Court File No. 10-8630-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

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 NELSON FINANCIAL GROUP LTD.

Applicant

ARGUMENT AND BOOK OF AUTHORITIES IN RESPECT OF THE CLAIMS OF CLIFFORD STYLES, JACKIE STYLES AND PLAYLE INVESTMENTS LTD.

INDEX

B	**Schedule B – List of Statutes**
1	*Bankruptcy and Insolvency Act, R.S.C.* 1985, c. B-3 as amended at s. 2.
2	*Business Corporations Act, R.S.O. 1990,* c. B-16 at ss. 248(2) and 248(3)
3	*Companies Creditors Arrangement Act*, R.S.C. 1985, c. C-36 as amended at s. 2.
4	*Securities Act, R.S.O. 1990, c. S-5* at ss. 53(1) and 130.1(1).

TAB 1

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ARGUMENTS IN RESPECT OF THE CLAIMS OF CLIFFORD STYLES, JACKIE STYLES AND PLAYLE INVESTMENTS LTD.

The following are the arguments in respect of Clifford Styles and Jackie Styles currently listed as Preferred Shareholders of Nelson Financial Group Ltd. And Playle Investments Ltd. also listed as Preferred Shareholder of Nelson Financial Group Ltd. (collectively the "Claimants").

I BACKGROUND FACTS

1. Nelson Financial Group Ltd. ("Nelson" and/or the "corporation") is owned and controlled by Marc Boutet, the principal. Nelson's primary business was borrowing money from investors and then relending such money on automobile loans and other consumer loans and financing leases of equipment including consumer equipment such as automobiles.

Report of the Monitor dated April 15, 2000, Paragraphs 8 and 9

2. Marc Boutet was a long time personal friend and had a personal relationship with

Clifford Styles, Jackie Styles and their company, Playle Investments Ltd. ("Playle"). As such he was in a position of trust and confidence.

Affidavit of Clifford Styles, Paragraph 4

3. Marc Boutet, on behalf of Nelson, approached Clifford and Jackie Styles and Playle with respect to investing in the corporation. These investments started in 1998. They were based on Promissory Notes with a fixed interest rate repayable on the dates set out in the respective Promissory Notes.

Affidavit of Clifford Styles, Paragraph 4

4. Marc Boutet, on behalf of Nelson, approached Clifford and Jackie Styles and Playle to convert their Promissory Notes into Preferred Shares. After the initial refusal, Marc Boutet on behalf of the corporation promised a special deal to Clifford and Jackie Styles and Playle to convert their Notes to Preference Shares.

Affidavit of Clifford Styles, Paragraphs 7 and 8

5. Clifford and Jackie Styles only converted their Notes to Shares in reliance on the specific promises and agreement which included:

(a) a different dividend than the dividend rate set out in the Articles for the Preferred Shares issued;

(b) a promise by the corporation to pay the amounts owed as debt in the same priority as their prior status as Noteholders in effect guaranteeing payment as if they were

not converted.

Affidavit of Clifford Styles, Paragraphs 8 and 9

6. Nelson paid dividends at the rate of 13 ¾% on the Preference Shares to Clifford and Jackie Styles and Playle notwithstanding the rate for said shares under the Articles of Nelson was only 10%.

Affidavit of Clifford Styles, Paragraphs 10 and 11

7. In reliance on these promises, Clifford and Jackie Styles and Playle made further investments in Nelson.

Affidavit of Clifford Styles, Paragraph 12

8. At the time of conversion, Nelson was insolvent and known by Marc Boutet to be insolvent. Because of large accumulated deficits and significant debt it was necessary to convert debt to equity to allow Nelson to continue to operate to allow it to continue to borrow funds and allow it to earn income for Marc Boutet personally. The conversion was done at a time Nelson was insolvent with a view to trying to keep Nelson going.

Affidavit of Clifford Styles, Paragraphs 15, 16, 17 and 18

9. At no time was this disclosed to Clifford and Jackie Styles. In fact, it was deliberately concealed.

Affidavit of Clifford Styles, Paragraph 21

10. There was no signed agreement with Clifford and Jackie Styles or Playle relating to the Preference Shares or conversion of debt to shares which is an all-encompassing single agreement covering all of the terms. The standard documents including a term sheet, advertisement, share certificates, and Accredited Investors Certificate, among others.

Seventh Report of the Monitor dated September, 2010

11. At no time was a prospectus issued nor prospectus type of disclosure made nor offering memorandum type of disclosure made to Clifford or Jackie Styles or Playle.

Affidavit of Clifford Styles, Paragraph, Paragraph 19

II LEGAL ARGUMENTS SUMMARY

There are essentially six legal arguments as to why the claim of Clifford and Jackie Styles and the claim of Playle both be treated as unsecured claims in the proposal of the corporation and any subsequent bankruptcy of the corporation as follows:

1. That the claim is in respect of a separate agreement, separate and apart from the Preferred Shares and the Preferred Shares attributes which is separately enforceable and gives rise to a claim provable in any bankruptcy in a claim under the *Companies' Creditors Arrangement Act* and the *Bankruptcy and Insolvency Act*.

2. That the failure to issue a prospectus made the transaction converting the Promissory Notes to Preferred Shares void, not merely voidable, and as a void transaction restores the parties to their position prior to the transaction and therefore restores the claims of

Clifford and Jackie Styles and Playle with respect to any converted debt to that of a Noteholder. In respect of any new investments, it converts them into a creditor in the amount of the investment as the share issuance was void.

3. That the conduct including the acts and omissions of the corporation and its principal in this matter were oppressive and unfairly prejudicial and unfairly disregarded the interest of Clifford and Jackie Styles as both creditors and security holders in the corporation contrary to the provisions of Section 248(2) of the *Business Corporations Act* and entitles Clifford and Jackie Styles and Playle to make a claim to be converted back to Noteholders or to a judgment which are both claims provable in the bankruptcy and a claim under the *Companies' Creditors Arrangement Act.* Thus, the actions of the corporation in converting their debt to equity at a time the corporation was insolvent and was known to be insolvent and was for the benefit of the corporation and its principal but which was not disclosed to the creditor at the time of the conversion to Clifford and Jackie Styles and Playle.

4. The issuance of the Preference Shares in consideration for the conversion or surrender of the Promissory Notes is contrary to the provisions of Section 23(3) of the *Business Corporations Act* and therefore the share issuance is a nullity and the Claimants are not shareholders of Nelson and therefore do not have an equity interest in Nelson in respect of those shares. Under Section 23(3) of the *Business Corporations Act* shares could not be issued unless consideration is paid in full in money which is not less than the fair equivalent of the money the corporation would have received if the share had been issued

for money. Given that Nelson was insolvent at the time, and given the Preference Shares have a fixed redemption value, the notes exchanged for the Preference Shares were not worth the full face value of the Note and therefore did not represent full consideration for the shares so the share issuance was a nullity.

5. That the claims of Clifford and Jackie Styles and Playle were not "equity claims" within the meaning of the *Bankruptcy and Insolvency Act* according to the new definition effective July 7, 2008. The section is to be read narrowly as it limits their rights and their claims do not fit within the definition under the section An equity claim is a claim in respective of an equity interest. An equity interest is a share in a corporation or a warrant or option or the right to acquire a share in the corporation. The claim of Clifford and Jackie Styles and the claim of Playle arises out of a separate agreement, is in respect of that separate agreement and therefore does not arise out of, and is quite separate from, their rights as Preferred Shareholders. In fact, the separate agreement is quite different from their rights as Preferred Shareholders including different dividend rates.

6. The conversion arose out of a fraudulent misrepresentation at the time of the conversion. As will be discussed below, the prior cases do not apply as they were prior to the recent amendments to the *Bankruptcy and Insolvency Act* defining equity claims and equity interests. The definition of "equity claim" under the *Bankruptcy and Insolvency Act* does not make any reference to misrepresentation including specifically fraudulent misrepresentation. This is not a right of rescission as rescission arises under fraudulent misrepresentation under a prospectus and no prospectus was issued in respect of these

shares.

III SEPARATE AGREEMENT

1. Clifford and Jackie Styles and Playle entered into a separate agreement with the corporation.

2. This is an oral agreement for which there has been part performance which agreement is therefore enforceable. The oral agreement has been partly performed both by the conversion of the Promissory Notes to Preferred Shares and also by the payment of the higher rate of dividend provided for in the separate agreement which is different than the rate of dividend provided for in the Articles of Amendment creating the Preferred Shares. It is also different than the terms of the Terms Sheets which have been presented to the Court as typical Term Sheets by the Monitor in his Seventh Report. At no point has any Term Sheet been provided for Clifford Styles or Jackie Styles or Playle. It is a separate agreement in part because of the difference in terms.

3. There is no subscription agreement or other single agreement covering all aspects of the conveerstion and their investment in the corporation. There are a number of agreements and documents in even a typical transaction, as is evident from the Monitor's Seventh Report. For the Claimants there is no single document evidencing all the terms of the contract. Therefore, the parole evidence rule does not apply as there is no single agreement being amended.

4. The separate agreement is in effect akin to a "guarantee" of repayment of a "debt" by the

corporation. It is a separately enforceable agreement and the claim is being made in respect of such agreement.

IV PROSPECTUS

1. The *Securities Act,* provides that no company shall trade in a security on own account if the trade would be distribution of security unless a preliminary prospectus and a prospectus has been filed and receipts have been issued for them by the Director.

Securities Act, R.S.O. 1990, c.S-5, ss.53(1)

2. No prospectus was issued in respect of any trades in respect of the corporation.

3. The intervention of the Ontario Securities Commission with respect to the corporation is on the basis of the failure to comply with the *Securities Act* including the prospectus requirements. The issuance of further Preferred Shares was prohibited on agreement between the corporation and Ontario Securities Commission due to the violation of the requirements for filing of prospectuses.

4. The trades with Clifford Styles and Jackie Styles and Playle were not permitted under the *Securities Act* including the exemptions thereto. In the case of *Jones v. F. H. Deacon Inc., 1986 LNONOSC 452 (Ont. Supreme Court)* Henry, J. found that a sale of shares in contravention of Section 52 of the *Securities Act,* which is essentially the same as the current provisions of Section 53 of the *Securities Act*, was void and not merely voidable.

Jones v. F. H. Deacon Hodgson Inc., 1986 LNONOSC 452

5. The effect of a transaction being void means that this transaction is as if it had not occurred. If the transaction had not occurred, the conversion of the investments of Clifford Styles and Jackie Styles and Playle from Noteholders to Preferred Shares would not have occurred and they are restored to their prior status as Noteholders.

6. In respect of any subsequent transactions, which are subscriptions for Preferred Shares, because the transaction is void, not merely voidable, the Claimants do not validly own any shares in Nelson, but instead have a claim to be repaid their investment. The Claimants do not have an equity interest as defined under the *Bankruptcy and Insolvency Act* as the share issuance was void. They have a claim not in respect of equity interest but a claim as a creditor for the return of their monies. The transaction was void and therefore the claim is that of an unsecured creditors.

7. This is not a right of rescission. There is a separate right of rescission under the *Securities Act* for misrepresentation in prospectuses. There was no prospectus and therefore no misrepresentation under the prospectus and no right of rescission under the *Securities Act* applicable here.

Securities Act, R.S.O. 1990, c.S-5, Section 130.1(1)

V OPPRESSION CLAIM

1. The oppression claim arises out of the conversion of the Promissory Notes to Preferred Shares at the time the corporation was insolvent. Under Section 248(2) of the *Business Corporations Act,* the actions of the corporation and its principal, Marc Boutet, at the

conversion as well as the issuance of further shares were oppressive to and unfairly prejudicial to the Claimants' interest particularly as Noteholders. The particular conduct included the conversion of debt to equity at a time Nelson was insolvent, effectively reduced the status of their investment from a partial loss to a complete loss and was unfavourably prejudicial to their ranking in repayment on insolvency. This arose out of their status as a creditor and not their status as a shareholder . It resulted in them being shareholders but was oppressive and unfairly prejudicial to their rights as a creditor. The changing of the status of Clifford and Jackie Styles from Promissory Noteholders to Preferred Shareholders with lesser rights at a time when the director, sole officer and shareholder of the corporation knew the corporation was insolvent leaves the corporation liable to the creditor on the basis of oppression.

Fogal Legware of Switzerland v. Garonelli Fashions Inc. (1995), 58 A.C.W.S. (3d) 408 (Ont. General Division).

Canadian Opera Co. v. 680800 Ontario Inc., (1989), 69 O.R. (2d), 532.

Prime Computer of Canada Ltd. v. Jeffery (1991), 60 O.R. (3d) 733.

2. The claim of Clifford and Jackie Styles and Playle for oppression under Section 248(2) is in the capacity as creditor in the conversion as the transaction which unfairly disregarded their interest and was prejudicial and oppressive to them occurred on the conversion of their investment from a Noteholder to a Preferred Shareholder.

3. The oppression claim in respect of the conversion is not an equity claim in the meaning

of the *Bankruptcy and Insolvency Act*. It is a claim for a conversion of status back to the proper status of Promissory Noteholder. It is a claim not arising out of an equity interest, i.e. their Preferred Shares in the corporation, but out of their status as a creditor. Therefore it is not an equity claim and as such should be viewed as a claim provable in bankruptcy.

4. It is clearly oppressive to a creditor to convert their credit to a status of an equity holder, i.e. a holder of Preferred Shares with a lower ranking in priority in repayment on bankruptcy when at the time the corporation was insolvent and that insolvency was not disclosed and in fact was deliberately hidden.

5. Under Section 248(3) of the *Business Corporations Act*, the court may make any interim or final order it thinks fit including an order varying or setting aside a transaction or contract which a corporation is a party and an order compensating the aggrieved person.

6. It is appropriate given the conduct here for an order of the court setting aside the transaction and restoring the parties to their prior status as Noteholders to restore the higher priority on bankruptcy of a Noteholder which they would have kept if they had known of the insolvency at the time of the proposed conversion.

7. It is also appropriate given the conduct here for an Order of the Court setting aside the transaction of the issuance of the further new Preferred Shares and granting a judgment for the repayment of money to our clients representing the reimbursement of the investment or issuance price, which claim would be a claim provable in the bankruptcy.

VI SHARE ISSUANCE ANNULITY

1. Under the provisions of the *Business Corporations Act* and in particular Section 23(3):

   A share shall not be issued until consideration for the shares fully paid in money or in property or past service that is not less in value than the fair equivalent of the money that the corporation would have received if the share had been issued for money.

2. The shares issued on the conversion from Promissory Notes were issued in consideration of the surrender of the Promissory Notes. The financial statements disclosed that at the time of conversion the corporation was insolvent. The corporation was known by its sole director to have been insolvent at such time.

Cross-Examination of Marc Boutet held on August 17, 2010 at Questions 72, 73, 76, 77-79 and 134-137

3. Therefore the Promissory Notes were not worth their face value given the corporation was insolvent at the time of conversion. The Articles of Amendment of the corporation provided that the Preferred Shares were to be redeemed at the amount paid for the shares. They had a stated redemption value of $25.00 per share under the term sheet. However, the Notes with a face value of $25.00 exchanged for such share were not worth their face value and therefore the consideration for the share was not fully paid.

4. Because the section provides that shares shall not be issued until the consideration has been fully paid in property (in this case in the form of Promissory Notes), the shares could not and must not be issued until fully paid. Therefore, the purported issue of

Preferred Shares on the conversion of the Promissory Notes and its consideration for the surrender of the Promissory Notes was a nullity.

Re Dunham and Apollo Tours Ltd. (1978), 20 O.R. (2d) 3

Javelin International Ltd. (Receiver) v. Hillier, 40 B.L.R. 249

VII EQUITY CLAIM DEFINITION

1. A provision which is punitive in nature or restricts or removes rights of parties is to be read and construed narrowly. The definition of "equity claim" and "equity interest" removes persons who have such claim from having any claim in or any priority in the estate of the bankrupt/insolvent corporation and as such it is restrictive and/or punitive and should be read narrowly.

2. For a claim to constitute an equity claim, first of all it must be in respect of an "equity interest". As the corporation is a corporation, equity interest means, under the provisions of the *Bankruptcy and Insolvency Act* in the case of a corporation a share in the corporation or a warrant or option or the right to acquire a share in the corporation other than one that is derived from a convertible debt.

Bankruptcy and Insolvency Act, R.S.C. 1985, c.B-3, ss.2

3. By the reference to exceptions to shares which are derived from a convertible debt, the section makes it clear that equity interest is limited to shares in the corporation or rights to acquire shares in the corporation and that other instruments or agreements of the

corporation such as those relating to convertible debts do not constitute an equity interest.

4. As such, the separate agreement with respect to the repayment or guarantee of the repayment of the monies and their priority is a separate agreement which does not constitute an equity interest. It may be related to an equity interest such as a convertible debt would be but it is not a share nor an interest in a share and therefore is not an equity interest. A right to be restored because the transaction is void under the Securities Act or set aside by the court under either the *Securities Act* or the oppression remedy under the *Business Corporations Act* which restores the creditor to the position of an unsecured creditor is not a share, warrant, an option or another right to acquire a share. It is therefore not an equity interest.

5. The definition of equity claim means a claim in respect of an equity interest including:

(a) a claim for a dividend or similar payment;

(b) a return of capital;

(c) a redemption or retraction obligation;

(d) a monetary loss arising from the ownership, purchase or sale of an equity interest or from the rescission of a purchase or sale of an equity interest; or

(e) contribution or indemnity in respect to the claim referred to in any of sub-paragraphs (a) through (d).

A guarantee or agreement of repayment of amounts which are treated as having the same

rights and priority as a loan to the corporation is not within any of the sub-headings under the definition of an equity claim nor is it a claim in respect of an equity interest but is a separate claim in respect of repayment of monies loaned and that the monies be treated as a loan notwithstanding that there may also be preferred shares issued. As such it does not fit within the definition of equity claim.

6. A right to declare a transaction void which restores the prior status of the parties to being a Noteholder is not a dividend, a return of capital, a redemption or retraction obligation, a monetary loss or contribution or indemnity. It is a right to a particular status and as such does not fall within the definition of equity claim.

7. A claim under the oppression remedy which includes a claim for restoration to the status as a creditor as it derives out of a judgment that the parties' status would have remained as a creditor if not for the oppressive conduct, is not an interest in respect or a claim in respect of an equity interest. In fact it is a claim in respect of an interest as a creditor who has been treated oppressively by the corporation and therefore does not fit within the definition of equity claim.

VIII MISREPRESENTATION

1. A claim for misrepresentation is a tort claim and is a separate claim. In the definition of equity claim there is no reference to a tort claim arising from or relating to the conversion of one asset, namely a Promissory Note to another asset, Preferred Shares, or in respect of the issuance of a Preferred Share without a prospectus.

2. There is reference in the opinion of Ms Pillon of Stikeman Elliott LLP to the case *Blue Range Resources Corp., Re (2000), 2000 Carswell Alta 12 (Alta Court of Queens Bench). ("Blue Range")*

3. The Blue Range case was decided prior to the encoding of the definition of equity interest and equity claim and as such is not applicable to the case in hand.

4. The Blue Range case does not deal with claims under a separate agreement such as here, where the true relationship has been turned into that of a debtor and creditor. In fact, the court in the Blue Range case makes reference to the Central Capital case in Paragraph 20 for the proposition that the court must look to the surrounding circumstances to determine whether the true nature of the relationship is that of a shareholder who has equity in the company or whether it is that of a creditor owed a debt or liability. In this case, the separate agreement turns it into a debtor/creditor relationship.

Re Central Capital Corporation (1996), 132 D.L.R. (4th), 223 (Ont. C.A.)

5. The comment is made in the Blue Range case "this tort claim derives from Big Bear's status as a shareholder and not from a tort unrelated to that status" at Paragraph 22.

6. In this case the tort arises out of the claimant's status as a creditor and the improper conversion of their status from creditor to shareholder due to oppressive conduct and due deliberate or fraudulent misrepresentation as to the status of the corporation.

7. In Blue Range it is recognized that some claims of misrepresentation may be a claim in tort as opposed to a claim as a shareholder in any event even prior to the codification of

the definitions in the *Bankruptcy and Insolvency Act*. The courts said at Paragraph 22 "the claim for misrepresentation therefore is hybrid in nature and combines the elements of both a claim in tort and a claim as a shareholder. It must be determined what character it has in substance".

8. In Blue Range it was a request for damages. In this case in part, on the conversion, no damages are being requested, only the restoration of the status of the claimants as Noteholders. Therefore the subject facts are distinguishable from the Blue Range case in any event.

9. In Paragraph 33 of the Blue Range case reference is made to a U.S. case to the effect that "defrauded stockholder claimants in the purchase of stock are presumed to have been bargaining for equity-type profits and assumed equity-type risks. The conventional creditors are presumed to have dealt with the corporation with the reasonable expectation that they would have a senior position against its assets to that of the alleged stockholder claims based on fraud".

10. Based on the facts, the Claimants here have dealt with the corporation on the reasonable expectation that they would have a debtor's position against the assets and in fact would have a similar or equal ranking against the assets of the corporation as the Noteholders. At no time were they bargaining for equity-type profits or assuming equity-type risks. In fact, they had all understood that they were bargaining for equivalent rights to the Noteholders.

IX SEPARATE REPRESENTATION

1. It is quite clear that the claimants here have a unique claim based on the particular circumstances of the agreements made , the oppressive conduct, and the failure to issue a prospectus. As such, they should be entitled to separate representation as other classes of creditors are entitled to separate representation in this Companies' Creditors Arrange Act proceeding to ensure their rights are properly protected and their case put forth to the court properly. Therefore we would respectfully suggest that separate counsel be retained on the same basis as separate counsel has been retained for the Noteholders, for the Preferred Shareholders/Debtholders in the corporation.

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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 NELSON FINANCIAL GROUP LTD.

Court File No. 10-8630-00C>

SUPERIOR COURT OF JUSTICE
(Commercial List)

(Action commenced in Toronto, Ontario)

ARGUMENTS IN RESPECT OF THE CLAIMS OF CLIFFORD STYLES, JACKIE STYLES AND PLAYLE INVESTMENTS LTD.

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TAB 2

Court File No. 10-8630-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

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 NELSON FINANCIAL GROUP LTD.

TABLE OF AUTHORITIES IN RESPECT OF THE CLAIMS OF CLIFFORD STYLES, JACKIE STYLES AND PLAYLE INVESTMENTS LTD.

A	**Schedule A – Cases**
1	*Canadian Opera Co. v. 670800 Ontario Inc.*, 69 O.R. (2d) 532, [1989] O.J. No.1307.
2	*Jones v. F.H. Deacon Hodgson Inc.,* (1986), 9 OSCB 5579, 1986 LNONOSC 452.
3	*Fogal Legwear of Switzerland, Inc. v. Garoneli Fashions Inc.*, 58 A.C.W.S. (3d) 406, [1995] O.J. No. 3022.
4	*Javelin International Ltd (Receiver of) v. Hillier*, 40 B.L.R. 249, [1988] Q.J. No. 928
5	*Prime Compute of Canada Ltd. v. Jeffrey*, 6 O.R. (3d) 733, [1991] O.J. No. 2317.
6	*Re Blue Range Resource Corp.*, (2000), 15 C.B.R. (4th) 169, 2000 ABQB 4 (Ab.QB.).
7	*Re Central Capital Corporation* (1996), 132 D.L.R. (4th) 223, 27 O.R. (3d) 494
8	*Re: Dunham and Apollo Tours Ltd.* (1978) 20 O.R. (2d) 3
B	**Schedule B – Statutes**
1	*Bankruptcy and Insolvency Act, R.S.C.* 1985, c. B-3 as amended at s. 2.
2	*Business Corporations Act, R.S.O. 1990,* c. B-16 at ss. 248(2) and 248(3)
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TAB A

TAB 1

Re

Canadian Opera Co. and 670800 Ontario Inc. et al.** Indexed as: Canadian Opera Co. v. 670800 Ontario Inc. (H.C.J.)

69 O.R. (2d) 532

[1989] O.J. No. 1307

Action No. RE1251/89

ONTARIO
High Court of Justice

Hollingworth J.

June 13* and September 11, 1989.

**On appeal to the Ontario Divisional Court (File No. 872/ 89).

*Released August 4, 1989.

Corporations -- Oppression -- Charity giving cheque for car to dealer -- Dealer not registered, failing to deliver car or return most of money -- Charity a creditor and entitled to claim under oppression provision -- Business Corporations Act, 1982, S.O. 1982, c. 4, ss. 244(b)(iii), 247.

The applicant was a charity, which contracted with the respondents for the purchase of a luxury car. The charity delivered a cheque for the purchase price to the respondents, but they failed to deliver the car. Subsequently, it was discovered that the respondents were not registered to deal in cars and faced innumerable fraud charges. They only returned a small amount of the moneys. The applicant brought this application under the oppression provision of the Business Corporations Act, 1982, S.O. 1982, c. 4, for the return of the moneys.

Held, the application should be granted.

The applicant was a creditor of the respondent corporation and was, therefore, a complainant under s. 244(b)(iii) of the Act as "any other person who, in the discretion of the court, is a proper person to make an application". Further, the action of the respondents was oppressive or unfairly prejudicial to or unfairly disregarded the interests of the applicant as creditor, as required by s. 247. The applicant was, therefore, entitled to recover the amount paid with interest, less the amount repaid.

First Edmonton Place Ltd. v. 31588 Alberta Ltd. (1988), 60 Alta. L.R. (2d) 122, 40 B.L.R. 28, consd

Statutes referred to

Business Corporations Act, 1982, S.O. 1982, c. 4, ss. 244(b), 245(1), (2), 246(a), (b), (c), 247(1), (2), (3)
Courts of Justice Act, 1984, S.O. 1984, c. 11
Motor Vehicle Dealers Act, R.S.O. 1980, c. 299

APPLICATION by a creditor of a corporation for judgment on the ground of oppression.

N.B. Gross, for applicant.

G.G. Hector, for respondent.

June 13, 1989.

HOLLINGWORTH J. (orally):-- This is an application for a declaration granting judgment against both respondents on the basis of the following facts. Implicit in this application is a request for leave to bring the application, and that is the first question I must determine.

On October 6, 1988, the Canadian Opera Company (the C.O.C.), endeavoured to purchase a 1988 Ferrari from 670800 Ontario Inc. and Van Essen for $131,760. Van Essen promised delivery on October 20, 1988, and the fact is that delivery has never been made. Incredibly, C.O.C. delivered the money before receiving the car, and did not check to find out whether or not the numbered company or Van Essen were registered and carried on business under the Motor Vehicle Dealers Act, R.S.O. 1980, c. 299. They were not registered as such and were subsequently convicted under the Act.

C.O.C. has indicated it never did receive the car, and only $10,000 as part repayment. It asks for the balance, plus interest plus costs. I understand that the numbered company is a shell, and both defendants face innumerable fraud charges.

The applicant sues under the Business Corporations Act, 1982, S.O. 1982, c. 4, and subsequent amendments and particularly ss. 244 and 247 of that Act. It will be seen that this application for relief is under the oppressive section of that statute.

It is necessary to cite some sections of this statute: s. 244 reads, in part, as follows:

Interpretation

244. In this Part,

. . . . .

(b) "complainant" means,
(i) a registered holder or beneficial owner, and a former registered holder or beneficial owner, of a security of a corporation or any of its affiliates,
(ii) a director or an officer or a former director or officer of a corporation or of any of its affiliates,
(iii) any other person who, in the discretion of the court, is a proper person to make an application under this Part.

Derivative actions

245(1) Subject to subsection (2), a complainant may apply to the court for leave to bring an action in the name and on behalf of a corporation or any of its subsidiaries, or intervene in an action to which any such body corporate is a party, for the purpose of prosecuting, defending or discontinuing the action on behalf of the body corporate.

Idem

(2) No action may be brought and no intervention in an action may be made under subsection (1) unless the complainant has given fourteen days' notice to the directors of the corporation or its subsidiary of his intention to apply to the court under subsection (1) and the court is satisfied that,

(a) the directors of the corporation or its subsidiary will not bring, diligently prosecute or defend or discontinue the action;

(b) the complainant is acting in good faith; and

(c) it appears to be in the interests of the corporation or its subsidiary that the action be brought, prosecuted, defended or discontinued.

. . . . .

Court order

246. In connection with an action brought or intervened in under section 245, the court may at any time make any order it thinks fit including, without limiting the generality of the foregoing,

(a) an order authorizing the complainant or any other person to control the conduct of the action;

(b) an order giving directions for the conduct of the action;

(c) an order directing that any amount adjudged payable by a defendant in the action shall be paid, in whole or in part, directly to former and present security holders of the corporation or its subsidiary instead of to the corporation or its subsidiary;

. . . . .

Application to the court: oppression of remedy

247(1) A complainant, the Director and, in the case of an offering corporation, the Commission may apply to the court for an order under this section.

Idem

(2) Where, upon an application under subsection (1) the court is satisfied that in respect of a corporation or any of its affiliates,

(a) any act or omission of the corporation or any of its affiliates effects or threatens to effect a result;

(b) the business or affairs of the corporation or any of its affiliates are, have been or are threatened to be carried on or conducted in a manner; or

(c) the powers of the directors of the corporation or any of its affiliates are, have been or are threatened to be exercised in a manner,

that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer of the corporation, the court may make an order to rectify the matters complained of.

Court order

(3) In connection with an application under this section, the court may make any interim or final order it thinks fit including, without limiting the generality of the foregoing,

. . . . .

(h) an order varying or setting aside a transaction or contract to which a corporation is a party and compensating the corporation or any other party to the transaction or contract;

. . . . .

(j) an order compensating an aggrieved person;

Historically, it will be seen that this oppressive section originally dealt with a director or shareholder and allowed such to sue the company, but this was extended by s. 244(b) (iii) which states:

(iii) any other person who, in the discretion of the court, is a proper person to make an application under this Part.

The fact that a creditor may sue is confirmed also by the fact that in s. 247 the operative cause says that any act:

> ... that is oppressive or unfairly prejudicial to or unfairly disregards the interests of any security holder, creditor, director or officer of the corporation, the court may make an order to rectify the matters complained of.

Mr. Gross argues that his client is a complainant under s. 244(b)(iii) and is of course a creditor under s. 247. Mr. Hector indicates that this Act was not meant to cover a creditor in the applicant's position and as a result thereof, the creditor has many other remedies and is precluded from suing under this particular section.

The jurisdiction, as would be expected for a brand new section of a statute, is sparse. Mr. Gross relies heavily on an Alberta case which covers exactly the same section, namely s. 244 (b)(iii). This case is First Edmonton Place Ltd. v. 31588 Alberta Ltd. (1988), 60 Alta. L.R. (2d) 122, 40 B.L.R. 28 (Q.B.). In this prolix, carefully reasoned and comprehensive decision, Mr. Justice McDonald has really, so far as I can divine, explored this area for the first time, namely that a creditor may apply for judgment under the oppressive section of the Alberta Business Corporations Act.

In the result, the learned judge found against the applicant in that case because the applicant did not establish that there was a creditor-debtor relationship. Mr. Gross distinguishes this case because clearly, he contends, there is a creditor-debtor relationship as soon as C.O.C. contracted for the car, particularly because they had turned over the money. I would agree with him in this aspect.

As I see it, Mr. Gross has to establish that the applicant is a person who could reasonably be entrusted with the responsibility of advancing the interest of the corporation by seeking to remedy a wrong allegedly done to the corporation. Once this is established, and I think that Mr. Gross has been able to do so by bringing the application under s. 244(b)(iii), then the matter of good faith must be established and "it appears to be in the interest of the corporation or subsidiary that the action be brought".

On the facts in this case, it appears clear that the good faith of the applicant in this case cannot be impugned.

Finally, the tests of inequity, oppression, unfair prejudice and unfair disregard of the interests of the corporation must be weighed, and I have no hesitation in finding that the applicant succeeds under this head.

I therefore find that the applicant is a complainant under s. 244(b)(iii) and I give him leave to bring this application. I further find that he has met the requirements of the subsections of the Act to which I have already alluded, and I therefore give him a declaration to the effect that judgment will go in the amount of $131,760 less the return of the $10,000 or a total of $121,740 plus interest according to the Courts of Justice Act, 1984, S.O. 1984, c. 11, from October 8, 1988.

The applicant is also entitled to its costs on a solicitor-and-client basis, against both defendants.

SUPPLEMENTARY REASONS

September 11, 1989.

I am amending my reasons of August 4, 1989, as follows:

At the bottom of p. 7 of my reasons, I add this paragraph:

I also grant a declaration that the $131,760 paid by the applicant to 670800 Ontario Inc. on October 6, 1988, constitutes trust moneys held by the respondent for the benefit of the applicant.

Application granted.

TAB 2

Sale of Securities Contrary to Section 52 of the OSA
Case Name: Jones v. F.H. Deacon Hodgson Inc.
Between
Malcolm Jones, Plaintiff, and
F.H. Deacon Hodgson Inc., Defendant
Supreme Court of Ontario - High Court of Justice
Toronto Weekly Court

1986 LNONOSC 452

Also reported at: (1986), 9 OSCB 5579

Ontario Securities Commission

Henry J.

Heard: August 21, 1986
Judgment: September 17, 1986

The following is a judgment of the Supreme Court of Ontario concerning the Sale of Securities contrary to section 52 of the Ontario Securities Act.

COUNSEL:

R. Paul Steep and Susan Reid, for the Plaintiff.

M. McGowan, for the Defendant.

HENRY J.:-- The issue on this motion is whether a sale of shares in contravention of s. 52 of the Securities Act, R.S.O. 1980, c. 466, is void for failure to file a prospectus with the Ontario Securities Commission. That section provides in part:

> 52(1) No person or company shall trade in a security on his own account or on behalf of any other person or company,
>
> (a) before the 15th day of March, 1981, where such trade would be a distribution to the public of such security;
> (b) on and after the 15th day of March, 1981, where such trade would be a distribution of such security,
>
> unless a preliminary prospectus and a prospectus have been filed and receipts therefor obtained from the Director.

The facts as pleaded by the plaintiff in the action are as follows and are not disputed for the purposes of this motion.

The defendant F.H. Deacon Hodgson Inc. (Deacon), is an investment dealer. In December 1980, Deacon caused a private company Bacova Investments Limited to be incorporated for the purpose of investing in Lumax Oil and Gas Limited, an oil

exploration company whose shares are traded over the counter. In January 1982, Deacon offered for sale shares in Bacova and solicited subscribers. It is common ground that this constituted a distribution of shares to the public within the meaning of s. 52(1) of the Securities Act; it is also common ground that Bacova did not file a prospectus with the Ontario Securities Commission as required by s. 52(1)(a).

The plaintiff purchased shares in Bacova through the defendant Deacon in January 1982. The plaintiff's action, commenced in February 1986, is for a declaration that the contract of purchase and sale of the shares is void; he also claims return of $24,000, the price paid by him to Deacon for the shares together with interest.

The defendant now brings this motion to dismiss the action on the ground that is it statute-barred. The rationale of this position is as follows:

(1) Section 70(1) of the Securities Act creates an obligation for a dealer to deliver a prospectus to a purchaser of securities and states as follows:

> 70(1) A dealer not acting as agent of the purchaser who receives an order or subscription for a security offered in a distribution to which subsection 52(1) or section 61 is applicable shall, unless he has previously done so, send by prepaid mail or deliver to the purchaser the latest prospectus and any amendment to the prospectus filed either before entering into an agreement of purchase and sale resulting from the order or subscription or not later than midnight on the second day, exclusive of Saturday, Sundays, and holidays, after entering into such agreement.

(2) Section 130 of the Securities Act creates civil liability for a dealer or offeror who fails to deliver a prospectus to a purchaser of securities. That section provides:

> 130 A purchaser of a security to whom a prospectus was required to be sent or delivered but was not sent or delivered in compliance with subsection 70(1) or an offeree to whom a take-over circular or issuer bid circular was required to be communicated but was not communicated in compliance with section 92 has a right of action for rescission or damages against the dealer or offeror who failed to comply with the applicable requirement.

