CANADA
Province of British Columbia

District of British Columbia
Division No. 03
Estate No. 11-253837
Court No. B-131248

TRUSTEE'S PRELIMINARY REPORT

IN THE MATTER OF THE BANKRUPTCY OF R HOME SUPPLY CENTRE LTD.

Introduction

R Home Supply Centre Ltd. ("R Home" or the "Company") was incorporated under the laws of the Province of British Columbia on January 8, 1974. R Home operated a hardware store located in Dawson Creek as a dealer of Home Hardware Stores Limited ("HH"), Canada's largest dealer-owned hardware, lumber building materials and furniture cooperative.

R Home has two major secured creditors, The Bank of Nova Scotia (the "Bank") and HH. The Bank holds a general security agreement over all of R Home's assets, as well as a first mortgage over certain real property described further in this report.

HH provides services to dealers in the Home Hardware network including advertising and bulk inventory purchasing. On August 11, 2005, R Home and HH entered into a dealer agreement (the "Dealer Agreement") pursuant to which R Home was eligible to purchase inventory from third parties. Under the Dealer Agreement, the purchase of third party inventory would be billed to HH and R Home would then be liable to HH for that amount. As a dealer of HH, R Home held certain shares and notes in HH. HH, as security on the amounts owed to it by R Home had the right to realize on the HH shares and held a second mortgage on real property owned and used by R Home in operating its business.

During 2011, R Home began experiencing financial difficulties and amounts owing to HH began to grow rapidly. In early 2012, R Home was no longer able to make payments to HH as required under the Dealer Agreement.

Between June 2012 and March 2013, R Home also encountered financial difficulties with the Bank and was in default of its credit facilities. During this time, the Bank provided R Home with several extensions to seek alternate financing arrangements without success. In July 2013, the Bank enforced its security and appointed Grant Thornton Ltd. ("GT" or the "Receiver") as receiver of the assets of R Home. GT immediately terminated the business operations of R Home and commenced a liquidation process.

HH and the Bank then made an application to the Supreme Court of British Columbia (the "Court") on August 27, 2013 for an assignment of R Home into bankruptcy. The bankruptcy application was heard by the Court in October 2014 and R Home was ultimately petitioned into bankruptcy by Order of the Court on December 23, 2014. Deloitte Restructuring Inc was appointed as Trustee over the Company. The sole director of the Company, Mr. Rock Petrick (the "Director") filed an appeal and the Company was automatically granted a stay of the Order on December 30, 2014. The appeal was subsequently heard and on December 2, 2015 the Order was reinstated. Further details on Court filings, the Court's Reasons for Judgement for the Order and the subsequent dismissal of the Director's appeal are attached to this Report as Appendix A and Appendix B, respectively.

Conservatory and Protective Measures

All operations of the Company were terminated by GT upon its appointment as Receiver. The Trustee's staff has confirmed with the Receiver that:

- All inventory has been liquidated;
- All bank accounts have been closed;
- Any receivables that could be collected have been realized upon; and
- The Receiver has arranged security and insurance for the primary real property owned by the Company located at Lot A - 1628 Alaska Avenue in Dawson Creek, British Columbia ("Lot A"), and the adjacent property (Lot 1 – 1628 Alaska Avenue in Dawson Creek, British Columbia) ("Lot 1").

The Trustee also sought information on, and arranged for insurance coverage for the residential property located at 115 Bullmoose in Tumbler Ridge, British Columbia ("Bullmoose").

Books & Records

All books and records of the Company are with GT. The Trustee has not had an opportunity to review the books and records of the Company at this time. However, the Receiver will arrange to transfer the Company's books and records to the Trustee in the normal course of the estate administration.

Assets

($) Asset	Book value at date of Receivership	Value realized by Receiver
Cash	12,370	15,428
Inventory/furniture	2,661,741	786,213
Receivables	296,067	175,552
Securities	847,413	27,697
Other realizations	-	36,997
Real property	2,663,030	-
Total	6,480,621	1,041,887

I) Assets realized by Receiver

The assets realized by the Receiver are detailed above. All funds realized are fully encumbered.

II) Real Property

The Bank commenced foreclosure proceedings in respect of Lot A on November 5, 2013. HH commenced foreclosure proceedings in respect of Lot A on February 3, 2014.

HH has sought and received conduct of sale for Lot 1, Lot A and Bullmoose.

Lot A and Lot 1 remain under the control of the Receiver. The Receiver has advised that it has maintained insurance and security monitoring for Lot A and Lot 1. Lot 1 is expected to

be fully encumbered by the mortgages granted to HH and the Bank while Lot A is unencumbered. The Receiver has advised that as Lot A and Lot 1 are adjoining lots, and are surrounded by a contiguous fence, the security and insurance has been arranged to continue for both properties. The Receiver will provide the Trustee with notice prior to proceeding with its discharge so that the Trustee can arrange to have these services continued.

Bullmoose is an unencumbered asset of the Company. The Trustee has arranged for insurance coverage for Bullmoose. The realtor with whom Bullmoose is listed has been engaged to provide regular monitoring for the property as well as to engage a contractor to assess the condition of the residence. The Trustee has been advised that certain damage may have occurred to the residence prior to the Trustee's appointment that may negatively impact realization efforts.

HH and the Bank have sought appraisals for all of the properties. Once the appraisals have been received, a realization strategy will be implemented to maximize recoveries.

Secured creditors

As noted previously in this report, the following creditors hold registered security over certain assets of the Company:

- The Bank holds a general security agreement over the Company's assets and a first mortgage over Lot A; and

- HH holds security over the HH shares held by R Home and a second mortgage over Lot A.

To the extent that the Bank and HH do not fully recover funds owed to them through the receivership and foreclosure proceedings, they will be eligible to file proofs of claim in the bankruptcy proceeding as unsecured creditors, receiving a pro-rata share of the net proceeds along with other unsecured creditors who prove their claims.

