1990 CarswellOnt 108, 79 C.R. (3d) 1, 113 N.R. 53, 59 C.C.C. (3d) 92, [1990] 2 S.C.R. 531, 41 O.A.C. 353, 11 W.C.B. (2d) 10, J.E. 90-1356

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R. v. Khan

KHAN v. R.

Supreme Court of Canada

Lamer C.J.C., Wilson, Sopinka, Gonthier and McLachlin JJ.

Heard: November 3, 1989
Judgment: September 13, 1990
Docket: No. 20963



Counsel: *R.J. Carter, Q.C.*, and *L.B. O'Brien*, for appellant.

*K.L. Campbell*, for the Crown.

Subject: Criminal

Criminal Law --- Sexual offences — Sexual assault — General offence — Evidence.

Evidence — Children — Understanding of oath — Former provision of Canada Evidence Act for sworn evidence by child requiring that oath in some way get hold of conscience and appreciation of testifying in court under oath.

Evidence — Hearsay — More flexible approach than absolute rule subject to exception being appropriate, especially where declarant being child and statement concerning sexual abuse — Statement being admissible where necessary and reliable.

Evidence — Exceptions to hearsay rule — Child's statement to mother concerning sexual assault, made 10 to 15 minutes after event, not meeting requirements of traditional spontaneous declaration exception to hearsay rule — Not being contemporaneous or being made under pressure or emotional intensity.

The accused, a medical doctor engaged in a general family practice, was charged with sexually assaulting a child. The child, 3 1/2 years old, had attended at the accused's office with her mother. While the mother was waiting in the examination room, the child and the accused were alone in his private office. After the examination the mother noticed a wet spot on the sleeve of her daughter's clothing. After the mother and child left the doctor's office, about 10 to 15 minutes later, they had a conversation about the visit, and the child described an incident which would amount to a sexual assault. At trial, this conversation was excluded as inadmissible hearsay. The daughter's clothing was examined by a forensic biologist, who testified that analysis of the spot on the sleeve showed it to be semen and saliva. The child, 4 1/2 years old at the time of the trial, was called as a witness. The trial judge conducted an inquiry as to her compe-

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tency to testify. He decided that the child could not give evidence, sworn or unsworn, and concluded that the Crown had fallen short of proving the accused's guilt beyond a reasonable doubt; the doubt entertained arose from the view that semen samples might have been on the accused's desk on the day in question and somehow ended up on the child's clothes. The accused was acquitted, and the Crown appealed.

The Court of Appeal ordered a new trial, holding that the trial judge had erred in holding the child's conversation with her mother inadmissible. Greater latitude should have been given to the temporal proximity between the alleged event and the statement, with possible unreliability being relevant to weight rather than admissibility. The court also found error in the refusal of the trial judge to permit the child to give unsworn testimony.

The accused appealed.

**Held:**

Appeal dismissed.

The distinction between the ability to testify under oath and the ability to give unsworn evidence has been narrowed but not eliminated. Before a person can give evidence under oath, it must be established that the oath in some way gets a hold on his conscience, that there is an appreciation of testifying in court under oath. It was wrong for the trial judge to apply this test to the child witness in this case, as the Crown was only seeking to have the child give unsworn evidence. In such a situation the only two requirements are sufficient intelligence and an understanding of the duty to tell the truth. The trial judge also erred in placing critical weight on the child's young age. The Canada Evidence Act makes no distinction between children of different ages.

Applying the traditional tests for spontaneous declarations, the trial judge was correct in rejecting evidence of the child's conversation with her mother. The statement was not contemporaneous, nor was it made under pressure or emotional intensity which would give the guarantee of reliability upon which the spontaneous declaration rule has traditionally rested. However, the traditional approach to the hearsay rule, as an absolute rule subject to exceptions, while providing a degree of certainty, has frequently proved unduly inflexible in dealing with new situations and new needs in the law.

A more flexible approach to hearsay, rooted in principle and policy, is the correct direction to take, particularly where the declarant is a child and the statement concerns sexual abuse. The first question should be whether reception of the hearsay statement is necessary. The inadmissibility of the child's evidence might be one basis for a finding of necessity. But sound evidence based on psychological assessments that testimony in court might be traumatic for the child or harm the child might also serve. The next question should be whether the evidence is reliable. Many considerations, such as timing, demeanour, the personality of the child, the intelligence and understanding of the child and the absence of any reason to fabricate, may be relevant. The mother's statement in this case describing her conversation with her daughter should have been received. It was necessary, the child's viva voce evidence having been rejected. It was also reliable. The child had no motive to falsify her story, which emerged naturally and without prompting. The fact that she could not be expected to have knowledge of such sexual acts imbued her statement with its own peculiar stamp of reliability.

**Cases considered:**

*Ares v. Venner*, [1970] S.C.R. 608, 12 C.R.N.S. 349, 73 W.W.R. 347, 14 D.L.R. (3d) 4 [Alta.] — *applied*

*Foote v. Foote*, [1988] B.C.W.L.D. 1264, [1988] W.D.F.L. 799, [1988] B.C.J. 278 (C.A.) — *considered*

*H. (D.R.) v. B.C. (Supt. of Fam. & Child Services)* (1984), 58 B.C.L.R. 103, 41 R.F.L. (2d) 337, 14 D.L.R. (4th)

1990 CarswellOnt 108, 79 C.R. (3d) 1, 113 N.R. 53, 59 C.C.C. (3d) 92, [1990] 2 S.C.R. 531, 41 O.A.C. 353, 11 W.C.B. (2d) 10, J.E. 90-1356

105 (C.A.) [leave to appeal to S.C.C. refused 42 R.F.L. (2d) xxxv, 14 D.L.R. (4th) 105n] — *considered*

*M. (W.) v. P.E.I. (Dir. of Child Welfare)* (1986), 3 R.F.L. (3d) 181, 10 C.P.C. (2d) 188, 60 Nfld. & P.E.I.R. 32, 181 A.P.R. 32 (P.E.I.C.A.) — *considered*

*Myers v. D.P.P.*, [1965] A.C. 1001, [1964] 3 W.L.R. 145, 48 Cr. App. R. 348, [1964] 2 All E.R. 881 (H.L.) — *not followed*

*Official Solicitor v. K.*, [1965] A.C. 201, [1963] 3 W.L.R. 408, [1963] 3 All E.R. 191 (H.L.) — *referred to*

*R. v. Abbey*, [1982] 2 S.C.R. 24, 29 C.R. (3d) 193, [1983] 1 W.W.R. 251, 39 B.C.L.R. 201, 68 C.C.C. (2d) 394, 138 D.L.R. (3d) 202, 43 N.R. 30 — *referred to*

*R. v. B. (G.)*, [1990] 2 S.C.R. 30, 77 C.R. (3d) 347, 56 C.C.C. (3d) 200 [Sask.] — *applied*

*R. v. Bannerman* (1966), 48 C.R. 110, 55 W.W.R. 257, affirmed [1966] S.C.R. v, 50 C.R. 76, 57 W.W.R. 736 [Man.] — *considered*

**Statutes considered:**

Canada Evidence Act, R.S.C. 1985, c. C-5

s. 16 [since re-en. R.S.C. 1985, c. 19 (3rd Supp.), s. 18]

**Authorities considered:**

McCormick on Evidence, 3rd ed. (1984), p. 859.Wharton's Criminal Evidence, 13th ed. (1972), vol. 2, pp. 84, 90.

Appeal by accused from judgment of Ontario Court of Appeal, 64 C.R. (3d) 281, 42 C.C.C. (3d) 197, 27 O.A.C. 142, reversing accused's acquittal of sexual assault and ordering new trial.

**The judgment of the court was delivered by *McLachlin J.*:**

1 This case [appeal from 64 C.R. (3d) 281, 42 C.C.C. (3d) 197, 27 O.A.C. 142] raises the question of the admissibility of a child's unsworn evidence and statements made by a child to an adult concerning sexual assault.

**The Facts**

2 On 26th March 1985, Mrs. O. and her daughter, T., who was 3 1/2 years old, attended at the office of their family doctor, Dr. Khan, for a general examination of the mother and a routine immunization of T.

3 Dr. Khan examined T. first, in the presence of her mother. He then told her to wait in his private office while he conducted the examination of her mother. Dr. Khan and T. were alone in his private office for a period of five to seven minutes while the mother undressed and put on a hospital gown. T. was alone in the office for the following 15 minutes while her mother's examination was being conducted. T. did not come into contact with any other male person during this period.

4 When the mother rejoined T., she noticed the child picking at a wet spot on her sleeve. They left and went to a nearby drugstore. Upon leaving the store, approximately 15 minutes after leaving Dr. Khan's office, mother and child

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had essentially the following conversation:

> MRS. O.: So you were talking to Dr. Khan, were you? What did he say?
>
> T.: He asked me if I wanted a candy. I said "Yes". And do you know what?
>
> MRS. O.: What?
>
> T.: He said, "Open your mouth." And do you know what? He put his birdie in my mouth, shook it and peed in my mouth.
>
> MRS. O.: Are you sure?
>
> T.: Yes.
>
> MRS. O.: You're not lying to me, are you?
>
> T.: No. He put his birdie in my mouth. And he never did give me my candy.

The mother testified that the word "birdie" meant "penis" to T. As a result of the police investigation T.'s jogging suit was examined and the spot on the sleeve was determined to have been produced by a deposit of semen and, in some areas, a mixture of semen and saliva that had soaked through the fabric before it dried. The concentration of the mixture suggested to the forensic biologist that the substances were probably mixed before they were applied to the material.

5 The appellant was charged with sexual assault. At trial he elected to call no evidence. With respect to the Crown's case, the trial judge made two significant rulings. The trial judge held that T. was not competent to give unsworn evidence, and also refused to admit the evidence of the mother as to the above-noted conversation on the basis that the statement was not contemporaneous with the event. The trial judge acquitted the appellant of the charges. The Crown appealed the acquittal to the Court of Appeal for Ontario, which allowed the appeal, set aside the acquittal and ordered a new trial.

**Relevant Statutory Provision**

6 Canada Evidence Act, R.S.C. 1970, c. E-10 [now R.S.C. 1985, c. C-5], s. 16 (since repealed and replaced by S.C. 1987, c. 24, s. 18 [now R.S.C. 1985, c. 19 (3rd Supp.), s. 18]):

> 16. (1) In any legal proceeding where a child of tender years is offered as a witness, and such child does not, in the opinion of the judge, justice or other presiding officer, understand the nature of an oath, the evidence of such child may be received, though not given upon oath, if, in the opinion of the judge, justice or other presiding officer, as the case may be, the child is possessed of sufficient intelligence to justify the reception of the evidence, and understands the duty of speaking the truth.
>
> (2) No case shall be decided upon such evidence alone, and it must be corroborated by some other material evidence.

**Judgments**

***District Court of Ontario***

1990 CarswellOnt 108, 79 C.R. (3d) 1, 113 N.R. 53, 59 C.C.C. (3d) 92, [1990] 2 S.C.R. 531, 41 O.A.C. 353, 11 W.C.B. (2d) 10, J.E. 90-1356

7 Locke D.C.J. did not admit the testimonial evidence of the child, T. He also rejected the argument that the statements T. made to her mother were admissible as an exception to the hearsay rule because they were "spontaneous statements". Therefore, Locke D.C.J. did not admit the evidence of the mother with regard to the conversation that took place shortly after leaving the doctor's office. He concluded:

> In all of the circumstances, and however suspicious I remain to this moment, the Crown has fallen just short of proof of the accused's guilt beyond a reasonable doubt.

***Court of Appeal***

8 Robins J.A., writing for the court, found that the trial judge erred when considering the admission of the child's testimony. He found that the trial judge applied the more strenuous test, for admission of sworn testimony, when he should have applied the less strenuous test, applicable to unsworn testimony. Robins J.A. also held that the trial judge erred when considering the admissibility of the spontaneous statements. In his opinion, because the child was of tender years and because a sexual event was alleged, greater latitude should have been given in respect of the lapse of time between the event and the declaration.

**Issues**

9 1. Did the Court of Appeal err in concluding that the trial judge misdirected himself in ruling that the child witness was incompetent to give unsworn testimony?

10 2. Did the Court of Appeal err in holding, contrary to the ruling of the trial judge, that a "spontaneous declaration" allegedly made by the child to her mother after the alleged sexual assault was admissible?

**Analysis**

***1. Did the trial judge err in law in holding that the child was incompetent to give unsworn evidence?***

11 T. was called as a witness at the trial. She was 4 years and 8 months old. Questioning revealed that she did not understand what the Bible was and did not understand the nature of telling the truth "in court". The Crown did not contend that she was competent to give evidence under oath. It submitted, however, that her unsworn evidence should be received under s. 16 of the Canada Evidence Act:

> 16. (1) In any legal proceeding where a child of tender years is offered as a witness, and such child does not, in the opinion of the judge, justice or other presiding officer, understand the nature of an oath, the evidence of such child may be received, though not given upon oath, if, in the opinion of the judge, justice or other presiding officer, as the case may be, the child is possessed of sufficient intelligence to justify the reception of the evidence, and understands the duty of speaking the truth.
>
> (2) No case shall be decided upon such evidence alone, and it must be corroborated by some other material evidence.

The trial judge refused to receive T.'s unsworn evidence on the ground that, while she possessed sufficient intelligence to justify the reception of the evidence, he was not satisfied that she understood the duty of speaking the truth.

12 The Court of Appeal, per Robins J.A., concluded that the trial judge had erred in rejecting T.'s testimony. It found that he made two errors.

1990 CarswellOnt 108, 79 C.R. (3d) 1, 113 N.R. 53, 59 C.C.C. (3d) 92, [1990] 2 S.C.R. 531, 41 O.A.C. 353, 11 W.C.B. (2d) 10, J.E. 90-1356

13 The first error, in the view of the Court of Appeal, was to apply the test in *R. v. Bannerman* (1966), 48 C.R. 110, 55 W.W.R. 257, affirmed [1966] S.C.R. v, 50 C.R. 76, 57 W.W.R. 736 [Man.], a case where the issue was the reception of evidence *under oath*, and in particular the statement of Dickson J. at p. 138 that: "The object of the law in requiring an oath is to get at the truth relative to the matters in dispute by getting a hold on the conscience of the witness." Robins J.A. stated, at p. 206:

> To satisfy the less stringent standards applicable to unsworn evidence, the child need only understand the duty to speak the truth in terms of ordinary everyday social conduct. This can be demonstrated through a simple line of questioning directed to whether the child understands the difference between the truth and a lie, knows that it is wrong to lie, understands the necessity to tell the truth, and promises to do so. It is to be borne in mind that under s. 16(2) the child's unsworn evidence must be corroborated by some other material evidence. Any frailties that may be inherent in the child's testimony go to the weight to be given the testimony rather than its admissibility.

14 The second error, the Court of Appeal concluded, was to place too much weight on the fact that the child was very young, in effect drawing a distinction between children of very tender years and older children. It is clear that the trial judge was concerned by the very young age of the witness. He pointed out that most of the cases concerned children of 10 to 13 years and that he could find no case of the evidence of a child under 5 being received. While acknowledging that theoretically evidence of a child of any age could be proffered in court, he noted in his concluding comments:

> [T.], however intelligent she may be to this day, is still very much an infant who is just beginning to embark upon childhood. She is still mentally and physically normal, but very immature.

15 I agree with the Court of Appeal that the trial judge made the two errors to which it referred. He erred first in applying the *Bannerman* test to s. 16 of the Evidence Act and emphasizing that T. did not understand what it meant to lie "to the court". While the distinction between the ability to testify under oath and the ability to give unsworn evidence under s. 16 has been narrowed by rejection in cases such as *Bannerman* of the need for a religious understanding of the oath, it has not been eliminated. Before a person can give evidence under oath, it must be established that the oath in some way gets a hold on his conscience, that there is an appreciation of the significance of testifying in court under oath. It was wrong to apply this test, which T. clearly did not meet, to s. 16, where the only two requirements for reception of the evidence are sufficient intelligence and an understanding of the duty to tell the truth.

16 The trial judge also erred in placing critical weight on the child's young age. The Act makes no distinction between children of different ages. The trial judge in effect found that T. met the two requirements for permitting a child to testify under s. 16, but, emphasizing her immaturity, rejected her evidence. He found that T. had sufficient intelligence, and conceded that she "seemed to be aware at least of the consequences of telling a lie". This is clear from T.'s evidence, as revealed by the following portions of the transcript:

> Q. Yes, and do you know what it is to tell the truth? You're sort of shrugging your shoulders, there, and smiling. Do you know what it is to tell a lie?
>
> A. U-hmm.
>
> Q. What's a lie?
>
> A. If you say you cleaned up the room and you didn't, and your mother and your father went to see it and it's messy, that's a lie.
>
> Q. I see. What happens when you tell a lie?

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A. The parent spank their bum ...

Q. I see. You're doing just fine. Tell me, what else happens to you if you tell a lie?

A. I get spanked and I get sent in my room and I get cleaned up and I cry and I come back out and I not cry, and that's okay.

Q. And then everything is fine, is it?

A. [nods]

17 Having found that the two requirements for reception of the evidence under s. 16 had been fulfilled, the trial judge erred in letting himself be swayed by the young age of the child. Were that a determinative consideration, there would be danger that offences against very young children could never be prosecuted.

***2. Did the trial judge err in rejecting the mother's statement of what the child told her after the incident?***

18 Fifteen minutes after leaving Dr. Khan's office, in response to her mother's query, "So you were talking to Dr. Khan, were you?", T. told her mother about the sexual act the doctor had performed on her. The issue is whether the mother's statement of what she was told is admissible in evidence. The trial judge rejected the statement, holding that it was hearsay and did not fall within any of the established exceptions to the hearsay rule, and in particular the spontaneous declaration exception. The Court of Appeal held that the statement should have been received on the ground that the inherent reliability of the child's statement was such that the usual requirements for spontaneous declarations of contemporaneity and intensity or pressure should be relaxed.

19 I am satisfied that, applying the traditional tests for spontaneous declarations, the trial judge correctly rejected the mother's statement. The statement was not contemporaneous, being made 15 minutes after leaving the doctor's office and probably one-half hour after the offence was committed. Nor was it made under pressure or emotional intensity which would give the guarantee of reliability upon which the spontaneous declaration rule has traditionally rested. The question, then, is the extent to which, if at all, the strictures of the hearsay rule should be relaxed in the case of children's testimony. The issue is one of great importance, in view of the increasing number of prosecutions for sexual offences against children and the hardships that often attend requiring children to retell and relive the frequently traumatic events surrounding the episode in a long series of encounters with parents, social workers, police and finally different levels of courts.

20 The hearsay rule has traditionally been regarded as an absolute rule, subject to various categories of exceptions, such as admissions, dying declarations, declarations against interest and spontaneous declarations. While this approach has provided a degree of certainty to the law on hearsay, it has frequently proved unduly inflexible in dealing with new situations and new needs in the law. This has resulted in courts in recent years on occasion adopting a more flexible approach, rooted in the principle and the policy underlying the hearsay rule rather than the strictures of traditional exceptions.

21 This court took such an approach in *Ares v. Venner*, [1970] S.C.R. 608, 12 C.R.N.S. 349, 73 W.W.R. 347, 14 D.L.R. (3d) 4 [Alta.]. The plaintiff was suing for medical malpractice, which had resulted in amputation of his leg for gangrene. He wanted to introduce hospital records containing entries by nurses as evidence of the onset of symptoms which the doctor should have noticed and treated. He was met with the objection that the records were hearsay and he should call the nurses who made the notations. But he could not prove which nurse had made which entry, which made that approach impossible.

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22 This court held that the records should be admitted notwithstanding that, on the traditional rules, they were inadmissible. The court accepted (at p. 624) the proposition that "The common law is moulded by the judges and it is still their province to adapt it from time to time so as to make it serve the interests of those it binds," particularly in the field of procedural law: per Lord Donovan, dissenting, in *Myers v. D.P.P.*, [1965] A.C. 1001 at 1047, [1964] 3 W.L.R. 145, 48 Cr. App. R. 348, [1964] 2 All E.R. 881 (H.L.). Hall J. at p. 624 quoted the following passage from the reasons in *Myers* of Lord Pearce, dissenting (at pp. 1040-41):

> I find it impossible to accept that there is any "dangerous uncertainty" caused by obvious and sensible improvements in the means by which the court arrives at the truth. One is entitled to choose between the individual conflicting obiter dicta of two great judges and I prefer that of Jessel M.R. His dictum was as follows, 1 P.D. 154, 241: "Now I take it the principle which underlies all these exceptions is the same. In the first place, the case must be one in which it is difficult to obtain other evidence, for no doubt the ground for admitting the exceptions was that very difficulty. In the next place the declarant must be disinterested; that is, disinterested in the sense that the declaration was not made in favour of his interest. And, thirdly, the declaration must be made before dispute or litigation, so that it was made without bias on account of the existence of a dispute or litigation which the declarant might be supposed to favour. Lastly, and this appears to me one of the strongest reasons for admitting it, the declarant must have had peculiar means of knowledge not possessed in ordinary cases." On that expression of principle he admitted the extension which has been acted on ever since in the Probate Division.

In the result, this court concluded that the nurses' records should be admitted, noting however that the admission "should, in no way, preclude a party wishing to challenge the accuracy of the records or entries from doing so" and adding that "the nurses were present in court and available to be called as witnesses if the respondent had so wished" (p. 626).

23 Lord Pearce's four tests may be resumed in two general requirements: necessity and reliability. The child's statement to the mother in this case meets both these general requirements as well as the more specific tests. Necessity was present, other evidence of the event, as the trial judge found, being inadmissible. The situation was one where, to borrow Lord Pearce's phrase, it was difficult to obtain other evidence. The evidence also bore strong indicia of reliability. T. was disinterested, in the sense that her declaration was not made in favour of her interest. She made the declaration before any suggestion of litigation. And beyond doubt she possessed peculiar means of knowledge of the event of which she told her mother. Moreover, the evidence of a child of tender years on such matters may bear its own special stamp of reliability. As Robins J.A. stated in the Court of Appeal (at p. 210):

> Where the declarant is a child of tender years and the alleged event involves a sexual offence, special considerations come into play in determining the admissibility of the child's statement. This is so because young children of the age with which we are concerned here are generally not adept at reasoned reflection or at fabricating tales of sexual perversion. They, manifestly, are unlikely to use their reflective powers to concoct a deliberate untruth, and particularly one about a sexual act which in all probability is beyond their ken.

24 Because of the frequent difficulty of obtaining other evidence and because of the lack of reason to doubt many statements children make on sexual abuse to others, courts in the United States have moved toward relaxing the requirements of admissibility for such statements. This has been done in the context of the doctrine of spontaneous declarations. In McCormick on Evidence, 3rd ed. (1984), at p. 859, the authors refer to this development as the "tender years" exception to the general rule, and describe it as follows:

> A tendency is apparent in cases of sex offences against children of tender years to be less strict with regard to permissible time lapse and to the fact that the statement was made in response to inquiry.

25 Similarly, Wharton's Criminal Evidence, 13th ed. (1972), vol. 2, at p. 84, states that, while "The res gestae rule

in sex crimes is the same as in other criminal actions", the rule "should be applied more liberally in the case of children". In an attempt to analyze the many authorities in this area and arrive at some general "rule of thumb" with respect to the generally permissible time lapse between the alleged sexual assault and the spontaneous declaration, the author notes that declarations made up to an hour following the assault will generally be admissible, whereas such declarations "will not ordinarily be regarded as part of the res gestae where the time interval between the crime and the declaration is more than one hour" (p. 90).

26 These developments underline the need for increased flexibility in the interpretation of the hearsay rule to permit the admission in evidence of statements made by children to others about sexual abuse. Insofar as they are tied to the exception to the hearsay rule of spontaneous declarations, however, they suffer from certain defects. There is no requirement that resort to the hearsay evidence be necessary. Even where the evidence of the child might easily be obtained without undue trauma, the Crown would be able to use hearsay evidence. Nor is there any requirement that the reliability of the evidence in the particular be established; hence inherently unreliable evidence might be admitted. Finally, the rule being of an absolute "in-or-out" character, there is no means by which a trial judge could attach conditions on the reception of a particular statement which the judge might deem prudent in a particular case, as, for example, the right to cross-examine the deponent referred to in *Ares v. Venner*, supra. In addition to these objections, it can be argued that to extend the spontaneous declaration rule as far as these cases would extend it is to deform it beyond recognition and is conceptually undesirable.

27 In Canada too, courts have been moving to more flexibility in the reception of the hearsay evidence of children, although not under the aegis of the spontaneous declaration exception to the hearsay rule. Relying on *Official Solicitor v. K.*, [1965] A.C. 201, [1963] 3 W.L.R. 408, [1963] 3 All E.R. 191, where the House of Lords admitted such evidence in child protection proceedings, the British Columbia Court of Appeal admitted similar evidence in *H. (D.R.) v. B.C. (Supt. of Fam. & Child Services)* (1984), 58 B.C.L.R. 103, 41 R.F.L. (2d) 337, 14 D.L.R. (4th) 105 (C.A.). At issue was hearsay evidence in the context of child protec tion proceedings. A 5-year-old child had been apprehended after allegations of sexual abuse committed by the father. Counsel sought to introduce evidence of statements made by the child to a psychologist. Counsel for the parents objected to the use of these statements for their truth, and argued that the decision of this court in *R. v. Abbey*, [1982] 2 S.C.R. 24, 29 C.R. (3d) 193, [1983] 1 W.W.R. 251, 39 B.C.L.R. 201, 68 C.C.C. (2d) 394, 138 D.L.R. (3d) 202, 43 N.R. 30, was applicable. Hinkson J.A., for the court, justified the reception of the evidence on the nature of the proceedings, stating (at pp. 340-41):

> The concern with admitting hearsay evidence and acting upon it when dealing with a grave allegation of misconduct on the part of a parent to a child is not to be overlooked. ...
>
> However, in proceedings involving children this court has adopted another approach which is exemplified by the decision in *R. v. Arbuckle*, 59 W.W.R. 605 ...
>
> In my opinion the principle discussed in *R. v. Abbey*, supra, should not be applied to the inquiry with which we are concerned. Rather, in this type of inquiry, the approach adopted in the *Arbuckle* case, supra, is to be followed. Thus a judge, conducting an inquiry of this nature, involving a child of tender years who is too young to testify in the inquiry, can receive hearsay evidence and rely upon such evidence in coming to the decision as to whether or not the child is in need of protection.

28 The Prince Edward Island Supreme Court, Appeal Division, in *M. (W.) v. P.E.I. (Dir. of Child Welfare)* (1986), 3 R.F.L. (3d) 181, 10 C.P.C. (2d) 188, 60 Nfld. & P.E.I.R. 32, 181 A.P.R. 32, also found in child protection proceedings that hearsay evidence was admissible. The court did not justify the decision on the ground of the type of proceeding in question. Rather, Mitchell J. held that the proceedings were subject to the same procedural standards that apply to other civil cases but asserted at p. 185 that: "The list of exceptions has never been closed." Mitchell J., for the court, stated at p. 185:

1990 CarswellOnt 108, 79 C.R. (3d) 1, 113 N.R. 53, 59 C.C.C. (3d) 92, [1990] 2 S.C.R. 531, 41 O.A.C. 353, 11 W.C.B. (2d) 10, J.E. 90-1356

> Oftentimes in cases of alleged sexual abuse of a young child the only evidence available is contained in a statement made by the child to some third party. Usually such statements are not made in circumstances that would meet the criteria for admission under the traditional exceptions to the hearsay rule. If the child can not or for some valid reason does not testify about the facts asserted in the out-of-court statement and hearsay is excluded the court will be deprived of hearing what could be the most relevant of evidence. Faced with that situation, the court may admit the third party's evidence as proof of the facts contained in the child's statement, even though that evidence be hearsay, provided that, as groundwork for its admission, sufficient evidence is first led to establish the reliability of the out-of-court statement, and of the circumstances which establish the need to introduce the content of the child's statement through hearsay. In such cases, the court must always proceed with great caution both with regard to satisfying itself on the question of the reliability of the child's statements, as well as with respect to those circumstances which justify the need for the admissibility of the out-of-court statements.

29 In *Foote v. Foote*, [1988] B.C.W.L.D. 1264, [1988] W.D.F.L. 799, [1988] B.C.J. 278 (C.A.), in an access hearing, reception of hearsay evidence of a child's statement was justified on the basis of *Ares v. Venner*, supra. The child had told a day-care worker of an assault. Anderson J.A., for the court, noted at p. 17 the dangers inherent in receiving such evidence:

> The concern with admitting hearsay evidence and acting upon it when dealing with a grave allegation of misconduct on the part of a parent to a child is not to be overlooked. Clearly, no judge would be satisfied to act upon it in a case where direct evidence would be produced. But that consideration does not resolve the problem.

However, he went on to find it admissible:

> Quite apart from the *H. (D.R.)* case, the reception of hearsay evidence in this case is justified on grounds of necessity and reliability: see *Ares v. Venner*, [1970] S.C.R. 608, where nurses' notes, although hearsay, were admitted in evidence as proof of the truth of their contents on grounds of necessity and reliability. The judgment of the Supreme Court of Canada in that case indicates that the rules of evidence relating to hearsay evidence in civil cases are not entirely inflexible.

30 These cases point the way in the correct direction. Despite the need for caution, hearsay evidence of a child's statement may be received where the requirements of *Ares v. Venner* are met. The general approach is summed up in the comment of Wilson J. in *R. v. B. (G.)*, [1990] 2 S.C.R. 30 at 55, 77 C.R. (3d) 347, 56 C.C.C. (3d) 200 [Sask.]:

> In recent years we have adopted a much more benign attitude to children's evidence, lessening the strict standards of oath taking and corroboration, and I believe that this is a desirable development.

31 The first question should be whether reception of the hearsay statement is necessary. Necessity for these purposes must be interpreted as "reasonably necessary". The inadmissibility of the child's evidence might be one basis for a finding of necessity. But sound evidence based on psychological assessments that testimony in court might be traumatic for the child or harm the child might also serve. There may be other examples of circumstances which could establish the requirement of necessity.

32 The next question should be whether the evidence is reliable. Many considerations, such as timing, demeanour, the personality of the child, the intelligence and understanding of the child, and the absence of any reason to expect fabrication in the statement, may be relevant on the issue of reliability. I would not wish to draw up a strict list of considerations for reliability or to suggest that certain categories of evidence (for example the evidence of young children on sexual encounters) should be always regarded as reliable. The matters relevant to reliability will vary with the child and with the circumstances, and are best left to the trial judge.

33 In determining the admissibility of the evidence, the judge must have regard to the need to safeguard the

1990 CarswellOnt 108, 79 C.R. (3d) 1, 113 N.R. 53, 59 C.C.C. (3d) 92, [1990] 2 S.C.R. 531, 41 O.A.C. 353, 11 W.C.B. (2d) 10, J.E. 90-1356

interests of the accused. In most cases a right of cross-examination, such as that alluded to in *Ares v. Venner*, would not be available. If the child's direct evidence in chief is not admissible, it follows that his or her cross-examination would not be admissible either. Where trauma to the child is at issue, there would be little point in sparing the child the need to testify in chief only to have him or her grilled in cross-examination. While there may be cases where, as a condition of admission, the trial judge thinks it possible and fair in all the circumstances to permit cross-examination of the child as the condition of the reception of a hearsay statement, in most cases the concerns of the accused as to credibility will remain to be addressed by submissions as to the weight to be accorded to the evidence and submissions as to the quality of any corroborating evidence.

34 I add that I do not understand *Ares v. Venner* to hold that the hearsay evidence there at issue was admissible where necessity and reliability are established only where cross-examination is available. First, the court adopted the views of the dissenting judges in *Myers v. D.P.P.*, supra, which do not make admissibility dependent on the right to cross-examine. Second, the cross-examination referred to in *Ares v. Venner* was of limited value. The nurses were present in court at the trial, but, in the absence of some way of connecting particular nurses with particular entries, meaningful cross-examination on the accuracy of specific observations would have been difficult indeed.

35 I conclude that hearsay evidence of a child's statement on crimes committed against the child should be received, provided that the guarantees of necessity and reliability are met, subject to such safeguards as the judge may consider necessary and subject always to considerations affecting the weight that should be accorded to such evidence. This does not make out-of-court statements by children generally admissible; in particular, the requirement of necessity will probably mean that in most cases children will still be called to give viva voce evidence.

36 I conclude that the mother's statement in the case at bar should have been received. It was necessary, the child's viva voce evidence having been rejected. It was also reliable. The child had no motive to falsify her story, which emerged naturally and without prompting. Moreover, the fact that she could not be expected to have knowledge of such sexual acts imbues her statement with its own peculiar stamp of reliability. Finally, her statement was corroborated by real evidence. Having said this, I note that it may not be necessary to enter the statement on a new trial if the child's viva voce evidence can be received as suggested in the first part of my reasons.

