswellOnt 1717, 70 C.L.R. (3d) 274 (Ont. S.C.J.) — considered
Ford Credit Canada Ltd. v. Welcome Ford Sales Ltd. (2010), 2010 ABQB 199, 2010 CarswellAlta 2518 (Alta. Q.B.) — referred to

M.J. Dixon Construction Ltd. v. Hakim Optical Laboratory Ltd. (2009), 2009 CarswellOnt 1671, 79 C.L.R. (3d) 144 (Ont. Master) — considered

Ma, Re (2001), 143 O.A.C. 52, 2001 CarswellOnt 1019, 24 C.B.R. (4th) 68 (Ont. C.A.) — considered

Statutes considered:

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

Generally — referred to

s. 69.4 [en. 1992, c. 27, s. 36(1)] — considered

s. 69.4(a) [en. 1992, c. 27, s. 36(1)] — considered

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

Generally — referred to

s. 37 — considered

s. 37(1) — considered

s. 37(1) ¶ 1 — considered

s. 37(1) ¶ 2 — considered

s. 54(3) — considered

s. 67(3) — considered

Rules considered:

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

R. 19.03(1) — considered

MOTION by creditor set aside stay of proceedings due to receivership in action under *Construction Lien Act.*

***D.M. Brown J.*:**

I. Motion to lift stay in a receivership in order to set down for trial a construction lien action

1 On September 27, 2011, C. Campbell J. appointed Deloitte & Touche Inc. receiver and manager of all the assets, undertakings and properties of Rose of Sharon (Ontario) Retirement Community. Paragraph 8 of the Appointment Order contained the standard clause staying proceedings against the debtor.

2 Rose of Sharon owned a long-term care condominium located on Maplewood Avenue, Toronto. Prior to the appointment of the Receiver construction lien litigation had broken out over the condominium project and the general contractor, Mikal-Calladan Construction Inc., had initiated lien proceedings. On January 30, 2012, Trisura Guarantee Insurance Company obtained an assignment of Mikal-Calladan's lien. On November 26, 2012, Trisura obtained an order to continue the construction lien action. As required by the terms of section 37 of the *Construction Lien Act*, R.S.O. 1990, c. C.30, Trisura must set the construction lien action down for trial by December 31, 2012, failing which its lien will expire.

3 Trisura therefore moved for an order lifting the stay of proceedings to allow it to pursue the construction lien action so that it can set the action down for trial.

4 The Receiver did not oppose the lifting of the stay, but it sought certain terms for the order. Trisura has agreed to all the terms, but one — whether as a condition of lifting the stay this Court should set aside a default judgment granted against Rose of Sharon some two days after the Appointment Order was made and the earlier noting in default of Rose of Sharon.

II. Governing legal principles governing the lifting of stays

5 On a motion to lift a stay of proceedings in a receivership the moving party bears the onus of convincing the court that the relief should be granted, and in considering such a request the court should look at the totality of the circumstances and the relative prejudice to both sides. [1] The parties agreed that the court may find guidance in the jurisprudence which has developed around requests to lift stays imposed by the *Bankruptcy and Insolvency Act*. Section 69.4(1) of the *BIA* provides that a court may declare that the statutory stays no longer operate, "subject to any qualifications that the court considers proper", where the court is satisfied that the creditor is likely to be materially prejudiced by the continued operation of the stays or that it is equitable on other grounds to make such a declaration. In *Ma, Re* [2] the Court of Appeal set out the basic considerations on a request to lift a stay under *BIA* s. 69.4:

> Under s. 69.4 the court may make a declaration lifting the automatic stay if it is satisfied
>
> (a) that the creditor is "likely to be materially prejudiced by [its] continued operation" or
>
> (b) "that it is equitable on other grounds to make such a declaration." The approach to be taken on s. 69.4 application was considered by Adams J. in *Re Francisco* (1995), 32 C.B.R. (3d) 29 at 29-30 (Ont. Gen. Div.), a decision affirmed by this court (1996), 40 C.B.R. (3d) 77 (Ont. C.A.):
>
> > In considering an application for leave, the function of a bankruptcy court is not to inquire into the merits of the action sought to be commenced or continued. Instead, the role is one of ensuring that sound reasons, consistent with the scheme of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, exist for relieving against the otherwise automatic stay of proceedings.
>
> As this passage makes clear, lifting the automatic stay is far from a routine matter. There is an onus on the applicant to establish a basis for the order within the meaning of s. 69.4. As stated in *Re Francisco*, the role of the court is to ensure that there are "sound reasons, consistent with the scheme of the *Bankruptcy and Insolvency Act*" to relieve against the automatic stay. While the test is not whether there is a prima facie case, that does not, in our view, preclude any consideration of the merits of the proposed action where relevant to the issue of whether there are "sound reasons" for lifting the stay. For example, if it were apparent that the proposed action had little prospect of success, it would be difficult to find that there were sound reasons for lifting the stay.

III. The basic chronology

6 Mikal-Calladan preserved a Claim for Lien on November 19, 2010 against title to the Project. It perfected its lien by commencing the construction lien action — CV-10-417426 — on December 31, 2010. On July 21, 2011, Peoples Trust served a statement of defence in the Lien Action. Rose of Sharon was noted in default in the Lien Action; exactly when, the materials did not disclose.

7 On August 31, 2011, with the consent of Peoples Trust, the parties agreed to refer the Lien Action to a construction lien master in Toronto for a trial. MacDonald J. made a standard Reference Order on that day which provided that "the Master determine all questions arising in this action on the reference".

8 Then, less than a month later, at the suit of Peoples Trust, the Appointment Order was made.

9 On September 12, 2011, before the Appointment Order was made, Mikal-Calladan had requisitioned default judgment against Rose of Sharon. On September 29, two days after the Appointment Order was made, the Registrar signed default judgment against Rose of Sharon for $4,195,768.64, plus costs of $1,350.00 (the "Default Judgment").

10 As mentioned, earlier this year Trisura took an assignment of Mikal-Calladan's Lien Claim and obtained an order to continue the Lien Action about a month ago.

11 With the December 31 deadline looming to set down the Lien Action or face the expiry of its lien, on November 7, 2012 Trisura's counsel wrote to the Receiver's requesting that the Receiver consent to a lifting of the stay so it could set the Lien Action down for trial. Trisura's counsel indicated that "the main issue in the lien action relates to the priority of the lien over the People's Trust mortgage".

12 Receiver's counsel responded on November 22, 2012 advising that the Receiver was prepared to consent to lifting the stay on the following terms:

> Condition 1: Trisura obtained an order to continue in the Lien Action;
>
> Condition 2: Trisura agreed to set aside the noting in default of Rose of Sharon and the Default Judgment so that the Receiver could defend the Lien Action;
>
> Condition 3: Issues of liability, timeliness and quantum in the Lien Action would be determined in a Reference before a Master; and,
>
> Condition 4: The issue of the priorities of the construction lien vis-à-vis any other encumbrance would be determined by a judge of the Commercial List.

13 Mr. Edouard Chassé, a claims adjuster retained by Trisura, in his affidavit stated that Trisura had obtained an order to continue and it agreed to Conditions 3 and 4. Trisura opposed Condition 2 "as the Receiver has had notice of the default for 14 months and has taken no steps" to set aside the noting in default and default judgment.