Legal Proceedings, Reviewable transactions and preference payments

The Trustee understands that the Director had initiated certain civil claims against HH and the Bank on behalf of R Home. The Trustee has not been provided with any details or evidence in support of these claims. The Director has not responded to any attempts by the Trustee's office to contact him in respect to these proceedings since reinstatement of the Order on December 2, 2015. Given the lack of information and cooperation by the Director as required under the *Bankruptcy and Insolvency Act*, the Trustee does not anticipate continuing the claims initiated by the Director.

Although the Trustee has not yet reviewed the records of the Company, based on discussions with the Receiver, the Trustee is not aware of any reviewable transactions or preference payments. A review of the banking and financial records of the Company will be conducted upon receipt of the Company's records.

Provable Claims

At the time of finalizing this report, no claims have been filed.

The Trustee understands that any employee priority claims have been addressed by the Receiver.

Anticipated Realization and Projected Distribution

It is anticipated that the only realizations available to the Trustee from the sale of R Home's assets will be from Lot A and Bullmoose. As noted earlier in this report, HH and the Bank have sought appraisals for these properties which the Trustee has been advised will be shared with the Trustee. The net proceeds, after deducting upkeep costs, the Trustee's time charges and any other necessary disbursements, are expected to be made available for distribution to the unsecured creditors. As appraisals have not yet been completed, no estimate of the quantum of funds that will be available can be made at the date of this report.

Conduct of the Director

The Trustee has made several attempts to contact the Director, by email, telephone and mail since reinstatement of the Order on December 2, 2015, however, the Director has not responded to the Trustee.

The Director has refused to comply with the duties of a director including assisting in the preparation of the Statement of Affairs for the Company or acknowledge the duties of a director of a bankrupt corporation.

Other Matters

The secured creditors have agreed to advance $10,000 to the Trustee to cover the Trustee's anticipated disbursements in relation to Bullmoose. These funds will be provided by the Receiver, who is currently holding funds for the secured creditors. The Trustee anticipates that further advances will be required to maintain the properties during the realization process.

We are not aware of any other potential conflicts of interest with respect to our appointment as Trustee.

Dated at Vancouver, this 17th day of December, 2015.

DELOITTE RESTRUCTURING INC.
In its capacity as Trustee in Bankruptcy
of R Home Supply Centre Ltd.
and not in its personal capacity.

Per: _____
Huey Lee, MBA, CPA, CMA, CIRP
Trustee

APPENDIX A

IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation: *R Home Supply Centre Ltd. (Re)*, 2014 BCSC 2430

Date: 20141223
Docket: B131248
Registry: Vancouver

In Bankruptcy and Insolvency

In the Matter of the Bankruptcy of R. Home Supply Centre Ltd.

Before: The Honourable Mr. Justice Sewell

Reasons for Judgment

Counsel for the Creditor, Home Hardware Stores Ltd.:	S.R. Andersen
Counsel for the Creditor, Bank of Nova Scotia:	M.J. Peerson
Counsel for R Home Supply Centre Ltd., R. Petrick and A. Petrick:	D. Fitzpatrick
Place and Date of Hearing:	Vancouver, B.C. July 22, 2014 October 6-7, 2014
Place and Date of Judgment:	Vancouver, B.C. December 23, 2014

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Introduction

[1] The Bank of Nova Scotia ("BNS") and Home Hardware Stores Limited ("HHSL") apply for a bankruptcy order against R Home Supply Centre Ltd. ("R Home") pursuant to s. 43(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 [*BIA*].

[2] This application was heard at the same time as an application by HHSL for an order nisi of foreclosure of a second mortgage granted to it by R Home (the "Foreclosure Petition"). These reasons should be read together with my reasons in the Foreclosure Petition, 2014 BCSC 2431.

[3] R Home opposes the granting of the bankruptcy order or, in the alternative, seeks an order that it be stayed or the application be adjourned pending the resolution of a cross-claim it is advancing against BNS and HHSL.

[4] BNS and HHSL depose that each are owed in excess of $1000 by R Home and that R Home has committed an act of bankruptcy by failing to meet its obligations generally as they fell due in the six-month period preceding the filing of this application.

[5] R Home raises a number of defences to the granting of the bankruptcy order. I will address the defences in more detail later in these reasons. However, the principal grounds on which the bankruptcy order is opposed are that R Home has a defence to the claims of the applying creditors, that the application is brought for an improper purpose, and that BNS has ample security for its claims and therefore has no standing to bring this petition.

[6] For the reasons that follow, I find that there should be a bankruptcy order made against R Home.

Background

[7] R Home operated a hardware store in Dawson Creek for many years prior to 2013. The hardware store was part of the Home Hardware chain, which is made up

of a large number of independent hardware store owners. HHSL provides various services to the stores in the chain, including arranging national advertising and acquiring or permitting Home Hardware affiliates to acquire inventory at more favourable prices than individual stores could obtain if they were operating independently.

[8] The relationship between HHSL and R Home was governed by a Dealer Agreement dated August 11, 2005. Pursuant to the Dealer Agreement, HHSL agreed to supply some merchandise directly, or permit R Home to order merchandise directly from third party suppliers and have that merchandise invoiced to HHSL. In either case, R Home agreed to pay HHSL for such merchandise upon receipt of invoices from HHSL. Because it was a Home Hardware dealer, R Home was entitled to obtain shares and notes in HHSL. As security for amounts outstanding pursuant to the Dealer Agreement, HHSL had the right to realize on the value of R Home's interest in HHSL. In addition, HHSL held a second mortgage on real property used by R Home in operating its business. That property is the subject of the Foreclosure Proceeding. As I did in my reasons in the Foreclosure Proceeding, I will refer to that property as Lot A.

[9] BNS was R Home's principal banker. It holds a general security agreement against all of R Home's assets, including a first mortgage against Lot A.

[10] Beginning in 2011, R Home began to experience financial difficulties. The amounts it owed to HHSL increased significantly. By early 2012 at the latest, R Home could not pay HHSL in accordance with the terms of the Dealer Agreement.