(3) Section 135 of the Securities Act provides a maximum three-year limitation period in the following language:

> 135 Unless otherwise provided in this act, no action shall be commenced to enforce a right created by this Part more than,
>
> (a) in the case of an action for rescission, 180 days after the date of the transaction that gave rise to the cause of action; or
> (b) in the case of any action, other than an action for rescission, the earlier of,
> (i) 180 days after the plaintiff first had knowledge of the facts giving rise to the cause of action, or
> (ii) three years after the date of the transaction that gave rise to the cause of action.

To this the plaintiff simply replies that he is not relying on s. 130 which creates a civil remedy for breach of s. 70(1); he relies solely on the breach of s. 52(1) which he submits gives rise to a common law right of action for its breach; it is not a right of action created by Part XXII of the Act and the limitation provision in s. 135 does not apply to it.

The defendant counters by saying that by enacting s. 52(1) the legislature did not intend to provide a civil remedy for its breach but has provided a criminal penalty only. The only civil remedy available to the plaintiff is s. 70 which is "triggered" by the breach of s. 52(1) and s. 130; hence the action, being commenced more than three years after the shares were purchased and sold, is statute-barred.

I have reached the conclusion on the basis of the full and able submissions of counsel, that the plaintiff's cause of action properly lies for breach of s. 52(1) and that the limitation period prescribed by s. 135 does not apply to it.

The starting point in the resolution of this issue is the decision of the Supreme Court of Canada in Re Northwestern Trust Co; McAskill's case [1926] S.C.R. 412. That decision applied the general principle that a contract expressly or impliedly prohibited by statute is void. McAskill subscribed for shares of Northwestern Trust and was allotted shares which were not fully paid. Subsequently, one and a half years later, the company was ordered to be wound up by the court and the liquidator called on McAskill for the balance of his contribution. It transpired that the company had failed to obtain the permission and

authority of Public Utilities Commission of Manitoba to sell its shares as required by the Manitoba Sale of Shares Act, R.S.M. 1913, c. 175. It had failed to file documents disclosing the financial and other affiars of the company (analogous to a prospectus) and had not obtained for itself or its agents a certificate and a licence of the Commission to sell its shares. Unknown to McAskill at the time, the sale to McAskill thereby contravened the Manitoba Sale of Shares Act. The court held the sale to be void so that the liquidator was precluded from getting in the balance of his contribution for the shares. As Mignault J. put it at p. 430-431:

> Taking into consideration the character of the statute, its language and also the purpose for which it was enacted - which was to protect the general public against schemes or campaigns to sell shares or securities of doubtful value to unwary investors through agents, and with the aid of advertisements, circulars or other methods of publicity - the conclusion seems inevitable that the Sale of Shares Act deals with a matter of public policy and that anything done in contravention of its prohibitions is void and not merely voidable. It is true that per se every sale of its shares by a company is not made unlawful (s. 5 of c. 105 of 1914). It is the sale effected "in the course of continued and successive acts," as defined, which falls under the prohibitions of the statute. A sale so made, and all steps taken to carry it out, such as an allotment of shares, are void.

This general principle again came before the Supreme Court of Canada in relation to sale of shares in Myers v. Freeholders Oil Company Limited, (1960) 25 D.L.R. (2d) 81; [1960] S.C.R. 761. The Security Frauds Prevention Act, R.S.S. 1940, c. 287 (later the Securities Act, 1954 c. 49) was invoked to nullify trading in the shares of a mining lease. The salesman's qualification to sell the shares was not in issue as the company itself was licensed as a broker; but the Act prohibited salesmen calling at a private residence to trade in securities with the public. The court, per Martland J. reiterated the principal in Re Northwestern Trust Co., McAskill's case, but said that where the statute provided a penalty for the offence the court must then look to the act as a whole to determine if that is the sole remedy intended by the legislature. The court concluded that the prohibition against salesmen calling at investors' homes to sell securities was not part of the fundamental scheme of protecting the public against unauthorized trading; the penalty prescribed was the only remedy and the sale was not void.

The analysis of Martland J. is instructive as to the proper approach that the courts should take (pp 92 - 93)

> The determination of the effect of the breach of a statutory provision upon a contract is often a difficult one and must, of course, depend upon the terms and the intent of the provision under consideration. In some cases the statute clearly forbids the making of a certain kind of contract. In such a case the contract cannot be valid if it is in breach of the provision. An example of this kind is found in the provisions of the Manitoba Sale of Shares Act, R.S.M. 1913, c. 175, which was considered by this Court in Re Northwestern Trust Co., McAskill's Case, [1926], 3 D.L.R. 612, S.C.R. 412, 7 C.B.R. 440. Section 4 of that Act provided:
>
> > It shall hereafter be unlawful for any person or persons, corporation or company, or any agent acting on his, their or its behalf, to sell or offer to sell, or to directly or indirectly attempt to sell, in the Province of Manitoba, any shares, stocks, bonds or other securities or any corporation or company, syndicate or association of persons, incorporated or unincorporated, other than the securities hereinafter excepted, without first obtaining from the Public Utility Commissioner, hereinafter styled the commissioner, a certificate to the effect hereinafter set forth and a license to such agent in the manner hereinafter provided for.
>
> Section 6, in part, read:
>
> > It shall not be lawful for any person or any such company, either as principal or agent, to transact any business, in form or character similar to that set forth in section 4, until such person or such company shall have filed the papers and documents hereinafter provided for.
>
> The Court held in that case that a sale of shares made by a company which had failed to comply with the statutory provisions was void and not voidable.
>
> Section 16 of the Security Frauds Prevention Act, itself, contains an express provision whereby, in the circumstances therein defined, a contract by a customer of a broker shall be void, at the option of such customer.

On the other hand, some statutes have been construed as only imposing a penalty, where the Act provides for one, although that is not necessarily the result of a penalty provision being incorporated in the Act. Lord Esher posed the question which must be determined in Melliss v. Shirley Local Board (1885), 16 Q.B.D. 446 at pp. 451-2, as follows:

> Although a statute contains no express words making void a contract which it prohibits, yet, when it inflicts a penalty for the breach of the prohibition, you must consider the whole Act as well as the particular enactment in question, and come to a decision, either from the context or the subject matter, whether the penalty is imposed with intent merely to deter persons from entering into the contract, or for the purposes of revenue, or whether is it intended that the contract shall not be entered into so as to be valid at law.

In the present case I have come to the conclusion that it was not the intention of s. 17a of the Security Frauds Prevention Act to render completely void a trade in securities because it is made at a residence. The general intent of the statute is to afford protection to the public against trades in securities by persons seeking to trade who have not satisfied the Registrar as to their proper qualification so to do. For that reason the registration provisions of s. 3 are incorporated in the Act. But s. 17a is not a part of this general pattern, because it applies to registered brokers and salesmen as well as to those who are not registered. As I see it, its purpose is not to prevent trading of an unauthorized kind, but is intended to prevent persons in their own residences from being sought out there by stock salesmen. It is the place at which the negotiations occur which is important in this section and not the character of the negotiations themselves. It seeks to deter salesmen from attempting to make contracts, which otherwise may be quite proper, at a particular place. This being so, it is my opinion that a breach of s. 17a in relation to a transaction otherwise lawful, results, not in preventing the contract from being valid, but in the incurring of a penalty by the person who is in breach of it.

I do not think, therefore, that the breach of s. 17a resulted in the agreement in question here being rendered void.

In my opinion the appeal should be dismissed with costs.

This, in my opinion, is the proper approach which ought to be followed by this court in determining whether the Ontario Securities Act by the clear and unambiguous prohibition in s. 52(1) leaves unimpaired the common law principle that a breach of its injunction results in a sale of shares that is void as was the case in re Northwestern Trust. I add that the British Columbia Court of Appeal in Ames et al. v. Investo-Plan Ltd. et al. (1973), 35 D.L.R. 93d) 613 which appears to be the last word on a statute in pari materia reached the conclusion that breach of a provision similar to s. 52(1) in the British Columbia Securities Act did not result in a contract that was void or voidable. I shall return to this decision which, with respect, I consider should not be applied to the Ontario Act before me.

Section 52(1) of the Ontario Securities Act in clear terms prohibits any person from trading shares of a company unless a prospectus has been filed with the Ontario Securities Commission and a receipt therefore obtained from the director. By s. 60 (1) the director shall issue a receipt for a prospectus filed unless it appears to him that it is not in the public interest to do so; the remainder of the section sets out the grounds on which the director shall not issue the receipt and for a hearing before the Commission where he intends to refuse to issue it. In short, not only must the prospectus be filed but the Commission and the director must be satisfied that the prospectus does not contain any element that is contrary to the public interest. Absent the receipt, no person may trade in the shares of the issuing company.

There can be no question but that the filing of a prospectus and its acceptance by the Commission is fundamental to the protection of the investing public who are contemplating purchase of the shares. The effect of s. 60 is, by the issue of the receipt, to authorize the sale of the company's shares; the effect of s. 52 is to prohibit outright trading in the shares by way of distribution to the public unless the distribution is authorized by the Commission. In the language of Mignault J. in Re Northwestern Trust, the purpose of the statute "is to protect the general public against schemes or campaigns to sell shares or securities of doubtful value to unwary investors". That, as the court said, "deals with a matter of public policy and that anything done in contravention of its prohibitions is void and not merely voidable." The principle as applied to the fundamental as opposed to nonfundamental provisions in my opinion, is not in any way impaired by the court's subsequent decision in Myers - see per Martland J. at p. 93 set out above.

Breach of that provision without more, gives rise to a common law right in the purchaser (the plaintiff in this case) to

have the sale declared a nullity. There are, however, three factors that must also be considered:

(a) the Act by s. 118 in Part XXI entitled 'Enforcement' provides that any person who contravenes the Act is guilty of an offence and on summary conviction is liable to a fine or in the case of an individual to a fine and imprisonment or both; the penal provisions are applied by the courts in accordance with the procedure for offences punishable on summary conviction with the consent and under the direction of the Minister (s. 119). Part XXI also provides authority to the Commission, where a person or company has failed to comply with a provision of the Act or regulations, to apply to a high court judge for an order directing compliance or restraining further violation (s. 122). The Commission may, where in its opinion it is in the public interest to do do so, order that trading shall cease in the securities affected (s. 123). Proceedings under this part are subject to periods of limitation in s. 125. No doubt in the case at bar, it would have been open to the Minister to institute a prosecution for the breach of s. 52(1) or to the Commission to have taken the regulatory action authorized by ss. 122 and 123 had the breach been drawn to the attention of the Commission in the first place; but none of the provisions in Part XXI appears to me to assist a purchaser of securities who is already committed to an unlawful transaction such as that before me. Part XXI merely permits the barn door to be locked after the horse has bolted.

(b) the Act by Part XXII prescribes civil remedies by creating causes of action for breach of specific provisions of the Act. There is no reference to a civil remedy for breach of s. 52(1). The cause of action is provided only in the case of a purchaser of shares who is not provided with a prospectus as required by s. 70 which does not apply here.

(c) there is no provision in the act that expressly deprives a person of his common law remedy for breach of s. 52(1).

Counsel have not been able to discover any judicial decisions on the effect of s. 52 of the Ontario Securities Act. (The decision of the British Columbia Court of Appeal in Ames however, relates to the corresponding provision in the British Columbia Securities Act, but I pass it over for the present.)

The combined effect of the Supreme Court of Canada's decisions in Re Northwestern Trust and Myers is that a sale of securities that is prohibited by the statute is void; but that where a penalty is provided the court must determine whether that penalty is intended merely to deter persons from entering into the contract or is also intended to invalidate the contract of purchase and sale in law. The court held in Myers that the prohibition of sales at a residence i.e. at a particular place, was not part of the "general pattern" of protecting the public against trading in securities by persons who have not satisfied the regulatory authority of their proper qualifications to do so; its purpose was not to prevent trading of an unauthorized kind but it was to prevent trading at a specified place. The penalty was held to be merely a deterrent and the contract of sale was not invalidated by the breach. That is not the case here; the breach is of a fundamental element of the statutory scheme to protect the public against unauthorized trading.

The statutory scheme in the Ontario Securities Act as it relates to this subject is this: first the seller may not trade in the shares unless the company has filed a prospectus and it has been accepted by the Commission. The prohibition is absolute (s. 52(1)) and the provision is fundamental.

Second, Part XXII creates several civil remedies. Section 70(1) makes a special provision respecting a purchaser who places an order to purchase shares to which s. 52(1) applies; the dealer is required to deliver to the purchaser the latest prospectus and amendments filed with the Commission. He must do so either before entering into the agreement of purchase and sale or within two days after making the agreement. By s. 70(2) the purchaser may reject the sale within two days after receiving the prospectus. It is therefore open to the purchaser to abort the transaction after receiving the prospectus.

It is important to recognize that the prospectus that s. 70(1) requires to be delivered to the purchaser is the most recent prospectus and amendments thereto filed with the Commission in accordance with s. 52(1). The investing public is protected first by the requirement that the prospectus be filed and accepted and second by ensuring that the purchaser is provided with a copy of it before he is finally committed to the contract of purchase and sale.

It is also notworthy that s. 70(1) does not make the resulting sale unlawful or prohibited as does s. 52(1). By contrast the contract is one that can be aborted or rescinded at the option of the purchaser; he may avoid being bound once he receives the prospectus or if he does not receive it he may if so advised proceed by way of an action for rescission or damages against the dealer who failed to comply with s. 70(1). That cause of action is created by s. 130 supra, in Part XXII; it is one of several created by Part XXII of the Act (others in that part relate to liability for misrepresentation in a prospectus or circular, (s. 125, 127) liability for failure to make a followup of or take up securities under s. 91 (s. 129) and liability of a person or company in a special relationship with a reporting issuer for failure to disclose a material fact or change or an insider who improperly uses his knowledge or information (s. 131). By s. 135 (supra) no action shall be commenced to enforce the right created by Part XXII after the expiry of the limitation period therein prescribed.

In ss. 126 and 127, which create special liability for misrepresentation in a prospectus it is also provided that the right of action for rescission or damages thereby conferred is in addition to and not in derogation of any other right the purchaser may have at law, thereby preserving any common law action he may have for fraud or misrepresentation.

Third, none of the remedies created by Part XXII applies to a breach of s. 52(1) by failure to file any prospectus at all. In such a case s. 70 does not avail the purchaser because it assists him only when the dealer fails to provide him with a prospectus filed with the Commission; if none is filed there is no breach as no such prospectus exists. There is a lacuna; the Act neither provides a cause of action for breach of s. 52(1) nor does it expressly or by necessary intendment abolish the purchaser's remedy in common law or equity to have the prohibited transaction declared null and void as in Re Northwestern Trust.

It is therefore not correct to say, as Mr. Steep submits, that breach of s. 52(1) "triggers" the cause of action created by s. 70 so that the purchaser has a remedy created by Part XXII albeit one that is limited by s. 135. Section 70 applies only where a prospectus has been filed; the Act does not contemplate a sale where no prospectus that is required by s. 52(1) has been filed with the Commission. Where none is filed the purchaser is left to such remedy as he may otherwise have in law or equity. (I add that s. 52(1) does not apply to certain distributions of securities which are exempted by Part XVI from prospectus requirements; those provisions are not relevant here.)

The rule as applied in Re Northwestern Trust is founded on public policy for the protection of the investing public. The requirement in s. 52(1) in equally to protect the public and it is one of the fundamental components of the scheme of the Securities Act. The prohibition is clearly expressed; the result of its breach is that the sale of shares to the plaintiff is void. Having regard to the scheme of the Act and the central place in that scheme of the requirement to file a prospectus, that result in law is not to be taken to be abrogated by the legislature unless it is abrogated in clear terms or by necessary intendment. The creation of specific causes of action in Part XXII, even on the expressio unius rule, does not achieve that result; nor is that result achieved by mere failure to deal with the effect of a breach. The transaction is illegal and void and there is no contract of purchase and sale of the shares. That is the effect in law and I cannot find any ground for holding that the legislature has altered it.

I do not overlook the decision of the Alberta Court of Appeal in Ames v. Investo-Plan which I have mentioned earlier. The court considered inter alia s. 37 of the Securities Act, 1967, c. 45 (B.C.) which provided:

> 37. No person or company shall trade in any security issued by a ... mutual fund company ... where the trade would be in the course of primary distribution to the public of the security until there has been filed with and accepted by the Commission a prospectus in respect of the offering of the security and a receipt therefor in writing has been obtained from the Commission.

The mutual fund company whose shares were sold to the plaintiff had submitted a prospectus to the Alberta Securities Commission. It had been cleared by the Quebec Commission and is said to have conformed to the requirements of the Securities Acts of Nova Scotia and Newfoundland. The British Columbia Commission had not, however, accepted it. Anderson J. held that the contract of purchase and sale was void ab initio as being prohibited by s. 37 relying on Re Northwestern Trust. The Court of Appeal distinguished that case on the ground that the provisions of the British Columbia Securities Act were "substantially different" from the Manitoba Sale of Shares Act which was at the root of the decision in Re Northwestern Trust. it is not clear to me from the judgment what the differences were; the Court of Appeal firstly said that in the case of the Manitoba statute the language used was "it shall hereafter be unlawful" and "it shall not be lawful" to sell securities in the circumstances of that case. I can see no difference in substance between that language and s. 37 of the British Columbia Securities Act.

The Court of Appeal then turned to Myers v. Freeholders Oil and observed that the Supreme Court of Canada there held that breach of the provision prohibiting a salesman from selling securities at a residence did not void the contract of purchase and sale because it was not part of the "general pattern" of protection. The Court of Appeal referred to specific provisions in the British Columbia Securities Act 1967 which provided a cause of action for rescission by the purchaser which bears some resemblance to Part XXII of the Ontario Securities Act; that remedy is provided, so far as appears from the reasons for judgment, to cases where a prospectus has been filed and contains untrue or misleading statements of fact or a material omission. The nub of the Court of Appeal's reasons on this point is essentially the expressio unius rule:

> In my opinion a contract for purchase of shares in contravention of s. 37 is not voidable at the election of the purchaser except in the circumstances described in the Act itself. In other circumstances the consequence of failure to comply with s. 37 is liability to the statutory penalties.

The Court of Appeal also stated at p. 618, that the transaction is not void for breach of s. 37:

> It is evident that the object of the statute is to regulate and control the business of trading in securities in order to protect the public. The statute does not prohibit trading in securities or declare contracts for sale of shares void or unlawful. I cannot, on a consideration of it, impute to the Legislature an intention to prevent the enforcement of contracts made in contravention of it as against the persons who are required to comply with it. Applying the test described by Martland, J., I do not believe it was intended to allow companies which agree to issue shares in violation of s. 37 to escape their obligations to perform their agreements. This would be the result if such agreements are void. Looking, for example, at s. 51 I do not think it was the intention that a purchaser of shares from a person or company which has failed to give a notice required by that section should be prevented from enforcing the purchase or from recovering damages for failure to deliver. I am, therefore, of the opinion that the contract in this case made in contravention of s. 37 is not rendered void by the statute.

I am puzzled by this rationale for two reasons: first it seems clear to me that s. 37 (the section breached) clearly prohibits trading. Second it seems equally clear that s. 37 goes to the core of the scheme of protection of the public investing in mutual fund securities - it is part of the "general pattern" to use the expression of Martland J. in Myers v. Freeholders; the Court of Appeal however appears to place it in the subsidiary or ancilliary category which Martland J. held decisive in that case; or else they say that as a matter of judicial policy the breach ought not to void the transaction or to make it voidable by the purchaser. Whatever the rationale the Court of Appeal's decision I do not regard it as applicable in the case at bar. Rather, I consider that I am bound by the Supreme Court of Canada's decisions referred to as falling within Re Northwestern Trust and upon a review of the objects of the statute as a whole, not within the ratio of Myers in that s. 52(1) of the Ontario Securities Act is clearly part of the "general pattern" referred to by Martland J.

By way of recapitulation;

(a) No prospectus was filed with the Ontario Securities Commission and the sale by Deacon was in breach of s. 52(1) which is a fundamental element of the statutory scheme of full disclosure and regulation by the Commission for protection of the investing public in cases not exempt by the Act from the prospectus requirements.

(b) Section 70 does not here create a remedy for the plaintiff because that section applies only where a prospectus has been filed and a receipt obtained from the Director.

(c) Breach of s. 52(1) does not "trigger" an offence under s. 70(1) where no prospectus is filed; the limitation in s. 135 does not apply because no cause of action is here created by Part XXII.

(d) Breach of s. 52(1) stands on its own; it is subject to a quasi criminal penalty and regulatory action under Part XXI. The general rule however, is that the sale is void in common law. That principle requires a clear expression by the legislature if it was intended to abrogate it - there is none here.

While the court should be reluctant to interfere with contracts freely made, in this case the over-riding consideration is the need to support the fundamental purpose of the statute as a matter of public policy to protect the integrity of the regulatory scheme of the Act; contractual integrity must give way; the penalty alone and the remedies available to the Commission, in my opinion, ought not to be the only deterrent or remedy. Moreover the scheme would be seriously impaired were the court to preserve the legal transaction and deprive the purchaser of a remedy where no prospectus has been filed at all and to recognize his only civil remedy is that created by s. 70 and other provisions of Part XXII all of which are limited to cases where s. 52 has been complied with; that would ignore the fundamental breach and support only the remedies provided in cases in which the prospectus has been filed and accepted as required.

(e) I am aware that while my decision precludes the dealer from enforcing an illegal contract against the purchaser, the purchaser cannot enforce it against the vendor should he prefer to do so; he of course, may prefer not to exercise his remedy and continue to hold the shares. It seems to me however, that the purchaser otherwise may maintain an action for a declaration that the contract is void and that he is entitled to recover the price paid for the shares as a form of unjust enrichment in the hands of the vendor. The court ought to provide him with that remedy at least as an innocent party (so far as this motion is concerned). On the other hand, I should deem it sound judicial policy for the court to refuse to entertain an action by the vendor (or allow it a defence), in reliance on the void transaction on the ground that to do so would enable the vendor to profit by his illegal conduct. This latter point I am frank to say is obiter as I am not obliged to decide it.

The defendant's motion is for an order dismissing the action. For the reasons I have outlined the motion must fail.

The motion is dismissed. As the point is apparently one of first impression so far as the Ontario Securities Act is concerned there will be no order for costs; however if counsel wish to speak to costs further they may do so before the order is entered, in writing if desired.

HENRY J.

TAB 3

Indexed as:

Fogal Legwear of Switzerland, Inc. v. Garoneli Fashions Inc.

Between
Fogal Legwear of Switzerland, Inc. and Fogal of Canada Ltd., plaintiffs, and
Garoneli Fashions Inc., Heather Samuel and Gary Samuel, defendants

[1995] O.J. No. 3022

58 A.C.W.S. (3d) 406

File No. 69380/91Q

Ontario Court of Justice (General Division)
Toronto, Ontario

Gibson J.

October 16, 1995.

(38 pp.)

Company law -- Actions against corporations and directors -- Actions for oppressive conduct -- Persons entitled -- Creditors -- Oppression, prejudice or disregard of interests.

This was an action by a creditor against a corporation and two directors for recovery of monies owed for goods sold and delivered. The action was brought under section 248 of the Business Corporations Act and on the basis the defendants made invalid assignments or preferences. The defendants' evidence as to the business was that a great many cheques had been written without a great deal of documentation. The female defendant did not have any inventory records. The male defendant testified a number of cheques were for "emergency loans" he had made. Many of the cheques were made out to cash. The inventory had declined by about $77,000, according to the female defendant, since the parties had decided to wind up the business. Her evidence was it was of little value. At issue was the initial value of the inventory and what happened to it.

HELD: The action was allowed. The individual defendants had engaged in conduct which was oppressive or unfairly prejudicial to the plaintiffs and unfairly disregarded their interests. Alternately they had made transfers which resulted in an unjust preference or assignment, and the transfers were accordingly void.

Statutes, Regulations and Rules Cited:

Assignments and Preferences Act, ss. 4, 5. Business Corporations Act, ss. 245, 248(2), 248(3)(j).

Counsel:

Bruce North, counsel for the plaintiffs.
Benjamin Salsberg, counsel for the defendants.

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1 **GIBSON J.**:-- In this action the plaintiff corporations Fogal Legwear of Switzerland, Inc. and Fogal of Canada Ltd. ("Fogal") seek to recover $27,345.15, being the balance of monies owed for goods sold and delivered to the defendant Garoneli Fashions Inc. ("Garoneli"). All invoices were addressed to Garoneli.

2 The defendants Heather Samuel and Gary Samuel are husband and wife and were the sole principals of Garoneli. It is alleged that in the last few months prior to the closing of Garoneli, these defendants sold off the bulk of the remaining inventory and applied the proceeds to their own personal benefit, contrary to section 248 of the Business Corporations Act, or made invalid assignments or preferences.

3 Under section 245 of the Business Corporations Act, it is provided that a trade creditor qualifies as a "complainant" within the meaning of the Act, and as such can bring an application or an action. I do not believe Mr. Salsberg ever denied that a creditor can sue or bring an application.

4 Under section 248(2) a director/officer/executive of a corporation who is guilty of sharp business practise in conducting the affairs of a corporation, which conduct has the effect of depriving a creditor of a payment, is acting in a manner that is "oppressive" or "unfairly prejudicial" or unfairly disregards the interest of a creditor of the corporation. In such circumstances, a court will "rectify the matters complained of" or "compensate an aggrieved person" under section 248(3)(j) by ordering the offending director/officer/executive to pay to the creditor all or part of its loss, as the circumstances require.

5 On the evidence, I find that Fogal is a trade creditor of Garoneli and is entitled to bring this action. I understand that on September 26, 1991, the plaintiff obtained a default judgment against Garoneli in the amount of $29,463.45.

6 I also find that on the basis of section 242(2), supra, an action may be brought by Fogal against the two personal defendants, who, in my view, fall within the category of "director/officer/executive" of Garoneli and who may be ordered under subsection (2) to pay compensation upon proof of the appropriate circumstances as outlined in subsection (2).

7 I will now summarize the evidence. In this, my final draft, I have done my best to exclude non-relevant evidence.

8 The evidence of Katherine Eltz ("Ms. Eltz"), on behalf of the plaintiff, set forth the transactions between Fogal and Garoneli for the period October 22, 1990 to December 13, 1990 (exhibits 8 and 9), whereby goods were sold and delivered to Garoneli, and have not been paid for. I find her evidence to be accurate and truthful, and I accept it.

9 Fogal received a letter dated February 7, 1991 from the Samuels advising that their store would be closed down as of the end of March 1991.

10 Ms. Eltz met the Samuels in Toronto following receipt of this letter, and discussed with them whether there was anyone else available to carry on with the store. Garoneli carried the Fogal product exclusively. Mrs. Samuel wanted to carry on the mail-order business, but was advised by Ms. Eltz that Fogal was not interested in such a business operation.

11 Negotiations were carried on with another party, but nothing concrete came out of these negotiations. Ms. Eltz testified that she was disappointed with the attitude of Gary Samuel, which was that "there was nothing in it for him" since only Fogal would be paid as a result of such negotiations, and he advised her that he could walk out free, as he would liquidate the stock and they could sue him.

12 Ms. Eltz testified that with respect to Fogal product, the usual mark-up was 2.2 times the cost price. She maintained that she was not aware that the defendants sold the product at a discount. She had visited the store four to six times in the previous year, and was never advised by Mrs. Samuel that discount sales took place, though she did concede that she knew that Garoneli discounted certain of the Fogal styles.

13 Fogal's sales to Garoneli in 1989 and 1990 were increasing yearly and were always in excess of $100,000.

14 In cross-examination Ms. Eltz conceded that Fogal had no security interest in the goods in question and Garoneli was simply obligated to pay Fogal.

15 Fogal was not interested in transferring the ownership of the store to another operator.

16 Ms. Eltz testified that she was not aware that the Canadian Imperial Bank of Commerce ("CIBC") had a security interest in the Garoneli inventory.

17 Also called was Benjamin Cooper ("Cooper"), who has been in the ladies' hosiery business for some years, and knew the defendant Mrs. Samuel.

18 As best he can recall, Mrs. Samuel came into his store sometime in 1991, advised him that she had some stock left over, and asked him if he was interested in buying it. She provided him with details of what was available, and the cost of same.

19 Cooper testified he made some inquiries in New York about what was being offered, and when he was advised that the product was an old fashioned line, he was not interested and did not make her an offer.

20 Also introduced into evidence from Canada Trust were Garoneli's bank records (exhibit 1, a bank statement dated January 1, 1990) and cancelled cheques (exhibit 2).

21 D.J. McCormick ("McCormick") testified as to the CIBC records. Exhibit 3 was a bank statement for the period June 1, 1990 to December 13, 1991, at which time the account was closed.

22 Exhibit 4 were photocopies of cancelled cheques.

23 McCormick testified that CIBC held a general security agreement on the Garoneli inventory but never acted upon it and the assets were never seized.

24 Exhibit 6 was a financial statement.

25 According to McCormick's evidence, exhibit 3 indicated that Gary Samuel had a loan and was repaying the bank on that loan.

26 Morris Snow ("Snow"), who was the accountant for Garoneli up to the time he prepared the financial statement for the year ending November 1989, testified that he had no recollection of a November 1990 statement and nothing was prepared. Any records that he had were returned to Heather Samuel in April of 1991.

27 Gary Samuel had made a shareholders' loan in 1988. Other shareholders of Garoneli had been repaid.

28 Mr. North read in, as part of the plaintiffs' case, various portions of the discoveries of Mr. and Mrs. Samuel.

29 In respect of Mrs. Samuel, the evidence was that Garoneli was incorporated December 4, 1985. She was the president and director of the company until it closed in March of 1991. The business was basically a retail store in Hazelton Lanes, selling panty hose and body wear, exclusively of the Fogal line.

30 The decision to close the store in March 1991 was made in January or a little earlier. The company had been in financial difficulties prior to this period, and some of their cheques to Fogal were marked NSF. The store ceased operating around March 29 or 30, 1991.

31 The company had two accounts, one at Canada Trust and the other at CIBC. All of the company receipts were deposited in either of these two accounts.

32 Janice Gutstadt was initially an employee at the outset, and an officer near the end, but received no income and only signed cheques if Mrs. Samuel was not available.

33 An employee, Laurie, was paid every two weeks.

34 CIBC did not honour Mastercard credit card payments, so revenue from these credit transactions was deposited into the Canada Trust account, and then the money was transferred to CIBC to pay Fogal.

35 At one point in her discovery, Mrs. Samuel testified that there was no inventory left when the shop closed, but at another point she stated that some of the inventory was sold after the store was actually closed.

36 The last financial statement that was available, and was produced, was for the year ending November 30, 1989, but no financial statement was produced for the year ending November 1990, although the accountant had material to be used to prepare such a statement. A daily sales inventory was kept, as well as a yearly inventory. However, there was a physical inventory taken at the end of November, but she does not have it now, although at another point she said it was "available". It

was never produced at trial, as I recall it.

37 She was unable to state what the inventory was in 1990, as she did not have any inventory records for that period.

38 Gary Samuel testified that he had been a vice-president and a director, since sometime in 1986. He was never an employee of Garoneli. His recollection was that he had no authority to sign cheques and never wrote cheques on the corporate accounts. In 1990 he received no income (his wife had said she took home around $30,000 in the year ending November of 1990).

39 At the conclusion of the plaintiffs' case, Mr. Salsberg moved to introduce some Garoneli business records, including deposit books, which documents had never been produced prior to trial. Over Mr. North's understandably vigorous objections, since they appeared to be material and relevant to the issues between the parties, I allowed them to be entered into evidence.

40 The defendant Heather Samuel, who was 35 at the time of the trial, testified that she had been a teacher in a private school, and opened the Garoneli retail business in 1985 or 1986. At the start there were other partners, but she has been the only person who has been fully involved in the business.

41 The store was constructed in accordance with Fogal's requirements, and the initial inventory was 70-$75,000. Tab 8 of exhibit 5 was the original agreement with Fogal, which she signed on behalf of Garoneli.

42 She first said the store closed around the end of March, but later stated that it was closed around March the 14th of 1991. She had previously sent out sales notices to obtain mail and phone orders, some of which were completed after the store was closed. Thereafter there was no other business conducted.

43 They wrote to Eric Schreiner ("Schreiner") of Fogal in Switzerland (exhibit 11) that they were interested in selling the store, however if Fogal was not able to find a purchaser, then they would close it in late March. This letter was dated February 7, 1991. Fogal would have to approve any transfer of the business.

44 Mrs. Samuel testified that she had built up a successful mail-order business and she wanted to carry this on. They received no written reply from Fogal.

45 In January they decided to close the outlet in March. She had been in hospital in December of 1990, and only returned to work in early January and found it difficult to carry on the store. Initially, Schreiner, the owner of Fogal, had been interested in purchasing the business if they had ever decided to sell it, and this continued on to 1989, but when they advised Schreiner that they wanted to try and sell it, there was no response from him, and she felt she had been led on by him.

46 Schreiner allegedly told Ms. Eltz that the Samuels had no choice but to sell the merchandise for the best price possible.

47 They met Ms. Eltz in February and March as she had come up from New York. There was a couple of meetings but there were no meaningful discussions about a possible purchaser. One prospect, with Ron Hibbert ("Hibbert") looked promising, and there was an unsigned offer in March, but nothing came of these discussions.

48 As a result of Fogal not being interested in buying the store or the inventory, or anybody else, they had to liquidate the inventory at very low prices. All the proceeds were put into a company bank account, prior to and after the store was closed.

49 Mrs. Samuel testified she kept a daily inventory, listing the styles, etcetera, and the quantity, together with details of what inventory was purchased, and to reflect reduction by sales.

50 Exhibit B was an inventory in March of 1991 which inventory indicated her cost price in U.S. and Canadian dollars.

51 The cost of this inventory was $22,982.25.

52 These documents had not been produced earlier, and her husband had found these documents in her brother's garage just a few days prior to the trial. When they packed up the store in 1991 a lot of boxes, etcetera, were moved to a friend's garage and she has no idea what was actually done with everything, since her husband took care of this aspect of the matter. A physical inventory was made in November, near the year end, but she does not now know where such inventory for November of 1990 is. The material for the year end in November of 1989 was given to the accountant.

53 Exhibit C were boxes of hosiery which were found at the same time as the March 1991 inventory. She had not been

aware that some were still in existence because once she closed the store she forgot about things. There were some 585 items in these boxes but she is unable to estimate an actual value for them.

54 Also produced were eight deposit books with respect to their sales. She noted on the front in summary form the deposits. She prepared the deposits to the bank, and it is noted the sources of the deposit.

55 Either she or one of the employees signed any bank deposits. Emergency loans were necessary from time to time because of the recession. Their problems became worse because there was a huge price increase put through by Fogal, and there was higher client resistance. It was suggested to her that she increase the mark-up, but she was unable to obtain one.

56 There was a general price increase in 1981. The balance of the deposits represents the proceeds from their sales.

57 Tab 15 contains a breakdown of invoices from Fogal, together with the credit notes, for the periods December 1989 to March of 1990, and April of 1990 to October of 1990.

58 June and August figures of 1990 are missing and she does not know what happened to them. There was probably some small purchases during that period.

59 The above documents were also found in the same garage as the other documents were found. There were actual purchase orders. Summaries were prepared as unboxed merchandise at the end of the month.

60 The purchases less credits were some $85,000.

61 She prepared Tab 16 (a list of deposits by Gary Samuel to Garoneli) from bank deposits and cheques. The documents are from February 13, 1989 to August 23, 1990. With respect to the emergency loans from the bank, she was to repay them as soon as possible, which totalled $84,500.