IV. Analysis

14 There is no doubt that if the stay is not lifted, Trisura would be prejudiced materially by losing its ability to advance its lien claim. Section 37(1) of the *Construction Lien Act* provides that a perfected lien, such as that assigned to Trisura, expires immediately after the second anniversary of the commencement of the lien action unless either (i) an order is made for the trial of an action in which the lien may be enforced or (ii) an action in which the lien may be enforced is set down for trial. December 31, 2012 is the second anniversary of the commencement of the Lien Action, so unless the stay is lifted, Trisura's lien claim will expire. As mentioned, the Receiver has consented to the lifting of the stay, so the remaining dispute centres only around Condition 2 — the Receiver's requirement that the noting of default and Default Judgment against Rose be set aside.

15 Trisura advanced two arguments why no setting aside should occur. First, Trisura argued that because the August 31, 2011 Reference Order of MacDonald J. stipulated that "the Master determine all questions arising in this action on the reference and all questions arising under the *Construction Lien Act*", it was not open to the court supervising the receivership proceedings to set aside a noting of default which had occurred in the Lien Action.

16 I disagree, for two reasons. First, the Default Judgment was made two days after the Appointment Order. No doubt that occurred because the papers requisitioning the Default Judgment were moving through the court's administrative office and the Registrar was unaware of the Appointment Order. Nonetheless, given the stay of proceedings ordered in the Appointment Order, the Default Judgment contravened the Appointment Order and therefore was of no force or effect.

17 Second, Trisura's submission ignored what occurred less than one month after MacDonald J. made his Reference Order — this receivership came about. As a result of the Appointment Order, the court supervising the receivership considers all issues relating to or touching upon the receivership and therefore is the proper court to determine whether, as a condition of lifting a stay of proceedings, certain relief should be granted to the receiver as part of the process of balancing the respective interests at stake on the lift-stay motion.

18 Which brings me to the second argument made by Trisura: it contended that the appropriate test for considering whether to set aside a noting in default in a construction lien action is that set out in the *Construction Lien Act* and the related jurisprudence and, in the circumstances of this case, the Receiver could not meet that test. Section 54(3) of the *CLA* provides that where a

defendant has been noted in default, it shall not be permitted to contest the claim "except with leave of the court, to be given only where the court is satisfied that there is evidence to support a defence". Section 67(3) of the *CLA* states that "except where inconsistent with this Act...the *Courts of Justice Act* and the rules of court apply to pleadings and proceedings under this Act."

19 In *M.J. Dixon Construction Ltd. v. Hakim Optical Laboratory Ltd.*, Master Polika held that Rule 19.03(1) of the *Rules of Civil Procedure* dealing with the setting aside of notings in default was inconsistent with *CLA* s. 54(3) because it was less stringent than the test under the *CLA* by reason of granting the court a discretion to set aside a noting of default on such terms as were just. Master Polika stated that the sole test a party moving to set aside the noting of default in a construction lien action needed to meet was that set out in *CLA* s. 54(3) — i.e. to satisfy the court that there existed evidence to support a defence. [3] In *A1 Equipment Rental Ltd. v. Borkowski* Lederer J. stated that a party moving to set aside a noting in default under the *CLA* must not only demonstrate that evidence existed to support a defence, it also had to move promptly to set aside the noting in default. [4]

20 Whether, when a lien claimant seeks leave of the court supervising a receivership to lift the stay of proceedings and the receiver seeks a condition that a noting of default be set aside, the court must apply the test under *CLA* s. 54(3) or may proceed on a less stringent basis as part of its discretion in lifting the stay, is a question I need not determine for the simple reason that on the facts of this case the Receiver meets the test under the *CLA*.

21 Trisura submitted that the Receiver cannot now attempt to impose a condition setting aside the noting of default when over a year has passed since that event. The evidence does not support that contention. First, just over a week after the making of the Appointment Order, counsel for Mikal-Calladan wrote to Receiver's counsel advising of the Default Judgment and stating:

> Under the circumstances, we will not take any steps to enforce our client's judgment in the absence of obtaining the necessary leave from the Court.

In light of that position taken by the lien claimant, it is not surprising that the Receiver took no immediate steps to set aside the Default Judgment or the noting in default.

