COM March 25, 2024

COURT FILE NUMBER	2401-01422
COURT	COURT OF KING'S BENCH OF ALBERTA
JUDICIAL CENTRE	CALGARY
	IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED AND IN THE MATTER OF THE COMPROMISE OR ARRANGEMENT OF GRIFFON PARTNERS OPERATION CORPORATION, GRIFFON PARTNERS HOLDING CORPORATION, GRIFFON PARTNERS CAPITAL MANAGEMENT LTD., STELLION LIMITED, 2437801 ALBERTA LTD., 2437799 ALBERTA LTD., 2437815 ALBERTA LTD., and SPICELO LIMITED
APPLICANTS	GRIFFON PARTNERS OPERATION CORPORATION, GRIFFON PARTNERS HOLDING CORPORATION, GRIFFON PARTNERS CAPITAL MANAGEMENT LTD., STELLION LIMITED, 2437801 ALBERTA LTD., 2437799 ALBERTA LTD., 2437815 ALBERTA LTD., and SPICELO LIMITED
DOCUMENT	**BENCH BRIEF OF THE APPLICANTS**
ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT	**OSLER, HOSKIN & HARCOURT LLP** Barristers & Solicitors Brookfield Place, Suite 2700 225 6 Ave SW Calgary, AB T2P 1N2 Solicitors: Randal Van de Mosselaer / Julie Treleaven Telephone: (403) 260-7000 Facsimile: (403) 260-7024 Email: RVandemosselaer@osler.com / JTreleaven@osler.com File Number: 1247318

APPLICATION BEFORE THE HONOURABLE JUSTICE GILL ON MARCH 25, 2024 AT 2:00 PM ON THE COMMERCIAL LIST

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I. INTRODUCTION

1. This Bench Brief is submitted on behalf of the applicants, Griffon Partners Operation Corp. ("**GPOC**"), Griffon Partners Holding Corp. ("**GPHC**"), Griffon Partners Capital Management Ltd. ("**GPCM**", and together with GPOC and GPHC, the "**Griffon Entities**"), Stellion Limited, 2437801 Alberta Limited, 2437799 Alberta Limited, 2437815 Alberta Limited, and Spicelo Limited ("**Spicelo**") (collectively, the "**Applicants**").

2. The Applicants seek an Order, *inter alia*:

   (a) declaring that Tamarack Valley Energy Ltd. ("**Tamarack**") has no claim against the assets of Spicelo, whether pursuant to the doctrine of marshalling or otherwise;

   (b) declaring that Signal Alpha C4 Limited and Trafigura Canada Ltd. (collectively, the "**Lenders**") are not required, pursuant to the doctrine of marshalling or otherwise, to exhaust their remedies under the Spicelo Guarantee (as that term is defined below) granted to the Lenders by Spicelo and the shares pledged to the Lenders by Spicelo (the "**Pledged Shares**") prior to the Lenders realizing upon any of proceeds from the SISP (as that term is defined in the February 7, 2024 Amended and Restated Initial Order in these proceedings); and

   (c) declaring that:

      (i) upon payment of all amounts owing to the Lenders pursuant to the Amended Loan Agreement (as that term is defined below); and

      (ii) to the extent that Spicelo is required to make payment to the Lenders pursuant to the terms of the Spicelo Guarantee by which Spicelo unconditionally guaranteed the due and punctual payment, and the due performance of the Guaranteed Obligations (as that term is defined in the Spicelo Guarantee);

   then Spicelo is, to the extent of such payment to the Lenders under the Spicelo Guarantee, entitled to be subrogated to the Lenders' security against GPOC, in priority to Tamarack.

3. In short, the Applicants have had financial difficulties, necessitating the filing of Notices of Intention to Make a Proposal under the *Bankruptcy and Insolvency Act,* R.S.C. 1985, c. B-3, as amended (the "**BIA**") on August 25, 2023. These proceedings were subsequently converted into proceedings under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended ("**CCAA**") on February 6, 2024.

4. In connection with the February 6, 2024 application, and with no Application or other explanation, Tamarack's counsel filed a Bench Brief incorrectly asserting that: "the doctrine of marshalling requires the Lenders to realize upon the entirety of Spicelo's Pledged Shares pursuant to the [Spicelo Guarantee] between it and the Lenders prior to realizing upon any of proceeds from the sale of all or any portion of GPOC's assets pursuant to the ongoing [SISP]."

5. The Applicants submit that this is a gross mischaracterization of the doctrine of marshalling. It is further submitted that the doctrine of marshalling has no application in the circumstances of this case, and to the relationships between the Griffon Entities, Spicelo, the Lenders, and Tamarack. Further, as the SISP is nearing its conclusion, it is critical that the rights and obligations of the Griffon Entities, Spicelo, the Lenders and Tamarack be determined so that all parties can be certain of their rights of recovery from the assets belonging to the Griffon Entities under the SISP, and from Spicelo.

II. FACTS AND BACKGROUND

Secured Debt of the Griffon Entities and Spicelo

6. The Griffon Entities' business is focused on the exploration and development of light oil and natural gas liquids in the Viking formation in western Saskatchewan and eastern Alberta. Each of the Griffon Entities are private corporations existing under the laws of the Province of Alberta, with their registered offices in Calgary, Alberta.

> Affidavit of Daryl Stepanic, sworn September 14, 2023 (the "**Stepanic Affidavit**") at paras 6, 13.

7. Spicelo is an investment company incorporated pursuant to the laws of Cyprus and extra-provincially registered in Alberta. Spicelo is beneficially owned by Jonathan Klesch, one of the directors of the Griffon Entities.

Stepanic Affidavit at paras 7-8, 11.

8. GPOC is the borrower (and GPCM and GPHC are guarantors) under a Loan Agreement dated July 21, 2022 with the Lenders as lenders, GLAS USA LLC as administrative agent, and GLAS Americas LLC as collateral agent (the "**Collateral Agent**") as amended as of August 31, 2022 (the "**Amended Loan Agreement**"), pursuant to which:

(a) GPOC borrowed approximately USD$36 million from the Lenders, and

(b) GPOC granted to the Collateral Agent a security interest (the "**Lenders' Security Interest**") over all of GPOC's present and after-acquired real and personal property.

Stepanic Affidavit at paras 11, 26-30.

9. In addition, GPOC issued a Subordinated Secured Promissory Note dated July 21, 2022 in the amount of CAD$20 million to Tamarack (the "**Subordinated Tamarack Note**"), and granted to Tamarack a security interest (subordinate to the Lenders' Security Interest) in all of GPOC's present or after-acquired property.

Stepanic Affidavit at para 31.

10. GPOC, Tamarack, and the Collateral Agent are party to an Intercreditor Agreement, dated July 21, 2022 (the "**Intercreditor Agreement**") pursuant to which Tamarack agreed to subordinate all security interests granted with respect to the Subordinated Tamarack Note to all senior loan obligations outstanding under the Amended Loan Agreement. Accordingly, the Lenders are the senior secured creditor against GPOC and its assets, and Tamarack is a subordinated secured creditor against GPOC and its assets.

Stepanic Affidavit at para 33.

11. Spicelo entered into a Limited Recourse Guarantee and Securities Pledge Agreement dated July 21, 2022 (the "**Spicelo Guarantee**") pursuant to which:

(a) Spicelo guaranteed GPOC's obligations to the Lenders under the Amended Loan Agreement, and

(b) Spicelo pledged to the Collateral Agent for the benefit of the Lenders securities owned by Spicelo in the capital of Greenfire Resources Ltd. (the "**Spicelo Pledged Shares**").

Stepanic Affidavit at para 29(c).

12. As a result of the above:

(a) The Lenders and the Collateral Agent are the senior secured creditors over GPOC's present and after-acquired property, and Tamarack's security interest is subordinate to that of the Lenders and Collateral Agent; and

(b) The Collateral Agent (and only the Collateral Agent) holds a security interest over the Spicelo Pledged Shares. Tamarack has no claim whatsoever against Spicelo or the Spicelo Pledged Shares.

The Applicants' Insolvency Proceedings

13. On August 16, 2023, the Lenders served each of the Applicants with Demands for Payment and Notices of Intention to Enforce Security pursuant to s. 244 of the BIA (the "**Demands**").

Stepanic Affidavit at para 48.

14. In response to the Demands, on August 25, 2023, the Applicants each filed a Notice of Intention to Make a Proposal under the BIA.

Stepanic Affidavit at para 49.

15. On October 18, 2023 the Court granted an Order approving a Sale and Investment Solicitation Process (“**SISP**”) pursuant to which the assets of GPOC were to be marketed and sold. The SISP is nearing its conclusion.

Affidavit of Daryl Stepanic, sworn January 29, 2024 at paras 71-72.

16. It appears that the proceeds from the SISP and the sale of the GPOC assets will not satisfy in full the amount outstanding to the Lenders. Consequently, it is anticipated that the Lenders will call upon Spicelo Guarantee in an effort to be paid in full. This will necessitate a liquidation of at least some of the Spicelo Pledged Shares.

17. On February 2, 2024 Tamarack’s counsel filed and served a Bench Brief asserting that: “the doctrine of marshalling requires the Lenders to realize upon the entirety of Spicelo’s Pledged Shares pursuant to the [Spicelo Guarantee] between it and the Lenders prior to realizing upon any of proceeds from the sale of all or any portion of GPOC’s assets pursuant to the ongoing [SISP].” The Applicants submit that this is incorrect as a matter of law, and is a misstatement of the doctrine of marshalling.

III. ISSUES

18. This Bench Brief addresses the following issues:

(a) The doctrine of marshalling does not apply on the facts of this case, and

(b) In the event that Spicelo is required to make payment to the Lenders pursuant to the terms of the Spicelo Guarantee, Spicelo shall be entitled, upon payment of all amounts owing to the Lenders, to be subrogated to the Lenders’ security against GPOC, in priority to Tamarack.

IV. LAW AND ARGUMENT

A. Marshalling and Subrogation

Marshalling is not available on the facts of this case

19. The doctrine of marshalling is an equitable remedy, intended to protect the recovery of a junior creditor against the arbitrary action of a senior creditor, and to thereby treat all secured creditors equitably. In short, this doctrine is intended to prevent a secured creditor who can resort to two funds of a debtor from defeating another secured creditor who can resort to only one fund belonging to that debtor.

> *Wolfe et al v Taylor et al,* 2020 MBCA 44 [*Wolfe*] at para 31 **[Tab 9]**.
> *Green v Bank of Montreal*, 1999 CarswellOnt 3954 [*Green*] at para 10 **[Tab 5]**.

20. Although Tamarack provides a general description of marshalling consistent with the above, its further statement that "[m]arshalling has been applied in situations where two funds available are from a principle [*sic*] debtor and a guarantor" omits key context. While this statement may be true on certain facts, the fact that is omits key facts means that it is overly broad. A review of the relevant authorities makes clear that the doctrine of marshalling does not apply on the facts of this case.

21. Taking a step back, in order to obtain marshalling, it is well established that certain specific criteria must be met. Most notably, these criteria include the requirement that two or more creditors share a <u>single common debtor</u>; and the senior creditor has a claim against two of that debtor's funds, while the junior creditor, ranking behind the doubly secured senior creditor, has recourse to only one of that debtor's funds. This is sometimes referred to as the "Single Debtor Rule".

> *Wolfe* at para 33 **[Tab 9]**.

22. In this case, these criteria are not satisfied. Most importantly, the Single Debtor Rule is not satisfied. The two funds in this case (being the GPOC assets and the Spicelo Pledged Shares) do not belong to a single debtor – one belongs to the principal debtor (GPOC) and the other belongs to the guarantor (Spicelo).

23. If this were the end of the matter, then the outcome would be obvious. But Tamarack is attempting to rely upon an exception to the Single Debtor Rule. This is sometimes referred to as the "Surety Exception" to the Single Debtor Rule that has developed in the jurisprudence. But an examination of the Surety Exception to the Single Debtor Rule makes clear the Surety Exception does not apply on the facts of this case. In fact, the facts of this case are the precise <u>opposite</u> of the Surety Exception to the Single Debtor Rule.

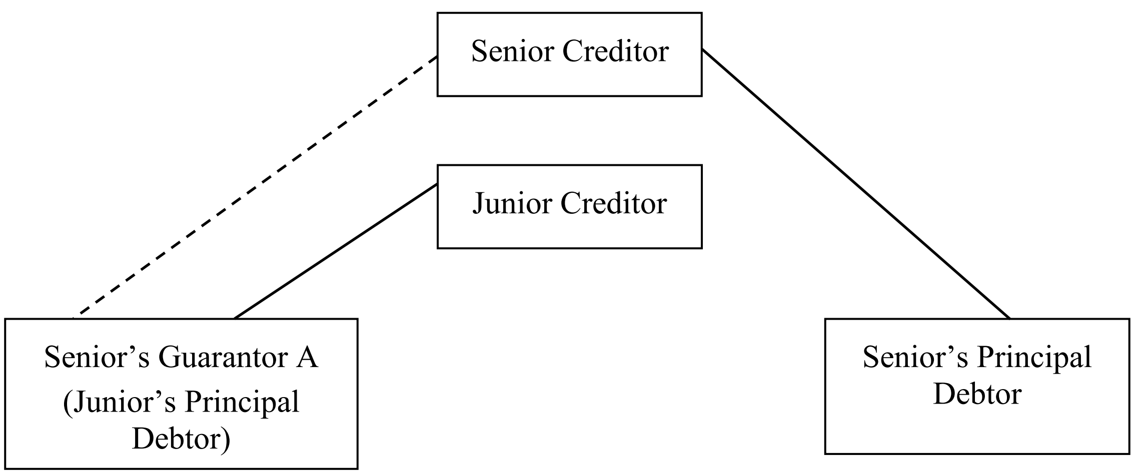
24. Specifically, under the Surety Exception to the Single Debtor Rule, marshalling can be applied where there are two debtors – a principal debtor and a guarantor – and:

(a) the senior creditor has security against the assets of both the principal debtor and the guarantor ("A");

(b) the junior creditor has security only against the assets of A, and

(c) the senior creditor seeks to enforce its security against its guarantor A (to the detriment of the junior creditor which only has security against the property of A.)

25. This scenario can be illustrated as:



*Solid lines represent primary obligations.
*Dotted line represents guarantee.

26. In such a case, the junior creditor can invoke the doctrine of marshalling (and rely on the Surety Exception to the Single Debtor Rule) in order to have the senior creditor's claim paid first by the principal debtor.

Wolfe at para 60 **[Tab 9]**.
Brown v Canadian Imperial Bank of Commerce, 1985 CarswellOnt 729 [*Brown*] at paras 11-12 **[Tab 2]**.
Quay v Sculthorpe, 1869 CarswellOnt 110 **[Tab 6]**.
See also Halsbury's Laws of Canada (online), Guarantee and Indemnity, "The Rights of a Surety: As Against the Creditor: Securities in Favour of the Creditor" (V.1.(5)) at HGI-234 "Surety Entitled to Securities Received by Creditor from Principal" (2022 Reissue) **[Tab 10]**.

27. The logic behind the surety exception is clear. Where the senior creditor has potential claims against both its principal debtor and a guarantor, but the junior creditor has only a principal claim against the senior creditor's guarantor, the senior creditor should not be able to claim first against its guarantor, depriving the junior creditor of any recovery. The principal debtor has certain obligations owing to its guarantor at law (namely, one of indemnity), which is why it, and not the guarantor, should bear primary responsibility for the debt in such circumstances.

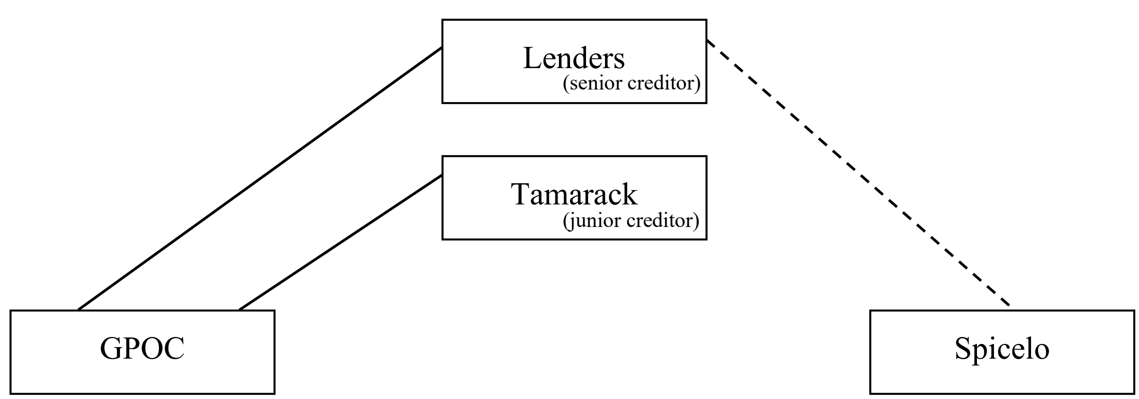
28. However, importantly, these are not the facts of our case. In fact, the present case is the precise opposite of the Surety Exception to the Single Debtor Rule. In our case:

(a) the senior creditor has security against the assets of both the principal debtor and the guarantor;

(b) the junior creditor has security only against the assets of the principal debtor, and

(c) the senior creditor seeks to enforce its security against the <u>principal debtor</u>.

29. This structure can be illustrated as:



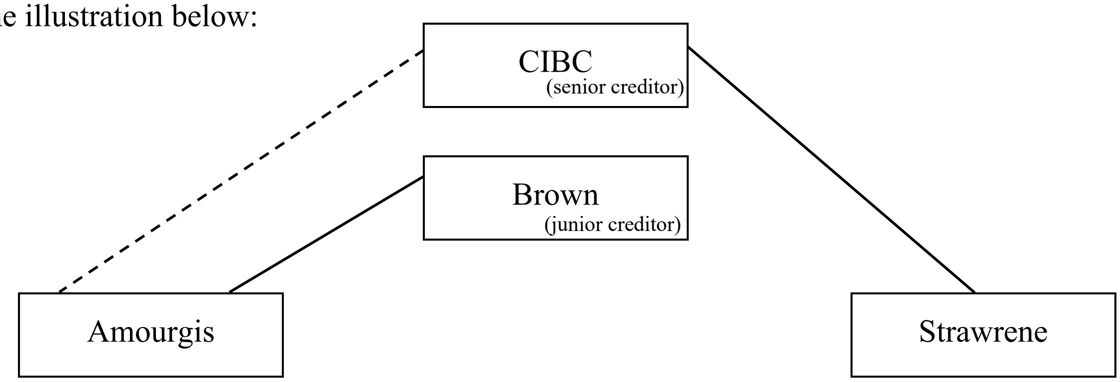
30. The differences between these two situations is clear:

(a) In the Surety Exception to the Single Debtor Rule the senior creditor and the junior creditor both have security against the senior creditor's guarantor's assets, and the senior creditor is attempting to enforce its security against the guarantor rather than its principal debtor; whereas

(b) On the facts of our case, the senior creditor and the junior creditor both have security against the senior creditor's principal debtors' assets, and the senior creditor is attempting to enforce its security against the principal debtor rather than the guarantor.

31. Tamarack is therefore attempting to create what might be called a "reverse surety exception". But such an exception is illogical, contrary to established law, and untenable at law.

32. Notably, Tamarack is unable to provide a single authority where this reverse surety exception has been applied to invoke the doctrine of marshalling. In particular, Tamarack cites *Brown v. CIBC*, but this case merely followed the typical Surety Exception to the Single Debtor Rule. Specifically, in *Brown* the mutual debtor ("**Amourgis**") was a guarantor with respect to the senior lender CIBC and was also the principal debtor with respect to the junior lender Brown. As security for the guarantee, Amourgis granted CIBC a mortgage over her property on D Street. Amourgis also granted Brown a subordinate mortgage on the same D Street property. Strawrene was the principal debtor to CIBC, and as security for its obligation, Strawrene granted CIBC security over its A street property. As such, this was a classic Surety Exception to the Single Debtor Rule, as can be seen in the illustration below:



33. In *Brown,* CIBC (as the senior lender) could either look to the A Street mortgage (granted by the principal, Strawrene) or the D Street mortgage (granted by the guarantor, Amourgis) to satisfy the its debt. Brown (the subordinate secured creditor) brought an application for marshalling, requiring CIBC to first satisfy itself from the principal debtor before enforcing against Amourgis. The Ontario Supreme Court granted such a marshalling order.

34. However, *Brown* was the traditional Surety Exception to the Single Debtor Rule situation, and not the reverse surety exception which Tamarack is seeking to create and have applied for the first time in the history of Canadian law. For reasons we will further discuss below, such an exception to the single common debtor rule would be both completely illogical and untenable at law, as it would create inconsistencies in the law.

35. Tamarack also cites *Condominium Corp. No. 082 6970 v. 1117398 Alberta Ltd*. for the principle that marshalling does not require that the two funds at issue belong to the same debtor, that it is sufficient that they simply relate to the same debt. Although *111 Alberta Ltd.* does contain broad language regarding the availability of marshalling, a review of its underlying facts indicates it did not actually involve a guarantee or surety at all. Therefore, as discussed in further detail below, this decision can be distinguished and has no application here.

> *Condominium Corp No 082 6970 v 1117398 Alberta Ltd.*, 2012 ABQB 233 [*111 Alberta Ltd*] at para 11 **[Tab 3]**.

36. Accordingly, there is clear authority for the proposition that: (a) marshalling only applies where there is a single debtor, unless (b) the Surety Exception to the Single Debtor Rule applies (as described above), and (c) the facts in the present case do not fit within the Surety Exception to the Single Debtor Rule, and in fact are the complete opposite of that exception.

37. Moreover, there are compelling reasons for the existence of the Surety Exception to the Single Debtor Rule, and for not expanding the exception to the reverse facts as urged by Tamarack:

(a) It would be inequitable for a creditor to fail to realize against a security which is available to the creditor in respect of the guaranteed debt, and instead to throw the whole liability upon the surety. Therefore, in circumstances where the senior creditor of both the principal debtor and surety seeks payment from the surety—to the detriment of the junior creditor of the surety which has access only to the property of the surety – the Surety Exception should permit that junior creditor to invoke marshalling.

(b) In any case, applying marshalling in the reverse case as suggested by Tamarack would either not lead to any greater recovery for Tamarack (for the reasons outlined below), or would result in a decision which be entirely inconsistent with the established law that a guarantor who has paid the principal debtor's debt is entitled to be subrogated to any security interest that the creditor has in respect of the debt.

Wolfe at paras 59-60 **[Tab 9]**.

38. As discussed more fully below, even if the Lenders were required to first realize against Spicelo's Pledged Shares, Spicelo would then become the senior creditor of GPOC, benefitting from the Lenders first ranking security against GPOC's assets and outranking Tamarack is the process. In other words, invoking marshalling in the present circumstance would be completely pointless.

39. For these reasons, it is submitted that it is clear that the doctrine of marshalling is not available to Tamarack to give Tamarack access to any recovery either against Spicelo, or to compel the Lenders to seek recovery first against their guarantor, Spicelo.

Even if marshalling order was made, subrogation would apply

40. As mentioned above, even if the Lenders were required to first realize against Spicelo's Pledged Shares (as urged by Tamarack in its Bench Brief), the doctrine of subrogation would apply, meaning that Spicelo would step into the Lenders' shoes to receive the benefit the Lenders' security against GPOC.

41. The doctrine of subrogation provides that a surety who has paid the principal debtor's debt is entitled to be subrogated to any security interest that the creditor has in respect of the debt in order to be indemnified for the amounts paid. For example, suppose that A lends money to B and is given a security interest in B's property. C also guarantees repayment of B's debt by granting a guarantee to A. If C pays B's debt which is owed to A, C is entitled to be subrogated to the security interest that A holds against B. Even if B is bankrupt, C is nevertheless able to assert the security interest against B's trustee.

> Roderick J. Wood, *Bankruptcy & Insolvency Law*, 2nd ed (Irwin Law, 2015) at 138 **[Tab 12]**.
> See also Kevin P. McGuinness, *The Law of Guarantee*, 3rd ed (LexisNexis, 2013) at §10.153 **[Tab 11]**.

42. This principle has been repeatedly confirmed by Canadian courts in many binding authorities, both within the context of marshalling and not. There is no doubt that it remains good law.

43. Specifically, in *Royal Bank v. Fox*, the Supreme Court of Canada confirmed that a guarantor discharging the principal debtor's liability becomes subrogated to the rights of the creditor and stands in the shoes of the creditor, with all the rights to which it was entitled (acknowledging that in this case the court was considering rights the paying guarantor had against other guarantors).

> *Royal Bank v Fox,* [1976] 2 SCR 2 at para 8 **[Tab 7]**.

44. Similarly, the Alberta Court of Appeal confirmed that if a guarantor pays a creditor the guaranteed debt, that guarantor becomes subrogated to the rights of the creditor so paid, giving the guarantor every remedy, every security and every means of payment the creditor had (again, much like above, this case specifically concerned rights between the guarantors).

> *Trinier v Shurnaik,* 2011 ABCA 314 at paras 32-33 **[Tab 8]**.

45. Although the two higher court decisions cited above are specifically in the co-guarantor context, the same principles hold as between guarantor and principal debtor. For example,

in *Bank of Montreal v. Ladacor AMS Ltd* the Alberta Court of Queen's Bench explained that where a guarantor pays off a claim against the principal debtor, the guarantor is entitled to be subrogated to that claim, and to stand in the creditor's shoes with respect to any security it held against the principal debtor.

Bank of Montreal v Ladacor AMS Ltd, 2019 ABQB 985 at paras 45-47 **[Tab 1]**.

46. The doctrine of subrogation is in fact the reason for the Surety Exception to the Single Debtor Rule discussed above which allows the doctrine of marshalling to be applied where the senior creditor seeks payment from the guarantor to the detriment of the junior creditor, which has access only to the property of the senior's guarantor. This is because if the senior creditor did in fact obtain payment from the guarantor first, then that guarantor would then have a subrogated claim against the principal debtor, the proceeds of which could ultimately end up going to the junior creditor because the junior creditor still has its claim against the guarantor. An order of marshalling in such circumstances is entirely consistent with the concept of subrogation, merely shortcutting the process such that the senior creditor must claim against the principal debtor first (or in the alternative, allowing the junior creditor to enforce its security against the principal debtor).

47. In other words, the Surety Exception to the Single Debtor Rule arises entirely because of a principal debtor's obligations to the surety (specifically those involving indemnity and subrogation). Since a surety does not have corresponding obligations to the principal debtor, there is no reason at law to accept Tamarack's arguments in favour of a reverse surety exception.

Wolfe at paras 60-61**[Tab 9]**.

48. Not only are Tamarack's arguments incorrect as a matter of law, practically speaking, granting the order it seeks would not lead to any greater recovery for Tamarack.

49. In these circumstances, the Limited Recourse Guarantee does not waive any rights of subrogation. It acknowledges that such rights exist, although the right of subrogation cannot be exercised until the Lenders are repaid in full.

Limited Recourse Guarantee (attached as Exhibit "L" to the Stepanic Affidavit), s. 13.

50. Given this, even if the Lenders were required to first realize against Spicelo's Pledged Shares (as Tamarack has suggested – but for which proposition there is no support at law), the doctrine of subrogation would apply as soon as the Lenders were fully repaid, allowing Spicelo to step into the Lenders' shoes and benefit from the Lenders' security against any remaining assets of GPOC ahead of Tamarack, and ultimately not leading to any greater recovery for Tamarack.

Tamarack seeks marshalling in breach of the Intercreditor Agreement

51. It should also be noted that Tamarack seeking marshalling here is itself a breach of the Intercreditor Agreement between the Lenders, Tamarack and GPOC. The Intercreditor Agreement prohibits Tamarack from taking any Enforcement Action (a) unless it has given the Lenders 180 days' notice, and (b) in any case, as long as the Lenders are precluded from enforcement themselves due to insolvency proceedings. Suffice to say, Tamarack has not given the Lenders the required notice and, in any event, the Lenders are precluded from enforcement due to the CCAA proceedings.

Intercreditor Agreement (attached as Exhibit "O" to the Stepanic Affidavit), s. 5.1(1).

52. Note that the Intercreditor Agreement specifically defines Enforcement Action in part as any "step or proceeding … to … exercise any of its rights or remedies", including "commenc[ing] judicial enforcement of any of the rights and remedies … under applicable law". Bringing this application seeking marshalling is a breach of these provisions, as Tamarack clearly seeks judicial enforcement and recognition of its rights as a secured creditor.

Intercreditor Agreement, s. 1.1, s.v.

53. Tamarack's application is thus in breach of the Intercreditor Agreement. This Court should not grant an order for equitable relief which would have the effect of sanctioning a breach of contract.

111 Alberta Ltd. can be distinguished

54. In its Bench Brief, Tamarack places a great deal of reliance on a single line from the decision of *111 Alberta Ltd.* However, it is important to note (as we have done above) that *111 Alberta Ltd.* can be distinguished and has no application to the current facts.

55. Although *111 Alberta Ltd.* contains a broad statement that seemingly permits marshalling where the two funds at issue "either belong to the same debtor or relate to the same debt" it is important to note two things: (a) the case apparently does not involved a guarantee, and hence the statement is *obiter dicta*, and, in any case (b) the factual circumstances of *111 Alberta Ltd.* significantly differ from the facts of the present case, meaning the decision is not at all instructive in the present case. (The statement above is actually correct to the extent that it refers to the Surety Exception to the Single Debtor Rule, but is overly broad.)

56. Although the facts of *111 Alberta Ltd.* are difficult to fully ascertain from the judgment, it is important to note that nowhere does the decision anywhere make any reference to a "guarantee", "guarantor" or "surety". There is therefore no reason to believe that *111 Alberta Ltd.* involved a guarantee or suretyship in any way, much unlike the current circumstances which centre around the Limited Recourse Guarantee as a key fact. Accordingly, there is no reason to believe that *111 Alberta Ltd.* is authority for the "reserve surety exception" urged by Tamarack.

57. Further, in *111 Alberta Ltd.*, the court stated that there was no evidence or explanation for why the two debtors would have security rights against one another. This significantly differs from the facts in the present case where (as discussed above) after realization against the Pledged Shares, Spicelo would have a first ranking security interest against GPOC under the doctrine of subrogation.

111 Alberta Ltd, para 40 **[Tab 3]**.

58. The Court also notes in *111 Alberta Ltd.* that there is no evidence or explanation advanced about a potential breach of contract. However, as discussed above, Tamarack seeking marshalling here is itself a breach of the Intercreditor Agreement.

111 Alberta Ltd, para 40 **[Tab 3]**.

59. Accordingly, it is clear that the facts of the present case differ substantially from the facts at issue in *111 Alberta Ltd.* Therefore, the decision has no application and does not provide the necessary foundation to depart from the established jurisprudence requiring the two funds at issue to both belong to the same debtor (absent a narrow surety exception) in order to invoke the doctrine of marshalling, and *111 Alberta Ltd.* provides no authority for the "reserve surety exception" urged by Tamarack.

Marshalling would cause prejudice to Spicelo's other stakeholders

60. Since marshalling is an equitable remedy, it is not available if it causes prejudice to a third party.

Wolfe at para 38 **[Tab 9]**.
111 Alberta Ltd at para 34-41 **[Tab 3]**.
First Investors Corp v Veeradon Developments Ltd, 1988 CarswellAlta 9 at para 12 **[Tab 4]**.

61. In this case, Spicelo is effectively a third party from the perspective of Tamarack. Spicelo is a stranger to the obligations between GPOC and Tamarack, but Tamarack is seeking to benefit from the security Spicelo granted to the Lenders. Effectively, Spicelo would be forced to grant security to Tamarack for GPOC's obligations, which is not what Spicelo bargained for when it entered into the Limited Recourse Guarantee.

62. While Spicelo agreed to make the Pledged Shares available on a limited recourse basis to the Lenders, Spicelo did not consent to make the Pledged Shares available to satisfy the obligations of any other creditors, including Tamarack. If Tamarack's application is not granted, then Spicelo will be entitled to any remaining value from the Pledged Shares after GPOC's obligation to the Lenders has been satisfied. If Tamarack's application is granted, then effectively Tamarack will be permitted to satisfy part of GPOC's obligation to Tamarack out of the value of the Pledged Shares – a result which neither Spicelo nor Tamarack bargained for.

63. Granting marshalling in these circumstances would prejudice Spicelo and its shareholders. Marshalling would also prejudice any creditors of Spicelo who might have recourse to the Pledged Shares. An equitable remedy such as marshalling should not be granted in the face of such prejudice.

V. CONCLUSION AND RELIEF SOUGHT

64. For the foregoing reasons, the Applicants respectfully submit that this Court should grant an Order substantially in the form of as Schedule "B" to the Application.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 18th day of March, 2024.

Randal Van de Mosselaer / Julie Treleaven
Osler, Hoskin & Harcourt LLP
Counsel for the Applicants

TABLE OF AUTHORITIES

TAB	AUTHORITY
Jurisprudence	
1.	*Bank of Montreal v Ladacor AMS Ltd*, 2019 ABQB 985
2.	*Brown v Canadian Imperial Bank of Commerce,* 1985 CarswellOnt 729
3.	*Condominium Corp No 082 6970 v 1117398 Alberta Ltd,* 2012 ABQB 233
4.	*First Investors Corp v Veeradon Developments Ltd*, 1988 CarswellAlta 9
5.	*Green v Bank of Montreal,* 1999 CarswellOnt 3954
6.	*Quay v Sculthorpe,* 1869 CarswellOnt 110
7.	*Royal Bank v Fox*, [1976] 2 SCR 2
8.	*Trinier v Shurnaik,* 2011 ABCA 314
9.	*Wolfe et al v Taylor et al,* 2020 MBCA 44
Secondary Sources	
10.	Halsbury's Laws of Canada (online), Guarantee and Indemnity, "The Rights of a Surety: As Against the Creditor: Securities in Favour of the Creditor" (V.1.(5)) at HGI-234 "Surety Entitled to Securities Received by Creditor from Principal" (2022 Reissue)
11.	Kevin P. McGuinness, The Law of Guarantee, 3rd ed (LexisNexis, 2013)
12.	Roderick J. Wood, Bankruptcy & Insolvency Law, 2nd ed (Irwin Law, 2015)

TAB 1

Court of Queen's Bench of Alberta

Citation: Bank of Montreal v Ladacor AMS Ltd, 2019 ABQB 985

Date: 20191219
Docket: 1803 09581
Registry: Edmonton

Between:

Bank of Montreal

Plaintiff

- and -

Ladacor AMS Ltd, Nomads Pipeline Consulting Ltd, 2367147 Ontario Inc, and Donald Klisowsky

Defendants

Corrected judgment: A corrigendum was issued on January 13, 2020; the corrections have been made to the text and the corrigendum is appended to this judgment.