[11] R Home also experienced difficulties in its banking relationship with BNS. On June 12, 2012, BNS, R Home, and Mr. and Ms. Petrick signed a letter agreement in which the respondents acknowledged several defaults by R Home in its credit agreement with BNS and BNS gave notice that it would no longer provide financing after August 31, 2012, by which date it required repayment of its loans to R Home. BNS subsequently agreed to continue to provide financing until March 31, 2013, but would not agree to any further extension beyond that date.

[12] In July 2013, BNS appointed Grant Thornton Ltd. as receiver of the assets of R Home. Grant Thornton Ltd. ceased operation of the business and proceeded to liquidate the inventory of the hardware operation.

[13] This application was commenced on August 27, 2013. For various reasons, and through no fault of the parties, this application was not fully heard until October 7, 2014.

[14] On September 11, 2103, R Home obtained a without-notice injunction in this proceeding against BNS and Grant Thornton Ltd. restraining them from taking any steps to realize on the assets of R Home until further court order or the hearing of the Bankruptcy Application. On October 4, 3013, I ordered that that injunction be set aside because I found that the evidence placed before the judge who granted the injunction was materially misleading. The misleading evidence included a statement in Mr. Petrick's affidavit that R Home was a successful hardware operation and that HHSL had provided a guarantee to BNS of an amount equal to 80% of the value of R Home's inventory and 75% of R Home's accounts receivables of less than 90 days. In fact, by 2013, R Home was clearly in a grave financial condition and no such guarantee existed.

[15] On February 24, 2014, R Home and its principals commenced an action in the British Columbia Supreme Court (the "R Home Action") seeking damages against BNS and HHSL. The notice of civil claim in that action makes numerous allegations of wrong-doing against HHSL and BNS.

[16] In the Foreclosure Petition, I held that the allegations made in the R Home Action did not constitute a defence to the claims for judgment and foreclosure in the HHSL foreclosure petition and granted an order nisi of foreclosure and personal judgment against R Home and Mr. and Ms. Petrick in the amount of $2,369,902.57. However, I did not make any findings about the merits of the matters raised in the R Home Action.

Position of the Parties

[17] The applicants submit that they have established entitlement to a bankruptcy order against R Home in accordance with the requirements of the *BIA*. In particular, they submit that:

1. They are creditors of R Home;
2. R Home committed an act of bankruptcy by failing to meet its obligations generally as they fell due within the six months preceding the filing of the application; and
3. The debts owed to each of them by R Home exceed $1000.

[18] R Home submits:

1. BNS has no standing to file a bankruptcy application because its claim is fully secured;
2. Because BNS has no standing there is only one petitioning creditor and there are no special circumstances justifying a bankruptcy order on the petition of only one creditor;
3. R Home has a claim for set off against BNS and a cross claim against BNS and HHSL that should be resolved before a bankruptcy order is made; and
4. The bankruptcy application was filed for the improper purposes of permitting HHSL to gain control of R Home's business, avoiding a trial of the R Home Action on its merits and facilitating the sale of R Home's assets to other Home Hardware dealers.

Discussion

[19] The applicants apply for a bankruptcy order pursuant to s. 43(1) of the *BIA*, the relevant portions of which state:

> Bankruptcy application
>
> 43. (1) Subject to this section, one or more creditors may file in court an application for a bankruptcy order against a debtor if it is alleged in the application that
>
> (*a*) the debt or debts owing to the applicant creditor or creditors amount to one thousand dollars; and
>
> (*b*) the debtor has committed an act of bankruptcy within the six months preceding the filing of the application.
>
> If applicant creditor is a secured creditor
>
> (2) If the applicant creditor referred to in subsection (1) is a secured creditor, they shall in their application either state that they are willing to give up their security for the benefit of the creditors, in the event of a bankruptcy order being made against the debtor, or give an estimate of the value of the applicant creditor's security, and in the latter case they may be admitted as an applicant creditor to the extent of the balance of the debt due to them after deducting the value so estimated, in the same manner as if they were an unsecured creditor.
>
> Affidavit
>
> (3) The application shall be verified by affidavit of the applicant or by someone duly authorized on their behalf having personal knowledge of the facts alleged in the application.

[20] I am satisfied that the applicants have met the requirements of s. 43(1) of the *BIA*.

[21] I have granted judgment in favour of HHSL in the foreclosure action. I am satisfied that HHSL has an unsecured claim in an amount in excess of $1000.

[22] I am also satisfied that BNS has valued its claim honestly and in good faith and has complied with the requirements of s. 43, and therefore is entitled to assert that it has an unsecured claim in excess of $1000.

[23] In the six months preceding the filing of the application, R Home failed to make its required payments to HHSL and failed to pay the balance owed to BNS when its credit facility became due in accordance with its terms. In addition, the

evidence before me is that, as of August 12, 2013, the books and records of R Home show that R Home had accounts payable in the amount of $3,176,051 with respect to invoices that were 90 days past due, of which $2,889,185 was owed to HHSL and $286,871 was owed to 77 other creditors. In addition, as of June 26, 2013, R Home had outstanding and overdue obligations for unremitted source deductions, employee claims, sales taxes, and WorkSafeBC remittances of $217,000.

[24] Based on the forgoing evidence, I am satisfied that R Home had committed an act of bankruptcy in the six months preceding the filing of the bankruptcy application by failing to meet its obligations generally as they fell due. Therefore, unless any of the objections raised by R Home to the making of a bankruptcy order are valid, the bankruptcy order should be made.

R Home's Grounds for Opposing Bankruptcy Order

[25] R Home's first ground of opposition is that BNS has no standing because it is fully secured. In my view, this is not a valid ground for denying BNS standing.

[26] The law is well settled that the court will not review a creditor's estimate of the value of its security unless the estimate is a sham or absurdly low: *Re Hugh M. Grant Ltd.* (1982), 41 C.B.R. 28 (Ont. S.C.). In this case, R Home has led no reliable evidence in support of its assertion that BNS's estimate of the value of its security meets that definition. There is considerable conflict over the value of the remaining assets of R Home after the liquidation of its inventory and fixtures. However, I can see nothing in the evidence to persuade me that BNS has not acted honestly in valuing its security, or that its estimate of the value of its security is a sham or absurdly low.