**Conclusion**

37 I would dismiss the appeal and direct a new trial.

*Appeal dismissed.*

END OF DOCUMENT

# EVIDENCE

IN

# TRIALS AT COMMON LAW.

## BOOK I: ADMISSIBILITY.

## PART II: AUXILIARY RULES OF PROBATIVE POLICY.

### TITLE II: THE HEARSAY RULE.

### SUB-TITLE II (*continued*): EXCEPTIONS TO THE HEARSAY RULE.

### TOPIC VIII: OFFICIAL STATEMENTS.

### CHAPTER LIV.

## *A.* GENERAL PRINCIPLES OF THE EXCEPTION.

§ 1630. **Name of the Exception.** The scope of this exception is often designated by the term "public documents." But this term is inadequate and misleading. In the first place, the word "public" is ambiguous. It may signify "open to all," "capable of being known or observed by all"; or it may signify "having an interest for persons in general"; or it may signify "made or done by an officer of the government." These are decidedly different senses. So far as the term may indicate a general principle, it is obvious that the principle may result in different rules according to the sense in which the word "public" is to be interpreted. This ambiguity of phrase has already caused an undesirable uncertainty in the scope of the exception; and it is better to avoid a confusing terminology. The word "official" more accurately signifies the essence of the principle dominating the exception; it indicates the official character of the person stating and of his statements, as the reason for their admissibility. In the second place, the word "document" is here inapplicable. It is true that the exception includes only written statements. Nevertheless, the Hearsay rule applies only to statements or assertions offered testimonially (*ante*, § 1361), and thus the present exception, so far as it is an exception, is concerned with statements or assertions as such, and not with writings or documents as such. The Hearsay rule excludes them only as containing testimonial assertions, and therefore this exception deals with them only as assertions. The word "statement" indicates the source of the objection to them, and the word "document" does not. In the third place, the word "document" is ambiguous in so far as it suggests also other rules quite distinct from the Hearsay rule. To documents or writ-

ings, as such, applies the rule requiring the production of the original (*ante*, § 1177), and the rule requiring certain modes of authentication (*post*, § 2129); and still other rules may also have special application to certain kinds of documents. It is essential that these independent rules be kept distinct from each other and from the Hearsay rule; and the use of the word "document" to designate a Hearsay exception tends to prevent this separation of distinct principles in their application to documents. For all these reasons, the term "Official Statements" seems preferable as a designation of the present exception to the Hearsay rule.

§ 1631. **The Necessity Principle; Inconvenience of Requiring the Official's Attendance.** The principle of necessity, which in one form or another is found in all the Hearsay exceptions (*ante*, § 1421), is satisfied in the foregoing exceptions by the impossibility of obtaining testimony in court from the same person; *i. e.* death, absence, insanity, or other like circumstance, has made it impossible to obtain the person's testimony now on the stand. In the present and ensuing exceptions, this rigorous application of the principle of necessity is found relaxed. Something less than an absolute impossibility is regarded as sufficient. The necessity reduces itself to a high degree of expediency. In none of these exceptions is it required that the witness be shown to be unavailable by reason of death, absence, or the like circumstance.

In the present exception, it is easy to see why it is highly expedient, if not practically necessary, to accept the hearsay statement of an official, in certain classes of cases, instead of summoning him to attend and testify *viva voce* before a court or by deposition before a commissioner. The litigation is unlimited in which testimony by officials is daily needed; the occasions in which the official would be summoned from his ordinary duties are numberless. The public officers are few in whose daily work something is not done which must later be proved in court; and the trials are rare in which testimony is not needed from official sources. Were there no exception for Official Statements, hosts of officials would be found devoting the greater part of their time to attending as witnesses in court or delivering their depositions before an officer. The work of administration of government and the needs of the public having business with officials would alike suffer in consequence. Although, then, there is strictly no necessity for employing hearsay, in the sense that the personal attendance of the officer is corporally impossible to obtain, there is nevertheless a high degree of expediency that the public business be not deranged by insisting on the strict enforcement of the Hearsay rule. The principle, therefore, is in spirit here identical with that of the preceding exceptions.

§ 1632. **The Circumstantial Guarantee of Trustworthiness; Official Duty; Publicity.** The second essential (*ante*, § 1422) for an exception to the Hearsay rule is that some circumstantial guarantee of trustworthiness be found, to take the place of cross-examination so far as may be. Two reasons are judicially sanctioned as justifying the present exception in this respect.

1992 CarswellOnt 103, 15 C.R. (4th) 133, 139 N.R. 323, 75 C.C.C. (3d) 257, 94 D.L.R. (4th) 590, 55 O.A.C. 321, [1992] 2 S.C.R. 915, 17 W.C.B. (2d) 97, J.E. 92-1312

1992 CarswellOnt 103, 15 C.R. (4th) 133, 139 N.R. 323, 75 C.C.C. (3d) 257, 94 D.L.R. (4th) 590, 55 O.A.C. 321, [1992] 2 S.C.R. 915, 17 W.C.B. (2d) 97, J.E. 92-1312

R. v. Smith

R. v. ARTHUR LARRY SMITH

Supreme Court of Canada

Lamer C.J.C., La Forest, Sopinka, Gonthier, Cory, McLachlin and Iacobucci JJ.

Heard: June 15, 1992
Judgment: August 27, 1992
Docket: Doc. 22281



Counsel: *Milan Rupic*, for the Crown.

*D. Fletcher Dawson*, for respondent.

Subject: Criminal; Evidence

Evidence --- Hearsay rule and exceptions — Exceptions — Declarations — As to state of mind.

Evidence --- Exclusionary rules — Admissibility of character evidence — In criminal matters — Similar fact evidence — To demonstrate intent.

Evidence --- Exclusionary rules — Admissibility of character evidence — In criminal matters — Similar fact evidence — To demonstrate motive.

Evidence — Exceptions to hearsay rule — Declaration as to physical or mental condition — Phone calls by murder victim to mother on night of murder as to movements of accused not being admissible to prove those movements occurred.

Evidence — Exceptions to hearsay rule — Guarantee of trustworthiness — Hearsay evidence being admissible even if not within recognized exception where necessary and reliable — Two of three phone calls by murder victim to mother on night of murder as to movements of accused meeting reliability test and being admissible.

The accused was charged with murder. The evidence at trial indicated that the accused had picked the deceased up at her mother's house in Detroit, that they had driven to Canada, and had spent the weekend together in a hotel. The theory of the Crown was that the accused was a drug smuggler who had travelled to Canada with the deceased in order to obtain cocaine. He had asked her to take the cocaine back to the United States concealed in her body, but she had refused. According to the Crown, he abandoned her at the hotel, but later returned and picked her up. He then drove

1992 CarswellOnt 103, 15 C.R. (4th) 133, 139 N.R. 323, 75 C.C.C. (3d) 257, 94 D.L.R. (4th) 590, 55 O.A.C. 321, [1992] 2 S.C.R. 915, 17 W.C.B. (2d) 97, J.E. 92-1312

her to a service station where he strangled her. To support this theory, the Crown relied upon evidence of four telephone calls made by the deceased to her mother. The mother testified that in the first call, her daughter said that the accused had abandoned her and she wanted a ride home. In the second call, an hour later, the deceased told her that the accused had still not returned. In the third call, a half-hour later, her daughter told her that the accused had come back for her, and that she would not need a ride home. The fourth telephone call, about an hour later, was traced to a pay telephone at the service station near which the deceased's body was found. In that call her daughter told her that she was "on her way". The Crown also led evidence of a phone call, about 20 minutes later, traced to the pay telephone at the service station, which was made to the accused's residence in Detroit. A witness testified that he saw the accused near that pay telephone.

The accused was convicted. The Court of Appeal ruled the third and fourth phone calls were inadmissible hearsay and ordered a new trial. The Crown appealed the rulings respecting the first three phone calls.

**Held:**

The appeal was dismissed.

On the traditional view of hearsay, the statements made by the deceased to her mother on the night of her death are hearsay, and inadmissible, if introduced to prove the truth of the assertions they contain.

One exception to the hearsay rule arises when the declarant's statement is adduced in order to demonstrate the intentions, or state of mind, of the declarant at the time when the statement was made. Evidence of the first two phone calls was not admissible, by virtue of the present intentions exception, to prove the truth of the factual assertion that the accused abandoned the deceased at the hotel on the night of her death. To conclude otherwise would be to admit the statements for the purpose of proving that past acts or events referred to in the utterances occurred. At its highest, the present intentions exception would operate only to allow the first two statements into evidence for the purpose of proving that the deceased wanted to return home. The third statement would not have been admissible under the present intentions exception for any purpose at all. To admit the statement to show that the deceased intended to continue her journey with the accused presupposes the truth of the anterior factual assertion that the accused had in fact come back to the hotel. Under the present intentions exception, hearsay evidence is not admissible for this purpose.

The fact that the evidence did not fit within a recognized hearsay exception was not fatal to the Crown's case. This court has signalled an end to the old categorical approach to the admission of hearsay evidence. Hearsay evidence is now admissible on a principled basis, the governing principles being the reliability of the evidence, and its necessity. The criterion of reliability, the circumstantial guarantee of trustworthiness, is a function of the circumstances under which the statement in question was made. If a statement sought to be adduced by way of hearsay evidence is made under circumstances which substantially negate the possibility that the declarant was untruthful or mistaken, the hearsay evidence may be said to be reliable. The companion criterion of necessity refers to the necessity of the hearsay evidence to prove a fact in issue.

The approach that excludes hearsay evidence, even when highly probative, out of the fear that the trier of fact will not understand how to deal with such evidence, is no longer appropriate. Hearsay evidence of statements made by persons who are not available to give evidence at trial ought generally to be admissible, where the circumstances under which the statements were made satisfy the criteria of necessity and reliability and subject to the residual discretion of the trial judge to exclude the evidence when its probative value is slight and undue prejudice might result to the accused. Properly cautioned by the trial judge, juries are perfectly capable of determining what weight ought to be attached to such evidence, and of drawing reasonable inferences therefrom.

Applying these principles to the evidence in question in this case, the hearsay evidence of what happened in the first two telephone conversations on the night of her murder satisfied the criteria of necessity and reliability. The declarant

is dead and will never be able to testify as to what happened on that night. In respect of the first two telephone conversations, there is no reason to doubt the deceased's veracity. She had no known reason to lie. The hearsay evidence relating to the first two telephone conversations could reasonably be relied upon by the jury, as the traditional dangers associated with hearsay evidence — perception, memory and credibility — were not present to any significant degree. The conditions under which the third phone call was made do not, however, provide that circumstantial guarantee of trustworthiness that would justify its admission without the possibility of cross-examination. The deceased may have been mistaken, or, indeed, might have intended to deceive her mother on this account.

**Annotation**

In 1970, the Supreme Court of Canada signalled a new approach to the hearsay rule. In *Ares v. Venner*, [1970] S.C.R. 608, 12 C.R.N.S. 349, 73 W.W.R. 347, 14 D.L.R. (3d) 4, Justice Hall decided that it was not too late for the judiciary to create a new exception to the hearsay rule. He noted that the rule was judge-made and, therefore, reform to meet modern conditions did not have to await legislative action. The court relied on Professor Wigmore for the proposition that the existing exceptions to the hearsay rule were based on considerations of necessity and circumstantial guarantees of trustworthiness. The court decided that it therefore could create new exceptions when those criteria were satisfied.

This new, principled approach to the "absurdly technical" hearsay rule was not enthusiastically welcomed by the profession, which seemed to prefer the time-honoured category approach. Over the next 20 years, *Ares v. Venner* was only sporadically judicially considered. For reference to a few see Delisle, "*Ares v. Venner* and the Criminal Law" (1990), 78 C.R. (3d) 158, criticizing *R. v. Gould* (1990), 78 C.R. (3d) 151, 57 C.C.C. (3d) 500 (B.C. C.A.), where one judge wrote that the principle in *Ares v. Venner* had never been adopted in a criminal case. In *R. v. Khan*, [1990] 2 S.C.R. 531, 79 C.R. (3d) 1, 113 N.R. 53, 59 C.C.C. (3d) 92, 41 O.A.C. 353, the Supreme Court accepted the wisdom of *Ares v. Venner* in a criminal context. Chief Justice Lamer in *Smith* wisely characterizes that decision as a "triumph of a principled analysis over a set of ossified judicially created categories." It is to be hoped that the profession and the judiciary will now be more receptive to the new thinking.

While applauding this move to principle and discretion, the next task, the articulation of what will qualify as the required grounds of necessity and reliability, is perhaps more daunting. In *Smith*, the court was easily satisfied that there were grounds of necessity; the declarant in the case was dead. The court went on, however, to provide guidelines to assist in determining the necessity issue. The court gave an expansive definition which does not confine necessity to instances of unavailability. The court adopted Wigmore's flexible approach and allowed that "expediency or convenience" will do. Counsel will establish necessity if the court is persuaded that the relevant evidence, or evidence of the same value, is not otherwise available. We will have to await future cases to flesh out this idea. The message of *R. v. Aguilar*, at p. 157, poste, is that counsel must lay a foundation for the court to find necessity. Since no evidence was there led to explain the complainant's failure to testify to the matters described by her mother, the court held that necessity had not been made out and the mother could not relate the child's statement.

The court in *Smith* was persuaded that the first two telephone calls had the necessary indicia of reliability since there was perceived to be no known reason for the victim to lie. The court was satisfied that the traditional dangers associated with hearsay evidence — perception, memory and sincerity — were minimal and the absence of cross-examination would affect only the weight to be given to the evidence and not admissibility. The court theorized that a trier of fact could be properly instructed to take those possible dangers into account in assessing the worth of the statements. The court took a different view with respect to the third telephone call. The court hypothesized that the victim may then have been mistaken or may have intended to deceive her mother. In the court's judgment, these dangers were too great to let the jury consider the contents of the third call. This decision, a judgment call, illustrates a potential difficulty with the principled discretionary approach. There is a serious risk that trial judges will differ greatly in applying the elastic standard of equivalent trustworthiness, and the lack of uniformity will make preparation for trial difficult. (See J.B. Weinstein and M.A. Berger, *Weinstein's Evidence, United States Rules* (New York: Matthew Bender, 1975), Pub. No. 803, at p. 385.) Another judge could conclude that considering all the circumstances

1992 CarswellOnt 103, 15 C.R. (4th) 133, 139 N.R. 323, 75 C.C.C. (3d) 257, 94 D.L.R. (4th) 590, 55 O.A.C. 321, [1992] 2 S.C.R. 915, 17 W.C.B. (2d) 97, J.E. 92-1312

surrounding the third call, the evidence was sufficiently trustworthy to warrant putting it to the jury with a cautionary instruction: see, e.g., this writer, "*R. v. Smith:* The Relevance of Hearsay" (1991), 2 C.R. (4th) 260, commenting on the ruling of the Ontario Court of Appeal in the instant case.

The *Federal Rules of Evidence* in the United States, adopted by many of the states, provides a wide residual exception to the hearsay rule, with the availability of the declarant being immaterial:

(24) Other exceptions. A statement not specifically covered by any of the foregoing exceptions but having equivalent circumstantial guarantees of trustworthiness, if the court determines that (a) the statement is offered as evidence of a material fact; (b) the statement is more probative on the point for which it is offered than any other evidence which the proponent can procure through reasonable efforts; and (c) the general purposes of these rules and the interests of justice will best be served by admission of the statement into evidence. However, a statement may not be admitted under this exception unless the proponent of it makes known to the adverse party sufficiently in advance of the trial or hearing to provide the adverse party with a fair opportunity to prepare to meet it, the proponent's intention to offer the statement and the particulars of it, including the name and address of the declarant.

We, in Canada, should pay particular attention to the closing sentence. Having embarked on a principled, discretionary approach to the law of hearsay, it seems only fair that the adversary be given notice of a litigant's intention to so justify the reception of the evidence to allow for competing arguments on the criteria of necessity and reliability. If notice is required for the existing rigid and detailed exception for business records, s. 30(7) of the *Canada Evidence Act*, R.S.C. 1985, c. C-5, then, a fortiori, it is required here. Since the new approach to hearsay was judicially created, perhaps the courts might give some thought to the creation of this precaution.

R.J. Delisle

**Cases considered:**

*Ares v. Venner*, [1970] S.C.R. 608, 12 C.R.N.S. 349, 73 W.W.R. 347, 14 D.L.R. (3d) 4 — *considered*

*Home v. Corbeil*, [1955] O.W.N. 842, [1955] 4 D.L.R. 750 (H.C.) [affirmed [1956] O.W.N. 391, 2 D.L.R. (2d) 543 (C.A.)] — *referred to*

*Mutual Life Insurance Co. v. Hillmon*, 145 U.S. 285 (1892) — *considered*

*Myers v. Director of Public Prosecutions*, [1965] A.C. 1001 at p. 1009, 48 Cr. App. R. 348, [1964] 2 All E.R. 881 (H.L.) — *considered*

*R. v. Blastland*, [1986] A.C. 41, [1985] 2 All E.R. 1095 (H.L.) — *considered*

*R. v. Cloutier*, [1979] 2 S.C.R. 709, 12 C.R. (3d) 10, 28 N.R. 1, 48 C.C.C. (2d) 1, 99 D.L.R. (3d) 577 — *applied*

*R. v. Kearley*, [1992] 2 All E.R. 345 (H.L.) — *referred to*

*R. v. Khan*, [1990] 2 S.C.R. 531, 79 C.R. (3d) 1, 113 N.R. 53, 59 C.C.C. (3d) 92, 41 O.A.C. 353 — *considered*

*R. v. Moore* (1984), 5 O.A.C. 51, 15 C.C.C. (3d) 541 (C.A.) [leave to appeal to S.C.C. refused (1985), 15 C.C.C. (3d) 541n, 7 O.A.C. 320 (S.C.C.)] — *considered*

*R. v. P. (R.)* (1990), 58 C.C.C. (3d) 334 (Ont. H.C.) — *considered*

1992 CarswellOnt 103, 15 C.R. (4th) 133, 139 N.R. 323, 75 C.C.C. (3d) 257, 94 D.L.R. (4th) 590, 55 O.A.C. 321, [1992] 2 S.C.R. 915, 17 W.C.B. (2d) 97, J.E. 92-1312

*R. v. Wysochan* (1930), 54 C.C.C. 172 (Sask. C.A.) — *referred to*

*Subramaniam v. Public Prosecutor*, [1956] 1 W.L.R. 965 (P.C.) — *considered*

**Statutes considered:**

Criminal Code, R.S.C. 1985, c. C-46 —

s. 686(1)(*b*)(iii)

s. 693(1)

Appeal from judgment of Ontario Court of Appeal, reported at (1990), 2 C.R. (4th) 253, 75 O.R. (2d) 753, 61 C.C.C. (3d) 232, 42 O.A.C. 395, quashing respondent's conviction on charge of second degree murder.

**The judgment of the court was delivered by *Lamer C.J.C.*:**

1 The principal issue raised by this appeal is the admissibility of hearsay evidence as part of the Crown's case in a murder trial, when the declarant is dead.

**The Facts**

2 The respondent was convicted of the murder of Aritha Monalisa King and was sentenced to imprisonment for life with no parole eligibility for 13 years. Both the respondent and Ms. King were American citizens, ordinarily resident in Detroit. At the respondent's trial, the evidence showed that on August 6, 1986, the respondent picked up Ms. King at her mother's house in Detroit. Together, they drove across the border to Canada. The respondent spent the weekend of August 9 and 10 with Ms. King in a hotel in London, Ontario. Ms. King's body was subsequently discovered at approximately 1:30 a.m. on August 11, near a service station at Beechville, Ontario. The body was found lying on a sheet which may have come from the hotel where Ms. King and the respondent had spent the night. Certain fibres found on the sheet matched fibres from the clothing of the respondent and Ms. King. The body's arms had been cut off, and were never found.

3 The theory of the Crown was that the respondent was a drug smuggler who had travelled to Canada with Ms. King in order to ob tain cocaine. The Crown hypothesized that the respondent had asked Ms. King to take the cocaine back to the United States concealed in her body, but that she had refused. According to the Crown, he then abandoned her at the hotel in London. However, he later returned to pick her up, and drove her to a place where he strangled her, cut off her arms to impede identification, and dumped her body.

4 In support of this theory, the Crown relied upon evidence of four telephone calls made by the deceased to her mother in Detroit at 10:21 p.m., 11:21 p.m., 11:54 p.m. and 12:41 a.m. on the night between August 10 and August 11, 1986. The first two telephone calls were traced to the telephone in Ms. King's room at the hotel in London. Ms. King's mother testified that in the first telephone call, her daughter said that Larry (the respondent) had abandoned her at the hotel in London and that she wanted a ride home. In the second call, Ms. King told her mother that Larry had still not returned. Her mother testified that she then telephoned from Detroit to a taxi company in London to attempt to arrange a ride home for her daughter. A taxi did arrive at the hotel, but refused to take Ms. King because the credit card that she had been using had been confiscated at the hotel.

5 The third call was traced to a pay telephone in the hotel lobby. Ms. King's mother testified that in this call her daughter told her that Larry had come back for her, and that she would not need a ride home after all. The fourth

telephone call was traced to a pay telephone at the service station near which Ms. King's body was found. Ms. King's mother testified that in this call her daughter told her that she was "on her way".

6 In addition to these calls, there was evidence that a further telephone call had been made shortly after 1:00 a.m. on August 11 from a pay telephone at the service station near which Ms. King's body was later found. This call was traced to the respondent's residence in Detroit. There was no direct evidence as to who made this telephone call, or what was said. However, a witness at the service station testified that he had seen the respondent near the pay telephones at the service station around this time.

7 The Crown also led evidence from one Hope Denard, a woman who had travelled with the respondent from Detroit to Canada in the month prior to the murder. Ms. Denard testified that the respondent had asked her to smuggle illegal drugs back to the United States for him, and that when she refused, he drove her to Windsor and abandoned her at a restaurant.

8 The respondent did not testify at his trial, but set up a defence of alibi supported by the evidence of various witnesses who placed him in Windsor or Detroit at or around the time of the murder. Defence counsel did not object to the testimony by Ms. King's mother as to what her daughter told her in the first three telephone calls. Indeed, it was apparently the theory of the defence that the respondent actually did abandon Ms. King at the hotel in London, a hypothesis supported by the evidence of what Ms. King said in the first two telephone calls to her mother. However, the defence contended that after leaving Ms. King, the respondent returned to Detroit and did not return to the hotel, and therefore, could not have been with her when she was murdered.

9 The respondent appealed his conviction to the Ontario Court of Appeal, which allowed the appeal and ordered a new trial. The Court of Appeal found that evidence as to what was said in the telephone calls made by Ms. King to her mother on the night of the murder was hearsay, and therefore was inadmissible unless it fell within some recognized exception to the hearsay rule. The Court of Appeal went on to decide that the evidence as to what was said by Ms. King in the first two telephone conversations was admissible under an exception to the hearsay rule, but only for the purpose of establishing her state of mind at the time when she made the calls, i.e., that she wanted to come home. The evidence as to what was said in the third telephone conversation, however, fell within no exception to the hearsay rule, and was, therefore, not admissible for any purpose.

10 The Court of Appeal concluded that the inadmissible hearsay evidence had been so gravely prejudicial to the respondent that it could not say that, had it not been admitted, the verdict would necessarily have been the same. Therefore, notwithstanding the failure of defence counsel to object to the evidence at trial, the Court of Appeal declined to apply the curative provision in s. 686(1)(*b*)(iii) of the *Criminal Code*, R.S.C. 1985, c. C-46, quashed the respondent's conviction, and ordered a new trial: (1990), 2 C.R. (4th) 253, 75 O.R. (2d) 753, 61 C.C.C. (3d) 232, 42 O.A.C. 395, 11 W.C.B. (2d) 335, para. 497.

11 The Crown sought leave to appeal to this court under s. 693(1) of the *Criminal Code*, and leave to appeal was granted (Lamer C.J.C., Sopinka and McLachlin JJ.) on May 9, 1991: [1991] 1 S.C.R. xiii.

**Judgments Below**

***Ontario Court of Appeal***

12 The Ontario Court of Appeal (per Brooke J.A., Houlden and Labrosse JJ.A. concurring) noted that the Crown's case at trial rested upon two hypotheses: first, that the respondent had abandoned Ms. King at the hotel in London on the night of August 10, an act consistent with there having been some dispute between them; secondly, that the respondent returned to her later that night, or early the following morning, which would place him with her near the time when she was murdered. The hearsay evidence as to what Ms. King said to her mother when she telephoned her on the

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night of her death was therefore very important to the Crown's case.

13 The Court of Appeal proceeded from the premise that, as hearsay, all this evidence was inadmissible unless it fell within some recognized exception to the hearsay rule. Referring to *Mutual Life Insurance Co. v. Hillmon*, 145 U.S. 285 (1892), and *R. v. Moore* (1984), 5 O.A.C. 51, 15 C.C.C. (3d) 541 (C.A.), the Court of Appeal concluded that there did exist an exception to the hearsay rule where the declarant's statements were adduced to indicate the intention, or state of mind, of the declarant at the time the statements were made.

14 However, the Court of Appeal rejected the Crown's argument that all the evidence of what Ms. King said to her mother on the telephone fell within this exception. Citing *R. v. P. (R.)* (1990), 58 C.C.C. (3d) 334 (Ont. H.C.), the Court of Appeal noted that while hearsay evidence was potentially admissible to prove the state of mind of the declarant when the statements were made, such evidence was not admissible to prove the intentions or state of mind of persons other than the declarant, or that such persons acted in accordance with the declarant's expectations, or, indeed, to prove the truth of the factual assertions contained in the declarant's statements of intention. Consequently, the Court of Appeal concluded that the hearsay evidence relating to the first two telephone calls (Larry has left me; I need a ride home) was admissible, but only to show Ms. King's state of mind at the time she telephoned her mother, i.e., that she wanted to come home. This evidence was not admissible, however, to prove the factual assertion that the respondent had abandoned her. The Court of Appeal concluded, further, that the hearsay evidence of the third telephone call (Larry has come back) was not admissible for any purpose at all, and could not be introduced to prove that the respondent later returned and picked up Ms. King.

15 The Court of Appeal went on to conclude that the inadmissible hearsay evidence relating to the telephone conversations had been of vital importance to the Crown's case. In particular, it had been used to place the respondent with Ms. King around the time of her death, which had the effect of buttressing certain identification evidence of questionable reliability which placed the respondent at the service station near which the body was found. Concluding, therefore, that the inadmissible hearsay evidence had been prejudicial to the respondent, the Court of Appeal decided that it could not be said that the verdict would necessarily have been the same had the evidence not been admitted, and, therefore, refused to apply the curative provision in s. 686(1)(*b*)(iii) of the *Criminal Code* to dismiss the appeal notwithstanding the error.

16 In respect of the evidence of Ms. Denard, the Court of Appeal concluded that the history of the respondent as a drug dealer was relevant, if at all, to show the context in which the events between August 6 and August 11 occurred. However, the evidence was only put to the jury as going to the respondent's motive to commit the murder, for which purpose it had no probative value. Indeed, the court concluded that this problem had been exacerbated by remarks made by the Crown in its closing address to the jury, which could have been interpreted as suggesting that the jury ought to conclude that the respondent, having the "character" of a drug smuggler, was more likely to have committed this murder.

17 The Court of Appeal concluded that the trial judge's charge to the jury was inadequate to cure this defect, and consequently ordered a new trial on this additional ground as well.

***Grounds for Appeal***

18 The Crown now appeals to this court under s. 693(1) of the *Criminal Code* against the decision of the Ontario Court of Appeal quashing the respondent's conviction and ordering a new trial. The grounds for appeal are as follows:

> 1. Whether the Court of Appeal for Ontario erred in law in holding that evidence of statements of the deceased during the first and second telephone conversations were admissible only to show her state of mind, and that evidence of the statement of the deceased during the third telephone conversation was hearsay and inadmissible for any purpose.

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2. Whether or not the Court of Appeal erred in law in holding that, in the circumstances of the case, the proviso in s. 686(1)(*b*)(iii) had no application.

**Analysis**

19

**(1) Hearsay Evidence**

20 This is not the proper context in which to attempt to undertake an exhaustive definition of "hearsay evidence." However, for present purposes, the following formulation found in *Subramaniam v. Public Prosecutor*, [1956] 1 W.L.R. 965 (P.C.), at p. 970, is helpful to establish the parameters of the debate:

> Evidence of a statement made to a witness by a person who is not himself called as a witness may or may not be hearsay. It is hearsay and inadmissible when the object of the evidence is to establish the truth of what is contained in the statement. It is not hearsay and is admissible when it is proposed to establish by the evidence, not the truth of the statement, but the fact that it was made. The fact that the statement was made, quite apart from its truth, is frequently relevant in considering the mental state and conduct thereafter of the witness or of some other person in whose presence the statement was made.

21 This statement of the "hearsay rule" is a useful illustration of the circumstances in which statements made by persons who are not called as witnesses have traditionally been considered inadmissible. When such statements are introduced to prove the truth of their contents, they have generally been considered to be inadmissible. However, when introduced simply to prove that they were made, they have traditionally been regarded as admissible, either under an "exception" to the hearsay rule, or more correctly from an analytical point of view, because they fall outside the definition of hearsay. What is important is that the evidentiary dangers traditionally associated with statements by persons not called as witnesses — principally, the unavailability of the declarant for cross-examination — are not present, or are present to a far less significant degree, when the relevance of such statements lies simply in the fact that they were made.

22 Clearly, therefore, on the traditional view of hearsay, the statements made by Ms. King to her mother on the night of her death — (1) "Larry has gone away"; (2) "Larry has not come back and I need a ride home"; (3) "Larry has come back and I no longer need a ride"; and (4) "I am on my way", are hearsay and inadmissible, if introduced to prove the truth of the assertions they contain. However, as noted above, such statements are not hearsay if they are adduced simply to prove that they were made. The fact that the statement was made, however, would in itself have to be relevant for the statement to be received on this ground.

23 One exception to the hearsay rule arises when the declarant's statement is adduced in order to demonstrate the intentions, or state of mind, of the declarant at the time when the statement was made. The "current intentions" exception to the hearsay rule was set out by the Supreme Court of the United States in *Mutual Life Insurance Co. v. Hillmon*, supra. In that case, the appellant insurance company resisted payment under a policy on the life of the respondent's husband, arguing that there had been a conspiracy to fake the death of the husband, and that the body discovered was actually that of a third person. This third person had written a letter to his family, in which he indicated his intention to go travelling with the respondent's husband. The letter could not be located, but a witness was prepared to testify as to its contents. The issue, therefore, was whether the evidence of the contents of the letter could be received in evidence. Writing for the court, Gray J. decided that testimony as to the contents of the letter, while technically hearsay, was admissible both to prove the intention of the third person to go travelling with the respondent's husband, and to support the inference that he had acted on this intention.

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24 It would appear that at least the "state of mind" exception to the hearsay rule has been accepted in the English common law of evidence. The position seems to be that where the intentions or state of mind of the declarant are relevant to a fact in issue, hearsay evidence is admissible, and, indeed, may be the best evidence to prove this. In *R. v. Blastland*, [1986] A.C. 41, [1985] 2 All E.R. 1095 (H.L.), Lord Bridge of Harwich said, at p. 54 [A.C.], that:

> It is, of course, elementary that statements made to a witness by a third party are not excluded by the hearsay rule when they are put in evidence solely to prove the state of mind either of the maker of the statement or of the person to whom it was made. What a person said or heard said may well be the best and most direct evidence of that person's state of mind. This principle can only apply, however, when the state of mind evidenced by the statement is either itself directly in issue at the trial or of direct and immediate relevance to an issue which arises at the trial.

25 However, the *Hillmon* formulation of the "present intentions" exception, which allows inferences to be drawn concerning subsequent acts of the declarant, does not appear to have been accepted in English law. See *R. v. Kearley*, [1992] 2 All E.R. 345 (H.L.).

26 The "present intentions" or "state of mind" exception to the hearsay rule has been recognized in the Canadian law of evidence as well: *R. v. Wysochan* (1930), 54 C.C.C. 172 (Sask. C.A.): statements made by a dying person found admissible to prove how the death occurred; *Home v. Corbeil*, [1955] O.W.N. 842, [1955] 4 D.L.R. 750 (H.C.): statements made by an estranged husband found relevant to his intention to resume cohabitation with his wife, and therefore to his wife's pecuniary interest in his continuing life. Most recently, in *R. v. P. (R.)*, supra, Doherty J. summarized the case law and outlined the scope of the exception, and its limitations, at pp. 343-344, when he said:

> An utterance indicating that a deceased had a certain intention or design will afford evidence that the deceased acted in accordance with that stated intention or plan where it is reasonable to infer that the deceased did so. The reasonableness of the inference will depend on a number of variables including the na ture of the plan described in the utterance, and the proximity in time between the statement as to the plan and the proposed implementation of the plan.
>
> The rules of evidence as developed to this point do not exclude evidence of utterances by a deceased which reveal her state of mind, but rather appear to provide specifically for their admission where relevant. *The evidence is not, however, admissible to show the state of mind of persons other than the deceased (unless they were aware of the statements), or to show that persons other than the deceased acted in accordance with the deceased's stated intentions, save perhaps cases where the act was a joint one involving the deceased and another person. The evidence is also not admissible to establish that past acts or events referred to in the utterances occurred.*

[Emphasis added.]

27 Against this background, it is possible to evaluate the appellant's first argument that the hearsay evidence relating to the statements made by Ms. King in telephone conversations on the night of her murder was admissible under the "present intentions" or "state of mind" exception to the hearsay rule. With respect, I am of the opinion that Statement 1 ("Larry has left me") and Statement 2 ("Larry has not come back and I need a ride") are not admissible under the "present intentions" exception, or, to be more precise, they are certainly not admissible, by virtue of the "present intentions" exception, to prove the truth of the factual assertion that the respondent abandoned Ms. King at the hotel in London on the night of her death. To conclude otherwise would be to admit the statements for the purpose of proving "that past acts or events referred to in the utterances occurred." At its highest, therefore, the "present intentions" exception to the hearsay rule invoked by the appellant would operate only to allow the first two statements into evidence for the purpose of proving that the deceased wanted to return home.

28 In my opinion, the third statement ("Larry has come back") would not have been admissible under the present intention exception to the hearsay rule for any purpose at all. The appellant argued that the statement "Larry has come

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back" was admissible to show that Ms. King intended to continue her journey with the respondent. With respect, this presupposes the truth of the anterior factual assertion that the respondent had, in fact, come back to the hotel. Under the "present intentions" exception, hearsay evidence is not admissible for this purpose. Consequently, I conclude that the "present intentions" exception to the hearsay rule would not have supported the admission of the third statement for the sole purpose for which the Crown desired to adduce it. As the Crown did not appeal on the matter of the admissibility of the contents of the fourth telephone call ("I am on my way"), I need not consider it. Once again, this would amount to an inference from a hearsay statement going beyond what can be supported under the "present intentions" exception to the hearsay rule. Consequently, I conclude that, in respect of the operation of the "present intentions" or "state of mind" exception to the hearsay rule, the Court of Appeal was not in error.