62 Tab 17 was a Gary Samuel cheque to Fogal of October 22, 1990 for outstanding merchandise of $2,696.45 to help keep the company in business.

63 Tab 18 are various documents, including cheques to Fogal which were cleared through the Swiss bank.

64 Also filed were various notes made by her with respect to deposits and cheques.

65 She drew a salary from the company with a slight increase as time progressed.

66 A lot of the cheques were made out to cash. She did a lot of mail-order, etcetera, and it was necessary to pay for mailings. Part-time help was paid in cash.

67 Tab 2 contained many cheques to Gary Samuel, with respect to emergency loans, mailing costs, and part salary to Mrs. Samuel (Gary was never paid a salary, as he was not an employee).

68 She had part-time help during sales in December of 1990 and up until the store was closed.

69 Tabs 3 and 4 were the financial statements for 1988 to 1989, and she supplied the correct information to the accountant.

70 Her guarantee to CIBC was tab 6. Tab 10 was a general assignment of accounts to CIBC which was executed by her, as well as the general security agreement in tab 11.

71 Tab 13 demonstrated that the Canada Trust accounts were used to facilitate Mastercard payments. Cheques were deposited in this account and used to pay company debts so that the CIBC loan was not overdrawn. Tab 14 are the cheques drawn on the Canada Trust account and were all for cash.

72 Mrs. Samuel denied that either she or her husband applied any proceeds from the business to their personal benefit, and she never took any personal salary from the company account, and that the closing of the business was not a scheme to defeat Fogal's claims.

73 She only spoke to Cooper once, as she knew he represented Fogal. He asked her about the merchandise and she told him to contact Fogal to see if it was all right to purchase the inventory. As it turned out, he was not interested in purchasing her stock.

74 Her husband packed up most of the product. She gave a small amount of the product to a relative or friends and donated some to a temple. The mail-order sales were honoured and what was produced in court was the balance of the inventory.

75 In cross-examination she maintained that the decision to close the store was made in January, even though she stated on her discovery that she decided to close the shop "a little earlier than January". She conceded that she had made the above answer on the discovery.

76 She paid herself a salary every second week, depending upon what was in the account.

77 Mrs. Samuel maintained that she always paid monies to Gary Samuel by cheque, as she was not involved in the loan terms. On occasion her husband provided her emergency loans. She conceded that a cheque dated December 6 in the amount of $1,800 went into her account. Her note is that it is repayment of a loan from Gary Samuel. Exhibit 4 indicates that she endorsed it and it went into her account, and her explanation for this transaction was that it was for petty cash, as it was not convenient to obtain petty cash from the company account. However, she reiterated it was a repayment of a loan to her husband.

78 She was questioned extensively by Mr. North with respect to various cheques and what was the purpose of such cheques.

79 She conceded that she never obtained receipts from employees to whom she paid salary by way of cash and some of her explanations as to what the expenditures were frankly sounded somewhat weak to me.

80 Mrs. Samuel continued to maintain that she paid herself according to what was available, and any payment to her depended on what monies were available. She conceded she paid herself up until the end of March, as she felt that she had worked sufficient hours and that she had earned such payment.

81 Mrs. Samuel took out $200 in April to cover mail-orders to clients but has no receipt to cover same.

82 The cheques outlined in tab 2 ended March 16, 1991.

83 Mrs. Samuel stated that she paid an employee, Laurie, $3,000 in one day, Laurie having earned $30,000 over the year, and her best recollection was that Laurie probably was owed some monies.

84 She stated she was still liquidating product in May of 1991 as there was some stock left..

85 Cheques were still being made payable in May and June of 1991 to Gary Samuel for repayment of a loan, or as well as mail-order expenses, as they were still trying to sell the Fogal inventory at that time.

86 Mrs. Samuel conceded partway through her cross-examination that she had been mistaken on discovery when she said that all the inventory was sold by the end of March, and they continued to try to carry out the mail-order aspect of the business during the spring. However, she denied that they took as much as they could out of the corporate account, liquidated the inventory, and then pocketed the funds.

87 She was questioned extensively on the sales of the business during its operation. The product was sold for approximately twice its cost.

88 She conceded that there were no figures for gross sales in 1990.

89 Mrs. Samuel denied that the inventory on November 30, 1990 was probably $100,000, because there was a lot of discounted product. Approximately $85,000 of inventory was purchased in 1990. Mr. North tried to get her to concede that the 1990 sales were about the same as 1989, with a view to showing that the inventory at the end of 1990 was about the same as it was previously, however, Mrs. Samuel professed not to be able to agree or disagree with that question. The thrust of her evidence was that she had a lot of old stock, at this time, and the fair value of the inventory was not in the area of $100,000 but much less.

90 The inventory around March of 1991 was somewhere around $22,982.25.

91 Mrs. Samuel again maintained that she noted sales on a daily basis and professed to have forgotten about the running daily sales inventory as was produced as exhibit B. She had refused on the discovery to answer questions as to what the

inventory was, however, during the second discovery, when she was asked about the value of the inventory, she was unable to calculate what the fair value of the inventory was, and was not able to do so until just prior to trial.

92 Mrs. Samuel stated that she prepared the deposit slips at tab 5 to confirm contribution by her husband. Most of the deposit slips are in her handwriting, although some of the handwriting was by one of the employees, Laurie. She had stated in her discovery that she made up the deposits although it appears that someone else wrote at least part of the deposits.

93 Garoneli was never told that it owed Samuel $65,000 although it was understood that this was the case. The minute book of Garoneli never indicated that there was such a debt to her husband.

94 Part of the income they received in the later part of December of 1990 went to pay the debt to Fogal and some payments were made to Fogal in January. She maintained that her husband was only receiving back his personal monies which he had loaned to Garoneli. These were emergency loans and had to be repaid. However, she also stated that these monies were their own personal monies.

95 In February of 1991 she started to deposit most of the receipts in Canada Trust, because the overdraft was too high. She denied ever being concerned that the CIBC could have frozen their account. She admitted that she paid the corporate expenses and deposits out of the Canada Trust account in February, whereas prior to that all of the transactions went through the CIBC account.

96 Mrs. Samuel could not recall whether various cheques were honoured or not - #716 at tab 18 of January 30, 1991, or a cheque for $7,749.20 dated December 28, 1990.

97 The deposit books, previously exhibit A, were made exhibit 16.

98 Gary Samuel, aged 36, a graduate of University of Western Ontario Law School, and called to the Bar in 1983, testified that he had not practised law after graduation and had been involved in commercial real estate and management.

99 They had seen a Fogal store in New York City, and they thought that a similar concept would be a worthwhile venture in Toronto. There were other partners initially, but they lost interest. His wife was to be the manager of the store and the wives of the other partners worked in the store initially for awhile.

100 $70,000 was put up by two other partners, and Gary Samuel invested $17,500 of his own money. Over the subsequent years, more cash was infused into the business, and Gary Samuel contributed the most. The deposit slips in tab 5 reflected payments made by Gary Samuel. They were emergency short term loans to Garoneli, as it was experiencing cash flow problems, and was to permit the company to continue. He had some personal cash, and drew on a line of credit so as to make these contributions. He made it clear that he was to be repaid fairly quickly, and his wife understood that this was the case, as it was not to be a long term investment.

101 In tab 2 were cheques to Mr. Samuel, which were mostly repayment of emergency loans. Garoneli had a line of credit but his wife wanted to increase it, so he borrowed $15,000 to infuse into the business. Garoneli was to pay monthly instalments on the loan to CIBC, and he had given CIBC postdated cheques.

102 Mr. North conceded that the plaintiff could not attack payments to Gary Samuel prior to December of 1990 since the debts which are the subject matter of this action were incurred in October and November of 1990.

103 All the payments to him, either by way of cash or cheque, were for repayment of loans. He never received any salary or any cash from the company other than payments representing repayment of the loan.

104 His cheque to Fogal of October 22, 1990 (tab 17) was because the CIBC line of credit was exceeded, and he was asked to send his personal cheque so that the Garoneli cheque would clear.

105 On one or two occasions he paid rent directly from his account as the credit limit of the company account at that time had been exceeded. (This apparently was the first time that Gary Samuel had made such a statement in this case, according to Mr. North.) Tab 16 sets out deposits that he had made into the Garoneli account at CIBC but does not include cheques he sent to Fogal or to the landlord.

106 Gary Samuel signed a personal guarantee (tab 9) of Garoneli's indebtedness to CIBC dated February 21, 1986.

107 The minute book was produced. He paid Greenberg, on a buy-out arrangement, some $20,000, but the deal was not

completed.

108 During the last two years before the business was closed, Fogal had been very happy with the way their shop was running, and Fogal had enquired as to whether or not they would be interested in selling the business. His wife had not been well, and there was a recession, so they asked the Fogal owner in Switzerland whether he was interested in purchasing the business, but nothing ever came of this overture. He felt that the mail-order aspect of the business was a sound business, and this was proposed to Fogal, but Fogal subsequently turned down this proposal, even though the Samuels thought that this was going to be acceptable to Fogal. It was his evidence that Fogal procrastinated in giving them an answer. Efforts were made to work out an arrangement with Fogal and one or two other prospective purchasers, but to no avail.

109 One of the proposals was that he infuse another $28,000 into the company so that Garoneli could pay the Fogal invoices, but he felt that this was not a prudent business arrangement from his standpoint and did not want to be involved in that arrangement.

110 He could not recall whether he told Fogal about the CIBC having a security interest in Garoneli.

111 His evidence was that he had no idea what the value of the inventory was at the time of closing, as there were only odds and ends left, and product that would not move. He was not involved in the sale of any of the inventory. He packed up the store with the help of some friends, and stored it in a friend's garage, and that it was later moved to his brother-in-law's garage. He later found it, after much urging from Mr. Salsberg, just the weekend before the trial commenced and brought what he had found into the court.

112 He professed to have no familiarity with the mark-up situation. Fogal had suggested a mark-up but his wife complained that she was unable to get the necessary mark-up that she needed and there had been several significant price increases.

113 After the store closed, CIBC in effect called the loan and required repayment. He was able to enter into agreement as to payments and the indebtedness was subsequently discharged, in the amount of $30,000. In effect, he paid 100% of the CIBC loan over a period of time by way of postdated cheques.

114 His letter of February 7, 1991 (exhibit 11) to Fogal set out his position. Fogal was to let him know what it was prepared to do, otherwise they would liquidate the stock. He did not receive any word so he felt it was okay to carry on with the mail-order business.

115 They advised Fogal that they were closing down the business, but he denied that he was going to apply the proceeds as alleged.

116 He maintained that he received no personal benefit from the liquidation and any monies all went to the bank.

117 He received no other monies from Garoneli and denied that there was any scheme to treat Fogal unfairly, or breach the appropriate statutory provisions.

118 His initial investment was $17,500, the other partners investing $70,000. The other two partners and he invested further cash.

119 His investments in the 1990's were not an investment but a short term emergency loan, and this was made quite clear to his wife, and this was the arrangement. He admitted that there were no documents supporting that this was a loan, and he simply made the loan because he was requested to do so. He conceded he had not produced any cheques to himself, although he has been requested to do so. He conceded also there are no documents stating that the monies paid to him were repayment of a loan made by him to Garoneli, as he did not feel that such was necessary because of the family arrangement.

120 The nature of his banking arrangements was that he does not receive any cancelled cheques, only a statement, although there was the cheque at tab 17.

121 Samuel reiterated that he made it clear when he advanced funds to Garoneli in late 1990 and early 1991 that he needed early repayment otherwise he would not have advanced these monies and he felt that this was not unfair. It was a condition of making the loan that it would be repaid at an early date.

122 He denied that he and his wife in December decided to close down the business and maintained that this decision was made in January, with respect to the retail portion of the business, as it could not continue, but felt there was a good chance

for the mail-order section to carry on. They told Fogal in January that they wanted to sell.

123 Samuel conceded there was no document saying that he borrowed $15,000 in 1985 and lent it to Garoneli, and there were no documents to indicate that he borrowed monies or that he advanced them to Garoneli.

124 He reiterated that the arrangement was that he would get a loan, advance some monies to Garoneli, on the understanding that the monies were to be paid directly to him. While he received monies, and Fogal did not, the monies he received paid off the balance of the CIBC loan.

125 Samuel testified that with respect to payments to him in tab 2, they are all in respect to repayment of the loan. On one occasion his wife inadvertently made a double salary payment to herself. On one occasion she made the cheque out as a pay cheque but it was clarified that it was only a loan. He denied that he took funds in priority over Fogal, and maintained that the arrangement was that the monies were to be paid to him to repay the loans which he had made to the company.

126 He stated that due to the nature of the banking arrangements his wife had, it was awkward for her to get monies to be used as petty cash by way of deposits, so it was necessary to do so by cheques.

127 He reiterated that they understood from Fogal that the mail-order business was still possible and was a viable prospect. He and his wife felt it was a good idea, and were waiting to hear from Fogal in Switzerland. They never received any definite decision, and so they did the best they could, since they never received a definite yes or no.

128 Samuel felt that the proposed arrangement with Hibbert was not a good financial arrangement for him, as there was "nothing in it for him and his wife", and he may very well have said that the next step was liquidation.

129 His evidence was that the store was closed in mid-March, although on discovery he stated it could have been in March but was not sure.

130 On discovery, at questions 68 and 69 in October of 1992, he was asked questions about the inventory, and his answer was that he was not aware as to what the inventory was, as he was not involved in management. At trial he stated that last week he realized where the balance of the inventory and the business documents were stored, and he was able to get them just prior to trial. His memory as to the inventory has had a lapse.

131 He paid CIBC some $22,500 in July of 1991. He does not have any cancelled cheque as it was too late to get one before the trial. He appreciated it was an important cheque and had asked the bank for it, but was advised they could not get it in time for the trial.

132 Since then, he has paid CIBC another 10 to $20,000. Again, he does not have any cancelled cheques allegedly for the same reason he was unable to get the earlier one.

133 Monies from Garoneli after December of 1990 and thereafter went back into his personal or investment account.

134 Also called was Elliot Gutstadt, who is also a member of the Bar. He and his wife were personal friends of the defendants. His wife had been a business associate with Mrs. Samuel in the Fogal store. The business was set up in the mid-80's.

135 The corporation was incorporated December 4, 1985 and the minute book was exhibit 17. Mrs. Samuel was a 50% shareholder, and his wife and Mrs. Greenberg were 25% shareholders each. The business was closed in March of 1991.

136 It was agreed that the shareholders were to be responsible for the company's indebtedness. Gary Samuel was to pay off CIBC and he paid off Royal Bank.

137 The borrowing ability limits were reached on occasion, and the banks wanted an infusion of further capital. Initially the arrangement was that the investors would share the proportionate cost of any further loans. And such were made a year to two years later.

138 The Royal Bank loan is still outstanding. It was agreed that he would pay off a smaller amount to CIBC, and Samuel would pay the rest, and that Gutstadt would be responsible for the Royal Bank.

139 At the conclusion of the defence, the defendants asked for an extension of time to obtain the cheques in tab 17 and in respect of the further investment, but I sustained the objection by Mr. North that the defence had been given ample time to

obtain these documents, that the defence had already been given extensive latitude to introduce documents which had never been produced prior to trial, and to grant a further adjournment would be unfair to the plaintiff. It was apparently going to take another two or three weeks to get the cheques and Mrs. Samuel was leaving for Hawaii for six weeks on the 14th, which posed a practical problem. I accordingly sustained Mr. North's objection.

140 No reply evidence was called.

141 As I had advised counsel previously, and despite Mr. Salsberg's able argument, judgment will go for the plaintiff against Heather and Gary Samuel.

142 The alleged misconduct in this case is quasi fraudulent since the matter is covered under civil statutes.

143 As a matter of law the burden of proof in this case is upon the plaintiff. The authorities are clear that while the burden of proof is on the balance of probabilities (and not beyond a reasonable doubt) the degree of proof should be commensurate with the circumstances or nature of the alleged misconduct.

144 Clearly the major issues are what was the amount of the inventory in late 1990 and early 1991, in what way was it disposed of and, in addition, in what manner were the funds from the sale of the inventory distributed (and whether same was proper) once the decision had been made to close down the store and dispose of the inventory. These issues involve a large critical issue of credibility particularly as to when the decision was made to close the store, and the basis for transfer of such funds.

145 On my review of the evidence of the individual defendants, particularly that of Heather Samuel, the evidence given by her as to when the decision was made to close down the store changed from that which was given at trial from that given on discovery (this occurred in several key instances), and the plaintiff's solicitor was never advised prior to trial that there were material changes in the evidence of the individual defendants, what the revised evidence would be, or that portions of the inventory or other corporate documents (i.e. deposit slips and books) had been unearthed, even though the case had been fixed for trial for a lengthy period prior to the trial actually commencing.

146 The monies sought to be recovered are in respect of product ordered and purchased from Fogal in November and December 1990.

147 Upon reviewing the various exhibits, and the explanation given by the defendant Heather Samuel, and to a certain extent by Gary Samuel (and their demeanour in the giving of their evidence), as to what payments were made out of corporate income, I am not satisfied that the explanation given is credible.

148 Many of the cheques drawn were for postage, but there are no receipts for same. Since Mrs. Samuel struck me as a very intelligent person, I cannot really understand why there were no receipts involving payments of several hundred dollars, when it would be clear to a person who had been operating a business for some time that receipts were necessary for both corporate financial statements and tax returns, and Mrs. Samuel would have been aware of such a requirement.

149 Quite a few of the payments by cheque were to provide cash to part-time employees. While I can understand cash would be more attractive to certain employees, again from tax and corporate business purposes it would have been prudent that receipts be obtained to confirm the purpose of the cheques.

150 Mrs. Samuel continued to pay herself while the business was still being operated.

151 One of the larger concerns I had was in respect of payments to Gary Samuel, which were by cheque, and which were stated to be repayment to him of "emergency loans" to Garoneli. The loans were allegedly made on condition that they be repaid within a short period of time. While the business was not a multi-million dollar one, if there were bona fide emergency loans being made by him to Garoneli, even though the original partners were friends, one would have thought (particularly since the two main investors were solicitors) that there would be some memorandum or acknowledgment by the company that there had been loans, and that the corporate cheques, having regard to the circumstances existing at the time, would clearly have indicated that payments were being made in respect of the so-called emergency loans. No cheques were produced to support Gary Samuel's evidence that loans had been made, and I sustained Mr. North's objection to an adjournment near the end of the trial to provide Gary Samuel further time to obtain these cheques as I was of the view that there had been more than ample time for such evidence to have been obtained prior to the trial.

152 None of the employees were called to testify as to the business operation, the state of the inventory, et cetera, or the deposits.

153 There is really no satisfactory explanation of where the November 1990 inventory was, although Mrs. Samuel maintained that one was kept. At one point in her evidence she stated that it was "available" but it was never tendered (either before the trial, apparently, or at trial). Over Mr. North's strenuous objections I did admit some documents on behalf of the defendant, which apparently were unearthed just prior to trial, but the timing of their production and the reasons given for the lateness of their production left me with a serious reservation about the credibility of the individual defendants upon the material issues in this case.

154 On the basis of the evidence, I am satisfied (and so find) that during the December 1990 to January 1991 period the actual inventory was in the range of at least $75,000.

155 Another point that concerned me was that Gary Samuel stated he had no recollection that he had ever advised anybody at Fogal that CIBC had a security interest in the Garoneli inventory, and Ms. Eltz, as I recall it, testified that she was not aware that such existed.

156 Mr. North argued that the transfer of assets and certain payments were invalid assignments or preferences. I must confess that this is the first time in my judicial career that I have had to consider a claim under the Business Corporations Act, or unjust preferences under sections 4 and 5 of the Assignment and Preferences Act.

157 Considering all of the circumstances - orders for the product from Fogal, which were delivered; cheques to Fogal which were NSF; Gary Samuel wrote cheques for rent on a couple of occasions and cheques to the company for so-called emergency loans - I am satisfied that the individual defendants by late December 1990 or early January 1991 knew or ought to have known that the company was either insolvent or was on the verge of insolvency.

158 While the provisions in the Business Corporations Act, and the Assignments and Preferences Act clearly may cover different situations, on the evidence in this case I find (a) that the individual defendants under s. 248(2) of the Business Corporations Act, both being "director/officer/executive" of Garoneli, in the manner in which they disposed of the inventory and the proceeds from the sale of the inventory, were guilty of sharp practise in conducting the Garoneli affairs in making payments to CIBC and to Gary Samuel, deprived Fogal of payment of its accounts, and such conduct was "oppressive" or "unfairly prejudicial" or "unfairly disregarded the interest" of Fogal who was a creditor of the corporation, and they are therefore liable to Fogal under s. 248(3)(j) of the above Act.

159 Secondly, in my view in the circumstances, and on the above evidence, the individual defendants in late December and January being aware that either Garoneli was insolvent, or if not, was on the verge of same, transferred assets and/or monies which resulted in an unjust preference or assignment and therefore such were void.

160 I find that the individual defendants decided in mid to late December 1990 to close the business.

161 On the issue of damages, which is an intricate issue in itself (the burden being on the plaintiff to prove quantum), on my review of the various exhibits, and having made my finding on liability as above, I find that the plaintiff corporation is entitled to judgment against both individual defendants in the amount of $13,162.30. To reflect my view that certain payments or transfer of funds after December 22, 1990 were, in the circumstances, not proper (it is not possible to find exact inventory so as to use for basis of damages):

* Payments to Canada Trust $ 3,005.00
* Payments to Gary Samuel (in tab 2) 2,809.14
* Payments to Heather Samuel - 7,348.16 in tab 2, in cash or to her (since $13,162.30 no salary entered after March 14/91, no receipts for postage expenses, duplicate salary payment (i.e. item #39 ended up in her personal account) and no receipts for salary payments).

162 I would be pleased to have submissions of counsel with respect to the issue of pre-judgment interest and costs which hopefully can be made by way of conference call. My secretary, Michelle Rowntree, can be spoken to about an appointment which can be arranged for some morning at 9:00 at the convenience of counsel.

GIBSON J.

qp/d/mmr/DRS/DRS

TAB 4

Indexed as:

Javelin International Ltd. (Receiver of) v. Hillier

IN THE MATTER OF Javelin International Ltd.
Between
Michel Robert, petitioner, and
Suzanne Hillier, respondent, and
Frédérick H. Sparling and Melvin C. Zwaig, in his capacity as trustee to the bankruptcy of Parsons & Landrigan Ltd., mis-en-cause

[1988] Q.J. No. 928

[1988] R.J.Q. 1846

J.E. 88-910

40 B.L.R. 249

No. 500-05-000798-825

Quebec Superior Court (Civil Division)
District of Montreal

Gomery J.

May 30, 1988

Counsel:

Yves Bériault, for the petitioner.
Simon Potter, for the respondent.
François Garneau, for the mis-en-cause, F.H. Sparling.

REASONS FOR JUDGMENT

1 **GOMERY J.**:-- This litigation concerns the right of a person in possession of share certificates, issued by a corporation and endorsed in blank for transfer, to request that the shares represented by the certificates be registered in his or her name on the books of the corporation, when he or she had acquired their possession by way of gift. It also concerns the validity of shares issued by a corporation for an inadequate or improper consideration.

I. The Parties and the Proceedings

2 By judgment rendered on April 7, 1982, reported at (sub nom. Inversions Montforte S.A. c. Javelin International Ltd.), [1982] C.S. 425, petitioner Robert was appointed receiver-manager to carry on the business of Javelin International Ltée [hereinafter "Javelin"]. He appears in the present proceedings in that capacity. His appointment terminated in June 1986 but

he has been duly authorized to pursue this matter to a conclusion.

3 The application with which the Court is seized is in the form of a motion for directions presented in accordance with s. 95(e) of the Canada Business Corporations Act, S.C. 1974-75-76, c. 33 [hereinafter C.B.C.A.], initiated by the petitioner in February 1986 to deal with the following situation.

4 During or about the month of December 1985 the respondent Suzanne Hillier submitted a request to the petitioner that he give appropriate instructions to Javelin's transfer agent so as to cause to be registered in her name 13,500 shares of Javelin's common stock. The shares are represented by certificates No. B3146 (5,000 shares), B3147 (5,000 shares), B3155 (1,000 shares), B3156 (1,000 shares), B3157 (1,000 shares), and B3162 (500 shares), which were issued by Javelin on April 14, 1970 and registered in the name of Parsons and Landrigan Limited, a stock broker of St. John's Newfoundland. They were endorsed in blank for transfer on April 17, 1970. Respondent said that they had been given to her by her late father in 1972, and had been in her possession since then.

5 Because he had suspicions concerning the circumstances surrounding the issuance of the shares represented by these certificates, and doubts about the effect of the restrictive legend that they bear as well as about the actual date when they were endorsed, the petitioner felt that there were serious questions as to whether he should or should not accept and authorize the requested registration. He decided to refer the matter to the Court for directions. As a result of what he has learned in the course of the hearing, his position has hardened, partly for reasons other than those that originally caused him to hesitate. Now he asks that the Court conclude that the registration of the shares in the respondent's name should not take place, and that the shares should be annulled.

6 The mis-en-cause Frederick H. Sparling is the director of corporations under the C.B.C.A. He was instrumental in the appointment of the petitioner as receiver-manager and has continued to follow all aspects of the file closely. He was made a party to the motion, and has presented evidence and arguments to support his contention that the petitioner's submission is well-founded and that the respondent does not have a good and valid title to the shares.

7 The mis-en-cause Melvin C. Zwaig, in his capacity as trustee to the bankruptcy of Parsons & Landrigan Ltd., was made a party to the proceedings at a time when there was doubt as to whether the certificates had been endorsed prior to the bankruptcy. He has not appeared or participated in the proceedings in any way. The Court is now satisfied that neither Parsons & Landrigan Ltd. nor its trustee has any proprietary or other interest with respect to the shares.

8 The respondent Suzanne Hillier is an attorney practising her profession in the Toronto area. She wishes to be recognized as the registered owner of the shares represented by the share certificates of which she has had the possession for many years. At the request of the Court she has filed a written contestation of the petitioner's application, in which she alleges that she is the owner of the shares represented by the certificates, having acquired them in good faith as a gift from her father. She asks that directives issue in the form of a declaration that she is entitled to obtain their transfer into her name. She also asks that costs be awarded in her favour against both the petitioner and the mis-en-cause Sparling.

II. The Presentation for Transfer

9 The position taken by the respondent when she presented the certificates for transfer and requested registration of the shares in her name was, on the face of it, straightforward. She said that she had noticed that the market price of Javelin stock, which is traded on the Vancouver Stock Exchange, had recently increased, and had decided to sell her shares. However, her ability to do so was uncertain since each certificate bears the following restrictive legend, typewritten in red letters on both its face and reverse:

> "The shares represented by this certificate have not been registered under the Securities Act of 1933, as amended. Such shares have been acquired for investment and may not be offered for sale, sold, delivered after sale or transferred, in the absence of an effective registration statement covering such shares under the Securities Act or an opinion of counsel satisfactory to the company that such registration is not required."

10 To overcome this difficulty, respondent submitted with her request for registration a letter of opinion dated December 16, 1985 which she had secured from a firm of attorneys in Buffalo, New York. The letter states that respondent had represented to them that she had received the share certificates as a gift from her father approximately 15 years ago, that her father had made full payment for them prior to such gift, and that she has been the beneficial owner of the shares at all times since she was given them by her father. On the basis of these representations they express the opinion that she may sell them without the necessity of registration under the Securities Act, a law of the United States of America.

11 Obviously, the letter of opinion is only as valid as the representations upon which it was premised. The petitioner's concern increased when he learned that the respondent is the daughter of the late Leslie Curtis, in his lifetime a prominent Newfoundland politician and member of the government led by the Right Honourable Joseph Smallwood, who was during the 1960's and early 1970's a close collaborator with John C. Doyle, the founder and guiding spirit of Javelin. The petitioner was aware that in 1972 the Royal Canadian Mounted Police had started an extensive investigation into the links between some members of the Smallwood government, including Mr. Curtis, and Javelin. All of this tended to cause him to view with suspicion any Javelin shares which had at one time belonged to Mr. Curtis.

12 He proceeded to look into the origin of these particular shares, to the extent to which Javelin's records could enlighten him. This is what he found.

III. The Origin of the Shares and Certificates

13 On May 26, 1965, Newfoundland and Labrador Corporation Limited [hereinafter "Nalco"], a corporation controlled by Javelin, and Kuna Corporation [hereinafter "Kuna"], a company incorporated under the law of Panama and having its head office there, entered into a contract of sale by which Kuna sold Nalco certain off-shore oil rights allegedly granted by the Province of Newfoundland to Kuna, in consideration for which Nalco issued to Kuna 150,000 shares of Nalco's capital stock. No price for these shares is mentioned in the contract but a note to the Nalco financial statements for the year ended December 31, 1965 states that it was $150,000.

14 The petitioner has not been able to find out if in fact any underwater mineral rights had ever in fact been validly granted by the Province of Newfoundland, to Kuna. He has been able to determine that the latter company is generally assumed to belong to Mr. Doyle. The persons who signed documents on Kuna's behalf were Mr. Doyle's Panama attorneys.

15 A letter dated November 19, 1969 written by Kuna to Javelin confirms that it had been agreed that Javelin would issue 70,000 shares of its capital stock in exchange for 140,000 of the Nalco shares Kuna had acquired in 1965. The exchange was concluded on Javelin's books in 1970. The 13,500 shares which are the subject of the present litigation are part of an issue of 71,250 shares issued from Javelin's treasury on April 14, 1970 as part of this transaction. No explanation is given for the discrepancy between 70,000 shares and 71,250 shares.

16 Two journal entries in Javelin's registers deal with the consideration for which the 71,250 new shares were issued. Being no par value stock, Javelin's financial statements record the consideration for which shares were issued. The first entry, made in June 1970 reads:

> "Investment Nalco $110,103.52
>
> Common share capital to record the issuance of 71,250 treasury shares of Canadian Javelin to Nalco shareholders for their Nalco stock (1 share of Javelin for each 2 sh's of Nalco). Javelin shares capitalized $14,375 U.S. (per listing application No. 8370 - American Stock Exchange) Exchange at 7 1/2%"

17 A simple calculation reveals that 71,250 shares issued at a price of $14,375 per share would require a consideration of $1,024,218.70 U.S.; adding an additional 7 1/2 per cent for U.S. Exchange gives a total of $1,101,035.10. The journal entry of June 1970 mentions a consideration of only 10 per cent of this amount. The error was corrected by a later journal voucher dated December 1970, apparently requested by Javelin's auditors on April 15, 1971 as part of their year end verification. It reads:

> "Investment Nalco $990,931.63
>
> Capital stock common to reflect the correction in recording values of common stock issued to Nalco shareholders in exchange for their shares of Nalco. Correction made to Dec./70 working paper file by HAR April 15/71."

18 The financial statements of Nalco for the year ending December 31, 1970 show shareholders' equity valued at $3,561,180 consisting of 3,330,172 shares of no par value issued for a total consideration of $2,860,560, to which is added surplus of $700,620. Each Nalco share therefore had a book value in 1970 of $1.07.

19 From the foregoing, it may be concluded that in 1970 Javelin issued 71,250 shares of its capital stock having a current

market value of $1,101,035.10, in consideration for which it received 142,500 shares of Nalco, a company over which Javelin already had voting control. The Nalco shares had a book value of $152,475. None of Nalco's assets as they appear on its balance sheet could conceivably be so seriously undervalued as to justify any important premium on the price of its stock.

20 Although the Javelin shares issued in 1970 were exchanged for Nalco shares belonging to Kuna, the share certificates were issued in various denominations, registered in the name of Parsons & Landrigan Ltd. and endorsed in blank almost immediately. This had the effect of giving apparent title to any person in possession of such a certificate. There is no direct evidence as to how certificates representing 13,500 of these shares came to be in the possession of Mr. Curtis. He told an R.C.M.P. investigator in 1972 that he had at one time received 30,000 shares of Javelin from Mr. Doyle, but he also declared that he had returned them when he realized the impropriety involved.

21 The C.B.C.A. provides in s. 25(1) that shares may be issued at such times and to such persons and for such consideration as the directors may determine. There is no evidence that the directors of Javelin fixed the price or consideration for which the 71,250 shares would be issued. The journal entries indicate that the internal officers of Javelin made an error in the calculation of the price and thought that shares worth only $110,000 were being issued. In fact Javelin was issuing capital stock worth ten times that amount.

22 From all of the foregoing there can be little doubt that the shares were issued for an inadequate consideration.

23 In the Court's opinion, a situation such as this is envisaged by s. 25(3) of the C.B.C.A., which provides:

> "A share shall not be issued until the consideration for the share is fully paid in money or in property or past service that is the fair equivalent of the money that the corporation would have received if the share had been issued for money."

24 The imperative word "shall" indicates that if in fact shares are issued for an inadequate consideration, the issue is a nullity as between the issuer corporation and the registered holder. This interpretation is proposed by Professor Bruce Welling, Corporate Law in Canada (Toronto: Butterworths, 1984 at 683:

> "The C.B.C.A. approach to inadequate subscriptions is interesting. Section 25(3) provides that a share 'shall not be issued' until its full value is paid to the corporation in money, property or past services. This, as was earlier pointed out, seems to indicate that the purported issue of shares in exchange for inadequate consideration will result in a nullity. The subscriber will not have shares at all. Nevertheless, he will have a share certificate."

25 Accordingly, the issuance of the shares in 1970 was a nullity. Nevertheless, the matter does not end there.

IV. The Law Respecting Transfers

26 Under the C.B.C.A., it is possible for share certificates issued illegally or for an inadequate or improper consideration to become valid instruments of title, depending upon the circumstances under which the bearer acquired them. The general principle is stated in s. 51(2):

> "A security is valid in the hands of a purchaser for value without notice of any defect going to its validity."

27 The C.B.C.A. has transformed share certificates into negotiable instruments (s. 44(3)), subject only to certain limitations where transfers are restricted and noted on the security itself. As concisely stated by Professor Welling :

> "Making share certificates negotiable instruments primarily has the effect of giving a purchaser a potentially better title than his vendor."

28 The C.B.C.A. defines "purchaser" in s. 44(2) to mean:

> ". . . a person who takes by sale, mortgage, hypothec, pledge, issue, reissue, gift or any other voluntary transaction creating an interest in a security;"

29 In the context of the present case it is particularly important to note that the C.B.C.A. makes a donee the equivalent of a

purchaser. But a donee is not the equivalent of a "bona fide purchaser", defined in s. 44(2) as follows:

> " 'bona fide purchaser' means a purchaser for value in good faith and without notice of any adverse claim who takes delivery of a security in bearer form or of a security in registered form issued to him or endorsed to him or endorsed in blank;" [emphasis added.]

30 One characteristic that distinguishes a "purchaser" from a "bona fide purchaser" is that the latter must have given value for the security, however acquired. A donee acquires by gratuitous title and does not give value for what he receives; therefore he cannot be a "bona fide purchaser" within the meaning of the C.B.C.A. This does not mean that a donee does not ever have good title to the security thus acquired. It only means that he does not acquire a better title to the security than the donor. As Professor Welling says succinctly [at 690]: "those who receive gifts from rogues cannot benefit".

31 The respondent has presented securities in registered form for transfer, and the petitioner has a duty to comply with her request, if she satisfies the conditions set out in s. 71(1) of the C.B.C.A.:

> "71(1) Where a security in registered form is presented for transfer, the issuer shall register the transfer if
>
> (a) the security is endorsed by an appropriate person as defined in section 61;
> (b) reasonable assurance is given that that endorsement is genuine and effective;
> (c) the issuer has no duty to inquire into adverse claims or has discharged any such duty;
> (d) any applicable law relating to the collection of taxes has been complied with;
> (e) the transfer is rightful or is to a bona fide purchaser; and
> (f) any fee referred to in subsection 45(2) has been paid."