[27] This finding also negates R Home's second ground of objection, that is, that there is only one petitioning creditor and no special circumstances have been shown to justify the making of a bankruptcy order. In addition, in this case HHSL relies on the failure of R Home to meet its obligations generally as they fell due. There is credible evidence before the Court that there are numerous creditors. In these

circumstances there is no need to show special circumstances: *Pro-Lam Industries 1986 Ltd., (Re.)* (1989), 75 C.B.R. (N.S.) 239 (B.C.S.C.).

[28] For the reasons given in the Foreclosure Petition, I am satisfied that there is no right of set off to the HHSL claim and this ground of objection has no merit.

[29] With respect to the claim of set off against BNS, I do not find this a valid reason for refusing a bankruptcy order. In this regard, I respectfully agree with the analysis of the Honourable Mr. Justice Burnyeat in *Central Coast Carrier Ltd. (Re) (Trustee of)*, 2002 BCSC 312, to the effect that a debtor who alleges a counterclaim or set off that would eliminate a claim of a creditor seeking a bankruptcy order must present a well-documented claim in some detail. In this case, I find the notice of civil claim to be vague and lacking in detail. The documentation that was before the Court does not support the allegations of R Home against BNS.

[30] I am also satisfied that the bankruptcy application was brought for a proper purpose: to reverse the priority of Crown claims that would otherwise rank ahead of the security interests of BNS and HHSL: *Bank of Montreal v. Scott Road Ent. Holdings Ltd.* (1989), 36 B.C.L.R. (2d) 118 (C.A.). In addition, I can find no evidence to support the other improper purpose alleged by R Home. The documentary evidence does not indicate that these proceedings were brought for any improper purpose.

[31] Finally, essentially for the reasons I have already given with respect to the grounds of objection raised by R Home, I can see no useful purpose in staying this application.

Disposition

[32] The application for a bankruptcy order against R Home is granted.

[33] Given the high level of conflict in this case and the allegations made against the receiver, I order that Deloitte Restructuring Inc. be appointed Trustee in respect of R Home instead of Grant Thornton Ltd.

"The Honourable Mr. Justice Sewell"

APPENDIX B

COURT OF APPEAL FOR BRITISH COLUMBIA

Citation: *Home Hardware Stores Limited v. R Home Supply Centre Ltd.*, 2015 BCCA 500

Date: 20151202
Docket: CA42469

Between:

Home Hardware Stores Limited

Respondent
(Petitioner)

And

R Home Supply Centre Ltd.,
Rock Allan Petrick, and Angela Clark Petrick

Appellants
(Respondents)

- and -

Docket: CA42470

Between:

Home Hardware Stores Limited and
The Bank of Nova Scotia

Respondents
(Applicants)

And

R Home Supply Centre Ltd.

Appellant
(Respondent)

Before: The Honourable Madam Justice Newbury
The Honourable Madam Justice Bennett
The Honourable Mr. Justice Harris

On appeal from: Orders of the Supreme Court of British Columbia, both dated December 23, 2014 (*Home Hardware Stores Limited v. R Home Supply Centre Ltd.*, 2014 BCSC 2431, Vancouver Docket No. H140172; *R Home Supply Centre Ltd. (Re)*, 2014 BCSC 2430, Vancouver Docket No. B131248).

Counsel for the Appellants R Home Supply Centre Ltd., Rock Allan Petrick and Angela Clark Petrick:	A.G. Sandilands
Counsel for the Respondent Home Hardware Stores Limited:	S.R. Andersen
Counsel for the Respondent The Bank of Nova Scotia	M. Parrish
Place and Date of Hearing:	Vancouver, British Columbia November 16, 2015
Place and Date of Judgment:	Vancouver, British Columbia December 2, 2015

Written Reasons by:
The Honourable Madam Justice Newbury

Concurred in by:
The Honourable Madam Justice Bennett
The Honourable Mr. Justice Harris

Summary:

The appellants appeal an order nisi of foreclosure and a bankruptcy order primarily on the basis that separate claims for various wrongs alleged against the respondents constituted the basis for equitable set-off of claims. They also claim that the respondent bank did not meet the requirements of s. 43 of the Bankruptcy and Insolvency Act, as well as various factual issues not advanced below. Held: Appeal dismissed. The trial judge made no error in fact or law.

Reasons for Judgment of the Honourable Madam Justice Newbury:

[1] These two appeals, which were heard sequentially, arise out of the indebtedness or alleged indebtedness of the appellant R Home Supply Centre Ltd. ("RH") to creditors. RH operated a "Home Hardware" business in Dawson Creek, B.C. in accordance with a "Dealer Agreement" with the respondent Home Hardware Stores Limited ("HH"). The Agreement provided for the (optional) purchase by RH of inventory from HH "in accordance with its usual terms," and related matters. Amounts accruing due to HH under the Agreement were secured by a mortgage granted by RH on one of two lots on which the business was located, and were guaranteed by the appellants Mr. and Mrs. Petrick, the shareholders of RH. The mortgage in favour of HH ranked behind a mortgage in favour of the Bank of Nova Scotia (the "Bank"), RH's main lender. The Bank also held a General Security Agreement on RH's chattels.

[2] RH's appeal in CA42469 is from an order *nisi* of foreclosure dated December 23, 2014 in favour of HH which fixed the amount for redemption of its mortgage at $2,369,902.57 as of July 22, 2014 plus interest. Because of the unlikelihood of redemption, the Court shortened the redemption period to one week and gave HH conduct of sale. The reasons of the chambers judge, Mr. Justice Sewell, are indexed as 2014 BCSC 2431.

[3] The appeal in CA42470 is from a bankruptcy order in respect of RH, which had been jointly sought by HH and the Bank. It was also granted on December 23, 2014 by Sewell J., for reasons indexed as 2014 BCSC 2430.

[4] Not surprisingly, there is much overlap in the factual background and in the issues raised by RH in its two appeals.