Reasons for Decision
of the
Honourable Mr. Justice Robert A. Graesser

Introduction

[1] Alvarez & Marsal Canada Inc. LIT (the "Receiver") is the Receiver and Manager of Ladacor AMS Ltd. ("Ladacor"), Nomads Pipeline Consulting Ltd. ("Nomads") and 2367147

Ontario Inc. (“236”). It was appointed receiver and manager of these entities by Court order dated May 18, 2018 (the “Receivership Order”). It now applies for a number of orders:

1. Approving the actions, conduct and activities of the Receiver and its legal counsel outlined in the Receiver’s Fourth Report to the Court dated September 3, 2019 and all other reports filed by the Receiver in these receivership proceedings;
2. Approving the Receiver’s final statement of receipts and disbursements for the period for May 18, 2018 to August 31, 2019 as set out in the Fourth Report;
3. Approving the accounts, fees and disbursements of the Receiver and its independent legal counsel in connection with the completion of these receivership proceedings, including the costs of this application;
4. Approving the proposed allocation of cash held by the Receiver for Ladacor and Nomads to 236, as set out in the Fourth Report;
5. Approving the Receiver’s proposal to assign the Debtors into bankruptcy in accordance with the Receivership Order;
6. Approving the transfer of all funds and property held by or collected by the Receiver, net of costs required to complete the administration of these receivership proceedings, into the bankrupt estates of the Debtors;
7. Declaring that the Receiver has duly and properly discharged its duties, responsibilities and obligations as Receiver;
8. Discharging and releasing the Receiver from any and all further obligations as Receiver and any and all liability in respect of any act done by the Receiver in these receivership proceedings, and its conduct as Receiver pursuant to its appointment in accordance with the Receivership Order, or otherwise; and
9. Authorizing the Receiver to transfer the books and records of the Debtors to the bankruptcy trustee, subject to preserving such records as required by statute.

[2] The application was initially heard by Topolniski J on September 13. She approved the Receiver’s accounts as set out in the Fourth Report and the Affidavit of Fees, a well as the accounts of the Receiver’s counsel, Blake, Cassels & Graydon LLP.

[3] Mr. Klisowsky was directed to provide the Receiver’s counsel with a list of issues or questions pertaining to the Receiver’s findings as reported in the Fourth Report and the Supplemental Report dated September 12, 2019.

[4] An application by Hythe & District Pioneer Homes (Advisory Committee) (“Hythe”) seeking to lift the stay of proceedings against Ladacor was adjourned to a later date. Hythe was attempting to file an amended statement of defence and counterclaim. It alleges that the work by Nomads was so deficient and defective that the entire project has to be demolished and Hythe will have to start again with a new contractor.

[5] Mr. Klisowsky's application in relation to Nomad's potential liability on performance bonds with Liberty Mutual Insurance Company, and Mr. Klisowsky's concerns about Nomad's potential liability to the Government of Canada under the Employment and Social Development Canada Wage Earner Protection Program ("WEPP"), were also adjourned to a later date. The Receiver's discharge application was adjourned as well.

[6] The adjourned applications were set down before me on November 27. The Hythe matter had been resolved directly between its counsel and counsel for the Receiver. That still left a number of issues that required resolution. Following submissions and argument, I reserved on all of the issues left to me to decide.

[7] I received written submissions from counsel for the Receiver (3 in total), from counsel for Mr. Klisowsky, and from counsel for J. Steenhof & Associates Ltd and 1459428 Ontario Inc. I heard submissions from those counsel as well as from counsel for Liberty Mutual Insurance Company ("Liberty Mutual").

[8] There was a significant volume of material put before me. The Receiver had prepared four reports over the course of the receivership, and added a supplement to the Fourth Report and provided a Fifth Report filed October 25, 2019 for the purposes of this application. The Supplement and Fifth Report mainly responded to the issues raised by Mr. Klisowsky.

[9] There was an affidavit of fees from Orest Konowalchuk, a senior vice president of the Receiver. There were also were affidavits from John Hermann, from the Bank of Montreal ("BMO"), sworn May 18, 2018, from Mr. Klisowsky sworn September 7, 2019, September 11, 2019, and October 5, 2019, from Larry Slywka, a former employee of Ladacor, sworn October 13, 2019, from Bonnie Erin Richard, another former employee of Ladacor, filed October 25, 2019, and a "secretarial affidavit" from Lindsay Farr, sworn November 20, 2019. There was also an affidavit from Jacob Steenhof, from J. Steenhof & Associates Ltd ("J. Steenhof") and 1459428 Ontario Inc ("145"), sworn October 25, 2019.

[10] Each of Mr. Klisowsky, Mr. Slywka, Ms. Richard and Mr. Steenhof were cross-examined on their affidavits and I have the transcripts from their cross-examinations.

Background

[11] Most of the background facts are not in dispute. Mr. Klisowsky is the majority shareholder in Nomads (97.28%). His son owns the remaining 2.72% of the shares. Nomads was a Calgary based company whose principal business was the manufacture and production of advanced modular buildings and structures. These structures were generally constructed of sea cans. Part of Nomads' business was investing in other assets. One of those investments is its 90% interest in 236. 236 is an Ontario corporation whose business was the ownership and operation of a Days Inn hotel in Sioux Lookout, Ontario. The remaining 10% of the shares in 236 are owned by J. Steenhof, an Ontario corporation.

[12] Ladacor is a wholly owned subsidiary of Nomads. Ladacor came into existence in 2017 and carried on the same advanced modular home business as did Nomads. It appears that the incorporation of Ladacor coincided with a banking change by Nomads.

[13] In the latter part of 2017, Nomads began a banking relationship with BMO. Mr. Klisowsky injected some $4,000,000 of capital into Nomads/Ladacor. BMO loaned approximately $4,000,000 to Nomads/Ladacor. Ladacor was the principal debtor. BMO took

typical security from Ladacor. Guarantees of the Ladacor debt to BMO were provided by Nomads, 236 and Mr. Klisowsky.

[14] After Ladacor was incorporated, all new work was directed to it, while Nomads completed the work it already had under contract. The work contracted by Nomads was, however, performed for it by Ladacor. Payments, whether from Nomads customers or Ladacor customers, were deposited into Ladacor's bank account with BMO

[15] The accounting records and the evidence of Mr. Klisowsky, Mr. Slywka and Ms. Richard show that Nomads and Ladacor essentially operated as one entity. All bills were paid from the Ladacor bank account with BMO, and all of the enterprise employees (but for Mr. Klisowsky, his wife, and his son, were paid by Ladacor.

[16] Ladacor entered into a bonding relationship with Liberty Mutual. Ladacor's indemnification obligations to Liberty Mutual were guaranteed by Nomads, 236, and by Mr. Klisowsky.

[17] The months following the incorporation of Ladacor were not financially successful. Nomads had a major contract with Hythe that was ongoing and far from completion. Nomads had a large receivable ($2,700,000) owed to it by 1507811 Alberta Ltd on a project in Edmonton known as "Westgate". That project had been completed, but there were ongoing discussions about the outstanding payment.

[18] Ladacor was performing the work on ongoing projects that were in various stages of completion, including a project in Banff. The Receiver completed these obligations over the course of the receivership.

[19] In May 2018, shortly before the Receivership Order, Ladacor was awarded a sub-contract for work on the new court house in Chateh, Alberta. From the information before me, it is likely that Liberty Mutual had previously provided a bid bond, and subsequently provided a surety bond in favour of the general contractor, Kor Alta Construction Ltd ("Kor Alta"). Physical work on the project had not begun at the time of the Receivership Order, and the Receiver disclaimed the contract. That led to a bond claim by Kor Alta against Liberty Mutual. The claim in favour of Kor Alta is tentatively valued at over $1,000,000. Liberty Mutual seeks indemnification for that amount from each of Ladacor, Nomads, 236, and Mr. Klisowsky.

[20] Following the Receivership Order, Hawke Electric, a subcontractor to Nomads, made a bond claim on a labour and material payment bond on the Westgate project against Liberty Mutual. Kor-Alta, the general contractor on the Chateh courthouse project, claimed in excess of $1,000,000 as a result of the termination of the subcontract by the Receiver. Liberty Mutual seeks indemnification for those amounts from each of Ladacor, Nomads, 236 and Mr. Klisowsky.

[21] Liberty Mutual values these claims at a total of approximately $1,100,000.

[22] The Receiver has reported throughout the receivership on its activities and realizations. A sale of the physical assets of Nomads and Ladacor was conducted in the late fall of 2018. The auction sale netted $606,000. Further physical assets (miscellaneous inventory) netted a further $76,000.

[23] The Receiver was successful in collecting most if not all of the $2,700,000 receivable owed to Nomads on the Westgate project. The Receiver collected $1,568,609 owed to Ladacor on the Banff project.

[24] Since 236 was also put into receivership, the Receiver took steps to sell 236's main asset, the Days Inn Hotel in Sioux Lookout. Of the roughly $5,000,000 sale proceeds, $4,000,000 were paid by the Receiver to BMO.

[25] Ultimately, the time of the Fourth Report, the Receiver had paid off the secured debt to BMO, the Receiver's borrowings from BMO to enable it to carry on the Receivership, the WEPP claims, CRA and Service Canada trust/priority claims, along with its and its lawyer's fees and disbursements.

[26] The supplemental report and Fifth Report update the figures. As at the time of that report, October 25, the Receiver was holding $10,398 for Nomads, $722,661 for Ladacor, and $637,241 for 236. The Receiver proposes to allocate all of the available proceeds currently in Ladacor's and Nomads' accounts to 236.

[27] All three corporations would then be placed in bankruptcy.

[28] Because Nomads and Ladacor had intermingled their physical assets, it was not possible for the Receiver to determine with any degree of certainty what assets belonged to Nomads and what assets belonged to Ladacor. For BMO, the secured creditor, it did not matter. It had reportedly good security against all of the assets regardless of which corporation owned them. For the purposes of the Fourth Report, which was from the date of the Receivership Order to August 31, 2019, the Receiver apportioned the auction proceeds $451,450 to Nomads and $154,407 to Ladacor. Ongoing expenses were apportioned between the two corporations based on the contracting party for the contract being worked on. Employee withholding claims by CRA and WEPP claims were broken down between the two corporations as well.

[29] Following receipt of Mr. Klisowsky's cross application and the concerns he expressed over the apportionments in the Fourth Report, the Receiver retained Erin Richard to explain the financial situation and accounting of Nomads and Ladacor while she was comptroller for the final year of their operations. She had worked with the Receiver during the course of the receivership. Ms. Richard outlined in her affidavit how employees and assets had been apportioned between the two entities. She attempted to determine from the available records what assets had been owned before Ladacor was incorporated. Those would have been Nomads. Because Ladacor had become the main operating entity after the fall of 2017, anything acquired since then was attributed to Ladacor.

[30] The same analysis was performed with respect to employees. For the purposes of payroll, withholdings and other employment related issues, the Receiver treated employees who had been employed with Nomads and who stayed on after Ladacor began operating as Nomads employees. Employees hired after Ladacor began operating were treated as Ladacor employees, even though they may have been working on Nomads projects.

[31] For accounts payable and monies owed to trade creditors, the Receiver looked at which entity an invoice was addressed to, or which project it related to. If it was addressed to Nomads, or was in relation to a Nomads project, it was attributed to Nomads. And vice versa for Ladacor.

[32] There does not appear to be any dispute that the Nomads/Ladacor records did not provide the Receiver with much guidance. There was no written agreement between Nomads and

Ladacor when Ladacor assumed all of the operations of the two corporations. There was no asset transfer agreement. There was no agreement transferring Nomads' rights under any of its ongoing contracts to Ladacor. There was no agreement relating to employees.

[33] According to Mr. Slywka, when Ladacor assumed the operations, employees at the time were simply told they were now working for Ladacor. It is unclear whether any of the parties Nomads had contracted with were ever told that Ladacor had taken over Nomads' operations, or that Nomads had assigned any rights to Ladacor.

[34] Mr. Klisowsky takes issue with the amount of the asset sale proceeds attributed to Ladacor versus Nomads. He challenges Ms. Richard's assessment, noting that she was a relatively new employee at Ladacor. He also takes issue with the allocation of employees between the companies, and says that only his wife and son were Nomads employees, as all other workers worked for Ladacor. That impacts wages paid to the employees (their WEPP claims) as well as claims by the government for employee deductions and other trust claims made by the Government of Canada.

[35] Mr. Klisowsky's view is that as at the beginning of 2018, Nomads was essentially a holding company. All of its projects, employees and assets had been transferred to Ladacor. Ladacor performed all of the work on all of the projects contracted to either Nomads or Ladacor. Ladacor paid all of the employee wages, regardless of what project they were working on. Ladacor paid all of the bills whether they were invoiced to Ladacor or to Nomads, as Ladacor had taken over all of the work on all of the ongoing projects.

[36] Whatever the arrangement between Nomads and Ladacor was, it was not reduced to writing. There is some suggestion that the merging of operations and the creation of Ladacor was linked to collection activities undertaken against Nomads by Alberta Treasury Board and Finance in relation to a reassessment of tax credits Nomads had been given under a government tax incentive program. A review by the Tax and Revenue Administration revisited the credits given to Nomads for 2012, 2013 and 2014 and assessed Nomads some $769,000. The Provincial government had apparently garnisheed Nomads' former bank, leading to Nomads setting up a new banking relationship with BMO.

[37] The best that can be said of the operations of Nomads and Ladacor once Ladacor came into existence is that they operated under Mr. Klisowsky's control as "owner" of both entities. Daryl Nimchuk was the chief operating officer for some time. Ms. Richard was comptroller, and Larry Slywka was Ladacor's production manager. The operations of both Nomads and Ladacor were merged so that all receipts went into the Ladacor bank account and all bills were paid out of that account. There was no internal attempt to separate assets, projects, employee functions, bills or receivables. The reporting to BMO and any financial statements produced were "consolidated", although the two corporations were never consolidated under the *Business Corporations Act*. The joint operation is frequently described internally and on contracts as "Nomads Pipelines Consulting Ltd o/a Ladacor". The internal treatment of the two entities' operations does not reflect either entity's legal rights or obligations.

[38] According to the brief filed on behalf of Mr. Klisowsky, and his affidavit evidence, he believes that despite all of the various claims being advanced against it, Nomads remains a solvent entity and that Nomads should not be put into bankruptcy. He points to the large receivable of $2,800,000 secured by a builder's lien against the Hythe project. He claims that

there is a good defence to Liberty Mutual's claim against Nomads on the indemnity and guarantee agreement on the bond issued in favour of Kor Alta.

[39] Mr. Klisowsky points to the wording of the indemnity agreement and argues that the agreement gave Nomads (or the Receiver when it took over control of Nomads following the Receivership Order) their right to cancel the bond in favour of Kor Alta. The Receiver failed to do so. The Receiver's failure should not be visited on Nomads, such that Nomads should not ultimately have to pay anything to the bonding company.

[40] He refers to paragraph 45 of the Indemnity agreement that provides:

> 45. *Termination of the present agreement and its effect upon outstanding Bonds* – The present agreement shall only be terminated by any Indemnitor, upon prior written notice to the Surety by registered mail and at its head office, at least thirty days prior to its effective date; however, the said prior notice of termination will not modify, nor exclude, nor discharge the Indemnitors' obligations relating to Bonds issued prior to the effective date of termination or Bonds issued after the effective date of termination by reason of undertakings by the Surety prior to such date, the present agreement will remain in full force and effect as regards the other Indemnitors without any obligation on the part of the Surety to advise such other Indemnitors of such termination.

[41] This argument affects Ladacor as well, as it is the primary obligee on the bond and it is required to indemnify Liberty Mutual. The Indemnity Agreement in favour of Liberty Mutual executed by Ladacor, Nomads and 236 by Mr. Klisowsky signing the same. Mr. Klisowsky signed a personal indemnification in favour of Liberty Mutual and there is a *Guarantees Acknowledgement Act* certificate dated January 4, 2018.

Issues

[42] The Receiver raises a number of issues and seeks the Court's direction on the following:

1. Should the Receiver's apportionment of funds be approved, including its treatment of the contribution and subrogation obligations and rights of the guarantors?
2. Is there a valid defence on Liberty Mutual's indemnification claims on the bond claims against it?
3. Has the Receiver erred in apportioning employees, assets and debts?
4. Should all or any of the entities be put into bankruptcy? and
5. Should the Receiver's actions be approved?

[43] Mr. Klisowky's application challenges a number of the Receiver's recommendations and conclusions and raises a number of issues:

1. The validity of the Liberty Mutual claims under the Indemnity Agreement;
2. The identification and allocation of unsecured debt as between Ladacor and Nomads;

3. The identification and allocation of the auction proceeds between Ladacor and Nomads;
4. The identification of employees of Nomads and any claims (CRA and WEPP);
5. The validity of the Alberta Treasury Board and Finance claim against Nomads;
6. The proposed subrogation from Nomads and Ladacor to 236;
7. The claim of J. Steenhof against 236; and
8. The conduct of the Receiver.

[44] I will deal with subrogation first as my decision on it will impact a number of the other issues. I will then deal with Mr. Klisowsky's concerns and claims, before dealing with the relief sought by the Receiver.

Subrogation

[45] BMO has been paid in full. It received $5,834,882. That included repayment of amounts loaned by BMO to fund the receivership. Most if not all of the funds that were paid to BMO resulted from the sale of 236's hotel in Sioux Lookout and the collection of the $2,600,000 receivable on the Westgate contract owed to Nomads. The principal debtor to BMO was Ladacor. It was the entity that borrowed and received the funds from BMO. The funds that resulted from collections on other Nomads and Ladacor projects and the sale of Nomads' and Ladacor's physical assets were mainly used to pay the ongoing costs of the receivership, including completion of some of the project work, and the Receiver's fees and disbursements.

[46] BMO was a secured creditor, subject only to the superior WEPP claims and CRA source deduction claims, and the costs of the receivership. The Receiver argues on this application that guarantors (such as Nomads and 236) are entitled to be subrogated to the claims they have paid out on behalf of the principal debtor, Ladacor.

[47] In this case, Nomads and 236 have paid off BMO's claims against Ladacor. Nomads and 236 are entitled to be subrogated to BMO's claim, and to stand in BMO's shoes with respect to any security BMO held against Ladacor. That means, according to the Receiver, that Nomads and 236 are now the primary secured creditors on any of Ladacor's remaining assets.

[48] Additionally, as between guarantors who have paid out on their guarantees, Nomads and 236 are entitled to be treated proportionately, so the debt paid off should be apportioned between them. Where guarantors are equally liable to the obligee, the guarantors are considered to be responsible for equal shares of the debt.

[49] Here, that would mean that each of Nomads and 236 should have paid off half of the debt owed to BMO. Since 236 paid more than half of the BMO debt, there should be an adjustment as between Nomads and 236, in 236's favor.

[50] The way the Receiver has accounted for this is that the excess of collections over required payments has left a surplus, some of which now stands to the credit of Ladacor. Because 236 paid more than its half of the obligation, 236 is entitled to recover that excess from Ladacor.

[51] Of the $5,834,882 paid to satisfy BMO's claims, $4,000,000 came from 236. The remainder came from Nomads. Because of contribution principles between guarantors, each of the guarantors should have paid $2,917,441. 266 overcontributed by $1,082,559. That amount is owed to it by Nomads.

[52] The Receiver proposes to pay the funds remaining in the Nomads account and the Ladacor account (after holdbacks for further administration costs) in the approximate amount of $465,000 (Receiver's Fifth Report). 236 is expected to have approximately $517,000 in its account, so it will recover $982,001. It will be short by approximately $100,559. Because of it standing into BMO's security, it will be Nomads' only secured creditor to that extent.

[53] This analysis and position is well supported by the Receiver's first brief for this application. The Receiver cites:

> ***Gerrow v Dorais***, 2010 ABQB 560;
>
> *Mercantile Law Amendment Act 1856*, 19 & 20 Vict, c 97;
>
> ***Karen Matticks v B & M Construction Inc (Trustee of)***, 1992 CarswellOnt 193 (ONCJGD);
>
> Andrews & Millett, *Law of Guarantees*, 7th Ed (London: Sweet & Maxwell, 2015) at para 11-017;
>
> ***Re Windham Sales Ltd***, 1979 CarswellOnt 227 (ONSC in bankruptcy);
>
> ***Wong v Field***, 2012 BCSC 1141;
>
> ***EC&M Electric Ltd v Medicine Hat General & Auxiliary Hospital & Nursing Home District N 69***, 1987 CarswellAlta 25 (ABQB); and
>
> ***Abaklhan v Halpen***, 2006 BCSC 1979, aff'd 2008 BCCA 29.

[54] J. Steenhof, as an unsecured creditor of 236, and 145 as an unsecured creditor of Nomads on the Hythe project, agree with this analysis, as does Liberty Mutual. Mr. Klisowsky raises no specific objection to this proposal on the part of the Receiver, but suggests that it is premature. He says that the proper contribution between Nomads and 236 can only be calculated once the assets and liabilities of Nomads and Ladacor (as between those entities) have been properly allocated.

[55] I am satisfied that for the purposes of finalizing the Receivership accounts, the monies the Receiver holds to the account of Ladacor and Nomads should be transferred to 236's account as a function of a guarantor's right to subrogation and to contribution rights and obligations as between co-guarantors.

Assets and Liabilities of the Debtors

Ladacor

[56] There is no doubt that Ladacor is insolvent under any interpretation of "insolvency". It has no remaining assets, other than a contingent interest in the funds proposed to be held back by the Receiver to deal with CRA's post-receivership withholdings claims (discussed below), and a $57,000 GST refund apparently owed to it by CRA. All physical assets have been disposed of. All of Ladacor's projects have been abandoned, completed or wound down. Its receivables have

been collected. There are still claims by CRA relating to pre-receivership GST. These claims total $33,446. While these claims presently enjoy priority status, they will drop down to unsecured status in the event of Ladacor’s bankruptcy.

[57] There is a post-receivership claim relating to source deductions assessed against the Receiver’s independent contractors used to complete project work and for other receivership purposes. CRA’s position is that these contractors should be treated as employees subject to employment insurance and Canada Pension Plan deductions. While the presently-advanced claim is approximately $10,000, the Receiver anticipates that there are a number of other claims that CRA will advance, depending on its success on the claims already made. The Receiver proposes to withhold $125,000 as a contingency to deal with those funds. It is possible that not all of those funds will be required, and some might ultimately be released back to Ladacor. Conversely, it is possible that the claims and costs of defending Ladacor against them will use up most or all of the contingency amount.

[58] The Receiver’s records list Ladacor’s unsecured creditors. The present list totals approximately $3,500,000 in unsecured claims. That does not include over $1,100,000 from Liberty Mutual under the Indemnity Agreement in favour of Liberty Mutual.

[59] The priority claims of CRA have been accounted for in the holdback of $125,000 discussed above. Ladacor’s only remaining secured creditors are 236 and Nomads, because they are able to step into BMO’s secured position because of their subrogation rights. Since 236’s and Nomads’ assets were used to pay off BMO, 236 and Nomads have a secured claim against Ladacor for up to $5,834,882, less the approximately $465,000 that will be paid to 236 as a result of this application.

[60] It appears from this analysis that Ladacor’s unsecured creditors are unlikely to make any recovery at all, as any remaining funds will go to or be attributed to 236 and Nomads, with 236 being able to recover all of any anticipated or hoped-for funds because of its contribution rights against Nomads.

[61] It is obvious that Ladacor should be placed into bankruptcy, although it is difficult to see any advantage to that for Ladacor’s unsecured creditors. The bankruptcy would appear to benefit only the creditors of 236, as discussed below.

[62] In any event, there needs to be an orderly resolution to the massive amount of unsecured debt owed to Ladacor’s creditors and the only way of achieving that is through bankruptcy

236

[63] 236 has no remaining assets, other than its subrogated claim against Ladacor and its claim against Nomads for contribution so that its and Nomads’ contributions to BMO will be equalized. 236’s creditors are all unsecured. The major claims are Liberty Mutual’s claim for indemnity for bond claims against Ladacor ($1,100,000) and a claim from J. Steenhof for approximately $444,000. It too has a GST claim by CRA ($33,000), which is presently a priority claim but which will become unsecured on bankruptcy. There are only a few other unsecured claims totaling about $40,000.

[64] Through its subrogation rights and contribution rights arising out of 236’s payments to BMO, 236 will receive all of the remaining cash in the three debtor accounts. There is the possibility that some further funds might come to 236 from Ladacor (any surplus from the CRA

holdback discussed above and the GST refund). Any such funds may be available for 236's creditors.

[65] It is unlikely that 236 will receive any more than the amount presently suggested by the Receiver. That will not satisfy Liberty Mutual's claim, if the claim is valid and anywhere close to the current amount claimed. If J. Steenhof's claim has any validity, it and Liberty Mutual will recover only a fraction of their claims.

Nomads

[66] In his submissions, Mr. Klisowsky emphasizes the $2,800,000 receivable and builder's lien claim Nomads has against Hythe. As discussed below, that claim is hotly disputed by Hythe. Hythe is attempting to amend its statement of defence and counterclaim to advance a claim against Nomads for damages significantly higher than the Nomads claim against Hythe.

[67] There are two investments owned by Nomads. The first is 27.5% of the common shares in a private corporation, Testalta Corporation Ltd. Nomads is also owed a shareholder's loan of $220,500. The Receiver has no information on the value of this investment. It says that Mr. Klisowsky has not provided any relevant information that would assist it in valuing this asset. As a result, the Receiver places no value on Nomads' investment in Testalta and the Receiver has no information as to whether the shareholders' loan is recoverable.

[68] The second of these investments is a 50% interest in 1878826 Alberta Ltd. This private corporation owns a Studio 6 Hotel in Bruderheim, Alberta. The Receiver's information is that the hotel is presently producing "minimal positive cash flow" and is subject to a mortgage of approximately $3,000,000. Because of the lack of information, the Receiver is unable to place any value on this investment.

[69] Nomads has a contingent claim to the $54,236 the Receiver paid into Court to discharge a builder's lien in favour of Hawk Electric, filed against the Westgate project. Those funds are in Court as security for the lien and will remain there until further Court order. It is possible that some of those funds might come back to Nomads.

[70] Nomads owns 23 modular storage units which were earmarked for the Hythe project. They remain in storage. Unless the Hythe project can use them, they have little residual value. No information was put before me as to the potential value of these storage units. The main value appears to be the ability to use them for completion of the Hythe project. It seems highly unlikely Nomads or the Receiver will have any further involvement with Hythe, other than in the litigation that has ensued.

[71] Nomads is entitled to be indemnified for its payments to BMO by Ladacor and in that regard is a secured creditor, being entitled to step into BMO's security position. There is a possibility that Ladacor may not need all of the CRA contingency it has set up, and that it might recover a pre-receivership GST refund. However, since 236 is entitled to contribution from Nomads to equalize their payments to BMO to pay off Ladacor's debts to BMO, 236 will be entitled to recover any of the required contribution from Nomads as a secured creditor.

[72] Having regard to the roughly $100,000 contribution owed to 236 and 236's security position, it appears highly unlikely that any funds will remain for the benefit of any of Nomads' unsecured creditors.

[73] By way of liabilities, CRA is a priority creditor in the amount of $152,742 in pre-receivership GST. As with Ladacor, this claim will drop down to unsecured status in the event of Nomads' bankruptcy.

[74] Nomads is liable to indemnify Liberty Mutual for both of the bond claims Liberty Mutual is liable for. Those claims total approximately $1,100,000.

[75] Alberta Treasury Board and Finance Tax and Revenue Administration has a claim (presumably unsecured) against Nomads following a reassessment of tax credits for 2012, 2013 and 2014 totaling $769,245.68. This claim has been outstanding since some time in 2017. Mr. Klisowsky professes to know nothing about this claim.

[76] 236 has a claim against Nomads to equalize what the two entities paid out to satisfy Ladacor's debts to BMO in the approximate amount of $100,000, assuming all available funds from Ladacor and Nomads are paid over to 236 as a result of this application.

[77] Hythe has recently provided information to the Receiver that the work done by Nomads should be demolished because of defects and mold infestation. The expert report provided states that the cost of repairing the existing work and completing it is likely to be significantly more expensive than demolishing the existing work and starting over again. The intended counterclaim will greatly exceed the amount of Nomads' builder's lien and claim for the value of work it claims to have done. While the relative merits of the positions of Nomads and Hythe are unknown, it seems clear that it will be a long and difficult fight for Nomads to collect anything from Hythe. It is not known what was agreed between the Receiver and Hythe with respect to this application such that Hythe's application to lift the stay of proceedings to allow it to file an amended statement of defence and counterclaim. However, the information presented by the Receiver casts doubt on the recoverability of the claimed receivable.

[78] Nomads also has approximately $1,900,000 in debts to creditors, after deducting the Liberty Mutual and Alberta Treasury Board claims. One of the J. Steenhof companies, 145, has a claim against Nomads for work done on the Hythe project, but its hopes of collection are likely tied to its builder's lien.

[79] It appears, following this analysis, that anything that Nomads may be able to recover from its few debtors will ultimately go to 236 until its and 236's payments to BMO have been equalized. The absence of information as to the potential value of Nomads' investments in Testalta and 1878826 Alberta Ltd makes it impossible to determine if there is any chance of recovery on either of those investments, or in what amount. The first $100,000 is likely to go to 236 and there are $4,700,000 in other creditors, so even if Nomads' present claim against Hythe were given full value (ignoring Hythe's counterclaim), Nomads would be unable to pay off its unsecured creditors. In my view, the suggestion that Nomads is solvent and should be able to resolve outstanding issues with its creditors is fanciful.

[80] Any remaining assets of Ladacor and Nomads will likely end up with 236 and be distributed to its creditors and not to any other creditors of Nomads or Ladacor. The resulting beneficiaries of that scenario are Liberty Mutual and J. Steenhof.

[81] 236 has no remaining assets other than its subrogated claim against Ladacor and the contribution claim against Nomads. The Receiver proposes to pay Ladacor's remaining funds in the amount of $799,000 less holdbacks and estimated administration costs to 236. Its claim

against Ladacor is secured because of its rights to subrogation. However, claims will not satisfy the $4,000,000 236 paid to BMO.

Positions of Liberty Mutual, J. Steenhof and 145

[82] Both Liberty Mutual and the Steenhof parties support the Receiver's application. They support the proposal to put all three of the debtor corporations into bankruptcy. They do not oppose any of the other relief sought by the Receiver.

Position of Mr. Klisowsky

[83] The foundation of Mr. Klisowsky's disputes with the Receiver's reports and recommendations is that Mr. Klisowsky believes that Nomads remains solvent. Because of its assets, and in particular the Hythe receivable and builder's lien claim, the mis-allocation of debt between Nomads and Ladacor, the invalidity of the Alberta Treasury Board claim and the invalidity of the Liberty Mutual indemnification claims, there is no need to put Nomads into bankruptcy. He argues that Nomads essentially shut down and transferred all of its business to Ladacor. After late 2017, when the transfer took place, all rights and all obligations under existing contracts were assumed by Ladacor. As a result, almost all of the claims against Nomads and Ladacor should be Ladacor's responsibility. Mr. Klisowsky challenges the commercial reasonableness of the Receiver's decision to attribute a significant portion of the creditors to Nomads.

[84] Mr. Klisowsky makes the same argument with respect to the physical assets of the enterprise. Effective late 2017, the assets that were eventually auctioned off by the Receiver were mainly assets of Ladacor and not Nomads. Mr. Klisowsky claims that the Receiver did not accurately identify equipment owned by Nomads such that it should be given credit for more of the proceeds of the physical asset sale than it was. The total proceeds of sale were $605,858, of which $451,450 was allocated to Nomads and $154,407 was allocated to Ladacor. Mr. Klisowsky says that most of this should have been allocated to Ladacor.

[85] The same holds true for employee claims and the Receiver's treatment of WEPP claims and CRA withholding claims. After the assignment of the business to Ladacor, all employees (but for Mr. Klisowsky's wife and son) became Ladacor employees. Thus none, or almost none, of Nomads' real assets should have been used to pay off the BMO claims. Any remaining claims should be to Ladacor's account. and all the allocation of debt as between Nomads and Ladacor should be attributed to Ladacor.

[86] According to Mr. Klisowsky, the Receiver overpaid the WEPP claims and CRA preferred/secured claims because of failing to properly identify what employees worked for Nomads and for Ladacor. From the Receiver's accounting, CRA source deductions for Nomads and Ladacor totaled $322,652. These do not appear to have been broken down between Nomads and Ladacor by the Receiver. The WEPP claims totaled $25,005 (attributed $18,056 to Nomads and $8949 to Ladacor.

[87] Mr. Klisowsky says the manner of apportionment of employees was not commercially reasonable.

[88] Ultimately, Mr. Klisowsky says that more work needs to be done by the Receiver to properly analyzed and the results amended.

[89] Mr. Klisowsky's position with respect to the Liberty Mutual indemnification claims is that if Ladacor had any outstanding bonds, and if there are any valid bond claims, the indemnity agreement should have been terminated by the Receiver immediately on their appointment thus avoiding liability on the bonds. Mr. Klisowsky also takes the position that the Receiver should not have terminated the subcontract with Kor-Alta because that triggered the performance bond claims. Mr. Klisowsky challenges the commercial reasonableness of the Receiver's decision to cancel the contract.

[90] Mr. Klisowsky argues that the work done by the Receiver to analyze and quantify the Alberta Finance claim relating to the reversed tax credits is deficient and needs further investigation as to whether the amount claimed is legitimate, whether it can be negotiated, and whether there is a process to appeal the reassessment. Mr. Klisowsky notes that the Alberta Finance claim is the most significant claim against Nomads other than the Liberty Mutual claim and suggests that the Receiver has not yet reached the point of commercial reasonableness in its work on this claim.

[91] Mr. Klisowsky also argues that the 145 claim against Nomads on the Hythe project is not valid. It is a claim for $603,000. Additionally, he disputes J. Steenhof's claim for $444,000 against 236. He says there is an issue for trial regarding that claim, as he says that amount represents part of J. Steenhof's investment in 236 and not a debt owed by 236 to J. Steenhof.

[92] Mr. Klisowsky argues that assigning any of the debtors into bankruptcy should only be done after the Receiver has completed a proper investigation and analysis of the assets and debts of the debtor corporations. Such a step should only occur when it is commercially reasonable to do so and that point has not been reached.

[93] Other issues raised include the reasonableness of the Receiver's actions when heavy rains damaged the roof and other parts of the under-construction Hythe project and its response to the theft of some property from that site.

[94] Mr. Klisowsky cites ***Royal Bank of Canada v Melvax Properties Inc***, 2011 ABQB 167 in support of his submissions. At the hearing, his counsel also referred to section 66(1) of the *Personal Property Security Act*, RSA 2000 c P-7, and ***Bank of Montreal v Tolo-Pacific Consolidated Industries Corp***, 2012 BCSC 1785.