32 The only one of these requirements to present any difficulty in the circumstances of the present case is subsection (e). Whether or not the shares were legally issued in the first place, the respondent is entitled to the transfer she has requested if it "is rightful or is to a bona fide purchaser". Since the respondent does not pretend that she gave value for the share certificates received from her father, she cannot claim the status of a "bona fide purchaser". Nevertheless, the use of the word "or" in subs. (e) indicates that she is still entitled to be registered as owner if the transfer of the shares is "rightful".

33 The term "rightful" is not defined in the C.B.C.A. and its meaning is not immediately apparent. In the French text, the equivalent word is "régulier". A clue to the legislator's intent may be found in the definition of the expression "adverse claim" in s. 44(2):

> " 'adverse claim' includes a claim that a transfer was or would be wrongful or that a particular adverse person is the owner of or has an interest in the security;" [emphasis added.]

34 One might be tempted by this to conclude that a "rightful" transfer means a transfer that is not "wrongful" but even this modest attempt at a definition is discouraged by a look at the French equivalent of "wrongful". It is not "irrégulier" as might be anticipated, but "illégal".

35 Professor Welling suggests that the term "rightful" may be redundant, but this would fly in the face of the rule of interpretation that the legislator must be presumed to have intended that a meaning attach to all of the words employed in a statute.

36 Taking the legislation as a whole, the Court is of the view that it was intended that transfers should not be registered in circumstances where to do so would ratify a known or apparent illegality or irregularity. Thus, for examples, where an adverse claim is known to exist, the transfer should not be registered. This intention is shown by the legislator's failure to supply an exhaustive definition of the meaning to be given to the term "adverse claim".

37 Accordingly, a transfer is rightful if it is requested in the absence of any known adverse claims, by a person who acquired the security in good faith from someone who had good title to it. Knowledge by the transferee of defects in the transferor's title to the security would be a bar to the requirement of good faith.

38 With respect to who must support the burden of proving that a requested transfer is rightful, the C.B.C.A. gives the answer in s. 49(c) which provides that production of the instrument entitles a holder to recover on it unless the defendant establishes a defence or a defect going to the validity of the security. Subsection (d) says that if such a defence or defect is established, the plaintiff has the burden of establishing that the defence or defect is ineffective against him or some person

under whom he claims.

39 Applying these principles to the facts of the present case, the inadequate consideration paid for the shares by Kuna constitutes a defect going to the validity of the share certificates presented for registration by the respondent. It is therefore incumbent upon her to establish that that defect is ineffective to deny her title, or that of her father, to the shares represented by the certificates.

40 More simply put, she has the burden of proving that the transfer of the shares to her is rightful.

41 The Court must therefore examine her evidence as to how she came into possession of the share certificates. Unfortunately the proof on this subject is less than perfectly clear.

V. Respondent's Acquisition of the Certificates

42 The hearing of the petitioner's application for directions commenced on May 20, 1986. On that date respondent testified that in 1972 she was living in the Toronto area with her husband and children and was visited socially from time to time by her father, who resided in Newfoundland, and who had retired from active politics in August 1971. She knew that Mr. Curtis had always been interested in the stock market, and bought and sold shares through stock brokers on the public exchanges in considerable volume. He was particularly interested in stocks of a speculative nature.

43 In the early months of 1972 the respondent's husband was seriously ill, prior to his death in September of that year. Respondent's testimony was to the effect that Mr. Curtis anticipated that his daughter might need financial assistance due to her husband's incapacity caused by illness, and, for this reason, on the occasion of a visit to Toronto in the spring of that year, he took her to two banks in the Toronto area where he rented safety deposit boxes which contained share certificates in a variety of companies. He gave her access to these certificates by making her joint tenant of the boxes. In one of them were the Javelin share certificates with which this case is concerned. From and after that time, she considered that she had the right to sell the shares in the boxes. In fact she did not do so because her father preferred her to wait, believing the market prices would rise. In the case of the Javelin shares, she also knew there would be a difficulty in selling them because of the restrictive legend they bore.

44 Although respondent asserted, in examination-in-chief, that the shares in the safety deposit boxes were given to her outright by Mr. Curtis in 1972, she wavered on this in cross-examination. For example she declared that until her father had a stroke in 1978, he could have withdrawn some or all of the shares from the boxes himself, which is hardly compatible with the divestiture which an outright gift involves. She added that she understood that the shares "would be completely mine at his death", which suggests that they were less than completely hers prior to that event. When pressed on these matters, she expressed the opinion that she and her father owned the shares jointly, and that she retained them after his death in 1980 under a "power of survivorship" according to the law of Ontario. The concept of "power of survivorship" is unknown to the law of Quebec; art. 758 of the Civil Code stipulates that every gift made so as to take effect only after death is void, unless made in a will or marriage contract.

45 At this point in the hearing it seemed obvious that proof of the law of Ontario would be necessary. Otherwise, the Court would have had to conclude that ownership of the share certificates had never passed from Mr. Curtis to the respondent, and that any interest that he had in them was part of his estate, which he had bequeathed by will to his widow. Therefore, the hearing was adjourned so as to permit respondent to obtain and file an opinion as to Ontario law acceptable to the petitioner, or to bring a qualified member of the Law Society of Ontario to testify, if agreement could not be reached with opposing counsel as to the relevant dispositions of Ontario law.

46 More than 18 months passed before the pending litigation was revived, and then it was at the initiative of the Court and counsel for the opposing parties. On February 25, 1988 respondent asked to be allowed to testify a second time. She declared that she had decided not to make proof of the law of Ontario since she had come to the conclusion that to do so was unnecessary; she had refreshed her memory with the assistance of bank records, and now was able to say that the gift of the shares made to her by her father in 1972 was complete and irrevocable.

47 The testimony of the respondent in February 1988 differs in many particulars from what she had said in 1986.

48 The bank records which respondent produces show that she and her father opened a safety deposit box jointly at the Bank of Montreal branch at First Canadian Place, Toronto, on October 18, 1972. She now says that it was on that occasion that her father gave her possession of the share certificates, not in the spring of 1972, prior to her husband's death, as she had earlier declared.

49 Contrary to what she had affirmed previously, this was not a box which her father had rented previously. In fact prior to October 1972 her father did not have a safety deposit box in a Toronto bank. On February 20, 1973 the rental agreement with the Bank of Montreal was changed; from then on the box was rented exclusively by the respondent. Her father did not have access to it after that date.

50 The second safety deposit box to which she had referred in her previous testimony was never jointly rented by the respondent with Mr. Curtis; it was opened in her name on January 25, 1972. Her father never had access to it.

51 Respondent further amends her earlier testimony by stating that she is now of the opinion that there was no joint ownership of the shares placed in her possession. Her father wished her to have them outright and, as far as she is concerned, she owned them from and after February 20, 1973.

52 Respondent's credibility as a witness suffers badly as a result of the foregoing. Other evidence leads the Court to the conclusion that she is not being completely frank about the circumstances under which she received the share certificates from her father.

53 It was in the autumn of 1972 that Mr. Curtis learned that he was being investigated by the R.C.M.P. He was questioned about Javelin's affairs by the police at about that time. In December 1972 search warrants were executed at his home in Newfoundland and at the respondent's office in Toronto. She knew that her father was the subject of a police investigation relating to alleged improprieties in the management of Javelin.

54 At some point in time in 1973 respondent acknowledges that she took the share certificates out of her safety deposit box and kept them thereafter in a suitcase in her closet at home. Previously she had declared that they were always kept in the safety deposit box.

55 The only explanation offered by the respondent for the many changes in her testimony is that she was poorly prepared to testify in 1986. The Court must regretfully find that she is not a reliable witness and is motivated by her own interest in not being truthful.

56 It is impossible not to conclude that in 1972 the share certificates were given to the respondent by Mr. Curtis to avoid the embarrassment, to say the least, that would have occurred had they been found by the R.C.M.P. in his possession. Hiding the certificates in a suitcase at her home is a good indication that the respondent knew how compromising it would be should the authorities discover that her father had transferred possession of the certificates to her. Apparently she considered that there was less chance that they would be found at her home than in a safety deposit box.

57 There are so many inconsistencies in respondent's testimony that it is impossible to accept her assertion that she genuinely believed that her father had acquired the shares by way of purchaser through a stockbroker. A restrictive legend is not usually found on share certificates acquired in the normal way on the stock exchange. Whether or not her father told her how he had come into possession of them, her suspicions were or should have been aroused. Good faith cannot be presumed in these circumstances. The Court cannot believe that she took the shares in total ignorance of the defects affecting her father's title to them. She has not shown that she was in good faith, and a finding of good faith is, in the Court's opinion, a necessary prerequisite to a determination that a transfer is rightful.

58 Respondent has not discharged the burden of proving that the defects going to the validity of the share certificates which she received from her father are ineffective against her. As donee of the shares, she is in no better position than her father would have been. She is unable to establish that he was a bona fide purchaser of the shares, or that the transfers of the shares from Kuna to her father, and from her father to herself, were rightful within the meaning of s. 71(e) of the Act. The issuance of the shares for an inadequate consideration made them a nullity, and the certificates in respondent's possession are worthless pieces of paper.

59 For these reasons, the Court directs the petitioner to refuse to register the transfer to the respondent of 13,500 shares of Javelin International Ltée, declares that the certificates numbered B3146, B3147, B3155, B3156, B3157 and B3162 and the issuance of the shares that they purport to represent are null and void, and dismisses the contestation of the respondent, the whole with costs against her.

GOMERY J.

qp/s/nnb

TAB 5

Prime Computer of Canada Ltd. v. Jeffrey and Robinson & Jeffrey Ltd. [Indexed as: Prime Computer of Canada Ltd. v. Jeffrey]

6 O.R. (3d) 733

[1991] O.J. No. 2317

Action No. 109/90

Ontario Court (General Division),

G.B. Smith J.

December 13, 1991

Corporations -- Oppression -- Unpaid judgment creditor with no hope of recovery being "complainant" within meaning of s. 244(b)(iii) of Business Corporations Act and entitled to apply for order under s. 247 -- President and major shareholder of judgment debtor ordered to pay to sheriff amount with which company excessively compensated him while it was indebted to judgment creditor -- Business Corporations Act, 1982, S.O. 1982, c. 4, ss. 244(b)(iii), 247.

The corporate respondent was a judgment debtor of the applicant. The individual respondent, J, was the president, major shareholder and director of the corporate respondent. For purchases made between October 1988 and January 1989, the corporate respondent became indebted to the applicant in excess of $171,000. The corporate respondent had ceased paying its current obligations in the ordinary course of business as they became due, and was insolvent by March 1989. For his services as manager of the company, J was paid $54,300 in the calendar year 1988 and $134,000 in the calendar year 1989. He could offer no explanation for the radical increase. The applicant sought an order pursuant to the Business Corporations Act, 1982 requiring J to pay to the sheriff the sum of $171,624.

Held, the application should be allowed in part.

J must have been aware of the dire financial straits in which the corporate respondent was operating when the lump sum payments to him were made, and of the company's indebtedness and failure to honour its obligations. The only reasonable conclusion was that J had embarked upon a policy of stripping the company of its cash assets while it floundered. As an unpaid judgment creditor with virtually no hope of realizing on its judgment, the applicant was a "complainant" within the meaning of s. 244(b)(iii) of the Business Corporations Act, 1982 and could apply for an order under s. 247 of the Act. The business of the corporate respondent had been carried on in a manner that was oppressive or unfairly prejudicial to the applicant. The money used by the corporate respondent to excessively compensate J, $79,700, should be paid forthwith by J to the sheriff.

Statutes referred to

Business Corporations Act, 1982, S.O. 1982, c. 4, ss. 244(b) (iii), 247
Courts of Justice Act, 1984, S.O. 1984, c. 11

APPLICATION for an order under s. 247 of the Business Corporations Act, 1982.

B.D. Barrie, for applicant.

B.R. Leonard, for respondents.

G.B. SMITH J.:--The applicant seeks an order pursuant to the Business Corporations Act, 1982, S.O. 1982, c. 4, requiring the respondent Rodger Jeffrey to pay to the sheriff the sum of $171,624 and interest.

Rodger Jeffrey is the president, major shareholder and director of Robinson & Jeffrey Limited, a judgment debtor against which company the applicant has a judgment for $211,668.20, and costs, unpaid since May 29, 1990.

The two corporate parties had a written value added reseller agreement by which the applicant sold to the corporate respondent computer components which that respondent would resell to its customers, often coupled with service agreements and software programs. It was agreed that the money owed to the applicant would be paid within 30 days of delivery of the computers. The business done by the corporate respondent in this fashion represented between 75 and 80 per cent of its total revenues.

For purchases made between October of 1988 and January of 1989, the corporate respondent became indebted to the applicant in excess of $171,000. During these months, the corporate respondent failed to make payments to the applicant in accordance with the agreement, as it had in the past. The company had ceased paying its current obligations in the ordinary course of business as they had generally become due; I find that the company was insolvent by March 1, 1989. The insolvency of the company is borne out by its balance sheet for the year ended September 30, 1989. It shows the accounts payable to have doubled over the previous year and retained earnings to have gone from a positive $73,000 to a negative $218,000. The company ceased doing business in April of 1990.

For his services as manager of his company, Rodger Jeffrey was paid a total of $54,300 in the calendar year 1988 and $134,000 in the calendar year 1989. Jeffrey was asked under oath to explain "why there would be such a radical jump from 1988 to 1989". He could offer no explanation. The records of the company show that the additional sums paid to Jeffrey by his company were in seven lump sum payments commencing on March 1, 1989 and ending on April 11, 1990 and ranging in amounts from $500 to $50,000.

The action which led to the judgment in favour of the applicant was commenced on May 25, 1989. It was defended by the corporate respondent with a counter-claim launched by it against the applicant for breach of contract and interference with the economic interest of the corporate respondent. The defence and the counter-claim were withdrawn on May 29, 1990 and judgment consented to. By then, the lump sum payments to Jeffrey had ceased and the company had gone out of business.

With the position Jeffrey held with the corporate respondent, there can be no doubt he was aware of the dire financial straits in which the company was operating during the time these lump sum payments were made. He was aware of the indebtedness of his company to the applicant and its failure to fulfil its payment obligations under the reseller agreement. With the lack of any explanation for the increased income enjoyed by Jeffrey from his company in 1989, the only reasonable conclusion to which I can come is that Jeffrey had embarked upon a policy of stripping the company of its cash assets while it floundered. There is no evidence to justify an increase in salary paid to Jeffrey in 1989 which resulted in his income from the company being two and one-half times that in 1988. In 1989 the company suffered a decrease in gross sales of some 40 per cent. By the method I have described, Jeffrey was paid an excess amount of $79,700 by way of salary in the year 1989.

As an unpaid judgment creditor with virtually no hope of realizing on its judgment with the present financial position of the judgment debtor company, I find that the applicant is a "complainant" within the meaning of the Business Corporations Act, 1982, s. 244(b)(iii). As a complainant, the applicant may apply to the court for an order under s. 247 of the Act. I find that the business of the respondent corporation has been carried on in a manner that is oppressive or unfairly prejudicial to the applicant creditor. The court in these circumstances may make an order to rectify the matters complained of, including an order compensating an aggrieved person.

It remains to be decided whether the specific order applied for is appropriate. As I read s. 247 of the Act, it appears designed to allow the court to put right, to the extent it can, dealings by a corporation found to be unfair to a creditor. The applicant has satisfied me that the acts of the corporation complained of were unfairly prejudicial to the creditor. The money being used by the corporation to excessively compensate Jeffrey in salary in effect belonged, for the most part, to the applicant. Apparently, there is but one other judgment creditor of the corporate respondent. I have considered whether it would be more appropriate to have Jeffrey repay to his company the sums to which he was obviously not entitled. That procedure, however, may result in little assistance to the applicant, the company remaining under the full control of Jeffrey. I therefore order that the sum of $79,700 be paid forthwith by Jeffrey to the sheriff of the Judicial District of Peel, plus pre-judgment interest and post-judgment interest as permitted under the Courts of Justice Act, 1984, S.O. 1984, c. 11, to be calculated on each of the seven payments from the date on which each was made to Jeffrey.

The applicant will have its costs of this application.

Application allowed in part.

[NOTE: Schedule A to this judgment, which comprised xeroxes of the Bankruptcy Act, R.S.C. 1985, c. B-3, s. 2 (definitions of "creditor", "debtor" and "insolvent person") and the Business Corporations Act, 1982, S.O. 1982, c. 4, Part XVII, ss. 13-42 and ss. 244 to 247, has not been reproduced.]

TAB 6

Indexed as:

Blue Range Resource Corp. (Re)

IN THE MATTER OF The Companies' Creditors Arrangement Act, R.S.C. 1985, C. C-36, as amended
AND IN THE MATTER OF Blue Range Resource Corporation

[2000] A.J. No. 14

2000 ABQB 4

[2000] 4 W.W.R. 738

76 Alta. L.R. (3d) 338

259 A.R. 30

15 C.B.R. (4th) 169

94 A.C.W.S. (3d) 223

Action No. 9901-04070

Alberta Court of Queen's Bench
Judicial District of Calgary

Romaine J.

Judgment: filed January 10, 2000.

(84 paras.)

Counsel:

R.J. (Bob) Wilkins and Gary Befus, for Big Bear Exploration Ltd.
A. Robert Anderson and Bryan Duguid, for Enron Trade & Capital Resources Canada Corp.
Glen H. Poelman, for the Creditors' Committee.
Virginia A. Engel, for MRF 1998 II Limited Partnership.

REASONS FOR JUDGMENT

ROMAINE J.:--

INTRODUCTION

1 This is an application for determination of three preliminary issues relating to a claim made by Big Bear Exploration Ltd. against Blue Range Resource Corporation, a company to which the Companies' Creditors Arrangement Act, R.S.C. 1985, c.C-36, as amended, applies. Big Bear is the sole shareholder of Blue Range, and submits that its claim should rank equally with claims of unsecured creditors. The preliminary issues relate to the ranking of Big Bear's claim, the scope of its entitlement to pursue its claim and whether Big Bear is the proper party to advance the major portion of the claim.

2 The Applicants are the Creditors' Committee of Blue Range and Enron Canada Corp., a major creditor. Big Bear is the Respondent, together with the MRF 1998 II Limited Partnership, whose partners are in a similar situation to Big Bear.

FACTS

3 Between October 27, 1998 and February 2, 1999, Big Bear took the following steps:

(a) it purchased shares of Blue Range for cash through The Toronto Stock Exchange on October 27 and 29, 1998;
(b) it undertook a hostile takeover bid on November 13, 1998, by which it sought to acquire all of the issued and outstanding Blue Range shares;
(c) it paid for the Blue Range shares sought through the takeover bid by way of a share exchange: Blue Range shareholders accepting Big Bear's offer received 11 Big Bear shares for each Blue Range share;
(d) it issued Big Bear shares from treasury to provide the shares used in the share exchange.

4 The takeover bid was accepted by Blue Range shareholders and on December 12, 1998, Big Bear acquired control of Blue Range. It is now the sole shareholder of Blue Range.

5 Big Bear says that its decision to undertake the takeover was made in reliance upon information publicly disclosed by Blue Range regarding its financial situation. It says that after the takeover, it discovered that the information disclosed by Blue Range was misleading, and in fact the Blue Range shares were essentially worthless.

6 Big Bear as the sole shareholder of Blue Range entered into a Unanimous Shareholders' Agreement pursuant to which Big Bear replaced and took on all the rights, duties and obligations of the Blue Range directors. Using its authority under the Unanimous Shareholders' Agreement, Big Bear caused Blue Range to apply for protection under the CCAA. An order stipulating that Blue Range is a company to which the CCAA applies was granted on March 2, 1999.

7 On April 6, 1999, LoVecchio, J. issued an order which provides, in part, that:

(a) all claims of any nature must be proved by filing with the Monitor a Notice of Claim with supporting documentation, and
(b) claims not received by the Monitor by May 7, 1999, or not proved in accordance with the prescribed procedures, are forever barred and extinguished.

8 Big Bear submitted a Notice of Claim to the Monitor dated May 5, 1999 in the amount of $151,317,298 as an unsecured claim. It also filed a Notice of Motion on May 5, 1999, seeking an order lifting the stay of proceedings granted by the March 2, 1999 order for the purpose of filing a statement of claim against Blue Range. Big Bear's application for leave to file its statement of claim was denied by LoVecchio, J. on May 11, 1999.

9 On May 21, 1999, the Monitor issued a Notice of Dispute disputing in full the Big Bear claim. Big Bear filed a Notice of Motion on May 31, 1999 for:

(a) a declaration that the unsecured claim of Big Bear is a meritorious claim against Blue Range; and
(b) an order directing the expeditious trial and determination of the issues raised by the unsecured claim of Big Bear.

10 On October 4, 1999, LoVecchio, J. directed that there be a determination of two issues in respect of the Big Bear unsecured claim by way of a preliminary application. On October 28, 1999, I defined the two issues and added a third one.

11 Big Bear's Notice of Claim sets out the nature and amount of its claim against Blue Range. The amount is particularized

by the schedule attached to the Notice of Claim, which identifies the claim as being comprised of the following components:

(a) the price of shares acquired for cash on October 27 and 29, 1998 ($724,454.91);
(b) the value of shares acquired by means of the share exchange of Big Bear treasury shares for Blue Range shares held by Blue Range shareholders ($147,687,298); and
(c) "transaction costs," being costs incurred by Big Bear for consultants, professional advisers, filings, financial services, and like matters incidental to the share purchases generally, and the takeover bid in particular ($3,729,498).

ISSUE #1

12 With respect to the alleged share exchange loss, without considering the principle of equitable subordination, is Big Bear:

(a) an unsecured creditor of Blue Range that ranks equally with the unsecured creditors of Blue Range; or
(b) a shareholder of Blue Range that ranks after the unsecured creditors of Blue Range.

13 At the hearing, this question was expanded to include reference to the transaction costs and cash share purchase damage claims in addition to the alleged share exchange loss.

Summary of Decision

14 The nature of the Big Bear claim against Blue Range for an alleged share exchange loss, transaction costs and cash share purchase damages is in substance a claim by a shareholder for a return of what it invested qua shareholder. The claim therefore ranks after the claims of unsecured creditors of Blue Range.

Analysis

15 The position of the Applicants is that the share exchange itself was clearly an investment in capital, and that the claim for the share exchange loss derives solely from and is inextricably intertwined with Big Bear's interest as a shareholder of Blue Range. The Applicants submit that there are therefore good policy reasons why the claim should rank after the claims of unsecured creditors of Blue Range, and that basic corporate principles, fairness and American case law support these policy reasons. Big Bear submits that its claim is a tort claim, allowable under the CCAA, and that there is no good reason to rank the claim other than equally with unsecured creditors. Big Bear submits that the American cases cited are inappropriate to a Canadian CCAA proceeding, as they are inconsistent with Canadian law.

16 There is no Canadian law that deals directly with the issue of whether a shareholder allegedly induced by fraud to purchase shares of a debtor corporation is able to assert its claim in such a way as to achieve parity with other unsecured creditors in a CCAA proceeding. It is therefore necessary to start with basic principles governing priority disputes.

17 It is clear that in common law shareholders are not entitled to share in the assets of an insolvent corporation until after all the ordinary creditors have been paid in full: Re: Central Capital Corp. (1996), 132 D.L.R. (4th) 223 (Ont. C.A.) at page 245; Canada Deposit Insurance Corp. v. Canadian Commercial Bank (1992), 97 D.L.R. (4th) 385 (S.C.C.) at pages 402 and 408. In that sense, Big Bear acquired not only rights but restrictions under corporate law when it acquired the Blue Range shares.

18 There is no doubt that Big Bear has exercised its rights as a shareholder of Blue Range. Pursuant to the Unanimous Shareholders' Agreement, it authorized Blue Range to file an application under the CCAA "to attempt to preserve the equity value of [Blue Range] for the benefit of the sole shareholder of [Blue Range]" (Bourchier November 1, 1999 affidavit). It now attempts to recover its alleged share exchange loss through the claims approval process and rank with unsecured creditors on its claim. The issue is whether this is a collateral attempt to obtain a return on an investment in equity through equal status with ordinary creditors that could not be accomplished through its status as a shareholder.

19 In Canada Deposit Insurance (supra), the Supreme Court of Canada considered whether emergency financial assistance provided to the Canadian Commercial Bank by a group of lending institutions and government was properly categorized as a loan or as an equity investment for the purpose of determining whether the group was entitled to rank pari passu with unsecured creditors in an insolvency. The court found that, although the arrangement was hybrid in nature, combining elements of both debt and equity, it was in substance a loan and not a capital investment. It is noteworthy that the equity

component of the arrangement was incidental, and in fact had never come into effect, and that the agreements between the parties clearly supported the characterization of the arrangement as a loan.

20 Central Capital (supra) deals with the issue of whether the holders of retractable preferred shares should be treated as creditors rather than shareholders under the CCAA because of the retraction feature of the shares. Weiler, J.A. commented at page 247 of the decision that it is necessary to characterize the true nature of a transaction in order to decide whether a claim is a claim provable in either bankruptcy or under the CCAA. She stated that a court must look to the surrounding circumstances to determine "whether the true nature of the relationship is that of a shareholder who has equity in the company or whether it is that of a creditor owed a debt or liability."

21 The court in Central Capital found that the true nature of the relationship between the preferred shareholders and the debtor company was that of shareholders. In doing so, it considered the statutory provision that prevents a corporation from redeeming its shares while insolvent, the articles of the corporation, and policy considerations. In relation to the latter factor, the court commented that in an insolvency where debts will exceed assets, the policy of federal insolvency legislation precludes shareholders from looking to the assets until the creditors have been paid (supra, page 257).

22 In this case, the true nature of Big Bear's claim is more difficult to characterize. There may well be scenarios where the fact that a party with a claim in tort or debt is a shareholder is coincidental and incidental, such as where a shareholder is also a regular trade creditor of a corporation, or slips and falls outside the corporate office and thus has a claim in negligence against the corporation. In the current situation, however, the very core of the claim is the acquisition of Blue Range shares by Big Bear and whether the consideration paid for such shares was based on misrepresentation. Big Bear had no cause of action until it acquired shares of Blue Range, which it did through share purchases for cash prior to becoming a majority shareholder, as it suffered no damage until it acquired such shares. This tort claim derives from Big Bear's status as a shareholder, and not from a tort unrelated to that status. The claim for misrepresentation therefore is hybrid in nature and combines elements of both a claim in tort and a claim as shareholder. It must be determined what character it has in substance.

23 It is true that Big Bear does not claim recission. Therefore, this is not a claim for return of capital in the direct sense. What is being claimed, however, is an award of damages measured as the difference between the "true" value of Blue Range shares and their "misrepresented" value - in other words, money back from what Big Bear "paid" by way of consideration. Although the matter is complicated by reason that the consideration paid for Blue Range shares by Big Bear was Big Bear treasury shares, the Notice of Claim filed by Big Bear quantifies the loss by assigning a value to the treasury shares. A tort award to Big Bear could only represent a return of what Big Bear invested in equity of Blue Range. It is that kind of return that is limited by the basic common law principal that shareholders rank after creditors in respect of any return on their equity investment. Whether payment of the tort liability by Blue Range would affect Blue Range's stated capital account is irrelevant, since the shares were not acquired from Blue Range but from its shareholders.

24 In considering the question of the characterization of this claim, it is noteworthy that Mr. Tonken in his March 2, 1999 affidavit in support of Blue Range's application to apply the CCAA did not include the Big Bear claim in his list of estimated outstanding debt, accounts payable and other liabilities. The affidavit does, however, set out details of the alleged mispresentations.

25 I find that the alleged share exchange loss derives from and is inextricably intertwined with Big Bear's shareholder interest in Blue Range. The nature of the claim is in substance a claim by a shareholder for a return of what it invested qua shareholder, rather than an ordinary tort claim.

26 Given the true nature of the claim, where should it rank relative to the claims of unsecured creditors?

27 The CCAA does not provide a statutory scheme for distribution, as it is based on the premise that a Plan of Arrangement will provide a classification of claims which will be presented to creditors for approval. The Plan of Arrangement presented by CNRL in the Blue Range situation has been approved by creditors and sanctioned by the Court. Section 3.1 of the Plan states that claims shall be grouped into two classes: one for Class A Claimants and one for Class B Claimants, which are described as claimants that are "unsecured creditors" within the meaning of the CCAA, but do not include "a Person with a Claim which, pursuant to Applicable Law, is subordinate to claims of trade creditors of any Blue Range Entities." The defined term "Claims" includes indebtedness, liability or obligation of any kind. Applicable Law includes orders of this Court.

28 Although there are no binding authorities directly on point on the issue of ranking, the Applicants submit that there are a number of policy reasons for finding that the Big Bear claim should rank subordinate to the claims of unsecured creditors.

29 The first policy reason is based on the fundamental corporate principle that claims of shareholders should rank below those of creditors on an insolvency. Even though this claim is a tort claim on its face, it is in substance a claim by a shareholder for a return of what it paid for shares by way of damages. The Articles of Blue Range state that a holder of Class A Voting Common Shares is entitled to receive the "remaining property of the corporation upon dissolution in equal rank with the holders of all other common shares of the Corporation". As pointed out by Laskin, J. in Central Capital (supra at page 274):

> Holding that the appellants do not have provable claims accords with sound corporate policy. On the insolvency of a company the claims of creditors have always ranked ahead of the claims of shareholders for the return of their capital. Case law and statute law protect creditors by preventing companies from using their funds to prejudice creditors' chances of repayment. Creditors rely on these protections in making loans to companies.

30 Although what is envisaged here is not that Blue Range will pay out funds to retract shares, the result is the same: Blue Range would be paying out funds to the benefit of its sole shareholder to the prejudice of third-party creditors.

31 It should be noted that this is not a case, as in the recent restructuring of Eatons under the CCAA, where a payment to the shareholders was clearly set out in the Plan of Arrangement and approved by the creditors and the court.

32 As counsel for Engage Energy, one of the trade creditors, stated on May 11, 1999 during Big Bear's application for an order lifting the stay order under the CCAA and allowing Big Bear to file a statement of claim:

> We've gone along in this process with a general understanding in our mind as to what the creditor pool is, and as recently as middle of April, long after the evidence will show that Big Bear was identifying in its own mind the existence of this claim, public statements were continuing to be made, setting out the creditor pool, which did not include this claim. And this makes a significant difference in how people react to supporting an ongoing plan...

33 Another policy reason which supports subordinating the Big Bear claim is a recognition that creditors conduct business with corporations on the assumption that they will be given priority over shareholders in the event of an insolvency. This assumption was referred to by Laskin, J. in Central Capital (supra), in legal textbooks (Hadden, Forbes and Simmonds, Canadian Business Organizations Law Toronto: Butterworths, 1984 at 310, 311), and has been explicitly recognized in American case law. The court in In the Matter of Stirling Homex Corporation, 579 F. 2d 206 (1978) U.S.C.A. 2nd Cir. at page 211 referred to this assumption as follows:

> Defrauded stockholder claimants in the purchase of stock are presumed to have been bargaining for equity type profits and assumed equity type risks. Conventional creditors are presumed to have dealt with the corporation with the reasonable expectation that they would have a senior position against its assets, to that of alleged stockholder claims based on fraud.

34 The identification of risk-taking assumed by shareholders and creditors is not only relevant in a general sense, but can be illustrated by the behaviour of Big Bear in this particular case. In the evidence put before me, Big Bear's president described how, in the course of Big Bear's hostile takeover of Blue Range, it sought access to Blue Range's books and records for information, but had its requests denied. Nevertheless, Big Bear decided to pursue the takeover in the absence of information it knew would have been prudent to obtain. Should the creditors be required to share the result of that type of risk-taking with Big Bear? The creditors are already suffering the results of misrepresentation, if it occurred, in the inability of Blue Range to make full payment on its trade obligations.

35 The Applicants submit that a decision to allow Big Bear to stand pari passu with ordinary creditors would create a fundamental change in the assumptions upon which business is carried on between corporations and creditors, requiring creditors to re-evaluate the need to obtain secured status. It was this concern, in part, that led the court in Stirling Homex to find that it was fair and equitable that conventional creditors should take precedence over defrauded shareholder claims (supra at page 208).

36 The Applicants also submit that the reasoning underlying the Central Capital case (where the court found that retraction rights in shares do not create a debt that can stand equally with the debt of shareholders) and the cases where shareholders have attempted to rescind their shareholdings after a corporation has been found insolvent is analogous to the Big Bear situation, and the same result should ensue.

37 It is clear that, both in Canada and in the United Kingdom, once a company is insolvent, shareholders are not allowed to rescind their shares on the basis of misrepresentation: McAskill v. The Northwestern Trust Company, [1926] S.C.R. 412 at 419; Milne v. Durham Hosiery Mills Ltd., [1925] 3 D.L.R. 725 (Ont. S.C.A.D.); Trusts and Guarantee Co. v. Smith (1923), 54 O.L.R. 144 (Ont. S.C.A.D.); Re: National Stadium Ltd. (1924), 55 O.L.R. 199 (Ont. S.C.); Oaks v. Turquend [1861-73] All E.R. Rep. 738 (H.L.) at page 743-744.

38 The court in McAskill (supra at page 419) in obiter dicta refers to a claim of recission for fraud, and comments that the right to rescind in such a case may be lost due to a change of circumstances making it unjust to exercise the right. Duff, J. then refers to the long settled principle that a shareholder who has the right to rescind his shares on the ground of misrepresentation will lose that right if he fails to exercise it before the commencement of winding-up proceedings, and comments:

> The basis of this is that the winding-up order creates an entirely new situation, by altering the relations, not only between the creditors and the shareholders, but also among the shareholders inter se.

39 This is an explicit recognition that in an insolvency, a corporation may not be able to satisfy the claims of all creditors, thus changing the entire complexion of the corporation, and rights that a shareholder may have been entitled to prior to an insolvency can be lost or limited.

40 In the Blue Range situation, Big Bear has actively embraced its shareholder status despite the allegations of misrepresentation, putting Blue Range under the CCAA in an attempt to preserve its equity value and, in the result, holding Blue Range's creditors at bay. Through the provision of management services, Big Bear has participated in adjudicating on the validity of creditor claims, and has then used that same CCAA claim approval process to attempt to prove its claim for misrepresentation. It may well be inequitable to allow Big Bear to exercise all of the rights it had arising from its status as shareholder before CCAA proceedings had commenced without recognition of Blue Range's profound change of status once the stay order was granted. Certainly, given the weight of authority, Big Bear would not likely have been entitled to rescind its purchase of shares on the basis of misrepresentation, had the Blue Range shares been issued from treasury.

41 Finally, the Applicants submit that it is appropriate to take guidance from certain American cases which are directly on point on this issue.

42 The question I was asked to address expressly excludes consideration of the principle of "equitable subordination". The Applicants submit that the principle of equitable subordination that is excluded for the purpose of this application is the statutory principle codified in the U.S. Bankruptcy Code in 1978 (Bankruptcy Code, Rules and Forms (1999 Ed.) West Group, Subchapter 1, Section 510 (b)). This statutory provision requires notice and a full hearing, and relates to the ability of a court to subordinate an allowed claim to another claim using the principles of equitable subordination set out and defined in case law. The Applicants submit, however, that I should look to three American cases that preceded this statutory codification and that dealt with subordination of claims by defrauded shareholders to the claims of ordinary unsecured creditors on an equitable basis.