Factual Background

[5] The chambers judge found that RH began to experience financial difficulties in 2011, as shown by growing levels of inventory and what HH described as "chronic arrears." Eventually RH defaulted on the agreed terms of payment referred to in the

Dealer Agreement. On May 31, 2013, the Bank demanded payment of its loans and on July 13, 2013 appointed a receiver of RH's assets. The receiver, Grant Thornton Ltd., closed RH's hardware business and began taking steps to liquidate its assets, including inventory.

[6] On August 27, 2013, both HH and the Bank sought the bankruptcy order and on February 3, 2014, HH initiated the foreclosure proceeding against RH. Mr. and Mrs. Petrick and RH commenced a separate action in the Supreme Court of British Columbia (Docket No. S141391, Vancouver Registry) against both HH and the Bank. It has not yet come to trial.

[7] In their Notice of Civil Claim in that action, the plaintiffs therein asserted that HH had breached its contract with RH in several ways, but also that it had sought to "weaken [RH] so that it would be forced to sell the Store Premises to [HH] or so it would be driven to liquidation"; interfered with RH's efforts to refinance with other lenders in 2011-12; made a false inventory count which had led the Bank to believe RH was falsifying its records; interfered with RH's relationships with other suppliers; was conducting itself oppressively and prejudicially towards RH's interests; and various other allegations. The causes of action pleaded included conversion, detinue, conspiracy, tort and breach of the *Interest Act*, R.S.C. 1985, c. I-15. Together, the pleadings make up the so-called "cross-claim" that was the focus of the chambers judge's reasons, and is the focus of the appeal in the foreclosure action.

The Foreclosure Action (CA 42469)

[8] In the court below, the chambers judge noted, correctly, that the law relating to applications for orders *nisi* is well settled: the court must be satisfied there is no genuine issue for trial with respect to the petitioner's claim. This is similar, Sewell J. noted, to the test for granting judgment under what is now Rule 9-6 of the *Supreme Court Civil Rules*.

[9] The only question before the chambers judge was whether HH should be granted the relief it sought before RH's cross-claim could be determined. The judge

set out the law as stated by Madam Justice McLachlin, as she then was, in *Royal Bank of Canada v. Rizkalla* (1984) 59 B.C.L.R. 324 (S.C.), distinguishing between a counterclaim and a defence in the foreclosure context:

> I thus arrive at the bank's contention that the issues raised by the mortgagors at best constitute only a counterclaim, not a defence.
>
> A defence is a contention that the plaintiff's claim is not established. It adopts one or more of the following positions:
>
> (i) an objection on grounds of jurisdiction;
>
> (ii) a denial of the plaintiff's allegations (traverse);
>
> (iii) a submission that if the plaintiff's allegations are true they disclose no cause of action (demurrer); and
>
> (iv) a submission that if the plaintiff's allegations are true there are facts which provide a legal justification for the defendant's conduct (confession and avoidance).
>
> A counterclaim, on the other hand, is an independent action raised by a defendant, which, because of the identity of the parties, can conveniently be tried with the plaintiff's claim. While a counterclaim frequently (although not necessarily) arises from the same events as the plaintiff's claim, and while it may result in reduction of the plaintiff's claim, it is in principle an independent action.
>
> The bank's claim is for money loaned pursuant to a contract of mortgage. No defences to that claim, whether in the nature of objections to jurisdiction, denial, demurrer or confession and avoidance, are raised. It is not disputed that the money was loaned, nor that it is repayable, together with interest. Nor is it denied that the contracts which the mortgagors signed gave the bank an equitable mortgage on their home in the amount of their indebtedness.
>
> The so-called "defences" raised by the mortgagors reduce, in essence, to the contention that the amount which they owe the bank would have been less had the bank not taken the steps of which they complain. This allegation is not a defence, but an independent claim for damages – a claim founded not upon the contracts upon which the bank bases its claim (the promissory notes and mortgage agreement) but upon a separate contract of assignment of a security. [At 327.]

[10] As the chambers judge noted, the law is clear that a cross-claim that can be advanced by way of equitable set-off (a concept not discussed in *Rizkalla*) does constitute a "defence" to a claim. On this point, he quoted from *Coba Industries Ltd. v. Millie's Holdings (Canada) Ltd.* (1985) 65 B.C.L.R. 31 (C.A.) at 35-6. The Court in that case referred to three types of situations in which set-off is permissible, the third being where a court of Equity would regard the cross-claim as "entitling the

defendant to be protected in one way or another against the plaintiff's claim". (Citing Morris L.J. in *Hanak v. Green* [1958] 2 Q.B. 9 (C.A.)). The circumstances in which Equity will be so engaged were described in *Cam-Net Communications v. Vancouver Telephone Co. Ltd.*, 1999 BCCA 751:

> The law recognizes a distinction between what may be termed abatement and equitable set-off. The former, a product of the common law, applies to cases in which a defendant can show that as a result of the plaintiff's breach, the goods, services, or work provided by the plaintiff are diminished in value. The latter, a product of equity, refers to cases in which a defendant raises a cross-claim which goes directly to impeach the plaintiff's demands, i.e., which is so closely connected with the plaintiff's claim that it would be unjust to allow the plaintiff to enforce payment without taking into account the cross-claim. The latter involves damages other than a diminution of the value of the goods or services provided. [At para. 33; emphasis added.].