Analysis

1. The validity of the Liberty Mutual claims under the Indemnity Agreement

[95] I cannot make any determination as to the validity of the Liberty Mutual claims as I have no documentation supporting the claims against the various bonds. In particular, none of the underlying contracts or subcontracts by Ladacor are in evidence. Mr. Klisowsky suggests that there was no signed contract between Ladacor and Kor-Alta. That may be so. However, that does not answer the matter, as there may well have been a bid bond issued in favour of Kor-Alta during the tendering process. A bid bond secures the successful tenderer's obligation to enter into a contract to perform the work and to provide a performance bond.

[96] Mr. Klisowsky's brief seems to suggest that a performance bond and labour and material payment bond were issued, which suggest that there were underlying contracts in existence. But it is premature to try to assess these issues. Liberty Mutual has indemnification agreements from

each of Ladacor, Nomads, 236 and Mr. Klisowsky. It does not appear that any of the bond claims have been finalized.

[97] Liberty Mutual claims that it is or will be owed approximately $1,100,000 on account of the labour and material payment bond claim by Hawke Electric and the performance bond claim by Kor-Alta. Those claims may be valid and if they are valid, the indemnification agreements appear valid on their face.

[98] The defence raised by Mr. Klisowsky: that the Receiver should have terminated the indemnity agreements thereby avoiding liability for the indemnitors, is entirely without merit. His reference to paragraph 45 of the Indemnity Agreement might provide an argument in his favour, it the paragraph ended after the first part of the first sentence. The sentence continues:

> …however, the said prior notice of termination will not modify, nor exclude, nor discharge the Indemnitors' obligations relating to Bonds issued prior to the effective date of termination or Bonds issued after the effective date of termination by reason of undertakings by the Surety prior to such date…

[99] It would make no sense at all for the indemnitors to be able to avoid their liability to indemnify the bonding company for bonds issued before the termination becomes effective. The essence of paragraph 45 is that the indemnitors can avoid liability for future bonds or bonding obligations by giving a 30-day notice. Existing arrangements are not affected.

[100] Standard form performance bonds, labour and material payment bonds and bid bonds do not have unilateral termination provisions or cancellation provisions on the part of either party. Once the bonding company is on the hook for a bonded obligation, the indemnitors are likewise on the same risk.

[101] This is so elementary in the bonding world that no authorities need be cited. Mr. Klisowsky's argument here is without merit. If Liberty Mutual is liable on any of the bonds it issued for Ladacor, the indemnitors are almost certainly liable to indemnify Liberty Mutual (subject to the usual types of defences available to guarantors.

[102] There is no basis to reject the Liberty Mutual claims from consideration of the merits of putting the debtor corporations into bankruptcy. Undoubtedly there may be litigation as to whether Liberty Mutual has properly paid out any of the claims against it and whether they have acted reasonably. But someone will have to carefully monitor the claims and Liberty Mutual's responses, and in doing so will be a costly venture for whomever is tasked with that.

2. The identification and allocation of unsecured debt as between Ladacor and Nomads

[103] This is another area where Mr. Klisowsky's arguments are without merit. A debtor cannot unilaterally pass its debts on to someone else and avoid further liability. Subject to the terms of the contract between the creditor and the debtor, a creditor can assign its rights (like its receivables or benefits accruing under a contract) to a third party. Sometimes that requires the consent or agreement of the debtor or other contracting party, and sometimes not. Nomads might have been able to assign its rights under the contract with Hythe and others to Ladacor, and it might not have been.

[104] While Nomads could by contract require another party to satisfy its obligations (such as Ladacor) that is not binding on the creditor. Someone cannot simply go to a creditor and say "I

don't owe that to you any more, I assigned my obligations to someone else". If that were possible, every debtor would rush to assign its obligations to a shell company or insolvent entity. Creditors are entitled to look to their debtor for payment or performance and they do not have to try to collect from someone else, unless they have specifically agreed to do that through some valid contractual mechanism.

[105] There is no evidence here that any of the Nomads creditors ever agreed to release Nomads and substitute Ladacor is its debtor. As a result, the method used by the Receiver with the assistance of Ms. Richard and others, was commercially reasonable. There were no written agreements between Nomads and Ladacor. Claims on contracts Nomads entered into are likely still Nomads' responsibility. Suppliers who supplied things on Nomads projects are likely still Nomads' creditors.

[106] I see no error in principle as to how the Receiver characterized the creditors. The Receiver has made no binding determinations; that would result from a claims process in the receivership, or the normal claims processes in bankruptcy. No one has suggested that it would be more efficient or effective to have a claims process within the existing Receivership.

[107] I do not see that the Receiver's actions in this area have been unreasonable in any way. It was faced with an undocumented mess and the Receiver has done its best to make sense of the disorganization created by the do-it-yourself creation of Ladacor by Mr. Klisowsky.

3. The identification and allocation of the auction proceeds between Ladacor and Nomads

[108] There were no transfer documents in evidence as to any transfers of assets between Nomads and Ladacor. No purchase documents were in evidence showing which entity actually purchased an asset in the first place. In the absence of documentation, the approach taken by the Receiver appears to be reasonable. Where an asset appears to have been in Nomads' possession at the time Ladacor came into existence, it remained Nomads'. Anything acquired after Ladacor began operations was attributed to Ladacor.

[109] I see nothing in this approach that is unreasonable. Again, any potential errors on the part of the Receiver were caused by the absence of appropriate documentation at the commencement of the receivership.

[110] In any event, arguments of this nature do not get Nomads anywhere. The fewer assets Nomads had, the less it contributed to paying off the BMO debt, and the more it would owe to 236's contribution claim.

4. The identification of employees of Nomads and any claims (CRA and WEPP)

[111] It does not appear that existing Nomads employees were properly transferred over to Ladacor's employment. Ladacor may well have been making all of the payroll payments once it took over as the operating company. For employment insurance, Canada Pension purposes, and employment standards purposes, the existing employees should have been terminated from Nomads and hired by Ladacor. Records of Employment should have been prepared and filed; accrued vacation pay should have been paid out.

[112] The failure to take those steps, however, does not invalidate a successor employer's employment or liability to the workers it has taken on. It creates liabilities for the former employer (in this case Nomads).

[113] This is one area where the Receiver may have been incorrect in its treatment of employees and liability for wages and withholdings. I only say “may”, as in the circumstances the Receiver faced, it is possible that any unpaid employee (and CRA) could have chosen which entity to pursue. It would have been possible for Ladacor employees to work on Nomads projects. Nomads could have subcontracted its obligations to Ladacor such that as between Nomads and Ladacor, Ladacor would have all future responsibilities.

[114] The absence of any agreement between Nomads and Ladacor makes it virtually impossible to determine what enforceable arrangements between Nomads and Ladacor were made. Consolidated financial statements were prepared. There is no evidence that Nomads and Ladacor had their own financial statements or books once Ladacor came into the picture.

[115] There is no evidence that Nomads was ever paid anything by Ladacor for Nomads assets or its ongoing contracts. There is no evidence that Ladacor ever indemnified Nomads against claims from any of Nomads’ creditors or contracting parties. Nevertheless, it is possible that most of the employee claims were Ladacor obligations.

[116] That being said, the amounts of the claims really makes this a *de minimus* area of concern. Mr. Klisowsky complains of $18,056 of WEPP claims already paid out by the Receiver from Nomads, and disputes the estimated $84,300 in unsecured WEPP claims remaining against Nomads. Charging $18,056 to Ladacor instead of Nomads changes nothing of significance with respect to the results of the receivership and indeed would increase the amount of contribution Nomads would owe to 236. The less attributed to Nomads means the more attributed to 236 such that 236 would itself be a larger creditor of Nomads. That takes on even more significance when 236’s status as a secured creditor is factored in, along with the unlikelihood of recovery for any of Nomads’ unsecured creditors.

[117] While Mr. Klisowsky makes a valid theoretical point, there is no merit to it in substance, as the amounts are too small to make any difference in the overall results.

5. The validity of the Alberta Treasury Board and Finance claim against Nomads

[118] The Alberta Finance claim will have to be dealt with whether in the receivership or in a bankruptcy. This is not a claim that was made after the receivership began; it was made against Nomads sometime in 2017. If an appeal period with respect to the reassessment of taxes was missed, it was likely missed long before the Receivership. The Receiver can hardly be faulted for not spending a lot of time investigating an unsecured claim that Nomads appeared to be ignoring and restructuring its affairs to avoid paying.

[119] There is nothing unreasonable in the Receiver’s approach to this claim. The Receiver did nothing with respect to investigating the validity of any of the unsecured claims, let alone trying to negotiate settlements on them. The main task of the Receiver was to identify secured and preferred claims, and pay out BMO, CRA, Service Canada, and WEPP, so that anything remaining could be properly divided amongst the unsecured creditors.

[120] The latter process has yet to occur, and is one of the reasons bankruptcy is a necessary process.

[121] I find no fault on the part of the Receiver in this area, and certainly no lack of commercial reasonableness.

6. The claim of J. Steenhof against 236

[122] There is little information about the validity of J. Steenhof's claims against 236. Mr. Klisowsky acknowledges that there is a triable issue between 236 and J. Steenhof as to whether the claim is a debt owed to a shareholder or whether the claim relates to the shareholder's investment in the corporation for the purchase of its shares. That needs to be decided in some binding manner. Absent a claims process, the Receiver is not in a position to make any determination. At the end of the day, however, that is really a question for the unsecured creditors of 236. Mr. Klisowsky does not claim to be a creditor of 236, let alone a secured creditor. He claims to be a shareholder. The information suggests that the shareholders of 236 are likely to receive nothing for any shareholders' loans, let alone any equity they may have in that corporation.

[123] It is certainly not an issue that can be decided summarily and will likely be a time consuming and expensive exercise.

[124] The Receiver cannot be criticized for its approach to this claim and there is nothing commercially unreasonable about maintaining the J. Steenhof claims in the list of unsecured creditors.

Relief sought by Receiver

[125] This takes us to the Receiver's requested relief, which I can now deal with having regard to the facts as I have found them.

1. Approving the actions, conduct and activities of the Receiver and its legal counsel outlined in the Receiver's Fourth Report to the Court dated September 3, 2019 and all other reports filed by the Receiver in these receivership proceedings

[126] Whether the Receiver should have taken different action after the rain damage to the Hythe project, and whether the Receiver should have taken different action after thefts of equipment or tools from that project, are arguable issues.

[127] However, Mr. Klisowsky has not raised any issues or arguments that require further evidence or a trial.

[128] In response to Mr. Klisowsky's criticisms of the Receiver, counsel says that it is too late for Mr. Klisowsky to raise these arguments. The Receiver has been transparent throughout; Mr. Klisowsky has been represented throughout and has been present at most if not all of the court appearances. The allocations of assets and employees and payment of secured and preferred claims have been dealt with in the Receiver's various reports and on the court applications approving payments and transactions. Mr. Klisowsky has been silent throughout the proceedings and took no appeals from any of the orders made. Counsel argues that any suggestion that the Receiver has not acted in a commercially reasonable manner is without foundation.

[129] Additionally, counsel for the Receiver points out that no expert evidence has been put forward as to what should have been done regarding any of these issues to achieve commercial reasonableness.

[130] The Receiver cites ***Jaycap Financial Ltd v Snowdon Block Inc***, 2019 ABCA 47 on the subject of commercial reasonableness and a receiver's obligation to:

> … exercise such reasonable care, supervision and control of the debtor's property as an ordinary person would give to his or her own. A receiver's duty is to discharge the receiver's powers honestly and in good faith. A receiver's duty is that of a fiduciary to all interested stakeholders involving the debtor's assets, property and undertaking (at paragraph 28).

[131] The Receiver says that here, it satisfied those obligations and acted in a fully transparent manner having regard to its various reports and court applications.

[132] The Receiver cites ***Western Union Petro International Co Ltd v Anterra Energy Inc***, 2019 ABQB 165 and argues that the record before me is sufficient to enable me to make a fair and just determination of the issues without requiring more evidence, or a trial.

[133] Counsel also refers to the decision in ***Royal Bank of Canada v Melvax Properties Inc***, 2011 ABQB 167 where Veit J referred to the weight to be given to the business judgments of others involved in the matter. Here, counsel points to the support the receiver has from Nomads', Ladacor's and 236's largest creditors, Liberty Mutual and the Steenhof parties. The other large creditor, Alberta Finance, has taken no position.

[134] The value of the theft was not significant in the overall scheme of things, and the Receiver's actions following the rain damage were aimed towards having Hythe continue on with some aspects of the construction contract. The objective there was to recover the amounts owed to date, and be able to make valuable use of the containers that still remain in storage. While those efforts ultimately proved unsuccessful, and the benefit of hindsight gives rise to the efficacy of those actions, the Receiver's actions do not appear to be outside the scope of commercial reasonableness. Nor do they approach the gross negligence or willful misconduct level required to have the Receiver liable for any loss resulting from those actions.

[135] To the extent that the Receiver's actions have not otherwise been approved in previous orders, I am satisfied that relief should be granted to the Receiver

2. Approving the Receiver's final statement of receipts and disbursements for the period for May 18, 2018 to August 31, 2019 as set out in the Fourth Report

[136] With the exception of Mr. Klisowsky's concerns addressed above, no one challenged the appropriateness of the Receiver's final statement of receipts and disbursements for this period. Mr. Klisowsky took no objection to the time spent or the hourly rates, but objected to the completeness of the Receiver's work.

[137] I am satisfied that it is appropriate to approve these accounts, and do so (to the extent not already covered by Topolniski J's Order of September 13).

3. Approving the accounts, fees and disbursements of the Receiver and its independent legal counsel in connection with the completion of these receivership proceedings, including the costs of this application

[138] While I do not see any problem with the anticipated accounts, fees and disbursements in connection with the completion of the receivership proceedings, I think it is more appropriate to approve these accounts, fees and disbursements when they have been incurred. Hopefully they can be completed within the budgeted amounts.

4. Approving the proposed allocation of cash held by the Receiver for Ladacor and Nomads to 236, as set out in the Fourth Report

[139] I acknowledge that the Receiver's work in allocating assets and employees between Ladacor and Nomads may not have resulted in a perfect allocation. That is not because the Receiver's work was deficient or flawed. Rather, it was because of the corporate mess that existed at the time of the Receivership Order. The Receiver had to try to make sense of an undocumented and ill-conceived "takeover" of Nomads by Ladacor. The proposed method of allocation by Mr. Klisowsky is unworkable, especially as it is founded on the incorrect assumption that Nomads could assign its obligations to Ladacor in a manner that would be binding on its creditors.

[140] The reality is that any reallocation of assets would be moot. Putting more assets and liabilities into Ladacor would result in Nomads making a smaller contribution to paying off the BMO debt. That would simply increase the amount of 236's secured claim for contribution from Nomads. While it might leave fewer unsecured creditors for Nomads to have to deal with, the above analysis indicates that Nomads' unsecured creditors are unlikely to make any recovery at all.

[141] As such, my conclusion is that no creditor is prejudiced by the allocations that were made by the Receiver between Nomads and Ladacor.

[142] The Receiver has, in my view, correctly applied the applicable principles of subrogation and contribution, such that it is appropriate to allocate all of the remaining cash of Ladacor and Nomads to 236.

5. Approving the Receiver's proposal to assign the Debtors into bankruptcy in accordance with the Receivership Order

[143] What is left with the three debtor corporations is a paucity of assets and a mountain of claims against them. Only the Liberty Mutual claim involves all three corporations. Total claims (counting Liberty Mutual only once) exceed $7,000,000. None of the claims have been proven. There may be defences to some or many of the claims, and some of the claims may be excessive in amount.

[144] Getting to the bottom of all of this will be time consuming and very expensive. Litigation with Hythe has already commenced. Its result is uncertain. Success on that litigation would appear to be the only real chance of any collection for Nomads' unsecured creditors. The only effective way of dealing with the numerous claims is through a statutory process such as bankruptcy. While there are possible ways of dealing with claims in a receivership, no one other than Mr. Klisowsky is recommending that the receivership continue. The Receiver's recommendation is to use the bankruptcy process to deal with the few remaining assets and myriad of claims.

[145] I agree with the Receiver's recommendation and accordingly approve its proposal to assign the three debtor corporations into bankruptcy.

6. Approving the transfer of all funds and property held by or collected by the Receiver, net of costs required to complete the administration of these receivership proceedings, into the bankrupt estates of the Debtors

[146] Having approved the assignments into bankruptcy, it flows that any funds and property remaining after the administration of the receivership has been completed should be transferred into the respective bankruptcy proceedings.

7. Declaring that the Receiver has duly and properly discharged its duties, responsibilities and obligations as Receiver

[147] There is no valid objection to this relief being granted, to the date of this decision and insofar is the Receiver carries out the orders herein.

8. Discharging and releasing the Receiver from any and all further obligations as Receiver and any and all liability in respect of any act done by the Receiver in these receivership proceedings, and its conduct as Receiver pursuant to its appointment in accordance with the Receivership Order, or otherwise

[148] This order appears to be premature, as there is still work to be done to carry out the terms of this order. To date, this relief appears appropriate but this relief should be applied for after the Receiver has completed its work and not in advance.

9. Authorizing the Receiver to transfer the books and records of the Debtors to the bankruptcy trustee, subject to preserving such records as required by statute.

[149] Having approved the assignments into bankruptcy, this relief flows from that order and is granted.

Heard on the 26th day of November, 2019.
Dated at the City of Edmonton, Alberta this 19th day of December, 2019.

Robert A. Graesser
J.C.Q.B.A.

Appearances:

Andrew Wilkinson
Rose LLP
for Liberty Mutual Insurance Company

James Reid and Keith D. Marlowe
Blake, Cassels & Graydon LLP
for the Receiver

Shaun D. Wetmore
McCuaig Desrochers LLP
for the Steenhof entities

Norman D. Anderson
Anderson James McCall Barristers
for Donald Klisowsky

Corrigendum of the Reasons for Decision
of
The Honourable Mr. Justice Robert A. Graesser

Under Appearances, Dean Hitesman was removed and Andrew Wilkinson was added.

TAB 2

1985 CarswellOnt 729
Ontario Supreme Court, High Court of Justice

Brown v. Canadian Imperial Bank of Commerce

1985 CarswellOnt 729, 30 A.C.W.S. (2d) 468, 37 R.P.R. 128, 50 O.R. (2d) 420

BROWN v. CANADIAN IMPERIAL BANK OF COMMERCE et al.

Southey J.

Heard: March 4 and 5, 1985
Judgment: April 22, 1985
Docket: No. 12802/83

Counsel: *C.C. Mark, Q.C.* and *M.P. Thompson*, for plaintiff.
Kenneth Rosenberg, for defendant Canadian Imperial Bank of Commerce.
Stephen Bale, for defendants Constantine and Julie Amourgis and Strawrene Ltd.

Subject: Property; Corporate and Commercial

APPLICATION for order to marshall funds.

***Southey J.*:**

1 The plaintiff, as trustee, was mortgagee under a third mortgage given by the defendant Julie Amourgis against a property at 24 Dunloe Road in Toronto. The result of proceedings brought by the plaintiff to enforce that mortgage was the sale of the property to one Stieglitz for $435,000. The full amount of the purchase price was used to pay the costs of the sale and the claims of first and second mortgagees and execution creditors whose claims had priority over that of the plaintiff. The second mortgage was in favour of the defendant Canadian Imperial Bank of Commerce; $174,937.50 was paid to discharge it. The bank had claims against two other funds for satisfaction of the indebtedness for which the second mortgage against 24 Dunloe was security. The issue in the case is whether the plaintiff can invoke the equitable doctrine of marshalling to require the bank to transfer to the plaintiff its rights against the two other funds so that the plaintiff can recoup therefrom the said sum of $174,937.50.

2 The bank took no position on the issue. Counsel agreed at the opening of trial that the costs of the bank should be fixed at $500, and that that sum should be paid first out of any fund to which the plaintiff was found to have access. Counsel for the bank was then excused.

3 The doctrine of marshalling is stated thus in 16 Hals. (4th ed.,) p. 962:

> Where one claimant, A, has two funds, X and Y, to which he can resort for satisfaction of his claim, whether legal or equitable, and another claimant, B, can resort to only one of these funds, Y, equity interposes so as to secure that A shall not by resorting to Y disappoint B. Consequently, if the matter is under the court's control, A will be required in the first place to satisfy himself out of X, and only to resort to Y in case of deficiency; and if A has already been paid out of Y, it will allow B to stand in his place as against X. This is known as the doctrine of marshalling, and is adopted in order to prevent one claimant depriving another claimant of his security. The doctrine is applied chiefly in regard to securities and to the administration of assets.

4 The authors go on in the next paragraph to state 3 conditions that are generally necessary for the application of the doctrine. The first of these is relevant to this case, as is a condition respecting third persons. The text reads as follows on pp. 962-963:

> Generally, three conditions must be satisfied in order that the doctrine of marshalling may be applied as regards claims by creditors. First, the claims must be against a single debtor. If one creditor has a claim against C and D, and another creditor has a claim against D only, the latter creditor cannot require the former to resort to C unless the liability is such that D could throw the primary liability on C, for example where C and D are principal and surety. ..... The doctrine will not be applied to the prejudice of third persons, even if they are volunteers; .....

The Facts

5 It is not clear from the authorities whether the doctrine of marshalling applies in this case, and I must describe in some detail the mortgages given on two properties, 24 Dunloe Road and 63 Shuter Street in Toronto, and the origin of two funds from which the bank claimed the right to payment of the debts of the defendant Strawrene Limited. The payment to the bank of the said sum of $174,937.50 out of the proceeds of the sale of 24 Dunloe was in satisfaction of the indebtedness of Strawrene to the bank, which had been guaranteed by both of the defendants Amourgis. The two other funds resulted from orders of Houlden J.A. dated November 26, 1982, and of John Holland J. dated April 29, 1983. The former contained about $77,250, with additional interest; the latter now stands at about $103,000, with further amounts totalling about $50,000 to be paid into it.

Title to 24 Dunloe Road

6 Julie Amourgis acquired title to 24 Dunloe as trustee on September 14, 1973. At the time of the sale to Stieglitz in November 1983, the property was subject to the following:

> (1) a first mortgage to Harold Kay, as trustee, on which $179,577.42 was owing at the date of closing of the Stieglitz sale.
>
> (2) A second mortgage to the defendant bank which was discharged on the closing of the Stieglitz sale by payment of $174,937.50. This mortgage was collateral security for the liability of Julie Amourgis on a guarantee of the indebtedness of Strawrene to the bank. Such indebtedness was paid in full by the said sum of $174,937.50.
>
> (3) A third mortgage to the plaintiff as trustee, for $350,000, which was collateral security for the 3rd, 4th and 5th mortgages given by Strawrene on 63 Shuter to Nugate Holdings, May Ekstein, and Rose and Bernard Fluxgold. Those mortgages are referred to in paras. (iii), (iv) and (v) below. When this 3rd mortgage on 24 Dunloe fell into arrears, the plaintiff commenced foreclosure proceedings early in 1982. Julie and Constantine Amourgis defended the action, and on December 14, 1982, Master Sandler gave judgment against them for $351,132.05, being the amount owing on the mortgage with costs, and directed that the property be sold with the approbation of the Master at Toronto unless that sum was paid into court by June 14, 1983. The sum was not paid, and the sale to Stieglitz for $435,000 resulted in November, 1983.

Title to 63 Shuter Street

7 Strawrene Limited, in Trust, acquired 63 Shuter Street in May, 1978. The following mortgages were outstanding against the property, in the following priority, as of January 1982:

> (i) Mortgage for $450,000 in favour of Harold Kay as trustee, dated 12th March, 1979. Constantine and Julie Amourgis joined in this mortgage as covenantors and principal debtors.
>
> (ii) Mortgage for $250,000 in favour of the bank, dated March 13, 1979.
>
> (iii) Mortgage for $70,000 in favour of Nugate Holdings Limited dated 9th May, 1978. Constantine and Julie Amourgis joined in this mortgage as covenantors and principal debtors.
>
> (iv) Mortgage for $50,000 in favour of May Ekstein, dated 7th July, 1981.
>
> (v) Mortgage for $150,000 in favour of Rose and Bernard Fluxgold, dated 7th July, 1981.

Fund resulting from order of Houlden J.A., November 26, 1982

8 Harold Kay proceeded under the power of sale contained in the mortgage to him of 63 Shuter Street. By deed dated January 15, 1982, he conveyed the property to Ming Sun Holdings Inc. Strawrene brought an action to set aside the conveyance on the ground that the power of sale was improperly exercised, and registered a lis pendens against the property. Montgomery J. dismissed the action and vacated the lis pendens by order dated October 19, 1982. The order dismissing the action was set aside on appeal, but not the order vacating the lis pendens. Instead, by order of Houlden J.A. dated November 26, 1982, Messrs. Hall, Baker, Goodman, the then solicitors for Harold Kay, as Trustee, were directed to continue to hold in trust in interest bearing certificates of deposit the surplus available for distribution to subsequent encumbrancers upon the sale under the power of sale, and that the surplus should not be distributed except upon a further order of the Court made upon notice to all subsequent encumbrancers. Strawrene has not proceeded with the action. The said surplus is presently being held in trust by the law firm of Saunders and Spring, which is the firm with which Mr. Harold Spring is now associated. He was associated with Hall, Baker, Goodman at the time of the order of Houlden J.A. The fund now amounts to about $77,250 together with accrued interest.

9 The indebtedness of Strawrene to the bank, for which the second mortgage on 63 Shuter was security, has been satisfied by payment of the sum of $174,937.50 out of the proceeds of the sale of 24 Dunloe. That payment resulted in the discharge of the second mortgage on 24 Dunloe. The plaintiff claims in this action under the doctrine of marshalling the right to have transferred to him the bank's rights against the surplus held by Harold Spring's firm as a subsequent encumbrancer under its second mortgage on 63 Shuter Street. Unless Strawrene is successful in its action to set aside the sale of 63 Shuter Street under the first mortgage, the plaintiff, if entitled to stand in the position of the bank, would be entitled to the whole of the said surplus, if marshalling is permitted.

Fund resulting from order of John Holland J., April 29, 1983.

10 By indenture dated December 15, 1978, the bank received an assignment from Strawrene of a chattel mortgage that had been given by a numbered company, 383782 Ontario Limited, to Strawrene on 13 June, 1978, and which was guaranteed by Edward A. Lai. The assignment was collateral security for the indebtedness of Strawrene to the bank. Strawrene and the bank sued Lai on the guarantee, and the action was settled by minutes of settlement dated November 9, 1982, in which Lai agreed to pay to or at the direction of the plaintiffs the sum of $145,616.25 in a series of payments over a period of time. Because of a dispute between the bank and Strawrene as to the disposition of payments from Lai, John Holland J. made an order on April 29, 1983, that all payments under the settlement be made into court. The amount paid into court as of December 13, 1984, with interest, was $103,512.21. A further sum of about $50,000 remains to be paid into court under the minutes of settlement.

Application of the doctrine of marshalling

11 The result of the foregoing is that the bank, when it received payment from the plaintiff of the sum of $174,937.50 in satisfaction of the indebtedness of Strawrene to the bank and of the indebtedness of Julie Amourgis under the second mortgage on 24 Dunloe, had, in addition to that second mortgage, two other funds from which it could claim payment of the indebtedness of Strawrene. The plaintiff, on the other hand, had only the security of his third mortgage on 24 Dunloe in respect of his claims against Julie Amourgis. The funds arose out of the debts of Strawrene, while the second mortgage on 24 Dunloe was a liability of Julie Amourgis, so that the claims of the creditors, the bank and the plaintiff, were not against a single debtor. But the second mortgage on 24 Dunloe was given by Julie Amourgis as collateral security for her guarantee of the debt of Strawrene to the bank. To use the words in the passage from Halsbury quoted above, Julie Amourgis was the surety and Strawrene was the principal (i.e. principal debtor), so that she could throw the primary liability on Strawrene. The exception to the general rule that there must be a single debtor for marshalling was therefore fulfilled.

12 I think Mr. Mark was right in his submission that Quay v. Sculthorpe (1869), 16 Gr. 449 (Ont. C.A.), is authority for applying the docrine of marshalling in this case, even though there is no common debtor. Van Koughnet C., with whom Mowat V.C. concurred, quoted at p. 456 and applied the following passage from the decision of Bell J., delivering the judgment of the Supreme Court of Pennsylvania in Neff v. Miller, 8 Barr 347:

> Here is a surety, whose money has been applied in payment of the debt of his principal, to the exclusion of his own proper creditors. That he would be entitled to come in, by way of substitution, upon the estate of the principal, is every-day equity; and I think it equally clear that his creditor, who has suffered by the appropriation of a fund which otherwise would have been available for the discharge of his claim, may well ask to stand upon this equity, to the extent of the deprivation to which he has been subjected.

13 The decision of Haines J. in G. Ruso Const. Ltd. v. Laviola (1976), 27 Chitty's L.J. 136 (Ont. H.C.), on which Mr. Bale relied, is clearly distinguishable, in my view, because there the debtor whose property was taken had no right to require the other debtor to pay in the first instance.

14 Mr. Bale further submitted that there should be no marshalling in this case, because the doubly secured creditor (the bank) had not taken proceedings to enforce its mortgage against 24 Dunloe. Those proceedings were brought by the singly secured creditor (the plaintiff), who then paid off the bank in order to obtain a discharge of the second mortgage against 24 Dunloe, when he was under no obligation to do so. Mr. Bale argued that the plaintiff could have sold the property to Stieglitz without paying off the second mortgage, and that, in fact, it was Steiglitz, not the plaintiff, who paid off the bank's indebtedness.

15 Although the doctrine of marshalling is usually relied upon in proceedings brought by the doubly secured creditor, I do not think it should be limited to such cases. There was evidence in the case at Bar that Julie Amourgis was in breach of her obligation under the third mortgage to pay the taxes on 24 Dunloe. I do not think the singly secured creditor should be required to stand by and watch his security deteriorate. Nor do I think the plaintiff had any real choice but to pay off the second mortgage to the bank. It would be most unlikely that the purchaser, Stieglitz, would have been willing to assume it, in view of the fact that it was a collateral mortgage. Had he done so, he would have become involved in the dealings between the bank and its debtor, Strawrene.

16 The doctrine of marshalling is intended to achieve fairness. In the absence of any authority to the contrary, I can see no reason why marshalling should be denied in this case simply because the proceedings were brought by the singly secured creditor, and he paid off the doubly secured creditor out of a practical necessity to do so, but without any legal obligation.

17 There is only one other point raised by Mr. Bale that I think should be mentioned, but it provides a complete defence to the claim for marshalling in respect of the fund created by the order of Houlden J.A. It is the equitable rule that marshalling will not be applied to the prejudice of third persons.

18 If the plaintiff is not permitted to be subrogated to the bank's rights against the surplus realized on the sale of 63 Shuter Street by power of sale under the first mortgage, then that surplus would be paid successively to the 3rd, 4th and 5th mortgagees. Most of it would be used to satisfy the 3rd mortgage for $70,000 to Nugate Holdings Limited. Although I was told by counsel that the plaintiff holds the 3rd mortgage on 24 Dunloe as trustee for the mortgagees under the 3rd, 4th and 5th mortgages on 63 Shuter, there was no evidence that the benefits to them of marshalling would be identical with the benefits they would enjoy from having the surplus applied to one or more of their mortgages. If such benefits were not identical, marshalling, in respect of such surplus, would have the effect in this case of prejudicing the rights of third parties.

19 I do not think it is any answer to this last point to say, as did Mr. Thompson, that the 3rd, 4th and 5th mortgagees would not be prejudiced by marshalling, because they never expected to be given priority over the claim of the bank against 63 Shuter Street under the 2nd mortgage. As it turned out, if marshalling is not permitted, they would be permitted to share the surplus as though they had priority over the bank's 2nd mortgage. It has not been shown that marshalling would not prejudice the rights of some of the 3rd, 4th and 5th mortgagees.

20 There do not appear to be any third parties whose rights would or might be prejudiced by marshalling in respect of the funds accumulated in court under the order of John Holland J. The action will succeed in respect of that fund, but not in respect of the fund held pursuant to the order of Houlden J.A.

21 There will be an order directing that the sum of $500 be paid forthwith to the bank in respect of its costs in this action out of the moneys paid into court pursuant to the order of John Holland J. dated April 29, 1983. The order will further direct that the bank transfer to the plaintiff its interest in the balance of the moneys paid into court pursuant to the said order of John Holland J., and that the plaintiff be entitled to realize the sum of $174,937.50 together with interest on that amount from the date of the order at the rate presently being paid for post judgment interest. The defendants Constantine Amourgis, Julie Amourgis and Strawrene Limited will pay to the plaintiff his costs of the action after taxation thereof, and the plaintiff may realize the amount of those costs out of the bank's interest in the funds in court pursuant to the said order of John Holland J., if the funds are sufficient for that purpose.

Order accordingly.

TAB 3

Court of Queen's Bench of Alberta

Citation: Condominium Corporation No. 082 6970 v 1117398 Alberta Ltd., 2012 ABQB 233

Date: 20120411
Docket: 1003 15475
Registry: Edmonton

Between:

Condominium Corporation No. 082 6970

Plaintiff

- and -

1117398 Alberta Ltd., Second Wind Enterprises Inc., Everest Builders Ltd., Becker Elzein & Associates Ltd., Omar Elzein, R. Saunder Architects Ltd., Raj Saunder, W. Jappsen Architect Ltd., Werner Japsen, Apem Engineering Ltd., S.K. Metha, the National Home Warranty Programs Ltd. Carrying on Business As National Home Warranty Program and David Ross Ives, Everest Builders Ltd.

Defendants

Reasons for Judgment
of the
Honourable Mr. Justice Donald Lee

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[1] Condominium Corporation No. 0826970 (the "Condominium Corporation") is the Respondent in the present appeal of 1117398 Alberta Ltd. ("111") and 1209900 Alberta Ltd. ("120") who seek to appeal the decision of the Master who on January 13, 2012, granted an order allowing the attachment order registered against the condominium units owned by 111 in Condominium Plan 082 6970 to be discharged upon closing of an Offer to Purchase and registered the attachment order to be registered against units owned by 120 in Condominium Plan 091 0178.

Background Facts and Procedural History

[2] On July 6, 2011, an attachment order was granted in favour of the Condominium Corporation on a without notice basis.

[3] The Condominium Corporation then brought an application on notice to 111 to continue the attachment order. The application was heard on July 21, 2011 and was adjourned to allow questioning on the affidavit of David Ross Ives.

[4] On August 26, 2011, an application was heard to continue the attachment order and Master Breitkreuz granted the extension as he was of the opinion that the matter had already been decided.

[5] 111 brought an application to set aside the attachment order and address the issue as to whether the equitable doctrine of marshalling was appropriate in relation to the proceeds from the foreclosure by the first mortgagee, Lanyard Holdings Inc. ("Lanyard"), on the units owned by 111.

[6] A special application was heard before the Master on November 29, 2011, where written submissions were submitted. The Master was again of the opinion that the validity of the attachment order was already decided and adjourned the marshalling issues *sine die*.

