

Court File No. CV-16-11331-00CL

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

BETWEEN:

ROYAL BANK OF CANADA

Applicant

- and -

2292319 ONTARIO INC.

Respondent

FACTUM OF THE COURT-APPOINTED RECEIVER
(Motion returnable July 28, 2016)

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PART I: FACTS

Overview

1. In order for msi Spergel inc. ("**Spergel**") to pursue its mandate effectively as the Court-appointed receiver (in such capacity, the "**Receiver**") of 2292319 Ontario Inc. (the "**Debtor**"), the Receiver seeks an Order, in substance:

- (a) declaring that any purchaser of the premises municipally known as 38 Metropolitan Road, Toronto, Ontario (the "**Premises**") from the Receiver shall be entitled to vacant possession of the Premises, free and clear of the interests and claims, if any, of any and all occupants of the Premises; and
- (b) authorizing the Receiver to terminate any and all purported leases, subleases and similar arrangements in respect of the Premises (the "**Leases**") and requiring any and all occupants of the Premises to deliver up vacant possession of the Premises to the Receiver.

2. The continued occupancy of the Premises precludes the Receiver from running a meaningful sale process of what is essentially the Debtor's sole asset, given multiple concerns with the physical state of the Premises, the operations of the occupants (and, in certain cases, questions as to their legality) and the uneconomical nature of the Leases.

Background

3. Spergel was appointed by the Court as the Receiver on March 31, 2016 on the application of Royal Bank of Canada ("RBC"), to which the Debtor was indebted in respect of a non-revolving term facility in the approximate principal amount of \$4 million. By the date of the Receiver's appointment, the Debtor had failed to pay its indebtedness to RBC, accumulated significant tax arrears to the City of Toronto, failed to account to RBC for rental income and been experiencing ongoing disputes amongst its shareholders.

Order of the Honourable Justice Wilton-Siegel dated March 31, 2016
[Receivership Order].

First Report of the Receiver dated July 18, 2016 at paras. 1.01 and 1.04
[First Report].

4. The Premises is an 87,000 square-foot commercial property, and constitutes essentially the Debtor's sole asset.

First Report, *supra* para. 3 at para. 1.02.

5. Immediately upon its appointment, the Receiver issued notice to all known occupants of the Premises of the receivership appointment (the "**Receivership Notice**"). The Receivership Notice required all occupants to provide copies of their respective Leases and directed that monthly rent payments now be made to the Receiver.

First Report, *supra* para. 3 at para. 4.01.

6. The Receiver was initially required to post copies of the Receivership Notice throughout the exterior of the Premises, as certain of the interior demises were locked-up and other occupants did not immediately allow access to the Receiver. As set out in more detail in the

First Report, the Receiver was unable to gain access to the entirety of the Premises until April 11, 2016.

First Report, *supra* para. 3 at paras. 4.01-4.05.

7. The Receiver was ultimately able to determine that the non-vacant portions of the Premises were purportedly leased by:

- (a) Green Island Trading Co. ("**Green Island**");
- (b) Universal Trading Company ("**Universal**"); and
- (c) a business operating under the name S.K. Food Equipment ("**SK**").

First Report, *supra* para. 3 at para. 1.04.

8. RBC has advised the Receiver that RBC did not consent to any of the Leases.

First Report, *supra* para. 3 at para. 6.0.1.

Green Island, Universal and their Marijuana Growing Operations

9. Green Island and Universal operated (and, in the case of Green Island, operates) marijuana growing facilities from the Premises, and there is a pungent aroma of marijuana emanating throughout the Premises and its exterior. A total of eight Health Canada Personal-Use Production Licenses for marijuana were posted in the spaces occupied by Green Island and Universal, but none of the personal license holders identified him/herself to the Receiver, and all the licenses had an expiry date of March 31, 2014. When questioned by the Receiver, both orally and in writing, as to how Green Island or Universal, as applicable, was operating under such circumstances, no response was provided.

First Report, *supra* para. 3 at paras. 4.05-4.06.