[11] The question, then, was whether RH's cross-claim "went directly to impeach" HH's demands and could therefore be advanced in the foreclosure proceeding by way of equitable set-off. HH argued that the allegations set forth in the action were not sufficiently connected to HH's claim under the Dealer Agreement, "which was to collect payment for goods and services supplied to [RH]." (Para. 35.) The chambers judge agreed. In his analysis:

> I have concluded that the respondents' cross-claims do not form the basis for a defence of equitable set off. In my view, there is not a sufficiently close connection between the relief sought by [HH] and the cross-claim to make it inequitable or unjust for [HH] to obtain relief before the cross-claim is resolved.
>
> [HH's] claim is for payment for goods and services supplied by it, directly or indirectly, to R Home. The respondents have not led any evidence to suggest that the goods were in any way diminished in value by any breach of contract or duty on the part of [HH].
>
> I am reinforced in my opinion in this regard by the somewhat nebulous nature of the cross-claim advanced by the respondents. Mr. Petrick's affidavit evidence alleges that [HH] actively took steps to frustrate his refinancing attempts. However, the documentary evidence of [HH's] written communications with potential lenders does not support these allegations. In his oral submissions, counsel for R Home argued that [HH] owed a duty to R Home to act in R Home's best interests and assist it in obtaining new financing. However, he could point to nothing in the Dealer Agreement or any specific element in the relationship between [HH] and R Home to support the existence of such a duty. [At paras. 37-9; emphasis added.]

[12] The chambers judge also rejected RH's contention that until there had been full document disclosure and discovery, it would be unjust to grant HH the relief it sought. On this point, he stated:

> ... this submission does not speak to the threshold issue of whether R Home's cross-claim can be pleaded as a matter of defence as an equitable set off. The respondents have not persuaded me that further disclosure would uncover evidence material to the question of whether it would be unjust to grant the order nisi before the cross-claim is determined. In my view, much of the further discovery sought relates more closely to R Home's claims against [the Bank] and, in particular, the realization steps taken by the Receiver.
>
> Nothing in these reasons precludes R Home, its trustee in bankruptcy, or any party wishing to pursue the cross-claim pursuant to s. 38 of the *BIA* from making an application for production of such documents or conducting examinations for discovery. [At paras. 41-2; emphasis added.]

[13] In the result, the Court granted HH an order *nisi* and judgment against Mr. and Mrs. Petrick under their guarantees. As I have already noted, he fixed the amount owing to HH at $2,369,902.57 plus interest from July 22, 2014.

On Appeal

[14] On appeal, RH contends that the chambers judge erred in finding that the plaintiffs' allegations in the cross-action did not give rise to a right of equitable set-off; in finding that the cross-claim should not be referred to the trial list; and in finding that the balance due to the petitioner HH was proven when there was "no evidence of statements of account, no evidence of what invoices were included, no evidence of the rate of interest applied, and no means of determining whether the amount claimed was correct."

[15] Counsel agreed that, as stated by Mr. Justice Savage in *Fairmont Hot Springs Resort Ltd. v. Linwood Homes Ltd.* 2013 BCSC 589:

> An order *nisi* of foreclosure will not be granted in summary chambers proceedings unless it is 'manifestly clear' that there is no *bona fide* triable issue as to the entitlement of the remedy. In determining whether a triable issue exists, the role of a judge in chambers or a master is not to determine any issue of fact or law. Rather, their function is limited to a determination of whether a *bona fide* triable issue arises on the material before the court in the context of the applicable law: *Re Hughes v. Sharp* (1969), 5 D.L.R. (3d) 760 at 763, 68 W.W.R. 706 (B.C.C.A.). [At para. 5; emphasis added.]

I agree with Mr. Sandilands that this test is "not a high one", as observed by Mr. Justice Hood in *Southeast Toyota Distributors Inc. v. Branch* [1997] B.C.J. No. 1426 (S.C.) at para. 61. On the other hand, I also agree with Hood J. that:

> Bald assertions in a given case may not be enough to resist the order *nisi*, and to justify the transfer of the proceedings to the trial list. This will depend to some extent on the state of the defendant's evidence or case at the time of the application. If he has basically presented his case, then assertion would probably not be enough. On the other hand if the evidence or facts upon which the defendant relies are not within his knowledge or control, and there is a real possibility of a factual base being developed as the trial proceeds, then assertion may be enough. Each case of course will stand alone on its particular circumstances. [At para. 62.]

[16] As we have seen, however, the question of equitable set-off depends not only on the raising of a triable issue, but also on whether the claims advanced by the defendant go to the "root" of the foreclosure action. (See also *TCC Mortgage Holdings Inc. v. Alysen Place Developments Inc.* 2011 BCSC 383 at para. 15.) This has been found to be a question of mixed fact and law to which a deferential standard of review applies: see *Algoma Steel Inc. v. Union Gas Ltd.* (2003) 63 O.R. (3d) 78 (C.A.) at 86-7; *Bardsley v. Stewart* 2014 NSCA 106 at para. 31.

[17] As for the chambers judge's exercise of his discretion in granting the order *nisi*, counsel for HH submitted – and Mr. Sandilands on behalf of RH did not take issue with the contention – that the standard of review is that described in *Dhillon v. Pannu* 2008 BCCA 514:

> An appellate court should not substitute its opinion in place of the opinion of the trial judge or chambers judge under the guise that the judge did not give sufficient weight to a relevant consideration. It is incumbent upon an appellant to demonstrate error on the part of the judge, and an appellate court should not interfere with the exercise of discretion by a judge simply because the judge failed to mention a relevant consideration: see *Garda v. Osborne* (1996), 72 B.C.A.C. 101 at para. 31, and *E.T. v. K.H.T.* (1996), 27 B.C.L.R. (3d) 347, 83 B.C.A.C. 267 at para. 29 (Lambert J.A. dissenting in the result). <u>If the judge's decision is not so clearly wrong as to amount to an injustice, it must be manifest from the judge's reasons that he or she misdirected himself or herself, or gave no weight, or insufficient weight, to a relevant consideration</u>. [At para. 28; emphasis added.]

The Cross-Claim

[18] I will address the first two grounds of appeal together, since they overlap to a large degree. Mr. Sandilands made various allegations of conduct of the part of HH which were said to be breaches of the Dealer Agreement or of a separate "arrangement" that had existed between HH and the Bank with respect to the repurchase of inventory by HH at cost in the event of default by RH under its bank loans. He contended that there was "no provision" in the Dealer Agreement under which HH could legitimately withhold merchandise or refuse to pay third party suppliers and that instead, the only remedy available to HH for RH's defaults under the Dealer Agreement was to terminate it. This contention cannot stand in the face of clear evidence that payment for goods sold by HH to RH under the Dealer Agreement was due within one month of invoicing and that interest accrued at 18% per annum. The arrangement between RH and HH with respect to the payment of third-party suppliers, moreover, was entirely discretionary. Once RH was in default, HH was undoubtedly entitled to decline to extend further credit in any form.