22 In its First Report dated December 12, 2011 the Receiver reported:

> While there may be setoffs against Mikail's claim that may be asserted by the Receiver, pending disposition of the Property, the Receiver does not intend to take any action in connection with any of the above-noted lien claims at this time.

Again, this constitutes evidence of a reasonable explanation by the Receiver about why it did not take steps at the time in the Lien Action.

23 On February 29, 2012, Trisura advised the Receiver of the assignment of the Lien Claim, but then took no further steps to move the Lien Action along until October 24, 2012 when it informed the Receiver that it wished to obtain a trial date. Further emails between counsel ultimately resulted in the Receiver's November 22, 2012 letter setting out the terms for lifting the stay of proceedings. In those circumstances, I see no argument that the Receiver failed to take steps promptly to set aside the noting in default once it became aware of Trisura's intention to proceed with the Lien Action. I also would note, by way of chronology, that on September 14, 2012, a month before Trisura approached the Receiver about further steps in the Lien Action, the Receiver had commenced a claim against Trisura under the performance bond for the Project.

24 As to whether the Receiver has filed evidence to support a defence, it has. Although the Receiver has not filed a draft Statement of Defence, the Receiver provided Trisura with ample details of its defence through its July 10, 2012 letter to Trisura's counsel, in particular the sections entitled "Set-Offs" and "Deficiencies", as well as in portions of its Statement of Claim in the performance bond action, specifically paragraphs 42 and 62 of the claim.

25 In balancing the interests of Trisura and the Receiver on this motion to lift the stay of proceedings, I conclude that it is fair and appropriate to require, as a term of lifting the stay, that both the noting of default of Rose of Sharon and the Default Judgment be set aside, and that the Receiver be permitted to file a Statement of Defence in the Lien Action within 20 days.

V. Summary and costs

26 By way of summary, I grant the motion of Trisura to lift the stay of proceedings contained in the Appointment Order to allow it to pursue the Lien Action, including allowing Trisura to set the Lien Action down for trial. Out of an abundance of caution, given the proximity of the December 31 deadline, I also order the trial of the Lien Action. As conditions for lifting the stay I order as follows:

> (i) the noting in default of Rose of Sharon and the Default Judgment against it are set aside so that the Receiver can defend the Lien Action;
>
> (ii) the Receiver may file a Statement of Defence in the Lien Action within 20 days;
>
> (iii) the issues of liability, timeliness and quantum in the Lien Action shall be determined in a Reference before a Master; and,
>
> (iv) the issue of the priorities of the construction lien vis-à-vis any other encumbrance shall be determined by a judge of the Commercial List in these receivership proceedings.

As to costs, the conditions sought by the Receiver in its November 22, 2012 letter were reasonable. There really was no need for a contested motion. Accordingly, I grant the Receiver its costs of this motion fixed at $4,000.00 payable by Trisura within 20 days of the date of this Order. I am available at a 9:30 appointment tomorrow, Friday, December 28, 2012, to issue this order, if required.

Motion granted.

Footnotes

1 *Ford Credit Canada Ltd. v. Welcome Ford Sales Ltd.*, 2010 ABQB 199 (Alta. Q.B.), paras. 13 and 14.

2 (2001), 24 C.B.R. (4th) 68 (Ont. C.A.), paras. 2 and 3.

3 (2009), 79 C.L.R. (3d) 144 (Ont. Master), para. 24.

4 (2008), 70 C.L.R. (3d) 274 (Ont. S.C.J.), para. 51.

IN THE MATTER OF Section 101 of the *Courts of Justice Act*, R.S.O. 1990 c.C.43, as amended, and in the matter of Section 243(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended

ROYAL BANK OF CANADA and **DISTINCT INFRASTRUCTURE GROUP INC. et al.**

Applicant Respondents

Court File No. CV-19-00615270-00CL

ONTARIO
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(COMMERCIAL LIST)

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