29 This, however, is not fatal to the appellant's case. This court has not taken the position that the hearsay rule precludes the reception of hearsay evidence unless it falls within established categories of exceptions, such as "present intentions" or "state of mind." Indeed, in our recent decision in *R. v. Khan*, [1990] 2 S.C.R. 531, 79 C.R. (3d) 1, 113 N.R. 53, 59 C.C.C. (3d) 92, 41 O.A.C. 353, we indicated that the categorical approach to exceptions to the hearsay rule has the potential to undermine, rather than further, the policy of avoiding the frailties of certain types of evidence which the hearsay rule was originally fashioned to avoid.

30 It has long been recognized that the principles which underlie the hearsay rule are the same as those that underlie the exceptions to it. Indeed, *Wigmore on Evidence*, 2d ed. (1923), described the rule and its exceptions at §1420 in the following terms:

> The purpose and reason of the Hearsay rule is the key to the exceptions to it. The theory of the Hearsay rule is that the many possible sources of inaccuracy and untrustworthiness which may lie underneath the bare untested assertion of a witness can best be brought to light and exposed, if they exist, by the test of cross-examination. But this test or security may in a given instance be superfluous; it may be sufficiently clear, in that instance, that the statement offered is free from the risk of inaccuracy and untrustworthiness, so that the test of cross-examination would be a work of supererogation. Moreover, the test may be impossible of employment — for example, by reason of the death of the declarant — so that, if his testimony is to be used at all, there is a necessity for taking it in the untested shape. These two considerations — a Circumstantial Guarantee of Trustworthiness, and a Necessity, for the Evidence — may be examined more closely. ...

Of the criterion of necessity, Wigmore stated:

> Where the test of cross-examination is *impossible of application*, by reason of the declarant's death or some other cause rendering him now unavailable as a witness on the stand, we are faced with the alternatives of receiving his statements without that test, or of leaving his knowledge altogether unutilized. The question arises whether the interests of truth would suffer more by adopting the latter or the former alternative. ... [I]t is clear at least that, so far as in a given instance some substitute for cross-examination is found to have been present, there is ground for making an exception.

[Emphasis in original.] And of the companion principle of reliability — the circumstantial guarantee of trustworthiness — the following:

> There are many situations in which it can be easily seen that such a required test [i.e., cross-examination] would add little as a security, because its purposes had been already substantially accomplished. If a statement has been made under such circumstances that even a sceptical caution would look upon it as trustworthy (in the ordinary instance), in a high degree of probability, it would be pedantic to insist on a test whose chief object is already secured.

31 Well before the decision of this court in *Khan*, therefore, it was understood that the circumstances under which

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the declarant makes a statement may be such as to guarantee its reliability, irrespective of the availability of cross-examination. "Guarantee", as the word is used in the phrase "circumstantial guarantee of trustworthiness", does not require that reliability be established with absolute certainty. Rather it suggests that where the circumstances are not such as to give rise to the apprehensions traditionally associated with hearsay evidence, such evidence should be admissible even if cross-examination is impossible. According to Wigmore, while it was not possible to generalize as to all cases in which other circumstances would provide a functional substitute for testing by cross-examination, certain broad categories could be identified:

> §1422 ... Though no judicial generalizations have been made, there is ample authority in judicial utterances for naming the following different classes of reasons underlying the exceptions:
>
> *a.* Where the circumstances are such that a sincere and accurate statement would naturally be uttered, and no plan of falsification be formed;
>
> *b.* Where, even though a desire to falsify might present itself, other considerations, such as the danger of easy detection or the fear of punishment, would probably counteract its force;
>
> *c.* Where the statement was made under such conditions of publicity that an error, if it had occurred, would probably have been detected and corrected.

The principled basis of the hearsay rule, and its exceptions, was thus understood by commentators on the common law of evidence early in this century. The decision of this court in *Khan*, therefore, should be understood as the triumph of a principled analysis over a set of ossified judicially created categories. *Khan* was a sexual assault case in which the infant complainant described the criminal act to her mother shortly after it occurred. The child was not permitted to testify at trial, and the issue was whether her mother would be permitted to testify as to the statements made to her by the child shortly after the event. Writing for the court, McLachlin J.concluded, at p. 540 [S.C.R.], that the hearsay evidence of the child's statements ought to have been admitted at trial, and rejected the approach to hearsay evidence based on categorical exceptions to an inflexible prohibition:

> The hearsay rule has traditionally been regarded as an absolute rule, subject to various categories of exceptions, such as admissions, dying declarations, declarations against interest and spontaneous declarations. While this approach has provided a degree of certainty to the law on hearsay, it has frequently proved unduly inflexible in dealing with new situations and new needs in the law. This has resulted in courts in recent years on occasion adopting a more flexible approach, rooted in the principle and the policy underlying the hearsay rule rather than the strictures of traditional exceptions.

McLachlin J. proceeded to observe that, while in England the House of Lords decided in *Myers v. Director of Public Prosecutions*, [1965] A.C. 1001 at p. 1009, 48 Cr. App. R. 348, [1964] 2 All E.R. 881, that the development of further exceptions to the hearsay rule required intervention by Parliament, this court in *Ares v. Venner*, [1970] S.C.R. 608, 12 C.R.N.S. 349, 73 W.W.R. 347, 14 D.L.R. (3d) 4, declined to follow the majority in *Myers*, preferring instead the dissenting opinion of Lord Donovan, where he said, at p. 1047 [A.C.], that "[t]he common law is moulded by the judges and it is still their province to adapt it from time to time so as to make it serve the interests of those it binds." Having concluded that it is open to the courts to create new exceptions to the hearsay rule on the basis of principle, McLachlin J. stated the principles that should govern the creation of such exceptions and the admission of such evidence to be the "necessity" of the evidence to prove a fact in issue and the "reliability" of this evidence (at pp. 546-547 [S.C.R.]):

> *The first question should be whether reception of the hearsay statement is necessary. Necessity for these purposes must be interpreted as 'reasonably necessary'.* The inadmissibility of the child's evidence might be one basis for a finding of necessity. But sound evidence based on psychological assessments that testimony in court might be

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> traumatic for the child or harm the child might also serve. There may be other examples of circumstances which could establish the requirement of necessity.
>
> *The next question should be whether the evidence is reliable.* Many considerations such as timing, demeanour, the personality of the child, the intelligence and understanding of the child, and the absence of any reason to expect fabrication in the statement may be relevant on the issue of reliability.

[Emphasis added.]

32 It is no accident that the criteria identified by McLachlin J. in *Khan* bear a close resemblance to the principle of necessity and the circumstantial guarantee of reliability referred to by Wigmore. Clearly, the facts of *Khan* are not similar to the facts on the present appeal. *Khan* was a case of hearsay evidence of statements made by a child, alleged to have been sexually assaulted, who was found to be insufficiently mature to be a competent witness. In the present case, the declarant would have been a competent witness had she been available to give evidence, but she is dead. However, *Khan* should not be understood as turning on its particular facts, but, instead, must be seen as a particular expression of the fundamental principles that underlie the hearsay rule and the exceptions to it. What is important, in my view, is the departure signalled by *Khan* from a view of hearsay characterized by a general prohibition on the reception of such evidence, subject to a limited number of defined categorical exceptions, and a movement towards an approach governed by the principles which underlie the rule and its exceptions alike. The movement towards a flexible approach was motivated by the realization that, as a general rule, reliable evidence ought not to be excluded simply because it cannot be tested by cross-examination. The preliminary determination of reliability is to be made exclusively by the trial judge before the evidence is admitted.

33 This court's decision in *Khan*, therefore, signalled an end to the old categorical approach to the admission of hearsay evidence. Hearsay evidence is now admissible on a principled basis, the governing principles being the reliability of the evidence and its necessity. A few words about these criteria are in order.

34 The criterion of "reliability" — or, in Wigmore's terminology, the circumstantial guarantee of trustworthiness — is a function of the circumstances under which the statement in question was made. If a statement sought to be adduced by way of hearsay evidence is made under circumstances which substantially negate the possibility that the declarant was untruthful or mistaken, the hearsay evidence may be said to be "reliable", i.e., a circumstantial guarantee of trustworthiness is established. The evidence of the infant complainant in *Khan* was found to be reliable on this basis.

35 The companion criterion of "necessity" refers to the necessity of the hearsay evidence to prove a fact in issue. Thus, in *Khan*, the infant complainant was found by the trial judge not to be competent to testify herself. In this sense, hearsay evidence of her statements was necessary in that what she said to her mother could not be adduced through her. It was her inability to testify that governed the situation.

36 The criterion of necessity, however, does not have the sense of "necessary to the prosecution's case". If this were the case, uncorroborated hearsay evidence which satisfied the criterion of reliability would be admissible if uncorroborated, but might no longer be "necessary" to the prosecution's case if corroborated by other independent evidence. Such an interpretation of the criterion of "necessity" would thus produce the illogical result that uncorroborated hearsay evidence would be admissible, but could become inadmissible if corroborated. This is not what was intended by this court's decision in *Khan*.

37 As indicated above, the criterion of necessity must be given a flexible definition, capable of encompassing diverse situations. What these situations will have in common is that the relevant direct evidence is not, for a variety of reasons, available. Necessity of this nature may arise in a number of situations. Wigmore, while not attempting an exhaustive enumeration, suggested at §1421 the following categories:

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> (1) The person whose assertion is offered may now be dead, or out of the jurisdiction, or insane, or otherwise unavailable for the purpose of testing [by cross-examination]. This is the commoner and more palpable reason. ...
>
> (2) The assertion may be such that we cannot expect, again or at this time, to get evidence of the same value from the same or other sources. ... The necessity is not so great; perhaps hardly a necessity, only an expediency or convenience, can be predicated. But the principle is the same.

Clearly the categories of necessity are not closed. In *Khan*, for instance, this court recognized the necessity of receiving hearsay evidence of a child's statements when the child was not herself a competent witness. We also suggested that such hearsay evidence might become necessary when the emotional trauma that would result to the child if forced to give viva voce testimony would be great. Whether a necessity of this kind arises, however, is a question of law for determination by the trial judge.

38 It is now necessary to apply these principles to the evidence in question in this case. In my opinion, the hearsay evidence of what Ms. King said to her mother in the first two telephone conversations on the night of her murder satisfied the criteria of necessity and reliability set out by this court in *Khan*. In my view, this evidence falls within the same principles. Ms. King is dead, and will never be able to testify as to what happened on the night of August 10 to August 11, 1986. The relevant direct evidence is therefore unavailable. Ms. King's mother's evidence as to what her daughter told her on the telephone that night was clearly necessary, in the sense that there was no possibility that evidence of what was said could be adduced through the declarant.

39 Moreover, in respect of the first two telephone conversations, there is no reason to doubt Ms. King's veracity. She had no known reason to lie. In my view, the hearsay evidence relating to the first two telephone conversations between Ms. King and her mother could reasonably be relied upon by the jury, as the traditional dangers associated with hearsay evidence — perception, memory and credibility — were not present to any significant degree.

40 In my view, it would be neither sensible nor just to deprive the jury of this highly relevant evidence on the basis of an arcane rule against hearsay, founded on a lack of faith in the capacity of the trier of fact properly to evaluate evidence of a statement, made under circumstances which do not give rise to apprehensions about its reliability, simply because the declarant is unavailable for cross-examination. Where the criteria of necessity and reliability are satisfied, the lack of testing by cross-examination goes to weight, not admissibility, and a properly cautioned jury should be able to evaluate the evidence on that basis.

41 However, I arrive at a different conclusion in respect of the contents of the third telephone conversation ("Larry has come back and I no longer need a ride"). While, as in the case of the first two telephone conversations, the unavailability of the declarant to testify satisfies the criterion of necessity, the conditions under which the statement was made do not, in my view, provide that circumstantial guarantee of trustworthiness that would justify its admission without the possibility of cross-examination. On the evidence, I cannot say that I am without apprehension that Ms. King may have been mistaken, or, indeed might have intended to deceive her mother on this account.

42 The evidence at trial disclosed that after making the second telephone call to her mother, Ms. King was observed to leave the hotel and get into a taxi that her mother had arranged to pick her up. She attempted to negotiate a fare to Detroit, but the taxi would not take her because, at this stage, she no longer had a credit card. She was then observed to leave the taxi and proceed immediately to the telephone booth from which she made the third telephone call. It is not, therefore, unreasonable, to ask whether she actually had time to observe the respondent's return. It is at least possible that she was mistaken, and had simply observed a car which resembled the respondent's car. In any case, it does seem somewhat curious that she would make the statement, "Larry has come back and I no longer need a ride" before having spoken to the respondent to ascertain whether he proposed to allow her to continue to travel with him.

43 In my view, it is highly significant that it was suggested in the course of the previous telephone conversations

1992 CarswellOnt 103, 15 C.R. (4th) 133, 139 N.R. 323, 75 C.C.C. (3d) 257, 94 D.L.R. (4th) 590, 55 O.A.C. 321, [1992] 2 S.C.R. 915, 17 W.C.B. (2d) 97, J.E. 92-1312

that one Philip come to pick up Ms. King and drive her back to Detroit. She was vehemently opposed to this suggestion, and there was some evidence that Philip had assaulted her on a previous occasion. When faced with the choice between a ride home with a person for whom she apparently had a great dislike, and of whom she was quite possibly frightened, on the one hand, and with telling her mother that Larry would take her home, on the other, Ms. King might well have preferred the latter alternative.

44 Moreover, with all due respect, it must be recalled that Ms. King was travelling under an assumed name and using a credit card which she knew was either stolen or forged. She was, therefore, at least capable of deceit. It may have been that she decided to lie to her mother to conceal some aspect of her activities or circumstances, or, indeed, simply to allay her mother's fears.

45 I wish to emphasize that I do not advance these alternative hypotheses as accurate reconstructions of what occurred on the night of Ms. King's murder. I engage in such speculation only for the purpose of showing that the circumstances under which Ms. King made the third telephone call to her mother were not such as to provide that circumstantial guarantee of trustworthiness that would justify the admission of its contents by way of hearsay evidence, without the possibility of cross-examination. Indeed, at the highest, it can only be said that hearsay evidence of the third telephone call is equally consistent with the accuracy of Ms. King's statements, and also with a number of other hypotheses. I cannot say that this evidence could not reasonably have been expected to have changed significantly had Ms. King been available to give evidence in person and subjected to cross-examination. I conclude, therefore, that the hearsay evidence of the contents of the third telephone conversation did not satisfy the criterion of reliability set out in *Khan*, and therefore were not admissible on that basis.

46 To conclude, as this court has made clear in its decisions in *Ares v. Venner*, supra, and *R. v. Khan*, supra, the approach that excludes hearsay evidence, even when highly probative, out of the fear that the trier of fact will not understand how to deal with such evidence, is no longer appropriate. In my opinion, hearsay evidence of statements made by persons who are not available to give evidence at trial ought generally to be admissible, where the circumstances under which the statements were made satisfy the criteria of necessity and reliability set out in *Khan*, and subject to the residual discretion of the trial judge to exclude the evidence when its probative value is slight and undue prejudice might result to the accused. Properly cautioned by the trial judge, juries are perfectly capable of determining what weight ought to be attached to such evidence, and of drawing reasonable inferences therefrom.

47 In the result, therefore, I conclude that the hearsay evidence of what Ms. King told her mother in the first two telephone calls satisfied the criteria of necessity and reliability set out in *Khan*, and was properly admissible on that basis. While the contents of the third telephone call satisfied the criterion of necessity as well, the events surrounding the making of that call were not sufficient to provide the circumstantial guarantee of trustworthiness which would justify their admission without the test of cross-examination. The Crown did not appeal in respect of the fourth telephone conversation, and therefore I make no comment as to the admissibility of hearsay evidence of its contents, other than to say that, in the event of a new trial, it will be governed by the same principles.

**(2) Other Grounds of Appeal**

48 In my view the order for a new trial must be affirmed on the basis of at least one of two supplementary grounds of appeal raised by the respondent, as well as on the basis of my above conclusion in respect of the hearsay evidence of the third telephone call received at trial.

***(a) Evidence of Hope Denard***

49 As indicated above, the Crown led evidence from the witness Hope Denard, who testified that in the month prior to the murder she had gone on a trip to Canada with the respondent. On this trip, he apparently abandoned her at a restaurant after she refused to assist him in smuggling illegal drugs from Canada back to Detroit for him. In his

1992 CarswellOnt 103, 15 C.R. (4th) 133, 139 N.R. 323, 75 C.C.C. (3d) 257, 94 D.L.R. (4th) 590, 55 O.A.C. 321, [1992] 2 S.C.R. 915, 17 W.C.B. (2d) 97, J.E. 92-1312

closing remarks to the jury, counsel for the Crown made the following statement:

> The accused, in my submission, was going to use Aritha King [the deceased] just like he did Hope Denard, to get a package of cocaine into the United States from Canada. This lifestyle of this accused is important in this case. We are talking about a murder. We are talking about a vicious murder and a mutilation.

50 The respondent argued that the evidence of Hope Denard had no relevance to motive and had the sole effect of suggesting to the jury that a person of the respondent's "lifestyle" or "character" would be more likely to commit a murder of this kind. The appellant's position, in contrast, is that this evidence was very relevant to establish the "context" in which the crime occurred, by suggesting a possible reason why Ms. King would have been travelling from Detroit to Canada with the respondent.

51 In his charge to the jury, the trial judge cautioned the jury with respect to the evidence of Hope Denard in the following terms:

> Members of the jury, you have heard evidence that described Mr. Smith as a person whose activities and conduct may not be entirely acceptable to you and some of which may involve illegal activity. I refer to the admitted dealing with girls and drugs, etc. I wish to caution you, members of the jury, that the fact that he has dealt in drugs, etc., is no basis for a conviction for murder. This man is on trial for murder. He is not on trial for any other activity. Under no circumstances can you allow yourselves to be influenced by such conduct in your verdict on a charge of murder. I cannot ask you to ignore the conduct completely because it forms a part of the Crown's theory. You will recall the Crown's references to Menard [sic], etc. Therefore his conduct should only be considered together with all of the other evidence to determine whether he killed Miss King or not, as suggested by the Crown in his theory. The fact that he dealt with girls or drugs does not mean that he could kill or does not mean that he killed anyone. That, as I say, can only be considered with all of the other evidence on the issue of murder and only to the extent that it forms part of the Crown's theory. As I said, and I repeat, he is not on trial for dealing in drugs or girls. He is on trial for murder.

In my opinion, the evidence of Hope Denard was inadmissible, because it was irrelevant to the charge of murder against the respondent. It was evidence going to character, the implication being that a person who had the "character" of a drug smuggler would be more likely to have committed this murder. Such evidence, in my view, was not admissible to establish that the respondent committed this murder.

52 In *R. v. Cloutier*, [1979] 2 S.C.R. 709, 12 C.R. (3d) 10, 28 N.R. 1, 48 C.C.C. (2d) 1, 99 D.L.R. (3d) 577, the appellant was charged with importing a narcotic into Canada. The trial judge refused to admit into evidence certain items seized at the appellant's residence which included, inter alia, a manuscript extolling the virtues of marijuana, a metric scale, tweezers, and three pipes. The appellant was acquitted and the Court of Appeal ordered a new trial. On an appeal to this court, it was decided that the articles in question were relevant only to show that the appellant had used marijuana, and, therefore, that they had no probative value in respect of the specific charge that he had committed the offence of importing a narcotic. Writing for the majority, Pratte J. said, at pp. 730-731 [S.C.R.], that:

> The general rule as to the admissibility of evidence is that it must be relevant. ...
>
> For one fact to be relevant to another, there must be a connection or nexus between the two which makes it possible to infer the existence of one from the existence of the other. One fact is not relevant to another if it does not have real probative value with respect to the latter. ...
>
> Thus, apart from certain exceptions which are not applicable here, evidence is not admissible if its only purpose is to prove that the accused is the type of man who is more likely to commit a crime of the kind with which he is charged; such evidence is viewed as having no real probative value with regard to the specific crime attributed to

1992 CarswellOnt 103, 15 C.R. (4th) 133, 139 N.R. 323, 75 C.C.C. (3d) 257, 94 D.L.R. (4th) 590, 55 O.A.C. 321, [1992] 2 S.C.R. 915, 17 W.C.B. (2d) 97, J.E. 92-1312

> the accused: there is no sufficient logical connection between the one and the other.

Pratte J. then proceeded, at p. 734 [S.C.R.], to apply this principle to the case before him:

> The question to be resolved in the case at bar is whether the fact that the accused uses marijuana creates a logical inference that he knew or ought to have known that the dresser contained a narcotic at the time it was imported. To me there is no connection or nexus between either of these two facts. The use of marijuana by the accused certainly established that he knew of this narcotic, that he was in a position to identify it, but it had no probative value in relation to the guilty knowledge which must be proven by the prosecution. The evidence that the prosecution sought to introduce can have only one effect: that of raising suspicions against the accused solely for the reason that a marijuana user is more likely to import the substance illegally than someone who does not use the narcotic. In my view, this is precisely the type of evidence which cannot be admitted.

53 I would respectfully adopt the reasoning of the majority in *Cloutier* as applicable in the present case. The evidence of the respondent's past activities involving illegal drugs could only have had one effect: that of raising suspicions against him solely for the reason that a person who is involved in smuggling drugs is more likely to commit murder than a person who has not engaged in that activity. In my view, there was no sufficient nexus between the respondent's alleged drug smuggling activities and the ultimate issue at his trial: whether he murdered Aritha King. Consequently, this evidence ought not to have been admitted.

54 However, the evidence of Hope Denard was admitted, and its effect on the jury may have been highly prejudicial. In my opinion, moreover, the trial judge's caution to the jury was inadequate to remove this possibility of prejudice. Indeed, this prejudice could not have been eliminated except by an instruction to the jury that they must ignore the Crown's theory in respect of the evidence of Hope Denard altogether. The learned trial judge did not go this far.

55 I am unable to say that, had the evidence of Hope Denard not been received at trial, the verdict returned would necessarily have been the same. Consequently, I would not apply the curative provision of s. 686(1)(*b*)(iii) of the *Criminal Code*, and I would affirm the order of the Court of Appeal for a new trial.

***(b) Use of prior statements by witnesses***

56 Certain witnesses, called by both parties, previously had made statements to the police, or testified at the preliminary inquiry. The respondent argued in his factum that the learned trial judge did not adequately instruct the jury as to the use to be made of past, unadopted statements and testimony by these witnesses.

57 Specifically, Amy King, the mother of Aritha King, testified at the preliminary inquiry and at the trial that her daughter told her on the telephone that the respondent had returned to her at the hotel. Prior to the preliminary inquiry, she had made statements to the police which may have been inconsistent with her subsequent testimony. The trial judge failed to instruct the jury on the use they could properly make of these statements to the police.

58 Two of the witnesses relied upon by the respondent at trial to support his defence of alibi gave evidence at the preliminary inquiry which also may have been inconsistent with their trial testimony. When confronted with the apparent discrepancies in cross-examination, both maintained that their trial testimony was a correct statement of the events in question. The trial judge did not instruct the jury that they could not rely upon the earlier testimony of these witnesses unless they adopted it in the course of their trial testimony.

59 Finally, the trial judge correctly instructed the jury that they could accept and rely upon those portions of the respondent's statements to the police that they found to be true. However, in the absence of the appropriate limiting instructions, this may have been taken by the jury as a general instruction that they could rely upon the past testimony

1992 CarswellOnt 103, 15 C.R. (4th) 133, 139 N.R. 323, 75 C.C.C. (3d) 257, 94 D.L.R. (4th) 590, 55 O.A.C. 321, [1992] 2 S.C.R. 915, 17 W.C.B. (2d) 97, J.E. 92-1312

and statements of other witnesses, whether adopted or not at the trial, provided they found them to be true.

60 This supplementary ground of appeal was not pressed before us in argument, and in view of the conclusions I have reached in respect of hearsay evidence and the evidence of Hope Denard, it is not necessary to decide this ground as well. Indeed, as we have not been invited to reconsider the principles governing the differential use that may be made of past statements by an accused and by other witnesses, in my view it would not be desirable to make a pronouncement on this issue in the present appeal.

**Conclusion**

61 In the result, in view of my conclusions with respect to the admissibility of the hearsay evidence of the contents of the third telephone conversation, and in relation to the evidence of Hope Denard, I am of the opinion that the conviction should be quashed and a new trial ordered. The Crown's appeal is dismissed.

*Appeal dismissed.*

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2001 CarswellOnt 908, 21 C.B.R. (4th) 194

2001 CarswellOnt 908, 21 C.B.R. (4th) 194

Anvil Range Mining Corp., Re

In the Matter of Anvil Range Mining Corporation

In the Matter of the Companies Creditors Arrangement Act, R.S.C. 1985 c. C-36, as Amended

In the Matter of the Courts of Justice Act, R.S.O. 1990 c. C-43, as Amended

In the Matter of the Bankruptcy and Insolvency Act, R.S.C. 1985, C.B-3, as Amended

In the Matter of a Plan of Compromise or Arrangement of Anvil Range Mining Corporation, Applicants

Ontario Superior Court of Justice [Commercial List]

Farley J.

Judgment: February 21, 2001
Docket: 98-BK-001208



Counsel: *George Karayannides*, *Kenneth Kraft*, for Moving Party, Deloitte & Touche Inc. in its capacity as Interim Receiver

*John Porter*, for Her Majesty the Queen in Right of Canada as represented by the Department of Indian Affairs and Northern Development

*Derek T. Ground*, for Ross River Dena Council, Ross River Development Corporation

*Geoff Morawetz*, for Yukon Energy Corporation

*James Grout*, for certain Yukon lien holders

*Fred Myers*, for Government of Yukon

*David Hager*, for Cominco Ltd.

*Tony Reyes*, for Golden Hills Ventures Ltd., MacMillan Mining Contractors Ltd., Vortex Mining Inc.

*Kevin R. Aalto*, for Cumberland Asset Management, Berner Company Inc., Global Securities Corporation, Peel Brouke Inc., Robert N. Granger, Adrian M.S. White

*Richard Jones*, for Rose Creek Vangorda Mines, Pelly River Mines Limited (NPL)

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

Bankruptcy --- Interim receiver — Miscellaneous issues

Creditors brought motion requesting adjournment of interim receiver's motion for sanction of plan under Companies' Creditors Arrangement Act — Motion granted — Material provided by interim receiver did not constitute valuation — Assets in question were unlikely to have significant value — Short form valuation could be prepared without significant cost — Interim receiver was officer of court and did not become adversarial party in contentious matter by virtue of bringing motion — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangement Act — Miscellaneous issues

Creditors brought motion requesting adjournment of interim receiver's motion for sanction of plan under Companies' Creditors Arrangement Act — Motion granted — Material provided by interim receiver did not constitute valuation — Assets in question were unlikely to have significant value — Short form valuation could be prepared without significant cost — Interim receiver was officer of court and did not become adversarial party in contentious matter by virtue of bringing motion — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

**Cases considered by *Farley J.*:**

*Avery v. Avery*, [1954] O.W.N. 364 (Ont. H.C.) — referred to

*Canadian Airlines Corp., Re*, 2000 ABQB 442, [2000] 10 W.W.R. 269, 20 C.B.R. (4th) 1, 84 Alta. L.R. (3d) 9, 9 B.L.R. (3d) 41, 265 A.R. 201 (Alta. Q.B.) — referred to

*Mortgage Insurance Co. of Canada v. Innisfil Landfill Corp.* (1995), 30 C.B.R. (3d) 100, 3 O.T.C. 23 (Ont. Gen. Div. [Commercial List]) — applied

*New Quebec Raglan Mines Ltd. v. Blok-Andersen* (1993), 9 B.L.R. (2d) 93 (Ont. Gen. Div. [Commercial List]) — considered

*Silver v. Kalen* (1984), 52 C.B.R. (N.S.) 320 (Ont. H.C.) — referred to

**Rules considered:**

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

R. 39.03 — referred to

R. 39.03(3) — referred to

MOTION by creditors for adjournment of motion of interim receiver to sanction plan under *Companies' Creditors Arrangement Act*.

**Endorsement.** ***Farley J.*****:**

1 Both Mr. Aalto (for Cumberland et al) and Mr. Jones (for Vangorda and Pelly River) request an adjournment of the motion of the Interim Receiver, Deloitte & Touche Inc., for the sanction of a CCAA plan approved by certain classes of creditors (the other classes not participating because of the view that they were so far under water they could not even see the Plimsoll line, let alone be in contact with it).

2 The first ground for the adjournment was that the Interim Receiver's report was not in affidavit form and that those parties opposing the sanctioning of the Plan required that the Interim Receiver be cross-examined. There had been no previous request to obtain any clarification or amplification on the Interim Receiver's 22nd and 23rd reports, which are germane to the sanctioning motion. Nor would it seem that over the years has there been any such requests with respect to previous reports which dealt with values, since I note that Mr. Farquharson's January 16, 2001 letter refers to his views not having changed from such previous times. The Interim Receiver indicated that he would be available to discuss the reports yesterday in response to the demand for cross-examination. Mr. Aalto relies on his summons to witness and did not attend; Mr. Jones did attend. Mr. Aalto raises the point of what would the record be of such a discussion. I would think in most situations there would be no record if the enquirer were satisfied. If not, then perhaps a transcript or a series of written questions and answers or merely a summary agreed by counsel would be appropriate, i.e. whatever the circumstances require.

3 The Interim Receiver is an officer of the Court. That designation with all of its obligations and responsibilities does not change merely because the Interim Receiver has brought a sanctioning motion. I disagree with and reject Mr. Jones' submissions that the Interim Receiver by virtue of bringing this motion has become an adversarial party in a contentious matter. Nor is this an exceptional or unusual circumstance situation which would require cross-examination.

4 See *Mortgage Insurance Co. of Canada v. Innisfil Landfill Corp.* (1995), 30 C.B.R. (3d) 100 (Ont. Gen. Div. [Commercial List])) at pp. 101-2 where I stated:

> As to the question, of there not being an affidavit of the Receiver to cross-examine on, I am somewhat puzzled by this. I do not understand that a Receiver, being an officer of the Court and being appointed by Court Order is required to give his reports by affidavit. I note that there is a jurisprudence to the effect that it would have to be at least unusual circumstances for there to be any ability of other parties to examine (cross-examine in effect) the Receiver on any report. However, I do acknowledge that in, perhaps what some might characterize as a tearing down of an institution in the rush of counsel "to get to the truth of the matter" (at least as perceived by counsel), Receivers have sometimes obliged by making themselves available for such examination. Perhaps the watchword should be the three Cs of the Commercial List — cooperation, communication and common sense. Certainly, I have not seen any great need for (cross-)examination when the Receiver is willing to clarify or amplify his material when such is truly needed. [emphasis added]

The jurisprudence which I referred to included *Silver v. Kalen* (1984), 52 C.B.R. (N.S.) 320 (Ont. H.C.) and *Avery v. Avery*, [1954] O.W.N. 364 (Ont. H.C.) as I recollect as I make this endorsement over this lunch hour break but was not limited to these two cases. I note that my view of the situation was adopted by Paperny J. (as she then was) in *Re Canadian Airlines Corp.* (2000), 20 C.B.R. (4th) 1 (Alta. Q.B.) at p.30. See also paper "Canadian Airlines - The Last Tango in Calgary" by Norm A. McPhedran at pp. 43-5 regarding cross examination of the monitor issue.

5 With respect to Mr. Jones' submissions concerning R.39.03, it would not seem to me that, in any event, there has been reasonable diligence in asking for an examination (see R.39.03 (3)).

6 Mr. Aalto raises as a second prong of his attack for an adjournment that the Interim Receiver has not, in its monitor capacity, lived up to its obligations required in Cameron J.'s order of January 16 [December 19] 2001, to have

its "report to include an updated valuation of assets." The complaint here is that there is no such "valuation". The Interim Receiver relies on paragraphs 44-45 of its 22nd report together with Tab L, the aforesaid Farquharson letter and paragraphs 35-40 of its 23rd report as being the "valuation". Mr. Aalto proffers an affidavit of Paul A. Carroll, Q.C., sworn February 20, 2001 (yesterday and therefore somewhat late in coming if anyone wished to cross-examine). Mr. Carroll swears at paragraph 7:

> 7. No updated valuation of the assets has been undertaken by the Interim Receiver as ordered by this Court. Indeed, so far as I can ascertain, no full and complete valuation of the assets has ever been obtained by the Interim Receiver. The only information provided by the Interim Receiver in its report number 22 was a letter signed by Graham Farquharson from Strathcona Minerals which letter is not a valuation. Indeed, Mr. Farquharson, in response to a question posed to him by James Spence, a corporate partner with Gowlings, advised that he was not retained to give a valuation of the assets of Anvil Range, but was only asked to provide information in respect of base metal prices. This conversation took place in my presence.

7 I am not able to agree that what the Interim Receiver has provided is a "valuation". Certainly, the cited paragraphs and Farquharson's letter would point to it being unlikely that there was any significant value for the assets in question. Certainly Mr. Farquharson's letter is a *gloomy one* as to the prospects for the mining operations. For example:

> We are responding to your request for an updated opinion on the potential for resumption of mining operations for Anvil Range ... (p.1).
>
> As we have consistently stated in our previous opinions on the economics of Anvil Range, the property was a high cost producer and always will be such and, therefore, needs a zinc price above US$1,200 per ton to result in reasonable operating margins. (p.3)
>
> There is not much expectation that there will be a shortage of zinc concentrates in the next few years which is not a positive factor if Anvil Range was considering resuming production with its less than premium quality zinc concentrate. (p.3)
>
> Lead prices have been in a steady decline since 1996 and again we have not heard of any reason to expect a substantial improvement in prices in the near term. (p.3)
>
> We also understand from your reports that there has been continued deterioration of the process plant with time and this would not facilitate any resumption of operations. (p.5)
>
> Consequently we see no reason to consider resuming mining operations at Anvil Range at this time. With only three to five years of potential reserves remaining and a substantial investment required to resume mining such an investment cannot be justified until metal prices increase substantially and have prospects of remaining at higher levels for at least a period of three years while the remaining reserves at Grum are mined. (p.5)

8 However, he only indicates a salvage operation as an alternative once a decision was made to eliminate any possibility of ever resuming mining operations.