[7] The Condominium Corporation learned that the units owned by 111 were sold with a closing date of January 13, 2012. There was evidence that the first mortgagee, Lanyard also held security over a condominium project in Okotoks owned by 120, and the Condominium Corporation sought a direction that the equitable doctrine of marshalling be applied to those units. The January 13, 2012, Order of the Master directs that the attachment order be registered on those Okotoks units owned by 120.

Issues

[8] The present appeal raises the following issue:

(a) Has there been an appropriate direction of "marshalling" with respect to the proceeds from the Lanyard foreclosure by the attachment orders issued herein?

Analysis

[9] The Appellants submit that the Master erred in concluding that "marshalling" applied to th Okotoks units owned by 120, after having previously granted an already extraordinary prejudgment attachment Order against 111 in another Condominium Plan.

[10] Marshalling is a doctrine rooted in a longstanding principle of equity which essentially provides that a "senior" creditor, or a creditor with access to multiple funds to satisfy its debt, should marshal its enforcement in such a way as to cause as little harm as possible to a "junior" creditor, or a creditor with access to only one of the same funds. Equity directs that the senior creditor look first to those funds that the junior creditor does not have access to, in order to avoid needlessly wiping out the junior creditor's security.

[11] Marshalling requires that there be more than one fund to which the senior creditor has recourse, and these funds either belong to the same debtor or relate to the same debt. Marshalling is not available where prejudice may be done to other junior creditors, to third parties, or to the senior creditor's paramount right to recover its debt.

[12] 111 submits that as a matter of law, marshalling is not available to creditors other than mortgagees, and is not available where there is more than one debtor in respect of the same debt.

[13] 111 also submits that marshalling in the present circumstances would cause "prejudice".

[14] A definition of marshalling is found in the decisions of Prothonotary Hargrave in ***Scott Steel Ltd. v Alarissa (The)***, [1996] 2 F.C. 883, 1996 CarswellNat 519 and in ***Bank of Scotland v Nel (The)***, [1998] 4 F.C. 388, 1998 CarswellNat 1409 In both decisions, Hargrave P. cites the definition from *Tetley on Maritime Liens and Claims, Business Law Communications Ltd.*, 2nd edition, 1998 at para. 100:–

> Marshalling is the equitable process, whereby the Marshall or the court orders a creditor who has a secured right on more than one res or more than one fund belonging to the debtor, or security from two or more debtors for the same debt, to exercise his right on the security in a manner which will be in the best interests of all creditors. The Marshal or court must also take into consideration the best interests of third parties and even of the debtor.

[15] The doctrine of marshalling was also discussed in ***First Investors Corp. v Veeradon Developments Ltd.*** (1988), 84 A.R. 364, 1988 CarswellAlta 9 (C.A.) ("***Veeradon***"). ***Veeradon*** is a 1988 decision by three different Justices of Appeal, who concurred in the result but not in their reasons for judgment. 111 relies on a number of statements from ***Veeradon***.

[16] ***Veeradon*** concerned a senior creditor, First Investors, who held a first mortgage over properties described as "A" and "B" in the Reasons for Judgment. A junior creditor, Butler, held a second mortgage on property "B" and no security on property "A". This was described by Beizil J.A. in his reasons as "the classic textbook foundation for marshalling between mortgagees."

[17] In ***Veeradon***, Butler had sought to convince the Court that First Investors should have to accept a higher, appraised value for the properties, as opposed to an apparent lower actual value. Butler then argued that the Court could not simply order the properties for sale, but under the

doctrine of marshalling First Investors had to purchase property “A” at the higher appraised value (referred to in the Reasons as a “Rice” order), and then allow Butler to redeem the shortfall in the mortgage amount to First Investors, at which point Butler would receive Title to property “B” free and clear.

[18] 111 offers ***Veeradon*** as authority for the proposition that “nothing [may] interfere with the primary mortgagee’s choice to enforce against either estate”, and that marshalling would cause “interference with Lanyard’s choice of which property to enforce against.”

[19] In ***Veeradon***, BeIzil J.A. held that the principle of marshalling could not have effect because the order sought by Butler would force First Investors to accept a remedy it had not sought: namely the “Rice” order. Harradence J.A. and Hetherington J.A. both concurred with this point as this offended the “paramount right” of the first mortgagee to realize its securities and pursue its remedies “as it pleases.”

[20] It is clear from Belzil J.A.’s reasons that the quote from Orde J. in ***Ernest Brothers Co. v Canada Permanent Mortgage Corporation*** 192047 O.L.R. 362 affirmed 48 O.L.R. 407, 57 D.L.R. 500 (C.A.) was presented in ***Veeradon*** in order to explore the definition of what “satisfaction” the first mortgagee was entitled to, in exercising its “paramount right’. Adopting the definition of “satisfaction” by Laycraft J.A. (as he then was) in ***Can. Permanent Trust Co. v King Art Dev. Ltd.*** (1984), 54A.R. 172 (CA.), Belzil J.A. goes on to point out that the “paramount right” of the first mortgagee was to be repaid in money.

[21] The term “as it pleases”, relating to this “paramount right” of the first mortgagee, refers to <u>how</u> the right is to be enforced, not against whom, as Belzil J.A. explained at para. 16:–

> The important qualification to marshalling which appears in the authorities cited, and was apparently overlooked below, is that <u>its application is not to prejudice the “paramount” right of the first mortgagee to realize its securities and pursue its remedies as it pleases. Its primary right is to receive and enforce payment of its debt in money</u>. It is its election, and its alone, to seek a ‘Rice” order upon terms satisfactory to it, to take the land by final foreclosure or pursue other courses of action such as simply leaving its security in force.
>
> [emphasis added]

[22] 111 says that it is a qualification of the doctrine of marshalling that a primary mortgagee may enforce against any fund “as it pleases”, without regard for subsequent encumbrancers. However, Belzil J.A.’s reasons state that a subsequent encumbrancer may not apply the doctrine of marshalling to force the first encumbrancer to accept a method of realization that it did not seek.

[23] Belzil J.A. proceeded to explain at paras. 17 and 18 the situation in which marshalling would be appropriate:

> Equity will not allow the first mortgage to needlessly wipe out the second mortgage by paying itself firstly out of funds derived from the properties covered by both mortgages. <u>The first mortgagee must leave as much as possible for the second mortgagee out of funds derived from properties covered also by the second mortgage. In modern practice, the funds derived from sale will be under control of the court, and the court will marshall by simply directing payment accordingly.</u>
>
> When marshalling applies, there is really no contest between the first and second mortgagees. The underlying issue is between the second mortgagee and the mortgagor and its assigns... <u>The sole interest of the first mortgagee is in receiving the money due to it, and marshalling will not affect that interest. It is immaterial to the first mortgagee whether it gets its money from one fund or the other.</u> Equity assumes that any reasonable first mortgagee would want to act honourably, and not capriciously, by leaving as much as possible for the second mortgagee....

[emphasis added]

Marshalling Is Available Where There Is More than One Debtor, and to Creditors Other than Mortgagees

[24] 111 also relies on the British Columbia decision of ***Bancorp Investments (Fund 2) Ltd. v Bhugra Holdings Ltd.***, 2006 BCSC 893 ["***Bancorp***"], in arguing both:

a) that marshalling may not be applied to a situation where (as here) there are two debtors granting security for the same debt; and

b) that marshalling is not available to "creditors with unproven claims" or those "whose interest in land arises by statutory charge."

[25] 111 cites and quotes from the two B.C. cases underpinning the reasoning in ***Bancorp***: ***Hirsh v 467145 B.C. Ltd.***, [1996] B.C.J. No. 1901 (S.C.) ["***Hirsh***"]; and ***Goodman v Parkhurst***, [1980] 6W.W.R. 601 (B.C.S.C.) ["***Goodman***"]. None of ***Bancorp***, ***Hirsh***, or ***Goodman*** is binding on this Court.

[26] In ***Narduzzi v Richardson***, 2009 BCSC 588 the B.C. Supreme Court dealt with an application for marshalling brought by a Builders Lien claimant. The owner of the property objected that the claimant was not entitled to marshalling, relying on ***Bancorp*** (there referred to as "***Bhugra***"), ***Hirsh***, and ***Goodman***. Burnyeat J. reviewed those cases and their reasoning and found at paras. 20, 23 and 24:–

> Regarding the decision in ***Goodman***, *supra*, it should be noted that no explanation is given by Hutcheon, J., as he then was, as to why he had "many doubts' whether

> the doctrine of marshalling applies to a person who has a charge against land created by statute. It should also be noted that the application was dismissed because the second property which the applicant sought to marshal was in Ontario, and there was insufficient evidence on the connection between the parties to confer jurisdiction on the B.C. Court. Accordingly, the decision in Goodman, supra, can be distinguished on the basis that the jurisdiction of the Court was not established.
>
> Regarding the decision in ***Hirsch***, *supra*, it should be noted that Master Bishop relied on the decision in ***Goodman***, *supra*, and followed that decision on the basis that the lienholders merely had claims for an undetermined amount of money on the property, whereas a mortgagee was a secured creditor for monies actually advanced from time to time on its mortgage. In addition to being satisfied that the decision in ***Hirsch***, *supra*, is not binding on me, I am also satisfied that the Learned Master was in error in assuming that a lienholder is not in the same position as a mortgagee with respect to the doctrine of marshalling.
>
> Regarding the decision in ***Bhugra***, *supra*, it should be noted that there was a finding that apportionment rather than marshalling was applicable and that the doctrine of marshalling did not apply. In that regard, apportionment can be described as a situation where an owner mortgages two properties in favour of the same first mortgagee, but then mortgages the first property to "8" and the second property to "C". In that situation, the doctrine of "marshalling by apportionment" applies as equity interposes to provide that the claim of the first claimant is borne by two funds rateably: *Halsbuy's* (4th ed) Vol. 16, p. 785, at para. 876. The decision in ***Bhugra***, *supra*, was that marshalling by apportionment did not apply as there were two properties owned by separate parties. Accordingly, the statements regarding whether marshalling or marshalling by apportionment was available to a lien holder were obiter dicta.
>
> [Emphasis added]

[27] In ***Narduzzi***, Burnyeat J. concluded that marshalling was available to the lien holder.

[28] ***Narduzzi*** was followed by this Court in ***Gerrow v Dorais***, 2010 ABQB 560. In ***Gerrow***, Manderscheid J. considered the reasoning in ***Veeradon***, ***Bancorp***, and ***Narduzzi*** in granting judgment, directing marshalling with apportionment. He found (citing ***Narduzzi***) at para. 27 that "[t]he doctrine of marshalling is not applied only to mortgagees, and accordingly, I know of no reason why the holder of a builders' lien cannot have resort to the doctrine of marshalling".

[29] It is of note that ***Gerrow*** adopts and applies the reasoning of Laskin J. (as he then was) in ***Victor Investment Corp. Ltd. et at v Fidelity Trust Co.***, [1975] 1 SCR 251, 41 D.L.R. (3d) 65 to the effect that marshalling by apportionment arises in relation to two properties held in separate hands, but subject to one mortgage debt covering both of them. The Applicant notes that

Bancorp distinguished these comments by Justice Laskin as being obiter dicta, however, Laskin, J.'s reasons have now been adopted as the *ratio decidendi* in ***Gerrow***.

[30] Both ***Gerrow*** and ***Victor*** follow the principle of law and equity discussed and applied in ***Brown v Canadian Imperial Bank of Commerce***, (1985), 50 O.R. (3d) 420 (H.C.J.) in which Southey J. found 'that ***Quay v Sculthorpe*** (1869), 16 Gr. 449 [a decision of the Upper Canada Court of Chancery, also reported at [1869] O.J. No. 246 [QL]] is authority for applying the doctrine of marshalling, even though there is no common debtor." Hargrave P. in both ***Nel*** and ***Alarissa***, *supra*, follows the same principle.

[31] 111 further submits that Prothonotary Hargrave in ***Nel*** concluded that Canadian authorities limit marshalling relief to those with "in rem" interests, based on the case of ***Williamson v Loonstra***, (1973), 34 D.L.R. (3d) 275 (B.C.S.C.).

[32] ***Williamson v Loonstra***, and a number of other cases, had been advanced in ***Nel*** by the Bank of Scotland in opposition to the application of marshalling. Prothonotary Hargrave reviewed the authorities and the legal principles and declined to follow the reasoning in the cases advanced by the Bank of Scotland, stating at paras. 20 and 21:–

> This present dispute over the right to marshal is an issue on which current precedent ought not to be followed blindly, particularly given the law surrounding the equitable roots of marshalling. However the cases cited on behalf of the Sank of Scotland can also be dealt with in another way, by limiting them to their facts.
>
> The ***Loonstra*** case (*supra*) may be distinguished as the interest of the creditors, in that instance, through the mortgagor, that is, a pure in personam claim. In the present instance the creditors have an in *rem* interest. This rationalization does no violence to the original concept of marshalling, which clearly extended to contractual creditors, yet does not disturb either ***Loonstra*** or ***Breadman Inc., Re***, which is based on ***Loonstra***.

[33] It is of note that "the creditors" referred to in ***Nel*** included lien claimants, as did the creditors in ***Narduzzi***, in which Burnyeat J. found the ***Loonstra*** case to be outdated and unhelpful, on the basis that it had been decided before amendments had been made to legislation respecting the registration of judgments against property.

Does Marshalling Cause "Prejudice" in the Present Matter

[34] 111 submits that third parties would be prejudiced by marshalling in this case, although the only "third parties" referred to by the Applicant are ***Lanyard***, 120, and 111.

[35] I conclude that there is no prejudice in applying the doctrine of marshalling with respect to the security held by Lanyard. Lanyard's "sole interest' is to receive the money due to it under

the Mortgage. It is immaterial to Lanyard which fund it looks to in order to do so. Equity dictates that Lanyard "must leave as much as possible for the second mortgagee out of funds derived from properties covered also by the second mortgage", so as to avoid needlessly wiping out of the second mortgagee's security.

[36] The Condominium Corporation does not ask for an order compelling Lanyard to enforce its security in any particular way, or at all. The Plaintiff has simply asked for, and been granted, an attachment order protecting its security against Title to the lands at issue, and wishes only for the Court marshal the prior securities in such a way that their enforcement will not "needlessly wipe out" that attachment order.

[37] 111 submits that it and 120 are 'third parties" who would be "prejudiced" by marshalling. 120 and 111 are the owners of Sheep Creek and Station 33rd, respectively. They are both debtors to Lanyard, and both stand in the same place as did the two owners before Manderscheid J. in ***Gerrow***, Laskin J. (as he then was) in ***Victor***, and Southey J. in ***Brown***.

[38] That the doctrine of marshalling is applied to require a first encumbrancer to realize first against one owner before the other, cannot be prejudical to the owners, or else the doctrine would be rendered meaningless. The "prejudice" referred to in ***Veeradon*** is explained by Belzil J.A., quoting from *Sneil's Principles of Equity*, 28th ed. (1982), p. 416:

> In the above example, B's right to marshal will be enforced not only against the original mortgagor but also against all persons claiming through him as volunteers, as where the mortgagor dies and Blackacre and Whiteacre pass to different persons. But it is not allowed to prejudice purchasers or mortgagees of one of the estates. Thus if in the above example the mortgagor had created another mortgage of Whiteacre in favour of C, B would have no equity to throw the whole of A's mortgage on Whiteacre, and so destroy C's security.
>
> [emphasis added]

[39] No such similar "prejudice" to party "C" exists in this case.

[40] 111 submits that there is prejudice against 120 or 111 as against each other, however there is no evidence or explanation for why 120 and 111 would have security rights against one another, or would be subsequent claimants against the Titles held by one another. Nor is there any evidence or explanation advanced about a potential breach of contract between 111 and 120.

[41] The fact that Lanyard enforces against Sheep Creek first and against Station 33rd second, so as to avoid extinguishing the Plaintiff's security on Station 33rd, is not prejudicial to the Appellants. "Prejudice" does not mean the loss of an opportunity to defeat the claim of a creditor by taking advantage of the actions of another creditor.

Conclusion

[42] Marshalling as a concept means that: if a senior creditor has recourse to two funds, “A” and “B”, for satisfaction of its debt, and a junior creditor ranking below has recourse to only fund “B”, then equity directs that the senior creditor recover first from fund “A” as far as possible, so as to avoid needlessly extinguishing the junior creditor’s recourse to fund “B”.

[43] Marshalling applies where the funds belong to the same debtor, or to two or more debtors with respect to the same debt.

[44] Marshalling will not allow prejudice to another junior creditor, such as where there is a third creditor with recourse only to fund “A”. Nor will marshalling allow prejudice to the senior creditor’s “paramount right” to be repaid in accordance with its debt agreement. However, the fact that marshalling requires the senior creditor to look to one fund versus the other is not prejudice: its only interest is in being repaid and it is immaterial which fund it is repaid from.

[45] In this situation, and absent demonstrated prejudice, equity dictates that marshalling should apply for the protection of the Condominium Corporation, requiring Lanyard to satisfy itself first from the fund available to it but not to the Condominium Corporation (Sheep Creek), so as to avoid needlessly extinguishing the Plaintiff’s security over the other fund (Station 33).

[46] In the result, I dismiss the appeal of 111 and 120, and uphold the Attachment Orders of the Master.

Heard on the 4th day of April, 2012.
Dated at the City of Edmonton, Alberta this 11th day of April, 2012.

Donald Lee
J.C.Q.B.A.

Appearances:

Jerritt R. Pawylk
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TAB 4

1988 CarswellAlta 9
Alberta Court of Appeal

First Investors Corp. v. Veeradon Developments Ltd.

1988 CarswellAlta 9, [1988] 3 W.W.R. 254, 47 D.L.R. (4th) 446, 47 R.P.R. 293, 57 Alta. L.R. (2d) 104, 84 A.R. 364, 9 A.C.W.S. (3d) 111

FIRST INVESTORS CORPORATION LTD. v. VEERADON DEVELOPMENTS LTD. et al.

Harradence, Belzil and Hetherington JJ.A.

Judgment: February 5, 1988
Docket: Edmonton Appeal No. 8603-0300-AC

Counsel: *R.M. Curtis*, for appellants.
D.F. Pawlowski, for respondent.

Subject: Property; Corporate and Commercial

Appeal and Cross-Appeal from judgment of Berger J. in foreclosure proceedings, 43 Alta. L.R. (2d) 262, [1986] 3 W.W.R. 358, 39 R.P.R. 1, 71 A.R. 82, varying an appeal from a master's order, 40 Alta. L.R. (2d) 333, [1986] 1 W.W.R. 469, 65 A.R. 135.

***Harradence J.A.*:**

1 While I concur in the disposition of this appeal [from judgment reported at 43 Alta. L.R. (2d) 262, [1986] 3 W.W.R. 358, 39 R.P.R. 1, 71 A.R. 82, varying 40 Alta. L.R. (2d) 333, [1986] 1 W.W.R. 469, 65 A.R. 135] as proposed by my brother Belzil, in my view there is a serious question as to whether the doctrine of marshalling is applicable in this province to any mortgage or encumbrance involving real property because of the Land Titles Act and the Law of Property Act currently in force. In any event, it is unnecessary for me to determine that question for I am of the view that even if the doctrine of marshalling were applicable, it cannot be applied as proposed in this case for two reasons. First, it is settled law that a mortgagee subjected to marshalling should never have its security put at risk by that process. Inasmuch as the proposed marshalling here forces the first mortgagee to accept an appraisal of the value of the land which ordinarily can be relied upon but which might particularly in the circumstances of this case be wrong, its security is at risk if marshalling were applied. Secondly, the doctrine of marshalling does not confer upon the court the power to compel a first mortgagee to accept a particular remedy against its wishes. Consequently, the court cannot compel the first mortgagee to purchase any or all of the property to satisfy its debt as proposed by the second mortgagee.

***Belzil J.A.*:**

2 The issue in this appeal is whether the court has the power, in foreclosure proceedings, to compel a first mortgagee to take at their appraised value two of three properties covered by its mortgage security in part satisfaction of its mortgage debt where a court-directed sale has been abortive and a second mortgagee seeks the protection of marshalling. Both the learned master in chambers [40 Alta. L.R. (2d) 333, [1986] 1 W.W.R. 469, 65 A.R. 135] and the learned justice of Queen's Bench to whom appeal was taken [43 Alta. L.R. (2d) 262, [1986] 3 W.W.R. 358, 39 R.P.R. 1, 71 A.R. 82] held that they had such power and ordered accordingly. In my view, and with all respect to them, the court has no such power and the orders made were in error.

3 Stripped of irrelevant material, the facts may be summarized as follows: after realizing part of its mortgage debt by the sale of one property, First Investors still held a first mortgage on three other properties, the first two of which I will refer to as property A and the other as property B. Butler held a second mortgage on property B only. This was the classic textbook foundation for marshalling between mortgagees. In foreclosure proceedings by First Investors against the mortgagor, the master granted the usual order nisi/order for sale fixing the balance owing and directing that the lands be offered for sale by advertising

at listing prices based on appraisals filed which if realized would have been sufficient to satisfy the first and second mortgages. The total "forced sale on terms" value shown for property A was $206,500, that for property B $189,000. Properties A and B did not attract offers at the listing prices, the highest offer received ($240,000) being lower than the balance owing to the first mortgagee ($244,404.85).

4 The power of the court in the event of an abortive sale is set out in s. 41(2)(*b*) of the Law of Property Act, R.S.A. 1980, c. L-8:

> (2) In an action brought on a mortgage of land or on an agreement for sale of land...
>
> > (*b*) if the land is not sold at the time and place so appointed, the Court may either order the land to be again offered for sale or make a vesting order in the case of a mortgage or an order of cancellation in the case of an agreement for sale, and ...

5 First Investors accordingly applied for final foreclosure with respect to properties A and B. Butler then launched its own application for an order entitling it to redeem property B on terms requiring First Investors to "purchase by Rice order" property A at its appraised value and entitling Butler to acquire clear title to property B by paying to First Investors the deficiency of approximately $53,000 thereafter remaining due to First Investors.

6 In chambers, the master was troubled by the fact that foreclosure would wipe out Butler's second mortgage and leave with First Investors an apparent windfall of $135,500 based on the appraisals before him. He held that the doctrine of marshalling applied and to give it effect he refused final foreclosure but gave to the first mortgagee the option of purchasing property A at its appraised "forced sale for terms" value in satisfaction pro tanto of its first mortgage debt and required Butler to pay the deficiency to First Investors. Upon payment of the deficiency, Butler should receive title to property B free of the first mortgage and free of encumbrances subsequent to its mortgage.

7 On appeal to the Queen's Bench, the chambers judge declared that the doctrine of marshalling applied and could be applied in this case by *compelling* the first mortgagee to purchase some of the properties. He made an unprecedented order requiring First Investors to purchase property A, at a "forced sale for terms value" shown in an updated appraisal filed by First Investors, if Butler paid the deficiency within 30 days. The updated appraisal now showed a "forced sale on terms" value on property A of $168,500, and that for property B of $182,000. The balance owing on the first mortgage was now $263,725. The order further provided that if Butler failed to make this payment, a foreclosure order would issue to First Investors with respect to property B and part of property A, but First Investors' mortgage would be discharged from the remainder of property A.

8 The chambers judge had before him the decision of this court in *Yorkshire Trust Co. v. Armwest Dev. Ltd.*, 41 Alta. L.R. (2d) 1, [1986] 1 W.W.R. 478, 66 A.R. 93 (C.A.), in which the court said that a mortgagee could not be compelled to purchase by Rice order against its wish. He distinguished that decision on the basis that the issue in *Yorkshire Trust* was between mortgagor and mortgagee, whereas the issue in the present case was between mortgagee and mortgagee in the context of marshalling. He held that the doctrine of marshalling "overrides" the principle stated in *Yorkshire*.

9 With all respect, there is no conflict between the doctrine of marshalling and the principle stated in *Yorkshire* which might require that one should override the other. There is nothing in the doctrine of marshalling which enhances the jurisdiction of the court in foreclosure.

10 The leading formulation of the doctrine of marshalling as a principle of equity is that of Lord Hardwicke in *Lanoy v. Duke and Duchess of Athol* (1742), 2 Atk. 444, 26 E.R. 668. He said at p. 669:

> It is not then the constant equity of this court that if a creditor has two funds, he shall take his satisfaction out of that fund upon which another creditor has no lien. (*Vide Clifton v. Burt, 1 Cox's P.W.* 679, note 1. *Galton v. Hancock, ante*, 436, 438. *Martin v. Martin, 1 Ves.* 212.)
>
> Suppose a person, who has two real estates, mortgages both to one person, and afterwards only one estate to a second mortgagee, who had no notice of the first; the court, in order to relieve the second mortgagee, have directed the first to take

> his satisfaction out of the estate only which is not in mortgage to the second mortgagee, if that is sufficient to satisfy the first mortgage, in order to make room for the second mortgage, even though the estates descended to two different persons.

11 There have been many subsequent reformulations of the doctrine by courts and authors. I adopt that quoted by the chambers judge from Snell's Principles of Equity, 28th ed. (1982), p. 416:

> 1. The doctrine. Where there are two creditors of the same debtor, one creditor having *a right to resort to two funds of the debtor for payment of his debt*, and the other a right to *resort to one fund* only, the court will so "marshall" or arrange the funds that both creditors are paid as far as possible. "A person having resort to two funds shall not by his choice disappoint another, having one only." Though the doctrine has several applications, marshalling as between mortgagees is perhaps the most usual. If, for instance, a person having two estates, Blackacre and Whiteacre, mortgages both estates to A, and afterwards mortgages only Blackacre to B, either with or without notice of A's mortgage, the proper course is for A to realise his debt first out of Whiteacre and to take only the balance out of Blackacre, in order to leave as much as possible of Blackacre to satisfy B. The *doctrine of marshalling is not allowed to prejudice the first mortgagee, however, and A can therefore realise his securities as he pleases*, for A is not a trustee for B. But if A pays himself out of Blackacre, B is allowed to resort to Whiteacre to the extent to which Blackacre has been exhausted by A, and to have the same priority against Whiteacre as A had.

> 2. No marshalling to the prejudice of purchasers. In the above example, B's right to marshal will be enforced not only *against the original mortgagor* but also against all persons claiming through him as volunteers, as where the mortgagor dies and Blackacre and Whiteacre pass to different persons. But it is not allowed to prejudice purchasers or mortgagees of one of the estates. Thus if in the above example the mortgagor had created another mortgage of Whiteacre in favour of C, B would have no equity to throw the whole of A's mortgage on Whiteacre, and so destroy C's security. [emphasis mine]

12 I also accept the definition of marshalling quoted by the chambers judge from the judgment of Orde J. in *Ernst Bros. Co. v. Can. Permanent Mtge. Corp.* (1920), 47 O.L.R. 362 at 367-68, affirmed 48 O.L.R. 407, 57 D.L.R. 500 (C.A.), per Orde J.:

> The doctrine of marshalling, in its application to mortgages or charges upon two estates or funds, may be stated as follows: If the owner of two estates mortgages them both to one person ... the second mortgagee may insist that *the debt of the first mortgagee shall be satisfied out of the estate not mortgaged to the second, so far as that will extend. This right is always subject to two important qualifications: first, that nothing will be done to interfere with the paramount right of the first mortgagee to pursue his remedy against either of the two estates*; and, second, that the doctrine will not be applied to the prejudice of third parties ... [emphasis mine]

13 (While I accept that definition, it is necessary to point out that *Ernst Bros.* was a case of subrogation against the owner and has no application in this case, where marshalling is sought against the first mortgagee.)

14 The foregoing definition speaks of "*satisfaction*" or "*payment*" of the first mortgage debt out of marshalled "funds". See, to the same effect, Halsbury's and the textbooks by Falconbridge, Keeton, Indermauer, Pomeroy.

15 In *Can. Permanent Trust Co. v. King Art Dev. Ltd.*, 32 Alta. L.R. (2d) 1, [1984] 4 W.W.R. 587, 12 D.L.R. (4th) 161, 54 A.R. 172 (C.A.), Laycraft J.A. (now C.J.A.) at p. 643 adopted the following definition of "satisfaction" in Black's Law Dictionary:

> ... "the discharge of an obligation by paying a party what is due to him (as on a mortgage, lien or contract), or what is awarded to him by the judgment of a court or otherwise".

Not only is this the meaning of "satisfaction" in law; in the case before us it is provided in the mortgage document itself that the debt should be paid "in lawful money of Canada".

16 The important qualification to marshalling which appears in the authorities cited, and was apparently overlooked below, is that its application is not to prejudice the "paramount" right of the first mortgagee to realize its securities and pursue its remedies as it pleases. Its primary right is to receive and enforce payment of its debt in money. It is its election, and its alone,

to seek a "Rice" order upon terms satisfactory to it, to take the land by final foreclosure or pursue other courses of action such as simply leaving its security in force.

17 If this paramount right of the mortgagee to receive satisfaction of its debt in money is not to be prejudiced, it necessarily follows that the prerequisite to the application of the doctrine of marshalling to mortgages is that first mortgage properties shall have been sold and converted to money funds exceeding the amount due under the first mortgage. In those circumstances, the first mortgagee must pay itself firstly out of the funds derived from the properties not covered by the second mortgage. Equity will not allow the first mortgage to needlessly wipe out the second mortgage by paying itself firstly out of funds derived from the properties covered by both mortgages. The first mortgagee must leave as much as possible for the second mortgagee out of funds derived from properties covered also by the second mortgage. In modern practice, the funds derived from sale will be under control of the court, and the court will marshall by simply directing payment accordingly.

18 When marshalling applies, there is really no contest between the first and second mortgagees. The underlying issue is between the second mortgagee and the mortgagor and its assigns. See for instance *Gibson v. Seagrim* (1855), 20 Beav. 614, 52 E.R. 741. The sole interest of the first mortgagee is in receiving the money due to it, and marshalling will not affect that interest. It is immaterial to the first mortgagee whether it gets its money from one fund or the other. Equity assumes that any reasonable first mortgagee would want to act honourably, and not capriciously, by leaving as much as possible for the second mortgagee. As North J. said in *Re Loder's Trusts* (1886), 56 L.J. Ch. 230, 55 L.T. (N.S.) 582:

> ... this is the course which a straightforward man would take.

19 The distinction of *Yorkshire Trust* made by the chambers judge is not a valid one.

20 Neither purchase nor foreclosure can be forced upon it. That is the principle affirmed by this court in *Yorkshire Trust* with respect to "Rice" orders and by *Central Trust Co. v. Stewart Brown Real Estate Ltd.* (1984), 32 Alta. L.R. (2d) 75, 53 A.R. 366, with respect to final foreclosure. If the first mortgagee applies to take all of the mortgaged properties by final foreclosure, the fact of its application does not empower the court to compel it to take less. An order compelling purchase or foreclosure is a gross interference with its right under the mortgage contract to insist on payment of its debt and to pursue its legal remedies as it pleases.

21 The chambers judge and the master may have been misled in this by the definition of marshalling which both adopted from Fisher and Lightwood's Law of Mortgage, 8th ed. (1969), at p. 446:

> The doctrine of marshalling rests upon the principle that a creditor who has the means of satisfying his debt out of several funds shall not, by the exercise of his right, prejudice another creditor whose security comprises only one of the funds.
>
> Thus, if the owner of two properties, X and Y, mortgages them both to A, and then mortgages one of them, Y, to B, B may require the securities to be marshalled, that is, that A's mortgage *shall be thrown upon property X* so far as it will suffice, and property Y, or so much as is not required for A's mortgage, be left to satisfy B's mortgage. [emphasis mine]

22 After correctly stating in the first paragraph the underlying principle of marshalling in terms of "satisfaction" of the first mortgage debt out of "funds", the learned authors speak of throwing the first mortgage "upon property X so far as it will suffice". The master and the chambers judge seem to have taken this to mean that marshalling could be effected by the court at the instance of the second mortgagee by allotting to the first mortgage sufficient of the mortgaged properties as might by appraisals filed appear sufficient to satisfy it and allotting the remaining property to the second mortgagee. If that is what the authors mean to say, and I do not believe it is, they are clearly in error for that would clearly be to prejudice the paramount interest of the first mortgagee by apportioning its security with the second mortgagee. None of the footnote authorities referred to by the authors supports that proposition and no others are cited or have been found to support that interpretation. The expression "thrown upon the property" is used by the Master of the Rolls (Lord Romilly) in *Gibson v. Seagrim* [supra], a case where the property had in fact been sold and the contest was over surplus moneys claimed under subrogation by the second mortgagee against assignees of the mortgagor.

23 As has been discussed in *Yorkshire Trust* and in *King Art*, the purpose of the appraisal is to assist the court in fixing a fair value as between the mortgagee and the mortgagor on an application for an order for sale, or "Rice" order where the mortgagee proposes to purchase. Valuation is required by the court for the protection of the mortgagor, second mortgagees and other subsequent encumbrances. It does not bind the first mortgagee although filed by it because it has conduct of the sale. Appraisals are after all only estimates, qualified though they may be, of the market value at which a willing buyer would purchase. As Laycraft J.A. (as he then was) said in *King Art*, the sale ascertains the value of the property. The corollary is that where the only offers received on a properly advertised sale are lower than the appraisals filed, the appraisals are too high. This cannot be an unexpected circumstance where appraisals are based on comparable sales in a tumbling market, and the first mortgagee cannot be penalized for it.

24 It should be noted that the second mortgagee is not without protection or remedy. It could have sought re-advertising for sale if satisfied with the accuracy of the valuations. It may redeem if it is satisfied that there is excess value.

25 No case is cited to us in support of the orders made by the master and the chambers judge and none have been found either under the former practice in chancery or under the law of foreclosure formerly or now applicable in Alberta. I accordingly conclude that the court had no power to compel First Investors to purchase part of the mortgaged property in satisfaction of its mortgage.

26 I would dismiss the appeal of Butler and allow the cross-appeal of First Investors, set aside the orders made below. Having regard to the fact that First Investors has now been delayed over two years as a result of Butler's intervention, and that Butler did not seek re-advertising, I would not in this case direct that the lands be again offered for sale. I would direct that the usual final foreclosure order issue to First Investors, with the right reserved to Butler to redeem within 30 days. With this direction, the matter is remitted to the master to settle the usual terms. Costs to First Investors of this appeal and the application below.

***Hetherington J.A.*:**

27 I have had the opportunity to read the reasons for judgment of Mr. Justice Belzil in this case. While I agree with the disposition of this appeal which he proposes, my reasons differ from his.

28 First Investors Corporation Ltd. applied for a final order for foreclosure of three pieces of property pursuant to s. 41(2) of the Law of Property Act, R.S.A. 1980, c. L-8. It also applied for an order for possession of these properties, which for convenience have been referred to throughout as the Mink Lake property, the Star Lake property and the Wetaskiwin property. Butler Engineering Ltd., a subsequent encumbrancer with respect to the Wetaskiwin property, applied inter alia for an order that it might redeem this property on certain terms. It relied on the doctrine of marshalling.