10. On April 13, 2016, the Receiver issued notices to the eight personal-use license holders via Green Island and Universal, once again requesting copies of the Leases, and also requesting current copies of their marijuana production licenses and proof of adequate

insurance coverage with respect to the spaces being occupied by Green Island and Universal. To date, the Receiver has not received a direct response from any of the license holders.

First Report, *supra* para. 3 at para. 4.06.

11. On April 14, 2016, the Receiver contacted Health Canada to determine the legal status of the licenses, but was not provided with any assistance. Health Canada refused to recognize the Receiver's authority.

First Report, *supra* para. 3 at paras. 4.07.

12. The Receiver then contacted the local division of the Toronto Police Service (the "Toronto Police") to report the Universal and Green Island operations and obtain direction regarding the licenses. The Toronto Police attended at the Premises with the Receiver, forcefully gaining access to spaces occupied by Green Island and Universal. The portion of the Premises occupied by Green Island alone contained approximately 1,000 marijuana plants. After investigation and discussion with Health Canada, a Toronto Police representative informed the Receiver that the law regarding marijuana production was in a state of flux and it was unclear whether the productions were illegal activities despite, amongst other things, the licenses' expiry.

First Report, *supra* para. 3 at paras. 4.07.

13. On April 18, 2016, Green Island provided copies of the Lease documentation upon which it was relying. Given, amongst other things, the marijuana production activities that were taking place, the Receiver requested proof of insurance coverage from Green Island in accordance with the terms of its purported Lease.

First Report, *supra* para. 3 at paras. 4.0.8 -4.0.9.

14. On May 3, 2016, Green Island provided the Receiver with a certificate of insurance – but not the underlying policy – which certificate contained multiple deficiencies between the types and limits of insurance coverage and the terms specified in the Green Island Lease. It became

clear to the Receiver that Green Island did not have existing insurance coverage in place at the time of the Receiver's appointment, and was now working to put this in place.

First Report, *supra* para. 3 at paras. 4.0.10 and 4.0.24.

15. Meanwhile, the Receiver had still not received any response from Universal or any of its purported marijuana personal license holders. On May 5, 2016, the Receiver issued a notice of termination to Universal due to its refusal to provide the Receiver with: (i) a copy of its Lease; and (ii) evidence of adequate insurance coverage. On May 10, 2016, after multiple attempts to serve the notice personally, the Receiver attended at the Premises to discover that Universal had vacated same and had removed all contents associated with its operating activities.

First Report, *supra* para. 3 at paras. 4.0.12 and 4.0.14.

16. On May 16, 2016, the Receiver issued a notice of default to Green Island regarding the insurance-related deficiencies, as well as other defaults regarding the terms of its Lease, and the Receiver set a deadline for May 23, 2016 for Green Island to cure its outstanding defaults.

First Report, *supra* para. 3 at para. 4.0.25.

17. On May 25, 2016, two days after the deadline, Green Island provided the Receiver with a revised insurance certificate, but did not provide a copy of the underlying policy.

First Report, *supra* para. 3 at para. 4.0.26.

18. On May 26, 2016, the Receiver served notice of termination in respect of Green Island's Lease as a result of Green Island having failed to respond adequately to the notice of default served on May 16, 2016.

First Report, *supra* para. 3 at para. 4.0.27.

19. Green Island failed to vacate the Premises. Moreover, in June 2016, it became apparent that Green Island had accumulated a hydro arrears for the period ending May 19, 2016 of approximately \$84,000.00 in breach of the terms of its Lease then in effect.

First Report, *supra* para. 3 at paras. 5.0.1 and 5.0.14.

20. The Receiver's counsel therefore issued a further notice to Green Island on July 11, 2016, which, amongst other things:

- (a) addressed Green Island's failure to provide vacant possession despite the notice of termination served on May 26, 2016 and the reasons therefor; and
- (b) advised of the Receiver's intention to seek an Order for possession.

First Report, *supra* para. 3 at para. 4.0.28.