> Given that we do not expect metal prices to improve significantly in the next few years, and Cominco should be consulted in case they have a contrary opinion as they do have much closer contact with metal markets than we do, perhaps one of the options that should now be given increased consideration by the current creditors would be to realize whatever salvage value may remain with the existing assets including the process plant and equipment and apply those proceeds to the continuation of the program for permenant reclamation. Before making that decision, which would eliminate any possibility of ever resuming mining operations at Anvil Range, a final critical

> review of the economic possibilities for the resources at the Grum pit should be made and be done by those with experience to make that last review. (p.6)

In conclusion he says:

> We trust this meets your requirements at this time and regret that we are not able to offer any more encouragement than we have expressed in previous comments on this matter. (p.6)

9 I doubt very much that Mr. Farquharson has changed from being a very cautious understated and excellent expert as I found him to be in *New Quebec Raglan Mines Ltd. v. Blok-Andersen* (1993), 9 B.L.R. (2d) 93 (Ont. Gen. Div. [Commercial List]). It does not surprise me then that he would not assert that his letter was a "valuation".

10 I would be of the view that a valuation could be prepared in short order without a significant cost. In other words, in these circumstances and for the procedural purpose of establishing on a *very broad band basis* where the Plimsoll line is, it seems to me that Mr. Farquharson (or some other valuator) could give such a valuation in point form and without elaboration. Certainly, one would have to conclude from Mr. Farquharson's letter that for the foreseeable future the property would be uneconomic and therefore of very limited value. Lead / zinc prices for this troubled ore body likely would have to soar.

11 The Interim Receiver's motion is therefore adjourned to provide this valuation or obtain a further order of the Court. The Interim Receiver and its supporting parties will have to consider whether this turn of events will require a new vote to be taken.

12 In any event, I do not think that this matter of Anvil Range should meander about. I would be of the view that even if a new vote were required that the parties would be back before me within two months at the outside. In the meantime, all should attend to their knitting.

*Motion granted.*

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2010 CarswellAlta 1702, 2010 ABQB 531, [2010] A.W.L.D. 4907, [2010] A.W.L.D. 5015

2010 CarswellAlta 1702, 2010 ABQB 531, [2010] A.W.L.D. 4907, [2010] A.W.L.D. 5015

SemCanada Crude Co., Re

In the Matter of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended

And In the Matter of a Plan of Compromise or Arrangement of SemCanada Crude Company, SemCAMS ULC, SemCanada Energy Company, A.E. Sharp Ltd., CEG Energy Options Inc. and 1380331 Alberta ULC (Re: Celtic Exploration Ltd.)

Alberta Court of Queen's Bench

B.E. Romaine J.

Judgment: August 27, 2010
Docket: Calgary 0801-08510



Counsel: A. Robert Anderson, Q.C., Carole J. Hunter, Doug Schweitzer for Applicant

Anthony Jordan, Q.C. for Respondent

Subject: Natural Resources; Property; Insolvency

Natural resources --- Oil and gas — Oil and gas leases — Interpretation

Parties were operator of natural gas facility, and natural gas producer who used facility — Operator entered protection under Companies' Creditors Arrangement Act, and plan was later implemented — Operator owed producer $30,578,976.80 for purchase of gas, and additional amount reflecting end of year adjustment — Operator claimed that after stay, processing was performed for producer at market rates, while producer claimed that it agreed to take payment in processed gas, and to pay processing fee — Operator brought application for order that agreement between parties was suspended as of date of stay, and for related relief — Application granted — As no agreement was in existence after stay, producer not entitled to set off to debts for end of year adjustment against money owing for processing — Correspondence showed that agreement between parties was suspended by their consent — Suspension occurred under producer's right to do so, and so therefore lack of notice to monitor was minor breach only — Equitable set off was not available — No evidence that producer was to be charged as third party producer, however, standard charges and terms charged to third party operators were appropriate measure of quantum meruit — Record was sufficient to determine issue of nature of payment.

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Initial application — Proceedings subject to stay — Contractual rights

Parties were operator of natural gas facility, and natural gas producer who used facility — Operator entered protection

under Companies' Creditors Arrangement Act, and plan was later implemented — Operator owed producer $30,578,976.80 for purchase of gas, and additional amount reflecting end of year adjustment — Operator claimed that after stay, processing was performed for producer at market rates, while producer claimed that it agreed to take payment in processed gas, and to pay processing fee — Operator brought application for order that agreement between parties was suspended as of date of stay, and for related relief — Application granted — As no agreement was in existence after stay, producer not entitled to set off to debts for end of year adjustment against money owing for processing — Adjustment constituted stayed payable under initial order as it reflected price adjustment to amounts before stay — Producer was not joint owner and could not participate in adjustment pool in same manner as joint owners — Producer did not have trust agreement over end of year adjustment — Parties were sophisticated negotiators who did not intend to create trust or agency relationship — Evidence was proper to determine nature of agreement on summary judgment.

**Cases considered by *B.E. Romaine J.*:**

*Bell Canada International Inc., Re* (2003), 2003 CarswellOnt 4537 (Ont. S.C.J. [Commercial List]) — considered

*Brook's Wharf & Bull Wharf Ltd. v. Goodman Brothers* (1936), [1937] 1 K.B. 534, [1936] 3 All E.R. 696 (Eng. C.A.) — referred to

*Craighampton Investments Ltd. v. Ayerswood Developments Ltd.* (1984), 4 O.A.C. 124, 1984 CarswellOnt 1229 (Ont. C.A.) — considered

*Craven-Ellis v. Canons Ltd.* (1936), [1936] 2 K.B. 403, [1936] 2 All E.R. 1066 (Eng. C.A.) — referred to

*Deglman v. Guaranty Trust Co. of Canada* (1954), [1954] 3 D.L.R. 785, [1954] S.C.R. 725, 1954 CarswellOnt 140 (S.C.C.) — considered

*Investors Compensation Scheme Ltd. v. West Bromwich Building Society* (1997), [1998] 1 All E.R. 98, [1998] 1 W.L.R. 896, [1997] UKHL 28 (U.K. H.L.) — referred to

*Meridian Development Inc. v. Toronto Dominion Bank* (1984), [1984] 5 W.W.R. 215, 1984 CarswellAlta 259, 52 C.B.R. (N.S.) 109, 32 Alta. L.R. (2d) 150, 53 A.R. 39, 11 D.L.R. (4th) 576 (Alta. Q.B.) — considered

*Pine Valley Mining Corp., Re* (2008), 41 C.B.R. (5th) 49, 2008 BCSC 446, 2008 CarswellBC 712 (B.C. S.C.) — referred to

*SemCanada Crude Co., Re* (2009), 2009 ABQB 398, 2009 CarswellAlta 1024, 479 A.R. 295, 55 C.B.R. (5th) 284 (Alta. Q.B.) — referred to

*SemCanada Crude Company, Re* (2009), 2009 ABQB 397 (Alta. Q.B.) — considered

*Telford v. Holt* (1987), 1987 CarswellAlta 188, 1987 CarswellAlta 583, 21 C.P.C. (2d) 1, [1987] 2 S.C.R. 193, 41 D.L.R. (4th) 385, 78 N.R. 321, (sub nom. *Holt v. Telford)* [1987] 6 W.W.R. 385, 54 Alta. L.R. (2d) 193, 81 A.R. 385, 37 B.L.R. 241, 46 R.P.R. 234 (S.C.C.) — followed

*Trilogy Energy LP v. SemCAMS ULC* (2009), 2009 ABCA 275, 2009 CarswellAlta 1240, (sub nom. *SemCanada Crude Co., Re)* 462 W.A.C. 269, (sub nom. *SemCanada Crude Co., Re v.)* 460 A.R. 269, 57 C.B.R. (5th) 42 (Alta. C.A.) — referred to

*Watson v. Manitoba Free Press Co.* (1908), 9 W.L.R. 77, 18 Man. R. 309, 1908 CarswellMan 102 (Man. K.B.) — considered

**Statutes considered:**

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

Generally — referred to

*Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36

Generally — referred to

s. 11 — considered

s. 11(1) — considered

**Rules considered:**

*Alberta Rules of Court*, Alta. Reg. 390/68

Generally — referred to

R. 159 — considered

APPLICATION by operator of gas facility regarding rights between producer and operator under agreement, and related relief.

***B.E. Romaine J.*:**

**Introduction**

1 SemCAMS ULC ("SemCAMS") applies for an order declaring that the sale of raw natural gas by Celtic Exploration Ltd. ("Celtic") to SemCAMS on its own account pursuant to the KA Plant Inlet Gas Purchase Agreement between SemCAMS and Celtic dated December 22, 2006, as amended (the "IGPA") was suspended effective July 22, 2008, and for relief flowing from that declaration. SemCAMS also applies for a declaration that Celtic is not entitled to set-off amounts that may be owed to Celtic pursuant to an equalization adjustment made pursuant to the terms of the IGPA against amounts Celtic owes to SemCAMS for gas processing after July 22, 2008, and for a declaration that Celtic's claim for damages relating to the suspension of the IGPA is properly dealt with under the Claims Process Order granted in these CCAA proceedings. SemCAMS applies for a declaration that Celtic did not file a proper claim in the proceedings for such damages and is therefore barred from asserting or enforcing the claim.

2 SemCAMS also applies for a declaration relating to the contractual relationship of the parties going forward with respect to the processing of Celtic's gas at the Kaybob South Amalgamated Plants Nos. 1 and 2 (the "KA Plant") which SemCAMS operates.

**Relevant Facts**

3 On July 22, 2008, SemCAMS was granted an Initial Order pursuant to s.11(1) of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "CCAA"). In a separate application on the same date, SemCanada Crude Company was also granted an Initial Order under the CCAA. On July 24, 2008, CEG commenced proposal proceedings in bankruptcy. On July 30, 2008, the CCAA proceedings of SemCAMS and SemCanada and the bankruptcy proceedings of CEG were procedurally consolidated with other proceedings commenced under the CCAA and the *Bankruptcy Act*, R.S.C. 1985, c. B-3 by affiliated or related companies for the purpose of administrative convenience.

4 The CCAA proceedings, including the stay that was imposed by the Initial Order, continued until plans of arrangement and reorganization of SemCAMS and other related entities, both in Canada and in the United States, were implemented on November 30, 2009.

5 This application relates only to SemCAMS. SemCAMS is the Operator of four natural gas processing plants and natural gas gathering systems and pipelines in Alberta including the facilities at the KA Plant. Celtic is a gas producer and uses the processing facilities at the KA Plant.

6 On July 22, 2008, SemCAMS owed Celtic $30,578,976.80 under the IGPA for the purchase of raw natural gas and Celtic filed a Proof of Claim in the CCAA proceedings with respect to this amount. The Monitor and SemCAMS subsequently determined that Celtic was owed an additional $1,414,349.31 by SemCAMS as a result of the so-called thirteenth month adjustment pricing mechanism under the IGPA. A Notice of Revision was issued on August 11, 2009 to reflect this additional indebtedness.

7 The dispute between SemCAMS and Celtic relates to two time periods:

a) the relationship between the parties from July 22, 2008 when SemCAMS was granted an Initial Order under the CCAA to the time of the application; and

b) the relationship of the parties going forward.

8 The parties agree that the IGPA was not terminated during the course of the CCAA proceedings. They disagree, however, with respect to how the relationship between the parties changed during this time and they disagree with respect to the current status of the IGPA.

9 SemCAMS submits that, effective July 22, 2008:

a) the parties expressly agreed to suspend the IGPA;

b) SemCAMS ceased purchasing raw natural gas from Celtic at the KA Plant inlets;

c) Celtic continued to deliver raw natural gas for processing to the KA Plant inlets;

d) SemCAMS in its capacity as Operator of the KA Plant commenced accepting deliveries of Celtic's raw natural gas at the KA Plant inlets on the understanding that the processing of Celtic's gas would be done pursuant to standard third party processing terms and rates; and

e) Celtic commenced marketing its processed gas and related products at the KA Plant outlets.

10 Celtic submits that the IGPA was not suspended but amended or changed such that SemCAMS continued to purchase Celtic's raw natural gas at the KA Plant inlets, but ended its sale of processed gas and related products at the

KA Plant outlets. Celtic submits that, commencing July 23, 2008, SemCAMS and Celtic modified the IGPA such that Celtic was paid for raw natural gas by "taking in kind" processed gas and products from SemCAMS at the KA Plant outlets. In addition to the alleged amendment or change to the IGPA to take all of the processed gas and products as payment in kind, Celtic alleges a further change to the IGPA, being that Celtic would pay SemCAMS for such processing a monthly amount economically consistent with the processing fee formula set out in the IGPA, less five cents per gigajoule of processed gas.

11 On the application, the parties adduced in evidence voluminous affidavits and cross-examinations on affidavits of a number of individuals. There is no doubt that there is conflicting affidavit evidence on some issues and that the credibility of such conflicting evidence cannot be determined without *viva voce* testimony. There is a great deal of evidence by various affiants with respect to how they interpreted agreements or emails or correspondence from the other side or what they intended by their own actions or correspondence or emails. However, the following facts are not disputed or can be determined by the evidence before me.

12 The KA Plant operates pursuant to a construction, ownership and operation agreement entered into among the joint owners of the plant and SemCAMS as the Operator (the "CO&O Agreement"). SemCAMS is both a joint owner and the Operator of the plant. Celtic is not a joint owner. The KA Plant is used to gather and process raw natural gas for joint owners and for third party producers.

13 Typically, a party may have its natural gas processed at the KA Plant in two ways:

a) as a joint owner under the CO&O Agreement; or

b) as a third party user under a gas handling and processing agreement (a "Gas Processing Agreement").

14 However, under the CO&O Agreement, joint owners are entitled to use throughput capacity in the plant in proportion to their ownership interest. Joint owners deliver raw natural gas to the plant for processing by the Operator, and when processing is complete, either take or sell the processed gas ("Sales Gas") and related products to purchasers. Joint owners retain title to their raw gas, Sales Gas and products at all times during processing.

15 If a joint owner does not use its throughput capacity, the excess capacity can be used by other joint owners or reallocated to third party producers under Gas Processing Agreements, but joint owners have the highest priority for processing. Third party users can be shut out of the plant if joint owners use all their capacity in a given month.

16 Under a Gas Processing Agreement between a third party user and the Operator, the third party user delivers raw natural gas to the plant for processing, and when processing is complete, either takes or sells Sales Gas and products. Third party users retain title to their raw gas, Sales Gas and products at all times.

17 Monthly payments made by joint owners and third party users are based on projected use of the plant. Projected throughput typically varies from actual throughput, and at the end of a calendar year, there is a "thirteenth month adjustment" that reconciles projected throughput to actual throughput (the "Thirteenth Month Adjustment").

18 Sales Gas and products derived from raw natural gas processed at the plant must be allocated at the plant outlets by the Operator to a designated shipper and pipeline. Evidence was adduced to the effect that the owner of the Sales Gas and products, whether a joint owner or third party user, provides the Operator with the necessary information and direction in that regard by way of a Notice of Take-in-Kind. Celtic put forward a slightly different interpretation of the meaning and significance of the Notice of Take-in-Kind, which will be discussed later in this decision. Before the Notice of Take-in-Kind was in general use, the Operator obtained information and direction about allocation of Sales Gas and product through email or correspondence with the owners of the gas.

19 Originally, Celtic processed its gas at the KA Plant under a Gas Processing Agreement and provided SemCAMS as Operator of the plant with information and direction on allocating Sales Gas and products.

20 On December 22, 2006 (to be effective January 1, 2007, as replaced on October 26, 2007 and amended on April 29, 2008), SemCAMS and Celtic entered into the IGPA and the previous Gas Processing Agreement was terminated. Under the IGPA:

a) Celtic sold raw natural gas to SemCAMS in its individual capacity at the KA Plant inlets;

b) SemCAMS agreed to pay Celtic a premium for its raw natural gas, less certain amounts (as described below);

c) SemCAMS took title to the gas at the KA Plant inlets;

d) amendments to the IGPA could only be made in writing executed by both parties; and

e) the raw natural gas sold by Celtic to SemCAMS would be processed at the KA Plant using the capacity and priority rights held by SemCAMS by virtue of its joint ownership interest in the KA Plant.

21 Since SemCAMS took title to the raw natural gas at the plant inlets, it could use its throughput capacity as a joint owner and Celtic would not be at risk of losing throughput capacity. Celtic delivered to SemCAMS as Operator of the KA Plant Notices of Transfer of Ownership Interest dated December 16, 2006 and June 21, 2007, confirming that Celtic was selling its gas to SemCAMS at the plant inlets and that SemCAMS would make the necessary take-in-kind instructions for allocation of the Sales Gas and products at the plant outlets. SemCAMS provided Notices of Take-in-Kind with respect to the gas it purchased from Celtic at the plant inlets from that point until July 23, 2008.

22 The parties have not located an executed version of a Notice of Transfer of Ownership Interest under the latest version of the IGPA, but this is not relevant to the dispute between the parties, as SemCAMS as the KA Plant Operator relied on the Notices of Take-in-Kind.

23 The pricing for the raw natural gas under the IGPA establishes through a "netback" pricing mechanism, which provides that SemCAMS would purchase the raw natural gas from Celtic at benchmark prices plus a premium (the "Gas Premium"), less the costs associated with the subsequent processing of the gas (the "Preferred Processing Charges"). SemCAMS as one of the joint owners of the KA Plant paid lower capital fees to process gas. The pricing mechanism was also subject to the Thirteenth Month Adjustment to adjust the sales price for the raw gas under the IGPA to reflect any equalization payments received or paid by SemCAMS as a joint owner.

24 SemCAMS entered into inlet gas purchase agreements similar to the IGPA with other producers.

25 On July 22, 2008, David Wilson, the President of Celtic, and Darren Marine, the President of SemCAMS, had a conversation about the CCAA proceedings. Mr. Marine says that he advised Mr. Wilson that there had been no decision on what was going to happen with the IGPA. Mr. Marine recalls the discussion as being along the lines of what the CCAA filing meant.

26 Mr. Wilson deposes that Mr. Marine told him that steps would be taken to make sure that the gas would be in Celtic's hands to deal with . He agrees that there was no termination of the IGPA discussed and agrees that there was no decision to change the IGPA discussed during the conversation.

27 Mr. Marine deposes that after his conversation with Mr. Wilson he had further discussions with SemCAMS'

in-house counsel, and that it was decided that it would be in the best interests of everyone if the producers under the IGPA agreements would suspend the agreements and take their gas back, as SemCAMS, given the CCAA proceedings, would no longer be in a position to sell Sales Gas and product.

28 On July 23, 2008, Mr. Marine instructed David Dachis, the SemCAMS' director of marketing and producer services, to start suspending SemCAMS' gas purchases under the IGPA agreements, including the one with Celtic, effectively suspending the agreements. He says that he instructed Mr. Dachis that the IGPA agreements would have to be replaced with standard third-party processing agreements. Mr. Marine says that he did not instruct Mr. Dachis to negotiate a new deal with IGPA producers.

29 William Love, Celtic's Marketing Manager, says that he learned that SemCAMS had started proceedings under the CCAA from a third party on July 22, 2008. He was ill at home, but called Mr. Wilson to advise him of what he had learned.

30 On July 23, 2008, Mr. Love spoke to Mr. Dachis, who was his main contact at SemCAMS. According to Mr. Love, Mr. Dachis said that SemCAMS had a problem selling the processed gas. Mr. Love deposes that Mr. Dachis said it would be necessary for Celtic to take the Sales Gas and other products and for Celtic to find another buyer. He says that Mr. Dachis asked him to complete a Notice of Take-in-Kind in order to give proper directions to the Operator with respect to the destination of the gas and other products. Mr. Love says in his affidavit that he said that this was not appropriate, but that Mr. Dachis assured him that this was just a technical formality required to give proper instructions to the Operator so that, when the Sales Gas and other products were delivered to the pipelines at the plant outlet, they would be delivered for Celtic's account. Mr. Love says that there were no discussions about terminating the IGPA or changing the arrangement.

31 Mr. Love received an email at about noon on July 23, 2008 from Ms. Bignell who worked for SemCAMS as the "Common Stream Operator" at the KA Plant, asking him to sign the Notice of Take-in-Kind sent to him previously "(i)n order to allocate the Celtic gas to the Celtic nomination".

32 Mr. Love says that he subsequently signed the Notice of Take-in-Kind that had been sent to him by SemCAMS on July 23, 2008 and sent it to the Operator by email later that day. The Notice of Take-in-Kind identifies Celtic as the "Product Owner Name / Take-in-Kind Agent". Mr. Love deposes that by July 29, 2008, he was able to arrange the sale of Celtic's Sales Gas and other products to third parties.

33 Mr. Dachis says that his instructions were to "cut [the inlet gas producers] loose", to have them repatriate their gas supply, free from their sales obligations to SemCAMS and make their own commercial arrangements. Mr. Dachis states that it was obvious that SemCAMS was not in a position to keep paying the inlet gas producers for their gas. Mr. Dachis' understanding of the purpose of the Notice of Take-in-Kind was that it was "a process whereby [Love] repatriates his supply versus adhering to the arrangements in place with [purchasers previously arranged by SemCAMS at the plant outlets] so they don't get the gas, he gets the gas, it goes on his account, and he does with it as he sees fit for redelivering to whatever buyer he and Mr. Wilson or whoever deem appropriate ..." He understood that after July 22, 2008, there was a change in the pattern of conduct between parties such that SemCAMS stopped giving Notices of Take-in-Kind to the KA Plant Operator and Celtic started giving them. Mr. Dachis commented that "the point being that Celtic took control of their own gas. That would be the ultimate outcome of that change in procedure." He said that he had no instructions to negotiate changes in the inlet gas purchase agreements, and that there was no discussions with respect to a new gas processing agreement. He said in response to the question of whether he discussed the suspension of deliveries by Celtic under the IGPA with Mr. Love that they may have discussed it, but it "would be more conjecture as opposed to doing anything specific." Mr. Love denied talking about suspension of either party's obligations under the IGPA at all.

34 On July 23, 2008, Katie Tonhauser, a SemCAMS' employee, sent an email to Greg Bosch, another SemCAMS'

employee who was assisting in the marketing of sulphur and liquids, copied to Mr. Dachis, asking whether Celtic was "staying" with SemCAMS. Mr. Dachis' reply was "no".

35 On July 24, 2008 at 2:44 p.m., Mr. Love sent an email to Mr. Dachis indicating that, at that time, Celtic had not served a Notice of Termination of the existing contract and that he did not believe that SemCAMS had served a Notice of Termination, adding, "Please advise if there is an issue here".

36 Mr. Marine and Mr. Wilson met on July 24, 2010, each accompanied by others in their organizations. Mr. Wilson states that Celtic wished to have the meeting so that it could explain the circumstances as it understood them to its shareholders in a press release. Mr. Wilson says that there was no discussion with respect to the termination of the IGPA or any suspension of either party's obligations under the IGPA. He also says that there was no discussion at the meeting nor at any time since about alternative arrangements between SemCAMS and Celtic with regard to the sale or delivery for processing of gas at the KA Plant.

37 Mr. Marine says that Mr. Wilson said that he was concerned about SemCAMS' financial health and did not want to be selling natural gas to SemCAMS. Mr. Marine had been advised by Mr. Dachis prior to this meeting that Celtic had executed a Notice of Take-in-Kind. He says that Brent Molesky, SemCAMS' in-house counsel, told Mr. Wilson that if Celtic was going to take its gas in kind, it would have to process its gas via third party agreements with SemCAMS as Operator of the plant. Mr. Marine deposes that he said that SemCAMS could not do a "buy/sell", that Celtic was either under an agreement or was a gas processing customer of SemCAMS as plant Operator. Mr. Marine denies that any agreement to amend or change the IGPA as now alleged by Celtic was discussed. Specifically, he said there was no discussion of Celtic taking Sales Gas at the plant outlets in payment for the raw gas it was delivering.

38 On July 25, 2008, Celtic issued a press release which indicated that Celtic was "now marketing its natural gas through an alternative purchaser with the agreement of SemCAMS." The press release indicated that these "new arrangements" would be effective immediately.

39 On July 28, 2008, Mr. Love sent an email to Mr. Dachis asking him to advise if the Notice of Take-in-Kind executed by Celtic had been approved by the CCAA Monitor. On cross-examination on his affidavit, Mr. Love indicated that it was possible that this email had been prompted by information he received from an employee of another producer indicating that he thought his company required the written consent of SemCAMS and the Monitor to new processing arrangements pursuant to the Initial Order relating to the CCAA filing.

40 On July 31, 2008, Mr. Dachis sent Mr. Love an email as follows:

> Further to your request, I have spoken with Brent Molesky of our legal group and SemCAMS hereby confirms acceptance of the suspension of Celtic's gas deliveries under our inlet purchase arrangement as of July 22nd (your nomination change was effective as of 20:00 hours).
>
> Brent also advised that he is in the process of seeking direction from Ernst and Young (the Court appointed Monitor) as well as our outside legal counsel; Brent is hoping to have formal letters regarding all SemCAMS inlet purchase arrangements sent out by the end of next week.

41 On August 6, 2008, Celtic's counsel wrote a letter to SemCAMS internal counsel and the Monitor, copied to Celtic, which included the following:

> Re:
>
> SemCAMS ULC Reorganization Pursuant to CCAA Suspension of Celtic Exploration Ltd.'s Inlet Gas Purchase Agreement and its Proprietary Interest in Sales Proceeds Received by SemCAMS ULC from Third Parties

. . . . .

The purpose of this letter is twofold. First, it outlines Celtic's new arrangements with respect to the suspension and renomination of the Inlet Gas Purchase Agreement with SemCAMS arising out of the CCAA proceedings. In addition, this letter requests that SemCAMS issue directions to pay to third party purchasers ("Purchasers") to ensure that sales proceeds arising from gas, condensate, NGL and sulphur (the "Products"), all attributable to raw natural gas supplied by Celtic ("Celtic Gas") are paid to Celtic from July 22, 2008 forward.

. . . . .

**Suspension of the Inlet Gas Purchase Agreement**

Effective as of July 22, 2008, SemCAMS accepted the suspension of the Inlet Gas Purchase Agreement (the "IGPA") dated October 24, 2007 and renewed by SemCAMS on April 29, 2008. From July 22, 2008 forward, all sales proceeds from Products derived from Celtic Gas are to be paid directly to Celtic and SemCAMS will invoice Celtic for fees related to processing and other services. As a result of the foregoing, Celtic requests that SemCAMS agree and provide confirmation in writing that Celtic shall take in kind all Products derived from Celtic Gas for the period July 22, 2008 forward and that SemCAMS provide directions to pay to any Purchasers of Products derived from Celtic Gas for the period commencing July 22, 2008 to present, to ensure that any payments made by the Purchasers in respect of Products derived from Celtic Gas from July 22, 2008 forward are paid directly to Celtic.

42 The balance of the letter set out counsel's theory that the operation of the IGPA prior to the CCAA filing gave rise to an implied trust. Celtic applied to the Court for a declaration that the proceeds of sales of products delivered to SemCAMS pursuant to the IGPA were held in trust by SemCAMS. I dismissed the application with reasons to follow. My reasons include the following comment:

There is no real issue that the [IGPAs] are agreements of purchase and sale of the Producers' natural gas to SemCAMS. They relate to raw natural gas produced by Auriga and Celtic and delivered for processing to the Kaybob Amalgamated Gas Plant. Producers are able either to deliver gas to the plant for processing without an inlet sale, such that they remain the owner of the gas through the processing and then arrange a sale of the processed products thereafter, or to sell their gas to an owner of the plant prior to processing, which was done pursuant to the Purchase Agreement in question. The latter option gives producers the benefit of a better price for their gas and a higher priority in processing. The Producers submit that one ambiguous reference in a schedule to the Purchase Agreements that relates to the priority movement of the gas may be an indication that the Producers were considered to be owners of the gas, but that interpretation cannot stand against the clear character of the Purchase Agreements as contracts of purchase and sale.

*SemCanada Crude Co., Re ("*Auriga/Celtic*")* 2009 ABQB 398, [2009] A.J. No. 725 (Alta. Q.B.) at paragraph 4.

43 In the Third Report of the Monitor dated August 11, 2008 to the Court and stakeholders in the CCAA proceedings, served on counsel to Celtic on August 12, 2008, the Monitor stated as follows:

Subsequent to the Initial Orders, SemCAMS discontinued the purchase of gas at the plant inlet gate (the "Inlet Purchases") as this gas was being processed and then sold to SemEnergy, and SemEnergy was no longer in a position to pay SemCAMS for the gas. As a result, SemCAMS does not have a need to prepay for gas purchases after July 22, 2008.

44 On August 26, 2008, SemCAMS in its capacity as Operator of the KA Plant sent Celtic new processing con-

tracts with a letter that asked Celtic to execute the contracts, noting as follows:

> With the suspension of your gas deliveries to SemCAMS ULC under the Inlet Purchase Contract # 160544P, SemCAMS ("SemCAMS"), in its capacity as operator of the KA Gas Plant for and on behalf of the other Gas Plant Owners (the "Operator") accepted delivery of Celtic Exploration Ltd.'s ("Celtic") gas volumes under standard gas handling terms.
>
> . . . . .
>
> Finally, Operator wishes to remind Celtic that the Subject Contracts are entered into by Operator in its capacity as operator of the KA Plant and Sulphur Facilities for and on behalf of the other Gas Plant Owners. Accordingly, no netting or set-off by Celtic shall be permitted or allowed on account of any amounts which may be owed to Celtic by SemCAMS, on its own account, under any Inlet Gas Purchase or other Agreements between SemCAMS and Celtic. Failure of Celtic to pay any amounts owing under the Subject Contracts to Operator will result in Operator exercising all remedies available to it.

45 On September 22, 2008, counsel for Celtic replied to the August 26, 2008 letter, refusing to execute the new agreements and denying that Celtic had agreed to suspend or terminate the IGPA. The letter suggests that the Notice of Take-in-Kind "appears only to provide that the gas purchased by SemCAMS is being paid for by the delivery of processed gas." The letter also states as follows:

> Section 14.3 of the Inlet Gas Purchase Agreement provides that waivers must be in writing and section 14.4 provides that amendments must be in writing and executed by both parties. Hence, in the absence of a written agreement signed by both Celtic and SemCAMS, we are at a loss to understand how SemCAMS can allege that the IGPA has been suspended.

46 Celtic continued to deliver gas for processing to the KA Plant and the gas was accepted for processing. When asked why SemCAMS continued to accept the gas, Mr. Marine stated that it was not practical or possible to separate Celtic's raw natural gas at the plant inlets because it is commingled with other gas and that SemCAMS would be shutting out other co-owners and producers. The letter of September 22, 2008 from Celtic's counsel also expressly warns SemCAMS that any attempt to shut in Celtic's gas production would be grossly prejudicial to Celtic.

47 From August 29, 2008, effective as of July 23, 2008, SemCAMS as Operator of the KA Plant has invoiced Celtic monthly for the gathering and processing of gas at the KA Plant pursuant to standard processing fees charged to third party users and has ceased issuing invoices to Celtic under the IGPA.

48 SemCAMS issued invoices indicating that it owes Celtic an additional $1,414,349.31 for the Thirteenth Month Adjustment. On October 9, 2009, Celtic purported to set off the Thirteenth Month Adjustment owed to it by Sem-CAMS against amounts owed by Celtic to SemCAMS for post-filing gas processing at the KA Plant.

49 In the Sixth Report of the Monitor dated October 6, 2008, the Monitor commented as follows:

> The inlet purchase program ended shortly after SemCAMS entered CCAA. Inlet gas payments were made to producers for gas purchased at the inlet from July 22-26 before the program ended.

50 On December 15, 2009, after the CCAA proceedings had terminated, SemCAMS through its counsel offered to reinstate the IGPA effective January 1, 2010, without prejudice to the rights and positions of either party in respect of the issues in dispute during the period from July 22, 2008 to and including December 31, 2009.

51 On December 23, 2009, Celtic through its counsel responded and proposed for the period from and after January 1, 2010 that Celtic would deliver raw natural gas to SemCAMS at the KA Plant inlets and then take back the Sales Gas and Products at the outlets. Celtic also expressed some concern about the pricing mechanism set out in the IGPA because it had already committed to a third party to fill orders for Sales Gas and products for a fixed period.

52 On December 23, 2009, SemCAMS through its counsel indicated that it would consider Celtic's proposal, as it differed from the IGPA, but required additional information regarding Celtic's pricing concerns. On December 31, 2009, Celtic through its counsel advised that such information was confidential and would not be provided.

53 In January, 2010, SemCAMS through its counsel stated that SemCAMS would agree to amend the IGPA to provide for the sale to Celtic of the Sales Gas and products at the KA Plant outlets. After a further exchange of correspondence, SemCAMS proposed in February, 2010 that Celtic would sell the raw natural gas to SemCAMS at the KA Plant inlets and receive payment for such raw natural gas by taking all of the Sales Gas and Products at the KA Plant outlets. In addition, Celtic would be responsible for paying SemCAMS the Preferred Processing Charges less the Gas Premium. As counsel to SemCAMS noted, this is the arrangement that Celtic claims to have been in place since July 22, 2008. There had been no response to this proposal at the time of the application, but I was advised that the parties would likely resolve the issue of arrangements going forward. Therefore, this issue was not addressed in oral argument. I have since been informed that the parties have been unable to conclude a settlement of "go forward" issues and that from SemCAMS' perspective, there was no reason to defer issuing reasons for decision on the other issues.