43 The first of these cases is Stirling Homex (supra). The issue dealt with by the United States Court of Appeals, Second Circuit, is directly on point: whether claims filed by allegedly defrauded shareholders of a debtor corporation should be subordinated to claims filed by ordinary unsecured creditors for the purposes of formulating a reorganization plan. The court referred to the decision of Pepper v. Litton (308 U.S. 295 at page 305, 60 S.Ct. 238, 84 L. Ed. 281 (1939)) where the Supreme Court commented that the mere fact that a shareholder has a claim against the bankrupt company does not mean it must be accorded pari passu status with other creditors, and that the subordination of that claim may be necessitated by principles of equity. Elaborating on this, the court in Stirling Homex (supra at page 213) stated that where the debtor corporation is insolvent, the equities favour the general creditors rather than the allegedly defrauded shareholders, since in this case, the real party against which the shareholders are seeking relief is the general creditors whose percentage of realization will be reduced if relief is given to the shareholders. The court quotes a comment made by an earlier Court of Appeals (Newton National Bank v. Newbegin, 74 F. 135, 140 (8th Cir. 1896):

> When a corporation becomes bankrupt, the temptation to lay aside the garb of a stockholder, on one pretense or another, and to assume the role of creditor, is very strong, and all attempts of that kind should be viewed with suspicion.

44 Although the court in Stirling Homex refers to its responsibility under US bankruptcy law to ensure that a plan of reorganization is "fair and equitable" and to the "absolute priority" rule of classification under US bankruptcy principles, it is clear that the basis for its decision is the general rule of equity, a "sense of simple fairness" (supra, page 215). Despite the

differences that may exist between Canadian and American insolvency law in this area, this case is persuasive for its reasoning based on equitable principles.

45 If Big Bear's claim is allowed to rank equally with unsecured creditors, this will open the door in many insolvency scenarios for aggrieved shareholders to claim misrepresentation or fraud. There may be many situations where it could be argued that there should have been better disclosure of the corporation's declining fortunes, for who would deliberately have invested in a corporation that has become insolvent. Although the recognition that this may greatly complicate the process of adjudicating claims under the CCAA is not of itself sufficient to subordinate Big Bear's claim, it is a factor that may be taken into account.

46 The Applicants also cite the case of In re U.S. Financial Incorporated 648 F. 2d 515 (1980)(U.S.C.A. 9th Cir.). This case is less useful, as it was decided primarily on the basis of the absolute priority rule, but while the case was not decided on equitable grounds, the court commented that support for its decision was found in the recognition of the importance of recognizing differences in expectations between creditors and shareholders when classifying claims (supra at page 524). The court also stated that although both creditors and shareholders had been victimized by fraud, it was equitable to impose the risks of insolvency and illegality on the shareholders whose investment, by its very nature, was a risky one.

47 The final case cited to me on this issue is In re THC Financial 679 F. 2d 784 (1982) (U.S.C.A. 9th Cir.), where again the court concluded that claims of defrauded shareholders must be subordinated to the claims of the general creditors. The court commented that the claimant shareholders had bargained for equity-type profits and equity-type risks in purchasing their shares, and one such risk was the risk of fraud. As pointed out previously, Big Bear had an appreciation of the risks of proceeding with its takeover bid without access to the books and records of Blue Range and took the deliberate risk of proceeding in any event.

48 In THC Financial, the claimants argued that since they had a number of possible causes of action in addition to their claim of fraud, they should not subordinated merely because they were shareholders. The court found, however, that their claim was essentially that of defrauded shareholders and not as victims of an independent tort. All of the claimants' theories of recovery were based on the same operative facts - the fraudulent scheme.

49 Big Bear submits that ascribing some legal impediment to a shareholder pursuing a remedy in tort against a company in which it holds shares violates the principle set out in Salomon v. Salomon and Company, Limited [1897] A.C. 22 (H.L.) that corporations are separate and distinct entities from their shareholders. In my view, this is not in issue. What is being sought here is not to limit a tort action by a shareholder against a corporation but to subordinate claims made qua shareholder to claims made by creditors in an insolvency situation. That shareholder rights with respect to claims against a corporation are not unlimited has already been established by the cases on rescission and recognized by statutory limitations on redemption and retraction. In this case, the issue is not the right to assert the claim, but the right to rank with creditors in the distribution of the proceeds of a pool of assets that will be insufficient to cover all claims. No piercing of the corporate veil is being suggested or would result.

50 Counsel for Big Bear cautions against the adoption of principles set out in the American cases on the basis that some decisions on equitable subordination require inequitable conduct by the claimant as a precondition to subordinating a claim, referring to a three-part test set out in a number of cases. This discussion of the inequitable conduct precondition takes place in the broader context of equitable subordination for any cause as it is codified under Section 510 of the US Bankruptcy Code. In any event, it appears that more recent American cases do not restrict the use of equitable subordination to cases of claimant misconduct, citing, specifically, that stock redemption claims have been subordinated in a number of cases even when there is no inequitable conduct by the shareholder. "Stock redemption" is the term used for cases involving fraud or misrepresentation: U.S. v. First Truck Lines, Inc. (1996) 517 U.S. 535; SPC Plastics Corporation et al v. Griffiths et al (1998) 6th Circuit Case No. 88-21236. Some of the American cases draw a distinction between cases where misconduct is generally required before subordination will be imposed and cases where "the claim itself is of a status susceptible to subordination, such as...a claim for damages arising from the purchase ... of a security of the debtor": U.S. v. First Truck Lines, Inc. (supra, at paragraph 542).

51 The issue of whether equitable subordination as codified in Section 510 of the U.S. Bankruptcy Code should form part of the law in Canada has been raised in several cases but left undecided. Big Bear submits that these cases establish that if equitable subordination is to be part of Canadian law, it should be on the basis of the U.S. three-part test which includes the condition of inequitable conduct. Again, I cannot accept this submission. It is true that Iacobucci, J. in Canada Deposit Insurance Corp., while he expressly refrains from deciding whether a comparable doctrine should exist in Canada, refers to the three-part test and states that he does not view the facts of the Canada Deposit Insurance Corp. case as giving rise to inequitable conduct. It should be noted, however, that that case did not involve a claim by a shareholder at all, since the lenders had never received the securities that were an option under the agreements, and that the relationship had at this point in the case been characterized as a debtor/creditor relationship.

52 At any rate, this case, together with Olympia and York Developments Ltd. v. Royal Trust Co. [1993] O.J. No. 181 (Ont. G.D.) and Unisource Canada Inc. v. HongKong Bank of Canada [1998] O.J. No. 5586 (Ont. H.C.) all refer to the doctrine of equitable subordination codified in the U.S. Bankruptcy Code which is not in issue here. The latter two cases appear to have accepted the erroneous proposition that inequitable misconduct is required in all cases under the American doctrine.

53 Big Bear also submits that the equitable principles that exist in U.S. law which have led the courts to ignore separate corporate personality in the case of subsidiary corporations are related to equitable principles used to subordinate shareholder claims. The basis for this submission appears to be a reference by the British Columbia Court of Appeal in B.G. Preeco I (Pacific Coast) Ltd. v. Bon Street Holdings Ltd. et al (1989) 43 B.L.R. 68 (1989) to the Pepper v. Litton case (supra) and the so-called "Deep Rock doctrine" under American law. I do not see a link between the comments made in Pepper v. Litton and referred to in B.C. Preeco on an entirely different issue and comments concerning the court's equitable jurisdiction in the case of claims by shareholders against insolvent corporations.

54 I acknowledge that caution must be used in following the approach taken in American cases to ensure that the principles underlying such approach do not arise from differences between U.S. and Canadian law. However, I find that the comments made by the American courts in these cases relating to the policy reasons for subordinating defrauded shareholder claims to those of ordinary creditors are persuasive, as they are rooted in principles of equity that are very similar to the equitable principles used by Canadian courts.

55 American cases are particularly useful in the areas of commercial and insolvency law given that the larger economy in the United States generates a wider variety of issues that are adjudicated by the courts. There is precedent for the use of such cases: Laskin, J. in Central Capital Corp. (supra) used the analysis set out in American case law on whether preferred shareholders can claim as creditors in an insolvency to help him reach his conclusion.

56 The three American cases decided on this direct issue before the 1978 statutory codification of the law of equitable subordination are not based on a doctrine of American law that is inconsistent with or foreign to Canadian common law. It is not necessary to adopt the U.S. absolute priority rule to follow the approach they espouse, which is based on equitable principles of fairness and policy. There is no principled reason to disregard the approach set out in these cases, which have application to Canadian business and economy, and I have found them useful in considering this issue.

57 Based on my characterization of the claim, the equitable principles and considerations set out in the American cases, the general expectations of creditors and shareholders with respect to priority and assumption of risk, and the basic equitable principle that claims of defrauded shareholders should rank after the claims of ordinary creditors in a situation where there are inadequate assets to satisfy all claims, I find that Big Bear must rank after the unsecured creditors of Blue Range in respect to the alleged share exchange loss, the claim for transaction costs and the claim for cash share purchase damages.

ISSUE #2

58 Assuming (without admitting) misrepresentation by Blue Range and reliance on it by Big Bear, is the alleged share exchange loss a loss or damage incurred by Big Bear and, accordingly, is Big Bear a proper party to advance the claim for such a loss?

Summary of Decision

59 As the alleged share exchange loss is not a loss incurred by Big Bear, Big Bear is not the proper party to advance this claim.

Analysis

60 The Applicants submit that negligence is only actionable if a plaintiff can prove that it suffered damages, as the purpose of awarding damages in tort is to compensate for actual loss. This is a significant difference between damages in tort and damages in contract. In order for a plaintiff to have a cause of action in negligent misrepresentation, it must satisfy the court as to the usual elements of duty of care and breach thereof, and it must establish that it has sustained damages from that breach.

61 The Applicants argue that Big Bear did not suffer any damages arising from the share exchange. The Big Bear shares used in the share exchange came from treasury: Big Bear did not use any corporate funds or corporate assets to purchase the Blue Range shares. As the shares used in the exchange did not exist prior to the transaction, Big Bear was essentially in the same financial position pre-issuance as it was post-issuance in terms of its assets and liabilities. The nature and composition

of Big Bear's assets did not change as the treasury shares were created and issued for the sole purpose of the share exchange. Therefore, Big Bear did not sustain a loss in the amount of the value of the shares. The Applicants submit that the only potential loss is that of the pre-takeover shareholders of Big Bear, as the value of their shares may have been diluted as a result of the share exchange. However, even if there was such a loss, Big Bear is not the proper party to pursue such an action. Just as shareholders may not bring an action for a loss which properly belongs to the corporation, a corporation may not bring an action for a loss directly incurred by its shareholders.

62 Big Bear claims that it is entitled to recover the value of the Big Bear shares that were issued in furtherance of the share exchange. It says that it can prove all the elements of negligent misrepresentation: there was a special relationship; material misrepresentations were made to Big Bear; those representations were made negligently; Big Bear relied on those representations; and Big Bear suffered damage.

63 It submits that damages for negligent misrepresentation are calculated as the difference between the represented value of the shares less their sale value. Big Bear contends that it matters not that the consideration for the Blue Range shares was Big Bear shares issued from treasury. As long as the consideration is adequate consideration for legal purposes, its form does not affect the measure of damages awarded by the courts for negligent misrepresentation. Big Bear says that it bargained for a company with a certain value, and, in doing so, it gave up its own shares worth that value. Therefore, Big Bear submits that it clearly incurred a loss.

64 Big Bear submits that it is the proper party to pursue this head of damages. While the corporation has met the test for negligent misrepresentation, the shareholders likely could not, as the representations in questions were not made to them. In any event, Big Bear indicates that it does not claim for any damages caused by dilution of the shares. It also notes that a claim for dilution would not be the same as the face value of the shares issued in the share exchange, which is the amount claimed in the Notice of Claim.

65 Big Bear's claim is in tort, not contract. This is an important distinction, as the issue at hand concerns the measure of damages. The measure of damages is not necessarily the same in contract as it is in tort.

66 It is a first principle of tort law that a person is entitled to be put in the position, insofar as possible, that he or she was before the tort occurred. While the courts were historically loath to award damages for pure economic loss, this position was softened in Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd., [1964] A.C. 465 (H.L.) where the court confirmed that damages could be recovered in this type of case. When assessing damages for negligent misrepresentation resulting in pure economic loss, the goal is to put the party who relied on the misrepresentation in the position which it would have been in had the misrepresentation not occurred. While the parties to this application appear to agree on this principle, it is the application thereof with which they disagree.

67 The proper measure of damages in cases of misrepresentation is discussed in S.M. Waddams, The Law of Damages (Toronto: Canada Law Book Inc., Looseleaf, Dec. 1998), where the author states:

> The English and Canadian cases have consistently held that the proper measure [with respect to fraudulent misrepresentation] is the tortious measure, that is the amount of money required to put the plaintiff in the position that would have been occupied not if the statement had been true but if the statement had not been made. The point was made clearly in McConnel v. Wright , [1903] 1 Ch. 546 (C.A.):
>
> > It is not an action for breach of contract, and, therefore, no damages in respect of prospective gains which the person contracting was entitled by his contract to expect come in, but it is an action of tort - it is an action for a wrong done whereby the plaintiff was tricked out of certain money in his pocket; and therefore, prima facie, the highest limit of his damages is the whole extent of his loss, and that loss is measured by the money which was in his pocket and is now in the pocket of the company. That is the ultimate, final, highest standard of his loss. (at 5-19, 5-20)
>
> ...
>
> Since the decision of the House of Lords in 1963 in Hedley Byrne Ltd. v. Heller & Partners Ltd., [1964] A.C. 465 (H.L.) it has been established that an action lies for negligent misrepresentation causing economic loss. It naturally follows from acceptance of out-of pocket loss rather than the contractual measure as the basic measure of damages for fraud, that the same basic measure applies to

negligent misrepresentation. (at 5-28).

68 Big Bear claims to be entitled to the difference between the actual value and the exchange value of the shares. The flaw in this assertion is that it focuses on what Big Bear bargained for as opposed to what it actually received, which is akin to a contractual measure of damages. Big Bear clearly states that it is not maintaining an action in contract, only in tort. Damages in tort are limited to the losses which a plaintiff actually incurs as a result of the misrepresentation. Thus, Big Bear is not entitled to recover what it expected to receive as a result of the transaction; it is entitled to be compensated only for that which it actually lost. In other words, what did Big Bear have before the loss which it did not have afterwards? To determine what losses Big Bear actually sustained, its position after the share exchange must be compared with its position prior to the share exchange.

69 The situation at hand is unique. Due to a negligent misrepresentation, Big Bear was induced to give up something which, although it had value, was of substantially no cost to the corporation, and in fact did not even exist but for the misrepresentation. Big Bear created shares which had a value for the purpose of the share exchange, in that Blue Range shareholders were willing to accept them in exchange for Blue Range shares. However, outside of transaction costs, those shares had no actual cost to Big Bear, as compared to the obvious costs associated with a payment by way of cash or tangible assets. Big Bear cannot say that after the share exchange, it had lost approximately $150 million dollars, because the shares essentially did not exist prior to the transaction, and the cost of creating those shares is not equivalent to their face value. Big Bear retains the ability to issue a limitless number of shares from treasury in the future; any loss in this regard would not be equivalent to the actual value of the shares. Therefore, all that is required to return Big Bear to its pre-misrepresentation position is compensation for the actual costs associated with issuing the shares.

70 That Big Bear has not incurred a loss in the face value of the exchanged shares is demonstrated by comparing the existing facts with hypothetical situations in which such a loss may be found. Had Big Bear been required to pay for the shares used in the exchange, for instance, by purchasing shares from existing Big Bear shareholders, there would have been a clear loss of funds evidenced in the Big Bear financial statements. Big Bear's financial position prior to the exchange would have been significantly better than its position afterwards. However, no such difference results from the mere exchange of newly-issued shares. If there had been evidence that Big Bear was or could be compelled to redeem or retract the new shares at the value assigned to them at the time of the share exchange, Big Bear may have a loss in the amount of the exchange value of the shares. However, there is no evidence of such a redemption or retraction feature attaching to these shares.

71 In sum, Big Bear's position prior to the share exchange is that the Big Bear shares issued as part of the exchange did not exist. As a result of the alleged misrepresentation, Big Bear issued shares from treasury. These shares would not have been issued but for the misrepresentation. All that is required to put Big Bear back into the position it was in prior to the negligent misrepresentation is compensation for the cost of issuing the shares, which is not the same as the exchange value of those shares. Although this is somewhat of an anomalous situation, it is consistent with the accepted tort principle that, except in cases warranting punitive damages, damages in tort are awarded to compensate for actual loss. A party may not recover in tort for a loss of something it never had. Indeed, if Big Bear was awarded damages for the share exchange equal to what it has claimed, it would be in a better position financially than it was prior to the exchange. To the extent that shareholders would indirectly benefit, they would not only be Big Bear's pre-exchange shareholders, who may have suffered a dilution loss, but a new group of shareholders, including former Blue Range shareholders who participated in the exchange.

72 Big Bear submits that it incurred other losses as a result of the misrepresentation. Transaction costs incurred in the share exchange may be properly characterized as damages in tort, as those costs would not have been incurred but for the negligent misrepresentation. The same is true for the Big Bear claim for cash expended to purchase Blue Range shares prior to the share exchange. However, as I have indicated in my decision on Issue #1, Big Bear's claim for transaction costs and for cash share purchase damages ranks after the claims of other unsecured creditors. There may also be losses such as loss of ability to raise equity. There was no evidence of this before me in this application, and I have addressed Big Bear's ability to advance a claim for this type of loss in the decision relating to Issue #3.

73 Finally, there may also be a loss in the form of dilution of the value of the Big Bear shares. However, as Big Bear admits in its submissions, no such claim is made by the corporation, and any loss relating to a diluted share value would not be the same amount as the exchange value of the shares.

74 In the result, I find that Big Bear is not the proper party to pursue a claim for the alleged share exchange loss.

ISSUE #3

74a Is Big Bear entitled to make or advance by way of argument in these proceedings the claims represented by the heads of damage specified in the draft Statement of Claim set out at Exhibit "F" to the affidavit of A. Jeffrey Tonken dated June 25, 1999?

[The Court did not paragraph number Issue #3. Quicklaw has assigned the number 74a.]

75 In addition to claims for damages for negligent misrepresentation, the claims that are set out in the draft Statement of Claim are claims for remedies for oppressive and unfairly prejudicial conduct and claims for loss of opportunity to pursue valuable investments and endeavours and loss of ability to raise equity.

Summary of Decision

76 Given the orders made by LoVecchio, J. on April 6, 1999 and May 11, 1999, Big Bear is not entitled to advance the claims represented by the heads of damage specified in the draft Statement of Claim other than as set out in its Notice of Claim.

Analysis

77 Big Bear submits that it is clear that, in an appropriate case, a complex liability issue that arises in the context of CCAA proceedings may be determined by a trial, including provision for production and discovery: Algoma Steel Corp. v. Royal Bank of Canada [1992] O.J. No. 889 (Ont. C.A.). Big Bear also submits that the court has the jurisdiction to overlook technical complaints about the contents of a Notice of Claim. The CCAA does not prescribe a claim form, nor set the rules for completion and contexts of a claim form, and it is common ground that in this case, the form used for the "Notice of Claim" was not approved by any order of the court. At any rate, Big Bear submits that it is not seeking to amend its claim to add new claims or to claim additional amounts.

78 It makes that assertion apparently on the basis that the major parties concerned with CCAA proceedings in the Blue Range matter were aware of the nature of Big Bear's additional claims by reason of the draft Statement of Claim attached to Mr. Tonken's May 5, 1999 affidavit, although that affidavit was filed in support of an application to lift the stay imposed under the CCAA, an application which was dismissed by LoVecchio, J. on May 11, 1999.

79 Big Bear characterizes the issue as whether it must prove the exact amount claimed in its Notice of Claim or otherwise have its claim barred forever. It submits that the bare contents of the Notice of Claim cannot be construed as a fixed election barring a determination and assessment of an unliquidated claim for tort damages, and that it would be inequitable to deny Big Bear a hearing on the substance of its claim based on a perceived technical deficiency in the contents of the Notice of Claim.

80 In summary, Big Bear asks that the court direct an expedited trial for the hearing of its claim as outlined in the draft Statement of Claim.

81 The Applicants submit that, by attempting now to make claims other than the claims set out in the Notice of Claim, Big Bear is attempting to indirectly and collaterally attack the orders of LoVecchio, J. dated April 6, 1999 and May 11, 1999, specifically:

a) by adding claims for alleged heads of damage other than those specified in the Notice of Claim contrary to the claims bar order of April 6, 1999; and

b) by attempting to include portions of the draft Statement of Claim relating to other alleged heads of damage in the Notice of Claim contrary to the May 11, 1999 order dismissing leave to file the draft Statement of Claim.

82 While it is true that a court has jurisdiction to overlook technical irregularities in a Notice of Claim, the issue is not whether the court should overlook technical non-compliance with, or ambiguity in, a form, but whether it is appropriate to do so in this case where previous orders have been made relating to these issues. Here, Big Bear chose to pursue its claims through two different routes. It filed a Notice of Claim alleging damages for a share exchange loss, transaction costs and the cost of shares purchased before the takeover bid, all damage claims that can reasonably be identified as being related to an action for negligent misrepresentation. At about the same time, it brought an application to lift the stay granted under the CCAA and file a Statement of Claim that alleged other causes of action. That application was dismissed, and the order dismissing it was never appealed. This is not a situation as in Re Cohen (1956) 19 W.W.R. 14 (Alta. C.A.) where a claim made on one basis was later sought to be made on a different basis, nor an issue of Big Bear lacking the necessary information to make its claim, although quantification of damage may have been difficult to determine. Given the previous application by Big Bear, this is a collateral or indirect attack on the effectiveness of LoVecchio, J.'s orders, and should not be allowed: Wilson v. The Queen (1983) 4 D.L.R. (4th) at 599). The effect of the two orders made by LoVecchio, J. is to prevent Big Bear from advancing its claim other than as identified in its Notice of Claim, which cannot reasonably be

interpreted to extend beyond the claims for damages for negligent misrepresentation.

83 It is true that the Notice of Claim form is not designed for unliquidated tort claims. I do not accept, however, that it was not possible for Big Bear to include claims under other heads of damages in the claim process by, for example, attaching the draft Statement of Claim to the Notice of Claim, or by incorporating such claims by way of schedule or appendix, as was done with respect to the claims for damages for negligent misrepresentation.

84 I note that LoVecchio, J. issued a judgment after this application was heard relating to claims for relief from the impact of the claims procedure established by the court by a number of creditors who filed late or wished to amend their claims after the claims bar date of May 7, 1999 had passed. Although LoVecchio, J. allowed these claims, and found that it was appropriate in the circumstances to grant flexibility with respect to the applications before him, he noted that total amount of the applications made to him would be less than 1.4 million dollars, and the impact of allowing the applications was minimal to the remaining creditors. The applications before him do not appear to involve issues which had been the subject of previous court orders, as in the current situation, nor would they have the same implication to creditors as would Big Bear's claim. The decision of LoVecchio, J. in the circumstances of the applications before him is distinguishable from this issue.

ROMAINE J.

cp/i/qljpn

TAB 7

Case Name:

Royal Bank of Canada v. Central Capital Corp.

RE: Royal Bank of Canada et al., and Central Capital Corporation

[1996] O.J. No. 359

27 O.R. (3d) 494

132 D.L.R. (4th) 223

88 O.A.C. 161

26 B.L.R. (2d) 88

38 C.B.R. (3d) 1

61 A.C.W.S. (3d) 18

Nos. C21479 and C21477

Ontario Court of Appeal
Toronto, Ontario

Finlayson, Weiler and Laskin JJ.A.

February 7, 1996.

(154 paras.)

Counsel:

Bryan Finlay, Q.C., and John M. Buhlman, for appellants, James W. McCutcheon and Central Guaranty Trust.

James H. Grout and Anne Sonnen, for appellant, Consolidated S.Y.H. Corp.

Terrence J. O'Sullivan and Paul G. Macdonald, for the unsecured creditors of Central Capital Corp.

Neil C. Saxe, for Peat Marwick Thorne Inc.

Raesons for judgment were delivered by Finlayson J.A., concurred in by Weiler J.A. Separate reasons were delivered by Laskin JJ.A.

1 **FINLAYSON J.A.** (dissenting): -- The appellant James W. McCutcheon and Central Guarantee Trust Company as Trustee for the Registered Retirement Savings Plan of James W. McCutcheon (hereinafter sometimes referred to collectively

as "McCutcheon") and the appellant Consolidated S.Y.H. Corporation ("SYH") appeal from the order of the Honourable Madam Justice Feldman of the Ontario Court (General Division) dated January 9, 1995 (reported as Re Central Capital Corp. (1995), 29 C.B.R. (3d) 33, 22 B.L.R. (2d) 210). Feldman J. dismissed appeals from decisions dated January 20, 1993 and February 16, 1993 of the respondent Peat Marwick Thorne Inc., in its capacity as Interim Receiver, Manager and Administrator ("Administrator") of certain assets of Central Capital Corporation ("Central Capital"). The Administrator disallowed proofs of claim submitted by the appellants with respect to a plan of arrangement under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 ("CCAA"). Leave to appeal the order of Feldman J. was granted on March 17, 1995 by the Honourable Mr. Justice Houlden.

Overview of the Proceedings

2 These appeals arise out of the insolvency of Central Capital which in and prior to December 1991 defaulted under its obligations to various unsecured lenders, note holders and subordinated debt holders. In early December of 1991, Central Capital advised its creditors that, pending implementation of new financial arrangements, it had decided to discontinue payment of all interest and principal due under outstanding loans, with the exception of indebtedness due under secured notes issued to the Royal Trust Company. In an agreed statement of facts, which was prepared by the parties for the purposes of appeals from the disallowances of the Administrator, it was agreed that at all material times since in or prior to December 1991, Central Capital was insolvent. It had a total unsecured debt of $1,577,359,000 and, among other things:

(a) it was unable to pay its liabilities as they became due; and
(b) the realizable value of its assets was less than the aggregate of its liabilities.

3 By notice of application issued June 12, 1992, 39 of the creditors commenced an application pursuant to the CCAA for an order declaring the following: that Central Capital was a debtor company to which the CCAA applied; that Peat Marwick Thorne Inc. be appointed Administrator of the property, assets and undertaking of Central Capital; that a stay of proceedings against Central Capital, except with leave of the court, be granted; and that the applicants be authorized and permitted to file a plan of compromise or arrangement under the CCAA.

4 By order of Houlden J. made June 15, 1992, Central Capital was declared to be a company to which the CCAA applied and all proceedings against Central Capital were stayed. By further order of Houlden J. made July 9, 1992, it was provided, among other things, that:

(a) Peat Marwick Thorne Inc. was appointed Administrator, Interim Receiver and Manager of such of the undertaking, property and assets of Central Capital as necessary for the purpose of effecting the transaction described in the order pursuant to which specified significant assets of Central Capital would be transferred to a newly incorporated company called Canadian Insurance Group Limited ("CIGL");
(b) the Administrator was authorized to enter into and carry out a subscription and escrow agreement with creditors of Central Capital pursuant to which creditors of Central Capital would be entitled to elect to exchange a portion of the indebtedness owing to them by Central Capital for shares and debentures to be issued by CIGL;
(c) the Administrator was authorized and directed to supervise the calling for claims of creditors of Central Capital who elected to exchange a portion of the indebtedness from Central Capital for shares and debentures to be issued by CIGL as aforesaid; and
(d) Central Capital was authorized and permitted to file with the court a formal plan of compromise or arrangement with Central Capital's secured and unsecured creditors and shareholders in accordance with the CCAA and the Canada Business Corporations Act, R.S.C. 1985, c. C-44 (the "CBCA"), which would provide for the restructuring and reorganization of the debt and equity of Central Capital in the manner set out in the said order.

5 According to the agreed statement of facts, the order of Houlden J. was made without prejudice to the rights of the appellants to assert claims as creditors in the CIGL transaction. Pursuant to the terms of the July 9, 1992 order, all claims of creditors of Central Capital who wished to participate in CIGL were required to be submitted to the Administrator by September 8, 1992, or such other date fixed by the court. The Administrator received claims from various persons who wished to participate, including the claims submitted by the appellants herein.

6 The Administrator disallowed the claims of McCutcheon and SYH by notices of disallowance dated January 20, 1993 and February 16, 1993 in which various reasons were cited as to why the appellants did not qualify as creditors. The effect of this disallowance was that McCutcheon and SYH could participate only as shareholders in the plan of compromise and arrangement under the CCAA to be put forward by Central Capital. In dismissing the appeals from this disallowance,

Feldman J. found that the appellants were not creditors because they did not have a claim provable under the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3 ("Bankruptcy and Insolvency Act").

Issue

7 The agreed statements of facts sets out the issue in the appeal in the following language:

> Do the appellants, or any of them, have claims provable against CCC [Central Capital] within the meaning of the Bankruptcy Act (Canada), as amended as of the date of the Restated Subscription and Escrow Agreement? If the appellants, or any of them, have provable claims, then the proof of claim of any appellant that has a claim provable is to be allowed as filed and the appeal from the disallowance allowed, and the appellants, or any of them, whose claim is allowed are to participate in the Plan of Arrangement of Central Capital as a senior creditor.

8 The determination of this issue was deferred by Houlden J.'s order of October 27, 1992. He ordered therein that preferred shareholders who had filed claims against Central Capital as creditors were not permitted to vote at the meeting of creditors called to consider the plan of arrangement "but such is without prejudice to the rights of those claimants to prosecute their claims as filed". The last paragraph in the order ended:

> For greater certainty, the validity of any claim filed by a preferred shareholder shall not be affected by the terms of this paragraph.

Overview of the Restructuring of Central Capital

9 The order of Houlden J. of July 9, 1992 directed the restructuring of Central Capital under the aegis of the court. The order, and others that would follow, contemplated that the restructuring would take place in two stages. The first stage involved the transfer to the Administrator of certain major assets of Central Capital to a company to be incorporated called Central Insurance Group Limited (CIGL). This company is frequently referred to in the documentation and the reasons of Feldman J. as "Newco". CIGL was then to be owned by those Central Capital creditors who chose to participate in the reorganization by accepting a reduction in their debts due from Central Capital and exchanging this reduced indebtedness for debentures in CIGL. Subscription for debentures by this means additionally entitled the creditors to subscribe for shares in CIGL. Our understanding from counsel is that the assets transferred to CIGL included the assets acquired by Central Capital from the appellants in purchase agreements described later in these reasons.

10 The court approved a subscription and escrow agreement setting out this arrangement. In order to participate, the creditors were required to file with the Administrator a proof of claim in the prescribed form along with other documents confirming the creditor's intention to reduce its claim against Central Capital and to subscribe for debentures and shares of CIGL. Claims were to be based on Central Capital's indebtedness to creditors as of June 15, 1992, the date of the court-ordered stay of proceedings. This transaction was completed on October 1, 1992 and resulted in CIGL being owned by the creditors of Central Capital in exchange for a reduction in Central Capital's unsecured debt in the amount of $603 million.

11 The second stage of the restructuring involved a plan of arrangement under the CCAA. That plan as put forward by Central Capital recognized four classes of creditors, only one of which, namely that of "Senior Creditors", could apply to the appellants. The plan of arrangement, as amended, provided that Central Capital would issue to Senior Creditors pro rata on the basis of their senior claims a class of secured promissory notes in the aggregate principal amount of $20 million of secured debt, which were to be known as first secured notes. A similar arrangement was made for the issuance of $1 million of second secured promissory notes to subordinated creditors. Senior and subordinated creditors included any creditor whose claim had been allowed under the CIGL claims procedure in the first stage, to the extent of that creditor's reduced claim.

12 The plan of arrangement also called for the creation of a new class of shares in Central Capital to be called the Central New Common Shares. Central Capital would issue to the above Senior and Subordinated Creditors 90 per cent of the new share capital of Central Capital in extinguishment of the balance of their debt. The Central Capital shareholders of all classes would have their existing shares converted into the remaining 10 per cent of the Central New Common Shares. All of the existing preferred and common shares would be cancelled upon implementation of the plan.

13 The amended plan of arrangement was ultimately voted on and approved by all four classes of creditors of Central Capital. On December 18, 1992, Houlden J. sanctioned this plan of arrangement under the CCAA. He authorized and directed Central Capital to apply for articles of reorganization pursuant to s. 191 of the CBCA, so as to authorize the creation of the Central New Common Shares for implementation of the amended plan of arrangement. He also lifted the stays of proceedings affecting Central Capital and its ability to carry on business as of January 1, 1993.

14 The effect of the amended plan of arrangement after approval was that all remaining debts and obligations owed by Central Capital to its creditors on or before June 15, 1992 were extinguished and all outstanding and unissued shares of any kind in Central Capital were cancelled and replaced by Central New Common Shares. Central Capital was then free to carry on business. It was no longer insolvent.

Facts as they Relate to the Claim of McCutcheon

15 By a share purchase agreement dated June 15, 1987 between Central Capital and Gormley Investments Limited ("Gormley") and Heathley Investments Limited ("Heathley"), Central Capital agreed to purchase all Class "B" voting shares of Canadian General Securities Limited ("CGS") that were owned by Gormley and Heathley. James W. McCutcheon and his brother, who were the sole shareholders of Gormley, represented to Central Capital that CGS owned substantially all of the shares of Canadian Insurance Sales Limited, which in turn owned substantially all of the shares in a number of operating insurance, credit and trust companies. The consideration for the purchase of the CGS shares was $575 per share. The vendors were to be paid $400 per share in cash on closing and were to receive seven Series B senior preferred shares of Central Capital. These shares contained a retraction clause entitling the holder to retract each preferred share on July 1, 1992 for $25. Failing issuance of the shares by Central Capital, the vendors were to receive an additional $175 for each CGS share. The share purchase agreement and later the Articles of Central Capital further provided that the holders of Series B Senior Preferred Shares were entitled to receive dividends as and when declared by the directors of Central Capital out of moneys of the corporation properly applicable to the payment of dividends and in the amount of $1.90625 per share per annum (being 7 5/8 per cent per annum on the stated capital of $25 per share) payable in equal quarterly payments. No dividends were in fact declared.

16 The certificate of amendment for Central Capital dated July 30, 1987, and the articles of amendment setting out the provisions attaching to the Series B Senior Preferred Shares contain all the terms and conditions governing the said shares. I am setting out below a description of those that are relevant to this appeal.

17 Pursuant to art. 4.1 of the Senior Series B Provisions, each holder of Series B Senior Preferred Shares was entitled, subject to and upon compliance with the provisions of art. 4, to require Central Capital to redeem all or any part of the Series B Senior Preferred Shares registered in the name of that holder on July 1, 1992 at a price equal to $25 per share, plus all accrued and unpaid dividends thereon, calculated to but excluding the retraction date.

18 Article 4.2 of the Senior Series B Provisions sets out the procedure for retraction of the shares. Article 4.3 of the Senior Series B Provisions provides that if the redemption by Central Capital of all of the Series B Senior Preferred Shares required to be redeemed on the retraction date would be contrary to applicable law or the rights, privileges, restrictions and conditions attaching to any shares of Central Capital ranking prior to Series B Senior Preferred Shares, then Central Capital shall redeem only the maximum number of Series B Senior Preferred Shares which it determined was permissible to redeem at that time. Article 4.3 provides the mechanism for a pro rata redemption from each holder of the tendered Series B Senior Preferred Shares and redemption of the tendered Series B Senior Preferred Shares by Central Capital at further dates.

19 Article 4.4(a) provides that subject to s. 4.4(b), the election of any holder to require Central Capital to redeem any Series B Senior Preferred Shares shall be irrevocable upon receipt by the transfer agent of the certificates for the shares to be redeemed and the signification of election of the holder of the Series B Senior Preferred Shares.

20 Article 4.4(b) of the Senior Series B Provisions provides that if the retraction price is not paid by Central Capital, Central Capital shall forthwith notify each holder of the Series B Senior Preferred Shares who has not received payment for his deposited shares of the holder's right to require Central Capital to return all (but not less than all) of the holder's deposited share certificates and the holder's rights under art. 4.3 outlined above.

21 Article 4.5 of the Senior Series B Provisions provides that the inability of Central Capital to effect a redemption shall not affect or limit the obligation of Central Capital to pay any dividends accrued or accruing on the Series B Senior Preferred Shares from time to time not redeemed and remaining outstanding.