29 The master was of the view that the doctrine of marshalling was applicable (40 Alta. L.R. (2d) 333, [1986] 1 W.W.R. 469 at 473, 65 A.R. 135). He directed (at p. 475) that if First Investors was prepared to purchase the Mink Lake property and the Star Lake property on terms which he stipulated (including payment by Butler of the balance of the debt to First Investors), title to those properties would issue in the name of First Investors subject only to prior encumbrances. Title to the Wetaskiwin property would then vest in the name of Butler free and clear of the mortgage to First Investors. If First Investors did not wish to purchase the Mink Lake property and the Star Lake property on the terms stipulated, the master directed that no order would be made in its favour.

30 First Investors appealed from this order. The chambers judge who heard the appeal directed that notice of it be given to other subsequent encumbrancers including Chris Jan Koershuis and Jantiena Koershuis. Mr. and Mrs. Koershuis then appeared and supported the position taken by Butler. The chambers judge agreed with the master that the doctrine of marshalling applied (43 Alta. L.R. (2d) 262 at 268, [1986] 3 W.W.R. 358, 39 R.P.R. 1, 71 A.R. 82). However, he did not give First Investors a choice. He directed it (at pp. 268 and 269) to purchase the Mink Lake property and the Star Lake property on terms which he stipulated, including payment by Butler of the deficiency. If Butler paid the deficiency, he directed that it would be entitled to take title to the Wetaskiwin property free and clear of the mortgage to First Investors. If Butler did not pay the deficiency, he directed that

First Investors would have a final order for foreclosure with respect to the Mink Lake and the Wetaskiwin properties. The First Investors mortgage on the Star Lake property would then be discharged.

31 Butler and Mr. and Mrs. Koershuis have appealed from some of the provisions of the order of the chambers judge and First Investors has cross-appealed from the entire order.

32 These appeals raise three issues. They are:

(1) Did the chambers judge have jurisdiction to give effect to the doctrine of marshalling?

(2) If so, was this an appropriate case in which to consider the application of the doctrine of marshalling?

(3) If so, did the chambers judge err in giving effect to that doctrine?

33 The facts with respect to these issues are set out in the judgment of the chambers judge. Did he have jurisdiction to give effect to the doctrine of marshalling?

34 In *Yorkshire Trust Co. v. Armwest Dev. Ltd.*, 41 Alta. L.R. (2d) 1, [1986] 1 W.W.R. 478, 66 A.R. 93 (C.A.), a mortgagee in an action for foreclosure applied for a Rice order (*Trusts & Guar. Co. v. Rice*, 20 Alta. L.R. 444, [1924] 2 W.W.R. 691, [1924] 3 D.L.R. 352 (C.A.)) approving a sale to it of the property covered by the mortgage at a value of $850,000. The chambers judge ordered the sale, but at a value of $1,065,000. The Court of Appeal held that he had no jurisdiction to make such an order and directed that the sale would not take place unless the mortgagee agreed.

35 The chambers judge in the present case was of the view that the doctrine of marshalling operated so as to override the principle of law in *Yorkshire Trust*.

36 This subject was dealt with by Master Funduk in *T.D. Bank v. Whitaker*, [1986] A.W.L.D. 1279, Edmonton No. 8603-03450, 14th July 1986 (not yet reported). In that case a mortgagee applied for an order for foreclosure. The application was opposed by the Farm Credit Corporation, which relied on the doctrine of marshalling. Master Funduk stated at pp. 3 and 4:

> Counsel for the corporation advances the dubious proposition that the court can order the plaintiff to buy some of the land and at a certain price on the ground it is "just and equitable". That would then leave the balance of the land for the corporation.
>
> There is no contractual basis for ordering the plaintiff to buy some of the land. There is no legislative basis for ordering the plaintiff to buy some of the land.
>
> The submission that the court of chancery can order anything it wants on the ground it is "just and equitable" would be a total reversion of the evolutionary process which culminated in that court coming into existence as a court in its modern sense.
>
> To suggest that the *jurisdiction* of the court is founded on whatever is "just and equitable" would be a throwback to the days when the ultimate power lay in the Crown and "justice" was dispensed, or not dispensed, by the Crown to those who felt they had grievances not redressable at law and who petitioned the Crown for "justice".
>
> The days of the Crown as the ultimate power dispensing "justice", on petitions made to it, through the chancellor and the curia regis are long gone.

37 In Hanbury and Maudsley, Modern Equity, 12th ed. (1985), in discussing the meaning of the word "equity", the authors quoted from the judgment of the Court of Appeal in *Re Diplock; Diplock v. Wintle*, [1948] Ch. 465 (at p. 481), [1948] 2 All E.R. 318, as follows at p. 3:

> A plaintiff asserting some equitable right or remedy must show that his claim has "an ancestry founded in history and in the practice and precedents of the court administering equity jurisdiction. It is not sufficient that because we may think that the 'justice' of the present case requires it, we should invent such a jurisdiction for the first time."

38 Applying this proposition to the cases under consideration, in the *Yorkshire Trust* case no claim founded on the practice and precedents of the court of equity was put forward to give the chambers judge jurisdiction to order a sale to the mortgagee. In the absence of the consent of the mortgagee, therefore, the chambers judge was without jurisdiction to order a sale.

39 In the *Toronto-Dominion* case, on the other hand, the claim of the Farm Credit Corporation was founded on the practice and precedents of a court of equity. It was founded on the equitable doctrine of marshalling. It is my view, therefore, that in that case the master would have had jurisdiction to make an order to give effect to this doctrine, had he found the doctrine applicable. However, for reasons which I will discuss in dealing with the third issue raised by this appeal, he could not have exercised that jurisdiction by making the order sought by the Farm Credit Corporation.

40 Similarly in the present case the chambers judge had jurisdiction to give effect to the equitable doctrine of marshalling. Was this an appropriate case in which to consider the application of this doctrine?

41 The law with respect to the circumstances in which the doctrine of marshalling is applicable is set out in the judgment of the chambers judge. He concluded that this was an appropriate case in which to consider the application of that doctrine, and I agree with him.

42 In his reasons for judgment Mr. Justice Belzil stated that the doctrine of marshalling could not be applied in this case because "the prerequisite to the application of the doctrine of marshalling to mortgages is that first mortgage properties shall have been sold and converted to money funds exceeding the amount due under the first mortgage." With respect I do not agree. In my view the proposition set out in this quotation is inconsistent with the ratio of *Ernst Bros. Co. v. Can. Permanent Mtge. Corp.* (1920), 47 O.L.R. 362 (H.C.), affirmed 48 O.L.R. 407, 57 D.L.R. 500 (C.A.).

43 The *Ernst Bros.* case involved two pieces of property, lot 13 and lot 14. Both were mortgaged to Canada Permanent. Subsequently lot 13 was charged in favour of Ernst Bros. Both lots were advertised for sale. Lot 13 was sold, but lot 14 was withdrawn. Ernst Bros. then sought (at p. 365) "a judgment marshalling the securities held by the Canada Permanent so as to entitle the plaintiffs to the benefit of the security of lot 14 ..." The trial judge, Mr. Justice Orde, applied the doctrine of marshalling and found as follows at p. 371:

> ... the plaintiffs are entitled to a judgment declaring that, subject to the mortgage of the Canada Permanent Mortgage Corporation for the balance due them ... the plaintiffs have a charge upon the west half of lot 14 for the balance due them ...

The owner of lot 14 appealed. The Court of Appeal agreed with the trial judge that the doctrine of marshalling applied, and the appeal was dismissed.

44 In my view the doctrine of marshalling is not limited in its application to money funds. It was therefore appropriate to consider it in this case even though no funds of money were involved. However, in my view the chambers judge erred in giving effect to it.

45 The right of an encumbrancer to the benefit of the doctrine of marshalling is subject to the qualification that nothing should be done to interfere with the paramount right of the first encumbrancer to pursue his remedy against any one of the estates or funds. (See *Ernst Bros. Co. v. Can. Permanent Mtge. Corp.*, supra, at p. 368.) It seems to me a logical extension of this qualification that the first encumbrancer should not be forced to accept a remedy which it has not sought. It should have the right to choose its remedy and the doctrine of marshalling should not be applied in such a way as to interfere with that right. Thus in this case First Investors should not have been forced to accept what was in effect a Rice order, when it had sought a final order of foreclosure. And the chambers judge erred in so ordering.

46 I would therefore allow the appeals from the order of the chambers judge and set it aside.

47 It is then necessary to look at the order made by the master. The master found (at p. 471) that the final order of foreclosure sought by First Investors would give it a windfall of $135,500. In making this calculation he used the forced sale on terms values in the appraisals. He therefore refused the application of First Investors for a final order of foreclosure. He also made

what was in effect a Rice order conditional on First Investors consenting to it by a certain date. However, that date has passed. It was conceded before the chambers judge (at p. 267) that on the basis of the market values submitted by First Investors, the final order of foreclosure sought by First Investors would give it a windfall of $130,000. In light of these facts, in my view the master was correct when he refused to grant First Investors' application for a final order of foreclosure, and the chambers judge should have dismissed the appeal from his order.

48 However, the order of the master was made on 20th September 1985. The order of the chambers judge was made on 13th February 1986. Should this court now grant to First Investors the final order of foreclosure which it seeks? If it does not, First Investors will have to take further legal steps to realize on its security. This will mean further delay for First Investors. What effect will it have on other parties to this action?

49 The chambers judge was advised (at p. 264) that on 15th October 1985 the balance owing on the First Investors mortgage was $263,725.91. The appraisals which were before him showed (at p. 264) that the market value of the three properties in question on 3rd October 1985 was $387,500. The interest rate provided for in the First Investors mortgage is 23 per cent. Thus the balance owing on this mortgage must now be at least $438,000. It therefore exceeds by at least $50,500 the market value of the properties in October 1985. It is possible, of course, that the value of these properties has increased since October 1985. If it now substantially exceeds the balance owing on the First Investors mortgage, a final order of foreclosure should not be granted. If the value of these properties has not increased, however, there is a risk that in subsequent legal proceedings First Investors will obtain a deficiency judgment against the mortgagor, Veeradon Developments Ltd., and its guarantor, Donald R. Wiber — a deficiency judgment greatly increased as a result of the delays and by the costs of these proceedings. In my view in these circumstances this court should grant to First Investors the final order of foreclosure for which it has applied.

50 I therefore concur in the disposition of this appeal proposed in the judgment of Mr. Justice Belzil.

Appeal dismissed; cross-appeal allowed.

TAB 5

DATE: 19991207
DOCKET: C31829

COURT OF APPEAL FOR ONTARIO

FINLAYSON, WEILER and MOLDAVER JJ.A.

B E T W E E N :

IRVING GREEN, IRVING GREEN IN TRUST and BOSTON CONSTRUCTION INC.	S. Harvey Starkman, Q.C. and Kevin Fisher for the appellants
(Appellants)	
–and–	
BANK OF MONTREAL and THE CORPORATION OF THE TOWN OF AJAX	Irving Marks and Adam Babker, for the respondent Bank of Montreal
(Respondent)	N. Cameron Murkar, for the respondent The Corporation of the Town of Ajax
	Heard: November 18, 1999

On appeal from the judgment of Sachs J. dated February 26, 1999.

FINLAYSON J.A.:

[1] This is an appeal from the summary judgment of the Honourable Madam Justice Sachs dated February 26, 1999, wherein she awarded the Bank of Montreal ("Bank") $212,152.05 and upheld the assignment to the Bank by the Corporation of the Town of Ajax ("Town") of a portion of its municipal lien created under a subdivision agreement for a plan of subdivision in the Town.

[2] The appellants were the original owners of the properties in issue in this action. They sold the property to a developer and took back a mortgage as part of the purchase price. The appellants, the developer, the Town and the Bank executed the subdivision agreement. The Bank had provided the developer with credit facilities amounting to $15,000,000. The credit included commercial letters of credit totalling $3,500,000 issued

by the Bank to the Town to provide guarantees for the performance by the developer of his obligations under the land servicing arrangements. The security arrangements of all the parties consisted of the following:

i) the Bank held a $15,000,000 first charge pursuant to a debenture on the residential portion of the subdivision referred to as the housing lots;

ii) the appellants had a collateral second mortgage on the housing lots for $700,000;

iii) the appellants had a first mortgage over the portions of the property known as the school block, the apartment block and the commercial block;

iv) the Town was given a first lien over all of the property as security for any obligation of the developer under the subdivision agreement. Both the Bank and the appellants agreed to postpone and subordinate their respective security interests to the lien of the Town.

v) the Bank received a conditional assignment by the developer of all contracts and agreements including a profit sharing agreement the developer had with two builders.

[3] The developer became insolvent and defaulted on its obligations to the Bank and on its mortgage to the appellants. A receiver was appointed. The appellants exercised their power of sale under their mortgage that covered the school block and agreed to sell the property to the School Board. One of the problems that emerged was that the developer had stock piled topsoil on the school block and this had to be removed. The question arose as to who was to assume the burden and the cost of removing the topsoil.

[4] The Town made a demand on the developer to remove the top soil and to grade and seed the school block and stated that if this was not done, it would call on the letters of credit provided by the Bank to complete the necessary work. The Bank then agreed to complete the grading of the school block and in exchange the Town agreed to assign to the Bank its first charge over the school block.

[5] The effect of this assignment was that the Bank had acquired the first security interest of the Town in the school block and on the closing of the sale to the School Board, it insisted upon being reimbursed for the cost it had incurred in carrying out the obligations of the developer with respect to the school block. In order to close the sale, the parties agreed that the amount in dispute would be paid into a trust account pending the determination of the right of the parties.

[6] The appellants initiated this action for a declaration that the transfer of the Town's municipal lien to the Bank was of no force or effect. The respondents moved for summary judgment to dismiss the appellants' action with costs and for the release of the monies paid into trust sufficient to pay out what was now the Bank's lien on the school block.

[7] The appellants' position was that the Bank's actions in obtaining a transfer of the Town's lien was merely an attempt to shift the Bank's financial obligations to the appellants, for the Bank had provided the Town with irrevocable and unconditional letters of credit and agreed to pay the Town for the same obligations which the Bank sought to enforce against the appellants.

[8] The motions judge found that the Town had the authority to enter into the subdivision agreement and to assign its lien created thereby to the Bank. No serious complaint was made in this court as to these findings. To the extent that the issues were raised in the factum of the appellant, I would accept the reasoning of the motions judge that the authority existed in both cases. The real complaint, here and below, was that somehow the Town had improperly preferred the Bank over the appellants by declining to call on the Bank to honour its letters of credit to pay for the cost of removing the topsoil from the school block. In my view, this approach was totally misconceived. Absent any express agreement restricting the manner in which the security holders could realise on their respective securities, they were all entitled to act in their own best interests. If the Town thought that its interests were best served by having the Bank take over the grading responsibilities of the developer rather than engaging contractors to do the work for the Town and claiming against the Bank under its letters of credit, it was entitled to do so. If the Bank was prepared to take on this responsibility in return for upgrading the quality of its security, there is no reason why it should not have done so.

[9] The appellants argued that, on their reading of the subdivision agreement, the Town was obliged to have recourse to the letters of credit provided by the Bank in enforcing its rights against the insolvent developer and that it could only rely upon its first lien rights on exhausting those letters of credit. The agreement certainly does not say that this is the case and it is now conceded that there were no representations by the Bank or any one else to that effect. This brings the appellants to their primary argument that the court as a matter of equity should bring about the same result by invoking the equitable doctrine of marshalling.

[10] As has been stated by this court in *Re Allison* (1998), 38 O.R. (3d) 337 at p.341, citing *Aldrich v. Cooper* (1803), 8 Ves. 382, 32 E.R. 402 (L.C.), the right to marshal securities is an equitable one intended to prevent a creditor who can resort to two funds of a debtor from defeating another creditor who can resort to only one of them.

Fundamentally, the doctrine is applied for the purpose of regulating the rights of the two creditors among themselves, although in so regulating their rights the court will never interfere with the paramount claim of the superior creditor (the one which has the choice of the two funds of the debtor from which to collect) to pursue his or her remedy against either fund, but provides that if he or she resorts to the fund which the inferior creditor can alone resort, then the inferior creditor shall not be prejudiced. The doctrine is applicable unless some other equity prevents its application such as in the case where its application would prejudice third parties. There are five criteria: (a) two creditors; (b) one common debtor; (c) two funds of the debtor with the superior creditor having access to both and the inferior creditor to but one; (d) no interference with the choice of remedy of the superior creditor and (e) no prejudice to third parties.

[11] There are a number of reasons why the doctrine of marshalling has no application here. In the first place, marshalling will not permit the court to instruct the Town that it must choose one avenue of relief over another. In the second place, the Town was not attempting to recover a debt from the developer, it was attempting to have remedied a default of the developer by having someone remove top soil from the school block so that it would be useable for school purposes. The issue of how it would be recompensed would only come up if it chose to do the work itself. As we know, however, it did not make this choice but instead chose to assign its lien to the Bank in return for the Bank's commitment to see that the work was done. In the third place, there was no common debtor for both "funds". Even assuming that the letters of credit and the lien could be treated as sources of funds for the purposes of this doctrine, while the Town had access to the two funds, only one of them was a resource of the debtor. That resource was the school block and the money that its sale would represent. The letters of credit were an obligation of the Bank to the Town. While admittedly access by the Town to the letters of credit could only be triggered by the default of the developer, it was the Bank, not the developer, which would become the debtor on the happening of that event. Accordingly, there was no common debtor to the appellants and the Town with respect to the two funds that the Town had access to such as to permit the invocation of the doctrine of marshalling. Fourthly, the effect of the order sought would prejudice the Bank, which is a third party to the marshalling scheme.

[12] In summary then, there are three parties that are affected by the insolvency of the developer: the Town, the appellants and the Bank. All are creditors. The doctrine of marshalling does not permit the court to prefer the rights of one creditor to another. It cannot dictate to the Town which of a number of options it must exercise in order to protect the appellants at the expense of the Bank because to do so would not only interfere with the paramount claim of the Town as the superior creditor, it would prejudice the rights of the Bank. In this instance, the appellants are asking the Town to do two things: first to do the work itself and second to make a claim against the security it holds from the Bank. The Town apparently thought it would be more advantageous to its

interests to arrange to have the Bank remove the topsoil in return for its first lien on the property affected. In this way it had no responsibility to see that the work was properly done and it retained the full value of its security with the Bank against any other defalcations by the developer. What this analysis discloses is that the appellants are asking the court to unscramble this omelette at the behest of one creditor to the detriment of the other two. The sole beneficiary of such an order would be the appellants who would receive the full proceeds of the sale of the school block. The equitable doctrine of marshalling offers no support for this request and I see no basis at all to provide the appellants with the relief that they seek.

[13] Accordingly, for the above reasons, I would dismiss the appeal with costs.

Released: DEC 06 1999
GDF

Signed: "G.D. Finlayson J.A."
"I agree K.M. Weiler J.A."
"I agree. M.J. Moldaver J.A."

TAB 6

1869 CarswellOnt 110
Court of Chancery of Ontario

Quay v. Sculthorpe

1869 CarswellOnt 110, [1869] O.J. No. 246, 16 Gr. 449

Quay v. Sculthorpe

VanKoughnet, C., Mowat, V. C.

Judgment: 1869

Counsel: *Mr. Roaf, Q. C.*, for the plaintiff.
Mr. Strong, Q. C., for the defendant *Catharine Fox*.
Mr. Blake, Q. C., for the defendant *Robert E. Sculthorpe*.
Mr. Hector Cameron for other defendants.

Subject: Estates and Trusts; Corporate and Commercial

The leading facts of this case were that the defendant *James S. Fox* had created a mortgage in favor of the Canada Permanent Building and Savings' Society, for the payment whereof the defendant *James Sculthorpe* executed a mortgage on his lands as surety. *Fox* subsequently created a mortgage in favor of the defendant *Catharine Fox*. The mortgage to the Building Society having gone into default, they instituted proceedings on it against the mortgagor and his surety, in which action they recovered judgment and issued execution against lands, and placed the writ in the hands of the proper Sheriff.

James Sculthorpe created mortgages in favor of the plaintiff and the defendants *Barrett* and *Perry* respectively. Subsequently thereto the Sheriff sold, under the writ which had been so placed in his hands, the lands of *Sculthorpe* which had been mortgaged to the plaintiffs *Barrett* and *Perry*. Afterwards, the defendant *Robert E. Sculthorpe*, recovered a judgment against *James Sculthorpe*, the surety, and obtained a garnishee order garnisheeing the debt due from *Fox*, such debt having accrued from the satisfaction, by sale of *James Sculthorpe's* property, of the debt less $280 due by *Fox* to the Building Society, which *Fox* was ordered to pay to *Robert E. Sculthorpe*, who thereupon issued execution against the lands of *Fox. Robert E. Sculthorpe* then paid to the Building Society the balance of $280 left due them on account of *Fox's* debt: and the Society thereupon assigned to him the mortgage created in their favor by *Fox*, the debtor; *Robert E. Sculthorpe* alleging that the proceedings which he had taken at law put him in a position to redeem the Society.

The plaintiff thereupon instituted the present suit, praying to have the lands so mortgaged to the Building Society and assigned by them to *Robert E. Sculthorpe* made liable in the first instance to the claims of himself, *Barret* and *Perry* in preference to the claim of *Robert E. Sculthorpe* and of *Catharine Fox*.

On the cause coming on for hearing before Vice Chancellor *Spragge*, he refused the plaintiff the relief he asked and dismissed the bill with costs.

The plaintiff thereupon set the cause down for rehearing, and the same came on for argument hefore the Chancellor and Vice Chancellor *Mowat*.

Mr. *Roaf*, Q. C., for the plaintiff.

Mr. *Strong*, Q. C., for the defendant *Catharine Fox*.

Mr. *Blake*, Q. C., for the defendant *Robert E. Sculthorpe*.

Mr. *Hector Cameron* for other defendants.

***VanKoughnet, C.*:**

1 This case was argued before my brother *Spragge*, without reference to the doctrine of marshalling; and had I to decide now without any reference to that doctrine, I do not see that I could have arrived at any other decision than he did. He, however, at the close of the opinion expressed by him, threw out a suggestion that, possibly on the doctrine of marshalling, the plaintiff might have relief, and the plaintiffs have availed themselves of this suggestion by arguing and urging it upon us on a rehearing of the cause.

2 There is no doubt that ordinarily, and as a rule, the doctrine of marshalling securities is applied to the case of creditors having respectively a double and a single fund, the property of a common debtor; and I find no case in the English Courts in which this doctrine has been extended so far as is sought to apply it here. It seems to me, however, that the plaintiff's conclusion is right on principle. The leading case on the subject is that of *Aldrich v. Cooper*, decided by Lord *Eldon*, and reported in 8 Vesey at page 382. In that case, Lord *Eldon*, speaking of the doctrine of marshalling, says: "It does not depend upon assets only, a species of marshalling being applied in other cases, though *technically* we do not apply that term except to assets. So where in bankruptcy the Crown by extent laying hold of all the property, even against creditors the Crown has been confined to such property as would leave the securities of incumbrancers effectual. So in the case of the security *it is not by force of the contract*; but that equity, upon which it is considered against conscience that the holder of the securities should use them to the prejudice of the surety; and therefore there is nothing hard in the act of the Court, placing the surety exactly in the situation of the creditor." Again he says: "In the consideration of this subject, the word *assets* has been very frequently used. But when you come to look at the case of marshalling, though that term so frequently occurs, the operation is upon the principle that the party has a double fund." And again: "Suppose another case, *two estates* mortgaged to A. and one of them mortgaged to B. He has no claim under the deed upon the other estate. It may be so constructed that he could not affect that estate after the death of the mortgagor. But it is the ordinary case to say a person having two funds shall not by his election disappoint the party having only one fund." Here, it is true, that the Building Society had not two funds of the common debtor, the surety; but they had one fund of the common debtor and another fund belonging to the principal debtor for whom the common debtor, the surety, had become liable to them, and to the benefit of which the surety was undoubtedly entitled. Now, the plaintiffs here having a lien and charge upon this one fund of the common debtor, the surety, subsequent to that acquired by the Society under their judgment against both the principal and surety, and standing *pro tanto* in the place of the surety as owner of the property affected by the judgment, say to the society, as the surety whom or whose interest in the property *pro tanto* they represent: "Exhaust not another property of the common debtor on which we have no charge, and leave us that on which we have, but exhanst the property of the principal debtor for whom our common debtor is only surety, before you assail that property of the surety on which alone we have a security." Now, does not this really seem a higher order of equity than the ordinary case first put, of two creditors having respectively a double and a single fund of the common debtor on which to rely? What does Lord *Eldon* say of the position of a surety: "That it rests not on contract but on that equity upon which it is considered against conscience that the holder of the securities should use them to the prejudice of the surety." Is it not equally against conscience that the holder of the security, the society here, should use them to the prejudice of the surety's representative in the property to which alone his charge extends?

3 The right of the surety himself to insist on this would be, and is, undoubted. Why may not his representative in the property insist upon the like equity? May not the surety, when he executed this mortgage subsequent, and consequently subject to the judgment against himself and the principal debtor, be taken to have conferred upon his mortgagee and so transferred to him the same rights and means to free this property from this judgment as the surety himself possessed? These mortgages are in the ordinary form, with the usual covenants, as I understand. But independently of any such implied contract, it seems to me the equity exists at the suit of these mortgagees, and resting, as I think it does, upon the same principle on which the surety himself could exert it, and I do not think we should refuse to apply it, merely because we find no case in the English Courts exactly in point, either affirming or disaffirming such an application of the doctrine. In the American Courts it has been frequently applied in a similar case, and I cannot do better than quote the language of *Bell*, J., in delivering the judgment of the Supreme Court of Pennsylvania, in the case of *Neff v. Miller*, as reported in 8 Barr 347. The question was as to the right of judgment creditors of a surety, whose lands had been taken in payment of another judgment against himself and the principal, to substitution on

this judgment. The same objection was raised there as here that, although as between creditors of the same debtor, those who had but one fund could not be deprived of their remedy by the election of others who had two, yet that this did not hold good where the fund belonged to different persons. The learned Judge says: —

> Under this state of facts the question is, whether the owners of *Jane Smith's* judgment are entitled to be subrogated as they claim to be. This question is not affected by the fact that they were defendants in the judgment, for it is part of the case that they were merely sureties, to whom equity accords all the securities and means of payment within the power of the creditor.
>
> It will be perceived that this is not the case of a lien creditor, with power of recourse to two funds belonging to his debtor, in satisfaction of his lien, and another lien creditor of the *same debtor*, having only one of these funds to which he can resort for the payment of his debt. In such a case, a Chancellor will, of course, interfere by compelling the first creditor to look to the fund against which the other has no remedy, or, if the first creditor has already satisfied his debt from the fund to which the second creditor can alone apply, equity will substitute the latter to the place of the former, so as to permit him to avail himself of the unappropriated fund.
>
> But the peculiarity of the question before us is, that one creditor, having a joint and several incumbrance against the estates of *two distinct* debtors, claimed and received the amount of that incumbrance from the separate estate of one of the debtors, and thus defeated the claim of a lien creditor of the latter. It is then the case of two funds belonging to different debtors, and not an instance of a double fund belonging to a common debtor. Under such circumstances, a Court of equity will not, in general, compel the joint creditor to resort to one of his debtors for payment, so as to leave the estate of the other debtor for the payment of his separate and several debt, for, as between the two debtors, this might be inequitable; and the equity subsisting between them ought not to be sacrificed merely to promote the interest of the separate creditor. Nor will Chancery, for the same reason, substitute the several to the place of the joint creditor, who has compelled payment from the estate of the debtor of the former. But where the joint debt ought to be paid by one of the debtors, a Court of equity will so marshal the securities as to compel the joint creditors to have recourse to that debtor, so as to leave the estate of the other open to the claims of his individual creditors; or, if the joint creditor has already appropriated the latter fund, it will permit the several creditors to come in *pro tanto*, by way of subrogation upon the fund which ought to have paid the joint debt: 1 *Story*, Eq. sec. 642-3; Per. Ld. *Eldon, ex parte Kendall*, 17 Ves. 520; *Sterling v. Brightbill*, 5 W. 229. Thus, if A. have a judgment which is a lien on the lands of B. and C.; and D. own a younger judgment which is a lien on the land of C. only, and the joint judgment be levied on and paid out of the estate of C., to the exclusion of the younger judgment, D. will not be subrogated to the rights of A., to enable him to obtain from the estate of B. payment of his several judgment; for B. was not the debtor of D., and for aught that appears, C. may be indebted to B. to the full amount of A.'s judgment. But if B. and C. were partners, and gave the first judgment on the partnership account; and on a settlement of accounts between them, it appeared that B. was indebted to C. to the amount of the joint judgment, the judgment creditor of C. would be substituted as against the estate of B., *pro tanto: Dorr v. Shaw*, 4 Johns. C. Rep. 17. It would be the same if the judgment was recovered by A. for B.'s proper debt, C. being merely surety; for in both these cases B. ought to have paid the judgment, and C.'s estate being taken for it, to the exclusion of C.'s judgment creditor, he ought, on equitable principles, to be permitted to receive out of B.'s estate so much as he had lost by the application of C.'s estate to the payment of B.'s proper debt. Nor can the subsequent judgment creditors of B. complain of this. They acquired their securities with a full knowledge of and subordinate to the prior joint judgment, and have no legal or equitable right to demand that a mere surety shall discharge it for their benefit.
>
> The principles that have been brought to view are of easy application in this instance, and, indeed, the illustration which has been offered exactly embraces the case. Here is a surety, whose money has been applied in payment of the debt of his principal, to the exclusion of his own proper creditors. That he would be entitled to come in, by way of substitution, upon the estate of the principal, is every-day equity; and I think it equally clear that his creditor, who has suffered by the appropriation of a fund which otherwise would have been available for the discharge of his claim, may well ask to stand upon this equity, to the extent of the deprivation to which he has been subjected.

4 The Court thus carefully guards against any supposed equity existing in favor of the creditors generally of a surety whose property has been swept away for the debt of his principal, as undefined or undefinable, which has nothing to fasten upon, and has no fixed range or limit.

5 Adopting the law of this case and applying it here, we think the plaintiff entitled to the relief he seeks [1].

6 In the present case there are three mortgagees, two of them defendants, who have let the bill be taken *pro confesso*. The other mortgagee, the plaintiff, has placed all of their mortgages in the same rank as entitled equally to share *pro rata* in the benefit of the security taken by the Society from the principal debtor, and therefore no dispute as to its appropriation between these incumbrancers exists. If it did, the question as to the fund being equitable assets and the appropriation thereof, without regard to priorities, would have to be considered.

7 I of course need not say that where the Court interferes to limit the owner of a charge on two funds to the realization of his debt out of one of them (if the Court ever does so interfere), it substitutes the person having the charge on one fund only in the place of the party who has the two funds. The whole law on this subject is to be found in the notes to *Aldrich v. Cooper* [2].

8 As to Mrs. *Catharine Fox*, she took, subject to the mortgage of the Building Society, which the surety or the surety's property has paid off. Her mortgagor did not pay it off, and it remains in the hands of the surety's representative, as it undoubtedly might in the hands of the surety, a charge upon the property as it was originally. She is no better or worse than she was before; and so as to *Robert Elias Sculthorpe*, who, after the Sheriff's sale of *James Sculthorpe's* lands, recovered judgment against the latter, and subsequently purchased from the Building Society and obtained from them an assignment of the security in question on paying them an alleged balance of $280, remaining due on the judgment against the principal and the surety *James Sculthorpe*. He had no lien on the lands of the surety, because they had been sold by the Sheriff before his judgment; and as he does not deny the notice which is charged against him when he purchased from the Building Society, he can stand in no better position than they would, had they retained the mortgage. He must be repaid any balance paid by him to the Building Society.

9 The garnishee order, we think, could not disturb the prior equities of the parties, and is therefore as against them of no effect [3].

10 As to the costs, we think the defendants must pay the costs of this contention, not the costs of the rehearing; and that *R. E. Sculthorpe* should have the ordinary costs of a redemption suit in respect of any sum properly paid by him to the Building Society.

***Mowat, V. C.*:**

11 I concur in the conclusion to which the Chancellor has come, and in the general reasoning with which he supports it.

> Declare that the plaintiff and the defendants *Perry* and *Barrett* are entitled to a lien in respect of the amounts due on their several mortgage securities in the pleadings mentioned in substitution of and subrogation of and to the extent of the amount realized by the sale of the lands mortgaged to them by *James Sculthorpe* towards satisfaction of the mortgage from the defendant *Fox* to the Canada Permanent Building and Savings' Society upon the lands and premises comprised in the said mortgage; reference to the Master at Cobourg to take the following accounts, &c.
>
> > 1. An inquiry whether any person or persons, and if so, who other than the plaintiffs and the defendants *R. E. Sculthorpe, Perry*, and *Barrett*, has or have any lien &c., upon the lands and premises comprised in said mortgage from the defendant *J. S. Fox* to the Canada Permanent Building and Savings' Society subsequent thereto: such persons to be served with process, &c., and an account of what is due to them taken. Also an account of the amount properly paid by the defendant *R. E. Sculthorpe* to the Canada Permanent Building and Savings' Society for the assignment of their mortgage to him as in the pleadings mentioned, and to tax the defendant *R. E. Sculthorpe* his costs of this suit as of an ordinary redemption suit; tax to the plaintiff his costs of this suit, save and except the costs of the rehearing: upon plaintiff and the defendants *Perry* and *Barrett*, or any or either of them paying to the defendant *R. E. Sculthorpe* the

amount which the Master shall find to be due, within one calendar month after the Master's report, *R. E. Sculthorpe* to assign, &c., the mortgaged premises free to plaintiff and defendants *Perry* and *Barrett*, or to such of them as shall make such payment; such conveyance to be settled, &c.: Upon the plaintiff and the defendants *Perry* and *Barrett*, or any or either of them making such payment, the following accounts are to be taken by the said Master:

> 2. An account of the amount realized by the sheriff's sale, mentioned in the 11th paragraph of the plaintiff's bill of complaint in this cause, and interest thereon to the day to be appointed for payment as hereinafter directed, and to add thereto the amount which shall have been paid by the plaintiff and the defendants *Perry* and *Barrett*, or either of them, to the defendant *R. E. Sculthorpe*, as hereinbefore directed, and interest thereon to the day to be appointed for payment, and the costs of the plaintiff and of the defendants *Perry* and *Barrett* subsequent to this decree.