**Issues and Analysis**

54 SemCAMS submits that the issues are as follows:

a) Did SemCAMS and Celtic suspend the IGPA? If so, was Celtic a third party user for the period from July 22, 2008 to December 31, 2009?

b) Is Celtic entitled to set off the Thirteenth Month Adjustment owing by SemCAMS to Celtic against the post-filing Celtic indebtedness owing by Celtic to SemCAMS as Operator?

c) Is Celtic's purported damages claim against SemCAMS barred by the Claims Process Order and would it have been compromised under the CCAA plan of arrangement had it been made prior to the Claims Bar Date?

d) What arrangement governs the relationship between SemCAMS and Celtic at the KA Plant on a go-forward basis?

55 Celtic submits that much of the relief claimed by SemCAMS depends on factual elements that cannot be determined on the basis of affidavit evidence without trial. Celtic also submits that some of the relief is beyond the jurisdiction of a Court acting under the CCAA, and that certain procedural steps have not been followed. Celtic agrees that the issue of set off is within the Court's jurisdiction, but that there should be a trial of certain factual issues.

56 Given the question of whether a trial is necessary in order to determine certain factual issues, I have started my analysis with the issue that both parties agree is within the jurisdiction of the CCAA Court, Celtic's ability to set off the Thirteenth Month Adjustment.

***Is Celtic Entitled to Set Off the Thirteenth Month Adjustment Owing by SemCAMS Against the Amounts Owed by Celtic to SemCAMS for Gas Processing After July 22, 2008?***

57 As previously indicated, Celtic does not dispute that the Court has jurisdiction over this issue in context of the

CCAA proceedings but submits that there should be a trial of certain factual issues.

58 SemCAMS submits that the Thirteenth Month Adjustment is a stayed payable under the Initial Order granted in the CCAA proceedings as it simply represents a price adjustment to amounts owing to Celtic from the period January 1, 2007 to July 22, 2008 under the IGPA. SemCAMS submits that Celtic's purported set off is invalid and that the Thirteenth Month Adjustment is properly dealt with pursuant to the Claims Process Order because:

> a) amounts owed by Celtic for post-filing gas processing are owed to SemCAMS as Operator of the KA Plant for the joint account and may not be set off against pre-filing amounts payable by SemCAMS in its individual capacity as purchaser under the IGPA, citing my previous decision in *SemCanada Crude Company, Re*, 2009 ABQB 397 (Alta. Q.B.) ("Trilogy"), leave to appeal refused: *Trilogy Energy LP v. SemCAMS ULC*, 2009 ABCA 275 (Alta. C.A.); or
>
> b) any amendment that may have been made to the IGPA during the CCAA proceedings should not be construed to permit the set off of post-filing amounts payable against pre-filing obligations of SemCAMS, including the Thirteenth Month Adjustment, since that would be contrary to the basic principles of the CCAA and a breach of the Initial Order.

59 Celtic submits that it is entitled to set off the Thirteenth Month Adjustment on the basis of four alternative arguments:

> a) first, Celtic submits that the language of the IGPA should be interpreted as meaning that Celtic is entitled to participate in the Thirteenth Month Adjustment pool in the same way as joint owners and third party processors, that amounts received by SemCAMS from parties who are payors in determining such adjustment are held in trust by SemCAMS and are payable to Celtic and that thus the Thirteenth Month Adjustment is an unaffected claim under the CCAA plan of arrangement;
>
> b) second, Celtic submits that the money owing to Celtic as a Thirteenth Month Adjustment should be treated in the same way as if Celtic was a third party gas processor because the same principles the benefit those processors work to benefit Celtic. Celtic characterizes this as a constructive trust argument;
>
> c) third, Celtic submits that if the raw gas delivered by Celtic to the KA Plant inlets after July 22, 2008 was processed in accordance with the IGPA, Celtic is entitled to contractual and legal set off and the only issue is the question of set off between pre and post filing debts; and
>
> d) fourth, Celtic submits that if its gas was processed pursuant to a Gas Processing Agreement or some other arrangement after July 22, 2008, Celtic is entitled to equitable set off.

60 As previously described, the IGPA is a purchase and sale agreement pursuant to which SemCAMS purchased raw natural gas and other products from Celtic at the KA Plant inlets. The price paid by SemCAMS to Celtic for its gas at the KA Plant outlets is determined using a netback pricing mechanism which is comprised of two key components: (a) the sales price for Sales Gas and Products after the processed gas is sold at the plant outlets; and (b) Gathering & Processing Fees, which are made up of capital fees and operating expenses.

61 The purchase price to be paid by SemCAMS consists of the Sales Price as defined less capital fees and operating expenses as described under the heading in the IGPA entitled "Gathering & Processing Fees".

62 An increase to the Sales Price in a given month results in an increase to the net payment made by SemCAMS to Celtic. Similarly, an increase to operating expenses in a given month resulted in a decrease in the net payment made by SemCAMS to Celtic.

63 After SemCAMS purchased raw natural gas from Celtic at the Plant inlets, it processed the gas at the KA Plant in its capacity as a joint owner of the Plant. As described previously, joint owners make monthly payments to the plant Operator based on projected throughput of delivered gas. At the end of each calendar year, the estimated or projected throughput is reconciled to actual throughput in the Thirteenth Month Adjustment and through periodic audits. The Thirteenth Month Adjustment results in "Equalization Payments", which constitute a redistribution of the funds paid by joint owners and third party users throughout the year at the KA Plant. Equalization payors are invoiced for the amount they underpaid. The invoiced amount is paid to the Operator for the purpose of redistribution, on a *pro rata* basis, to the equalization recipients.

64 The IGPA provides that the operating expenses that form a component of the price paid by SemCAMS to Celtic for the raw gas shall be subject to the Thirteenth Month Adjustment. Specifically, it provides as follows:

> Celtic will be charged the actual operating expenses set each year according to the KA Plant Operating Committee. Celtic will be notified of the operating expenses for 2008 when they are completed, the expenses for 2007 are listed below [...].
>
> These operating costs are subject to the 13th month adjustment. Celtic shall have the right to audit the books, accounts and records of SemCAMS to the extent necessary to verify the accuracy of any statement, charge or computation as per the respective CO&O.

65 Since precise operating expenses are only ascertained following the calculations made at the end of the year, the final price paid by SemCAMS to Celtic under the IGPA for raw gas can only be known once the Thirteenth Month Adjustment is made. As a joint owner, SemCAMS is either an equalization payor or an equalization recipient.

66 If SemCAMS is an equalization payor, Celtic would be required to make a payment to SemCAMS to reflect the Thirteenth Month Adjustment that SemCAMS had to pay to the Operator: this would correct an aggregate annual overpayment by SemCAMS to Celtic for Celtic's raw gas. Similarly, if SemCAMS is an equalization recipient, SemCAMS would be required to make an additional payment to Celtic to reflect the Thirteenth Month Adjustment to the operating expenses. This would correct an aggregate annual underpayment by SemCAMS to Celtic for Celtic's raw gas.

67 SemCAMS was a equalization recipient at the KA Plant for the 2007 year and the period from January 1 to July 22, 2008. Consequently, SemCAMS determined that it owed Celtic $1,414,349.31 pursuant to the Thirteenth Month Adjustment under the IGPA.

68 Celtic's first submission, that the language of the IGPA should be interpreted as giving Celtic the rights to be a direct participant in the Thirteenth Month Adjustment process, fails by reason of the nature of the IGPA. The raw gas purchased by SemCAMS under the IGPA is processed by SemCAMS as the owner of the gas and a joint owner of the KA Plant and nothing incorporates the terms of the KA Plant CO&O Agreements into the IGPA for the benefit of Celtic. While the description of capital fees and operating costs under the heading "Gathering & Processing Fees" refers to Celtic being "charged" these fees, the context of the agreement as a whole and particularly the description of "Sales Price" precludes the interpretation that Celtic is charged these fees and costs by SemCAMS as Operator of the KA Plant, rather than as purchaser of the gas. The last sentence of the "Gathering & Processing Fees" section of the IGPA makes it clear that the raw gas is being processed by SemCAMS as a working interest owner in the KA Plant.

69 In paragraph 47 of the *Trilogy* decision, I considered Trilogy's submission that an inlet gas purchase agreement that included terms substantially similar to the IGPA incorporated and built on previously existing third party Gas Processing Agreements between Trilogy and SemCAMS and that the gas processing agreements and the inlets purchase agreement were thus not distinct contractual obligations. In the context of that submission, I noted that a pro-

vision relating to setting-off processing fees in the inlet gas purchase agreement merely referred to how the final price paid by SemCAMS for the natural gas it purchased from Trilogy in a given month was to be calculated, that there was nothing to suggest that the previous Gas Processing Agreements were incorporated into the inlet gas purchase agreement and that the inlet gas purchase agreement was not a continuation of the Gas Processing Agreements. The same comments can be made in this case. The references to the "13th month adjustment" and the "KA Plant Operating Committee" in the IGPA are benchmark references with respect to how the operating expenses will finally be calculated and do not incorporate the KA Plant CO&O Agreement or any previous Gas Processing Agreement into the IGPA for the benefit of Celtic.

70 As I noted at paragraph 50 of the *Trilogy* decision, references such as these in the IGPA are merely to aid in the formulaic calculation of the sales price SemCAMS is to pay Celtic under the IGPA. The right of audit in the IGPA does not serve to incorporate the CO&O Agreement or to change the status of SemCAMS under the IGPA from purchaser in its own right to Operator of the KA Plant.

71 I noted at paragraph 45 of the *Trilogy* decision that:

> By contrast, the Inlet Purchase Agreement is the only agreement of its kind among the others [CO&O Agreements and third party Gas Processing Agreements], not only because SemCAMS contracted as purchaser of the gas in its' own right, but because it is inconsistent with the pattern of contracting with an Operator for Joint Owners represented by the other contracts, and in fact was entered into deliberately to avoid that situation and its implications for security of access to processing capacity.

72 SemCAMS submits that Celtic's second argument, that it should be treated in essentially the same manner as a third party purchaser under a Gas Processing Agreement with the KA Plant Operator is treated, has also been previously determined in the CCAA proceedings.

73 In the *Auriga/Celtic* decision, Auriga and Celtic submitted that an agency relationship existed under their IGPAs, giving rise to a trust relationship and fiduciary duties between Auriga and Celtic as producers and SemCAMS. I rejected this submission, noting that the producers are sophisticated commercial parties who negotiated their contracts with SemCAMS at arms-length and that the IGPAs do not contain any indication of an intention to create an agency agreement or a trust. I stated at paragraph 9 that:

> The Producers have failed to establish a pattern of conduct or communication that would signal or justify the imposition of a trust or the characterization of the relationship between the Producers and SemCAMS as an agency. As noted in *Zeitler v. Zeitler Estate* (2008), 40 E.T.R. (3d) 185, [2008] B.C.J. No. 1126 at para.70:
>
> In cases in which it is established that there is a contractual relationship between the parties, the interpretation of either facts or documents must not be distorted or given undue emphasis in order to impose the existence of a trust, where a reasonable and impartial interpretation would reveal that such a trust was neither intended nor created.
>
> (emphasis added.)

74 Despite this finding, Celtic submits that comments I made in the *Trilogy* decision amount to a finding of a constructive trust for the benefit of third party producers operating under Gas Processing Agreements and that there is thus no reason why SemCAMS is not also a constructive trustee for the benefit of Celtic.

75 Celtic relies on the description of the equalization process as it operates under the CO&O Agreements among joint owners of plants set out in paragraph 15 of the *Trilogy* decision for its comments on constructive trust. In *Trilogy*, I noted that the plant operator acts as a conduit to facilitate payments under the CO&O Agreements. Later in the

decision at paragraph 21, I found that nine of the sixteen CO&O Agreements that I reviewed in that case gave rise to a contractual trust relationship and that characteristics of a trust relationship pervaded the remaining seven. With respect to the twenty-four Gas Purchase Agreements entered into between Trilogy and SemCAMS as operator at facilities in which Trilogy was not a joint owner, I commented at paragraphs 31 and 32 of the decision when analysing the issue of a whether legal set-off was available to Trilogy that:

> Even if SemCAMS contracting as Operator was not acting as a trustee for the Joint Owners under the CO&O Agreements and the Gas Processing Agreements, it was at a minimum acting as administrator of an account set up for a special purpose. The Joint Owners would surely consider it a misappropriation if money designated for such account was used for the unauthorized purpose of setting-off SemCAMS' debt in its individual capacity.
>
> Thus, whether or not SemCAMS when contracting as Operator was acting as a trustee or on behalf of a "special purpose" Joint Account, the debt owed by SemCAMS in its individual capacity under the Inlet Purchase Agreement cannot be set-off against the debt owed by Trilogy to SemCAMS as Operator under the Gas Processing Agreements or as Operator and Joint Owner under the Trilogy CO&O agreements.

76 Celtic's arguments in this regard ignore the basic distinction between the CO&O Agreements and Gas Processing Agreements on the one hand and the inlet gas purchase agreements on the other that was stressed as part of the *Trilogy* decision. SemCAMS contracts in its own capacity as purchaser of the raw gas at the plant inlet in the inlet gas purchase agreements, while it contracts as Operator of the KA Plant in the CO&O Agreement and in the Gas Processing Agreements. There is a direct contractual relationship between SemCAMS as Operator and the gas producers and joint owners in the CO&O Agreements and the Gas Processing Agreements. Title remains with the owners of the gas under the CO&O Agreements and the Gas Processing Agreements throughout the proceeding. Title transfers to SemCAMS at the KA Plant inlets under the IGPA. SemCAMS as joint owner received the Thirteenth Month Adjustment at issue from SemCAMS as Operator of the KA Plant and owes it to Celtic in its individual capacity under the IGPA.

77 As I indicated in paragraph 27 of the *Trilogy* decision, the very purpose of the IGPA is to avoid any implication that SemCAMS is acting as an Operator under a Gas Processing Agreement rather than in its individual capacity as a joint owner, so as to give Celtic the ability to avoid the risk of being shut out of the plant if the joint owners use their full capacity. While Celtic is entitled contractually to a reconciliation of the sales price for its raw gas in accordance with the Thirteenth Month Adjustment, it is not the beneficiary of a constructive trust with respect to the credit generated by the process. It is noteworthy that the process could also have generated a liability from Celtic to SemCAMS.

78 The Thirteenth Month Adjustment is not a claim that Celtic has against SemCAMS as Operator of the KA Plant, but part of its unsecured claim for the unpaid portion of what SemCAMS as purchaser under the IGPA owed for the raw gas it purchased from Celtic prior to the CCAA filing.

79 Celtic's third argument, that it is entitled to contractual and legal set-off because the debts arise out of the same contract, raises the issue of whether the raw gas delivered by Celtic to SemCAMS after July 22, 2008 was processed in accordance with the IGPA.

80 Celtic submits that, while the Court has jurisdiction over the question of set off during CCAA proceedings, there should be a trial of the issue of whether the IGPA was suspended as alleged by SemCAMS or continued to operate as Celtic alleges. While there is conflicting evidence with respect to what was said by various parties and why on and after July 22, 2008 with respect to the delivery of Celtic's raw gas to the KA Plant and how it continued to be processed, much of that conflicting evidence involves after-the-fact opinions as to the meaning of various emails and letters, or what various Celtic and SemCAMS employees subjectively intended by their actions.

81 While it is appropriate to have regard to the surrounding circumstances or commercial context of an alleged

agreement, and I have had the benefit of that evidence in the affidavits, cross-examinations and documentary evidence of what occurred in the summer and fall of 2008 between the parties, evidence relating to the subjective intentions of the parties, rather than the factual matrix of what occurred, is inadmissible: *Investors Compensation Scheme Ltd. v. West Bromwich Building Society* (1997), [1998] 1 W.L.R. 896 (U.K. H.L.). Much of the alleged "conflicting" evidence relates to such subjective intentions.

82 In addition, evidence of negotiations between the parties is generally inadmissible for the purpose of interpreting the eventual agreement: *The Law of Contracts*, John D. McCamus, Irwin Law Inc., 2005 at page 711. As noted by Professor McCamus, in *Craighampton Investments Ltd. v. Ayerswood Developments Ltd.* (1984), 4 O.A.C. 124 (Ont. C.A.), at 126, the Ontario Court of Appeal commented that "it verges on idle activity for a court to rehash the negotiations, activities and conduct of the parties and hear their professed expression of what their intentions were at an earlier time". Thus, while evidence of negotiations between the parties is admissible as part of the factual matrix of the agreement or to aid in the interpretation of the terms of the agreement, the evidence unhelpful and inadmissible in terms of determining the consensus reached by the parties. The interactions between Mr. Love and Mr. Dachis on July 22 and 23, 2008, while a part of the factual matrix, do not need to be further analysed to determine intention. The July 31, 2008 e-mail from Mr. Dachis to Mr. Love and the August 6, 2008 letter from Celtic's counsel to SemCAMS are the best evidence of the consensus that was finally reached by the parties, and a trial on the differing statements of intention or on what was exactly communicated during negotiations is not necessary.

83 This is not a question of the parole evidence rule. The parties did not intend to reduce their agreement as to what would happen with the IGPA to writing only, and the factual matrix is such that it is clear that the parties intended that any agreement would be both oral and in writing. The relevant prior oral and written communications have been put in evidence in this hearing: no one suggests that any meeting or communication or document relevant to the existence of an agreement is missing. The July 31, 2008 email and the August 6, 2008 letter are the written documents that best confirm an agreement to suspend the IGPA. As noted by Professor McCamus at pages 204 and 205 of his text, the effect of current Canadian jurisprudence is to create a presumption in favour of the written documents. That presumption could be weakened if there was evidence of an oral understanding that is contrary to the terms of the written documents, but there is no admissible evidence that would support an agreement to amend or change the IGPA rather than to suspend it, other than inadmissible evidence of intention or attempts to interpret former communications to fit in with the theory first raised by Celtic in its September 22, 2008 letter from counsel.

84 The question is whether sufficient non-conflicting evidence exists to allow the Court to determine the issue without the necessity of a trial and findings of credibility to resolve issues on which the parties are in conflict.

85 It is common ground that the arrangements between the parties after SemCAMS' filing under the CCAA changed. SemCAMS submits that there are three possible conclusions that can be drawn from what occurred.

86 The first is that there was an agreed suspension of the IGPA. Under this scenario, there can be two alternative interpretations of what occurred. The first, which SemCAMS submits is the correct conclusion, is that SemCAMS first initiated and then SemCAMS and Celtic mutually agreed to the suspension of the IGPA. SemCAMS submits that since SemCAMS initiated the process to suspend, the suspension did not require the consent of the Monitor under the Initial Order, but that at any rate, the Monitor was informed of what was occurring by both SemCAMS and Celtic and reported on the suspension of the inlet purchase agreements to the stakeholders and the Court in the Monitor's Reports.

87 The second alternative, SemCAMS submits, is that Celtic suspended the IGPA, as was within its powers under the agreement to do, as it was apparent to everyone that SemCAMS would be unable to continue to market the processed gas under the IGPA and Celtic was at risk of losing sales, and that the parties agreed to the suspension. SemCAMS concedes that, under this alternative, the Monitor's consent in writing should have been obtained in accordance with the plain language of the Initial Order and that the Monitor did not provide formal written consent with respect to this particular IGPA. However, the Monitor was informed of what was occurring and advised the Court that the inlet purchase agreements were not continuing in its Monitor's Reports. SemCAMS submits that this was tanta-

mount to consent by the Monitor, as it is implicit in the Monitor's Reports that the Monitor was not concerned about the suspension, and that any breach of the Initial Order in this regard was a minor technical breach that can be cured by the Court. The Monitor took no position on this application, and SemCAMS submits that if the Monitor was concerned, it would have expressed such concern to the Court.

88 The second possible conclusion is that there was no agreement to suspend, which is what Celtic alleges and SemCAMS says was not the case given the evidence. SemCAMS submits that, if the Court accepts this conclusion, the evidence establishes that SemCAMS nevertheless proceeded to conduct itself on the basis that the IGPA was suspended and processed Celtic's raw gas as Operator of the KA Plant as if Celtic was a third party producer. SemCAMS submits that this amounts to repudiation of the IGPA by SemCAMS with the attendant consequences as set out under the Initial Order.

89 The third possible conclusion is that the parties agreed to a new arrangement under the IGPA as alleged by Celtic. SemCAMS submits that this is not a viable conclusion since it is clear from the evidence that SemCAMS treated the IGPA as suspended and there is no evidence of an agreement to amend the IGPA, no amendment in writing as required by the IGPA and no Court approval of such an amendment as would be required by the Initial Order. Celtic concedes that there was no amendment of the IGPA, either in writing or merely by agreement, but submits that there was either agreement on a new "arrangement" (impliedly less than an amendment to the IGPA), or waiver by Celtic of the terms of the IGPA.

90 SemCAMS submits that an arrangement that changes the situation under which SemCAMS is obliged to make a cash payment to Celtic for its raw gas at the KA Plant inlets to a situation where Celtic takes the Sales Gas and product at the Plant outlets as payment in kind and agrees to reimburse SemCAMS for the inevitable overpayment which would result is either an amendment that requires agreement in writing. To suggest otherwise, submits SemCAMS, is a contorted view of waiver. SemCAMS thus submits that, if there was no agreement to amend and the change to the IGPA proposed by Celtic cannot be considered a waiver, the Court cannot conclude that the IGPA continued to operate during the period of the CCAA filing, and the only alternatives left are an agreed suspension or an implied repudiation, both of which lead to the same ultimate result on the issues.

91 With respect to the third possible conclusion, that the IGPA continued with the parties agreeing to a new arrangement that did not need to be evidenced in a formal arrangement or that Celtic merely waived certain provisions of the IGPA, I must agree with SemCAMS that these submissions are unsupported by the evidence and by an analysis of the IGPA or by the law of waiver.

92 There is no evidence that SemCAMS agreed to amend the IGPA in the manner suggested by Celtic, and Celtic concedes the lack of a valid amendment. The idea that Celtic would take Sales Gas from the Plant "apparently in payment of the purchase price payable by SemCAMS" first appears in the September 22, 2008 letter from Celtic's counsel to SemCAMS' counsel, which also confirmed that the IGPA required that both waivers and amendments be in writing and executed by both parties. Counsel for Celtic in that letter appears to equate suspension with amendment so as to require mutual agreement in writing under the IGPA. This will be discussed further under the analysis of suspension.

93 The suggestion in Celtic's submissions that the alleged arrangement is less than an amendment of the IGPA and does not require an agreement in writing is unsustainable. As noted by SemCAMS, the effect of this arrangement would be to turn SemCAMS from a monthly debtor under the IGPA to a monthly creditor for the excessive payment for the raw gas that would result from Celtic taking Sales Gas and product in kind. This would not be a minor change to the IGPA but a major change to the way the agreement operates, and would require clear agreement and a formal amendment.

94 This issue does not require further trial, nor does it depend on the credibility of conflicting evidence. What Mr.

Love thought he was doing when he executed the Notice to Take-in-Kind, for instance, is not relevant to the characterization of the suggested arrangement and the question of whether it would require a formal amendment.

95 I also reject the submission that Celtic was merely waiving SemCAMS obligation to pay cash for the raw gas at the KA Plant inlets.

96 What Celtic suggests is a waiver is not just Celtic waiving its right to strict performance, but accepting what it characterizes as an offer by SemCAMS to pay for the raw gas by delivering title to the Sales Gas and product and being paid back the excess value of that delivery. There is no evidence that SemCAMS offered to do this, and what Celtic characterizes as a waiver is essentially the same amendment to the IGPA that it seeks to establish without evidence of agreement in writing. Changes to an agreement that purport to alter a relationship in the way Celtic seeks to establish are properly characterized as amendments and not waivers. Even if the new arrangement could be considered a waiver, counsel to Celtic in the September 22, 2008 letter pointed out that the IGPA provides that waivers must also be in writing under the IGPA.

97 I find, therefore, that the IGPA did not continue to operate during the period of the CCAA proceedings and that Celtic cannot justify set off on the basis of contractual or legal set off. It is therefore not necessary to consider the issue of set off between pre and post filing debts under the same contract. The next question is whether it is possible to address the other possible conclusions identified by SemCAMS without a trial and findings of credibility on conflicting evidence.

98 With respect to whether there was an agreement to suspend the IGPA, SemCAMS references the following evidence:

> a) The July 31, 2008 email from Mr. Dachis to Mr. Love in which he advises that, further to Mr. Love's request, he has spoken to SemCAMS' in-house counsel and that SemCAMS confirms acceptance of the suspension of Celtic's gas delivery under IGPA as of July 22, 2008.
>
> SemCAMS submits that a common sense interpretation of this email means that Celtic's raw gas deliveries under the IGPA had been suspended by agreement. Celtic submits that the email could refer to the suspension of deliveries at the KA Plant outlets, but that interpretation makes no sense, as there were no deliveries of gas at the KA Plant outlets by Celtic, given that ownership of the raw gas transferred to SemCAMS at the KA Plant inlets under the IGPA. It is true that when he was examined by Celtic's counsel, Mr. Dachis said that he was talking about deliveries of Sales Gas in this email. However, that response followed immediately after his comment that his recollection of the email was very vague, "a bit of a stretch" and that he had nothing to do with inlet sales generally. It is clear that Mr. Dachis was only involved with the marketing of Sales Gas in the ordinary course of his employment and his usual contact with Mr. Love was on that topic. It is also clear, however, that Mr. Dachis understood his instructions from Mr. Marine to be to "cut [the inlet gas producers] loose" and to have them repatriate their gas supply. While Mr. Love initially denied making any request as referred to in the email, he later recollected otherwise, and referred to an email from him to Mr. Dachis of July 28, 2008 in which he asked Mr. Dachis to advise that the Notice to Take-in-Kind executed by Celtic had been approved by the Monitor.
>
> I agree that the July 31, 2008 email by its plain meaning refers to SemCAMS' acceptance of the suspension of Celtic's gas deliveries under the IGPA.
>
> b) The August 6, 2008 letter from Celtic's counsel to SemCAMS which "outlines Celtic's new arrangements with respect to the suspension and
>
> renomination of the [IGPA] arising out of the CCAA proceedings" and states that "(e)ffective as of July 22, 2008, SemCAMS accepted the suspension of the [IGPA].

Celtic submits that nothing changed in the relationship between SemCAMS and Celtic as a result of this letter, alluding to evidence of Mr. Wilson's understanding or lack of understanding of the letter. This evidence is unhelpful with respect to the plain meaning of the letter. Celtic's suggestions, made without any evidence to support them, that the references to the suspension of the IGPA were merely "mistakes in expression" by the author of the letter, or that the author of the letter was operating under an "erroneous view"do not detract from the clear and unambiguous language of the letter. While it is true that the letter also refers to Celtic receiving all sales proceeds from products delivered for the raw gas supplied by Celtic directly, it does not reference any amendment of the IGPA in that regard, but follows on the reference to the suspension of the IGPA.

Celtic notes that SemCAMS did not respond to the letter, but there is no reason why it should have responded, given that the references to suspension of the IGPA accorded with its understanding of what had occurred. Celtic also submits that SemCAMS did not take any action as a result of the letter. This is inaccurate, as SemCAMS' next step was to forward draft Gas Processing Agreements to Celtic in its capacity as Operator of the KA Plant.

SemCAMS submits that these two pieces of documentary evidence establish an agreement to suspend the IGPA. Celtic submits that the Court should concentrate on what occurred between Mr. Love and Mr. Dachis during the days following the Initial Order, and that this evidence fails to establish an agreement to suspend. This approach would ignore the documentary evidence that followed and the additional evidence that SemCAMS submits reflects the mutual agreement to suspend the IGPA. I agree.

c) The August 26, 2008 letter from SemCAMS in its capacity as Operator of the KA Plant to Celtic, which references "the suspension of your gas deliveries to [SemCAMS] under the [IGPA] and purports to accept delivery of Celtic's gas under " standard gas handling terms".

It is noteworthy that the September 22, 2008 letter from Celtic's counsel to SemCAMS in which Celtic first denies in writing that the IGPA has been suspended follows in time the dismissal of the application made by Celtic and Auriga for a declaration that the proceeds of sales from products derived from raw gas under the IGPA were held in trust by SemCAMS for the producers and the delivery of draft agreements to Celtic by SemCAMS which made the financial implications of the suspension of the IGPA clear. By this time, however, an agreement to suspend had been reached.

d) The references by the Monitor in its Third and Sixth Report relating to the discontinuance of the purchase of gas at the KA Plant inlets.

99 Initially, Celtic submitted that the Monitor's Reports were hearsay and could not be referred to in evidence. During later submissions however, Celtic indicated that, given the special position of the Monitor as a court appointed officer under the CCAA and having regard to established authority with respect to the acceptability of Monitor's Reports in evidence generally, it had over-stated its position, but nevertheless maintained that it was inappropriate to adduce as evidence portions of the Monitor's Report in this application.

100 There is no reason why these portions of the Monitor's Reports should not be adduced as evidence. As noted by Farley, J. in *Bell Canada International Inc., Re*, [2003] O.J. No. 4738 (Ont. S.C.J. [Commercial List]) at paragraph 6, such reports are recognized as being admissible evidence in a CCAA proceeding. This approach was followed in *Pine Valley Mining Corp., Re*, 2008 BCSC 446 (B.C. S.C.), and in many unreported applications of this kind in Alberta. The excerpts of the Monitor's Report relied upon by SemCAMS do not include inadmissible opinions or conclusions. They are not relied upon to shield SemCAMS from cross-examination. The Monitor is not acting as an advocate for SemCAMS in this application. The excerpts merely establish that the Monitor was aware that the inlet gas purchase arrangements that SemCAMS had entered into pre-filing were no longer in operation. Counsel for the Monitor confirmed that these reports were delivered to the Court and to the stakeholders, and there is no reason to

doubt their reliability.

e) The fact that SemCAMS in its personal capacity ceased purchasing raw natural gas as of July 22, 2008 from any producer.

f) The July 22, 2008 Notice of Take-in-Kind.

101 SemCAMS concedes that this is not alone dispositive of the issue, as the Notice of Take-in-kind may also be interpreted as consistent with Celtic's version of what occurred had there been any other admissible evidence of an agreement to amend the IGPA. SemCAMS submits however, that the Notice of Take-in-Kind is consistent with the suspension of the IGPA and demonstrated a change in the relationship of the parties.

102 Celtic submits that the absence of a document that purports to terminate or override the Change of Ownership Notice that had originally been sent to the KA Plant Operator when the IGPA was first executed is evidence against an agreement to suspend, but the Notice of Take-in-Kind served to alert the Operator that Celtic would be marketing its sales gas and product from July 23, 2008 forward, whatever its normal significance in the oil and gas industry. As Mr. Dachis put it, as a result of this and subsequent Notices of Take-in-Kind delivered by Celtic after July 22, 2008. "Celtic took control of their own gas. That would be the ultimate outcome of that change in procedure"

103 I find that the July 31, 2008 email and the August 6, 2008 letter are evidence that an agreement had been reached between SemCAMS and Celtic to suspend the IGPA because of SemCAMS' inability to market Sales Gas and product as a result of the CCAA proceedings. Other admissible evidence as outlined above supports the conclusion that the parties reached an agreement to suspend. Existence of an agreement to suspend must be ascertained by having regard to the words and acts of the parties as assessed by a reasonable, objective standard:

> If a man's words or acts, judged by a reasonable standard, manifest an intention to agree in regard to any matter, that agreement is established, and it is immaterial what may be the real but unexpressed state of his mind on the subject [...] *Watson v. Manitoba Free Press Co.* (1908), 9 W.L.R. 77 (Man. K.B.), at paras. 6-9.

104 Celtic is a sophisticated commercial entity, acting through experienced counsel, and must be presumed to intend what it has said through its employees and counsel. Celtic submits that the email and letter are "simply after-the-fact attempts by the parties to characterize what had already happened". Indeed, they are objectively discernable acknowledgments by both parties of a meeting of minds and an agreement that the IGPA was suspended.

105 Celtic submits that, if there was an agreement to suspend, it must have happened on July 23, 2008, and that the evidence of Mr. Dachis and Mr. Love does not support the formulation of an agreement. This blurs the distinction between negotiations and final agreement and does not take into account that the meeting of minds necessary to establish an agreement can be evidenced by conduct as well as by words.

106 Celtic also submits that there could not have been an agreement to suspend the IGPA because Celtic would not have agreed to a suspension that relieved SemCAMS of all its obligations, but did not relieve Celtic of its obligations. This refers to Celtic's submission that, after taking the position that the IGPA was suspended, SemCAMS objected to Celtic's stated intention to proceed with the development of a new sour gas processing plant. This issue is more complicated than suggested by Celtic's counsel and mischaracterizes SemCAM'S position. Firstly, Celtic submits that the IGPA does not contain any reference to this project. While Mr. Marine appears to say in an affidavit that the IGPA prevents the construction of the plant, there is an issue with respect to whether a party can take an irrevocable step prohibited by a contract while that contract is merely suspended and not terminated. At any rate, SemCAMS has not asked the Court to find that this was a term of the suspension. It is not accurate to say that only SemCAMS was relieved of its obligations under the IGPA: Celtic was relieved of its obligation to sell raw gas to SemCAMS at the KA Plant inlets.

107 Celtic also submits that there was no agreement to suspend the IGPA because there was no agreement that Celtic gas would be processed under third party Gas Processing Agreements. I agree that there is no evidence of agreement on this issue, as discussed later in this decision. This is not, however, essential to a finding that the parties agreed to suspend the IGPA. Celtic suggests that SemCAMS submits that the agreement to suspend included the term that SemCAMS could unsuspend the IGPA anytime it wanted to. SemCAMS does not take that position, and submits instead that a reinstatement requires the agreement of both parties and that what has changed is that the state of affairs that made performance of SemCAMS' obligations under the IGPA impossible has now been alleviated.

108 Celtic submits that Mr. Love's July 24, 2000 email with its reference to "termination" should be read to include "suspension". There is no reason to read this into the email and no admissible evidence to support such an interpretation.