22 Article 7 of the Series Senior B Provisions provides that in the event of the liquidation, dissolution or winding-up of Central Capital, whether voluntary or involuntary, or any other distribution of assets of Central Capital among its shareholders for the purposes of winding up its affairs, the holders of the Series B Senior Preferred Shares shall be entitled to receive, from the assets of Cental Capital, $25 per Series B Senior Preferred Shares, plus all accrued and unpaid dividends thereon, to be paid prior to payment to junior ranking shareholders. Upon payment of such amounts, the holders of the Series B Senior Preferred Shares shall not be entitled to share in any further distribution of assets of Central Capital.

23 A notice of retraction privilege was sent by Central Capital to the holders of Series B Senior Preferred Shares with a cover letter dated April 23, 1992. The letter stated, among other things, that Central Capital would not redeem any shares because the redemption of such shares would be contrary to applicable law in the context of Central Capital's then current financial situation. McCutcheon and Central Guaranty Trust deposited for redemption 406,800 and 26,000 Series B Senior Preferred Shares, respectively, in accordance with the Senior Series B Provisions and the notice of retraction privilege. The shares were deposited on May 28, 1992, with Montreal Trust Company of Canada, pursuant to the notice of retraction privilege. The shares were properly tendered for redemption in the manner and within the time required by Central Capital's articles of amendment.

24 Central Capital did not pay the redemption price on July 1, 1992 and on July 20, 1992 it notified each holder of Series B Senior Preferred Shares of its right to require Central Capital to return all of the holder's deposited share certificates as required by art. 4.4(b) of the Senior Series B Provisions. McCutcheon and Central Guaranty Trust did not exercise that right.

25 Pursuant to the terms of Houlden J.'s order of July 9, 1992 directing the restructuring of Central Capital, McCutcheon submitted to the Administrator, as a creditor of Central Capital, proofs of claim dated September 3, 1992 and September 4, 1992, respectively. McCutcheon claimed the amount of $10,913,593.69 in respect of his Series B Senior Preferred Shares tendered for redemption. Central Guaranty Trust claimed the amount of $697,526.68 in respect of its tendered 26,000 Series B Senior Preferred Shares. McCutcheon also executed and submitted the restated subscription and escrow agreement and other documents electing to participate in CIGL. These claims were completed and submitted in the prescribed form and within the time required by Houlden J.'s order.

26 As was previously noted, these claims were disallowed by the Administrator. The substance of the Administrator's reasons for disallowance was that the ability of Central Capital to redeem these preference shares is restricted by the provisions of the CBCA and it would be contrary to applicable law to redeem the shares in the context of Central Capital's financial position. The relevant provision of the CBCA provides:

> 36(1) [Redemption of shares] Notwithstanding subsection 34(2) or 35(3), but subject to subsection (2) and to its articles, a corporation may purchase or redeem any redeemable shares issued by it at prices not exceeding the redemption price thereof stated in the articles or calculated according to a formula stated in the articles.
>
> (2) [Limitation] A corporation shall not make any payment to purchase or redeem any redeemable shares issued by it if there are reasonable grounds for believing that
>
> (a) the corporation is, or would after the payment be, unable to pay its liabilities as they become due; or
> (b) the realizable value of the corporation's assets would after the payment be less than the aggregate of
>
> (i) its liabilities, and
> (ii) the amount that would be required to pay the holders of shares that have a right to be paid, on a redemption or in a liquidation, rateably with or prior to the holders of the shares to be purchased or redeemed.

Evidently, the Administrator equated redemption by the corporation with the right of retraction by the preferred shareholder. It agreed with Central Capital's position that once it became insolvent in December of 1991, Central Capital no longer had the ability to redeem the shares tendered for retraction and thus McCutcheon was restricted to exercising what rights it might have as a shareholder.

Facts as they Relate to the Claim of SYH

27 Pursuant to an agreement of purchase and sale made as of June 30, 1989, as amended, Scottish & York Holdings Limited (the predecessor to SYH) sold to Central Capital the shares of Central Canada Insurance Services Limited, Eaton Insurance Company, Scottish & York Insurance Co. Limited and Victoria Insurance Company of Canada (collectively the "Insurance Companies"), except for certain preference shares held by the directors of those corporations. In consideration of this transfer, Central Capital issued to Scottish & York Holdings Limited 60,116,000 Series A Junior Preferred Shares and 9,618,560 Series B Junior Preferred Shares.

28 The articles of Central Capital provided that it would pay on each dividend payment date prior to the fifth anniversary of this issue, as and when declared by the directors out of the assets of the corporation properly applicable to the payment of dividends, a dividend of $.08 for each outstanding Series A Junior Preferred Share. The dividend was payable quarterly by the issuance of .02 Series B Junior Preferred Shares for every outstanding Series A Junior Preferred Share. No dividends were in fact declared.

29 The Articles also provided that Central Capital was obligated to retract the Series A Junior Preferred Shares and Series B Junior Preferred Shares, at the option of the holders of those shares, on the fifth anniversary of their issuance. The retraction price was $1.00 per share plus all accrued and unpaid dividends. Payment of the retraction price of these shares by Central Capital was subject to the provisions of the CBCA, which governs the affairs of Central Capital. For the purposes of this appeal, I believe that we can treat the balance of the provisions relating to these preferred shares as being the same as those governing the McCutcheon Series B Senior Preferred Shares.

30 Given that the operative date for proving claims against Central Capital was June 15, 1992, the retraction date governing the preferred shares of SYH was some two years removed. Notwithstanding, on September 8, 1992 SYH executed and delivered to the Administrator a proof of claim, a counterpart of the restated subscription and escrow agreement, an initial share subscription and an instrument of claims reduction form, all in the prescribed form and within the time required. The claim was that SYH was holding or entitled to hold the following shares of Central Capital:

(a) 60,116,000 Junior Preferred Series A shares;
(b) 9,618,560 Junior Preferred Series B shares;
(c) 4,611,095 Junior Preferred Series B shares accrued to June 15, 1992 but not yet issued to SYH;

for a total of 74,345,655 shares, each having a retraction value of $1.00. However, because of some adjustments in favour of Central Capital to the purchase price of the shares sold by SYH to Central Capital under the June 30, 1989 agreement of purchase and sale, the net claim as of June 15, 1992 was reduced from $74,345,655 to $72,388,836.

31 By notice of disallowance dated January 20, 1993, the Administrator disallowed the claim by SYH to subscribe for debentures and common shares to be issued by CIGL. The reasons for the disallowance are similar to those provided for disallowing the claims of McCutcheon. The Administrator found that SYH's right to require Central Capital to retract the Series A and B Junior Preferred Shares only arose on the expiry of the fifth anniversary of their issuance and that Central Capital was precluded from retracting those shares by virtue of its insolvency and the provisions of the CBCA. Hence SYH, like McCutcheon, was limited to exercising what other rights it might have as a shareholder.

Analysis

32 Although the factual groundwork is necessary for putting in perspective the sole issue before the court, the final question confronting us is a narrow one. Did the retraction clauses in the appellants' shares create a debt owed by Central Canada as of June 15, 1992 within the meaning of the Bankruptcy Act? I think that they did.

33 It is agreed that the operative section of the Bankruptcy and Insolvency Act is s. 121(1). It reads as follows:

> 121(1) All debts and liabilities, present or future, to which the bankrupt is subject at the date of the bankruptcy or to which he may become subject before his discharge by reason of any obligation incurred before the date of the bankruptcy shall be deemed to be claims provable in proceedings under this Act.

There was no bankruptcy in this case and thus the relevant date was agreed to be June 15, 1992. The obligations of Central Capital to the appellants were incurred before that date, and so the only question becomes whether the obligations created a debt between the appellants and Central Capital.

34 What then is a debt? All the parties turn to Black's Law Dictionary, quoting different editions. The following is from the Sixth Edition (1990), at p. 403:

> Debt. A sum of money due by certain and express agreement. A specified sum of money owing to one person from another, including not only the obligation of debtor to pay but right of creditor to receive and enforce payment ...

> A fixed and certain obligation to pay money or some other valuable thing or things, either in the present or in the future.

35 The above is consistent with what is defined as a debt by Jowitt's Dictionary of English Law, 2d ed. (1977), at p. 562:

> A debt exists when a certain sum of money is owing from one person (the debtor) to another (the creditor). Hence "debt" is properly opposed to unliquidated damages; to liability, when used in the sense of an inchoate or contingent debt; and to certain obligations not enforceable by ordinary process. "Debt" denotes not only the obligation of the debtor to pay, but also the right of the creditor to receive and enforce payment.

And finally, The Shorter Oxford Dictionary, 3d ed. (1973), at p. 497:

> Debt 1. That which is owed or due; anything (as money, goods or service) which one person is under obligation to pay or render to another. 2. A liability to pay or render something; the being under such liability.

36 I have no difficulty in finding that the claims of the appellants in the case under appeal fall within all of the above definitions. As will be discussed herein, concern was expressed in this case over whether or not the appellants as creditors were entitled to "receive and enforce payment" on the "debt" because of the insolvency of Central Capital on June 15, 1992. I will deal with the specific arguments relating to the effect of insolvency on this particular indebtedness in due course, but for the moment I am content to observe that the above definitions contemplate only that the creditor's right to recover is the reciprocal of the debtor's obligation to pay. For every debtor there must be a creditor. There may be cases where it is difficult to identify the person who in law may receive and enforce payment, but this is not such a one.

37 With great respect to the judge of first instance and to the submissions of counsel for the unsecured creditors, I believe that the fundamental error that has been made in these proceedings arises from the conception that the preferred shares in question can either be debt instruments or equity participation instruments, but they cannot have the attributes of both. Feldman J. had this to say at p. 48 of her judgment:

> Although the right of retraction at the option of the preferred shareholder may be less common than the usual right of the company to redeem at its option, that right is one of the incidents or provisions attaching to the preferred shares, but does not change the nature of those shares from equity to debt. The parties have characterized the transaction as a share transaction. The court would require strong evidence that they did not intend that characterization in order to hold that they rather intended a loan.
>
> In my view, this case turns on whether the right of retraction itself creates a debt on the date the company becomes obligated to redeem even if it cannot actually redeem by payment on that date, or a contingent future debt on the same analysis, not on whether the preferred shares themselves with the right of retraction are actually debt documents.
>
> Because the preferred shares remain in place as shares until the actual redemption, the appellants are not creditors and have no claim provable under the Bankruptcy Act (Canada), and the appeals are therefore dismissed.

38 As I read these reasons, the learned judge is in effect stating that these instruments are preferred shares in the corporation because the parties have so described them. In the first place, I do not think that describing the documents as preferred shares is conclusive as to what instrument the parties thought they were creating. In the second place, it is not what the parties call the documents that is determinative of their identity, but rather it is what the facts require the court to call them. The character of the instrument is revealed by the language creating it and the circumstances of its creation. Although these instruments may "remain in place as shares" until they are actually redeemed, they also contain a specific promise to pay at a specified date. This is the language of debt. I cannot accept the proposition that a corporate share certificate cannot create a corporate debt in addition to the certificate holder's rights as a shareholder.

39 The rules relating to the competing rights of shareholders and creditors of an insolvent corporation have become so regulated by governmental action that one can readily lose sight of the common law basis for making a distinction. To understand the difference in treatment, we must re-examine what a share of a corporation represents. Initially, a share is issued by the corporation to raise share capital. The price of the share is money or the promise of money. Accordingly, an individual share is one of a number of separate but integral parts of the authorized capital of a corporation. Even though it is

the shareholders who contribute to the capital of the corporation, the capital remains the property of the corporation. The shareholders, however, as owners of the shares of capital, effectively control the corporation. They have the responsibility of managing its affairs through their control over the board of directors and in popular terminology are considered to be the owners of the corporation. However, the corporation is a separate entity in law, and if in the course of carrying out its business it incurs debts to third parties, those debts are those of the corporation. A corporation is an intangible and its capital therefore represents its substance to third parties having business dealings with the corporation. A preferred share is simply a share of a class of issued shares which contains a preference over other classes of shares, whether preferred or common: see Sutherland, Fraser and Stewart on Company Law of Canada, 6th ed. (1993), at pp. 157 and 195 for further discussion.

40 The rights of shareholders are conveniently summarized by R.M. Bryden in his chapter, "The Law of Dividends", contained in Ziegel ed., Studies in Canadian Company Law (1967), at p. 270:

> The purchaser of a share in a business corporation acquires three basic rights: he is entitled to vote at shareholders' meetings; he is entitled to share in the profits of the company when these are declared as dividends in respect of the shares of the class of which his share forms a part; and he is entitled, upon the winding-up of the corporation, to participate in the distribution of the assets of the company that remain after creditors are paid. A fourth right which should be noted is the right to transfer ownership in his share, whereby the owner for the time being may realize upon the increase in value of the company's assets, or its favourable prospects, by selling his share at a price reflecting the buyer's estimation of the value of the rights he will acquire. Unless the shareholder chooses to sell his share, he can realize a return upon his investment only through receipt of dividends or by the return of his capital upon an authorized reduction of capital or winding up.

41 Shareholders are variously characterized as entrepreneurs, investors or risk-takers and as such they have the opportunities of benefitting from the successes of the corporation and suffering from its failures. While the corporation is an operating entity, the shareholders receive their rewards, if there are any, through the payment of dividends declared from time to time by the board of directors. While the source of these dividends is not restricted to surplus funds, the result of the payment of the dividend must not result in a return of capital to the shareholders. The classic justification for this rule was stated by Sir George Jessel, Master of the Rolls, in Flitcroft's Case (1882), 21 Ch. D. 519 at pp. 533-34, 52 L.J. Ch. 217 (C.A.):

> The creditor has no debtor but that impalpable thing the corporation, which has no property except the assets of the business. The creditor ... gives credit to that capital, gives credit to the company on the faith of the representation that the capital shall be applied only for the purposes of the business, and he has therefore a right to say that the corporation shall keep its capital and not return it to the shareholders ...

42 Creditors, on the other hand, do not have an ownership or equity interest in the corporation. They are third parties who have loaned money or otherwise advanced credit to the corporation. They look to the company for payment in accordance with the terms of the contract creating the indebtedness. They are also restricted in their recovery to the amounts stipulated in the terms of indebtedness. They are entitled to payment regardless of the financial circumstances of the debtor corporation and accordingly are not restricted to receiving payment of the debt from surplus. They can be paid out of assets or through the creation of further indebtedness. It is immaterial how the corporation records this indebtedness in its internal books. In some circumstances the indebtedness could properly reflect the acquisition of property from a creditor as a capital asset. This does not, however, convert the creditor into an investor. The vendor of the property remains a creditor and retains priority over shareholders in the event of a bankruptcy or insolvency.

43 In my view, the reasons under appeal do not reflect a sensitivity to the circumstances which gave rise to the issuance of the preference shares. The shares were not issued by Central Capital to the general public in order to raise capital and do not represent an investment by the public in the capital of the corporation. They were issued to specific persons as payment for the acquisition of specified assets. While the corporation was authorized by its articles of incorporation to issue preferred shares generally, the shares issued to the appellants were structured to meet the requirements of the appellants as vendors of the controlling interest in the operating companies that Central Capital was acquiring. In my view, these preference shares are the equivalent of vendor shares in that the appellants received them in exchange for the transfer of assets to Central Capital.

44 In the case of McCutcheon, the retraction provision in the preferred shares represented only partial payment of an agreed value for the assets, but in the case of SYH, they represented the full value. In both cases, the agreed value as reflected in the retraction price was guaranteed by Central Capital to be retractable at a fixed price at a predetermined date. By postponing the obligation to pay the purchase price in this way, Central Capital was using the retraction provisions of the preference shares as a vehicle for the financing of its expanding asset base. The appellants, for their part, deferred the

realization of the purchase price of their assets to the agreed dates and thereby extended credit to the corporation. In return for extending credit for some or all of the selling price, the appellants agreed to receive dividends calculated in advance but payable as and when declared by the board of directors.

45 Thus, in looking at the substance of the transaction that led to the issuance of the preference shares, it appears to me that the retraction clauses were promises by Central Capital to pay fixed amounts on definite dates to the appellants. They evidenced a debt to the appellants. The fact that the appellants as holders of the preference shares had rights as shareholders in the corporation up to the time when the retraction clauses were exercisable did not affect their right to enforce payment of the retraction price when it became due.

46 The validity of an analysis directed to the substance of the transaction is supported by Canada Deposit Insurance Corp. v. Canadian Commercial Bank, [1992] 3 S.C.R. 558, 97 D.L.R. (4th) 385, a judgment of the Supreme Court of Canada delivered by Iacobucci J. The case involved a number of corporations constituting a support group which entered into an arrangement to provide emergency financial assistance to Canadian Commercial Bank ("CCB"). On the ultimate failure of the bank, the issue arose as to whether the moneys advanced to CCB under this support arrangement were in the nature of a loan or in the nature of a capital investment. I find instructive to our situation Iacobucci J.'s observation at pp. 590-91:

> As I see it, the fact that the transaction contains both debt and equity features does not, in itself, pose an insurmountable obstacle to characterizing the advance of $255 million. Instead of trying to pigeonhole the entire agreement between the Participants and CCB in one of two categories, I see nothing wrong in recognizing the arrangement for what it is, namely, one of a hybrid nature, combining elements of both debt and equity but which, in substance, reflects a debtor-creditor relationship. Financial and capital markets have been most creative in the variety of investments and securities that have been fashioned to meet the needs and interests of those who participate in those markets. It is not because an agreement has certain equity features that a court must either ignore these features as if they did not exist or characterize the transaction on the whole as an investment. There is an alternative. It is permissible, and often required, or desirable, for debt and equity to co-exist in a given financial transaction without altering the substance of the agreement. Furthermore, it does not follow that each and every aspect of such an agreement must be given the exact same weight when addressing a characterization issue. Again, it is not because there are equity features that it is necessarily an investment in capital. This is particularly true when, as here, the equity features are nothing more than supplementary to and not definitive of the essence of the transaction. When a court is searching for the substance of a particular transaction, it should not too easily be distracted by aspects which are, in reality, only incidental or secondary in nature to the main thrust of the agreement.

(Emphasis in original)

47 I have no difficulty in finding that the appellants' preferred shares with their retraction clauses are of "a hybrid nature, combining elements of both debt and equity". As to the equity component, the appellants are shareholders prior to exercising their retraction rights in that they have the right to vote in certain circumstances and have a right to receive dividends when and if they are declared by the board of directors. The debt component is more significant however. The shares were not issued to investors, but to vendors of property. The vendors were entitled to receive a fixed sum at a specified time in payment therefor. Pending payment, the vendors were entitled to receive dividends which were the equivalent of interest on the unpaid balance.

48 I can think of no reason why the holders of these preferred shares should not be treated as both shareholders and creditors. It does not concern me that these appellants act as shareholders before their retraction rights are exercisable. Nor do I see any hardship to other creditors of Central Capital arising from the ability of these appellants to claim as creditors in the restructuring of the company given that the appellants are unpaid with respect to substantial assets sold to the corporation and now transferred on the restructuring to CIGL.

49 Much was made in argument of the fact that the retraction amounts could not be paid on the retraction dates. In the case of McCutcheon, the corporation was insolvent and subject to court administration on the due date of July 1, 1992. In the case of SYH, the retraction date did not arrive before the reorganization was complete.

50 The narrow issue of the effect of insolvency on a debt has been dealt with by the British Columbia Court of Appeal in Re East Chilliwack Agricultural Co-Operative (1989), 74 C.B.R. (N.S.) 1, 58 D.L.R. (4th) 11. In this case, the appellants were one-time members of three co-operative associations. The rules of the co-operatives permitted a member to withdraw upon written notice to the board of directors to that effect. The member was entitled to elect to have his shares redeemed

either in equal instalments over five years or in one payment with interest at the end of five years. In April of 1987, the superintendent of co-operatives, under the authority of the Cooperative Association Act, R.S.B.C. 1979, c. 66, suspended the co-operatives' right to redeem their shares until their financial situation was no longer impaired. The three co-operatives subsequently went bankrupt and a two-fold issue came before the bankruptcy court: (1) whether those members whose notices of withdrawal had been accepted by the board of directors but who had not yet received the value of the shares were entitled to rank as unsecured creditors, and (2) whether those who had delivered notices that had not been accepted were to be treated as unsecured creditors. The court of first instance found that the members were shareholders and answered both questions in the negative. That judge was reversed on appeal with the majority of the court deciding that the answer to both questions was yes. Hutcheon J.A. for the majority stated at p. 13:

> I shall use Mr. Neels [a co-operative member] as my example. According to R. 3.06 he ceased to be a shareholder in May 1983. In May 1984 the Agricultural Co-operative owed him the first of five payments, or $686.40. I know of no principle of law that would support the proposition that Neels could not sue for that amount if the Agricultural Co-operative failed to pay in May 1984. Of course, the superintendent of co-operatives has power under s. 15(2) to suspend payments if, in his opinion, the financial position of the co-operative was impaired. Subject to that power, the position of Neels and the Agricultural Co-operative would be that of ordinary creditor and debtor. In my opinion, the order made by the judge cannot be sustained on the first ground.

From this case, I extract the proposition that the fact of an insolvency, whether declared or not, does not change the nature of the relationship between debtor and creditor. It continues notwithstanding the inability of the debtor to pay or the creditor to collect.

51 It appears to me, with deference, that the issue of the effect of Central Capital's insolvency on the character of the retraction payments is something of a red herring. The contest in this appeal is between those who are conceded to be unsecured creditors and those whose claim to such status is contested. In both cases, any right to payment was suspended by Central Capital's announcement in December of 1991 that it was insolvent and that it had suspended all payments of principal and interest to unsecured creditors. This course of action was not freely chosen but was required by law. Any payments to creditors after the date of insolvency would be voidable at the instance of creditors on the basis that they were fraudulent preferences. In addition to ss. 95 and 96 of the Bankruptcy Act dealing with fraudulent preferences generally, there is provincial legislation in the form of the Fraudulent Conveyances Act, R.S.O. 1990, c. F-29, and the Assignments and Preferences Act, R.S.O. 1990, c. A-33, that would be applicable. Counsel for the unsecured creditors maintains that the right to redeem shares, including preference shares, was postponed by s. 36(2) of the CBCA, supra. I am not certain that s. 36(2) applies to the retraction provisions of the appellants' preference shares as opposed to the redemption privileges of Central Capital, but in my opinion the point is irrelevant to this appeal. Once Central Capital acknowledged its insolvency, it could neither redeem its shares nor honour its retraction obligations. The whole purpose for the creditors applying to the court for a stay of Central Capital's obligations, including those of the acknowledged unsecured creditors, was to arrange for a scheme of payments to all creditors that could not be subject to attack as preferences. There is no suggestion on the evidence before us that the claims of unsecured creditors accepted by the Administrator were claims that had crystallized prior to the insolvency of Central Capital. Nor is it suggested that any creditors were rejected because some or all of their claims were not payable until after the date of the insolvency. The fact of insolvency, by itself, does not provide a rational basis for distinguishing the claims of the appellants from those of other unsecured creditors.

52 Much also was made of the provision in the Articles authorizing the shares in question, which states that if the obligation to redeem "would be contrary to applicable law", then Central Capital "shall redeem only the maximum number of [shares] it is then permitted to redeem". Counsel for the unsecured creditors submits that the reference to "applicable law" is to s. 36 of the CBCA. The reference certainly embraces the CBCA, but it is not restricted by its terms to that statute. For example, "applicable law" would also capture s. 101 of the Bankruptcy and Insolvency Act, which provides for penalties against directors and shareholders where insolvent companies redeem shares or pay dividends.

53 There was no evidence led as to why this provision was placed in the articles and the share certificates. It appears to be a standard clause in all the preference shares issued by the corporation and not just those that were adapted to the appellants' situations where specific retraction clauses were drafted to satisfy the particular asset acquisitions. For my part, I have difficulty in understanding how a consideration of this provision assists the process of determining the underlying character of the retraction obligations. The statement is so self-evident that it is almost banal. I can only assume that the statement was included in the share provisions of a corporation marketing its securities world-wide so as to inform purchasers that legal restrictions in this jurisdiction apply to the company's right to redeem shares.

54 In summary then regarding the insolvency argument, these various statutes prohibit payments of any kind to shareholders by an insolvent company. As I understand it, counsel does not question that when a dividend has been lawfully

declared by a corporation, it is a debt of the corporation and each shareholder is entitled to sue the corporation for his proportion: see Fraser and Stewart, supra, at p. 220 for a list of authorities. However, once a company is insolvent it cannot make payments to shareholders or creditors so long as it continues to be insolvent. On the other hand, nowhere in the CBCA or elsewhere will we find authority for the proposition that once a corporation is insolvent, it is no longer obliged to pay its debts. The obligation is postponed until the insolvency is corrected or the corporation makes an accommodation with its creditors and obtains a release with or without the assistance of the various statutes dealing with insolvency.

55 The existence of provisions prohibiting payment to shareholders and creditors on insolvency does not in any way assist the determination of whether the retraction obligations at issue in this appeal constitute a debt or a return of capital at the time they are payable. Speaking of the obligation to honour the retraction in terms of the corporation redeeming its shares also introduces the wrong emphasis. The corporation is not redeeming the shares at its option as contemplated by most redemptions. It is being forced to redeem them because of a prior contractual obligation for which the preferred shareholder gave good consideration. It is for this reason that I question whether s. 36 of the CBCA is the appropriate reference point. This is not the type of payment which concerned Jessel M.R. in Flitcroft's Case, supra.

56 At the risk of oversimplifying this case, it appears to me that many of the arguments made against the appellants' claims to be creditors of Central Capital are impermissible in the context of the agreed statement of facts. The issue in appeal is frozen in time by the stipulation that the court is to determine if these retraction clauses created a debt within the meaning of the Bankruptcy and Insolvency Act on June 15, 1992. The arguments against the appellants' claims also ignore that debts under s. 121(1) of the Bankruptcy Act need not be payable at the date of the bankruptcy (or June 15, 1992 in our scenario). They need only come beneath the broad umbrella of "debts and liabilities, present and future, to which [Central Capital] is subject" on June 15, 1992. The fact that the debts could not be paid after June 15, 1992, does not mean that they were not provable claims pursuant to s. 121 of the Bankruptcy and Insolvency Act. Moreover, assuming the retraction clauses created a debt payable on a future date, neither the order of Houlden J. nor the restrictions in the articles creating the shares themselves purported to extinguish that debt.

57 There is nothing in either the articles of Central Capital or in the law that excuses the obligation to pay the retraction amounts. Rather, discharge of the obligation is simply postponed until the cessation of the disabling event of insolvency. Article 4.3 of the Senior Series B Provisions provides the mechanism for future redemption of tendered shares that are not redeemed because such redemption would be contrary to law. Article 4.5 provides that the inability to effect a redemption does not affect the obligation to pay dividends accrued or accruing on the unredeemed shares.

58 So far as SYH is concerned, the retraction price was not payable until the fifth anniversary of the June 1989 sale of assets. Therefore, no issue of the effect of insolvency arose in 1992. The orders of Houlden J. of June 15 and July 9, 1992 changed the rules of the game. If this appellant is a creditor, it does not have to wait until the retraction date. It can claim as a creditor now. It did and the claim was disallowed. However, if this court holds that the claim should have been allowed, then in accordance with the narrow issue put to us, SYH is entitled to be accepted as a full creditor in the entire reorganization of Central Capital.

59 An additional factor raised by counsel during argument was that art. 7, supra, provides that in the event of the liquidation, dissolution or winding-up of Central Capital, whether voluntary or involuntary, or any other distribution of assets among its shareholders for the purpose of winding up its affairs, the holders of these preferred shares are entitled to recover "from the assets of Central Capital" the retraction price plus all accrued and unpaid dividends thereon. Such amount is to be paid prior to payment to junior ranking shareholders. The article further provides that "[u]pon payment of such amounts, the holders of [the preferred shares] shall not be entitled to share in any further distribution of assets of [Central Capital]". Because it is trite law that shareholders are entitled to recover from assets only after all ordinary creditors have been paid in full, counsel for the unsecured creditors submits that the fact that the clause contemplates priorities between shareholders on a winding-up or a liquidation of assets is clear evidence that they were shareholders only.

60 I have two responses to this submission. The first is the obvious, that we are not dealing with this contemplated event. We are dealing with a reorganization in which the parties have put a single question to the court: are the appellants creditors? Consideration of issues of priority or the valuation of claims have been taken away by the narrow scope of the agreed question. If the answer to the question posed is yes, then in accordance with the agreed statement of facts, the appellants are entitled to have their claims as creditors allowed under the subscription and escrow agreement and to participate in the amended plan of arrangement as senior creditors. If the answer is no, they are to be treated as the Administrator has treated them: they are not creditors at all and are restricted to receiving Central New Common Shares under the amended plan of arrangement.

61 My second response is that counsel for the unsecured creditors misses the significance of the clause. He assumes that there will be a deficiency in all circumstances leading up to a liquidation, dissolution or winding-up that will necessitate a pro rata distribution, first to creditors and then to shareholders of all classes. However, the clause does not say that those with

retraction rights are not creditors. It says that the retraction amounts are to be paid out of assets, not surplus. Once the retraction amounts have been paid in full, the appellants are not entitled to share in any further distribution. This contemplates a surplus after all creditors, including the appellants, have been paid in full. Accordingly, far from classifying the appellants as shareholders, the clause provides that they are not entitled to be treated as shareholders under a winding-up or liquidation but only as creditors.

62 Finally, with respect to SYH's claims, it was submitted that these claims were so contingent as to be virtually non-existent. The claims anticipate a retraction date that as of June 15, 1992 was some two years into the future. Upon approval of the amended plan of arrangement on December 18, 1992, the shares of SYH were cancelled and replaced by a new issue of shares, the Central New Common Shares. Counsel relied upon the finding of Feldman J. that there was then no discernable basis upon which the retraction could occur. Once again, with respect, this conclusion misses the point. Following the final order of Houlden J. approving the amended plan of arrangement, all the shares and all the debts of Central Capital disappeared. There was thereafter no discernable basis upon which any event contemplated by any debt or share instruments could occur. We are only concerned with the status of shareholders and creditors as of June 15, 1992.

63 Based on the reasons set out above, I have concluded that the retraction amounts do fall within the definition of debts and liabilities, present or future, to which Central Capital was subject on June 15, 1992. This does not apply to undeclared dividends, however, because until a dividend is declared no action on behalf of a shareholder lies to enforce its payment: see Fairhall v. Butler, [1928] S.C.R. 369 at p. 374, [1928] 3 D.L.R. 161. If undeclared dividends have been claimed by any of the appellants they should be disallowed. In all other respects the claims should be allowed.

64 Accordingly, I would allow the appeals, set aside the order of Feldman J. and order that the appellants have provable claims that are to be allowed by the Administrator. The record does not disclose what order if any Feldman J. made as to costs. Certainly the appellants are entitled to their costs of this appeal. If the parties are unable to agree with respect to any other disposition of costs, I would suggest that they submit their positions to the court in writing.

65 WEILER J.A.: -- I have had the benefit of reading the reasons of Finlayson J.A. and for the reasons which follow I respectfully disagree with his conclusion that the appellants are entitled to prove a claim pursuant to the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 (the "CCAA").

66 Section 12(1) of the CCAA requires that persons wishing to participate in a reorganization have claims which would be provable in bankruptcy. Section 121(1) of the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, states that "[a]ll debts and liabilities, present or future ... shall be deemed to be claims provable in proceedings under this Act".

67 In order to decide whether the obligation of Central Capital to redeem the preferred shares of the appellants is a claim provable in bankruptcy, it is necessary to characterize the true nature of the transaction. The court must look to the surrounding circumstances to determine whether the true nature of the relationship is that of a shareholder who has equity in the company or whether it is that of a creditor owed a debt or liability by the company: Canada Deposit Insurance Corp. v. Canadian Commercial Bank, [1992] 3 S.C.R. 558, 97 D.L.R. (4th) 385. In this case, the decision is not an easy one. Where, as here, the agreements between the parties are reflected in the articles of the corporation, it is necessary to examine them carefully to characterize the true relationship. It is not disputed that if the true nature of the relationship is that of a shareholder-equity relationship after the retraction date and at the time of the reorganization, then the appellants do not have a claim provable in bankruptcy. Consequently, they will not have a claim under the CCAA.

68 As I see it, three main questions need to be addressed:

(1) Was Feldman J. correct in characterizing the relationship between Central Capital and the companies owned by James McCutcheon ("McCutcheon"), and between Central Capital and Scottish and York Holdings Limited (the predecessor to S.Y.H., hereinafter referred to as "SYH"), as a shareholder relationship?

(2) Did the nature of the relationship change after the retraction date for redeeming the shares of McCutcheon or, in the case of SYH, at the time of the reorganization?

(3) If the nature of the relationship is not a shareholder-equity relationship, are the appellants entitled to prove a claim under the CCAA?

69 In addition, the appellants raise the question of whether they have a right to prove a claim for dividends, which have accrued but have not yet been declared payable. The price to be paid by Central Capital to McCutcheon on the retraction date, July 1, 1992, was $25 per share plus all accrued and unpaid dividends thereon. The dividends are therefore part of the retraction price. Similar provisions apply to SYH.

70 The reasons of Finlayson J.A. contain a comprehensive statement of the background to the litigation and I will therefore only refer to the facts in a summary fashion.

71 James McCutcheon and his brother sold their shares in Central Guarantee Trust Company to Central Capital Corporation ("Central Capital"), a trust company, for $575 a share. They received $400 per share in cash. The balance of $175 owing on each share was paid through the issue of seven preferred shares in Central Capital, with each share having a par value of $25. Following this transaction, McCutcheon purchased his brother's shares. These preferred shares, known as Senior Series B Preferred Shares, were to be listed on the Toronto Stock Exchange. These shares carried with them a retraction privilege. The shareholder had the right to have his shares redeemed by Central Capital on July 1, 1992, for $25 a share, provided that such redemption would not be "contrary to law in the context of the Corporation's current financial position". McCutcheon chose not to sell his shares.

72 Scottish & York Holdings Limited (the predecessor to SYH) sold its shares in certain insurance companies which it owned to Central Capital. Central Capital paid for these shares by the issue of Series A Junior Preferred Shares. These shares were not posted on a stock exchange. SYH had the right to have its shares redeemed by Central Capital on or after September 1994 at a price of $1.00 per share, subject to the provisions of the Canada Business Corporations Act, R.S.C. 1985, c. C-44 (the "CBCA").

73 It should be noted that the right of retraction was not unique to these two classes of shareholders. Even common shareholders had the right to have their shares retracted under certain circumstances.

74 By December 1991, Central Capital was unable to pay its liabilities as they became due and its total liabilities greatly exceeded the value of its assets. As a result, the various banks and subordinated debtholders, collectively referred to as the lenders, had a choice to make. Inasmuch as the definition of a corporation in s. 2 of the Bankruptcy and Insolvency Act precludes a creditor from bringing a petition against a trust company, they could either wind up Central Capital under the Winding-up Act, R.S.C. 1985, c. W-11, or they could try to restructure Central Capital under the CCAA. In a winding-up or liquidation, the trustee would sell the company's assets, either piecemeal or as a going concern, to third parties. The proceeds from the sale would then be distributed to those who proved a claim according to set priority rules. In a reorganization, existing fixed amounts owed to Central Capital's creditors would be traded for new claims and ownership interests in the reorganized corporation which would remain a going concern. The lenders chose to reorganize.