[19] Counsel for RH also relied on the various allegations of wrongdoing in the Notice of Civil Claim I have described above. I do not intend to review these in detail here, as they involve detailed factual assertions that are of interest only to the parties. In my view, it is sufficient to state that no error has been shown on the part of the chambers judge in ruling that there was "not a sufficiently close connection between the relief sought by [HH] and the cross-claim to make it inequitable or unjust for [HH] to obtain relief before the cross-claim is resolved." (Para. 37.) I also agree with the trial judge's characterization of the cross-claim as of a "nebulous nature". In short, it was not shown that the cross-claim "goes directly to impeach the plaintiff's demands" or is such that it would be unjust to allow HH to enforce payment under the mortgage without taking the cross-claim into account.

[20] The remaining ground of appeal – that there was "no evidence" of how HH's claim had been calculated – was not an argument made in the court below. Assuming for the moment it could have been properly advanced in this court, there was ample evidence of RH's defaults and the calculation of the balance owing to

HH. Mr. Sandilands' statement, for example, that the chambers judge was given only a "bald statement" of the amount owing, without any evidence how it was reached, is simply not correct. There was detailed and ample evidence of the computation of the amounts due and owing to it by RH, with appropriate credits for amounts realized. The evidence has not been refuted.

[21] The question of interest was pursued in the court below, but again, we were referred to evidence that amply demonstrates how it was calculated both during periods when HH had agreed to charge a lower rate of 18% in an attempt to assist RH, and when this was not the case.

[22] In all the circumstances, I am not persuaded the chambers judge erred in concluding that the appellants' counterclaims were not such as to engage the principle of equitable set-off or in the exercise of his discretion to grant the decree *nisi*. I would dismiss this appeal.

The Bankruptcy Action (CA42470)

The Chamber Judge's Reasons

[23] As noted earlier, the bankruptcy application brought jointly by HH and the Bank was heard at the same time as HH's application in the foreclosure proceeding. The bankruptcy was resisted by RH, the chambers judge noted, on the principal grounds that it had a defence to the claims of the two creditors, that the application had been brought for an improper purpose, and that the Bank had ample security for its claims and therefore lacked standing to bring the petition. All of these arguments are inter-related.

[24] It will be recalled that by early 2012, RH was in default with respect to the amounts owing to HH under the Dealer Agreement. RH was also experiencing difficulty in its banking relationship and was in default. The Bank notified RH that it would no longer provide credit after August 31, 2012 and demanded repayment of its capital loan and line of credit by that date. The Bank extended this date to March 31, 2013 but when payment was not made by that date, it appointed the

receiver in July. The receiver closed the business and proceeded to liquidate the inventory of the hardware operation. (Para. 12.) It found that it could realize more by selling the inventory at an auction than by invoking HH's 'arrangement' with the Bank.

[25] It will also be recalled that the action commenced by RH and its principals in February 2014 was against the Bank as well as against HH, and made numerous allegations of wrongdoing on the Bank's part.

[26] Section 43 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the "*BIA*") provides as follows:

> *Bankruptcy application*
>
> 43. (1) Subject to this section, one or more creditors may file in court an application for a bankruptcy order against a debtor if it is alleged in the application that
>
> > (*a*) the debt or debts owing to the applicant creditor or creditors amount to one thousand dollars; and
> >
> > (*b*) the debtor has committed an act of bankruptcy within the six months preceding the filing of the application.
>
> *If applicant creditor is a secured creditor*
>
> (2) If the applicant creditor referred to in subsection (1) is a secured creditor, they shall in their application either state that they are willing to give up their security for the benefit of the creditors, in the event of a bankruptcy order being made against the debtor, or give an estimate of the value of the applicant creditor's security, and in the latter case they may be admitted as an applicant creditor to the extent of the balance of the debt due to them after deducting the value so estimated, in the same manner as if they were an unsecured creditor.
>
> *Affidavit*
>
> (3) The application shall be verified by affidavit of the applicant or by someone duly authorized on their behalf having personal knowledge of the facts alleged in the application. [Emphasis added.]

[27] The second alternative described in s. 43(2) was followed in this case. The chambers judge found that the Bank had satisfied the requirements of s. 43 and had valued its claim "honestly and in good faith" and was "entitled to assert that it has an unsecured claim in excess of $1,000." (Para. 22.) In particular, he found that in the six months prior to the filing of the application, RH had failed to make its required

payments to HH and to the Bank when its credit facility became due. The judge continued:

> ... In addition, the evidence before me is that, as of August 12, 2013, the books and records of R Home show that R Home had accounts payable in the amount of $3,176,051 with respect to invoices that were 90 days past due, of which $2,889,185 was owed to [HH] and $286,871 was owed to 77 other creditors. In addition, as of June 26, 2013, R Home had outstanding and overdue obligations for unremitted source deductions, employee claims, sales taxes, and WorkSafeBC remittances of $217,000.
>
> Based on the forgoing evidence, I am satisfied that R Home had committed an act of bankruptcy in the six months preceding the filing of the bankruptcy application by failing to meet its obligations generally as they fell due. Therefore, unless any of the objections raised by R Home to the making of a bankruptcy order are valid, the bankruptcy order should be made. [At paras. 23-4; emphasis added.]

[28] The judge next reviewed the grounds asserted by RH in opposition to the granting of the bankruptcy order. With respect to standing, RH contended that the Bank's estimate of the value of its security was a "sham" or "absurdly low". (See *Re Hugh M. Grant Ltd.* (1982) 41 C.B.R. 28 (Ont. S.C.)) The chambers judge found that RH had not led any reliable evidence in support of this assertion. Indeed there was nothing that persuaded the judge that the Bank "had not acted honestly in valuing its security, or that its estimate of the value of its security was a sham or absurdly low." (At para. 26.)