109 Celtic submits that evidence that an agreement was reached is insufficient, and that there must be specific evidence of when and how that agreement was reached. However, if there is ascertainable documentary evidence that an agreement has been reached, it is not necessary to hold a trial to analyse the negotiations that may have led to such an agreement, particularly on the basis of allegations of subjective intention that contradict the clear meaning of such documentary evidence and the absence of any admissible evidence of a reasonable alternative.

110 Celtic also submits that there can be no suspension of the agreement without a formal amendment in writing. I do not accept this argument. Parties to a contract may by mutual agreement agree to a suspension of that contract even if the contract itself does not specifically provide for it. Such a suspension does not necessarily constitute an amendment of the agreement. If written evidence of such agreement to suspend is required, the email and letter meet such requirement.

111 Having concluded that there is sufficient admissible evidence to support the conclusion that there was an agreement to suspend, it is necessary to consider whether this was pursuant to SemCAMS' first or second alternative. SemCAMS agues that under the first scenario, being that SemCAMS initiated the process and that then there was a mutual agreement to suspend, the consent of the Monitor was not necessary. Celtic correctly points out that the documentary evidence does not support this conclusion. It instead supports the second alternative, that Celtic purported to suspend the IGPA pursuant to its ability to do so under the contract, given SemCAMS' anticipatory breach of its obligation to market the Sales Gas and products. Celtic therefore submits that the Monitor's consent to the suspension should have been obtained and the fact that it was not is evidence that the parties did not consider the IGPA to be suspended. While the Monitor's formal consent should have been obtained, the failure to do so was a minor technical breach of the Initial Order, as it was clear from the Monitor's Reports that it was aware of the suspension. Had an application to relieve such a breach been brought, it would have been successful since the breach was technical and no damage was done in the context of the CCAA proceedings.

112 There is therefore no need to consider the submission that, if no agreement to suspend was reached, this was tantamount to a repudiation of the contact.

113 One additional issue raised by Celtic on the subject of the set off must be addressed: when the negative invoices for the Thirteenth Month Adjustment for 2007 were created and delivered to Celtic. SemCAMS in its responses to undertakings states that the first invoice was created and sent out on or about June 30, 2008. Celtic states that it did not receive the invoice until September, 2009. Celtic submits that it is relevant to the issue of set off as it affects the characterization of the Thirteenth Month Adjustment if it can be established that SemCAMS benefited from the Thirteenth Month Adjustment in 2009 and not 2008. It is not.

114 Celtic's final argument is that if the gas was processed under some form of third party gas processing arrangement or subject to a claim for *quantum meruit*, Celtic is entitled to equitable set off. Although SemCAMS

processed Celtic's raw gas as the Operator of the KA Plant after July 22, 2008, Celtic submits that equitable set-off is still available because the identity of the parties is the same and the obligations arise out of substantially the same relationship: that of a producer delivering gas to the KA Plant for processing. Celtic submits that, although SemCAMS may be acting in two different capacities, it is in the same position financially as a result of the Thirteenth Month Adjustment.

115 SemCAMS submits that this issue was decided in the *Trilogy* decision.

116 In paragraphs 38 to 40 of the *Trilogy* decision, I referenced the principles applicable to equitable set off as set out by the Supreme Court in *Telford v. Holt*, [1987] 2 S.C.R. 193 (S.C.C.) and cases that followed. The first thing to be determined in *Trilogy* was whether the debts sought to be set off arose from closely-related contracts or a closely-related series of events, from the same or a closely related transaction or from inter-related contracts. Trilogy sought to set off amounts owed to it by SemCAMS under an inlet gas purchase agreement against amounts owed by Trilogy to SemCAMS as Operator of various plants under CO&O Agreements (where Trilogy was a joint owner of a plant) and under third party Gas Processing Agreements (where Trilogy was not a joint owner). Since Celtic under in this submission seeks to set off the Thirteenth Party Adjustment owed to it by SemCAMS against amounts owed to SemCAMS as Operator, the factual background is the same as one of the situations dealt with in *Trilogy*. The fact that Celtic may be processing its raw gas subject to some kind of *quantum meruit* basis with SemCAMS as Operator of the KA Plant and not under a formal Gas Processing Agreement does not improve Celtic's situation with respect to a claim of equitable set off.

117 Trilogy made a number of submissions with respect to the degree of connection among the contracts, some of which would be available to or would apply to Celtic in this application. However, my conclusion on the degree of connection between an inlet gas purchase agreement and the Gas Processing Agreements is set out at paragraph 51 of *Trilogy* as follows:

> Trilogy also attempts to draw a connections between the Gas Processing Agreements and the Inlet Purchase Agreement by noting that they all relate to the processing and sale of the same natural gas, such that the result is essentially the same. This ignores the benefits that both parties derived under the Inlet Purchase Agreement that were not available under the previous Gas Processing Agreements at the Facility. The net result cannot be considered a manifestation of similarity when the purpose of the Inlet Purchase Agreement was to change how matters were conducted under the Gas Processing Agreements.

118 I found that the debts sought to be set off did not arise from a closely-related contract: paragraph 55 of *Trilogy*. I agreed that they arose from a series of events (which in Trilogy's case span a decade) but did not arise from the same transaction. The transactions were connected only "in the widest sense of all involving the gathering and processing of Trilogy's natural gas through Facilities operated by SemCAMS". The same can be said in this case.

119 I was not satisfied that Trilogy had established a sufficiently close connection among the debts to establish the right of equitable set off, but noted at paras. 56 and 57 that:

> Even if it had, however, the debts owing by Trilogy to SemCAMS as Operator under the Gas Processing Agreements must be so closely connected with the debt Trilogy owes SemCAMS under the Inlet Purchase Agreement that it would be manifestly unjust to allow SemCAMS to enforce payment without taking into account the cross-claims.
>
> Given the differences in the contracts, both in purpose and in the contracting parties, it cannot be said that it would be manifestly unjust to Trilogy to enforce its indebtedness under the Inlet Purchase Agreement. The Inlet Purchase Agreement was a special-purpose contract, out of the pattern of previous contracts. In addition, the remedy of equitable set-off must not result in any form of inequity: *Canadian Trustco Mortage Co. v. Sugarman*, *supra*,

supra, at para 18.

120 In *Trilogy*, I found that to allow set off against SemCAMS in its capacity as Operator would result in adverse impact on the joint owners of a plant. If equitable set off was allowed only against SemCAMS' share of revenues as a Joint Owner, this would materially complicate the operation of the Joint Account. The issue was not the specific circumstances of a particular creditor and a particular plant, but the precedent that this would set generally. In addition, I noted in paragraph 63 of *Trilogy* the inequity that would arise in the particular CCAA proceedings involving SemCAMS.

121 Allowing equitable set off to Celtic in this CCAA proceeding after denying it to Trilogy and other producers in similar circumstances would raise further issues of inequity. The issue of the availability of equitable set off in these circumstances has been decided in virtually identical circumstances in the *Trilogy* decision.

122 Celtic submits that SemCAMS has not acted honestly and in good faith because "on the evidence that is available it is more probably correct to say that" SemCAMS did not advise Celtic of the Thirteenth Month Adjustment until "it became apparent" that SemCAMS would benefit from a "windfall" at the expense of Celtic by having the Thirteenth Month Adjustment compromised under the plan of arrangement. This allegation is not established by the evidence. As in *Trilogy*, Celtic has the burden of proof of establishing a close connection between the cross-claims and that it would be manifestly unjust not to allow equitable set off. Celtic has not met this burden and is not entitled to set off on this basis.

***Was Celtic a third party gas processor for the period from July 22, 2008 to December 31, 2009.***

123 Since July 23, 2008, SemCAMS has been accepting delivery of Celtic's raw gas at the KA Plant inlets and invoicing Celtic as a standard third party processor. Celtic has calculated what it would be required to pay for processing charges under the IGPA and adding the full amount of operating costs that are invoiced to it by SemCAMS based on an estimate of the year's operating costs. From the sum of these amounts, Celtic deducts five cents per gigajoule of Sales Gas, on the theory that the capital component of the processing costs and the five cent premium were negotiated together so that they should be set off against each other. As a result, from SemCAMS' perspective, Celtic is under paying the amount invoiced by it as Operator by roughly $300,000 per month. The total amount in dispute between the parties to the end of November, 2009, the date that CCAA proceedings came to an end is $4,457,371.85 exclusive of GST.

124 Since I have found that the IGPA was suspended as of July 22, 2008, there remain only two alternatives with respect to the period of time subsequent to the suspension. Either there was an agreement that Celtic should be charged for processing as a normal third party producer or Celtic must pay for the processing of its gas on a *quantum meruit* basis. I find that there was no agreement reached between the parties that Celtic would execute a gas processing agreement on normal third party terms. The remaining alternative is that Celtic should be charged for the processing of its gas on a *quantum meruit* basis.

125 Celtic submits that this Court should not determine what the charges for processing should be on a *quantum meruit* basis for three reasons:

a) the CCAA does not allow the Court to make a summary determination of a claim made by SemCAMS as a creditor as distinct from its status as a debtor and the Court thus lacks jurisdiction to give the relief sought;

b) the application is tantamount to a summary judgment application and SemCAMS has not followed the necessary formalities set out in the *Alberta Rules of Court*;

c) there is a genuine issue to be tried on the question of *quantum merit* and this issue should be set down for trial.

126 While it may be true that the CCAA does not expressly provide for the facilitation of the collection by a CCAA debtor of its post-filing receivables, section 11 provides the Court with broad discretion to deal with matters that arise from or relate to the CCAA proceeding. The issue does not arise from a creditor/debtor relationship that exists apart from the CCAA proceedings, but arises directly as a result of the filing and relates to events that occurred in the course of the CCAA proceedings. It was the suspension of the IGPA due to SemCAMS' status as a CCAA debtor that gave rise to the changed circumstances of the parties and the necessity of determining the basis on which Celtic has continued to process its gas.

127 It is noteworthy that Celtic concedes that the question of set off of the Thirteenth Month Adjustment is within the jurisdiction of the Court under the CCAA. The issue of a CCAA debtor attempting to collect amounts owed to it as a creditor without deduction of amounts alleged to be owed by it as a debtor is what most set off litigation under the CCAA involves. As pointed out by SemCAMS, although Celtic did not claim the right to set off the roughly $30 million it was owed by SemCAMS as a purchaser of Celtic's gas under the IGPA against amounts Celtic owed SemCAMS post-filing for gas processing, if Celtic's argument that the IGPA continued to operate in an amended form had been accepted, there is no reason why Celtic could not have claimed a legal or contractual set off for this debt in addition to the Thirteenth Month Adjustment (subject to the issue of whether it should be permitted to set off pre-filing receivables against post-filing debt). The dispute between the parties if that claim had been made would more closely resemble a typical set off dispute. While this is not a standard set off scenario, the resulting impact on the CCAA process and the position of Celtic vis-a-vis other creditors and stakeholders is similar.

128 The issue of what Celtic should pay for post-filing gas processing also has implications on the question of whether Celtic has a claim for damages relating from the suspension of the IGPA. Celtic says that it has not made such a claim because it takes the position that it should pay the same amount for post-filing gas processing that it paid under the IGPA. SemCAMS submits that this would put it in the position of having to absorb the shortfall personally and that this would be tantamount to indemnifying Celtic for potential damages arising from the suspension of the IGPA while other unsecured creditors had similar claims compromised under the plan of arrangement. This issue therefore involves the integrity of the CCAA process and the need to prevent manipulation of the process so as to allow one creditor to obtain a benefit not available to others, and is an additional reason why the question falls within the jurisdiction of the CCAA Court.

129 Celtic submits that resolution of this issue is not essential to the restructuring. It is not a pre-requisite to the Court's jurisdiction that the resolution of a dispute must be necessary for a CCAA debtor to reach an arrangement with its creditors: the Court must also have regard to the integrity of the process and the comparative treatment of creditors. As noted in *Meridian Development Inc. v. Toronto Dominion Bank*, [1984] 5 W.W.R. 215, 52 C.B.R. (N.S.) 109 (Alta. Q.B.), at 114, the CCAA is intended to "prevent any manoeuvres for positioning among creditors during the interim period which would give the aggressive creditor an advantage to the prejudice of others who were less aggressive." SemCAMS is in essence arguing that what Celtic alleges it should pay for post-filing gas processing falls within this category of manoeuvring for position. I accept that it does. For all of these the reasons, the determination of this issue is within the Court's jurisdiction.

130 I must next determine whether there is a genuine evidentiary issue on the question of *quantum meruit* that would require a trial to resolve.

131 Celtic submits that this part of SemCAMS application is, in effect, an application for summary judgement, and that the criteria and process set out in *Rule* 159 of the *Alberta Rules of Court* ought to be applied, including the requirement of an affidavit by someone who expresses the belief that there is no genuine issue to be tried or that the only genuine issue is as to amount.

132 This application was brought pursuant to section 11 of the CCAA, and did not arise from the filing of a

Statement of Claim and a Statement of Defence. SemCAMS submits, and I agree, that the situation is more analogous to the commencement of an action by originating notice where the party bringing the motion is required to put before the Court sufficient evidence to warrant granting the relief sought. The formal requirements of *Rule* 159 need not be observed, even if the analogy to *Rule* 159 could be considered to be apt, if the applicant establishes sufficient and satisfactory evidence for the relief sought.

133 The CCAA procedure envisages that there may need to be a summary determination of issues that arise during or as a result of the CCAA filing, and there is no need for *Rule* 159 to provide an alternative to a full trial in such circumstances. As I indicated in discussing the various submissions with respect to set off, SemCAMS has provided sufficient and appropriate admissible evidence to support the finding that the IGPA was suspended. The parties have also adduced appropriate and admissible evidence on the issue of *quantum meruit*. There is no conflict on the evidence, merely a disagreement as to which approach is reasonable and equitable.

134 Celtic submits that the process has not been satisfactory, that Celtic has been deprived of the opportunity to have a full hearing of the issues. On the contrary, although certain procedural steps were not observed and time limits were theoretically truncated, there was full opportunity for the parties to cross-examine affiants, to require undertakings, to conduct further cross-examination on responses to undertakings, and to examine former employees of SemCAMS. Celtic could have sought to examine other employees, but did not take steps to do so. The Motion Record consists of five large volumes of documents and evidence. The hearing was adjourned a number of times and was finally argued over roughly two and a half days with opportunities for briefs to be filed in advance and during the course of the application. I find that the evidentiary record is sufficient to determine the issue of quantum meruit.

***What Should Celtic Pay on a Quantum Meruit Basis for the Processing of Its Gas at the KA Plant from July 23, 2008 to the Termination of CCAA Proceedings?***

135 There is no dispute about what SemCAMS purports to charge Celtic as a third party producer on standard terms and no dispute as to what Celtic has been paying and submits it should continue to pay. There is no conflict in the evidence necessary to make a determination, only a question of how the principles of *quantum meruit* should be applied.

136 *Quantum meruit* operates both as a contractual doctrine and as a quasi-contractual or restitutionary doctrine. In a quasi-contractual setting such as exists here, remuneration is paid on a *quantum meruit* basis when one person performs services at the request of another or freely accepts the services with the understanding that they are not rendered gratuitously: GHL Fridman, *Restitution*, 2nd ed. (Toronto: Thomson Canada Limited, 1992) at 289-290.

137 Recovery under the quasi-contractual doctrine of *quantum meruit* is based on the fulfilment of the following pre-requisites: (1) an understanding on the part of the recipient of the services that they are not rendered gratuitously; (2) a special relationship between the parties, frequently, as here, contractual at the outset, which would make it unjust for one party to retain a benefit conferred upon it by the other; (3) the parties failed to reach an agreement on compensation: Fridman, *supra* at 289 - 295.

138 The obligation to pay reasonable remuneration for services performed where there is no binding contract between the parties in that regard is imposed by a rule of law and not by an inference of fact arising from the acceptance of services or goods: *Craven-Ellis v. Canons Ltd.*, [1936] 2 K.B. 403, [1936] 2 All E.R. 1066 (Eng. C.A.), at 412. It is not an obligation on the ground of implied contract but imposed by the Court under the circumstances of the case on what the Court decides is just and reasonable, having regard to the relationship of the parties: *Brook's Wharf & Bull Wharf Ltd. v. Goodman Brothers* (1936), [1937] 1 K.B. 534, [1936] 3 All E.R. 696 (Eng. C.A.), at 545.

139 SemCAMS submits that, as the only fee structure open to Celtic if it wishes to have its gas processed at the KA Plant is that available to any other non-owner third party gas processor, the standard terms of processing should be

paid by Celtic. It also submits that, as Operator of the KA Plant, it cannot agree to the terms it had negotiated with Celtic when it was negotiating as a joint owner with capacity to use and the ability to market the Sales Gas, and that, if it did so, it would have to bear in its individual capacity the difference between standard operating costs and the lower costs that Celtic is saying should be payable as it could not as Operator pass that difference on to the joint owners of the KA Plant.

140 Celtic submits that its proposal covers operating costs and a capital cost component, and reflects what was previously negotiated under the IGPA. This, of course, ignores the difference between SemCAMS as Operator of the KA Plant and SemCAMS in its individual capacity. In addition, the negotiated amount was a negotiated amount under the IGPA which was suspended, and not a negotiated amount relating to a new gas processing arrangement.

141 Celtic concedes that in *Deglman v. Guaranty Trust Co. of Canada*, [1954] S.C.R. 725 (S.C.C.), Rand J. accepted the principle that the provider of the services is entitled to recover for those services what the recipient would have had to pay for them on a purely business basis to any other person in the position of the recipient, but seeks to distinguish Celtic's situation on the basis that Celtic and SemCAMS had negotiated an agreement. This is not a situation where the parties negotiated an agreement that is merely not enforceable for reasons of non-compliance with the Statute of Frauds: the parties have not negotiated an agreement on the provision of gas processing services by SemCAMS as Operator of the KA Plant, and reference to the price negotiated under the IGPA is not the same thing.

142 I find, therefore, that the standard charges and terms of processing charged by SemCAMS as Operator of the KA Plant with respect to third party gas processors are an appropriate measure of compensation, on a quantum meruit basis, as those charges represent the best evidence of the value of the services in the market to a non-owner gas producer in the position of Celtic.

143 *Is Celtic's purported damages claim against SemCAMS barred by the Claims Process Order and would it have been compromised under the CCAA plan of arrangement had it been made prior to the Claims Bar Date?*

144 Celtic points out that it has not made a claim for damages arising from the suspension of the IGPA. It is thus premature to rule on whether Celtic would be barred from filing a late claim in the CCAA proceedings. However, it is clear that such a claim, if allowed, would be subject to compromise in accordance with the plan of arrangement filed in these proceedings.

***What Arrangement Governs the Relationship Between SemCAMS and Celtic on a Go-Forward Basis?***

145 As the parties did not make oral submissions on this issue at hearing, I have not addressed it.

**Conclusion**

146 I have found that the IGPA was suspended and that Celtic is not entitled to set off the Thirteenth Month Adjustment against amounts owing to SemCAMS as operator for gas processing after July 22, 2008. I have found that Celtic should pay for such gas processing from July 23, 2008 until the CCAA proceedings were terminated on a *quantum meruit* basis in accordance with standard charges and terms of processing as imposed by SemCAMS as Operator of the KA Plant with respect to third party gas processors. I found that it was premature to make a determination of whether Celtic should be allowed to make a late claim for damages arising from the suspension of the IGPA. I did not make a determination with respect to the arrangement governing the parties from the termination of CCAA proceedings going forward.

147 If the parties are unable to agree on costs, that issue may be addressed.

*Application granted.*

2010 CarswellAlta 1702, 2010 ABQB 531, [2010] A.W.L.D. 4907, [2010] A.W.L.D. 5015

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2008 CarswellAlta 661, 2008 ABQB 286, [2008] A.W.L.D. 2547, [2008] A.W.L.D. 2548, [2008] A.W.L.D. 2546, 42 C.B.R. (5th) 293, 70 C.L.R. (3d) 46, 91 Alta. L.R. (4th) 202, [2008] 12 W.W.R. 355, 449 A.R. 185

2008 CarswellAlta 661, 2008 ABQB 286, [2008] A.W.L.D. 2547, [2008] A.W.L.D. 2548, [2008] A.W.L.D. 2546, 42 C.B.R. (5th) 293, 70 C.L.R. (3d) 46, 91 Alta. L.R. (4th) 202, [2008] 12 W.W.R. 355, 449 A.R. 185

Kerr Interior Systems Ltd., Re

In the Matter of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 as Amended

In the Matter of the Plan of Compromise or Arrangement of Kerr Interior Systems Ltd. and Composite Building Systems Inc.

Alberta Court of Queen's Bench

M.B. Bielby J.

Heard: April 4, 2008
Judgment: May 16, 2008
Docket: Edmonton 0703-14357



Counsel: Darren R. Bieganek for Applicants, Kerr Interior Systems Ltd., Composite Building Systems Inc.

James Hanley for Winroc, A Division of Superior Plus LP

James Ehmann, Q.C. for Kenroc Building Materials Co. Ltd.

Jeremy H. Hockin for Monitor, Bill McCulloch & Associates Inc.

Subject: Insolvency; Contracts; Corporate and Commercial

Bankruptcy and insolvency --- Proposal — Companies' Creditors Arrangement Act — Miscellaneous issues

Plan of arrangement under Companies' Creditors Arrangement Act ("CCAA") would see 34 creditors paid 52 per cent of debt owed to them by two debtor companies — All creditors were placed into one class for purpose of voting on plan — Of 34 proven creditors, 28 of them, holding about 84 per cent of debt, voted to approve plan — Two creditors opposed plan — Debtors brought application for order amending plan to increase amount to be paid to unsecured creditors and for order sanctioning plan — Opposing creditor brought application for, inter alia, order directing that plan be amended to classify opposing creditors as sole secured creditors — Plan of arrangement sanctioned — Opposing creditors were not secured creditors within definition of that term in s. 2 of CCAA although they had filed builders' liens in Saskatchewan and were beneficiaries of trust created by s. 7 of Saskatchewan Builders' Lien Act — Liens that attached to property of third party rather than property of debtor did not create secured claim under CCAA — Trust was merely statutory or deemed trust as it did not attach to traceable or existing asset belonging to debtor at time original stay was granted under CCAA and so did not fall within type of trust caught be definition of secured creditor in CCAA.

2008 CarswellAlta 661, 2008 ABQB 286, [2008] A.W.L.D. 2547, [2008] A.W.L.D. 2548, [2008] A.W.L.D. 2546, 42 C.B.R. (5th) 293, 70 C.L.R. (3d) 46, 91 Alta. L.R. (4th) 202, [2008] 12 W.W.R. 355, 449 A.R. 185

Bankruptcy and insolvency --- Proposal — Companies' Creditors Arrangement Act — Arrangements — Approval by court — Miscellaneous issues

Plan of arrangement under Companies' Creditors Arrangement Act ("CCAA") would see 34 creditors paid 52 per cent of debt owed to them by two debtor companies — All creditors were placed into one class for purpose of voting on plan — Two creditors opposed plan — Debtors brought application for order amending plan to increase amount to be paid to unsecured creditors and for order sanctioning plan — Opposing creditor brought application for, inter alia, order directing that plan be amended to classify opposing creditors as sole secured creditors — Plan of arrangement sanctioned — That opposing creditors were only creditors with builders' liens registered in Saskatchewan and governed by Saskatchewan Builders' Lien Act did not justify creating separate class for them — Other potential Saskatchewan lien claimants existed — Trust remedies created by s. 7 of Saskatchewan Builders' Lien Act did not bind fund paid into court by third party in Saskatchewan to obtain discharge of opposing creditors' liens — It would result in excessive fragmentation — Legal interests of opposing creditors were identical to those of 65 per cent of all creditors as all were lien claimants or potential lien claimants — Classifying opposing creditors separately would jeopardize realization of viable plan — Vast majority of creditors supported plan — Requirements of CCAA were met — Given intertwined nature of businesses of two debtors, fact that they were owned by same party, fact that one supplied products solely for other and existence of their cross-guarantees, consolidation of their two CCAA applications met letter and spirit of CCAA.

Bankruptcy and insolvency --- Proposal — Companies' Creditors Arrangement Act — Arrangements — Approval by court — "Fair and reasonable"

Plan of arrangement under Companies' Creditors Arrangement Act ("CCAA") would see 34 creditors paid 52 per cent of debt owed to them by two debtor companies — All creditors were placed into one class for purpose of voting on plan — Of 34 proven creditors, 28 of them, holding about 84 per cent of debt, voted to approve plan — Two creditors opposed plan — Debtors brought application for order amending plan to increase amount to be paid to unsecured creditors and for order sanctioning plan — Opposing creditor brought application for, inter alia, order directing that plan be amended to classify opposing creditors as sole secured creditors — Plan of arrangement sanctioned — Approval of plan would allow debtors to remain in business, to complete construction projects they were engaged in, to undertake new work that was available to them, to continue to satisfy debt of their secured creditors who supported plan, and to discharge all other debt owed by them — Monitor's analysis showed that of 34 proven creditors only eight would be better off under lien fund than under plan and, of those creditors, six voted in favour of plan — Overwhelming creditor support for plan led to conclusion that it was fair and reasonable.

**Cases considered by *M.B. Bielby J.*:**

*Alternative Fuel Systems Inc., Re* (2004), 2004 ABCA 31, 2004 CarswellAlta 64, 47 C.B.R. (4th) 1, 236 D.L.R. (4th) 155, (sub nom. *Remington Development Corp. v. Alternative Fuel Systems Inc.)* 346 A.R. 28, (sub nom. *Remington Development Corp. v. Alternative Fuel Systems Inc.)* 320 W.A.C. 28, 24 Alta. L.R. (4th) 1, [2004] 5 W.W.R. 475 (Alta. C.A.) — considered

*Arthur Andersen Inc. v. Merit Energy Ltd.* (2004), 37 C.L.R. (3d) 192, 254 Sask. R. 161, 336 W.A.C. 161, 2004 SKCA 124, 2004 CarswellSask 653, [2005] 4 W.W.R. 603, (sub nom. *Merit Energy Ltd. (Receiver of) v. Merit Energy Ltd.)* 245 D.L.R. (4th) 496, 7 C.B.R. (5th) 26 (Sask. C.A.) — considered

*British Columbia v. Henfrey Samson Belair Ltd.* (1989), 1989 CarswellBC 711, [1989] 1 T.S.T. 2164, 75 C.B.R. (N.S.) 1, [1989] 2 S.C.R. 24, 34 E.T.R. 1, [1989] 5 W.W.R. 577, 59 D.L.R. (4th) 726, 97 N.R. 61, 38 B.C.L.R. (2d) 145, 2 T.C.T. 4263, 1989 CarswellBC 351 (S.C.C.) — considered

2008 CarswellAlta 661, 2008 ABQB 286, [2008] A.W.L.D. 2547, [2008] A.W.L.D. 2548, [2008] A.W.L.D. 2546, 42 C.B.R. (5th) 293, 70 C.L.R. (3d) 46, 91 Alta. L.R. (4th) 202, [2008] 12 W.W.R. 355, 449 A.R. 185

*Canadian Airlines Corp., Re* (2000), 80 Alta. L.R. (3d) 213, 2000 ABCA 149, 2000 CarswellAlta 503, 19 C.B.R. (4th) 33, 261 A.R. 120, 225 W.A.C. 120 (Alta. C.A. [In Chambers]) — referred to

*Canadian Airlines Corp., Re* (2000), 19 C.B.R. (4th) 12, 2000 CarswellAlta 623 (Alta. Q.B.) — considered

*Canadian Airlines Corp., Re* (2000), [2000] 10 W.W.R. 269, 20 C.B.R. (4th) 1, 84 Alta. L.R. (3d) 9, 9 B.L.R. (3d) 41, 2000 CarswellAlta 662, 2000 ABQB 442, 265 A.R. 201 (Alta. Q.B.) — referred to

*D & K Horizontal Drilling (1998) Ltd. (Trustee of) v. Alliance Pipeline Ltd.* (2002), 33 C.B.R. (4th) 217, [2002] 6 W.W.R. 497, 17 C.L.R. (3d) 161, 2002 SKQB 86, 2002 CarswellSask 168, (sub nom. *D & K Horizontal Drilling (1998) Ltd. (Bankrupt) v. Alliance Pipeline Ltd.)* 216 Sask. R. 199 (Sask. Q.B.) — considered

*Deloitte, Haskins & Sells Ltd. v. Alberta (Workers' Compensation Board)* (1985), [1985] 1 S.C.R. 785, 1985 CarswellAlta 319, 1985 CarswellAlta 613, 19 D.L.R. (4th) 577, [1985] 4 W.W.R. 481, 60 N.R. 81, 38 Alta. L.R. (2d) 169, 63 A.R. 321, 55 C.B.R. (N.S.) 241 (S.C.C.) — referred to

*John M.M. Troup Ltd. v. Royal Bank* (1962), 3 C.B.R. (N.S.) 224, 34 D.L.R. (2d) 556, 1962 CarswellOnt 42, [1962] S.C.R. 487 (S.C.C.) — considered

*Northland Properties Ltd., Re* (1988), 73 C.B.R. (N.S.) 175, 1988 CarswellBC 558 (B.C. S.C.) — referred to

*Northland Properties Ltd., Re* (1989), (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada)* 73 C.B.R. (N.S.) 195, (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada)* [1989] 3 W.W.R. 363, (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada)* 34 B.C.L.R. (2d) 122, 1989 CarswellBC 334 (B.C. C.A.) — considered

*NsC Diesel Power Inc., Re* (1990), 79 C.B.R. (N.S.) 1, 97 N.S.R. (2d) 295, 258 A.P.R. 295, 1990 CarswellNS 33 (N.S. T.D.) — considered

*Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 17 C.B.R. (3d) 1, (sub nom. *Olympia & York Developments Ltd., Re)* 12 O.R. (3d) 500, 1993 CarswellOnt 182 (Ont. Gen. Div.) — considered

*PSINET Ltd., Re* (2002), 33 C.B.R. (4th) 284, 2002 CarswellOnt 1261 (Ont. S.C.J. [Commercial List]) — referred to

*Sammi Atlas Inc., Re* (1998), 1998 CarswellOnt 1145, 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]) — referred to

*Scaffold Connection Corp., Re* (2000), 2000 CarswellAlta 60, 2000 ABQB 33, [2000] 7 W.W.R. 516, 2 C.L.R. (3d) 117, 79 Alta. L.R. (3d) 144, 15 C.B.R. (4th) 289 (Alta. Q.B.) — considered

*Sovereign Life Assurance Co. v. Dodd* (1892), [1891-94] All E.R. Rep. 246, [1892] 2 Q.B. 573 (Eng. C.A.) — considered

*Stelco Inc., Re* (2005), 2005 CarswellOnt 6818, 204 O.A.C. 205, 78 O.R. (3d) 241, 261 D.L.R. (4th) 368, 11 B.L.R. (4th) 185, 15 C.B.R. (5th) 307 (Ont. C.A.) — referred to

*Sulphur Corp. of Canada Ltd., Re* (2002), 2002 CarswellAlta 896, 2002 ABQB 682, [2002] 10 W.W.R. 491, 5 Alta. L.R. (4th) 251, 319 A.R. 152, 35 C.B.R. (4th) 304 (Alta. Q.B.) — considered

*Wellington Building Corp., Re* (1934), 16 C.B.R. 48, [1934] O.R. 653, 1934 CarswellOnt 103, [1934] 4 D.L.R. 626 (Ont. S.C.) — referred to

*373409 Alberta Ltd. (Receiver of) v. Bank of Montreal* (2002), 2002 SCC 81, 8 Alta. L.R. (4th) 199, 2002 CarswellAlta 1573, 2002 CarswellAlta 1574, [2003] 2 W.W.R. 1, 317 A.R. 349, 284 W.A.C. 349, [2003] R.R.A. 1, (sub nom. *Bank of Montreal v. Ernst & Young Inc.)* 220 D.L.R. (4th) 193, (sub nom. *373409 Alberta Ltd. v. Bank of Montreal)* 296 N.R. 244, 29 B.L.R. (3d) 1, [2002] 4 S.C.R. 312 (S.C.C.) — considered

**Statutes considered:**

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

Generally — referred to

s. 67(1)(a) — referred to

*Builders' Lien Act*, S.S. 1984-85-86, c. B-7.1

Generally — referred to

s. 7 — referred to

s. 7(1) — considered

s. 7(1)(a) — considered

s. 7(1)(b) — considered

s. 7(2) — considered

s. 13 — referred to

s. 18(1) — referred to

s. 22(1) — referred to

s. 37 — referred to

*Builders' Lien Act*, R.S.A. 2000, c. B-7

s. 18 — referred to

s. 21 — referred to

s. 23 — referred to

s. 25 — referred to

*Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36

Generally — referred to

s. 2 "debtor company" — referred to

s. 2 "secured creditor" — considered

s. 2 "unsecured creditor" — referred to

s. 4 — considered

s. 5 — considered

s. 6 — considered

s. 6(a) — referred to

s. 11 — referred to

s. 12 — referred to

*Social Service Tax Act*, R.S.B.C. 1996, c. 431

Generally — referred to

**Tariffs considered:**

*Queen's Bench Rules*, Sask. Q.B. Rules

Tariff of Costs, Sched. I "C", item 1 — referred to

APPLICATION by debtors for order amending plan under *Companies' Creditors Arrangement Act* to increase amount paid to unsecured creditors and for order sanctioning plan; APPLICATION by opposing creditor for, inter alia, order directing that plan be amended to classify opposing creditors as secured creditors.

***M.B. Bielby J.*:**

**Decision**

1 A Plan of Arrangement under the *Companies Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ('CCAA') which would see 34 creditors paid 52% of the debt owed to them by two debtor companies was sanctioned over the opposition of 2 of those creditors, holding between them 3% of the total debt. All creditors had been placed into one class for the purpose of voting on the Plan of Arrangement ('the Plan') although 65% of them had possible additional recovery rights on insolvency as a result of having registered or unregistered lien claims. Of the 34 proven creditors 28 of them, holding approximately 84% of the debt, voted to approve the Plan, including 6 creditors who would likely have been

better off advancing a lien claim if the debtor companies were liquidated than they would be under the Plan.