75 Two transactions were involved. In the Consolidated Insurance Group Limited transaction, or "CIGL transaction", Central Capital transferred some of its significant assets to a newly incorporated company, CIGL. Thirty-nine creditors of Central Capital then elected to exchange a portion of Central Capital's debt owing to them for equity in this newly incorporated company. In the second transaction, common shares were issued for the remaining assets of Central Capital. The creditors of Central Capital were given 90 per cent of the common shares of the reorganized company. The balance of 10 per cent was allocated to the shareholders of Central Capital. All of the preferred, common and subordinate voting shares in Central Capital were then converted into these "new" common shares. The reorganization was subsequently approved by the creditors and sanctioned by the court as required by the Act, but this approval was given without prejudice to any claims that McCutcheon and SYH might have.

76 McCutcheon's position was that the right to have his shares retracted accrued before the reorganization, and that his exercise of this right of retraction in May 1992 constituted a present debt or liability entitling him to rank as a creditor in the CIGL transaction and in the reorganized Central Capital. SYH's position was that the right to have its shares retracted in 1994 created a future debt or liability and thus a provable claim. The administrator of Central Capital disallowed both claims. McCutcheon and SYH appealed the administrator's decision to Feldman J. In dismissing their appeals, she held that the appellants were shareholders and that the right of retraction attaching to the shares did not change the nature of the shares from equity into debt.

1. Was Feldman J. correct in characterizing the agreement between Central Capital and the companies owned by McCutcheon, and between Central Capital and SYH, as creating a shareholder relationship between the parties?

77 Feldman J. analyzed the transaction and came to the conclusion that it was an equity transaction.

78 Finlayson J.A. is of the opinion that the nature of this transaction is different and that Feldman J. erred in not showing sensitivity to the fact that she was dealing with the sale of a business by its owners. He is of the opinion that the shares issued by Central Capital are the equivalent to "vendor shares" in that the appellants received them in exchange for the transfer of assets to Central Capital. He does not see the transaction as being either a contribution to capital by McCutcheon and SYH or

as a return of capital. Although the transaction has debt and equity features, Finlayson J.A. is of the opinion that the true nature of the transaction is that of a debt owing by Central Capital to McCutcheon and SYH for the shares in their companies.

79 My analysis of the transaction is that when McCutcheon sold his shares in Central Guaranty and took back preferred shares in Central Capital as part payment, he transferred part of his capital investment from a smaller entity to a larger entity. Similarly, SYH transferred its investment in the shares of the insurance companies for shares in the larger entity of Central Capital. Both appellants could look to a larger asset base than before to generate a return on their capital. Until the retraction date, McCutcheon chose to take the risk of continuing his investment in Central Capital, which offered the prospect of a stable, yet relatively high, annual return through the receipt of 7 5/8 per cent dividends. Because the shares traded on the Toronto Stock Exchange, he would have had the option of realizing upon his investment by selling his shares for what they would bring on the open market, but he did not do so. In the case of SYH, although these shares were not required to be publicly listed, the corporation's articles did not restrict their transfer. The corporation's articles indicate that these shares had some preference over other shares with respect to the right to receive dividends and in the distribution of assets after creditors are paid on a liquidation. As preferred shareholders, McCutcheon and SYH did not have a voice in company affairs unless the company failed to pay the dividends it had promised to pay. This is quite typical: see Welling, Corporate Law in Canada, 2d ed. (1991) at p. 604; Ziegel et al., Cases and Materials on Partnership and Canadian Business Corporations, 2d ed. (1989) at p. 1198. Risk-taking, profit-sharing, transferability of investment, and the right to participate in a share of the assets on a liquidation after the creditors have been paid are the hallmarks of a shareholder: see R.M. Bryden, "The Law of Dividends," contained in Ziegel ed., Studies in Canadian Company Law (1967) at p. 270. In my opinion, Feldman J. was correct that the true nature of the relationship between the parties initially was that of an equity transaction.

2. Did the nature of the relationship change after the retraction date for McCutcheon's shares and did the reorganization trigger a right of redemption respecting SYH's shares?

80 Ordinarily, shareholders cannot realize on their investment in a company except by transferring their shares. The retraction privilege attaching to the shares gives the preferred shareholders the option of realizing on their investment other than by transferring their shares to a third party.

81 Feldman J. found that McCutcheon continued to be a shareholder after the retraction date and that he remained a shareholder at the time of the reorganization. She found SYH's claim to be too remote inasmuch as the retraction date had not yet arrived at the time of the reorganization.

82 The appellants argue that Feldman J. erred in this conclusion. They submit that although McCutcheon and SYH may have been shareholders initially, this relationship changed. Upon McCutcheon's exercise of his right to have the corporation pay him the retraction price of his shares, he ceased to be a shareholder. When Central Capital failed to pay him, he became a creditor of the corporation. In the case of SYH, it is submitted that when the lenders opted to reorganize the company, they, in effect, triggered the obligation to redeem SYH's shares.

(a) Nature of the transaction's relationship to the capital structure of the corporation

83 Section 25(3) of the CBCA states that shares shall not be issued until the consideration for the shares is fully paid either in cash or with property having a fair market value equivalent to the shares issued. Therefore, by issuing preferred shares with a fixed par value, Central Capital paid McCutcheon for his shares of Central Guaranty and paid SYH for the shares of the insurance companies that Central Capital received. Central Capital could not issue preferred shares except as full payment for the shares it received. The preferred shares were part of the capital of Central Capital and the preferred shares were always shown as shareholders' equity on Central Capital's books. The capital of the corporation is representative of the assets available to pay creditors. If, on the date for redemption of McCutcheon's shares, or on the date of reorganization in the case of SYH, the shares are redeemed, the amount paid must be deducted from the stated capital of the corporation: s. 39 CBCA. Consequently, the total assets that Central Capital will have available to pay the lenders and other creditors outside the corporation will be reduced. A reduction of capital by the redemption of redeemable shares is permitted under the CBCA but only where the requirements of s. 36 are met.

(b) Section 36 of the CBCA

84 Section 36 of the CBCA makes the ability of a corporation to redeem its redeemable shares subject to (1) its articles and (2) a solvency requirement. For ease of reference s. 36 is reproduced below.

> 36(1) Notwithstanding subsection 34(2) or 35(3) [both of which deal with a corporation's acquisition of its own shares in other circumstances], but subject to subsection (2) and to its articles, a

corporation may purchase or redeem any redeemable shares issued by it at prices not exceeding the redemption price thereof stated in the articles or calculated according to a formula stated in the articles.

(2) A corporation shall not make any payment to purchase or redeem any redeemable shares issued by it if there are reasonable grounds for believing that

(a) the corporation is, or would after the payment be, unable to pay its liabilities as they become due; or

(b) the realizable value of the corporation's assets would after the payment be less than the aggregate of

(i) its liabilities, and

(ii) the amount that would be required to pay the holders of shares that have a right to be paid, on a redemption or in a liquidation, rateably with or prior to the holders of shares to be purchased or redeemed.

(Emphasis added)

85 There is no dispute that Central Capital was unable to redeem McCutcheon's shares on the retraction date. Nor could it redeem SYH's shares on the date of the reorganization. The appellants agree that the effect of s. 36 renders the agreement between themselves and Central Capital unenforceable. It is the position of the appellants, however, that s. 36 does not extinguish a debt or liability which they say has been created. The appellants rely on the decision in Re East Chilliwack Agricultural Co-operative (1989), 74 C.B.R. (N.S.) 1, 58 D.L.R. (4th) 11 (B.C.C.A.), in support of their position that a debt or liability is created notwithstanding the solvency requirements of s. 36 respecting payment. The appellants' submission does not take into consideration the major differences between the decision in East Chilliwack and the present situation relating to the timing, effect of the solvency requirements and the provisions in the articles governing the relationship of the parties.

86 (1) In East Chilliwack, farmers who owned shares in an agricultural co-operative gave notice to the co-op of their intention to have their shares redeemed. After the notices had been given, the superintendent of co-operatives suspended the right of the co-op to redeem its shares. Here, the request to redeem the shares by McCutcheon and the retraction date occurred after Central Capital had sent out a notice that it would not be able to redeem the shares due to its financial position. SYH had no right to demand that its shares be retracted until the retraction date, which was some two years after the date of Central Capital's insolvency.

87 As in the instant case, the issue in East Chilliwack was whether the farmers were entitled to rank with the creditors of the co-op. Hutcheon J.A., with Toy J.A. concurring, held that they were entitled to be treated as creditors.

88 At the outset of his reasons, Hutcheon J.A. noted, at p. 11, that the effect of the superintendent's suspension on the farmers' rights was not argued on appeal and that the court had been asked to determine the status of the farmers without regard to the suspension.

89 Here, the effect of Central Capital's inability to redeem its shares due to insolvency is very much in issue and cannot be ignored. Although the articles provide for the redemption of all of the shares held by McCutcheon and SYH on or after the retraction date, the articles also state that Central Capital will only redeem so many of its shares as would not be "contrary to law". Pursuant to s. 36(1) of the CBCA, a corporation may purchase or redeem redeemable shares, but the corporation is prohibited from doing so if the corporation is unable to pay its liabilities as they become due or if the assets of the corporation are less than the total of its liabilities and the amount required for the redemption. Because Central Capital could not comply with the solvency requirements, redemption would be "contrary to law".

90 (2) In East Chilliwack, supra, at p. 13, the rules of the co-op provided that upon the giving of a notice of redemption, the farmer giving it ceased to be a shareholder. Central Capital's articles do not state that a request for redemption of the holder's shares terminates his status as a shareholder. McCutcheon continued to have the right to receive dividends pursuant to art. 4.5 while his shares were not redeemed. In effect, so long as Central Capital was unable to redeem the shares but had profits, McCutcheon continued to be entitled to a share of the profits through the declaration of dividends. If the dividends remained unpaid for eight consecutive quarters then, pursuant to art. 8, McCutcheon had the right to receive notice of, and to attend, each meeting of shareholders at which directors were to be elected and was entitled to vote for the election of two directors. The articles relating to the preferred shares held by SYH contain a similar provision. The result of insolvency as envisaged by the articles was that McCutcheon and SYH would continue as shareholders.

91 (3) In East Chilliwack, supra, Hutcheon J.A. held, at p. 13, that, subject to the power of the superintendent of co-operatives, the farmer's position would be that of an ordinary creditor.

92 Here, the terms attaching to McCutcheon's shares do not give him that right. Instead, he is given the right to continue to receive dividends so long as the company cannot pay him. The articles relating to the shares held by SYH contain a similar provision. In addition, art. 4.3(b), respecting the retraction of the shares, indicates that if the directors have acted in good faith in making a determination that the number of shares the corporation is permitted to redeem is zero, then the corporation is not liable in the event this determination proves inaccurate. This would hardly be the position vis-à-vis an ordinary creditor.

93 (4) Article 8 and a similar provision in the articles relating to the shares held by SYH provide that upon a sale of all or a substantial part of the company's undertaking, the preferred shareholders have a right to receive notice of and to be present at the meeting called to consider this sale. The farmers in East Chilliwack do not appear to have had any similar right.

94 (5) Article 7 provides that in the event of a liquidation, dissolution or winding-up of the corporation the preferred shareholders have a right to receive $25 per Series B Senior Preferred Shares before the corporation pays any money or distributes assets to shareholders in any class subordinate or junior to the Series B Senior Preferred Shares. Similarly, SYH, as the holder of Series A and B Junior Preferred shares, has the right, upon the dissolution or winding-up of the corporation, to receive a sum equivalent to the redemption amount for each series junior preferred share. This right is subject to the rights of shares ranking in priority to the shares of these series, but is ahead of the rights of the holders of common shares.

95 Nothing in the articles concerning the retraction date affects the right of McCutcheon and SYH to participate in Central Capital's liquidation. The participation of the farmer in East Chilliwack ceased once he had given notice to redeem. Article 4.4 of Central Capital provides that once the shares have been tendered for retraction this election is irrevocable on the part of the holder. In the event that payment of the retraction price was not made, however, the holder had the right to have all deposited share certificates returned. Central Capital offered to return McCutcheon's shares to him, but he refused. Because McCutcheon retained all the rights and privileges of a preferred shareholder after the retraction date, the fact that he refused to take back his share certificates cannot alter the true nature of the relationship. The refusal was merely evidence of a dispute concerning what the relationship was. SYH also retained its full status as a shareholder until the date of the reorganization. This was not the situation in East Chilliwack.

96 By way of summary, on the date of the reorganization McCutcheon and SYH had not ceased to be preferred shareholders of Central Capital. The rights attaching to their retractable preferred shares entitled them to continue to share in the profits of the company when these were declared as dividends, to vote at shareholders meetings to elect directors so long as dividends remained unpaid for a specified period of time, and, on a winding-up of the company, to participate in the distribution of assets that remained after the creditors were paid according to the ranking of the series of their shares. The company's obligation to redeem its shares was not absolute. Instead, the articles provided for what was realistically a "best efforts" buy-back based on solvency and continuation as a shareholder to the extent a buy-back could not take place. In East Chilliwack, because the farmer ceased to be a shareholder, the articles do not appear to make any provision for continued participation or for the postponement of payment depending on the solvency of the co-op.

(c) Evidence of a debtor-creditor relationship is lacking in the articles

97 Looked at another way, after the retraction date and at the time of the reorganization, the common features of a debtor-creditor relationship are not in evidence in Central Capital's articles. The agreements between the parties contain no express provision that the redemption of the shares is in repayment of a loan. The corporation was not obliged to create any fund or debt instrument to ensure that it could redeem the shares on the retraction date. There is no indemnity in the event that the money is not repaid on the retraction date. There is no provision for the payment of any interest after the retraction date in the event that the money is not repaid on the retraction date. There is no provision that after the retraction date and in the event of insolvency, the appellants would have the right to have the company wound up. (See R. v. Imperial General Properties Ltd., [1985] 2 S.C.R. 288, 21 D.L.R. (4th) 741, for a case where the articles of the company contained this right.) There is no provision that upon a winding-up or insolvency the parties are entitled to rank pari passu with the creditors as was the case in Canada Deposit Insurance Corp. v. Canadian Commercial Bank, supra.

(d) The effect of the reorganization

98 Finlayson J.A. is of the view that it is immaterial that the articles provide, in the event of the liquidation, dissolution or winding-up of the company, that the appellants are only entitled to rank after the creditors but ahead of the junior ranking shareholders. In his view, this provision is irrelevant because we are not dealing with a liquidation but with a reorganization. He finds it significant that, like debtors, the preferred shareholders are not entitled to participate in any surplus once they

have been paid. I am of the view that this provision in the articles is significant. It represents a clear indication that the holders of the retractable shares were not to be dealt with on the same footing as ordinary creditors even after the retraction date. Instead, they were to be dealt with as shareholders, albeit an elevated class. Under the CBCA all shares carry equal rights. Words used in the articles to differentiate a class of shares are nothing more than authorized deviations from this statutory position of equality: Welling, supra, at p. 683.

99 The appellants submit that a winding-up or liquidation is not the same as a reorganization. This is true. Both, however, are methods of dealing with insolvency. Both are methods for secured creditors to enforce their claims by seizing the assets in which they hold security interests. If the value of the corporation as a going concern exceeds the liquidation value of the assets, it is in the interest of all the debt holders that the corporation be preserved as a going concern. The purpose of both a liquidation and a reorganization is to permit the rehabilitation of the insolvent person unfettered by debt: Vachon v. Canada Employment & Immigration Commission, [1985] 2 S.C.R. 417, 23 D.L.R. (4th) 641. By virtue of s. 20 of the CCAA, arrangements under the Act mesh with the reorganization provisions of the CBCA so as to affect the company's relations with its shareholders. Shareholders have no right to dissent to a reorganization: s. 191(7), CBCA. On a reorganization, among other things, the articles may be amended to alter or remove rights and privileges attaching to a class of shares and to create new classes of shares: s. 173, CBCA. These statutory provisions provide a clear indication that, on a reorganization, the interests of all shareholders, including shareholders with a right of redemption, are subordinated to the interests of the creditors. Where the debts exceed the assets of the company, a sound commercial result militates in favour of resolving this problem in a manner that allows creditors to obtain repayment of their debt in the manner which is most advantageous to them.

100 The similarities between a liquidation and a reorganization, together with the express statement in the articles of Central Capital with respect to what is to happen on a winding-up, dictate that the interests of the holders of retractable shares, McCutcheon and SYH, are subordinated to the creditors and they are not entitled to claim under the CCAA equally with the creditors. This position is also consistent with the provisions of the Bankruptcy and Insolvency Act and the Winding-up Act. In the case of an insolvency where the debts to creditors clearly exceed the assets of the company, the policy of federal insolvency legislation appears to be clear that shareholders do not have the right to look to the assets of the corporation until the creditors have been paid.

Dividends

101 Although dividends were payable on the shares of McCutcheon and SYH, no dividends were in fact declared. The appellants contend that the dividends, which have accrued but which were not declared, are a debt or liability because they were stipulated to be part of the retraction price.

102 Article 7 of Central Capital respecting McCutcheon's shares states that in the event of a liquidation, dissolution or winding-up of the corporation, the shareholders are entitled to receive not only the $25 per Series B preferred share, but "all accrued and unpaid dividends thereon, whether or not declared ... before any amount is paid by the Corporation or any assets of the Corporation are distributed to the holders of any shares ... ranking as to capital junior to the Series B Senior preferred Shares".

103 It is trite law that a dividend may only be declared if a company is solvent. For corporations governed by the CBCA, it appears that the common law tests for solvency have all been subsumed or overruled: R. v. McClurg, [1990] 3 S.C.R. 1020 at pp. 1039-40, [1991] 2 W.W.R. 244 at pp. 259-60.

104 Section 42 of the CBCA provides:

> 42. A corporation shall not declare or pay a dividend if there are reasonable grounds for believing that
>
> (a) the corporation is, or would after the payment be, unable to pay its liabilities as they become due; or
>
> (b) the realizable value of the corporation's assets would thereby be less than the aggregate of its liabilities and stated capital of all classes.

105 Section 42 prevents the corporation from declaring or paying a dividend when it does not meet certain solvency requirements. There was no declaration of a dividend in the present case. Any obligation to pay a dividend as part of the retraction price cannot therefore be enforced when the company is insolvent. Dividends which have accrued but which are unpaid are not considered to be a debt because, on reading the articles as a whole, the provision for payment is not one which is made independent of the ability to pay: see Welling, supra, at p. 689, citing International Power Co. v. McMaster

University, [1946] S.C.R. 178, [1946] 2 D.L.R. 81, where it was held there was no guarantee of payment and hence the accrued but unpaid dividends were not a debt. Instead, accrued but unpaid dividends are considered to be akin to a return of capital. Making these accrued dividends part of the retraction price does not alter this.

106 By way of analogy to the treatment of dividends, it could be said that until the company has declared it will redeem the shares which are tendered to it the obligation to redeem them is not a debt or liability. The promise to pay in the articles of Central Capital is not made independent of any ability to pay.

107 In the event that I am wrong in my conclusion that the true nature of the relationship is one of equity, I shall now consider the position in the event that a debt has been created.

3. If the nature of the relationship is not an equity relationship are the appellants entitled to be claimants under the CCAA?

108 The parties agree that the effect of s. 36 renders the agreement to redeem their preferred shares unenforceable. It is the position of the appellants, however, that s. 36 does not extinguish Central Capital's obligation to repay them. Their position is that Central Capital's obligation to repay them is a contingent liability and therefore gives them a claim provable in bankruptcy, bringing them under s. 12(1) of the CCAA.

The Meaning of Debt

109 Debt is defined in a very broad manner in Black's Law Dictionary, 6th ed. (1990) at p. 403. It is the position of the appellants that this definition of "debt" is broad enough to include McCutcheon's right to have Central Capital redeem his shares. In the case of SYH, it is submitted that the right to redemption constitutes a future liability. It is the appellants' position that Feldman J. erred in holding that to have a provable claim, McCutcheon and Central Capital must be able to obtain a judgment against Central Capital for the retraction price and be entitled to seek payment on the judgment. Finlayson J.A. agrees with the appellant's position.

110 Debt is defined in Black's Law Dictionary, supra, as:

> A sum of money due by certain and express agreement. A specified sum of money owing to one person from another, including not only obligation of debtor to pay but right of creditor to receive and enforce payment ...
>
> A fixed and certain obligation to pay money or some other valuable thing or things, either in the present or in the future. In a still more general sense, that which is due from one person to another, whether money, goods, or services. In a broad sense, any duty to respond to another in money, labor, or service; it may even mean a moral or honorary obligation, unenforceable by legal action. Also, sometimes an aggregate of separate debts, or the total sum of the existing claims against person or company. Thus we speak of the "national debt", the "bonded debt" of a corporation, etc.

111 It will be readily apparent that in Black's the term "debt" is defined in two distinct ways. In order to constitute a debt as defined in the first paragraph, the obligation must be enforceable. In the second paragraph debt is defined more broadly as any duty or obligation even if unenforceable by legal action. Feldman J. considered the first portion of the definition in her reasons. If the first portion of the definition applies, no debt is created because the obligation is not enforceable under the CBCA. The appellants rely on the second portion of the definition. They also rely on the definition of the word "liability" in Black's which is also defined very broadly.

112 In one sense, support for the position of the appellants is found in s. 40 of the CBCA. Section 40 states that a contract with a corporation providing for the purchase of shares of the corporation is specifically enforceable against the corporation except to the extent that the corporation cannot perform the contract without being in breach of ss. 34 or 35. Section 34 contains the solvency requirements concerning the redemption by a company of its own shares other than those carrying a right of redemption. Section 35 deals with shares which have been issued to settle or compromise a debt. In s. 2, "lability" is defined as including "a debt of a corporation arising under section 40".

113 Section 40 does not include any reference to the obligation of a company to repurchase redeemable shares under s. 36. As a result s. 36 is not incorporated by reference into the definition of liability. While it might be suggested that this is a legislative oversight, the omission is also consistent with the position that only the articles of the corporation govern the relationships between the company and the holders of the retractable shares under s. 36. I have already stated my opinion that

the articles of Central Capital do not make the obligation to redeem the shares a debt or, for that matter, a liability. Moreover, even if a provision like s. 40 is implied with respect to redeemable preferred shares, it would also be necessary to imply a provision like s. 40(3) which states that in the event of liquidation where the company has not performed its contract to redeem, the other party is entitled to be ranked subordinate to the rights of creditors but in priority to the shareholders. This is a clear expression of legislative intention that on insolvency the claim of those entitled to have their shares redeemed should not be placed on the same footing with the claims of creditors but should rank subordinate to them: see Nelson v. Rentown Enterprises Inc., [1994] 4 W.W.R. 579, 16 Alta. L.R. (3d) 212 (C.A.), adopting the reasons of Hunt J. at 96 D.L.R. (4th) 586, 5 Alta. L.R. (3d) 149 (Q.B.). Policy reasons would again militate in favour of the result being the same on a reorganization.

Claims in Bankruptcy

114 Even if the broader definitions of a debt or liability in Black's are adopted, the appellants still do not have a claim provable in bankruptcy.

115 Persuasive authority already exists to the effect that in order to be a provable claim within the meaning of s. 121 of the Bankruptcy and Insolvency Act the claim must be one recoverable by legal process: Farm Credit Corp. v. Holowach (Trustee of), [1988] 5 W.W.R. 87 at p. 90, 51 D.L.R. (4th) 501 (Alta. C.A.), leave to appeal to the Supreme Court of Canada dismissed at [1989] 4 W.W.R. lxx.

116 In Holowach, the seven members of the court were dealing with a situation in which some persons borrowed money from a mortgagee and mortgaged certain lands as security for repayment of the loan. The mortgagors then made an assignment in bankruptcy. The mortgagee filed a proof of claim for the full amount of the deficiency, that is, the amount of the indebtedness less the value of the land which the mortgagee was permitted to purchase. The Alberta Law of Property Act, R.S.A. 1980, c. L-8, precluded deficiency claims against individuals in foreclosure actions, although the effect of the legislation was not to extinguish or satisfy the debt. The mortgagee argued that it had a claim provable in bankruptcy under s. 95(1) of the Bankruptcy Act, R.S.O. 1970, c. B-3, now s. 121(1) of the Bankruptcy and Insolvency Act. The court rejected this argument, holding that a provable claim must be one recoverable by legal process. In coming to its conclusion, the court relied on Reference re Debt Adjustment Act, 1937, [1943] 1 All E.R. 240, [1943] 1 W.W.R. 378 (P.C.), and a number of decisions at the trial level which are collected at p. 91 of the decision.

117 Here, the contract to repurchase the shares, while perfectly valid, is without effect to the extent that there is a conflict between the corporation's promise to redeem the shares and its statutory obligation under s. 36 of the CBCA not to reduce its capital where it is insolvent. As was the case in the Holowach decision, this statutory overlay renders Central Capital's promise to redeem the appellants' preferred shares unenforceable. Although there is a right to receive payment, the effect of the solvency provision of the CBCA means that there is no right to enforce payment. Inasmuch as there is no right to enforce payment, the promise is not one which can be proved as a claim.

118 It could be suggested that the decision in Holowach can be distinguished from the instant case on the basis that in Holowach the claim is made unenforceable forever by statute whereas under the CCAA the claim is unenforceable only so long as the corporation does not meet the solvency requirements of s. 36 of the CBCA. I do not believe this is a valid distinction for three reasons. First, the relevant date for determining any contingent liability is not the future but the past, namely, September 8, 1992, the date by which proofs of claim had to be submitted. On that date, Central Capital was insolvent. Second, it is only because the lenders were willing to convert their debt obligations into equity in the reorganization that Central Capital is now solvent. Central Capital is not the same company and its liabilities are not the same. The redeemable shares no longer exist. Third, in order to be profitable, the assets of a company must be managed. Any value in the assets after the insolvency of the company is, in this case, due to the new management and not to the preferred shareholders extending credit to the company by having their claim for redemption postponed.

119 Even if Central Capital's obligation to redeem the shares of the appellants created a debt or liability, the appellants do not have a claim provable within the meaning of s. 121 of the Bankruptcy and Insolvency Act.

CONCLUSION

120 I would dismiss the appeal. For the reasons I have given, the retraction amounts do not constitute a debt or liability within the meaning of s. 121 of the Bankruptcy and Insolvency Act. Even if I am wrong in my conclusion and a debt or liability is created, it is not a claim within the meaning of the CCAA. This is a case of first impression. For these reasons, I would not award any costs of this appeal.

121 LASKIN J.A. (concurring): -- I have read the reasons of my colleagues Justice Finlayson and Justice Weiler. Like Justice Weiler, I would affirm the decision of the motions judge, Feldman J., and dismiss these appeals. I prefer, however, to

state my own reasons for upholding the position of the unsecured creditors of Central Capital Corporation.

The Issue

122 The application was argued before Madam Justice Feldman on an agreed statement of facts. My colleagues have summarized the relevant facts and important provisions of the documents. Each appellant holds preferred shares of Central Capital and each appellant's shares contain a right of retraction -- a right to require Central Capital to redeem the shares on a fixed date and for a fixed price. The retraction date for the appellants James McCutcheon and Central Guarantee Trust Company (collectively McCutcheon) was July 1, 1992, and before that date McCutcheon exercised his right of retraction and tendered his shares for redemption. The retraction date for the appellant SYH Corporation was September 1994 and although it could not tender its shares for redemption, it did file a proof of claim with the Administrator of Central Capital. The Administrator disallowed each appellant's claim and Feldman J. dismissed appeals from the Administrator's decisions.

123 The issue on these appeals is whether McCutcheon and SYH Corporation "have claims provable against Central Capital Corporation within the meaning of the Bankruptcy Act (Canada) as amended as of the date of the Restated Subscription and Escrow Agreement". Under the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 2, a claim provable "includes any claim or liability provable in proceedings under this Act by a creditor" and a creditor "means a person having a claim, preferred, secured or unsecured, provable as a claim under this Act". Section 121(1) of the Bankruptcy Act further defines claims provable as follows:

> 121(1) All debts and liabilities, present or future, to which the bankrupt is subject at the date of the bankruptcy or to which he may become subject before his discharge by reason of any obligation incurred before the date of the bankruptcy shall be deemed to be claims provable in proceedings under this Act.

124 The date of the restated subscription and escrow agreement is May 1992.[1] at end of document.] By then, and indeed since December 1991, Central Capital had been insolvent and therefore was prohibited by s. 36(2) of the Canada Business Corporations Act, R.S.C. 1985, c. C-44, from making any payment to redeem the appellants' shares.

125 On June 15, 1992, Houlden J. provided that Central Capital could be reorganized under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, and he stayed proceedings against it. Houlden J.'s order of July 9, 1992, which approved the restructuring of Central Capital, was made without prejudice to the right of the appellants to assert claims as creditors. Thus the question for this court is whether the appellants' retraction rights created debts of Central Capital in May 1992. In other words were McCutcheon and SYH Corporation creditors of Central Capital in May 1992? If they were creditors, then like the other unsecured creditors of Central Capital, they can elect to take shares in the newly incorporated company, Canadian Insurance Group Limited; if they were not creditors, then they remain shareholders of Central Capital under the restructuring plan.

126 This is a question of characterization. I will address the question first, by considering the "substance" of the relationship between each appellant and the company; and second by considering s. 36(2) of the Canada Business Corporations Act, supra. In brief I conclude:

(1) Although the relationship between each appellant and the company has characteristics of debt and equity, in substance both McCutcheon and SYH Corporation are shareholders, not creditors of Central Capital. Neither the existence of their retraction rights nor the exercise of those rights converts them into creditors;

(2) Finding that the appellants were creditors of Central Capital would defeat the purpose of s. 36 (2) of the statute.

I. The Relationship Between the Appellants and Central Capital

127 Preferred shares have been called "compromise securities" and even "financial mongrels": Grover and Ross, Materials and Corporate Finance (1975), at p. 49. Invariably the conditions attaching to preferred shares contain attributes of equity and, at least in an economic sense, attributes of debt. Over the years financiers and corporate lawyers have blurred the distinction between equity and debt by endowing preferred shareholders with rights analogous to the rights of creditors. One example is the right of redemption -- the right of the corporation to compel preferred shareholders to sell their shares back to the corporation. Another example, and it is the case before us, is the right of retraction -- the right of shareholders to compel the corporation to buy back their shares on a specific date for a specific price.

128 I acknowledge, therefore, that redeemable or retractable preferred shares are somewhat different from conventional equity capital. What makes the appeals before us difficult is that although the appellants appear to hold equity, their right of retraction appears to be a basic characteristic of a debtor-creditor relationship: see Grover and Ross, supra, at pp. 47-49; Buckley, Gillen and Yalden, Corporations: Principles and Policies, 3d ed. (1995), at pp. 938-40.

129 If the certificate or instrument contains features of both equity and debt -- in other words if it is hybrid in character -- then the court must determine the "substance" of the relationship between the holder of the certificate and the company. This is the lesson of Justice Iacobucci's judgment in Canada Deposit Insurance Corp. v. Canadian Commercial Bank, [1992] 3 S.C.R. 558, 97 D.L.R. (4th) 385. In that case the Supreme Court of Canada had to determine whether the financial assistance given by several lending institutions to try to rescue the Canadian Commercial Bank was "in the nature of a loan" or "in the nature of a capital investment". Justice Iacobucci discussed his approach to the problem at pp. 590-91 of his judgment:

> As I see it, the fact that the transaction contains both debt and equity features does not, in itself, pose an insurmountable obstacle to characterizing the advance of $255 million. Instead of trying to pigeonhole the entire agreement between the Participants and CCB in one of two categories, I see nothing wrong in recognizing the arrangement for what it is, namely, one of a hybrid nature, combining elements of both debt and equity but which, in substance, reflects a debtor-creditor relationship. Financial and capital markets have been most creative in the variety of investments and securities that have been fashioned to meet the needs and interests of those who participate in those markets. It is not because an agreement has certain equity features that a court must either ignore these features as if they did not exist or characterize the transaction on the whole as an investment. There is an alternative. It is permissible, and often required, or desirable, for debt and equity to co-exist in a given financial transaction without altering the substance of the agreement. Furthermore, it does not follow that each and every aspect of such an agreement must be given the exact same weight when addressing a characterization issue. Again, it is not because there are equity features that it is necessarily an investment in capital. This is particularly true when, as here, the equity features are nothing more than supplementary to and not definitive of the essence of the transaction. When a court is searching for the substance of a particular transaction, it should not too easily be distracted by aspects which are, in reality, only incidental or secondary in nature to the main thrust of the agreement.

130 In determining the substance of the relationship, as in any other case of contract interpretation, the court looks to what the parties intended. In CDIC v. CCB, supra, Iacobucci J. put this proposition as follows at p. 588:

> As in any case involving contractual interpretation, the characterization issue facing this Court must be decided by determining the intention of the parties to the support agreements. This task, perplexing as it sometimes proves to be, depends primarily on the meaning of the words chosen by the parties to reflect their intention. When the words alone are insufficient to reach a conclusion as to the true nature of the agreement, or when outside support for a particular characterization is required, a consideration of admissible surrounding circumstances may be appropriate.

131 In these appeals what the parties intended is reflected mainly in the share purchase agreements and the conditions attaching to the appellants' shares, but also in the articles of incorporation and in the way Central Capital recorded the appellants' shares in its financial statements. These documents indicate that in substance the appellants are shareholders of Central Capital, not creditors. I rely on the following considerations to support my conclusion:

(i) Both appellants agreed to take preferred shares instead of some other instrument -- for example, a bond or debenture -- that would obviously have made them creditors. The appellant McCutcheon sold shares of one corporation (Canadian General Securities Limited) for cash and for shares of another corporation (Central Capital). Neither the share purchase agreements nor the share conditions support McCutcheon's contention that in taking preferred shares he was extending credit to Central Capital by deferring payment of the purchase price. He made an investment in the capital of Central Capital, no doubt because of the attractive dividend rate, the income tax advantages of preferred shares and "sweeteners" such as conversion privileges. Unlike Finlayson J.A., I place little weight on what he termed "the unique nature of the transaction". McCutcheon transferred assets to acquire his preferred shares rather than acquiring them with cash. But he nonetheless decided to invest in Central Capital and to take the risk and the profits (through dividends) of his investment.

Similarly, SYH Corporation exchanged its equity investment in four insurance companies for an equity investment in Central Capital. It too chose equity not debt. None of the contractual documents indicates that the appellants' retraction rights were intended to trigger an obligation on the part of Central Capital to repay a loan. Moreover, as Weiler J.A. points out, neither the share purchase agreements nor the share conditions provides for interest if Central Capital fails to honour its retraction obligations.

(ii) The senior preferred shares and junior preferred shares that the appellants own were part of the authorized capital of Central Capital before the appellants acquired them.

(iii) The appellants' shares were recorded in the financial statements of Central Capital as "capital stock", along with the company's issued and outstanding common shares, class "A" shares and warrants. The amount Central Capital might be obligated to pay the appellants if they exercised their retraction rights was not recorded as debt (even contingent debt) in the company's financial statements.

(iv) Both appellants had the right to receive dividends on their shares and McCutcheon had the right to vote his shares for the election of directors of Central Capital if dividends remained unpaid for a specified time. These rights -- to receive dividends and to vote -- are well recognized rights of shareholders. And these rights continue, even after the retraction dates, until the appellants' shares are redeemed.

(v) The preferred share conditions provide that on a liquidation, dissolution or winding-up, the holders rank with other shareholders and therefore, implicitly, behind creditors. The appellant McCutcheon, who holds senior preferred shares, would rank behind creditors but ahead of the holders of subordinate classes of shares; the appellant SYH Corporation, which holds junior preferred shares, would rank behind senior preferred shareholders but ahead of common shareholders.

132 These provisions in the preferred share conditions also state that on payment of the amount owing to them the appellants "shall not be entitled to share in any further distribution of assets of the corporation". Finlayson J.A. interprets this to mean that the appellants "are not entitled to be treated as shareholders under a winding-up or liquidation but only as creditors". I disagree. These are typical preferred share provisions, which limit the recovery of the holders but do not treat them as creditors: Sutherland, Fraser and Stewart on Company Law of Canada, 6th ed. (1993), at p. 198. At least on a liquidation, dissolution or winding-up, the preferred share conditions evidence that the appellants would be treated not as creditors but as shareholders. In CDIC v. CCB, supra, Iacobucci J. placed considerable weight on a provision in the participation agreement stating that each participant "shall rank pari passu with the rights of the depositors". No such provision exists in this case. Indeed the share conditions I have referred to state the opposite.