[29] Another objection advanced by RH was that the Bank's claim of $1,456,073.39 (as at December 31, 2013) had been fully secured on the basis of two real estate appraisals in evidence and that "special circumstances" must be shown to justify the making of a bankruptcy order at the behest of only one creditor. (This argument was based on the assumption that the Bank's claim was fully secured.) The chambers judge rejected this argument on the basis that there was credible evidence before him that numerous creditors of RH were unpaid, and that many of them were government agencies ranking ahead of HH and the Bank. There was no need to show special circumstances where, as here, the debtor had failed to meet its obligations generally to creditors.

[30] On this point, the judge cited *Pro-Lam Industries 1986 Ltd. (Re)* (1989) 75 C.B.R. (N.S.) 239 (B.C.S.C.). In that case, the debtor objected that one of two petitioning creditors had failed to show that it was not meeting its obligations as they fell due and that the bankruptcy petition was simply for the benefit of the one creditor rather than all creditors generally. Relying on *Action Video Centre Ltd. (Re)* (1979) 33 C.B.R. (N.S.) 14 (B.C.S.C.), the debtor submitted that in these circumstances, the creditor must show special circumstances such as fraud. (At 245.) Mr. Justice Legg (as he then was) ruled, however, that special circumstances need not be established "if the petitioner relies upon proof of indebtedness and non-payment of accounts of *other* creditors as well as that of the petitioning creditor." Proof of indebtedness to other creditors had been shown and accordingly, the Court said, the petitioner was not required to prove special circumstances before it could proceed with the receiving order. Legg J. granted the bankruptcy order.

[31] Finally, the chambers judge in the case at bar found no merit in RH's objection based on a right of set-off to the HH claim. In his analysis:

> With respect to the claim of set off against [the Bank], I do not find this a valid reason for refusing a bankruptcy order. In this regard, I respectfully agree with the analysis of the Honourable Mr. Justice Burnyeat in *Central Coast Carrier Ltd. (Re) (Trustee of)*, 2002 BCSC 312, to the effect that a debtor who alleges a counterclaim or set off that would eliminate a claim of a creditor seeking a bankruptcy order must present a well-documented claim in some detail. In this case, I find the notice of civil claim to be vague and lacking in detail. The documentation that was before the Court does not support the allegations of R Home against [the Bank.]
>
> I am also satisfied that the bankruptcy application was brought for a proper purpose: to reverse the priority of Crown claims that would otherwise rank ahead of the security interests of [the Bank] and [HH]: *Bank of Montreal v. Scott Road Ent. Holdings Ltd.* (1989), 36 B.C.L.R. (2d) 118 (C.A.). In addition, I can find no evidence to support the other improper purpose alleged by R Home. The documentary evidence does not indicate that these proceedings were brought for any improper purpose. [At paras. 29-30; emphasis added.]

In the result, he granted the bankruptcy order. He saw no useful purpose in staying the order as sought by RH.

On Appeal

[32] RH advanced three grounds of appeal in its factum, namely that:

> The learned judge erred in failing to find that BNS was not entitled to bring an application for a bankruptcy order because it was a secured creditor, without an unsecured claim in excess of $1,000.00.
>
> The learned trial judge erred in failing to find that there was only one eligible creditor applying for a bankruptcy order, and that no special circumstance existed which would justify making a bankruptcy order.
>
> The learned trial judge erred in failing to give effect to the Appellant's claim to an equitable set-off.

[33] I can deal briefly with the third ground, based as it is on the cross-claim asserted in the other Supreme Court action referred to earlier. In my respectful view, this objection must fail in the present context for the same reasons it failed in the foreclosure action – that the claims as pleaded do not go the root of the claims of the two creditors that were the basis of the bankruptcy application. In addition, the claims are, as the chambers judge stated, not well-documented and "vague" at best. Indeed, the cross-claims seem to be the result of a "kitchen sink" approach to the matter and are unsupported by credible evidence.

[34] With respect to the first and second grounds of appeal, both of which turn on s. 43 of the *BIA,* counsel for the creditors referred to the existence of some 70 other creditors to whom RH has outstanding indebtedness totaling some $286,000, and to the various expenses and disbursements relating to the receivership and the bankruptcy, which can be expected to increase the Bank's shortfall. In all of the circumstances, the amount owing to the Bank clearly exceeds $1,000 and in accordance with *Pro-Lam Industries,* no "special" circumstances were required to be shown, even if one assumed – an optimistic assumption – that the Bank's position was fully secured.

[35] Finally, Mr. Sandilands again asserted many challenges to affidavit evidence filed by the creditors which were not asserted below. He submitted that the receiver had not obtained maximum recovery for RH's inventory, since RH had not invoked its 'arrangement' with the Bank; that the receiver had wrongfully failed to account for some $217,000 in its hands and to pay same to the Bank; and that the Bank's estimate of the value of its security had been "absurdly small". All of these of course

are allegations of fact that should have been raised below so that this court would have findings to consider.

[36] Nevertheless, counsel for the creditors met each of RH's assertions directly. With respect to the value of the mortgaged real property, for example, Mr. Parrish reviewed the "proposals" from real estate agents obtained by the Bank and the more formal appraisals on which RH relied. As the receiver deposed, the appraisals were for the most part not helpful, having been prepared for different purposes and in earlier times. The Bank had used the midpoint of the two "proposals" and on the evidence, this would seem to have been an entirely reasonable and practical course of action. Mr. Parrish also pointed out that RH has had conduct of sale of the property for some time and yet has not been able to sell it for its asking price of $1.9 million.

[37] In the result, while Mr. Sandilands has said everything that could be said on behalf of RH, no error of fact or of law has in my opinion been shown in the chambers judge's findings or conclusions that would support interference by this court. It follows that in my view the appeal must be dismissed in the bankruptcy proceeding as well.

"The Honourable Madam Justice Newbury"

I AGREE:

"The Honourable Madam Justice Bennett"

I AGREE:

"The Honourable Mr. Justice Harris"