3. An account of the amount due to the plaintiff and the defendants *Perry* and *Barrett* respectively on their mortgages in the bill mentioned, and interest thereon to the day to be appointed for payment as hereinafter mentioned, and of what they shall have paid to the defendant *R. E. Sculthorpe*, as hereinbefore directed, with interest thereon to the same day, and the costs of the said plaintiff and the defendants *Perry* and *Barrett* subsequent to this decree; and in case the total amount of the accounts thirdly mentioned exceeds the total amount of the account secondly mentioned, the Master is to direct payment by the defendant *James Sculthorpe Fox* to the plaintiff and the defendants *Perry* and *Barrett* respectively of their respective costs subsequent to this decree, and of what they or either of them shall have paid as hereinbefore directed to the defendant *R. E. Sculthorpe*, and to deduct the total amount of such last mentioned costs and the total amount which shall have been so paid to the defendant *R. E. Sculthorpe* from the total amount of the accounts secondly mentioned, and to direct payment of the balance of the amount of the account secondly mentioned, after making such deductions to the plaintiffs and the defendants *Perry* and *Barrett* respectively ratably according to the amounts due on their said several mortgage securities, within three months after report: and in case the total amount of the accounts secondly mentioned exceeds the total amount of the accounts thirdly mentioned, then the Master is to direct payment by the defendant *J. S. Fox* of the amount of the accounts thirdly mentioned to the parties entitled to the several amounts thereof, within three months after subsequent report: and the said Master is to direct payment of the surplus of the amount of the accounts secondly mentioned at the same time and place to any incumbrancer who may establish any claims, &c., against the said *James Sculthorpe* on the said surplus: the said Master to make the necessary inquiries as to such incumbrancers and to settle their priorities and to tax to them their costs, &c.: and if the said Master shall find that there are no such incumbrancers, then he is to direct payment at the time aforesaid of the said surplus to the defendant *James Sculthorpe*, and upon the said defendant *J. S. Fox*, making such payments as aforesaid, order that the said plaintiff and defendants *Perry* and *Barrett*, do assign and convey the premises comprised in the mortgage to the Canada Permanent Building and Savings Society to the said *J. S. Fox*, &c.; but, in default of the defendant *J. S. Fox* making such payments as aforesaid, order the premises comprised in the said mortgage to the Canada Permanent Building and Savings' Society to be sold, &c.; the purchase money to be applied in payment of the amounts found due to the said parties as hereinbefore mentioned: and in case such purchase money shall not be sufficient to pay the amounts due to the plaintiff and the defendants *Perry* and *Barrett*, order the defendant *J. S. Fox* to pay the amount of such deficiency, together with subsequent interest and subsequent costs, &c.; Master also to tax to plaintiff his costs of this suit to this date, save and except the costs of the rehearing: order that the defendants *J. Sculthorpe, J. S. Fox, Catharine Fox*, and *R. E. Sculthorpe*, do pay the same immediately after such taxation.

Footnotes

1 See also Hales v. Cox, 32 Beav. 118; South v. Bloxam, 2 H. & M. 457.

2 2 W. & T., Lead. Ca. p. 1. 66.

3 See Webster v. Webster, 31 Beav.

TAB 7

1975 CarswellNS 34
Supreme Court of Canada

Royal Bank v. Fox

1975 CarswellNS 34F, 1975 CarswellNS 34, [1976] 2 S.C.R. 2, 13 N.S.R. (2d) 176, 59 D.L.R. (3d) 258, 6 N.R. 382

Frank B. Fox, Eastern Shore Construction Limited, a body corporate, William H. Jack and Frank B. Fox carrying on business under the firm name and style of Bent Brook Farms, Ford H. Webber, Harpell H. Power and D.D. Lynds, Appellants and The Royal Bank of Canada, a body corporate, and Standard Brands Limited, Respondents

Martland, Judson, Ritchie, Spence and Dickson JJ.

Judgment: October 7, 1974
Judgment: October 8, 1974
Judgment: October 7, 1975

Proceedings: On appeal from the Supreme Court of Nova Scotia, Appeal Division

Counsel: *Harry E. Wrathall*, and *Lewis A. Bell, Q.C.*, for the appellants.
David R. Chipman, Q.C., and *James S. Cowan*, for the respondents.

Subject: Corporate and Commercial

The judgment of the Court was delivered by *Ritchie J.*:

1 This is an appeal from a judgment of the Appeal Division of the Supreme Court of Nova Scotia affirming the judgment rendered at trial by Mr. Justice Jones whereby it was ordered that the plaintiffs are entitled to enter judgments against the several defendants in the amounts by which they had respectively guaranteed the account of Dolphin Holdings Limited with the Royal Bank of Canada.

2 The circumstances giving rise to this appeal are set out *in extenso* in the reasons for judgment of the learned trial judge and reviewed in the reasons for judgment delivered by Mr. Justice Cooper on behalf of the Appeal Division, and as Mr. Justice Jones' reasons have now been conveniently published in 29 D.L.R. (3d) 167, I do not find it necessary to retrace the course of events in the same detail.

3 The essentials of the matter are that one William H. Jack, who had been an employee of Moirs Limited, had become involved in a number of ventures the most prominent of which were Eastern Shore Construction Limited and Dolphin Industries Limited, all of which dealt with the Royal Bank of Canada through Jack.

4 Many of the Jack enterprises were indebted to the Bank in varying amounts and early in 1968 it was decided to incorporate Dolphin Holdings Limited for the sole purpose of consolidating the borrowings and the shares of the various other companies. Jack himself said: "It was to be strictly a shell holding company in which to consolidate the whole thing." The new company being in need of substantial capital, Jack arranged a loan of $100,000 for it with the bank to which he was already substantially indebted. In the result the bank accepted Jack as guarantor of this loan on the strength of the fact that he had been able to obtain from Standard Brands Limited, the successor of Moirs Limited, a guarantee of his liabilities to the bank to the extent of $100,000 and the learned trial judge found as a fact that this latter guarantee was given to support Jack's personal guarantee of the Dolphin Holdings account.

5 Armed with this additional security, Jack solicited and obtained guarantees of the same account from the appellants in this action and from Dolphin Industries Limited and Bentley and Archibald Limited, and in so doing he represented to the various

guarantors that Standard Brands had guaranteed the bank's loan to Dolphin Hold ings Limited. One of the turning points of this case is that no such guarantee had been given and that the sole responsibility assumed by Standard Brands Limited was to guarantee the indebtedness of Jack.

6 The financial position of the Jack enterprises deteriorated steadily and the bank called the loan and proceeded against Jack, Bentley and Archibald Limited and Dolphin Industries Limited to the limit of their guarantees, which were each for $100,000. Default judgments were obtained by the bank against these parties and the appellants joined them as third parties to the present action together with Standard Brands, for the purpose of ensuring that they could be made available to contribute along with the other guarantors to the indebtedness. Only Standard Brands filed a defence to the third party notices. A similar notice was filed against Dolphin Holdings Limited seeking indemnity to which no defence was entered. The present appellants constitute all the guarantors of Dolphin Holdings Limited except Dolphin Industries Limited, Jack and Bentley and Archibald Limited.

7 On April 9, 1970, a formal demand was made by the bank on Standard Brands as Jack's guarantor, and Standard Brands accordingly honoured its guarantee in respect of the liability of Jack as a defaulting guarantor of the account of Dolphin Holdings Limited.

8 The learned trial judge was, in my view, correct in holding that, as a matter of law, by discharging Jack's liability in this regard, Standard Brands Limited became subrogated to the rights of the bank and stood in its shoes with all the rights to which the bank was entitled against all guarantors of Dolphin Holdings Limited, including Jack. These are the rights which Standard now asserts against the appellants and I agree with Mr. Justice Cooper in summarizing the position as follows:

> The Bank was clearly the principal creditor and Dolphin Holdings Limited the principal debtor. The appellants as Guarantors of the indebtedness of Dolphin Holdings Limited were sureties for that indebtedness to the limits of their Guarantees and as among themselves (and the third parties) were co-sureties. Standard, having guaranteed the indebtedness of Jack and not of Dolphin Holdings Limited, was not a co-surety with the appellants. The trial Judge so found and indeed these findings do not appear to be in dispute. It is stated in the factum of the appellants
>
>> ...the Learned Trial Judge found that Standard, by virtue of its Guarantee, was a surety for Jack and was not a co-surety with Jack and the other Guarantors of the account of Dolphin Holdings, including the appellants. The appellants do not take issue with this finding...

I did not understand that the appellants had changed their position in this regard during the argument before this Court.

9 In treating Standard as an *alter ego* of the bank, the trial judge, in my opinion, rightly found that it was entitled to assert the bank's right to enforce all guarantees of the Dolphin Holdings account.

10 In reaching his conclusion on this issue, the most cogent finding of the learned trial judge was phrased as follows:

> In the present case, the primary responsibility for payment was upon Mr. Jack and his co-sureties in the event of default by Dolphin Holdings Limited. Standard's liability in turn only arose upon default by Mr. Jack. In my view, Standard was a surety for Mr. Jack and not a co-surety. A surety of a surety is entitled to full indemnity against the principal debtor and sureties in a prior degree. Sureties in a prior degree are not entitled to look to him for contribution.

I agree with this conclusion.

11 While I have been unable to find any authority directly governing the circumstances here disclosed, I am, like Mr. Justice Cooper, satisfied that the applicable principles are accurately described in *Rowlatt on Principal and Surety* (2nd ed.) at pp. 169 and 231 where it is said:

12 The rights of a surety may be classified as follows: —

> I. As against the creditor, to have his remedies exercised and his securities enforced

(a) Against the principal or sureties in a prior degree with a view to the relief *in toto* of the surety, and

. . . . .

II. As against the principal debtor and sureties in a prior degree, to be indemnified and to have the remedies and securities of the creditor kept alive for that purpose.

13 In the present case the creditor was, of course, the bank and the principal debtor Dolphin Holdings Limited, while the appellants were in the position of primary sureties or "sureties in a prior degree". Reference may also be had to the cases of *Craythorne v. Swinburne* [1] and *Re Denton* [2], both of which are referred to in the reasons for judgment of Mr. Justice Cooper.

14 Although Jack was the moving spirit in acquiring the Standard Brands guarantee of his account, the document itself manifested a relationship between the bank and Standard Brands to which Jack was not a party.

15 Jack had long acted as the representative of his various interests in their dealings with the bank and there is no doubt that the Standard Brands guarantee was designed for the purpose of shoring up the financial structure which was then represented by Dolphin Holdings Limited, but the guarantee which was executed by Standard Brands evidenced that Company's undertaking to the bank but not to Dolphin Holdings Limited or any of that Company's sureties, including Jack.

16 It appears to me to be both equitable and logical that one of a number of sureties who discharges the principal debt in full should be entitled to contribution from his co-sureties *pro tanto* in the amount of that debt less his own proportionate share of liability, but that a sub-surety who is a stranger to the guarantee of the liability of the principal debtor and who has discharged the debt as the guarantor of the personal liability of one of the co-sureties, should stand in the shoes of the principal creditor and be entitled to indemnity from the principal debtor and all the sureties, including the principal surety whose account he has guaranteed.

17 The appellants contended that their guarantees were null and void by reason of the fact that they had been obtained through misrepresentations made by Jack as an agent for the bank and that the guarantee forms were not given under seal. I agree with the learned trial judge that there is no evidence to justify a finding that Jack was acting as an agent or a representative of the bank in any representations which he made to the appellants and I note also that the guarantee forms which were exhibits in this action were formally executed and contained no such defects as those alleged.

18 In the result, the formal judgment in the Trial Division ordered that the plaintiffs were entitled to enter judgments against the appellants in the full amount of their respective guarantees but that they were not entitled to realize on those judgments or any other judgments with respect to the indebtedness which is the subject matter of this action, more than $100,652.05 with costs to be taxed.

19 It was further ordered at trial that on payment by any appellant pursuant to the aforesaid judgments, such appellant would be entitled to an order for contribution as against the third parties Dolphin Industries Limited and Bentley and Archibald Limited and as against the other appellants, and to an order for indemnity as against the third parties Dolphin Holdings Limited and William H. Jack. This order was affirmed by the Appeal Division and after careful consideration, I can see no reason to disturb it.

20 For all these reasons, as well as for those so fully stated at trial and in the Appeal Division, I would dismiss this appeal with costs.

Appeal dismissed with costs.

Solicitors of record:
Solicitor for the appellants: *Harry E. Wrathall*, Halifax,
Solicitor for the respondents: *James S. Cowan*, Halifax.

Footnotes

1 (1807), 14 Ves. Jun. 160, 33 E.R. 482.

2 [1904] 2 Ch. 178.

TAB 8

In the Court of Appeal of Alberta

Citation: Trinier v. Shurnaik, 2011 ABCA 314

Date: 20111104
Docket: 1103-0033-AC
Registry: Edmonton

Between:

Mark Wesley Trinier also known as Mark Trinier and Deborah Ellen Trinier also known as Debbie Trinier

Appellants
(Defendants)

- and -

Donald Shurnaik and Debbie Shurnaik

Respondents
(Defendants)

- and -

Alberta Treasury Branches

Not a Party to the Appeal
(Plaintiff)

- and -

Weatherlok Canada Inc.

Not a Party to the Appeal
(Defendant)

The Court:

The Honourable Mr. Justice Jean Côté
The Honourable Madam Justice Marina Paperny
The Honourable Mr. Justice R. Paul Belzil

Reasons for Judgment Reserved of The Honourable Mr. Justice Côté
Concurred in by The Honourable Madam Justice Paperny
Concurred in by The Honourable Mr. Justice Belzil

Appeal from the Order by
The Honourable Mr. Justice D.R.G. Thomas
Dated the 10th day of January, 2011
Filed on the 20th day of January, 2011
(Docket: 0303-22127)

Reasons for Judgment Reserved of
The Honourable Mr. Justice Côté

A. Introduction

[1] The issues here revolve about entitlement to solicitor-client costs after default judgment, and settling and entering formal orders. The respondents and the chambers judge under appeal have raised a number of procedural grounds for objecting to such costs and those orders.

[2] The biggest surprise of civil litigation befalls lay people who learn that their real troubles often begin after they win. Collecting on a judgment is often frustrating, even if the debtor has assets. Soon this suit will be eight years old, yet the successful appellants still have achieved limited progress.

B. Facts

[3] The appellants and the respondents are two couples who guaranteed the Treasury Branches' loan to a private company. The company did not pay, so the creditor Treasury Branches sued all of them. The respondents neither paid nor defended. So the Treasury Branches signed default judgment against the respondents.

[4] Over seven years ago, the appellants paid off the Treasury Branches and got an assignment from it. In the document, the Treasury Branches expressly assigned both its default judgment against the respondents, and also the costs (present or future), and the moneys recoverable. Since the appellants had paid the whole debt and not merely their proportionate share, they moved for contribution from the respondents; i.e. reimbursement of the excess.

[5] That post-judgment litigation has limped since. The appellants appeal the latest order (with leave of the Queen's Bench chambers judge who made it).

C. The Latest Proceedings

[6] The appeal is from an order whose formal portion reverses a decision of the taxing officer and reduces "costs" from solicitor-client to party-party. The formal order does not confine that costs reduction to any particular stage, nor to any particular issues. The chambers judge even gave some costs to the respondents (judgment debtors).

[7] The underlying motion to the chambers judge was an appeal from the Clerk and Taxing Officer's decision of late 2009. The chambers judge heard argument in January and April 2010. His formal order is based on his written Reasons issued on January 10, 2011. They are cited as 2011

ABQB 15. They conclude that the appellants were not entitled to solicitor-client costs, and set aside intermediate orders of another Queen's Bench judge giving solicitor-client costs. The Reasons do not purport to disturb the default judgment.

D. Benefit of the Contracts for Solicitor-Client Costs

[8] The guarantee to the Treasury Branches is in evidence and calls for solicitor-client costs. That part is quoted toward the end of Part F below.

[9] One part of the Reasons of the chambers judge finds no contractual right to solicitor-client costs. It so concludes on the basis that only the default judgment and the debt were assigned. The assignment does include costs present or future.

[10] I respectfully disagree with that reasoning.

[11] First, the assignment here contains a power of attorney clause. It expressly empowers the appellants to "do all acts matters and things in relation to the judgment as the [Treasury Branches] could do." That widens the assignment and fully links it to the loan documents and to the guarantee.

[12] The guarantee is in evidence (Ex C to December 12, 2009 affidavit). It expressly calls for solicitor-and-own-client costs (para 17). The guarantee is signed by both the appellants and the respondents, so the respondents cannot dispute the correctness or justness of solicitor-client costs. Nor is this a contract with strangers, so no assignment of it is necessary. (It is quoted below in Part F.)

[13] The debtor company had no money, and the costs were incurred in the suit. That suit, the payment, the default judgment, and steps since, were all on the guarantee. The judgment and later steps were not against the company; the part of the suit against the company went nowhere, and incurred none of the costs. The court proceedings were against the guarantors. I respectfully suggest that that alone suffices to found all the solicitor-client costs in question here.

[14] The statement of claim does recite the terms of the note and loan agreements between the plaintiff Treasury Branches and the company borrower (pp P1-P2). The statement of claim (p P2, para 8) recites that the borrower covenanted to pay "legal costs as between a solicitor and his own client on a full indemnity basis".

[15] The statement of claim also recites (paras 9-10) that the appellants contracted to guarantee all that, and (paras 15-16, pp P3-P4) that the respondents also guaranteed the whole indebtedness including "all costs, charges and expenses which may be incurred by the plaintiff in recovering any

indebtedness . . .”. And the statement of claim’s prayer expressly calls for solicitor-and-own-client costs (para (g), p P5). The defendants are the company, the appellants and the respondents.

[16] So which document was assigned does not matter here, because all three documents give these higher costs.

[17] The chambers judge’s Reasons are critical of a statement to him by the appellants’ counsel, that the underlying contracts (“financial documents”) called for solicitor-client costs. Indeed the Reasons purport to upset an earlier order of the same judge because of that statement. But all the above shows that that statement by counsel was accurate.

E. Default Binds Respondents

[18] Indeed the various covenants for solicitor-client costs are incontestible. The respondents did not defend, and default judgment was signed against them on April 21, 2004 (7-1/2 years ago). On its face, the default judgment taxes solicitor-client costs against the respondents.

[19] In July 2005, the respondents applied to open up that judgment (AR pp P7-8) (and on September 21, 2006, says the appellants’ factum, para 7). Argument (written and oral) concedes that the court never did open up the judgment, and it was never appealed. The respondents say that the opening up question was heard in October 2007. In any event, opening up has never happened, and no one suggests that it is going to happen or is still pending.

[20] The body of the statement of claim recites what the loan documents say. The recitals are not evidence, but they became stronger than evidence after default judgment. A long line of authority holds that not filing a statement of defence constitutes an admission of the facts alleged in the statement of claim. Older English authority is cited in ***Hill v Stephen Motor etc*** [1929] 2 WWR 97, 98-99 (Sask CA), which also adopts the proposition. Though at times some jurisdictions have had express Rules of Court on the topic, that is not necessary. See ***Sulef v Parkin*** (1966) 57 WWR 236, 239 (Alta CA). And most cases cite no Rule saying that.

[21] Supreme Court authority for the deemed admission is ***McElroy v Cowper-Smith*** [1967] SCR 425, 428, 60 WWR 85, 88. Its majority adopt statements to that effect by Spence J., dissenting on other grounds, who follows the Alberta Court of Appeal.

[22] Alberta Court of Appeal authority for the deemed admission is ***Brennan v Arcadia Coal Co*** [1929] 3 WWR 446, 448, 24 Alta LR 236 (CA); ***Sulef v Parkin***, *supra* (citing a 19th Century English textbook); and ***Spiller v Brown*** [1973] 6 WWR 663, 666 (Alta CA). There are similar *dicta* in ***Yaremchuk v Haight***, 2001 ABCA 7, 277 AR 160, 6 CPC (5th) 112.

[23] Alberta's Court of Queen's Bench has also held the same, adopting the defaulting defendant's deemed admission of the plaintiff's pleading: ***Klinck v Drinnan*** (1985) 66 AR 321, 325-36, 41 Alta LR (2d) 299 (paras 22-24) (citing much authority); ***Schwartz v Longview Motel etc*** (1994) 18 Alta LR (3d) 358, 385 (para 90); ***Syncrude Can v Tibo Steel Prod***, 2001 ABQB 478, 292 AR 368 (citing much law); ***Dykes v Goczan*** (1996) 188 AR 352; ***Robinson v Fiesta Hotel etc (#1)***, 2008 ABQB 311, [2008] 12 WWR 152, 450 AR 167, 172-73, 91 Alta LR (4th) 158 (paras 10-12) (citing authority); ***Dyck v Wilkinson***, 2004 ABQB 731, [2004] AR Uned 657, JDE 0103-01520 (para 9). A Master has held the same, in ***AMHC v Keith Empy Homes*** (M July 22 '86) JDE 8603-07910, AUD (M) 109.

[24] ***Dykes v Goczan***, *supra*, holds that contrary evidence by the defendant is inadmissible. The same thing is said in 16 *Hals. Laws of Eng.* § 1172-73 and 1559-1561 (4th ed), but in somewhat narrower circumstances than apply to the deemed admission.

[25] I have not found any exceptions to the rule which are relevant here. I see no need to discuss here the exceptions, nor their scope, whether based on type of claim, relief sought, relevance of the pleading, or otherwise.

[26] Furthermore, this default judgment does not say "costs to be taxed." An integral part of the judgment is an itemized and taxed bill of costs, and the judgment itself awards the bill's total amount. That amount is patently solicitor-client costs. The costs taxed and awarded there are far beyond Schedule C (i.e. beyond party-party costs). The services listed are lengthy and most bear no relation to the few services listed in Schedule C. Nor are any individual amounts from Schedule C (or for individual services) given. This is a solicitor-client bill of costs.

[27] The chambers judge relied on ***Arbitus Leasing v X-Zibit A***, 2006 ABQB 764, 405 AR 288. Even if it were correct, it would be distinguishable here for two reasons. First, the face of the default judgment here awards solicitor-client costs. Second, where the statement of claim leading to the default judgment recites a covenant for solicitor-client costs, there is no room for any presumption that "costs" mean party-party costs, as explained above.

[28] If a formal judgment is ambiguous, the taxing officer may look at the trial judge's Reasons for decision, in order to tax costs: ***Que Jacques-Cartier Elec Co v R (R v Frontenac Gas Co)*** (1915) 51 SCR 594, 598, 600. (That was a case about solicitor-client expenses.) Cf ***Standish Hall Hotel v R*** [1963] SCR 64, 35 DLR (2d) 140, 153. If a judgment gives a thing, that thing is not to be presumed then to be taken away by other words in the same judgment: ***Re Smith***, *supra*, at p 480 (DLR). One cannot go back further behind the reasons: ***Re Johnson Est*** (1957) 21 WWR 289, 201 (Sask CA).

[29] Reasons for decision are to be read reasonably, generously, and not *contra proferentem*: ***Elliott v Hill Bros etc*** (1999) 232 AR 258, 261 (CA) (para 18). Cf. 2 Williston and Rolls, *Law of Civil Procedure* 1046 (1970); ***Re Smith and McPherson*** (CA 1921) 51 OLR 457, 463, 69 DLR 477, 480. That should apply to oral reasons too. Reasons are to be read as a whole, not in little isolated pieces: ***Elliott v Hill Bros***, *supra* at para 22 (and cf paras 23-27).

[30] When there is an express covenant for solicitor-client costs, there is no reason to presume that a judgment does not speak of them.

F. Contribution Among Guarantors

[31] Next, I will go beyond the particular technical objections recited above. I turn to substance, and to the general rules about contribution among co-guarantors. The assignment of judgment and debt here is not the only cause of action which the appellants had against the respondents (despite what the Reasons seem to imply).

[32] If a guarantor pays the creditor the debt guaranteed (not merely the payor's proportionate share of it), the paying guarantor becomes subrogated to the rights of the creditor so paid: Goff & Jones, *The Law of Restitution*, paras 3-009, 3-025 (7th ed 2007); Maddaugh & McCamus, *The Law of Restitution*, 8-1, 8-2 (2d ed 2004); Fridman, *Restitution*, 403 (2d ed, 1992); ***Fox v Royal Bank*** [1976] 2 SCR 2, 7, 6 NR 382, 59 DLR (3d) 258.

[33] That subrogation gives the paying guarantor every remedy, every security, and every means of payment which the creditor had against the other guarantors. That subrogation is automatic, and does not depend in any way on contracts, such as an assignment. See Fridman, *op cit. supra* at 402-03; Goff and Jones, *op cit. supra* at paras 3-025 and 3-027; ***Re Stratford Fuel Ice etc Co*** (1914) 50 SCR 100, 104; cf ***Royal Tr Corp v Rick Hldg***, 1999 ABCA 187, 250 AR 156 (para 2).

[34] Besides, it is very doubtful that there is any gap or discrepancy here between the guarantee, the loan agreements, and the assignment. All are drafted in wide terms. Obviously the assignment is designed to give to the appellants the Treasury Branches' rights. And the guarantee is designed to enforce all the rights of the Treasury Branches under the loan. A contract should be interpreted to make it workable; it is not a penal statute for courts to construe narrowly and technically. See Burrows, *Interpretation of Documents* 92-94 (2d ed 1946); Broom, *Legal Maxims* 361-69 (10th ed 1939); ***WN Hillas & Co v Arcos***, 147 LT 503, 514, [1932] UKHL 2; ***Br Amer Assce v Wm Law & Co*** (1892) 21 SCR 325; ***Mills v Dunham*** (CA) [1891] 1 Ch 576, esp. at 590, 60 LJCh 362.

[35] What does the subrogation give here? To answer that, it is useful to look at the precise covenants to pay solicitor-client costs. One covenant in one loan and agreement (the General Security Agreement) was to pay

> all costs and expenses incurred . . . **in connection with** any recovery action commenced . . . including, without limitation, legal costs as between a solicitor and his own client on a full indemnity basis.
>
> (Statement of Claim, para 8, emphasis added)

The equivalent covenant in another loan agreement (the mortgage) called for:

> . . . all costs and expenses incurred by the Plaintiff in respect of exercising or enforcing or attempting to enforce or in pursuance of any right, power, remedy or purpose thereunder, including, without limitation, legal costs as between a solicitor and his own client on a full indemnity basis and an allowance for the time, work and expenses of the Plaintiff or of any agent, solicitor, or servant of the Plaintiff.
>
> (Statement of Claim, para 14)

The guarantee contained the respondents' covenant to pay

> . . . all costs, charges, and expenses (including, without limitation, lawyers' fees as between solicitor and his own client on a full indemnity basis) incurred by [the plaintiff] for the . . . enforcement of this guarantee . . .
>
> (December 12, 2009 affidavit, Ex C)

The appellants and the respondents are all direct original parties to the guarantee. They are bound by it, and can sue and benefit under it. It sets the extent of the obligations, and that expressly includes solicitor-client costs.

[36] These covenants about costs are not against public policy. The *Vendors' and Mortgagees' Costs Exaction Act* was repealed by 1965 c 98.

[37] The efforts and expenses of the appellants were expended to collect from guarantors on the guarantee. They were not incurred exclusively under the loan; the company (the principal debtor) obviously could not pay, and the steps in question here involved no futile attempts to get money from the company.

[38] The topic is costs. The guarantee is to enforce the loan agreements, which were assigned. Given all that, it appears to me beyond doubt that costs incurred by the appellants in trying to collect from the respondents were incurred under all the documents (loan agreements, guarantee, and assignment).

G. Any Discretion?

[39] It was argued before us that the chambers judge now appealed from had a "discretion" to deny solicitor-client costs. Given the covenants here, it is doubtful.

[40] But even if a discretion existed as to certain items, there is no proper legal ground to exercise such a discretion here. No misconduct or sharp practice by the appellants is even alleged. They ultimately lost no step, in my view. They did not churn, and did not pursue trivia in order to incur huge solicitor-client costs. And most of the steps whose costs were in issue had already been the subject of previous costs decisions.

[41] If there was any discretion as to costs, at best it was as to the costs of the "side issue" about contribution for the first $100,000 paid by the appellants before the suit. But any such discretion was that of the first judge (Lewis J.), not the (second) chambers judge now under appeal. So the second judge was not entitled to revisit that. And so even if he was, the Court of Appeal owes him no deference on further appeal on that topic. He purported to sit on appeal from the taxing officer who taxed solicitor-client costs.

[42] Besides, the covenants here are for solicitor-and-**own**-client costs, so a mere immoderate amount of costs or of the appellants' steps would likely not remove the right to such costs.

H. Previous Orders

[43] The chambers judge's Reasons offered another ground for denying solicitor-client costs. They concluded that there was no order providing for solicitor-client costs. This proposition was not argued earlier.

[44] In fact, however, in August and October 2007, Lewis J. had ordered solicitor-client costs. And in January 2008, the very chambers judge now appealed had done the same. Only one of those three previous orders was appealed, and then that appeal was abandoned.

[45] The Reasons now under appeal hypothesized that all three of those earlier orders lacked legal effect.

[46] First, the Reasons said that this same chambers judge's own previous order of 2008 should somehow be upset because the then-counsel for the appellants had stated that both the guarantee and the loan agreement called for solicitor-client costs. Counsel's statement was accurate; both contracts did (and in any event, one alone would suffice). There was no misrepresentation at all of any sort. Counsel was not required to foresee the narrow and strained interpretation later imposed by the

judge's Reasons. Such reasoning would be virtually circular. (And even the ***Arbitus*** case there relied upon, was not decided until late 2006.)

[47] The previous order by the same chambers judge in question was not *ex parte*, and it is not clear how or why it could be upset. There was no suit to upset it for fraud, and such a suit could not possibly succeed. No law on upsetting orders was cited.

[48] In my view, the transcript of the decision of the previous judge (pp F19-20) clearly says that costs are to be on a solicitor-client basis.

[49] In any event, there is an entered order on the topic, by the former judge, Lewis J. (AR pp F27-28). It clearly states that costs are to be on a solicitor-client basis (para 4). There was no ground for a different judge to revisit that question later.

[50] The explanation for that attempt to revisit is found in the "Background Facts" part of the Reasons now under appeal (para 20). It reads as follows:

> Mr. Moroz drafted forms of orders in relation to the appearances before Lewis, J. in October, 2007. Those orders have never been signed by any Judge of the Court, nor have they been filed with the Clerk. Therefore, to this date there are no formal filed orders of Lewis, J. in respect to the two October 2007 hearings.

However, the end of the recital is incomplete. As noted, there **were** settled formal orders of the previous judge filed with the clerk's office (i.e. entered).

[51] The chambers judge's Reasons and the respondents argue that the entered orders were nullities or had to be upset by the judge appealed from. They offer two grounds.

[52] The first ground suggested for invalidity is that the orders were never signed by a judge. However, the Rules then in force directed that the **Clerk** sign orders: see Rr 321(2), (3). This was not a case where the opposite party neglected to approve the draft. The parties disagreed as to what the formal order should say. In such circumstances, the Rules called on the **Clerk** to settle the wording: Rr 318, 319. Often judges used to do that, but no Rule called for that, and that practice could not detract from that Rule.

[53] The transcript of the sessions before Mr. Christensen shows no objection by anyone to his jurisdiction to settle the wording of these previous orders by Lewis J. pronounced on October 16, 2007 and October 30, 2007. (See transcripts of argument on September 17, 2009, October 27, 2009

and November 5, 2009.) Yet the proper wording was expressly decided at the last session (November 5).

[54] Mr. Christensen settled this wording for the formal order, after a formal appointment to do so (AB p P17), and after a contested hearing (transcript, pp F106-F122). He is a Deputy Clerk and so had the power to do so. The formal Appointment refers to him as Clerk, not as Taxing Officer. In practice the Clerk himself almost never acts, and such tasks are performed by Deputy Clerks.

[55] The statement in the Reasons under appeal that the "Taxing Officer attempted to settle the terms" is puzzling. Mr. Christensen did so in his capacity as a Deputy Clerk.

[56] In my view, the formal order of Lewis J. reflects the transcript of the hearing before him, and the minutes of the order as settled by the Deputy Clerk are correct.

[57] The chambers judge now being appealed was not the trier of fact, nor the one to settle the minutes. All that had occurred beforehand. The chambers judge sat in an appellate capacity. The standard of review on appeal from him to the Court of Appeal is therefore correctness.

[58] Now I turn to another argument made by the respondents (AR p 200).

[59] The respondents rely upon a letter of Wachowich J. responding to an inquiry about an unanswered letter to the previous judge (Lewis J.) who had since retired. Wachowich J. said to go to a judge. His letter did not refer to any specific judge, and even then said to get advice from "a chambers judge . . . as to how to deal with the matter, taking into account the Rules of Court that are to be considered . . .". In no sense was this letter an order, still less one removing jurisdiction. It did not remove the authority of the Clerk to settle minutes of previous orders, still less make such settlement a nullity. A letter from a judge could not repeal a Rule of Court.

I. Time Limit for Entry

[60] The second possible ground to upset the entered order of the previous judge, Lewis J., seems not to be a foundation for the Reasons now under appeal (though they recite that the argument was then made: para 28). Nor is this point mentioned in the respondents' "Notice of Appeal from Taxation", which is what was before the chambers judge. The respondents argue that a year having expired, the Clerk had no power to enter the order (old R 327).

[61] That Rule gave a time limit for entry, not for settling the contents of an order. It is impossible to enter an order until its wording is either approved or settled.

[62] And any breach of R 327 would not produce nullity. The grounds for extending the year are many, and the tests are lax. An unentered order exists and has force, and where parties have relied

on it, a later judge should not upset it just because he or she thinks that it is wrong, or because one year has gone by without it being entered.

[63] There is full discretion for the court to allow entry of an order despite expiry of a year: ***Wright v Murray Rosen PC***, 2005 ABCA 116, [2005] AR Uned 44, [2005] AJ #274, Calg 0301-0355 AC (March 10/16). Indeed, an extension of time to do so should not be refused unless it would cause real prejudice to the other side: ***Csepregi v Bygrove***, 2001 ABCA 108, [2001] AR Uned 31, [2001] AUD 1051 (April 17/May 3). At times, fairness requires entering an order late: ***Thimer v WC Bd***, 2000 ABQB 706, 276 AR 236, 252-53 (paras 53-59).

[64] If R 327 was operative before this chambers judge (which is far from clear), his Reasons did not consider the mandatory topic of a time extension. The appellants' factum argues it and calls it "a fiat" (paras 12-14, 27, 37). The appellants' factum also suggests (para 37) that the respondents lay in the weeds for years, and then raised technical objections after it seemed too late to fix them. The respondents' factum does not answer that.

[65] The fact that counsel for the respondents refused to sign the draft of the formal order of Lewis J. certainly explains some time gap. The minutes of the proposed order were correct. Why was it not entered promptly? Simply because counsel for the respondents would not approve it as to form, as admitted in the respondents' factum (p 5, para (3)). So it ill lies in the respondents' mouths to complain of the delay in entry.

[66] There is no suggestion (let alone evidence) that the appellants caused the delays. Both Lewis J. and Mr. Christensen lost some time over their health issues. Ordinary time hazards of litigation must not destroy an order.