133 Of course, Central Capital was reorganized, not liquidated, dissolved or wound up and the preferred share conditions are silent about what occurs on a reorganization. Still these conditions shed light on what the parties intended on the reorganization. Section 12(1) of the Companies' Creditors Arrangement Act, supra, defines claim as "any indebtedness, liability or obligation of any kind that, if unsecured, would be a debt provable in bankruptcy within the meaning of the Bankruptcy Act". The question the court has been asked to answer is the same question that would arise on a liquidation. It is illogical to conclude that the appellants could claim only as shareholders on a liquidation and yet can claim as creditors on the reorganization. Whether Central Capital's financial difficulties led to a liquidation or a reorganization, the issue is the same and the analysis and the result should also be the same.

134 The appellants argue, however, that they are shareholders only until they exercise their retraction rights but once they exercise these rights they become creditors. I do not agree with this argument. The share conditions provide that even after exercising their retraction rights, the appellants continue to be entitled to dividends and to vote until their shares are redeemed. In other words, they continue to enjoy the rights of shareholders. Moreover, if when the appellants exercised their retraction rights the company were insolvent and were to be subsequently liquidated (or dissolved or wound up), the appellants would rank as shareholders on the liquidation. And as I have indicated above the result should be no different on the reorganization.

135 It seems to me that these appellants must be either shareholders or creditors. Except for declared dividends, they cannot be both. Once they are characterized as shareholders, their rights of retraction do not create a debtor-creditor relationship. These rights enable them to call for the repayment of their capital on a specific date (and at an agreed-upon price) provided the company is solvent. Ordinarily shareholders have to recoup their investment by selling their shares to third parties. If they have retraction rights, however, they can compel the company (if solvent) to repay their investment at a given time for a given price. But the right of retraction provides for the return of capital not for the repayment of a loan. Certainly the Canada Business Corporations Act treats a redemption of shares as a return of capital because s. 39 of the

statute requires a company on a redemption to deduct from its stated capital account an amount equal to the value of the shares redeemed. The shares redeemed are then either cancelled or returned to the status of authorized but unissued shares.

136 Putting it differently, a preferred shareholder exercising a right of retraction on the terms that exist here must rank behind the company's creditors. Grover and Ross make this point more generally in their Materials and Corporate Finance, supra, at pp. 48-49:

> On the other hand, the company cannot issue "secured" preferred shares in the sense that shares cannot have a right to a return of capital which is equal or superior to the rights of creditors. Preferred shareholders are risk-takers who are required to invest capital in the business and who can look only to what is left after creditors are fully provided for. Thus, in the absence of statutory authorization, the claims of shareholders cannot be secured by a lien on the corporate assets. They rank behind creditors but before common shareholders (if specified) on a voluntary or involuntary dissolution of the company.

137 Admittedly there is little authority in Canada on the issue confronting this court. Some of the cases that the respondent relies on -- for example, Re Patricia Appliance Shops Ltd. (1922), 52 O.L.R. 215, [1923] 3 D.L.R. 1160 (S.C.), Laronge Realty Ltd. v. Golconda Investments Ltd. (1986), 63 C.B.R. (N.S.) 74, 7 B.C.L.R. (2d) 90 (C.A.), and even Re Meade, [1951] 2 All E.R. 168, [1951] Ch. 774 (D.C.) -- are of limited assistance because the shareholders in those cases did not have retraction rights.

138 Perhaps the closest case -- and the appellants rely heavily on it -- is the judgment of the British Columbia Court of Appeal in Re East Chilliwack Agricultural Co-operative (1989), 74 C.B.R. (N.S.) 1, 58 D.L.R. (4th) 11. In that case a majority of the court (Craig J.A. dissenting) held that a withdrawing member of a co-operative association who elected to have his shares redeemed in instalments over a five-year period should be treated on the subsequent bankruptcy of the association as an ordinary creditor rather than as a shareholder. I decline to apply East Chilliwack for three reasons. First, because the case was decided in 1989, the British Columbia Court of Appeal did not have the benefit of the Supreme Court of Canada's reasons in CDIC v. CCB, supra. In East Chilliwack Hutcheon J.A., writing for the majority, did not focus on what the parties intended when the member contracted with the co- operative. Instead he only considered the relationship between the member and the co-operative after the member had withdrawn. I do not think his approach is consistent with Justice Iacobucci's judgment in CDIC v. CCB, supra.

139 Second, there are important factual differences between East Chilliwack and the appeals before us. Justice Weiler has referred to these factual differences in her reasons. The most important of these differences are the following: in East Chilliwack the rules of the association provided that a member had to withdraw from the association to trigger the right of redemption, whereas the appellants' share conditions provide that they continue to be shareholders of Central Capital until their shares are redeemed; in East Chilliwack the member elected to withdraw and redeem his shares when the association was solvent whereas when the appellant McCutcheon exercised his right of retraction Central Capital was insolvent; and in East Chilliwack Hutcheon J.A. expressly stated that he was not considering the effect of the superintendent's power to suspend payments if the financial position of the co-operative was impaired, whereas the effect of the statutory prohibition against Central Capital making payment, found in s. 36(2) of the Canada Business Corporations Act, is in issue in these appeals.

140 Third, the decision in East Chilliwack is at odds with most of the American case-law and I favour the American approach. When a company repurchases shares by instalment and bankruptcy intervenes, the prevailing American position is that the shareholder's claim is deferred to the claims of ordinary creditors. The decision of the Fifth Circuit Court of Appeals in Robinson v. Wangemann, 75 F. 2d 756 (1935), is frequently cited. The facts of that case are virtually identical to the facts in East Chilliwack. A company had agreed to repurchase a stockholder's stock by instalments. Although the company was solvent when the agreement was made it went bankrupt before the repurchase was completed. The stockholder sought to prove as an ordinary creditor for the unpaid purchase price. Foster, Circuit Judge, writing for a unanimous court, rejected the stockholder's claim at p. 757:

> A transaction by which a corporation acquires its own stock from a stockholder for a sum of money is not really a sale. The corporation does not acquire anything of value equivalent to the depletion of its assets, if the stock is held in the treasury, as in this case. It is simply a method of distributing a proportion of the assets to the stockholder. The assets of a corporation are the common pledge of its creditors, and stockholders are not entitled to receive any part of them unless creditors are paid in full. When such a transaction is had, regardless of the good faith of the parties, it is essential to its validity that there be sufficient surplus to retire the stock, without prejudice to creditors, at the time payment is made out of assets.

141 At the heart of Robinson v. Wangemann is the finding that the selling stockholder is not a creditor in the sense of a person who loans money to a corporation, and therefore is not entitled to parity with the general creditors. The principle in Robinson v. Wangemann seeks to protect creditors by refusing to permit selling stockholders, who were risk investors, to withdraw their capital on the same terms as general creditors in the event of insolvency. Section 40(3) of the Canada Business Corporations Act -- a section to which I shall return when considering s. 36(2) of the same statute -- codifies the principle in Robinson v. Wangemann for share repurchases, though not for share redemptions. See also Blumberg, The Law of Corporate Groups (1987), at pp. 205-10 and see contra Wolff v. Heidritter Lumber Co., 163 A. 140 (N.J.Ch., 1932).

142 Quite apart from the instalment purchase price cases, American courts have often grappled with the question whether preferred stockholders can claim as creditors of the corporation. Although there are cases going both ways, most appear to come to the same conclusion as I do. The American cases are collected in Bjor and Solheim, Fletcher Cyclopedia of the Law of Private Corporations (1995), revised, vol. 11, and in Bjor and Reinholtz, Fletcher Cyclopedia of the Law of Private Corporations (1990), revised, vol. 15A. In volume 11 the authors of the text indicate -- as did the Supreme Court of Canada in CDIC v. CCB -- that "[w]hether or not the holder of a particular instrument or certificate is to be regarded as a shareholder or a creditor is a question of interpretation, and depends on the terms of the contract as evidenced by the instrument, the articles of incorporation, and the statutes of the state. The nature of the transaction is to be determined by the real substance and effect of the contract rather than by the name given to the obligations or its form" (at p. 566).

143 And in volume 15A the authors state at pp. 290 and 292 that even the arrival of a fixed redemption date does not change a preferred stockholder into a creditor:

> Holders of preferred stock of a corporation, in the absence of express provision to the contrary, are stockholders and not creditors of the corporation, except for dividends declared. They have no lien upon, and are not entitled to, any of the assets of the corporation when it becomes insolvent, until all debts are paid. Furthermore, there is authority that the status of a preferred stockholder is not changed to that of creditor, even though a dividend is guaranteed. Indeed it is beyond the power of a corporation to issue a class of stock, the holders of which are entitled to preference over general creditors.
>
> ...
>
> Even where preferred stock has a fixed redemption date, arrival of that date does not change the status of a preferred stockholder to that of a creditor.

144 I agree with these statements. I therefore conclude first that the appellants, in substance, were shareholders of Central Capital, not creditors; and second that neither the existence nor the exercise of their retraction rights turned them into creditors.

II. Provable Claims and Section 36(2) of the Canada Business Corporations Act

145 In May 1992 Central Capital was insolvent. It was unable to pay its liabilities as they became due and the realizable value of its assets was less than the aggregate of its liabilities. Because it was insolvent it was prohibited by s. 36(2) of the Canada Business Corporations Act from redeeming the appellants' shares. Section 36(2) of the statute provides:

> 36(2) A corporation shall not make any payment to purchase or redeem any redeemable shares issued by it if there are reasonable grounds for believing that
>
> (a) the corporation is, or would after the payment be, unable to pay its liabilities as they become due; or
>
> (b) the realizable value of the corporation's assets would after the payment be less than the aggregate of
>
> (i) its liabilities, and
>
> (ii) the amount that would be required to pay the holders of shares that have a right to be paid, on a redemption or in a liquidation, rateably with or prior to the holders of the shares to be purchased or redeemed.

146 As well, the appellants' share conditions provide that they are not permitted to redeem their shares if to do so would be

"contrary to applicable law", in this case s. 36(2) of the statute.

147 To hold that the appellants have provable claims would defeat the purpose of s. 36(2) of the Canada Business Corporations Act. At common law a company could not repurchase its own shares on the open market or in the language of Trevor v. Whitworth (1887), 12 App. Cas. 409, [1886-90] All E.R. Rep. 46 (H.L.), a company could not "traffick in its own shares". The obvious reason was to prevent companies from using their assets to destroy the claims of their creditors. Modern corporate statutes, such as the Canada Business Corporations Act, modified the rule in Trevor v. Whitworth to permit repurchases provided the company's creditors would not be prejudiced. Thus the legislation insisted that the company could not repurchase its own shares unless it satisfied stated solvency tests. And so, s. 34(2) of the Canada Business Corporations Act provides:

> 34(2) A corporation shall not make any payment to purchase or otherwise acquire shares issued by it if there are reasonable grounds for believing that
>
> (a) the corporation is, or would after the payment be, unable to pay its liabilities as they become due; or
>
> (b) the realizable value of the corporation's assets would after the payment be less than the aggregate of its liabilities and stated capital of all classes.

148 In Nelson v. Rentown Enterprises Inc. (1993), 96 D.L.R. (4th) 586 at p. 589, 5 Alta. L.R. (3d) 149, affirmed (1994), 109 D.L.R. (4th) 608n, 16 Alta. L.R. (3d) 212 (C.A.), Hunt J. of the Alberta Queen's Bench wrote:

> The policy behind the s. 34(2) limitation upon a corporation's power to purchase its own shares seems obvious. It is intended to ensure that one or more shareholders in a corporation do not recoup their investments to the detriment of creditors and other shareholders. It has been observed that:
>
> > Corporate power to purchase its own stock has been frequently abused. Done by corporations conducting faltering businesses, it has been employed to create preferences to the detriment of creditors and of the other stockholders.
> >
> > (Mountain State Steel Foundries, Inc. v. C.I.R., supra, at p. 741 [284 F.2d 737 (1960)].)
>
> Modern business statutes permit these share purchases to take place provided that the position of creditors and other shareholders is protected, by virtue of the application of the s. 34(2) tests.

149 Redemptions of preferred shares, unlike repurchases, were always permitted at common law as long as they were not made in contemplation of bankruptcy. But the solvency test in s. 36(2) of the Canada Business Corporations Act has the same purpose as the solvency test in s. 34(2): to prevent redemptions if they would allow the company to prejudice the claims of creditors. See Buckley et al., Corporations: Principles and Policies, supra, at pp. 968-71. To hold that the appellants' retraction rights gave rise to provable claims in the face of s. 36(2), thereby allowing the appellants to rank equally with the unsecured creditors, would undermine the purpose of the section. If a claim in a bankruptcy or reorganization proceeding is unenforceable under the statute, the claim is not entitled to recognition on a parity with the claims of unsecured creditors: see Blumberg, supra, at pp. 205-06; and Farm Credit Corp. v. Holowach (Trustee of) (1988), 68 C.B.R. (N.S.) 255, 51 D.L.R. (4th) 501 (Alta. C.A.).

150 I draw comfort in this conclusion from s. 40 of the Canada Business Corporations Act. Section 40(1) provides that a contract with a corporation for the purchase of its shares is specifically enforceable against the corporation "except to the extent that the corporation cannot perform the contract without thereby being in breach of s. 34". Section 40(3) then states:

> 40(3) Until the corporation has fully performed a contract referred to in subsection (1), the other party retains the status of a claimant entitled to be paid as soon as the corporation is lawfully able to do so or, in a liquidation, to be ranked subordinate to the rights of creditors but in priority to the shareholders.

151 In other words, the section recognizes that if a company contracts to repurchase its shares but is prohibited from doing so because it is insolvent, the vendor of the shares is not a creditor and on a liquidation ranks subordinate to the rights of creditors. The shareholder cannot be repaid at the expense of the company's creditors. Although s. 40 does not expressly apply to s. 36, I think that the rationale for s. 40(3) applies to redemptions as well as to repurchases. Whether a repurchase or

a redemption, the shareholder is not a creditor and is subordinate to the rights of creditors. More simply the shareholder does not have a provable claim.

152 The appellants rely on The Custodian v. Blucher, [1927] S.C.R. 420, [1927] 3 D.L.R. 40, but in my view this case does not assist them. In Blucher dividends were declared on stock but payment of the dividends was suspended during World War I. The Supreme Court of Canada held at p. 425 S.C.R., p. 43 D.L.R. that "[t]he right of recovery was in suspense during the war; but the debt nevertheless existed". In that case, however, the dividend was declared before the suspension of payment took place. Moreover, as Justice Finlayson points out in his reasons, courts have always accepted the proposition that when a dividend is declared it is a debt on which each shareholder can sue the corporation.

153 Holding that the appellants do not have provable claims accords with sound corporate policy. On the insolvency of a company the claims of creditors have always ranked ahead of the claims of shareholders for the return of their capital. Case-law and statute law protect creditors by preventing companies from using their funds to prejudice creditors' chances of repayment. Creditors rely on these protections in making loans to companies. Permitting preferred shareholders to be turned into creditors by endowing their shares with retraction rights runs contrary to this policy of creditor protection.

154 I would dismiss these appeals. I would not make any cost order. I am grateful to all counsel for their assistance on this interesting and difficult problem.

Order accordingly.

* * * * *

Note 1: There is a discrepancy in the materials before this court on the relevant date for establishing a claim provable against Central Capital: SYH Corporation used May 1992, the date of the restated subscription and escrow agreement whereas McCutcheon and the unsecured creditors of Central Capital Corporation used June 15, 1992, the date of the court-ordered stay of proceedings against Central Capital. I have used the May 1992 date but nothing turns on the use of this date as opposed to the June 15, 1992 date.

qp/e/qlgxc/qlbxr

TAB 8

Re

Dunham and Apollo Tours Ltd. (No. 1)

20 O.R. (2d) 3

ONTARIO
ONTARIO
HIGH COURT OF JUSTICE

CARRUTHERS, J.

23RD FEBRUARY 1978.

Corporations -- Shareholders -- Issued shares to be fully paid -- Whether person to whom shares issued without payment a "shareholder" -- Whether entitled to petition as shareholder for winding-up order -- Business Corporations Act, R.S.O. 1970, c. 53, ss. 44(4), 218(1).

Corporations -- Winding-up -- Application by shareholder -- Issued shares to be fully paid -- Whether person to whom shares issued without payment a "shareholder" -- Whether entitled to petition as shareholder for winding-up order -- Business Corporations Act, R.S.O. 1970, c. 53, ss. 44(4), 218(1).

By s. 44(4) (am. 1971, Vol. 2, c. 26, s. 10) of the Business Corporations Act, R.S.O. 1970, c. 53, shares must not be issued until fully paid. Consequently, a person to whom shares have been issued without payment is not a shareholder of the corporation and is not entitled to apply for a winding-up order as a shareholder under s. 218(1) of the Act. However, an application under the latter section may be adjourned in order to permit the applicant to make payment and to become retroactively a properly constituted shareholder.

[Re Marc-Jay Investments Inc. and Levy et al. (1975), 5 O.R. (2d) 235, 50 D.L.R. (3d) 45, distd]

RULING on the capacity of the applicant in proceedings to wind up a corporation.

W. G. Charlton, for applicant.

J. C. Savchuk, for respondent.

CARRUTHERS, J.:-- This application came before me in Chambers at Osgoode Hall on December 1, 1977. The application is basically one for the winding up of the respondent corporation pursuant to the provisions of s. 217 of the Business Corporations Act, R.S.O. 1970, c. 53. Other relief normally claimed in connection with such an application is also set out in the notice of motion.

The application is brought by the applicant James Howard Freeman Dunham in his capacity as a shareholder of the respondent corporation. Section 218 of the Business Corporations Act provides as follows:

> 218(1) A winding-up order may be made upon the application of the corporation or of a shareholder or, where the corporation is being wound up voluntarily, of the liquidator or of a contributory or of a creditor having a claim of $1,000 or more.
>
> (2) Except where the application is made by the corporation, four days notice of the application shall be

given to the corporation before the making of the application.

At the outset of the hearing of this motion, I inquired as to whether I was correct in my assumption, made from reading the material filed on behalf of the respondent, that the capacity of the applicant to bring the motion was being challenged. Counsel for the respondent confirmed this fact and advised specifically that the respondent was denying that the applicant was a shareholder within the meaning of s. 218 of the Business Corporations Act and, therefore, unable to bring the application.

It was agreed by both counsel that before proceeding to deal with the merits of the application to have the respondent corporation wound up, that the issue of the capacity of the applicant to bring the application should be dealt with first. Accordingly, following argument on this point, this application was adjourned pending my decision as to whether the application has been brought by a shareholder in accordance with the provisions of s. 218 of the Business Corporations Act.

There are three incorporators shown on the articles of incorporation and each of them is also shown as a first director of the respondent corporation. One of these individuals is the applicant herein, James Howard Freeman Dunham. The articles of incorporation provide that if any shares are to be taken by the incorporators, the shares shall be one common share each and for the consideration of $1 for each share.

On May 1, 1972, a resolution was passed by the directors at that time, being the three first directors, including the applicant, which provided in part as follows:

> WHEREAS each of the incorporators of APOLLO TOURS LIMITED (hereinafter called the "Corporation") has taken one share each in the capital of the Corporation:
>
> NOW THEREFORE BE IT RESOLVED THAT:
>
> 1. The directors of the Corporation, hereby fix the consideration for the allotment and issue of each of the common shares in the capital of the Corporation taken by the applicants for incorporation at $1.00 each.
> 2. The Corporation having received the aforesaid sum of $1.00 each in respect of such consideration for each of the said three common shares taken by the incorporators, the said shares are hereby alloted and issued to the said incorporators, the said shares to be held as fully paid and non-assessable.

By the same resolution the applicant was appointed president of the respondent corporation, and consent to the transfer of one common share to each of the incorporators was granted.

By a series of subsequent transactions two of the original three shares issued to the incorporators were ultimately transferred to James Worsick. According to the transfer ledger contained in the respondent corporation's records, on May 3, 1972, 1,998 common shares were transferred from the respondent corporation's treasury to the said James Worsick, and 1,999 common shares were transferred from the respondent corporation's treasury to the applicant. A resolution to that effect was passed on that date, and a copy thereof as contained in the respondent corporation's records is signed only by James Worsick; the signature of the applicant is missing. It is to be noted that by that date, May 3, 1972, the said James Worsick and the applicant were shown on the records as the only shareholders of the respondent corporation, each holding 2,000 common shares, and James Worsick had been appointed its president and the applicant its secretary-treasurer. The copy of the resolution appointing them officers as contained in the records of the respondent corporation is dated May 2, 1972, and is not signed by anyone.

At the time this application was first brought, September 16, 1976 (it having been adjourned from its original returnable date, September 24, 1976, on consent, to January 1, 1977, and then adjourned further on consent to December 1, 1977), the only officers and shareholders of the respondent corporation were and are, according to the records of the respondent corporation, James Worsick and the applicant. In addition, on occasions when required to do so, James Worsick purporting to act on behalf of the respondent corporation has so advised corporations or persons dealing with the respondent corporation. I refer specifically to an application which James Worsick prepared and sent on behalf of the respondent corporation to IATA and marked as ex. 5 on his cross-examination held on April 21, 1977.

I do not think that there is any question but that counsel acting for the respondent corporation, John Savchuk, has been retained by and is representing the interest of James Worsick. Mr. Savchuk said at the outset of the hearing of this application that it is the position of James Worsick that no shares of the respondent corporation have been properly issued in accordance with the provisions of s. 44 [am. 1971, Vol. 2, c. 26, s. 10] of the Business Corporations Act, which provides as follows:

> 44(1) In the absence of a provision to the contrary in the articles or by-laws of the corporation, shares may be allotted and issued at such times and in such manner and to such persons or class of persons as the directors determine.
>
> (2) Shares with par value shall not be allotted or issued except for a consideration at least equal to the product of the number of shares allotted or issued multiplied by the par value thereof.
>
> (3) Subject to section 25, shares without par value shall not be allotted or issued except for such consideration as is fixed by the directors.
>
> (4) No share shall be issued until it is fully paid and a share is not fully paid until all the consideration therefor in cash, property or services, as determined under this section, has been received by the corporation.
>
> (5) For the purposes of subsection 4 and paragraph 21 of subsection 2 of section 15, a document evidencing indebtedness of the allottee does not constitute property and services shall be past services actually performed for the corporation, and the value of property or services shall be the value the directors determine by express resolution to be in all the circumstances of the transaction the fair equivalent of the cash value.

Specifically, he states that a finding should be made that no consideration was ever paid upon the issuance or transfer of any of the shares held by James Worsick or the applicant and, accordingly, there is no shareholder of the respondent corporation capable of bringing this application.

It seems clear that the provisions of s. 44(4) of the Business Corporations Act do not allow for any shares to be issued from the treasury of a corporation to which the provisions of that Act apply, unless the shares are fully paid for within the meaning of that section. Partly paid shares can no longer be issued.

Section 156(3) of the Business Corporations Act provides as follows:

> 156(3) The bound or looseleaf book or, where the record is not kept in a bound or looseleaf book, the information in the form in which it is made available under clause b of subsection 2 is admissible in evidence as prima facie proof, before and after dissolution of the corporation, of all facts stated therein.

If the records of the respondent corporation do not indicate any payment for the shares which were purported to be issued to Worsick and the applicant on May 3, 1972, being 1,998 and 1,999 common shares, respectively, the records certainly indicate that the initial share received by the applicant as an incorporator and first director was paid for on May 1, 1972, the relevant portions of which I have outlined above. To my mind, therefore, having regard to the provisions of s. 156(3) of the Business Corporations Act, that resolution is within the meaning of that section, "... admissible in evidence as prima facie proof ... of all facts stated therein". What evidence then is there to the contrary? Mr. Savchuk has referred me to certain questions and answers made upon the cross-examination of the applicant on September 21, 1977, specifically contained at p. 25 of the transcript and being Qq. 125 and 126, which read as follows:

> 125. Q. Your account to the corporation dated September 4th, 1973 does not indicate that you received any monies in trust from any subscriber for shares for payment to the corporation, did you in fact receive any monies from any subscriber for shares in the capital stock of the corporation?
>
> A. I do not believe so, no.
>
> 126. Q. I'll ask this question and then I'll see if I can find your letter. If no subscription price was received by you in trust for the corporation and no subscription monies were deposited in the corporation's bank account how could you make the statement that certain shares were duly issued and allotted as you did in your reporting letter?
>
> A. Well the statement would have been made at that time believing that the shares had in fact been duly issued and allotted.

He has also referred me to para. 17 of the affidavit of Worsick sworn January 26, 1977, which paragraph reads as follows:

17. I have examined the Corporation's bank accounts and based on such examination, state that they show that no moneys were ever received from any subscriber for any shares in the capital stock of the Corporation.

As far as I can make out, Worsick was not cross-examined on that part of his affidavit and no evidence has been adduced on behalf of the applicant to contradict that statement, or to indicate that any moneys so received were for some reason not deposited in any bank account of the respondent corporation. I have no choice, then, but to find that there is not any evidence to suggest that full or any payment, in fact, was made for any of the shares, including the shares which were purported to have been issued to the three incorporators. The presumption of proof provided for by s. 156(3) of the Business Corporations Act has been offset by the evidence given on behalf of the respondent.

Although there is no definition of the word "shareholder" contained in the Business Corporations Act, there does not appear to be any question but that a shareholder is considered to be a person who has had a share certificate issued in his name and the fact of such issuance registered on the records of the corporation. Generally speaking, a corporation looks to the shareholder of record for the purpose of determining what person or persons shall receive, or be subject to, the rights and obligations and liabilities accorded to, or imposed upon, shareholders under the Business Corporations Act. An exception to this general rule has been applied to persons considered to be "beneficial owners" of shares of a corporation. In this respect, I have been referred to Re Marc-Jay Investments Inc. and Levy et al. (1975), 5 O.R. (2d) 235, 50 D.L.R. (3d) 45. There, O'Leary, J., found that a beneficial owner of shares, not at any relevant time a registered owner of any share, was a "shareholder" for the purposes of bringing an application under s. 99(2) of the Business Corporations Act. On July 11, 1974, Hughes, J., granted leave to appeal this decision on the basis that he held a doubt as to the correctness of the decision of O'Leary, J. A search of the records of this Court does not reveal that the matter went any further.

Contrary to what was suggested to me, I find that neither of these decisions assist me in dealing with the issue now under consideration in the present case. There was no dispute in the Re Marc-Jay Investments Inc. and Levy et al. decision that the shares in question there had not been properly issued in the first instance. It was not necessary for either O'Leary, or Hughes, JJ., to consider the provisions of s. 44 of the Business Corporations Act.

The only concern in that case, to my mind, was whether a person who was not shown on the register of a company as the holder of shares of that company, but who was acknowledged to be the beneficial owner of such shares, could be considered as a "shareholder" for the purposes of s. 99 of the Business Corporations Act.

I think it is clear that before any share or shares can be "issued" within the meaning of s. 44 of the Business Corporations Act, that the par value or consideration as fixed by the directors, whatever the case may be, be received in full by the corporation. As I have found above, that did not occur here and, accordingly, no shares of the respondent corporation have been properly issued to any person or persons, including the three incorporators.

I must find, therefore, that the respondent is correct in maintaining that the applicant is not a shareholder for the purpose of initiating this application under s. 218(1) of the Business Corporations Act. Ordinarily, then, I would proceed to dismiss this application on this ground. In the circumstances of this case, however, I am not inclined to do so without providing the applicant with an opportunity to avoid this inevitable result.

As I have noted above, the applicant is one of the incorporators of the respondent corporation and was named as a first director in the articles of incorporation. Section 123 of the Business Corporations Act provides that the first director or directors remain, until such time as they have been replaced by a person duly elected or appointed in his stead. The respondent, and actually James Worsick, has now successfully shown that any attempts to do so have not been successful for the simple reason that there are no shareholders of the respondent corporation able to elect or appoint any one in the stead of the first directors. Accordingly, the first directors named in the articles of incorporation remain as of this date as the only directors of the respondent corporation.

As has also been noted above, the three incorporators, one of whom is the applicant, were allotted one common share of the respondent corporation and the consideration for that was fixed at $1. It would seem to me that upon the payment of the sum of $1 the applicant would then become a holder of a share that has been properly issued and, accordingly, a shareholder entitled to bring an application under s. 218 of the Business Corporations Act.

I think it most unreasonable that all of the proceedings which have gone on to date since the launching of this application should be set aside with an accompanying waste of time, effort and money for the sake of the payment of $1.

I am, therefore, going to permit the applicant to make the payment of $1, if he is so advised, and upon his filing an affidavit containing proof of such payment, this application may proceed to be dealt with on its merits. I set Monday,

February 27, 1978, at the court-house in Hamilton for this purpose.

Although it is not necessary for my decision, which has been now reached on the ability of the applicant to bring this application, I believe that I should have it noted that in arriving at the conclusion that there are no shareholders of the respondent corporation at this point and time, that finding is only based on the fact of non-payment for the shares. This company has functioned as intended since the day of its incorporation and all of the individuals who intended to be shareholders have treated themselves as such without any qualification until the time of this application. They are then, in my mind, de facto shareholders. What, if any, effect in law this might have on the position of the applicant or Worsick or the respondent corporation is something which I do not have to consider or decide at this point.

Order accordingly.

TAB B

TAB 1

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

Definitions

2. In this Act,

"claim provable in bankruptcy", "provable claim" or "claim provable"

« réclamation prouvable en matière de faillite » ou « réclamation prouvable »

"claim provable in bankruptcy", "provable claim" or "claim provable" includes any claim or liability provable in proceedings under this Act by a creditor;

"equity claim"

« réclamation relative à des capitaux propres »

"equity claim" means a claim that is in respect of an equity interest, including a claim for, among others,

(a) a dividend or similar payment,

(b) a return of capital,

(c) a redemption or retraction obligation,

(d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or

(e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d);

"equity interest"

« intérêt relatif à des capitaux propres »

"equity interest" means

(a) in the case of a corporation other than an income trust, a share in the corporation — or a warrant or option or another right to acquire a share in the corporation — other than one that is derived from a convertible debt, and

(b) in the case of an income trust, a unit in the income trust — or a warrant or option or another right to acquire a unit in the income trust — other than one that is derived from a convertible debt;

TAB 2

Business Corporations Act, R.S.O. 1990, c. B.16

Oppression remedy

248. (1) A complainant and, in the case of an offering corporation, the Commission may apply to the court for an order under this section. 1994, c. 27, s. 71 (33).

Idem

(2) Where, upon an application under subsection (1), the court is satisfied that in respect of a corporation or any of its affiliates,

(a) any act or omission of the corporation or any of its affiliates effects or threatens to effect a result;

(b) the business or affairs of the corporation or any of its affiliates are, have been or are threatened to be carried on or conducted in a manner; or

(c) the powers of the directors of the corporation or any of its affiliates are, have been or are threatened to be exercised in a manner,

that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer of the corporation, the court may make an order to rectify the matters complained of. R.S.O. 1990, c. B.16, s. 248 (2).

Court order

(3) In connection with an application under this section, the court may make any interim or final order it thinks fit including, without limiting the generality of the foregoing,

(a) an order restraining the conduct complained of;

(b) an order appointing a receiver or receiver-manager;

(c) an order to regulate a corporation's affairs by amending the articles or by-laws or creating or amending a unanimous shareholder agreement;

(d) an order directing an issue or exchange of securities;

(e) an order appointing directors in place of or in addition to all or any of the directors then in office;

(f) an order directing a corporation, subject to subsection (6), or any other person, to purchase securities of a security holder;

(g) an order directing a corporation, subject to subsection (6), or any other person, to pay to a security holder any part of the money paid by the security holder for securities;

(h) an order varying or setting aside a transaction or contract to which a corporation is a party and compensating the corporation or any other party to the transaction or contract;

(i) an order requiring a corporation, within a time specified by the court, to produce to the court or an interested person financial statements in the form required by section 154 or an accounting in such other form as the court may determine;

(j) an order compensating an aggrieved person;

(k) an order directing rectification of the registers or other records of a corporation under section 250;

(l) an order winding up the corporation under section 207;

(m) an order directing an investigation under Part XIII be made; and

(n) an order requiring the trial of any issue. R.S.O. 1990, c. B.16, s. 248 (3).

Idem

(4) Where an order made under this section directs amendment of the articles or by-laws of a corporation,

(a) the directors shall forthwith comply with subsection 186 (4); and

(b) no other amendment to the articles or by-laws shall be made without the consent of the court, until the court otherwise orders. R.S.O. 1990, c. B.16, s. 248 (4).

Shareholder may not dissent

(5) A shareholder is not entitled to dissent under section 185 if an amendment to the articles is effected under this section. R.S.O. 1990, c. B.16, s. 248 (5).

Where corporation prohibited from paying shareholder

(6) A corporation shall not make a payment to a shareholder under clause (3) (f) or (g) if there are reasonable grounds for believing that,

(a) the corporation is or, after the payment, would be unable to pay its liabilities as they become due; or

(b) the realizable value of the corporation's assets would thereby be less than the aggregate of its liabilities. R.S.O. 1990, c. B.16, s. 248 (6).

TAB 3

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

Definitions

2. In this Act,
"claim"
« réclamation »
"claim" means any indebtedness, liability or obligation of any kind that would be a claim provable within the meaning of section 2 of the Bankruptcy and Insolvency Act;

"equity claim" means a claim that is in respect of an equity interest, including a claim for, among others,

(a) a dividend or similar payment,

(b) a return of capital,

(c) a redemption or retraction obligation,

(d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or

(e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d);

"equity interest"

« intérêt relatif à des capitaux propres »

"equity interest" means

(a) in the case of a company other than an income trust, a share in the company — or a warrant or option or another right to acquire a share in the company — other than one that is derived from a convertible debt, and

(b) in the case of an income trust, a unit in the income trust — or a warrant or option or another right to acquire a unit in the income trust — other than one that is derived from a convertible debt;

TAB 4

Securities Act, R.S.O. 1990, c. S.5

Prospectus required

53. (1) No person or company shall trade in a security on his, her or its own account or on behalf of any other person or company if the trade would be a distribution of the security, unless a preliminary prospectus and a prospectus have been filed and receipts have been issued for them by the Director. 2006, c. 33, Sched. Z.5, s. 2.

Filing without distribution

(2) A preliminary prospectus and a prospectus may be filed in accordance with this Part to enable the issuer to become a reporting issuer, despite the fact that no distribution is contemplated. R.S.O. 1990, c. S.5, s. 53 (2).

Liability for misrepresentation in offering memorandum

130.1 (1) Where an offering memorandum contains a misrepresentation, a purchaser who purchases a security offered by the offering memorandum during the period of distribution has, without regard to whether the purchaser relied on the misrepresentation, the following rights:

1. The purchaser has a right of action for damages against the issuer and a selling security holder on whose behalf the distribution is made.

2. If the purchaser purchased the security from a person or company referred to in paragraph 1, the purchaser may elect to exercise a right of rescission against the person or company. If the purchaser exercises this right, the purchaser ceases to have a right of action for damages against the person or company. 2004, c. 31, Sched. 34, s. 7.

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 NELSON FINANCIAL GROUP LTD.

Court File No. 10-8630-00C>

SUPERIOR COURT OF JUSTICE
(Commercial List)

(Action Commenced in Toronto, Ontario)

ARGUMENT AND BOOK OF AUTHORITIES IN RESPECT OF THE CLAIMS OF CLIFFORD STYLES, JACKIE STYLES AND PLAYLE INVESTMENTS LTD.

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