2 The 2 opposing creditors were not secured creditors within the definition of that term in s. 2 of the CCAA although they had filed builders' liens in Saskatchewan and were also the beneficiaries of a trust created by s. 7 of the Saskatchewan *Builders' Lien Act*, S.S. 1984-85-86, c. B-7.1 as amended ('Sask BLA.'). While some liens create a secured claim under the CCAA those which have attached to the property of a third party rather than the property of the debtor do not. The trust was merely a statutory or 'deemed' trust as it did not attach to a traceable or existing asset belonging to the debtor at the time the original stay was granted and so did not fall within the type of trust caught by the definition of secured creditor in the CCAA.

3 No conflict exists between the definition of 'secured creditor' in the CCAA and the provisions of the Sask BLA. The CCAA treats some types of liens and trusts created under the provincial legislation as creating secured claims for the purpose of its operation while excluding others. Any such exclusions do not impact on the effect of those liens and trusts for any other purpose including, in particular, the rights of lien-holders where no application under the CCAA has been made.

4 While the debtors failed to create a separate class for those creditors with actual or potential builders' lien claims in its application for reorganization, placing these creditors into the same class as unsecured creditors with no lien potential did not amount to a breach of the provisions of the CCAA in these circumstances. Placing the 2 opposing creditors in a separate class with all potential lien-holders would not likely have affected the results of the vote on the Plan given that a significant majority of those voting both by number and by value of claim, including the potential lien claimants, approved it.

5 While the opposing 2 creditors were the only creditors with builders' liens registered in the Province of Saskatchewan and therefore governed by the Sask BLA, that did not justify creating a separate, 2 member class for them alone because:

i. other potential Saskatchewan lien claimants exist; they were unable to file builders' liens because of the stay provisions of a court order granted November 7, 2007 to allow the Applicants time to negotiate and present a Plan of Arrangement for sanction; one of the 2 opposing debtors, Kenroc, filed its lien in breach of those stay provisions, having failed to apply for and obtain leave of the court in advance of so filing; it would be unseemly to grant it better rights because of a breach of court order than it would otherwise have had;

ii. the trust remedies created by s. 7 of the Sask BLA do not bind the fund of $150,000 paid into court by a third party in Saskatchewan to obtain the discharge of the opposing creditors' liens because that fund did not exist as of the date of the granting of the stay order; as of that date there was no asset to which a trust could attach; the type of trust required to create a secured claim under the CCAA requires an identifiable asset which is the subject of a trust;

iii. it would result in excessive fragmentation, especially given that it is far from certain the 2 opposing creditors would receive more from their lien claims than under the Plan; if sufficient other lien claimants filed liens in Saskatchewan upon the termination of the stay, recovery by the 2 opposing creditors from the monies held in court in that province could well be reduced to less than 52% of the amount of their claims;

iv. the legal interests of the opposing creditors are identical to those of 65% of all creditors in that they are all lien claimants or potential lien claimants;

v. classifying the opposing creditors separately would jeopardize the realization of a viable Plan;

vi. the vast majority of the creditors of all types voting on the Plan both in number and by value of claim supported

the Plan; this is evidence that the Plan is fair and equitable.

6 The Court should hesitate to exercise its discretion to amend a Plan of Arrangement itself to direct that certain creditors be paid out in full as a condition of sanction even if it has the power to do so.

**Facts**

7 Composite Building Systems Inc. ('Composite') specializes in prefabricating and panelizing load bearing steel stud walls with materials suited to the construction of apartments, condominiums and care facilities. Composite manufactures materials for one customer only, Kerr Interior Systems Ltd. ('Kerr'). Kerr is in the business of installing walls, ceilings, floors, and partitions in construction. While it has its own business separate from the installation of Composite's prefabricated walls, Composite's sole revenue source is from the prefabricated component purchases made by Kerr. Kerr and Composite are each fully owned subsidiaries of 1005559 Alberta Ltd.('105'). Some of the debts owed by one of Composite and Kerr ('the Debtors') are cross-guaranteed by the other.

8 Kerr and Composite ('the Debtors') found themselves in financial difficulties caused in part by their having given fixed price bids for projects in a time of rapidly escalating labour and material costs. With the support of their banker and other major secured creditor they engaged counsel to attempt to compromise their debt obligations, satisfy their outstanding construction contracts and remain in business.

9 To that end, on November 7, 2007 I granted an order ('the stay order') declaring the Debtors to be entities to which the CCAA applied and granting a stay of proceedings as follows:

> II)...no proceeding or enforcement process in any court or tribunal nor the taking of any self help or enforcement process in any court or tribunal nor the taking of any self help or seizure remedies (each, a 'proceeding') shall be commenced or continued against or in respect of the Applicants or the Monitor or affecting the Business or Property, except with the leave of this Court, and any and all proceedings currently underway against or in respect of the Applicants or affecting the Business or Property are hereby stayed and suspended pending further order of this Court.

10 Following the granting of the stay the Debtors prepared the Plan for review and approval by the creditors and the court.

11 Should the Plan be approved the Debtors will settle approximately $5 million in debt for $2.6 million. On April 4, 2008 the Applicants applied before me for court sanction of that Plan. Opposed were two creditors, Kenroc Building Materials Co. Ltd. ('Kenroc') and Winroc, a Division of Superior Plus LP ('Winroc'), each of which supplied materials as subcontractors to Kerr on a building project in Saskatoon, Saskatchewan. The debt owed to Kenroc and Winroc totals approximately $150,000 and represents about 3% of the debt addressed by the Plan.

12 Kenroc was served with a copy of the stay order on November 9, 2007. Without seeking or obtaining leave of this Court it nonetheless registered a lien with Land Titles Registry in the Province of Saskatchewan on November 15, 2007 against title to a building owned by 101051911 Saskatchewan Ltd. ("101") in the amount of $103,355.23. 101 is a third party with no relationship to 105 other than having hired the Debtors to be contractors on a project to construct a building.

13 Between June 2007 and November 2007 Winroc supplied materials and other services, for which it has not been paid, to Kerr for use in the renovations conducted by it on that building. On November 6, 2007 it filed a builders' lien in the value of $46,425.26 at the Saskatchewan Land Titles Registry against the title to that building. Winroc is also owed additional debt by Kerr in the approximate amount of $170,000 which is unarguably unsecured.

2008 CarswellAlta 661, 2008 ABQB 286, [2008] A.W.L.D. 2547, [2008] A.W.L.D. 2548, [2008] A.W.L.D. 2546, 42 C.B.R. (5th) 293, 70 C.L.R. (3d) 46, 91 Alta. L.R. (4th) 202, [2008] 12 W.W.R. 355, 449 A.R. 185

14 Without seeking nor obtaining the leave of this Court, on November 9, 2007 Winroc sued Composite in the Judicial District of Calgary for $138,749.27 in debt. No steps appear to have been taken in that action beyond the filing of the Statement of Claim.

15 101 encountered difficulties drawing down its construction financing due to the existence of these 2 liens with the result that it paid the sum of $150,000 into the Saskatchewan Court of Queen's Bench after the date of the stay order. The two liens were then discharged by order of the Court of Queen's Bench of Saskatchewan on January 18, 2008. This sum continues to be held by that court.

16 Subsequent to the granting of the stay order the Debtors continued to work to complete the construction contracts then outstanding. They have continued to operate their businesses in the ordinary course on the basis of existing cash flows. They have neither expanded their indebtedness through debtor-in-possession financing nor incurring fresh debt to their bankers. As anticipated by the Plan, Kerr reduced the size of its secured debt by $500,000 by the end of March 2008. Kenroc has continued to supply materials to Kerr for the work on the 101 building and has been paid $223,000 for these materials since the date of the stay order.

17 The Plan creates a single creditor class, defined as "unsecured creditors", which includes Kenroc and Winroc. Of those creditors whose claims were eventually found to be "proven" by the Monitor under the CCAA claims procedure, 65% have rights to liens or as trust beneficiaries under builders' lien legislation in Alberta and Saskatchewan. The Plan, if sanctioned by this Court, would see Kenroc and Winroc repaid 52% of the debt owed to it on November 7, 2007, the same percentage as all unsecured creditors, to be paid on the following basis:

a. the first 10% of the payments due will be made within 45 days of court sanction of the Plan;

b. the next 30% will be paid within 6 months of court sanction of the Plan;

c. the next 30% will be paid within 12 months of court sanction of the Plan; and

d. the balance will be paid within 18 months of court sanction of the Plan.

18 Once these payments have been made the $150,000 which was paid into court by 101 would be paid to Kerr. Kenroc and Winroc will have no further right to make any claim against Kerr as a result of their liens, nor otherwise in relation to the 48% of the debt which will remain unpaid. In other words the security standing in place of their builders' liens would be discharged.

19 On March 5, 2008 Bill McCulloch and Associates, the Monitor appointed by the stay order, rejected the Kenroc and Winroc claims for secured creditor status pursuant to the claims procedure established by this Court by order dated January 24, 2008. Kenroc and Winroc disputed their categorization as members of the unsecured creditor class in writing in a timely fashion.

20 The Royal Bank of Canada and Co-operators Investment Counseling Ltd. are the Debtors' major secured creditors. Both are supportive of the Plan and the proposal that the Debtors continue to operate in the future. The balance of any secured claims are either equipment leases which continue to be paid in the ordinary course of business or other smaller secured debt obligations which are not otherwise affected by the Plan.

21 A meeting of creditors to vote on the Plan was held in Edmonton on March 17, 2008. A full discussion of the Plan and its net effect occurred at that meeting. A vote resulted in the approval of the plan by creditors representing 91%in value and 92% in number. The Monitor provided the following specifics in its report dated March 26, 2008:

11) ... there are 34 proven creditors that have/may have lien rights with potentially $3,226,768.69 of debt owed by the CCAA Companies. Of these 34 creditors, 28 creditors totaling $2,761,842.71 have voted for the acceptance of the plan; 5 creditors totaling $461,135.13 have voted against the plan, and 1 creditor totaling $3790.85 did not vote on the plan. From this analysis it is evidence that the majority of the creditors with lien/potential lien claims support the claim filed by the CCAA Companies.

12) Also according to Exhibit 1, out of the 34 proven creditors, only 8 creditors totaling $574,536.51 would be potentially better off under the lien fund over the CCAA. It is interesting to note, however, that of those creditors 6 creditors totaling $414,930.38 have elected to vote in favour of the plan.

13) It is also interesting to note that...3 of the 5 creditors who voted against the plan would receive more under the plan instead of enforcing their lien rights.

22 Should the Plan be approved, the Debtors will be able to complete various construction projects currently partially complete as well as take on new projects. The Debtors advise that they have negotiated new contracts with an approximate value of $1m which can be started if Court approval is granted to the Plan.

23 The day prior to this application being heard counsel from the office of the Attorney General of the Province of Alberta gave notice of an intention to apply for the status of intervener on the issue of the alleged conflict between the federal CCAA and the provincial Sask BLA, albeit that Act is Saskatchewan legislation. That request was later withdrawn. The Attorney General for the Province of Saskatchewan, although notified of this application, advised that it did not seek to participate.

**Nature of Application**

24 The Debtors apply for an order amending the Plan to increase the amount to be paid to the unsecured creditors from $2.4 to $2.6 and for an order sanctioning the Plan. They did not advance their application for an order declaring Kenroc to be in contempt of court for filing a builders' lien 7 days after the imposition of the stay without first obtaining leave of the court, but preferred instead to rely upon that fact as impacting the merits of its claims.

25 Each of Kenroc and Winroc oppose approval of the Plan in its current form. Winroc further applies for an order directing that the Plan be amended to:

a. classify Kenroc and Winroc as the sole secured creditors, and

b. order Kenroc and Winroc paid in full from the monies held by the Court of Queen's Bench of Saskatchewan.

**Issues**

1. Is there a conflict between the provisions of the Sask BLA and the CCAA?

2. What are the requirements for the Court to sanction the Plan?

3. Are Kenroc and Winroc secured creditors as defined by s. 2 of the CCAA as either:

   i. lien claimants, or

   ii. trust beneficiaries?

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4. If not, should Kenroc and Winroc have nonetheless been placed in a separate class of their own because of the nature of their claims?

5. Is the consolidation of the interests of Kerr and Composite in the Plan a breach of statutory provisions?

6. Is the Plan fair and reasonable?

7. If the Plan is not fair and reasonable, should the Court amend the Plan itself to direct payment of the $150,000 in Court in Saskatchewan to Kenroc and Winroc while otherwise allowing them to participate as unsecured creditors receiving 52% of the balance of their claims?

**Analysis**

***Is there a conflict between the provisions of the Sask BLA and the CCAA?***

26 The parties' written briefs addressed the concern that court sanction of the Plan would amount to a determination that parts of the Sask BLA are in conflict to the provisions of the CCAA and a reading down or striking out of those conflicting provincial provisions. In oral argument, however, there was no disagreement with the proposition that this question does not arise in this application. If I conclude that Kenroc and Winroc are secured creditors within the meaning of s. 2 of the CCAA, s. 5 of that Act requires that they vote as members of a separate class. Failure to have placed them in a separate class could mean the Debtors have not met the prerequisites for court sanction of the Plan.

27 Conversely, if I conclude that Kenroc and Winroc are not secured creditors within the meaning of s. 2 of the CCAA I must then proceed to the question of whether they were nonetheless entitled to vote as members of a separate class of unsecured creditors under s. 4 of the CCAA because they are the only registered lien claimants in Saskatchewan or because of their status as beneficiaries under the trust created by the Sask BLA.

28 In other words, those entitled to vote in a separate class on a plan of arrangement under the CCAA must fall within the definition of "secured creditor" in that legislation or for other reasons be separated into a distinct creditor class. On the first alternative, I conclude below that any potential secured creditor class would not include all creditors who have filed builders' liens under the Sask BLA. The issue is simply whether the 2 opposing creditors fall within that definition or not. No conflict exists between the federal and provincial act. They work together as 2 parts of a whole.

29 Had I been required to address the issue of whether holders of registered builders' liens on third party property or beneficiaries of deemed trusts created under the Sask BLA are entitled to be classed separately for the purposes of voting on a plan of arrangement, even though they do not meet the definition of unsecured creditor in s. 2 of the CCAA, I would have considered the observations of LoVecchio J. in *Sulphur Corp. of Canada Ltd. (Re)*, [2002] A.J. No. 918 (Alta. Q.B.) at para. 35 to the effect that in the event of conflict between a provision in the CCAA and a provincial statute the former will prevail by application of the doctrine of paramountcy.

30 On my own part I note that Parliament carefully included within the definition of "secured creditor" in s. 2 of the CCAA only holders of liens on the debtor's property and excluded holders of liens on third party property. This implies that Parliament did not therefore intend that holders of liens registered against third party property be secured parties vis-à -vis the debtor; otherwise, it would have said so. Parliament, at least, expected that its legislation would prevail over any provincial legislation providing otherwise.

31 In any event, as a result of these concessions it is not necessary to address the issue of whether sanction of the Plan should be declined because of conflicts between the federal and the provincial legislation.

2008 CarswellAlta 661, 2008 ABQB 286, [2008] A.W.L.D. 2547, [2008] A.W.L.D. 2548, [2008] A.W.L.D. 2546, 42 C.B.R. (5th) 293, 70 C.L.R. (3d) 46, 91 Alta. L.R. (4th) 202, [2008] 12 W.W.R. 355, 449 A.R. 185

***What are the requirements for the Court to sanction the Plan?***

32 The Parties agree that for the Plan to be sanctioned I must conclude:

a. that there has been strict compliance with all statutory requirements and adherence to prior court orders;

b. that there has been nothing done or purported to be done that is not otherwise authorized by the CCAA; and

c. that the Plan is fair and reasonable.

See *Northland Properties Ltd. (Re)* (1988), 73 C.B.R. (N.S.) 175 (B.C. S.C.); *Sammi Atlas Inc. (Re)* (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]); *Wellington Building Corp., Re*, [1934] O.R. 653 (Ont. S.C.).

33 There is no issue that the Debtors fall within the definition of "debtor company" in s. 2 of the CCAA and that they have total claims within the meaning of s. 12 of that Act which exceed $5 million, both statutory prerequisites for approval of the Plan.

34 The opposing creditors however argue that there has been a breach of other statutory prerequisites:

a. relating to the proper classification of creditors, and

b. bearing upon consolidation of debtor applications.

35 In particular, they argue that they should have been placed in their own separate class for the purposes of voting on the plan because they meet the definition of secured creditor under s. 2 of the CCAA or alternately because of their rights under the Sask BLA or alternately because the application for the stay should not have been made for the two debtor companies jointly. This latter argument is discussed in issue 5 below.

36 On the question of creditor classification, the distinction between a secured and unsecured creditor is provided via s. 2 of the CCAA:

2 In this Act, ...

"secured creditor" means a...holder of a...*lien*...on or against...*any property of a debtor company*...or *a trust* in respect of, all or any property of the debtor company...

"unsecured creditor" means any creditor of a company who is not a secured creditor...(emphasis added)

37 Sections 4 and 5 direct the holding of meetings of creditors where a compromise or arrangement of debt is proposed. These sections mandate separate meetings and separate voting of secured creditors and of unsecured creditors:

Compromise with unsecured creditors

4 Where a compromise or an arrangement is proposed between a debtor company and its unsecured creditors or any class of them, the court may, on the application in a summary way of the company...order a meeting of the creditors or class of creditors...

> Compromise with secured creditors
>
> 5 Where a compromise or an arrangement is proposed between a debtor company and its secured creditors or any class of them, the court may, on the application in a summary way of the company.... order a meeting of the creditors...

38 Therefore, if Kenroc and Winroc are secured creditors they would have been entitled to vote as members of a separate class (secured creditors) from the unsecured creditors. Similarly, if Kenroc and Winroc should have been placed in a separate class of unsecured creditors, they should again have had a separate meeting and vote.

39 Section 6 sets out the purpose of these meetings and displays how, if Kenroc and Winroc had been considered to be the only secured creditors or the only creditors in a separate class of unsecured creditors, they could have defeated approval of the Plan. Their negative vote would have meant that 100% of the creditors in a class in number and in value would have voted against approval of the Plan. Such a vote by any single class would result in the court being unable to sanction it.

> Compromises to be sanctioned by court
>
> 6. Where a majority in number representing two-thirds in value of the creditors, or class of creditors, as the case may be, present and voting either in person or by proxy at the meeting or meetings thereof respectively held pursuant to sections 4 and 5, or either of those sections, agree to any compromise or arrangement as proposed or as altered or as modified at the meeting or meetings, the compromise or arrangement may be sanctioned by the court and, if so sanction is binding
>
> (a) on all the creditors or the class of creditors, as the case may be...and on the company...

40 Therefore, if any of these provisions has been breached in the creation of the Plan either by placing Kenroc and Winroc in the same category as all other creditors or by consolidating the businesses of Kerr and Composite within the Plan, the first two requirements for Plan approval will not have been established and I should decline to sanction it.

***Are Kenroc and Winroc secured creditors as defined by s. 2 of the CCAA?***

41 If Kenroc and Winroc were the only creditors in the secured class of creditors their negative votes would mean that neither a majority nor two-thirds in value of their class would have voted in favor of the Plan. That prerequisite to court sanctioning would fail and the Plan would be defeated even though together Kenroc and Winroc hold only 3% of the debt.

*i. lien claimants*

42 Kenroc and Winroc argue that they meet the definitions of "secured creditors" in s. 2 of the CCAA because they each held a lien.

43 However, their builders' liens do not bring them within that definition of "secured creditor" because those liens were filed against third party property, property belonging to 101 rather than against property belonging to Kerr. Section 2 of the CCAA explicitly requires that a lien which creates secured creditor status is"...on or against...all or any *property of a debtor company ...* (emphasis added). Here the land against which Kenroc and Winroc's liens were registered *did not belong to the debtor* but rather to a third party, 101.

2008 CarswellAlta 661, 2008 ABQB 286, [2008] A.W.L.D. 2547, [2008] A.W.L.D. 2548, [2008] A.W.L.D. 2546, 42 C.B.R. (5th) 293, 70 C.L.R. (3d) 46, 91 Alta. L.R. (4th) 202, [2008] 12 W.W.R. 355, 449 A.R. 185

44 Kenroc and Winroc argued, however, that their liens have been replaced by claims against the $150,000 fund held in court in Saskatchewan and that money belongs to Kerr so that this requirement has been met. This argument fails on several grounds.

45 First, the order of Mr. Justice M.D. Action of the Court of Queen's Bench of Saskatchewan of January 18, 2008 which vacates the liens of each of Winroc and Kenroc upon the payment into court of the $150,000 expressly provides:

> 3. Neither the terms of the within Order nor the payment of the aforesaid security shall operate to entitle the Respondents or any other Lien Claimants to recover a sum greater than they would be entitled to recover under the Builders' Lien Act had the within Order not been granted or the said posting of security into Court not been paid.
>
> 4. The consent of Kerr Interior Systems ("Kerr") shall not prejudice the legal position of Kerr, including, without restriction, that the matter of the liens noted herein, the validity thereof, the propriety of their filing and the amounts owing to the lien claimants by Kerr are matters that are properly dealt with under Kerr's *Companies Creditors Arrangement Act* proceedings in Alberta...

46 This provision means that Kenroc and Winroc cannot improve their position as a result of the payment into court of these monies over and above what that position was through the filing of the builders' liens themselves. They cannot rely upon Kerr's failure to oppose the granting of that order on the basis that this would be the case and now argue the contrary.

47 Further the $150,000 fund in court does not belong to Kerr. While it was paid into court in respect of an accounts payable owing to Kerr by the owner, that alone does not make it Kerr's property as it was paid only to discharge liens filed against third party property. As Justice Barclay stated in regard to a similar fund in *D & K Horizontal Drilling (1998) Ltd. (Trustee of) v. Alliance Pipeline Ltd.*, 2002 SKQB 86 (Sask. Q.B.) at para. 19:

> ...the money paid into Court is not the property of the Bankrupt. It is uncontroverted that the funds paid into Court never came into the hands of the Bankrupt. The funds were paid directly into Court by Alliance by virtue of Alliance's obligation and liability to the lien claimants under s. 56(6) of the [Sask] BLA...

48 Further, this argument assumes that the critical date for determining whether a creditor meets the requirements of s. 2 is the date of the vote on the Plan rather than on the date of the granting of the stay order. While the $150,000 fund existed on the date of the vote it did not exist prior to the granting of the stay order on November 7, 2007. The question of the time at which secured creditor status is to be determined has rarely been investigated by the courts because normally the stay which initiates the CCAA proceedings is honored, and no creditor seeks to improve its status by unilateral action between the granting of the stay and the holding of the vote.

49 That said, it is not necessary to answer this question here, however, because the wording of the January 18, 2008 order allowing the creation of the $150,000 fund effectively sets the critical date as the earlier date. Therefore the rights of these 2 opposing creditors must be ascertained as they were before January 18, 2008. The fund did not exist before that date and so Kerr and Composite cannot use it to bootstrap their positions into that of lien-holder on property owned by a debtor.

50 Last, I also note that these funds were paid into court to discharge a lien which was filed in the face of a court order precluding Kerr from so filing. This arguably contemptuous filing should not be allowed to put it in a better position than other subcontractors who had potential lien claims against Kerr relating to the 101 project but who complied with the stay order.

51 If creditors were permitted to ignore stay orders with impunity the effect of the CCAA would be rendered nil. It is only through the effective operation of stay orders that Debtors are given the time and opportunity they require to

negotiate compromises with their creditors. As is clearly indicated by *Alternative Fuel Systems Inc., Re*, 2004 ABCA 31 (Alta. C.A.) at para. 54, stay orders provide the debtors the crucial time and opportunity required to negotiate compromises with their creditors:

> Rehabilitation of a company under the CCAA is furthered by a climate that allows for commercial realities and variables to be considered and negotiated among and by the affected parties. The debtor company, through the operation of the stay, is given the breathing room to explore alternatives and to structure a proposed plan that will find favour with creditors, sufficient to support the restructuring.

52 This very concern was raised in *Scaffold Connection Corp., Re*, [2000] 7 W.W.R. 516 (Alta. Q.B.) by Wachowich A.C.J. (as he then was) of this Court when he refused to lift a stay to allow liens to be filed and refused to grant a declaration that liens filed in violation of that stay were effective. In that case, as in this, the stay order stayed and suspended any and all "proceedings" taken by any person against or in respect of the applicant company. Justice Wachowich concluded that the filing of a lien amounted to such a proceeding.

He stated at para. 22:

> ...the goal of the CCAA is to enable insolvent companies the opportunity to reorganize in order to continue operating, where that appears to be a realistic goal. It may be that in particular circumstances, leave to pursue a lien claim would not jeopardize the company's efforts at reorganization. However, this must be determined on the facts of each case. In cases where a lien claim would endanger the survival of the company, the court's jurisdiction enables it to stay proceedings, even those concerning third parties. *It would greatly hamper the usefulness of this legislation if such jurisdiction did not exist, as stays would in some cases (such as the present one) be rendered futile.*
>
> (emphasis added)

53 The parties to this application did not lead evidence to suggest that allowing the two lien claims in question to advance would not jeopardize the Debtors' reorganization efforts. In fact, it is easy to presume the contrary: a large proportion of creditors who have approved the plan are also lien claimants. Had the stay order not been granted these creditors would presumably have been in the same position as the two opposing creditors in relation to filing liens.

54 Kenroc and Winroc argue that they have separate liens which exist aside from their filed liens by operation of the Saskatchewan *Builders' Lien Act* s. 22 which provides:

> 22(1) A person who provides services or materials on or in respect of an improvement for an owner, contractor or subcontractor, has, except as otherwise provided in this Act, a lien on the estate or interest of the owner in the land...

55 Nowhere, however, does this section create a lien right against property of the contractor, here Kerr, and so this section does not aid Kenroc nor Winroc. The decision of *NsC Diesel Power Inc., Re* (1990), 79 C.B.R. (N.S.) 1 (N.S. T.D.), in which Davison J. held that the holders of a lien against a building owned by the debtor were properly part of the secured creditors class for the purposes of voting on a plan of arrangement under the CCAA does not help Kenroc and Winroc as the case may be distinguished on the critical point; the lien-holders there held a lien against the *debtor's property*, not against the *property of a third party*.

56 Further, *NsC Diesel Power Inc., Re*, accepts the proposition that class affiliation during CCAA re-organization should be based on the inter-relationship of creditors, rather than on the relationship of creditors to the debtor. The latter is the Alberta approach, also endorsed in Ontario: *Canadian Airlines Corp., Re*, 2000 ABCA 149 (Alta. C.A. [In Chambers]) at para. 27; *Stelco Inc. (Re)* (2005), 261 D.L.R. (4th) 368 (Ont. C.A.) at para. 30.

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*ii. trust beneficiaries*

57 Kenroc and Winroc argue that they were beneficiaries of a trust created for them by operation of s. 7 of the Sask BLA which reads:

> 7 (1) All amounts:
>
> > (a) *owing to a contractor*, whether or not due or payable; or
> >
> > (b) received by a contractor;
>
> on account of the contract price of an improvement *constitute a trust* fund for the benefit of:
>
> > (c) subcontractors who have subcontracted with the contractor and other persons who have provided materials or services to the contractor for the purpose of performing a contract... (emphasis added)

58 Is this trust in relation to property owned by the debtor, and thus a trust of the type referred to in the definition of secured creditor in the CCAA? The trust fund described catches all amounts owing to Kerr, whether or not due and payable on the date of the stay order, November 7, 2007. Counsel for all parties agree that is the critical date for determining the effect of s.7(1). That, in any event, is the inevitable conclusion to be drawn from the provisions in the January 18, 2008 order to the effect that nothing in that order improved Kenroc's and Winroc's entitlement to recovery over their rights as they existed prior to that date and prior to the payment of the $150,000 into court.

59 That said, the Debtors concede that Kerr was owed at least $150,000 by 101 on November 7, 2007. There is no evidence to show that this money was owed on account of the materials Kenroc and Winroc supplied which gave rise to their claims (liens) but Kenroc and Winroc say that is unnecessary. So long as 101 owed Kerr money on that date and Kerr owed Kenroc and Winroc money on that date in relation to the same project s. 7(1) comes into play.

60 Prior to January 18, 2008, 101 had not paid anyone any money on account of what it owed Kerr; had it, it would have not owed Kerr anything on that date. Therefore, at best, an account payable or potential account payable to Kerr was caught by s. 7(1)(a). There was no pool of money at that time, or anything separate, identifiable or traceable in 101's funds which would form the body of a trust.

61 I conclude that neither Kenroc nor Winroc were beneficiaries of a trust as that term is used in s. 2 of the CCAA because:

a."conversion" - while it is clear s. 7(1) created a trust, that trust is not in respect of Kerr's property. The account payable owed by 101, now represented by the $150,000 fund in court, never became Kerr's property. The Saskatchewan legislation did not intend it to be so, based on the interpretation of s. 7(2) of the Sask BLA which reads:

> 7(2) The contractor is the trustee of the trust fund created by subsection (1) and he shall not appropriate or *convert any part of the trust fund to his own use* or to any use inconsistent with the trust until all persons for whose benefit the trust is constituted are paid all amounts related to the improvement owed to them by the contractor. (emphasis added)

62 This language is echoed in the trust misappropriation provisions of Sask BLA, s. 18(1):

> 18(1) Every person who is a trustee under this Part and who knowingly appropriates *or converts any moneys*

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> *constituting a trust under this Part to or for his own use* or to or for any use inconsistent with the trust is guilty of an offence. (emphasis added)

63 If the body of the s. 7(1) trust belonged to Kerr there would be no need for the statutory prohibition against "convert[ing] any part of the trust fund to his own use" because if it was Kerr's own property it could not be conversion.

64 In *373409 Alberta Ltd. (Receiver of) v. Bank of Montreal*, [2002] S.C.J. No. 82 (S.C.C.), para. 8, Justice Major defined conversion as follows:

> The tort of conversion "involves a wrongful interference with the goods of another, such as taking, using or destroying these goods in a manner inconsistent with the owner's right of possession": ***Boma Manufacturing Ltd. v. Canadian Imperial Bank of Commerce,*** [1996] 3 S.C.R. 727, per Iacobucci J., at para. 31.

65 Conversion occurs only where the money of another is interfered with. There would be no need for the prohibition against Kerr converting any part of the trust fund if it owned any part of it. Therefore, the Sask BLA, s. 7(2), indicates that title in whatever property interest which was created under s.7(1) does not vest with Kerr. As s. 7(1) of the Sask BLA creates a trust only in property "owing to" or "received by" Kerr, neither of which applies to either 101's account payable or to the money in court, no trust is thereby created which is impressed upon that money.

b. deemed or statutory trust - the trust created by s. 7(1) of the Sask BLA does not fall within the meaning of the word "trust" found in s. 2 of the CCAA unless there is an identifiable asset which forms the subject matter of the trust. In this case no such asset existed as of the date of the granting of the stay order as, at that time, the debt owed by 101 to Kerr had not been converted into a fund of money and may not even have been due and payable on November 7, 2007.

66 The Supreme Court of Canada dealt with a similar situation in *British Columbia v. Henfrey Samson Belair Ltd.*, [1989] 2 S.C.R. 24 (S.C.C.) where the Court concluded that a similar trust, created under British Columbia's *Social Service Tax Act* did not give the province priority over other creditors under the *Bankruptcy Act* because it was merely a "statutory trust" as it did not meet the requirements of a trust at common law. There the bankrupt had collected provincial sales tax in the course of its business operations as required by that provincial legislation but had intermingled it with its other assets and not paid it to the province prior to becoming bankrupt. This type of trust was held not to fall within s. 47(a) of the *Bankruptcy Act*, "as property held by the bankrupt in trust for any other person". To meet that definition a trust had to meet the common-law requirements for a trust which include identifiable separate property which is subject to the trust.

67 While the sales tax money was identifiable at the moment it was collected so that a s. 47(a) trust existed at that moment, that quality was lost through intermingling that money with other funds so it could not be identified or traced. Where no specific property is impressed with the trust, s. 47(a) of the *Bankruptcy Act* did not protect the province's claim. This construction was consistent with the principle that provinces cannot create priority under the *Bankruptcy Act*, an area of exclusive federal jurisdiction, by their own legislation; see also *Deloitte, Haskins & Sells Ltd. v. Alberta (Workers' Compensation Board)*, [1985] 1 S.C.R. 785 (S.C.C.), at 806.

68 In the case at bar no specific property in the hands of 101 was ever impressed with the s. 7(1) trust, the trust thereby created does not meet the common-law requirements of trust and, for the same reasons as given in *British Columbia v. Henfrey Samson Belair Ltd.*, *supra*, does not make the two opposing creditors beneficiaries of a trust as that term is used in s. 2 of the CCAA.

69 Kenroc argued that the Supreme Court of Canada decision in *John M.M. Troup Ltd. v. Royal Bank*, [1962] S.C.R. 487 (S.C.C.) to the effect that provincial laws creating security schemes are not disabled by bankruptcy legislation must mean that it is a secured creditor under the CCAA because it is one under the Sask BLA. That is not at

issue here. No attack is made on the security scheme created by the Sask BLA. It is just that that scheme does not create secured creditors under the CCAA; creditors must meet the definitions in the CCAA to gain that status.

70 In summary, neither Kenroc nor Winroc meet the requirements of the definition of "secured creditor" who is entitled to a separate vote on the Plan because neither are lienholders nor trust beneficiaries of the type that s. 2 of the CCAA declares to be secured creditors, even though they might be for other purposes under provincial legislation.

***If not, should Kenroc and Winroc have nonetheless been placed in a separate class of their own because of the nature of their claims?***

71 Section 4 of the CCAA anticipates that different classes of unsecured creditors may be created with each class voting separately as to whether or not to approve the Plan. The phrase "meeting of the creditors or *class of creditors* (emphasis added) "found in that section compels this result.