[67] For a century, R 548 and similar Rules on extensions of time set by Rules or orders were always generously interpreted. It would be a rare case where someone would lose his rights through a few months' delay which were not wilful, and caused no significant irreparable prejudice. See the cases collected in 1 Stevenson & Côté, *Civil Procedure Encyclopedia*, pp 18-19 and 18-20 (Chapter 18, Part N) (2003).

[68] Maybe the factum of the respondents suggests that leave had to occur before entry (p 6, replying to ground 3). If so, that is wrong, because it is expressly contrary to old R 548(2).

[69] Rarely, an order can be abandoned by the party getting it; but what happened here was the opposite. The appellants kept trying to enforce the orders which they had obtained and entered, but were thwarted by the respondents' objections and motions.

[70] Therefore, solicitor-client costs were the proper basis for the costs of all these proceedings, the previous proceedings were proper, and there was no reason to question, to attack collaterally, nor to reverse, any order to that effect.

J. Can Default Judgments Give Solicitor-Client Costs?

[71] The respondents' factum relies on the entire ***Arbitus*** decision (factum, paras 16(1) and 18), and so do the Reasons under appeal. That decision suggests that a default judgment cannot give solicitor-client costs.

[72] The decision in ***Arbitus*** gave three grounds for not allowing solicitor-client costs on one particular default judgment there. The first and probably biggest point was as follows: default judgments supersede the covenant for solicitor-client costs (405 AR. p 293, at the end of para 19). The Reasons cite only two bits of authority: *Black's Law Dictionary* (no page cited, but maybe the definition of "merger"), and an 1844 decision. The latter decision merely says that one cannot sue a second time on a cause of action after one has got judgment on it. Of course that is not what happened here. And it would create a Catch 22: you cannot sue now because you sued before, and you cannot rely on the judgment because the part of it in your favour is invalid. That would be both unfair and self-contradictory.

[73] The second ground stated in the ***Arbitus*** case was just that the particular default judgment in that case merely said "costs" or maybe "costs to be taxed" with no further detail (p 294 AR, para 22). Of course that is not the situation here, where the default judgment itself awarded solicitor-client costs as described above in Part E.

[74] Finally, the ***Arbitus*** judgment came at the matter a third way. It suggested that a default judgment could not go above party-party costs because R 605(1) did not let a taxing officer go higher than party-party costs "unless ordered". It cited some decisions by taxing officers.

[75] With respect, that is another *non sequitur*. Default judgments are not given by taxing officers. These are given by the Clerk of the Court. And the Clerk of the Court had very clear power to grant judgment for any liquidated claim pleaded (or for recovery of a specific asset) after default: old Rr 142 (1)(a), 148(1); cf R 149(1). It is quite common for such default judgments to compute interest or unit prices in debt, and similar matters. Often the default judgment is for a whole set of accounts with amounts in both directions (e.g. new invoices and then partial payments).

[76] To support this third ground, the ***Arbitus*** judgment took out of context a statement that pleadings and admissions cannot confer on the court a new jurisdiction (pp 294-95). But there is no question about the jurisdiction of the court in the ***Arbitus*** case, nor the present case. Moreover, there is no doubt about the jurisdiction of the Clerk (or Deputy Clerk) to give default judgment, as noted.

[77] There is a somewhat similar brief argument in the respondents' factum in the Court of Appeal (reply to ground of appeal number 2, on p 6). It suggests that only a judge can award costs, and so the Clerk cannot even settle minutes of judgment or sign them, if their subject is entitlement to costs where what the judge pronounced was ambiguous. This proposition seems wrong in principle, and at the very best is circular reasoning. It is clear that pronouncing a decision (or reconsidering it) are totally different from settling the wording of the formal order recording that. Settling asks what was decided, not whether it was correct. See ***Davidson v Patten (#5)***, 2005 ABQB 370, JDC 0101-00193, [2006] AR Uned 318 (May 18); ***Re Collings (#2)*** [1936] SCR 613, 614-15, [1937] 1 DLR 409 (one judge). Whoever settles the minutes cannot go off on a voyage of discovery of his or her own, and is the servant not the master.

[78] The reply by the respondents' factum (to point number 1) implies that the minutes of the orders were settled by a taxing officer who cannot award solicitor-client costs. But the same person (here Mr. Christensen) has two hats. One is Deputy Clerk and the other is Taxing Officer. As noted, he settled the orders in the former capacity.

K. Side Issue?

[79] That leaves another argument of the respondents. Their counsel firmly suggested in oral argument to us that even if solicitor-client costs are proper for true collection procedure, they should not extend to (or not yet extend to) another substantive issue. It attempts to see whether the 45% contribution owed by the respondents should include a sum said to have been paid by the appellants to the Treasury Branches on the loan, before the suit and before its default judgment.

[80] The first answer to that argument is that the loan contracts and the guarantee antedate the past payment by the appellants which is now in question. That the evidence of the guarantee was filed later, or that the admission of the facts about the loan agreement came later, is irrelevant. In any event, the motions about that payment came after the default judgment. So there is nothing retroactive about this part of the claim for solicitor-client costs.

[81] The second answer is that the covenants for solicitor-client costs in all contracts (loan and guarantee) are very broad. (They are quoted above in Part F.) Those extend to indirect or ancillary proceedings.

[82] The appellants were only responsible for 55% of the obligations guaranteed, but actually paid the whole thing, and the Treasury Branches' default judgment and security assigned and subrogated to the appellants are for more than the amount the appellants seek from the respondents. Therefore, this one motion to fix the amount (of which the respondents must pay 45%) is connected to the respondents' covenants to pay solicitor-client costs, and connected to the security.

[83] The respondents next argue that the question of whether the respondents must pay 45% of the sum paid by the appellants before suit has not yet been decided and is to be tried. They say that it could even be decided against the appellants. That may be true, but the question at the moment is not the costs of some future trial of an issue. The question now is costs of motions on preliminary procedure decided some years ago. In no sense did the appellants lose these motions, and they had to bring them.

[84] Sometimes it may be sensible to defer costs awards of interim steps; but given the long gap, and the various contests with the respondents which intervened, such deferral is inappropriate here. The previous judge (Lewis J.) exercised his discretion and decided not to defer them. That costs question was no longer open. Settling terms of a formal order is not an appeal from it on the merits. It is not a reopening of the merits. Counsel who attempt that produce serious delay. Costs now and not years later involve no error in principle. This case has seen too much delay.

[85] The appellants should get solicitor-client costs of that issue too.

L. Conclusion

[86] I would allow the appeal, reinstate the formal orders of Lewis J. as settled by the Deputy Clerk, reinstate the former costs order dated August 27, 2007 which this chambers judge set aside, and would award the appellants solicitor-client costs (full indemnity) for all steps to date, with no deduction for unreasonableness or overcaution. The order for costs against the appellants should be set aside.

[87] If the parties cannot agree on costs, then within 10 days of the date of these Reasons they may each file and serve a submission on costs. These should be double spaced and not exceed 10 pages each.

[88] Court of Queen's Bench written Reasons are easily obtained on the Alberta Courts' website. The appeal record should not have used a faxed copy of the Reasons under appeal (with the faxing line and page numbers superimposed and scribbled marginal notes). The appeal record does not state who prepared it. I would deduct $200 from the appellants' disbursements on appeal for those flaws.

Appeal heard on September 7, 2011

Reasons filed at Edmonton, Alberta
this 4th day of November, 2011

Côté J.A.

I concur:

Authorized to sign for: Paperny J.A.

I concur:

Belzil J.

Appearances:

N.D. Anderson
for the Appellants

G.J. Lintz
for the Respondents

TAB 9

Citation: Wolfe et al v Taylor et al, 2020 MBCA 44

Date: 20200427
Dockets: AI18-30-09165;
AI18-30-09166;
AI18-30-09171

IN THE COURT OF APPEAL OF MANITOBA

Coram: Chief Justice Richard J. Chartier
Mr. Justice Marc M. Monnin
Madam Justice Karen I. Simonsen

BETWEEN:

	F. J. Trippier *and* ***I. Vakurova*** *for the Appellants*
LINCOLN WOLFE and 5606269 MANITOBA LTD. *(Applicants) Respondents*	***R. A. McFadyen*** *for the Respondents Lincoln Wolfe and 5606269 Manitoba Ltd.*
- and -	***J. R. N. Boudreau*** *for the Interveners*
DUANNE TAYLOR and 5608067 MANITOBA LTD. *(Respondents) Appellants*	***J. M. Lee, Q.C.*** *and* ***J. J. Burnell*** *for Deloitte Restructuring Inc., the Court-Appointed Liquidator for Taylor Bros. Farm Ltd. and Edwin Potato Growers Ltd.*
- and -	
TAYLOR BROS. FARM LTD. and EDWIN POTATO GROWERS LTD. *(Respondents)*	***T. W. Turner*** *for Pitblado LLP, a judgment creditor of Taylor Bros. Farm Ltd. and Edwin Potato Growers Ltd.*
- and -	
GERALD WIEBE and MARTHA WIEBE *Interveners*	*Appeals heard:* ***August 27, 2019***

) *Judgment delivered:*
) ***April 27, 2020***

MONNIN and SIMONSEN JJA

[1] These three appeals arise from liquidation proceedings under the provisions of *The Corporations Act*, CCSM c C225 (the *Act*), with respect to the assets of two corporations, namely, Taylor Bros. Farm Ltd. (TBF) and Edwin Potato Growers Ltd. (EPG). By a liquidation order dated April 28, 2017, the liquidation judge appointed Deloitte Restructuring Inc. (the liquidator) the liquidator of the assets and property of TBF and EPG. Those proceedings followed their course and culminated in the granting of the three orders under appeal in these proceedings:

a) an order pronounced August 31, 2018, whereby the liquidation judge ordered that certain funds in the hands of the liquidator be reallocated between TBF and EPG, allowing for the claim of a secured creditor, R. L. Wolfe Ltd. (RLW), to be paid in full, and the claims of a judgment creditor, the Pitblado LLP law firm (Pitblado), to be paid to a greater extent (the Marshalling Order);

b) another order pronounced August 31, 2018, whereby the liquidation judge approved a distribution schedule proposed by the liquidator (the Distribution Order); and

c) an order pronounced September 25, 2018, whereby the liquidation judge granted priority to the claims of Pitblado, to the extent not otherwise satisfied by the Distribution Order, over any other unsecured creditor of TBF and EPG notwithstanding a bankruptcy of either (the Supplemental Order).

<u>Background</u>

History and Corporate Structure

[2] In early 2008, Lincoln Wolfe (Wolfe) and Duanne Taylor (Taylor) began farming together using two corporate entities, TBF and EPG. The shares of those two companies were held equally by Wolfe and Taylor through their own personal holding companies, 5606269 Manitoba Ltd. (269) for Wolfe and 5608067 Manitoba Ltd. (067) for Taylor. Those two individuals entered into a unanimous shareholders agreement (USA) to define their relationships with each other and with TBF.

[3] TBF and EPG essentially carried on as one business operation. While EPG owned much of the land, all of the active farming operations were carried on through TBF. All of the obligations of TBF and EPG to the Bank of Montreal (BMO) were secured by a first charge over all of the assets of TBF and EPG.

[4] Disputes with respect to the farming operation arose between Taylor and Wolfe. Wolfe moved for the appointment of a liquidator and dissolution of the companies under the *Act*. The application was stayed by a motion judge to allow the dispute to proceed to arbitration. The arbitration proceedings resulted in an award on April 20, 2016, ordering the liquidation of all of the assets of TBF and EPG in accordance with section 207 of the *Act*. However, prior to the award being implemented, the parties agreed to a postponement of the liquidation until a series of interim steps were

completed, including the determination of issues with respect to the amounts owing to TBF and EPG by either of the shareholders or companies controlled by them.

[5] In a subsequent award made on August 24, 2016, the arbitrator dealt with the amounts owing between the respective corporations and individuals. Those amounts included debts owing by TBF to Farm Credit Canada (FCC) and the Bank of Nova Scotia (BNS) on account of input costs for previous farming years which Wolfe, through RLW (a corporation that he owned and controlled), had paid and received assignments of the securities held by those creditors. The allegation before the arbitrator was that Wolfe should not be entitled to the benefit of the securities he held on those loans and the benefits of the transfer since he had obtained them at a discounted amount, nor should TBF be liable for the increased interest rates charged as a result of the default. Wolfe's position was that he had advanced those funds to the creditors in order to ensure the continued operation of the farming operation.

[6] The arbitrator accepted Wolfe's version of events and confirmed that TBF owed RLW $1,823,842 for the loans it acquired from secured creditors, including the FCC and BNS loans.

[7] Between May and December 2016, Wolfe and Taylor agreed to liquidate the majority of the equipment owned by TBF and EPG through a third-party auctioneer. By December 2016, the primary assets of TBF and EPG that remained were approximately 2,900 acres of land and physical building structures located upon those lands.

[8] Wolfe and Taylor were unable to reach an agreement on how to deal with those remaining assets and Wolfe proceeded before the Court of Queen's Bench to enforce the April 20, 2016 arbitration decision to have a liquidator appointed. The liquidation judge granted that request on April 28, 2017 with the liquidation order being filed on June 5, 2017. A request was made to stay that liquidation order pending resolution of various matters which remained subject to the arbitration proceedings. The stay request was dismissed and appealed to this Court. By decision dated August 11, 2017, the application to stay the liquidation order was dismissed by a chambers judge in our Court (see 2017 MBCA 74).

The Liquidation Proceedings

[9] In its first report of October 31, 2017, the liquidator outlined the steps it had taken to secure the assets of the corporations and deal with their indebtedness.

[10] The liquidator confirmed that BMO was the principal lender to the companies and held various first-ranking security positions against both companies and their assets. It was owed approximately $5,200,000. As well, the liquidator confirmed that, during 2015, RLW purchased indebtedness owed by TBF to BNS, FCC and the Royal Bank of Canada (RBC).

[11] Given a lack of cooperation between the parties on how to proceed, the liquidator proposed and received approval from the Court of a liquidation plan which included a sale process with respect to the assets of the companies. As well, it proposed and received approval for a claims process.

[12] By the time of the second report dated March 26, 2018, the liquidator had updated the security claims and they were as follows:

- BMO $5,182,300
- RLW $2,407,367
- Gerald and Martha Wiebe (the Wiebes)..................... $788,711
- a small amount to another party

Unsecured debt included amounts owed pursuant to the arbitration award to Taylor and charges to the shareholders' accounts of both corporations reflecting the amounts in the award. However, by that time, the liquidator had formed the view that the proceeds from the sale process could well be insufficient to pay out all the companies' secured and unsecured creditors' claims in full.

[13] In a supplement to the second report, the liquidator confirmed the validity and enforceability of the security held by BMO against the assets of both TBF and EPG, the security held by the Wiebes against the assets of EPG and the security held by RLW against the assets of TBF. It is common ground that the BNS and RBC portions of TBF's debt to RLW were guaranteed by EPG but the FCC portion was not. The liquidator also confirmed the amounts owing to BMO and to RLW but was not able to do so with respect to the Wiebes. Given that the Wiebes' claim ranked in priority to the RLW claim in respect of the lands owned by EPG, the liquidator was not in a position to recommend a distribution to either RLW or the Wiebes. The liquidator recommended a distribution to BMO in the

amount of $5,518,039 in satisfaction of both companies' obligations. This distribution was premised on the successful sale of the lands and equipment.

[14] On April 13, 2018, the liquidation judge approved the sale and a vesting order. The sale and distribution of proceeds were made subject to certain conditions, namely:

a) With respect to priorities, the net proceeds from the sale would stand in the place and stead of the assets and any claims and encumbrances would attach to the net proceeds with the same priority as they had immediately prior to the sale.

b) The distribution could be made to BMO without prejudice to the rights of the parties as to how the distribution amounts would be allocated as between the assets of TBF and EPG and the costs of the liquidation proceedings would be allocated as between the assets of TBF and EPG; the allocations would be deferred to be made by the Court at a later date.

[15] The sale of the assets of TBF and EPG realised the amount of $9,357,455. The receipts were allocated by the liquidator as follows:

- TBF $4,238,475
- EPG $5,118,980

[16] On completion of the sale of the lands, the BMO debt was paid in full. BMO's own internal allocation of the debt between TBF and EPG, based on a payment statement summary provided by BMO, was as follows:

- TBF $3,838,986
- EPG $1,679,053

This was reflected in the liquidator's proposed distribution schedule as at May 30, 2018. The result was that considerable funds were left remaining in EPG but limited funds remained in TBF.

Marshalling Application

[17] RLW filed a motion in June 2018, seeking the application of "the equitable doctrine of marshalling" as between the secured creditors of TBF and EPG to have the debt owing to BMO by those two companies paid, or deemed to have been paid, from the proceeds realised from the sale of EPG assets to a greater extent than shown in the proposed distribution schedule of the liquidator.

[18] On the hearing of the marshalling application, RLW had agreed that the Wiebes would have a holdback from EPG funds pending a final determination of the quantum of their claim. The reallocation that RLW proposed would therefore not prejudice them. As well, Pitblado, a judgment creditor by virtue of the registration of two judgments for legal services, was also present seeking to have its priority against the TBF and EPG lands maintained.

[19] In a brief endorsement, the liquidation judge, acknowledging that he was unable to determine exactly the extent of RLW's secured interest—in particular, as assigned from FCC—was of the opinion that RLW had access

to both funds (presumably the proceeds from the sale of the TBF and EPG lands).

[20] As such, the liquidation judge was incorrectly of the view that RLW was a secured creditor in respect of both corporate debtors and it was irrelevant whether the doctrine of marshalling was applicable. In his conclusion, he held that RLW was entitled to the reallocation sought to the extent that its secured interest in both funds permitted.

[21] The initial order prepared by the successful party, RLW, and provided to the judge for signing, made a reference to the doctrine of marshalling. In a second endorsement dated July 27, 2018, the liquidation judge stipulated that the order should not refer to that doctrine. In the same supplemental endorsement, the liquidation judge recognised that he had not dealt with the claim advanced by Pitblado that it had a priority over other unsecured creditors. That issue was deferred to a later hearing.

[22] Subsequently, in a court appearance on August 31, 2018, scheduled to deal with the liquidator's request for approval of a distribution schedule, the liquidation judge confirmed that it was his intention to allow the reallocation of funds on an equitable basis similar to a marshalling principle.

[23] In the same proceeding, the liquidation judge was asked to grant Pitblado a priority over unsecured creditors as a result of it being a judgment creditor and reallocate funds from EPG to TBF to satisfy its judgment against TBF. Again, this was opposed by Taylor on the grounds that marshalling was not available. The liquidation judge disagreed and allowed Pitblado to rank in priority above the unsecured creditors with respect to the

proceeds from the sale of the lands behind only RLW and the Wiebes and also allowed reallocation in favour of Pitblado.

[24] At that appearance of August 31, 2018, the liquidation judge was also asked to approve the distribution to the Wiebes of their claim on EPG assets. This was opposed by Taylor, arguing that it had not been properly quantified before being accepted by the liquidator. The liquidation judge, finding that the liquidator had followed the claims process in dealing with the matter, confirmed the priority and the amount.

[25] The liquidator accepted, as part of the EPG claims process, a claim by TBF in the amount of $916,336 as against EPG. The basis for that claim were general ledger details from the books and records of TBF and the December 31, 2015 financial statement for EPG which indicated that EPG was indebted to TBF in that amount.

[26] In the proceedings of August 31, 2018, dealing with the liquidator's further report before the liquidation judge, Taylor sought to contest both the amount and the underlying indebtedness of EPG to TBF. It is unclear from the transcript of the proceedings whether the liquidation judge ever turned his attention to that issue. However, with the liquidation judge having accepted that a reallocation should occur, counsel for the liquidator made it clear that there were no longer funds available to satisfy that indebtedness. The matter was therefore moot.

<u>Issues</u>

[27] These appeals raise the following issues:

a) as to the Marshalling Order, whether the liquidation judge erred in ordering the reallocation of the BMO debt between TBF and EPG such as to allow RLW to recover fully on its securities acquired from BNS, FCC and RBC and to allow Pitblado to make a more substantial recovery, ahead of unsecured creditors;

b) as to the Distribution Order, whether the liquidation judge erred in dismissing the challenge to the claims of the Wiebes and TBF in the EPG claims process and, if the Marshalling Order is set aside, whether the intercompany debt claim between TBF and EPG should be reviewed; and

c) as to the Supplemental Order, whether Pitblado, as a judgment creditor, was entitled to rank in priority to unsecured creditors and benefit from the reallocation notwithstanding the potential bankruptcy of TBF or EPG.

<ins>Standard of Review</ins>

[28] The liquidation proceedings were conducted pursuant to the provisions of the *Act* (see section 207 and following).

[29] Pursuant to those provisions, a court has the power to make a number of different orders it thinks fit, including:

a) orders determining the validity of any claims made against a corporation (see section 210(e));

b) orders approving payment, satisfaction or compromise of claims (see section 210(h)); and

c) orders giving directions on any matter arising in the liquidation (see section 210(j)).

[30] These orders were made in the course of the Court's supervision of the liquidation. They are, for the most part, discretionary orders for which a liquidation judge is entitled to significant deference. Unless the liquidation judge has misdirected himself or the order is so wrong as to amount to an injustice, appellate interference is not justified (see *Perth Services Ltd v Quinton et al*, 2009 MBCA 81).

Issue #1—The Marshalling Order

The Doctrine of Marshalling

[31] Marshalling is an equitable remedy, intended to protect the recovery of a junior creditor against the arbitrary action of a senior creditor, and to thereby treat all secured creditors equitably.

[32] While its origin may be as early as Roman civil law, it found its way into English law in the mid-17th century (see Bruce MacDougall, "Marshalling and the Personal Property Security Acts: Doing Unto Others. . ." (1994) 28:1 UBC L Rev 91 at 91, online (pdf): *Allard Research Commons* <commons.allard.ubc.ca/fac_pubs/220>. One of the most recognised statements of the doctrine was set out by Lord Eldon in *Aldrich v Cooper* (1803), 8 Ves Jun 382, 32 ER 402 (Ch (Eng)) (at p 407):

> . . . a person having two funds shall not by his election disappoint the party having only one fund; and equity, to satisfy both, will throw him, who has two funds, upon that, which can be affected by him only; to the intent that the only fund, to which the other has access may remain clear to him.

[33] To obtain marshalling, certain specific criteria must be met. These criteria include the requirements that: two or more creditors share a single common debtor; and the senior creditor has a claim against two of the debtor's funds, while the junior creditor, ranking behind the doubly secured senior creditor, has recourse to only one (see *Green v Bank of Montreal*, 1999 CarswellOnt 3954 (CA)).

[34] The Supreme Court of Canada has not discussed marshalling in any detail. The most recent decisions of this Court addressing the doctrine are more than 100 years old (see *In Re Hamilton Trusts*, 1895 CanLII 155; and *Dominion Lumber & Fuel Co v Gelfand*, 1916 CarswellMan 110). In both *Hamilton* and *Dominion Lumber*, this Court declined to grant marshalling because there was no single common debtor.

[35] An exception to the single common debtor rule has developed in situations where a surety and principal relationship exists between the two debtors (see *Brown v Canadian Imperial Bank of Commerce*, 1985 CarswellOnt 729 (SC (H Ct J))).

[36] Furthermore, as stated in his text, Walter M Traub, *Falconbridge on Mortgages*, 5th ed (Toronto: Thomson Reuters, 2003) (loose-leaf updated 2019, release 29) at 14-23, the single common debtor requirement and a general exception can be described as follows based upon the decisions of *Ex parte Kendall* (1811), 17 Ves Jun 514, 34 ER 199; and *Ernst*

Bros Co v Canada Permanent Mortgage Corp, [1920] OJ No 147 (Ont SC (HC Div)):

> It is often stated that marshalling does not apply unless the creditors, in the language of Lord Eldon, "both are creditors of the same person" [quoting from *Kendall* at p 201]. . . . While, however, the ordinary case for the application of the doctrine is that of two creditors and a common debtor, it is sufficient that as between the persons interested [in] the two debts ought to be paid by the same person even though that person may not be directly liable to the creditor for the two debts.

[37] In *Ernst*, Orde J formulated the doctrine as follows (at para 24):

> . . . It must, of course, be almost universally the case that in the application of the doctrine there will be a single debtor and two creditors, and that in cases where there are two debtors the doctrine is inapplicable, not because there are two debtors but because it would be inequitable as between those debtors to marshal the securities. . . .

Bars to Marshalling

[38] Jurisprudence recognises bars to marshalling. The first one is that marshalling will not be permitted if it would interfere with the superior right of a secured creditor to pursue its remedy against either of the two funds. The other bar, for our purposes, is that the doctrine is applicable unless it causes prejudice to a third party. Potential prejudice to unsecured creditors is irrelevant (see *Williamson v Loonstra* (1973), 34 DLR (3d) 275 (BC SC), cited in *St Gregor Credit Union Ltd v Zimmer*, 2004 SKQB 75; and *Ledco Ltd, Re*, 2008 CarswellOnt 6137 (Sup Ct J)).

Position of Taylor and 067

[39] With respect to the appeal of the Marshalling Order, Taylor and 067 take the position that the liquidation judge committed reversible error by misapprehending the facts upon which he reached his conclusion and by failing to appreciate the law on marshalling. They recognise that the standard of review on the misapprehension is one of palpable and overriding error but argue that the failure to appreciate the requirements of the law on marshalling is to be reviewed on a standard of correctness.

[40] As to the misapprehension, they point to the liquidation judge's comments in his first endorsement, whereby he proceeded on the belief that RLW held security over the assets of EPG such that marshalling was not required, an obvious error.

[41] As to the misapplication of the law, they argue that marshalling was and is not available given that there is no single common debtor and that the exception relating to sureties and principals does not apply to the fact situation, particularly given that there was no guarantee of the FCC debt by EPG.

[42] Taylor and 067 also argue that there was no second fund available as RLW did not have access to both funds (being the proceeds of the sale of the assets of TBF and EPG) for which the senior creditor, BMO, had security. In their submission, the guarantee given by EPG did not constitute a fund at the disposal of RLW.

[43] For these reasons, they argue that there is no basis upon which the liquidation judge could find that RLW is entitled to the funds remaining in EPG for the purposes of satisfying the debts RLW had purchased from the creditors of TBF.

Position of Wolfe and 269

[44] In response, Wolfe argues marshalling is available simply because TBF and EPG should be treated as one entity. It was admitted in cross-examination by Taylor that the farming operation was conducted by both companies as one. The mutual cross-guarantees given to BMO by both entities in like amounts confirm that they were, in essence, being operated jointly. This would satisfy the one-debtor rule for the purposes of applying the doctrine of marshalling and would also address the issue of two funds as the single debtor would be the source of the second fund. Wolfe also argues that there has been recognition that the doctrine can be applied in situations of two or more debtors as long as the matter relates to the same debt (see *Condominium Corporation No 082 6970 v 1117398 Alberta Ltd*, 2012 ABQB 233 (*Condo Corp 6970*)). It is not limited to the precise principal/surety exception articulated in the *Brown* decision.

Position of the Wiebes

[45] The Wiebes acknowledge that the proposal advanced by Wolfe would not affect their interests as he requested that the EPG assets be subject to a holdback to satisfy their claim in priority to the reallocation of the BMO debt repayment. As such, there is no prejudice to a secured third party. The quantification of the Wiebes' claim is another issue and will be dealt with in the discussion of the Distribution Order.

Position of Pitblado

[46] Pitblado agrees with Wolfe and says that it too should benefit from the doctrine of marshalling as its judgments made it akin to a secured

creditor or, at the very least, that it should rank above other unsecured creditors. As mentioned previously, at the hearing of August 31, 2018, Pitblado advanced the argument that it should rank as a junior secured creditor.

Analysis

[47] The effect of the Marshalling Order was to reallocate between TBF and EPG funds in the hands of the liquidator to allow RLW to realise on its securities to a greater extent and provide funds to satisfy Pitblado's judgments.

[48] The liquidation judge reached his first decision on a factually incorrect premise, namely, that RLW had access to the assets of both TBF and EPG. That was an error and led him to the initial finding that marshalling was not required. It was a clear and palpable error. He then proceeded to reach a similar outcome by, in essence, ordering marshalling without calling it so. There was no basis for him to do so in law. This was also reversible error.

[49] In our view, marshalling is not available on the facts of this case as there is not a single common debtor. RLW argues that marshalling in favour of itself and Pitblado should be allowed on the basis that the single common debtor criterion is met because TBF and EPG should be considered as one entity. In our view, EPG and TBF can only be treated as one entity if the corporate veil between them is pierced.

Piercing the Corporate Veil

[50] Piercing the corporate veil in the context of marshalling has been the subject of considerable American authority (see Paul AU Ali, *Marshalling of Securities: Equity and the Priority-Ranking of Secured Debt* (Oxford: Clarendon Press, 1999) at 147-53), and has been mentioned by one Canadian court. In *Montmor Investments Ltd v Montreal Trust Co*, 1984 CarswellBC 130 (SC), McKenzie J discussed the possibility of piercing the corporate veil to allow marshalling but declined to do so. As explained by Professor MacDougall (MacDougall at pp 105-6):

> The question of two legal persons being considered a common debtor for the purposes of marshalling will often arise in the context of a corporate debtor. The court in [*Montmor*] . . . alluded to the possibility that a corporate veil could be lifted so as to make a shareholder and the company a common debtor for the purposes of the doctrine of marshalling. However, in that case, the court found that there was not such unity between the various corporate entities to justify lifting the corporate veil. <u>In the U.S., most courts have declined to lift the corporate veil so as to use the doctrine of marshalling because the proponent has not met the high standard of proof (clear and convincing evidence) required to rebut the presumption of separate entities. . . . The decision to lift the corporate veil will be made in accordance with the general rules of when it is appropriate to do so.</u> . . .
>
> [emphasis added]

[51] Canadian courts have been very reluctant to pierce the corporate veil, whether by looking behind the corporation at the shareholder or by treating two or more corporations as one entity. Generally, the separate identity of related or integrated corporations has been disregarded only where there is evidence that one corporation is a subsidiary, which is completely dominated by its parent, such that it does not operate independently—almost invariably with an improper purpose; or there is

clear evidence establishing that one corporation is an express or implied agent of the other corporation. That said, as an exception to the general proposition that the corporate veil should be lifted only in cases of illegality or agency, some courts have recognised a "group enterprise"[1] or "single business entity" concept[2] where an injustice would otherwise result, but this has been carefully limited (see *Salomon v Salomon & Co; Salomon & Co v Salomon*, [1897] (1896) AC 22 (HL (Eng)); *Fairview Donut Inc v The TDL Group Corp*, 2012 ONSC 1252, affirmed 2012 ONCA 867, leave to appeal to SCC refused, 35207 (16 May 2013); and *Teti and ITET Corp v Mueller Water Products*, 2015 ONSC 4434 at paras 17-21).

[52] The reason for the courts' reluctance to pierce the corporate veil is clear. As stated in CED 4th (online), *Business Corporations* (Ont), "Introduction: Characteristics of Corporation: Limited Liability: Piercing or Lifting Corporate Veil" (I.2.(b).(ii)) (at para 35):

> If investment is to be encouraged, it is necessary that stability prevail. The constant recognition of corporate personality promotes stability, for otherwise investors and business people would be unable to predict when the corporate form would be respected and when it would not, and thus no confidence would be placed in it. The need for stability justifies the limited willingness of the courts to pierce the corporate veil.

[53] In this case, the evidence does not establish the domination of either TBF or EPG by the other for improper purposes, or otherwise, nor an agency relationship between them. Furthermore, there is not sufficiently

[1] *Teti and ITET Corp v Mueller Water Products*, 2015 ONSC 4434 at para 19

[2] *Fairview Donut Inc v The TDL Group Corp*, 2012 ONSC 1252 at para 657, affirmed 2012 ONCA 867, leave to appeal to *SCC* refused, 35207 (16 May 2013), quoting from *801962 Ontario Inc v MacKenzie Trust Co*, 1994 CarswellOnt 6168 at para 37 (Ct J (Gen Div))

clear and convincing evidence of the unity between the two companies to support a finding that they should be treated as one.

The Operation of TBF and EPG

[54] As previously stated, for many years, starting in 2008, TBF and EPG were engaged in a farming enterprise. The two companies had the same owners and ownership structure. They provided full security and cross-guarantees to their primary secured creditor, BMO. While Taylor acknowledged on cross-examination that the companies were conducting business together, with EPG effectively operating as part of TBF, this arrangement is typical of the manner by which many enterprises structure and conduct their affairs.

[55] Furthermore, there is significant evidence indicating that TBF and EPG were operated as separate entities throughout:

- At the outset of Wolfe's involvement in the business, a decision was made to conduct the farming operation through two corporations as opposed to another business structure, such as a partnership.

- The USA signed by Wolfe and Taylor was in relation to TBF only.

- EPG was solely a landholding company whereas TBF operated the farm (and also owned some farmland). The lands held by the two companies were not owned jointly; each held separate parcels. Agricultural buildings were situated on land owned by

EPG while a farm home, older farm buildings and a vacant residence were on land owned by TBF.

- TBF employed about 40 people during the growing season and had liabilities to these employees. There is no evidence that EPG shared these liabilities.

- Although the evidence includes a Combined Financial Statement for TBF (together with EPG, 067 and 269) as of December 31, 2013, there are also Non-Combined Financial Statements for TBF only.

- The arbitration award dated August 24, 2016 addressed an issue regarding Taylor's remuneration as an employee of TBF during the years 2013 and 2016. The issue involved interpretation of a contract between TBF and Taylor—that is, whether "profits of the employer" meant only profits from the operation of TBF or also profits from the sale of TBF lands and profits from EPG. Interestingly, contrary to the positions taken on these appeals, Wolfe argued before the arbitrator that profits from EPG should not be included as TBF was the only party named in the employment contract, and Taylor argued that profits from EPG should be included because the parties always treated EPG and TBF as a single entity.

- Land titles registrations indicate that, over many years, the two companies gave individually secured mortgages to BMO and only the last $10,000,000 credit advance by BMO was a jointly secured debt on the land owned by each corporation.

- In 2014, BMO's term sheets for its loans set different credit limits for each corporation: $4,308,475 for TBF and $1,993,737.64 for EPG.

- BMO kept track of the amounts loaned to each corporation which is how it generated its payout statements. The parties were aware of this as counsel for Wolfe sent an email to counsel for Taylor on May 7, 2016, confirming an agreement between the parties that money received from renting EPG and TBF lands should be forwarded to BMO "with specific instructions that the amounts be applied to the credit of TBF against the outstanding debt owing by TBF to BMO on the line of credit."

- TBF borrowed money from FCC, BNS and RBC, and provided security to those entities. EPG only provided guarantees on those debts and did not provide a guarantee to FCC.

- The Wiebes are secured creditors of EPG but not of TBF.

- Pitblado, lawyers for both companies, sued TBF and EPG separately and obtained default judgment against each, treating them as separate entities.