72 Kenroc and Winroc argue that even if they do not meet the definition of secured creditor and thus be entitled to be members of a class separate from unsecured creditors as of right, see CCAA s. 5, they should have been placed in a separate class from the other unsecured creditors, a class of two because their situation was sufficiently different from every other one of the unsecured creditors.

73 Winroc first argued that such a separate class should be created because it and Kenroc were the only lien claimants which registered their liens in Saskatchewan. While those liens are insufficient to make them secured creditors for the above reasons they nonetheless would give additional rights on liquidation over those held by non-lien claimants, a difference which arguably justifies the creation of a separate class.

74 This argument falls apart for two reasons. First, the fact that there are no other creditors who filed liens is likely driven by the stay order. The Monitor advises that 65% of the creditors classified as unsecured had lien rights. The stay order expressly provides:

> (11)....no proceeding or enforcement process in any court or tribunal nor the taking of any self help or seizure remedies...shall be commenced or continued against or in respect of the Debtors...except with leave of this Court.

75 This wording was interpreted as generally prohibiting the filing of builders' liens in *Scaffold Connection Corp., Re*, para. 22. Any potential lien claimant receiving a copy of this order would not have filed a lien because it was prohibited from doing so because of the stay imposed in s. 11. Any potential lien-holder so effected might well not have applied to lift the stay to file the lien because of the suspension of the limitation period in para. 14 of that order. They would thereby have been lulled into thinking their rights were preserved pending the vote on any eventual Plan. To now allow Kenroc to argue that it is in a preferred and better class because it filed its lien, albeit in breach of the stay order, would be unseemly at best. It is similarly disingenuous to argue one should conclude that the absence of other filed liens indicates those potential lien-holders would be disinterested in sharing the $150,000 fund.

76 Further, it is faulty logic to suggest that Kenroc and Winroc should form a separate class simply because they filed in Saskatchewan where, unlike in Alberta, builders' lien legislation creates trust remedies. Those Saskatchewan specific trust remedies neither bind the $150,000 paid into court nor do not, in this case, give Kenroc and Winroc any superior right to have been paid over the rights of any other lien claimant in Saskatchewan.

77 The two opposing creditors next argue that the Saskatchewan Court of Appeal, in *Arthur Andersen Inc. v. Merit Energy Ltd.*, [2004] S.J. No. 585 (Sask. C.A.) determined that holders of even unregistered builders' liens had priority over the claims of unsecured creditors to funds in court realized from the sale of the lands to which those liens had attached. In these cases, however, the liens had been registered against the bankrupt Debtors' property rather than against the property of a third party. Further, the orders directing the sale of the property expressly directed that the

monies in court should stand in place of the liens and that any claims could be advanced against it as if the lands had not been sold, i.e. the reverse of the provisions incorporated in the January 18, 2008 order in this case.

78 The Debtors also note that the mere filing of a lien against an owner's property does not necessarily equate to the lien-holder getting paid 100 cents on the dollar. In both Alberta and Saskatchewan the land owner's liability is limited to the value of the lien fund which is set at 10% of the value of the work actually done and the materials actually furnished; see *Builders' Lien Act*, R.S.A. 2000, c. B-7, ss. 18, 21, 23 and 25; Sask BLA, S.S. 1984-85-86, c. B-7.1, s. 37. As to other amounts for which the owner is potentially liable, even pursuant to the Sask BLA s. 7(1) type of trust, the owner has a right of set-off for various amounts including charges incurred to complete work if a project is abandoned by a contractor; see Sask BLA, s. 13. If the Plan fails and the Debtors thus become bankrupt or a receiver is appointed to manage their affairs, they argue, there will be significant costs incurred by 101 and other owners to complete the work the Debtors have contracted to perform. These claims will give rise to set-offs which will likely consume all of the funds held in trust so that the only money available to the lien-holders will be the 10% in the lien fund. There is no evidence to establish whether the $150,000 in court exceeds this 10% amount but if it does, 101 could apply for recovery of the difference, thus reducing the recovery that would be available to all lien claimants including Kenroc and Winroc.

79 Further, if the Plan fails there may well be additional lien claimants who advance claims to that fund which would be in a position to file their liens upon the stay being removed. If so, recovery to Kenroc and Winroc would be further reduced.

80 Nothing in the CCAA and nothing in the case law expressly states that those holding builders' liens against third party property must be considered a class separate from other creditors. Rather, an application of the principles expressed in the case law leads to the conclusion that Winroc's and Kenroc's situation is insufficient to entitle them to placement in their own unique class.

81 The analysis of class creation generally begins with *Sovereign Life Assurance Co. v. Dodd*, [1892] 2 Q.B. 573 (Eng. C.A.) in which Lord Esher stated:

> The Act says that the persons to be summoned to the meeting (all of whom, be it said in passing, are creditors) are persons who can be divided into different classes - classes which the Act of Parliament recognizes, though it does not define them. This, therefore must be done: they must be divided into different classes. What is the reason for such a course? It is because the creditors composing the different classes have different interests; and, therefore, if we find a different state of facts existing among different creditors which may differently affect their minds and their judgment, they must be divided into different classes. ...
>
> 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 a view to their common interest.

82 A more recent discussion of the principles to be applied in dealing with this commonality of interest test are to be found in the decision of Paperny, J. (as she then was) in *Canadian Airlines Corp. (Re)* (2000), 19 C.B.R. (4th) 12 (Alta. Q.B.) at para. 31:

> In summary, the cases establish the following principles applicable to assessing commonality of interest:
>
> 1. Commonality of interest should be viewed on the basis of the non-fragmentation test, not on an identity of interest test.
>
> 2. The interests to be considered are the legal interests the creditor holds qua creditor in relationship to the

debtor company, prior to and under the plan as well as on liquidation.

3. The commonality of these interests are to be viewed purposively, bearing in mind the object of the C.C.A.A., namely to facilitate reorganizations if at all possible.

4. In placing a broad and purposive interpretation on the C.C.A.A., the court should be careful to resist classification approaches which would potentially jeopardize potentially viable plans.

5. Absent bad faith, the motivations of the creditors to approve or to disapprove are irrelevant.

6. The requirement of creditors being able to consult together means being able to assess their legal entitlement as creditors before or after the plan in a similar manner.

83 The Alberta and Ontario Courts of Appeal adopted these principles in *Stelco Inc., Re*, at para. 27, *Stelco Inc., Re*, at paras. 23, 30. In *Stelco Inc., Re* (2005), 15 C.B.R. (5th) 307 (Ont. C.A.), the Court added the following principle at para. 36:

> In the end, it is important to remember that classification of creditors, like most other things pertaining to the CCAA, must be crafted with the underlying purpose of the CCAA in mind, namely facilitation of the reorganization of an insolvent company through the negotiation and approval of a plan of compromise or arrangement between the debtor company and its creditors, so that the debtor company can continue to carry on its business to the benefit of all concerned. As Paperny, J. noted in ***Re Canadian Airlines***, "the Court should be careful to resist classification approaches that would potentially jeopardize viable Plans".

84 The CCAA is a rehabilitative and salvage tool; the Act provides a mechanism by which an otherwise insolvent corporation may be maintained, to the benefit of all. Classification of creditors should be made with that purpose in mind.

85 Applying these principles then to the case at bar:

*Canadian Airlines Corp. (Re) - factors 1 to 6:*

**1. commonality of interest should be viewed based on the basis of the non-fragmentation test, not on an identity of interest test**

86 When creditors share overall similar interests, classification should not cause excessive fragmentation of the creditor pool by creating different classes on the basis of small differences between creditors.

87 The right to a claim against a lien fund would not, in every case, amount to a small difference between those who have such a right and those who do not. Whether a difference is small or otherwise depends on whether it would substantially impact recovery on liquidation of the debtor. It is possible to imagine a situation where lien funds were sufficiently large to afford those with claims against them comfort that they would receive a substantially larger recovery on liquidation than those creditors without such a claim. In that case, separate classes could well be justified.

88 This general recovery of sums owed would not necessarily occur here if the Debtors went into liquidation. If the Plan failed, the stay was lifted and no other claimant filed a lien against the 101 building, Kenroc might receive more from the lien fund that it would under the Plan. Winroc, interestingly, would not given the size of its other unsecured claim.

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89 However, should sanction be refused and the stay thus lifted other lien claimants may well file liens on that project with the effect of reducing Kenroc's recovery. It is not possible at this time to determine if Kenroc would in fact do substantially better in a liquidation scenario than under the Plan. If it did not, creating a separate class would result in excessive fragmentation.

**2. the interests to be considered are the legal interests the creditor holds qua creditor in relationship to the debtor company, prior to and under the plan as well as on liquidation**

90 The legal interests held by Kenroc and Winroc are similar to those held by 65% of the creditors in the single creditor class created under the Plan. They argue that they are unique as they are the only two lien claimants registered in Saskatchewan but for the reasons given above that is not determinative. Registration in Saskatchewan will not necessarily put them in a better position than any other potential lien claimant.

**3. the commonality of these interests are to be viewed purposively, bearing in mind the object of the C.C.A.A., namely to facilitate reorganizations if at all possible**

91 If the lien claimants remain categorized as unsecured creditors the required level of creditor support exists to allow the Plan to be sanctioned; if the Debtors are required to hold a new vote based on restructuring the plan to create a separate class for all lien claimants, it is likely that even on that basis the Plan will be approved as an overwhelming majority of the creditors who would be moved to that group, both in number and value of claim, supported the Plan earlier. Therefore the reorganization is likely to succeed even if the result of this application was to require such a restructuring.

92 From the evidence provided by the Monitor, the only scenario that would likely result in defeat of the Plan would be where reclassification resulted in Kenroc and Winroc being assigned to their own unique class.

**4. in placing a broad and purposive interpretation on the C.C.A.A., the court should be careful to resist classification approaches that would potentially jeopardize potentially viable plans**

93 See 1 above.

**5. absent bad faith, the motivations of the creditors to approve or disapprove are irrelevant**

94 Winroc, especially, would seem to be playing a strategic game in opposing this application, hoping that it will result in a 100% payout of its lien claim without the Plan being defeated so that it can also recoup 52% of the balance of the money owed to it, unsecured debt. Absent bad faith strategic moves are fair game in negotiation, and so this goal is irrelevant to the issue of whether reclassification should occur.

**6. the requirement of creditors being able to consult together means being able to assess their legal entitlement as creditors before and after the plan in a similar manner**

95 All creditors including Kenroc and Winroc were able to assess the benefits of accepting 52 cents on the dollar when voting on the plan; the bulk of those with potential lien claims supported the plan nonetheless.

*Stelco Inc. (Re) - classification of creditors in accordance with the CCAA purpose:*

96 The additional principle suggested in *Stelco Inc. (Re), supra*, indicates that creditor classification should be crafted in accordance with the underlying CCAA purpose to facilitate reorganization of the debtor. That purpose will be best achieved if the class of unsecured creditors remains undivided as the overwhelming majority of all creditors by

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both number and percentage of debt voted in favour of the Plan.

97 Certain of these creditors would have potentially received more pursuant to builders' liens if the Plan failed and the debtor companies were liquidated. This fact clearly indicates the majority of creditors strongly favour the continued existence and operation of Kerr and Composite. These creditors have, in effect, waived a larger right of short-term recovery of debt for the long-term economic benefit provided by the continued existence and operation of the debtors. The court should not lightly discount this vote of confidence.

98 In conclusion, taking into account:

1. the uncertainty as to whether Winroc would receive more money if it was able to realize on its share of the funds in court on liquidation than under a sanctioned plan,

2. that it is unclear whether either Kenroc or Winroc would recover more than 52% of the monies in court if the Plan failed, the stay was lifted and other lien claimants could file,

3. that an overwhelming number of the creditors approved the plan even though 65% of them were in the same potential position as Winroc and Kenroc as lien claimants,

4. that the majority of creditors that would have obtained greater recovery via bankruptcy proceedings nevertheless voted for the Plan, and

5. that Winroc and Kenroc hold only 3% of the debt owned by the debtors,

I conclude that the requirements of the CCAA were met although Kenroc and Winroc were included in the class of unsecured creditors for the purpose of voting on the plan. There was no breach of any legislation by requiring them to do so.

***Is the consolidation of the interests of Kerr and Composite in the Plan a breach of statutory provisions?***

99 Kenroc argues that Composite has the majority of the receivables and Composite has the majority of the debt. Kenroc's claim is only against Kerr. As a result of consolidating the applications of these two companies, Kenroc's claim against Kerr has been subsumed into a situation where there is a greater debt to asset ratio given the size of the debt owed by Composite than there would be if Kerr alone was a part of the Plan. That may have put Kenroc into a poorer voting position than otherwise.

100 The consolidation of debtors for the purposes of a plan of arrangement pursuant to the CCAA may be sanctioned where the consolidated plan avoids complex and potentially litigious issues, the companies are intertwined in their business operations, there has been compliance with statutory requirements and court orders and the plan is fair and reasonable. Further, while"...consolidation by its very nature will benefit some creditors and prejudice others, it is appropriate to look at the overall general effect"; see *PSINet Ltd., Re*, [2002] O.J. No. 1156 (Ont. S.C.J. [Commercial List]) at para. 11.

101 Given the intertwined nature of the business of the two Debtors, the fact they are owned by the same party, the fact that one supplies products solely for the other and the existence of their cross-guarantees I do not conclude that the consolidation of their two CCAA applications does not meet the letter and the spirit of that Act.

***Is the Plan fair and reasonable?***

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102 Even though I have concluded that Kenroc and Winroc are not entitled to have voted in a separate class because they are secured creditors or because of the nature of their claims, if I do not also conclude that the Plan is fair and reasonable I must not sanction it.

103 These concepts were examined in *Olympia & York Developments Ltd. v. Royal Trust Co.*, [1993] O.J. No. 545 (Ont. Gen. Div.) at para. 28:

> "Fairness" and "reasonableness" are, in my opinion, the two keynote concepts underscoring the philosophy and workings of the Companies' Creditors Arrangement Act. "Fairness" is the quintessential expression of the court's equitable jurisdiction - although the jurisdiction is statutory, the broad discretionary powers given to the judiciary by the legislation make its exercise an exercise in equity - and "reasonableness" is what lends objectivity to the process.

104 Approval of the Plan would allow the two Debtors to remain in business, to complete the construction projects upon which they are now engaged, to undertake new work which is available to them, to continue to satisfy the debt of their secured creditors who support the Plan and to discharge all other debt owed by them as of November 7, 2007 upon the payment of 52% of it. Based on the evidence contained in the Monitor's Third Report there are 34 proven creditors including those which have potential lien rights (including Kenroc and Winroc) which are owed in total $3,226,768.69. Of those 34 creditors, 28 creditors holding $2,761,842.13 voted in favor of the Plan; 5 creditors totaling $461,135.13 voted against it and 1 creditor with a debt of $3,790.85 did not vote.

105 The Monitor's analysis shows that out of the 34 proven creditors only 8, with a potential debt of $574,536.51 would, in his view, be potentially better off under the lien fund than under the Plan. Of these creditors, 6 with debt valued at $414,930.36 voted in favor of the plan. Kenroc and Winroc, the only creditors appearing in opposition to the application for court sanction of the Plan hold about 3% of the debt owed by the Debtors.

106 This high degree of creditor approval of the plan creates an inference that it is fair and reasonable; see *Canadian Airlines Corp. (Re)*, [2000] 10 W.W.R. 269 (Alta. Q.B.) at para. 97. As I noted above, the willingness of creditors to suborn short-term debt recovery to maintain a business relationship with the debtors is of no small weight. In that sense, the court should generally recognize that the creditors themselves are the principal authorities for identification of a fair result (*Alternative Fuel Systems Inc., Re*, *supra*, at para. 55):

> What constitutes fairness is largely determined by the circumstances of each case. An important measure of fairness is the degree to which creditors approve it. Creditor support can create an inference that assenting creditors see the plan as viable and commercially reasonable given other available alternatives. *The courts generally accept the view that the creditors are in a better position to determine whether the plan is in their own best interests*. (emphasis added)

107 The fact that some creditors are compelled to accept a compromise without their consent, or to accept less than they might receive on liquidation of the debtor is an inherent result of the operation of the CCAA. Their objections are no reason to conclude the Plan is not, overall, fair and equitable. As the British Columbia Court of Appeal stated in *Northland Properties Ltd., Re* (1989), 34 B.C.L.R. (2d) 122, 73 C.B.R. (N.S.) 195 (B.C. C.A.) at 198:

> ...there can be no doubt about the purpose of the C.C.A.A. It is to enable compromises to be made for the common benefit of the creditors and of the company, particularly to keep a company in financial difficulties alive and out of the hands of liquidators. To make the Act workable, it is often necessary to permit a requisite majority of each class to bind the minority to the terms of the plan, but the plan must be fair and reasonable.

108 The overwhelming creditor support for the Plan leads me to conclude that it is fair and reasonable. Indeed, it would not be fair and reasonable to allow creditors holding 3% of the debt to defeat it.

2008 CarswellAlta 661, 2008 ABQB 286, [2008] A.W.L.D. 2547, [2008] A.W.L.D. 2548, [2008] A.W.L.D. 2546, 42 C.B.R. (5th) 293, 70 C.L.R. (3d) 46, 91 Alta. L.R. (4th) 202, [2008] 12 W.W.R. 355, 449 A.R. 185

***If the Plan is not fair and reasonable, should the Court amend the Plan itself to direct payment of the $150,000 in Court in Saskatchewan to Kenroc and Winroc while otherwise allowing them to participate as unsecured creditors receiving 52% of the balance of their claims?***

109 While it is unnecessary to decide this issue given my other decisions it is worthy of note that Kenroc and Winroc did not vigorously advocate the defeat of the Plan but rather candidly admitted that their opposition was designed to enhance their bargaining position with the Debtors, with the goal of being paid out directly rather than allowing the entire Plan to be defeated for $150,000 in claims. Indeed, as noted Winroc would be disadvantaged by having the Debtors' businesses liquidated as it stands to receive more overall through the Plan than it would if it had been successful in defeating it given the relative sizes of is lien claim to the size of the totally unsecured debt owed to it by Kerr.

110 They argued that I have the jurisdiction to amend the Plan directly from the Bench rather than to dismiss the application for sanction or to adjourn it, to direct the Plan be amended to create a separate class for them alone and then to order a new vote, the results of which would be a foregone conclusion. Even if that were true, and it is not necessary to decide that point, such jurisdiction still stops short of my granting a direct order for payment of the sums they are owed from the fund held in the Court of Queen's Bench of Saskatchewan or to otherwise order the Debtors to see them paid that sum as a price for retiring from the field.

111 In any event, Kenroc's conduct in filing its lien in direct contravention of the stay order would certainly disentitle it to any discretionary relief.

**Conclusion**

112 The Plan of Arrangement is sanctioned.

**Costs**

113 Costs may be spoken to if necessary, including on the issue of whether Kenroc should be required to pay costs on a basis elevated from taxable costs on Column 1 of Schedule C because it filed a builder's lien in breach of the terms of the stay order.

*Plan of arrangement sanctioned.*

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2010 CarswellOnt 1344, 2010 ONSC 1328, 65 C.B.R. (5th) 152

2010 CarswellOnt 1344, 2010 ONSC 1328, 65 C.B.R. (5th) 152

Canwest Publishing Inc./Publications Canwest Inc., Re

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

AND IN THE MATTER OF A PROPOSED PLAN OF COMPROMISE OR ARRANGEMENT OF CANWEST PUBLISHING INC./PUBLICATIONS CANWEST INC., CANWEST BOOKS INC. AND CANWEST (CANADA) INC.

Ontario Superior Court of Justice [Commercial List]

Pepall J.

Judgment: March 5, 2010
Docket: CV-10-8533-00CL



Counsel: Lyndon Barnes, Alex Cobb for Canwest LP Entities

Maria Konyukhova for Monitor, FTI Consulting Canada Inc.

Hilary Clarke for Bank of Nova Scotia, Administrative Agent for Senior Secured Lenders' Syndicate

Janice Payne, Thomas McRae for Canwest Salaried Employees and Retirees (CSER) Group

M.A. Church for Communications, Energy and Paperworkers' Union

Anthony F. Dale for CAW-Canada

Deborah McPhail for Financial Services Commission of Ontario

Subject: Insolvency; Civil Practice and Procedure

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Miscellaneous

In January 2010 LP Entities obtained order pursuant to Companies' Creditors Arrangement Act staying all proceedings and claims against them — Order permitted, but did not require, payments to employees and pension plans — There were approximately 45 non-unionized employees who were still owed termination and severance payments, as well as accrual of pensionable service — There were further nine employees who were, or would be, entitled pursuant to executive pension plan to pension benefits in excess of those under main pension plan — Moving parties sought order permitting them to represent those employees, for appointment of counsel, and for funding of counsel — Respondents

did not object to appointment representatives or counsel, but opposed funding of counsel — Motion granted — All four proposed representatives had claims against LP Entities that were representative of claims that would be advanced by former employees — Individuals at issue were unsecured creditors whose recovery expectations might be non-existent, however they found themselves facing legal proceedings of significant complexity — Evidence was that members of group had little means to pursue representation and were unable to afford proper legal representation at this time — Employees were vulnerable group and there was no other counsel available to represent their interests — Canadian courts did not typically appoint unsecured creditors committees — It would be of considerable benefit to have representatives and representative counsel who could represent interests of salaried employees and retirees — There were three possible sources of funding: LP Entities, Monitors, or senior secured lenders — Court had power to compel senior secured lenders to fund or alternatively to compel LP Administrative Agent to consent to funding — Source of funding other than salaried employees themselves should be identified now — Funding would be prospective in nature and would not extend to investigation of or claims against directors — Counsel were directed to communicate with one another to ascertain how best to structure funding and report back to court by certain date.

**Statutes considered:**

*Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36

Generally — referred to

*Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.)

Generally — referred to

MOTION by group of employees for funding for appointment of representatives, appointment of counsel, and funding of counsel.

***Pepall J.*:**

**Reasons for Decision**

***Relief Requested***

1 Russell Mills, Blair MacKenzie, Rejean Saumure and Les Bale (the "Representatives") seek to be appointed as representatives on behalf of former salaried employees and retirees of Canwest Publishing Inc./Publications Canwest Inc., Canwest Books Inc., Canwest (Canada) and Canwest Limited Partnership and the Canwest Global Canadian Newspaper Entities (collectively the "LP Entities") or any person claiming an interest under or on behalf of such salaried employees or retirees including beneficiaries and surviving spouses ( "the Salaried Employees and Retirees"). They also seek an order that Nelligan O'Brien Payne LLP and Shibley Righton LLP be appointed in these proceedings to represent the Salaried Employees and Retirees for all matters relating to claims against the LP Entities and any issues affecting them in the proceedings. Amongst other things, it is proposed that all reasonable legal, actuarial and financial expert and advisory fees be paid by the LP Entities.

2 On February 22, 2010, I granted an order on consent of the LP Entities authorizing the Communications, Energy and Paperworker's Union of Canada ("CEP") to continue to represent its current members and to represent former members of bargaining units represented by the union including pensioners, retirees, deferred vested participants and surviving spouses and dependants employed or formerly employed by the LP Entities. That order only extended to unionized members or former members. The within motion focused on non-unionized former employees and retirees although Ms. Payne for the moving parties indicated that the moving parties would be content to include other non-unionized employees as well. There is no overlap between the order granted to CEP and the order requested by the

Salaried Employees and Retirees.

***Facts***

3 On January 8, 2010 the LP Entities obtained an order pursuant to the *Companies' Creditors Arrangement Act* ("CCAA") staying all proceedings and claims against the LP Entities. The order permits but does not require the LP Entities to make payments to employee and retirement benefit plans.

4 There are approximately 66 employees, 45 of whom were non-unionized, whose employment with the LP Entities terminated prior to the Initial Order but who were still owed termination and severance payments. As of the date of the Initial Order, the LP Entities ceased making those payments to those former employees. As many of these former employees were owed termination payments as part of a salary continuance scheme whereby they would continue to accrue pensionable service during a notice period, after the Initial Order, those former employees stopped accruing pensionable service. The Representatives seek an order authorizing them to act for the 45 individuals and for the aforementioned law firms to be appointed as representative counsel.

5 Additionally, seven retirees and two current employees are (or would be) eligible for a pension benefit from Southam Executive Retirement Arrangements ("SERA"). SERA is a non-registered pension plan used to provide supplemental pension benefits to former executives of the LP Entities and their predecessors. These benefits are in excess of those earned under the Canwest Southam Publications Inc. Retirement Plan which benefits are capped as a result of certain provisions of the *Income Tax Act*. As of the date of the Initial Order, the SERA payments ceased also. This impacts beneficiaries and spouses who are eligible for a joint survivorship option. The aggregate benefit obligation related to SERA is approximately $14.4 million. The Representatives also seek to act for these seven retirees and for the aforementioned law firms to be appointed as representative counsel.

6 Since January 8, 2010, the LP Entities have being pursuing the sale and investor solicitation process ("SISP") contemplated by the Initial Order. Throughout the course of the CCAA proceedings, the LP Entities have continued to pay:

(a) salaries, commissions, bonuses and outstanding employee expenses;

(b) current services and special payments in respect of the active registered pension plan; and

(c) post-employment and post-retirement benefits to former employees who were represented by a union when they were employed by the LP Entities.

7 The LP Entities intend to continue to pay these employee related obligations throughout the course of the CCAA proceedings. Pursuant to the Support Agreement with the LP Secured Lenders, AcquireCo. will assume all of the employee related obligations including existing pension plans (other than supplemental pension plans such as SERA), existing post-retirement and post-employment benefit plans and unpaid severance obligations stayed during the CCAA proceeding. This assumption by AcquireCo. is subject to the LP Secured Lenders' right, acting commercially reasonably and after consultation with the operational management of the LP Entities, to exclude certain specified liabilities.

8 All four proposed Representatives have claims against the LP Entities that are representative of the claims that would be advanced by former employees, namely pension benefits and compensation for involuntary terminations. In addition to the claims against the LP Entities, the proposed Representatives may have claims against the directors of the LP Entities that are currently impacted by the CCAA proceedings.

9 No issue is taken with the proposed Representatives nor with the experience and competence of the proposed

law firms, namely Nelligan O'Brien Payne LLP and Shibley Righton LLP, both of whom have jointly acted as court appointed representatives for continuing employees in the Nortel Networks Limited case.

10 Funding by the LP Entities in respect of the representation requested would violate the Support Agreement dated January 8, 2010 between the LP Entities and the LP Administrative Agent. Specifically, section 5.1(j) of the Support Agreement states:

> The LP Entities shall not pay any of the legal, financial or other advisors to any other Person, except as expressly contemplated by the Initial Order or with the consent in writing from the Administrative Agent acting in consultation with the Steering Committee.

11 The LP Administrative Agent does not consent to the funding request at this time.

12 On October 6, 2009, the CMI Entities applied for protection pursuant to the provisions of the CCAA. In that restructuring, the CMI Entities themselves moved to appoint and fund a law firm as representative counsel for former employees and retirees. That order was granted.

13 Counsel were urged by me to ascertain whether there was any possibility of resolving this issue. Some time was spent attempting to do so, however, I was subsequently advised that those efforts were unsuccessful.

***Issues***

14 The issues on this motion are as follows:

(1) Should the Representatives be appointed?

(2) Should Nelligan O'Brien Payne LLP and Shibley Righton LLP be appointed as representative counsel?

(3) If so, should the request for funding be granted?

***Positions of Parties***

15 In brief, the moving parties submit that representative counsel should be appointed where vulnerable creditors have little means to pursue a claim in a complex CCAA proceeding; there is a social benefit to be derived from assisting vulnerable creditors; and a benefit would be provided to the overall CCAA process by introducing efficiency for all parties involved. The moving parties submit that all of these principles have been met in this case.

16 The LP Entities oppose the relief requested on the grounds that it is premature. The amounts outstanding to the representative group are prefiling unsecured obligations. Unless a superior offer is received in the SISP that is currently underway, the LP Entities will implement a support transaction with the LP Secured Lenders that does not contemplate any recoveries for unsecured creditors. As such, there is no current need to carry out a claims process. Although a superior offer may materialize in the SISP, the outcome of the SISP is currently unknown.

17 Furthermore, the LP Entities oppose the funding request. The fees will deplete the resources of the Estate without any possible corresponding benefit and the Support Agreement with the LP Secured Lenders does not authorize any such payment.

18 The LP Senior Lenders support the position of the LP Entities.

19 In its third report, the Monitor noted that pursuant to the Support Agreement, the LP Entities are not permitted to pay any of the legal, financial or other advisors absent consent in writing from the LP Administrative Agent which has not been forthcoming. Accordingly, funding of the fees requested would be in contravention of the Support Agreement with the LP Secured Lenders. For those reasons, the Monitor supported the LP Entities refusal to fund.

***Discussion***

20 No one challenged the court's jurisdiction to make a representation order and such orders have been granted in large CCAA proceedings. Examples include Nortel Networks Corp., Fraser Papers Inc., and Canwest Global Communications Corp. (with respect to the television side of the enterprise). Indeed, a human resources manager at the Ottawa Citizen advised one of the Representatives, Mr. Saumure, that as part of the CCAA process, it was normal practice for the court to appoint a law firm to represent former employees as a group.

21 Factors that have been considered by courts in granting these orders include:

- the vulnerability and resources of the group sought to be represented;
- any benefit to the companies under CCAA protection;
- any social benefit to be derived from representation of the group;
- the facilitation of the administration of the proceedings and efficiency;
- the avoidance of a multiplicity of legal retainers;
- the balance of convenience and whether it is fair and just including to the creditors of the Estate;
- whether representative counsel has already been appointed for those who have similar interests to the group seeking representation and who is also prepared to act for the group seeking the order; and
- the position of other stakeholders and the Monitor.

22 The evidence before me consists of affidavits from three of the four proposed Representatives and a partner with the Nelligan O'Brien Payne LLP law firm, the Monitor's Third Report, and a compendium containing an affidavit of an investment manager for noteholders filed on an earlier occasion in these CCAA proceedings. This evidence addresses most of the aforementioned factors.

23 The primary objection to the relief requested is prematurity. This is reflected in correspondence sent by counsel for the LP Entities to counsel for the Senior Lenders' Administrative Agent. Those opposing the relief requested submit that the moving parties can keep an eye on the Monitor's website and depend on notice to be given by the Monitor in the event that unsecured creditors have any entitlement. Counsel for the LP Entities submitted that counsel for the proposed representatives should reapply to court at the appropriate time and that I should dismiss the motion without prejudice to the moving parties to bring it back on.

24 In my view, this watch and wait suggestion is unhelpful to the needs of the Salaried Employees and Retirees and to the interests of the Applicants. I accept that the individuals in issue may be unsecured creditors whose recovery expectation may prove to be non-existent and that ultimately there may be no claims process for them. I also accept that some of them were in the executive ranks of the LP Entities and continue to benefit from payment of some pension benefits. That said, these are all individuals who find themselves in uncertain times facing legal proceedings of sig-

nificant complexity. The evidence is also to the effect that members of the group have little means to pursue representation and are unable to afford proper legal representation at this time. The Monitor already has very extensive responsibilities as reflected in paragraph 30 and following of the Initial Order and the CCAA itself and it is unrealistic to expect that it can be fully responsive to the needs and demands of all of these many individuals and do so in an efficient and timely manner. Desirably in my view, Canadian courts have not typically appointed an Unsecured Creditors Committee to address the needs of unsecured creditors in large restructurings. It would be of considerable benefit to both the Applicants and the Salaried Employees and Retirees to have Representatives and representative counsel who could interact with the Applicants and represent the interests of the Salaried Employees and Retirees. In that regard, I accept their evidence that they are a vulnerable group and there is no other counsel available to represent their interests. Furthermore, a multiplicity of legal retainers is to be discouraged. In my view, it is a false economy to watch and wait. Indeed the time taken by counsel preparing for and arguing this motion is just one such example. The appointment of the Representatives and representative counsel would facilitate the administration of the proceedings and information flow and provide for efficiency.

25 The second basis for objection is that the LP Entities are not permitted to pay any of the legal, financial or other advisors to any other person except as expressly contemplated by the Initial Order or with consent in writing from the LP Administrative Agent acting in consultation with the Steering Committee. Funding by the LP Entities would be in contravention of the Support Agreement entered into by the LP Entities and the LP Senior Secured Lenders. It was for this reason that the Monitor stated in its Report that it supported the LP Entities' refusal to fund.

26 I accept the evidence before me on the inability of the Salaried Employees and Retirees to afford legal counsel at this time. There are in these circumstances three possible sources of funding: the LP Entities; the Monitor pursuant to paragraph 31 (i) of the Initial Order although quere whether this is in keeping with the intention underlying that provision; or the LP Senior Secured Lenders. It seems to me that having exercised the degree of control that they have, it is certainly arguable that relying on inherent jurisdiction, the court has the power to compel the Senior Secured Lenders to fund or alternatively compel the LP Administrative Agent to consent to funding. By executing agreements such as the Support Agreement, parties cannot oust the jurisdiction of the court.

27 In my view, a source of funding other than the Salaried Employees and Retirees themselves should be identified now. In the CMI Entities' CCAA proceeding, funding was made available for Representative Counsel although I acknowledge that the circumstances here are somewhat different. Staged payments commencing with the sum of $25,000 may be more appropriate. Funding would be prospective in nature and would not extend to investigation of or claims against directors.

28 Counsel are to communicate with one another to ascertain how best to structure the funding and report to me if necessary at a 9:30 appointment on March 22, 2010. If everything is resolved, only the Monitor need report at that time and may do so by e-mail. If not resolved, I propose to make the structuring order on March 22, 2010 on a nunc pro tunc basis. Ottawa counsel may participate by telephone but should alert the Commercial List Office of their proposed mode of participation.

*Motion granted.*

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