- The liquidator's instructions to creditors indicated that the creditor should set out its claims against TBF and its claims against EPG separately.

- The liquidator has advanced a claim for an intercompany debt, owed by EPG to TBF, in excess of $900,000.

[56] In these circumstances, RLW has not established that it is equitable for the corporate veil between TBF and EPG to be pierced such that they should be considered one entity. The single common debtor criterion has not been satisfied.

Principal/Surety Exception

[57] An exception to the single common debtor rule has developed related to sureties and principals. We are of the view that the facts of this case do not bring it within that exception. The first factual problem is that a major component of the RLW debt, the FCC loan, is not the subject of any guarantee by EPG to TBF. As conceded by RLW in argument on appeal, the principal/surety exception has no application in the facts of this case, even where guarantees were provided.

[58] In *Brown* at para 12, the Court explained the exception, adopting the following passage from the decision of Bell J in the Supreme Court of Pennsylvania case of *Neff v Miller*, 8 PA 347 (1848):

> Here is a surety, whose money has been applied in payment of the debt of his principal, to the exclusion of his own proper creditors. That he would be entitled to come in, by way of substitution, upon the estate of the principal, is every-day equity; and I think it equally clear, that his creditor, who has suffered by

> the appropriation of a fund which otherwise would have been available for the discharge of his claim, may well ask to stand upon this equity, to the extent of the deprivation to which he has been subjected.

[59] Similarly, according to Halsbury's Laws of Canada (online), *Guarantee and Indemnity*, "The Rights of a Surety: As Against the Creditor: Securities in Favour of the Creditor" (V.1.(5)) at HGI-234 "Surety Entitled to Securities Received by Creditor from Principal" (Cum Supp – 1 June 2019):

> . . . ***It is an ancient*** principle, . . . founded upon the equitable doctrine of marshalling, . . . that unless otherwise agreed . . . on payment or performance by the surety of the guaranteed obligation, . . . the surety has the right to the benefit of all securities that the creditor has received from the principal debtor in respect of the debt in order to enable the surety to obtain satisfaction for what the surety has paid. . . .
>
> **Similar equitable principle governs marshalling of funds and securities.** The surety's rights with respect to securities existing in respect of the guaranteed obligation are derived from the equitable doctrine imposed upon the principal debtor to indemnify the surety. . . . In addition, it is felt to be inequitable for a creditor to fail to realize against a security which is available to the creditor in respect of the guaranteed debt, and instead to throw the whole liability upon the surety. (underlining added) . . . To compensate the surety for the payment that the surety has made on the principal's behalf in respect of the guaranteed debt, the surety is given a right to look to the security held by the creditor in respect of that debt. . . . As mentioned above, this right is based upon general principles of equity that are similar to those which govern the marshalling of funds and securities. . . .

[60] These passages confirm that marshalling may be allowed based on the principal/surety exception in circumstances where the senior creditor of both the principal debtor and surety seeks payment from the surety—to the

detriment of the junior creditor of the surety which has access only to the property of the surety. That junior creditor can invoke marshalling in order to have the senior creditor's claim paid by the principal debtor. This arises because of a principal debtor's obligations to the surety.

[61] By contrast, in the present case, it is the junior creditor (RLW) of the principal debtor (TBF) rather than the junior creditor of the surety (EPG) that seeks marshalling. It asks to have funds of the surety marshalled. However, marshalling is not fair in this situation because a surety has no obligation to indemnify a principal debtor (see MacDougall at p 108).

[62] Finally, the principal/surety exception has no application with respect to Pitblado as the debts owed to it by each of TBF and EPG are not the subject of guarantees.

<u>Other Circumstances Where Marshalling May be Just and Equitable</u>

[63] With respect to *Condo Corp 6970*, which was the authority relied upon by Wolfe on this issue and in which the Court found that marshalling was available where the "funds belong[ed] to the same debtor, <u>or</u> to two or more debtors with respect to the same debt" (at para 43), it is not clear how the Court arrived at that language. The decision, which seems to extend marshalling beyond the scope allowed in other cases, was not appealed, nor has it been judicially considered by any other court.

[64] In this case, we are of the view that it is not just and equitable to order marshalling. RLW assumed the loans of FCC, RBC and BNS to TBF on the basis that it would have security against the assets of TBF and partial

guarantees from EPG. Had RLW insisted on more security before assuming those loans, it could have sought it from EPG but it did not do so.

[65] Nonetheless, the effect of allowing marshalling is that RLW would be paid, before the unsecured creditors of EPG, from the funds of EPG that resulted from the sale of its land. RLW would effectively become a secured creditor of EPG despite it holding no security against the assets of EPG—and, with respect to the debt RLW assumed from FCC, not even having a guarantee from EPG.

Conclusion on the Issue of the Marshalling Order

[66] For the reasons outlined above, we would not order marshalling in favour of RLW or Pitblado on the facts of this case. That is not to say that an order of marshalling may not be allowed in a case of related companies which do not fall strictly within the criteria that have traditionally been followed in the granting of the remedy to date. In an appropriate case, a court retains the power to pierce the corporate veil in a situation where equity would demand such an outcome (in the context of the enforcement of a judgment, see the concurring reasons of Nordheimer JA in *Yaiguaje v Chevron Corporation*, 2018 ONCA 472, leave to appeal to SCC refused, 38183 (4 April 2019)). However, on the evidentiary matrix before us, our view is that it would not be just and equitable to pierce the corporate veil to allow marshalling.

<u>Issue #2—The Distribution Order</u>

[67] Taylor and 067 appeal from the Distribution Order made by the liquidation judge whereby he approved a distribution schedule. Two areas of contention by Taylor with respect to that schedule are:

a) recognition of an "inter-company debt" owing to TBF from EPG in the amount of $916,336; and

b) payment to the Wiebes with respect to security held by them over the assets of EPG.

Intercompany Debt

[68] As a consequence of our conclusion regarding marshalling, the intercompany debt claim of TBF against EPG is not moot.

[69] Taylor was only notified of the liquidator's approval of the intercompany debt in the EPG claims process on August 9, 2018 when it was included on a proposed distribution schedule for the first time.

[70] In correspondence with the liquidator and in submissions before the liquidation judge, Taylor/067 sought to challenge this intercompany debt. In a letter to the liquidator dated August 24, 2018, they argued that a thorough accounting between EPG and TBF would show that TBF owed funds to EPG for a number of reasons as set out in that letter. They also advised the liquidator that they would be taking that position at the next appearance before the liquidation judge on August 31, 2018.

[71] While no further affidavit evidence was provided to the liquidation judge at that hearing providing substantive details regarding this issue, it was raised before him at that time. However, the liquidation judge did not turn

his mind to the issue as it had been rendered moot once he ordered the reallocation sought by RLW. On appeal, Taylor/067 take the position that, if marshalling is not allowed, the issue of the intercompany debt should be remitted to the liquidation judge for adjudication.

[72] The liquidator argues that, even if marshalling is not allowed and no reallocation is made, there is no basis for this Court to interfere with its approval of the intercompany debt and the matter should not be returned to the liquidation judge. The liquidator notes that it conducted a claims process in respect of EPG in accordance with the order approving a claims process for both companies (the Claims Process Order), which provided for a final and conclusive determination of a claimant's claim by an independent court officer—the liquidator. The liquidator further argues that the Claims Process Order gives Taylor/067 no standing to challenge the claim; the relevant records to challenge the claim were in the possession of Taylor/067 and not presented to the Court; and the doctrines of collateral attack and issue estoppel protect the Claims Process Order.

[73] We are of the view that the liquidation judge has meaningful supervisory jurisdiction to review a determination made by the liquidator during the claims process. That jurisdiction has not yet been exercised in connection with the intercompany debt. Therefore, the matter should be remitted to the liquidation judge for that purpose.

[74] While it will be the liquidation judge's decision as to how to conduct that review, given the extensive litigation which has already taken place over these issues and the need to respect the proportionality principle, a summary proceeding in keeping with the liquidation process would appear

to be the desired approach. A quick resolution also takes into consideration the fact that no further information substantiating their position has been provided by Taylor/067 either by affidavit or other form notwithstanding a promise to do so in the August 24, 2018 letter.

The Wiebes' Claim

[75] The exact nature of the Wiebes' relationship with EPG and the nature of its security are unclear. However, as early as the liquidator's second report in March 2018, the fact that they were secured creditors was known. In its supplement to the second report, the liquidator advised that it had received a legal opinion to the effect that the Wiebes' security was valid and enforceable, that the lands owned by EPG were charged with a second fixed and specific charge in favour of the Wiebes ranking behind the BMO registration, and that their security ranked in priority to the claims of the unsecured creditors of the company. At that time, the exact amount of the indebtedness was not known given that the claims process, while approved by the Court, had not yet been instituted by the liquidator.

[76] As stated previously, the sale and vesting order preserved priorities in the sold lands as if the lands had not been sold and attached that priority to the net proceeds of the sale, in essence preserving whatever security interest the Wiebes had in the EPG lands.

[77] At the hearing of the marshalling argument on June 21, 2018, the liquidation judge was advised that, under the allocation proposed by RLW, the Wiebes would have a holdback from the EPG funds pending a final determination of the quantum of their claim.

[78] In the meantime, the Wiebes had submitted their proof of claim to the authorised claims officer on June 10, 2018. On August 21, 2018, the liquidator issued a notice of revision of proof of claim for the Wiebes, informing them that, after deduction of an offsetting claim by EPG, the amount was $813,928, which amount was disclosed in the liquidator's fourth report of August 27, 2018 and to which the Wiebes agreed.

[79] At the August 31, 2018 hearing before the liquidation judge, the liquidator sought the approval of its proposed distribution, including the payment of the Wiebes' claim.

[80] In an affidavit filed on August 30, 2018, Taylor disputed the Wiebes' claim on the grounds that "the claim may be extinct or significantly less than the amount stated by the [l]iquidator". In Taylor's affidavit, he suggests that the Wiebes removed equipment with an estimated value of approximately $400,000 and that the Wiebes had already received sale proceeds from the sale of the EPG lands.

[81] At the hearing of August 31, 2018, the liquidation judge determined that the claims process had resolved the matter and that he was not going to revisit it.

[82] On appeal, Taylor took the position that the liquidation judge failed to hear his argument on the Wiebes' claim, thereby failing to observe the rules of natural justice and procedural fairness.

[83] The liquidator's position before us was that Taylor had no standing to challenge the liquidator's decision approving the claim and its quantum. As well, the liquidator's actions were in accordance with the claims process,

which had been approved by the Court, and there was no appeal available from those determinations.

Analysis

[84] While we would not agree with the position taken by the liquidator's counsel on the hearing of the appeal that a court has such a limited supervisory role in reviewing a determination by the liquidator made during the claims process, we are satisfied that, on the facts of this case, the liquidation judge properly exercised his discretion not to interfere in the determination of liability and the quantum with respect to the Wiebes' claim. Taylor knew as early as the supplement to the second report that the liquidator had viewed the Wiebes' security as valid and enforceable and that only quantum was left to be determined. While, admittedly, the determination of the correct quantum came late in the day, the evidence which could have changed that determination could have been placed before the liquidator by Taylor much sooner than August 30, 2018 and in a more complete fashion. That the liquidation judge chose not to become involved in reviewing the correctness of the liquidator's decision based upon the limited information in Taylor's affidavit is understandable. While it would have been preferable for the liquidation judge to provide Taylor's counsel with a greater opportunity to explain the reasons for his challenge to the Wiebes' claim, a failure to do so does not amount to a breach of natural justice in the circumstances of this case.

Conclusion

[85] For these reasons, we would allow the appeal from the Distribution Order only to enable a review of the intercompany debt claim.

Issue #3—The Pitblado Claims

[86] Pitblado provided legal services to TBF and EPG. In 2016, it commenced proceedings against TBF and EPG and obtained default judgments in the sums of $51,889.33 and $23,296.14 respectively. It registered its judgments against the lands of both corporations. When those lands were sold pursuant to the sale and vesting order, their judgment registrations were erased. Noteworthy, however, as discussed previously, is that the sale and vesting order provided that all claims and encumbrances against the lands existing prior to the sale would attach in the same priority to the net proceeds of the sale as if the lands had not been sold.

[87] In his first endorsement, the liquidation judge failed to address Pitblado's argument but, upon being requested to do so, he held in a second endorsement that he was not convinced of the availability of the remedy to Pitblado but would consider further argument.

[88] At a further hearing on September 25, 2018, the liquidation judge granted relief to Pitblado, directing that they stood behind RLW but ahead of all other general unsecured creditors with respect to the net proceeds of the sale of the lands such that marshalling was available to it. He also directed that such a priority would exist notwithstanding a bankruptcy proceeding; the liquidation judge's order to that effect was made in the Supplemental Order.

[89] Taylor appeals the liquidation judge's decision to recognise Pitblado's judgment claims ahead of unsecured creditors on the basis that Pitblado is simply a judgment creditor and not a secured one. As well, the

issue of whether the order should survive a bankruptcy was sprung at the last minute and not properly dealt with.

[90] Pitblado argues that the registration of its certificates of judgment as against the TBF and EPG lands makes it a "junior secured creditor". Thus, the liquidation judge rightly found (in the context of considering the availability of marshalling) that it should hold a position as something less than a fully secured creditor but greater than an unsecured or general creditor.

[91] For the reasons we have given discussing the issue of marshalling, we are of the view that Pitblado's arguments fail on whether marshalling applies to its claims. However, we have come to the conclusion that Pitblado should be entitled to receive the funds owing to it under its judgments from each of TBF and EPG in advance of the other unsecured creditors in the liquidation. We reach this conclusion not on the basis of marshalling but because, in our view, the sale and vesting order granted in this case, which is not the subject of appeal, recognised the priority of the judgments of Pitblado as a registered judgment creditor, preserving its priority with respect to the proceeds of the sale of the lands as if the lands were still held by the respective owners. For that reason, we would grant the relief requested and authorise payment by the liquidator to satisfy the judgments.

[92] However, as to the provision in the Supplemental Order that such a priority would survive a bankruptcy, we hold a different view. The granting of that order in its current form raises concerns. In the first place, we agree with Taylor/067 that they were not provided with sufficient opportunity to

challenge the appropriateness of granting that order. It was raised at the last minute on the hearing to determine the form of the order.

[93] Of greater concern is that it was presented to the liquidation judge as a standard form of order in order to ensure that determinations made by the liquidation judge are not reviewed in a bankruptcy proceeding as a fraudulent preference. However, the Supplemental Order goes further. By its terms, it validates Pitblado's claims, to the extent they are not otherwise satisfied, over any other "unsecured creditor or creditors of TBF or EPG". This presumptively seeks to grant Pitblado a priority in not only the liquidation proceedings, but also on any further bankruptcy proceedings. No law or jurisprudence has been provided to warrant such a conclusion. It may well be that, in a bankruptcy proceeding, notwithstanding the terms of the sale and vesting order, Pitblado would rank solely as an unsecured creditor on the basis of its judgments. Unless there was some reason, equitable or otherwise, to justify a priority in a yet-to-occur bankruptcy, a presumptive order made in anticipation is not warranted in the circumstances. If a bankruptcy does occur, the matter of a priority should be determined by a bankruptcy court according to the appropriate legal principles governing that eventuality.

[94] Therefore, while Pitblado's claims should be recognised in advance of other unsecured creditors in accordance with the priorities set out in the sale and vesting order, the Supplemental Order should be limited to claims of fraudulent preferences or advances under the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3.

Disposition

[95] For the foregoing reasons, we would:

(1) allow the appeal from the Marshalling Order and from the Distribution Order to the extent that they provide for reallocation based on marshalling;

(2) refer the intercompany debt claim to the liquidation judge;

(3) subject to the results of the review of the intercompany debt claim by the liquidation judge, order distribution as set out in Scenario 1 (no residual fund reallocation) of the liquidator's fourth report;

(4) allow the Pitblado claims to rank in priority to other unsecured creditors in the liquidation proceedings but leave any priority to be claimed in a bankruptcy proceeding to the bankruptcy court if it arises; and

(5) allow distribution to the Wiebes according to their claim.

Costs

[96] We would allow costs as follows:

(1) costs in the Court below in connection with the Marshalling Order in accordance with the applicable tariff and one set of costs in this Court in accordance with Tariff C, both in favour of Taylor/067, to be paid by RLW;

(2) one set of costs in this Court in accordance with Tariff C in favour of each of the Wiebes and the liquidator to be paid by

Taylor/067 in respect of the Distribution Order appeal—we order no costs on the intercompany debt issue to any party but direct that the costs be dealt with by the liquidation judge upon the hearing of the matter; and

(3) as to the Pitblado claims, given the relative success of both parties, we order no costs in this Court and, as no costs were provided in the Court below, we make no disposition with respect to those costs.

_________________________________ JA

_________________________________ JA

I agree: _________________________________ CJM

TAB 10

HGI-234 Surety entitled to securities received by creditor from principal.

Halsbury's Laws of Canada - Guarantee and Indemnity (2022 Reissue)

Alison Manzer, Charles Newman, Marc Mercier, Jennifer Wasylyk, Corina Capmare (Main Title Contributors)

HGI-234

Halsbury's Laws of Canada - Guarantee and Indemnity (2022 Reissue) (Manzer, Newman, Mercier, Wasylyk, Capmare) > V. The Rights of a Surety > 1. As Against the Creditor > (5) Securities in Favour of the Creditor

V. The Rights of a Surety

1. As Against the Creditor

(5) Securities in Favour of the Creditor

HGI-234 Surety entitled to securities received by creditor from principal.

The surety's rights of subrogation are not limited to the rights *in personam* to which the creditor is entitled. It is an ancient principle,[1] founded upon the equitable doctrine of marshalling,[2] that unless otherwise agreed[3] on payment or performance by the surety of the guaranteed obligation,[4] the surety has the right to the benefit of all securities that the creditor has received from the principal debtor in respect of the debt in order to enable the surety to obtain satisfaction for what the surety has paid.[5] The surety will be released to the extent of any prejudice suffered if the creditor cannot, by reason of what the creditor has done, give the surety the securities in the same condition as they were formerly held by the creditor in respect of the guaranteed debt.[6] If the creditor diminishes or destroys through laches (unreasonable delay) or neglect a security to which the surety would otherwise have been entitled, the creditor is bound to credit the surety with the fair value of the security so prejudiced.[7] The surety's right to receive the benefit of these securities applies irrespective of whether the surety had knowledge of their existence at the time when they became a surety.[8] A surety for a limited amount has in respect of that amount the same rights as the creditor. To the extent of the surety's liability, therefore, the surety is entitled to the benefit of any security held by the creditor in respect of the whole debt.[9] These rights can be, and often are, waived in the guarantee agreement. Commonly, the right is delayed until full payment to the creditor, rather than waived.

Similar equitable principle governs marshalling of funds and securities. The surety's rights with respect to securities existing in respect of the guaranteed obligation are derived from the equitable doctrine imposed upon the principal debtor to indemnify the surety.[10] In addition, it is felt to be inequitable for a creditor to fail to realize against a security which is available to the creditor in respect of the guaranteed debt, and instead to throw the whole liability upon the surety.[11] To compensate the surety for the payment that the surety has made on the principal's behalf in respect of the guaranteed debt, the surety is given a right to look to the security held by the creditor in respect of that debt.[12] As mentioned above, this right is based upon general principles of equity that are similar to those which govern the marshalling of funds and securities.[13] The marshalling concept is a requirement imposed upon creditors by equity in those cases where one creditor of a debtor is able to draw upon two or more sources of payment, while a second creditor of that debtor may resort to a lesser number of sources.[14] The goal of the doctrine of marshalling is to ensure that one creditor does not act so as to deprive another creditor of their due proportion of the debtor's estate.[15]

Surety may rank ahead of other creditors of principal. The surety is entitled to the benefit of all securities held in respect of the guaranteed debt or obligation, including both those that existed at the time when the guarantee was given,[16] and those that came into existence after the assumption of liability by the surety.[17] The right of the surety to be subrogated to the rights of a secured creditor in respect of collateral securities deposited by the principal will in certain cases enable the surety to step ahead of subsequent encumbrancers and the general creditors of the principal.[18]

Securities to which surety may be entitled. The term "security" is given a wide meaning by the courts.[19] It has been held that a guarantee by one partner of a firm under which the creditor has a right of proof against the separate estate of that partner (in addition to the creditor's right of proof against the partnership property) is a security to which a surety may resort.[20] An insurance policy on the life of the principal,[21] or upon the principal's assets,[22] has also been held to be a security of which the surety is entitled to enjoy the benefit. Likewise, a sum of money standing to the credit of the principal, but which is appropriated to a particular purpose under the terms of a contract is considered to be comparable to a security, and the surety has similar rights in respect of that sum as the surety would have in the case of a genuine security.[23] A right of distress is not a security in the nature of a lien, but a lien arises once that right is exercised against the property concerned.[24]

Footnote(s)

1 *Morgan v. Seymour* (1638), Rep. Ch. 120, 21 E.R. 525 (Ch.); *Swain v. Wall* (1641), Rep. Ch. 149, 21 E.R. 534 (Ch.), *per* Hutton J.

2 The term "marshalling" refers to the practice in equity of ranking or arranging classes of creditors with respect to the assets of a common debtor so as to provide for the satisfaction of the greatest number of claims. In *Fiatallis North America, Inc. v. Pigott Construction Ltd.*, [1992] O.J. No. 178, 3 P.P.S.A.C. (2d) 30 at 34 (Ont. Gen. Div.), Austin J. explained the operation of the doctrine in the following terms:

> Marshalling is an equitable doctrine which applies to protect a creditor who has recourse to one fund of a debtor from the actions of another creditor who has access to more than one fund of the same debtor. … The court will not interfere with the rights of creditor X against any or all of the funds, but if X resorts to the one funds against which Y has rights, then in appropriate circumstances the court will subrogate Y to the rights of X in the other funds. … Three conditions must prevail in order for the doctrine to apply: (a) the claim must be against a single debtor; (b) the two funds must be at the debtor's disposal; (c) the two funds must be in existence when the question of marshalling arises.

See also *Halsbury's Laws of Canada – Equitable Remedies (2020 Reissue)*, **HER-21** ("Marshalling of Assets").

3 *Bauer v. Bank of Montreal*, *[1980] S.C.J. No. 46*, *[1980] 2 S.C.R. 102* (S.C.C.); but *cf. Pioneer Trust Co. v. 220263 Alta. Ltd.*, [1989] A.J. No. 56, 94 A.R. 86 at 94 (Alta. Q.B.), *per* Virtue J., affd [1991] A.J. No. 268 (Alta. C.A.); *CIBC v. Morrison*, [1986] N.S.J. No. 378, 33 D.L.R. (4th) 132 (N.S.C.A.).

4 In *Dixon v. Steel*, [1901] 2 Ch. 602 at 607 (Ch. D.), Cozens-Hardy J. made it clear that while the right of the surety to take an assignment does not arise till payment, the right to the benefit of a security arises at the time when the surety assumes their obligations as such.

5 See, for instance, *Ex p. Crisp* (1744), 1 Atk. 133 at 135, 26 E.R. 87 (L.C.); *Pledge v. Buss* (1860), John. 663, 70 E.R. 585 (V.C.); *Duncan, Fox & Co. v. North & South Wales Bank* (1880-81), L.R. 6 App. Cas. 1 (H.L.).

6 *Wulff v. Jay* (1872), 7 Q.B. 765 (Q.B.), *per* Hannen J.

7 *Taylor v. Bank of New South Wales* (1886), L.R. 11 App. Cas. 596 at 602-603, *per* Lord Watson (P.C.); *Traders Finance Corp. v. Ross*, [1942] O.J. No. 469, [1942] O.R. 618 (Ont. H.C.J.); *McKay v. O'Hanley* (1910), 8 E.L.R. 115 at 118 (P.E.I.S.C.), *per* Fitzgerald J.; *MacDonald v. Hirsch*, [1932] N.S.J. No. 9, 5 M.P.R. 469 (N.S.C.A.).

8 See, for instance, *Leicestershire Banking Co. v. Hawkins* (1900), 16 T.L.R. 317 (Q.B.); *Duncan, Fox & Co. v. North & South Wales Bank* (1880-81), L.R. 6 App. Cas. 1 (H.L.); *Nicholas v. Ridley*, [1904] 1 Ch. 192 (C.A.); *Merchants Bank of London v. Maud* (1871), 19 W.R. 657; *Forbes v. Jackson* (1881-82), L.R. 19 Ch. D. 615 (Ch. D.).

9 *Goodwin v. Gray* (1874), 22 W.R. 312; see also *Re Hamilton* (1895), 10 Man. R. 573 (Man. C.A.); *Rigney v. Vanzandt*, [1856] O.J. No. 322, 5 Gr. 494 (U.C. Ct. Ch.).

10 *Nicholas v. Ridley*, [1904] 1 Ch. 192 (C.A.); *Yonge v. Reynell* (1852), 9 Hare 809, 68 E.R. 744; *Lord Harberton v. Bennett* (1829), Beat. 386 (L.C.).

11 *Aldrich v. Cooper* (1803), 8 Ves. Jr. 382 at 389, 32 E.R. 402 (Ch.), *per* Lord Eldon V.C.

12 *First City Capital Ltd. v. Hall*, [1993] O.J. No. 135, 11 O.R. (3d) 792 (Ont. C.A.).

13 *Duncan, Fox & Co. v. North & South Wales Bank* (1880-81), L.R. 6 App. Cas. 1 at 12 (H.L.), *per* Lord Selborne; *Heyman v. Dubois* (1871-72), L.R. 13 Eq. 158 (Eq.).

14 Discussed in R.P. Meagher, J.D. Heydon & M.J. Leeming, *Meagher, Gummow and Lehane's Equity: Doctrines and Remedies*, 4th ed. (Sydney: Butterworths, 2002) at 309-31.

15 See, generally, *Re Cohen, National Provincial Bank v. Katz*, [1960] Ch. 179 at 190 (Ch.), *per* Dankwerts J.

16 *Forbes v. Jackson* (1881-82), L.R. 19 Ch. D. 615 at 621 (Ch. D.), *per* Hall V.C.; *Campbell v. Rothwell* (1877), 47 L.J.Q.B. 144 at 146 (Assizes), *per* Denman J.; *Re Davison's Estate* (1893), 31 L.R. Ir. 249 (L.J.C.), affd [1894] 1 I.R. 56 (C.A.). In *Personal Property Security Act* jurisdictions, there is no obligation to register a financing change statement under the *Personal Property Security Act* in order to protect the surety's rights against a trustee in bankruptcy: *Re Windham Sales Ltd.*, [1979] O.J. No. 4387, 1 P.P.S.A.C. 73 (Ont. S.C. in Bank.).

17 *Mayhew v. Crickett* (1818), 2 Swans. 185 at 191, 36 E.R. 585 (Ch.), *per* Lord Eldon L.C.; *Pledge v. Buss* (1860), John. 663, 70 E.R. 585 (V.C.); *Lake v. Brutton* (1856), 8 De G. M. & G. 440, 44 E.R. 460; *Scott v. Knox* (1838), 2 Jo. Ex. Ir. 778; *Campbell v. Rothwell* (1877), 47 L.J.Q.B. 144 (Assizes); *Traders Finance Corp. v. Ross*, [1942] O.J. No. 469, [1942] O.R. 618 (Ont. H.C.J.); *Leicestershire Banking Co. v. Hawkins* (1900), 16 T.L.R. 317 (Q.B.), *per* Mathew J.; but compare *Newton v. Chorlton* (1853), 10 Hare 646, 68 E.R. 1087 (V.C.).

18 *Badeley v. Consolidated Bank* (1888), L.R. 38 Ch. D. 238 (C.A.).

19 *Re Holland, ex p. Alston* (1868-69), L.R. 4 Ch. App. 168 (C.A.); but *cf. Royal Bank of Canada v. Western Vacations Ltd.*, [1994] A.J. No. 274, 114 D.L.R. (4th) 537 (Alta. C.A.); *Child & Gower Piano Co. v. Gambrel*, [1933] S.J. No. 33, [1933] 2 W.W.R. 273 at 281-82 (Sask. C.A.); see also *Alberta Opp. Co. v. Schinnour*, [1990] A.J. No. 1125, 78 Alta. L.R. (2d) 48 (Alta. C.A.).

20 *Re Stratton, ex p. Salting* (1883), 25 Ch. D. 148 at 153 (C.A.), *per* Fry L.J.

21 *Lake v. Brutton* (1856), 8 De G. M. & G. 440, 44 E.R. 460; *Heyman v. Dubois* (1871-72), L.R. 13 Eq. 158 (V.C.); but compare *Dalby v. India and London Life Assurance Co.* (1854), 15 C.B. 365, 139 E.R. 465 (C.P.).

22 *Watts v. Shuttleworth* (1861), 7 H. & N. 353, 158 E.R. 510 (Ex. Ch.). However, there is no general obligation on the creditor to keep the assets insured: *Bank of Montreal v. Kodiak Log Services Ltd.*, [1984] B.C.J. No. 1317, 6 C.C.L.I. 14 (B.C.S.C.), revd [1984] B.C.J. No. 1955, 8 C.C.L.I. 9 (B.C.C.A.).

23 *Re Sherry, London & County Banking Co. v. Terry* (1884), L.R. 25 Ch. D. 692 at 702 (C.A.), *per* Lord Selbourne L.C.; but *cf. Royal Bank of Canada v. Western Vacations Ltd.*, [1994] A.J. No. 274, 114 D.L.R. (4th) 537 at 540 (Alta. C.A.), where such a conclusion was rejected given the tenor of correspondence that had passed between the parties.

24 *Commercial Credit Corp. v. Harry D. Shields Ltd.*, [1980] O.J. No. 3639, 29 O.R. (2d) 106 (Ont. H.C.J.), *per* R.E. Holland J., affd [1981] O.J. No. 2999, 32 O.R. (2d) 703 (Ont. C.A.), *per* Weatherstone J.A.; *Leavere v. Port Colborne (City)*, [1995] O.J. No. 217, 79 O.A.C. 16 at 19 (Ont. C.A.), *per* Galligan J.A.

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TAB 11

§10.153

Where a surety has guaranteed only a part of the total debt of the principal and has paid that part, he is entitled (like any other creditor) to claim for and receive the dividend payable out of the assets of the principal, even if a further amount remains owing to the creditor.[486] Where, however, the guarantee is for the whole of the indebtedness of the principal but subject to a limit on maximum liability, the surety may not prove in a bankruptcy proceeding against the principal until such times as the surety has paid the creditor.[487] After having paid the creditor, there is no doubt that the surety is entitled to claim in the place of the creditor, and that right will not be lost even where the creditor has entered into an agreement with the principal's trustee, not to claim in the bankruptcy.[488] The surety may not, however, acquire a better claim against the principal than that to which the creditor was originally entitled against the debtor, merely as a result of paying the creditor's claim.[489]

Footnotes — §10.153:

[486] *Grey v. Seckham* (1872), L.R. 7 Ch. App. 680; see also *Re Smith* (1931), 3 M.P.R. 485 (N.S.C.A.), *per* Graham J.

[487] *Hobson v. Bass* (1871), 6 Ch. App. 792 at 792, *per* Hatherley L.C.; *Re McCrie v. Gray*, [1940] O.J. No. 291, 22 C.B.R. 390 (Ont. H.C.J.). In *Re Smith* (1931), 3 M.P.R. 485 (N.S.C.A.), Mellish J. stated: "In my opinion as long as any of the guaranteed shortage remains unpaid, the guarantors are postponed to the guaranteed creditor's claim against the Smith estate for the balance due. The guarantors in effect undertook to pay a limited sum towards the ultimate balance remaining after all moneys remaining from other sources have been applied in reduction of the principal debt." It is clear that creditors should take particular caution in ensuring that any limited guarantee will not permit the surety to claim in any bankruptcy proceeding in competition with the claim of the creditor. See also *Re Coughlin & Co.*, [1923] M.J. No. 56, [1923] 3 W.W.R. 1177 (Man. C.A.); *Martin v. McMullen*, [1891] O.J. No. 35, 18 O.A.R. 559 (C.A.).

[488] *Stratford Fuel Ice Cartage & Construction Co. (Liquidator of) v. Coughlin*, [1914] S.C.J. No. 35, 50 S.C.R. 100 at 107 (S.C.C.), *per* Fitzpatrick C.J.

[489] There is no general rule, however, against a surety taking a security in his own right. On the contrary, the taking of security by a surety is quite common where the guarantee is provided by a commercial surety, such as an insurance company, bank or other financial institution. See also: *In Re Walter's Deed of Guarantee*, [1933] Ch. 321.

TAB 12

BANKRUPTCY & INSOLVENCY LAW

SECOND EDITION

Roderick J. Wood

ESSENTIALS OF CANADIAN LAW

4) Subrogation to the Rights of a Secured Creditor

Subrogation permits a party to exercise the rights of another person. A person who does not have a valid security interest in certain circumstances may be subrogated to rights of a secured creditor. The person is thereby entitled to be substituted for and exercise the rights of the secured creditor. Subrogation to secured creditor status can occur in a number of situations. A surety who has paid the principal debtor's debt is entitled to be subrogated to any security interest that the creditor has in respect of the debt. Suppose that A lends money to B and is given a security interest in B's property. C also guarantees repayment of the money to A. If C pays the debt owed to A, C is entitled to be subrogated to the security interest that A holds against B. If B is bankrupt, C is nevertheless able to assert the security interest against B's trustee.[48]

A right of subrogation also arises where, at the request of a debtor, a lender pays out the loan of a third party. The lender is entitled to be subrogated to any security interest held by the third party. The fact that the lender may have taken security that is ineffective against the trustee is not relevant. So long as the security interest that was taken by the third party is valid and effective against the trustee, the right of subrogation permits the secured party to exercise the rights under that security interest.[49]

A right of subrogation also arises in connection with the equitable doctrine of marshalling of securities. This occurs when a senior secured creditor has a security interest in two funds and a junior secured creditor has a security interest in only one of them. If the senior secured creditor enforces its remedies against the common fund, this will undercut the junior secured party's position. Marshalling of securities permits the senior secured party to enforce its security interest against the common fund, and gives the junior secured party the right to be subrogated to the security held by the senior secured party against the other fund. The right of subrogation that arises in connection with the marshalling of assets is effective against the trustee in bankruptcy of the debtor.[50]

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48 *Re Windham Sales Ltd* (1979), 31 CBR (NS) 130 (Ont HCJ).

49 *Re N'Amerix Logistix Inc* (2001), 29 CBR (4th) 222 (Ont SCJ). And see R Wood, "Supplementing PPSA Priorities: The Use and Abuse of Common Law and Equitable Principles" (2014) 56 *Canadian Business Law Journal* 31 at 55–70.

50 *Re Bread Man Inc* (1978), 29 CBR (NS) 58 (Ont HCJ); *Canada Trustco Mortgage Co v Wenngatz Construction & Holdings Ltd* (1986), 60 CBR (NS) 270 (BCSC).