21. On July 13, 2016, the Receiver was finally provided with a copy of Green Island's commercial insurance policy. Upon review, the Receiver determined that the policy's coverage types and limits were with respect to the operations of a marijuana dispensary as opposed to a production facility. In light of this discrepancy, the Receiver contacted Green Island's insurance broker to determine if coverage would be provided in the event of a claim, and the Receiver has not received a response from the broker as of the date of the First Report.

First Report, *supra* para. 3 at para. 4.0.29.

SK and its Purported Sub-Leases

22. Other than Green Island (and Universal, prior to its departure), the other non-vacant portions of the Premises were purportedly leased by SK. The Receiver understands that SK had purportedly subleased these non-vacant portions of the Premises to:

- (a) a business operating under the name "**Cool Ocean Impex**", which appears to operate a frozen seafood and lobster distribution business; and
- (b) a business operating under the name "**Scrap to Go**", which appears to operate a scrap metal recycling business, and which purportedly further subleased part of the Premises to a sheet metal fabrication business.

First Report, *supra* para. 3 at para. 4.05.

23. On April 11, 2016, the Receiver, together with a general contractor and a team of real estate professionals, conducted an inspection of the space occupied by Cool Ocean Impex and Scrap to Go, which inspection identified the following significant concerns:

- (a) improperly-constructed demising walls;
- (b) deficient fire alarm and fire suppression systems;
- (c) poorly-constructed tenant improvements; and
- (d) poorly-installed and exposed electrical wiring.

First Report, *supra* para. 3 at para. 4.0.5.

24. On April 18, 2016, and in response to the Receivership Notice, the Receiver obtained copies of the three documents upon which SK was relying for its interest in the Premises. Two of the documents were in respect to the portion of the Premises occupied by Cool Ocean Impex; the third document was in respect to the portion of the Premises occupied by Scrap to Go (or its further sub-lessee, as applicable).

First Report, *supra* para. 3 at para. 4.0.8.

25. As was the case for Green Island and Universal, the Receiver requested proof of insurance coverage from SK.

First Report, *supra* para. 3 at para. 4.0.9.

26. On May 5, 2016, SK provided the Receiver with a certificate of insurance – but not the underlying policy – in respect to the portion of the Premises occupied by Cool Ocean Impex, which certificate contained multiple deficiencies between the types and limits of insurance coverage and the terms specified in the Cool Ocean Impex Leases. It became clear to the Receiver that SK/Cool Ocean Impex did not have existing insurance coverage in place at the time of the Receiver's appointment, and was now working to put this in place.

First Report, *supra* para. 3 at paras. 4.0.10.

27. On May 5, 2016, the Receiver issued notices of default in respect of the Cool Ocean Impex Leases. The Receiver detailed the insurance-related deficiencies in regards to Cool Ocean Impex, and also requested evidence of insurance in accordance with the Scrap to Go Lease, which had thus far not been provided by SK.

First Report, *supra* para. 3 at para. 4.0.11.

28. On May 6, 2016, SK provided the Receiver with a revised certificate of insurance – again without the underlying policy, and again only in respect to the portion of the Premises occupied by Cool Ocean Impex (i.e., nothing in respect to the portion of the Premises occupied by Scrap to Go).

First Report, *supra* para. 3 at para. 4.0.13.

29. On May 13, 2016, the Receiver served notice of termination in respect of the Scrap to Go Lease as a result of SK's failure to provide the Receiver with proof of insurance in a timely manner. To date, SK has failed to provide the Receiver with vacant possession of the portion of the Premises occupied by Scrap to Go, which continues to operate from the Premises, and does so, as far as the Receiver is aware, without insurance.

First Report, *supra* para. 3 at para. 4.0.15.

30. On May 16, 2016, after reviewing the revised certificate of insurance provided by SK in respect of the portion of the Premises occupied by Cool Ocean Impex, the Receiver issued a second notice of default to SK with respect to the deficiencies in this revised certificate, and extended the deadline to correct such deficiencies to May 23, 2016. The deficiencies included:

- (a) neither SK nor Cool Ocean Impex being listed as the insured;
- (b) incomplete coverage with respect to commercial general liability; and
- (c) an absence of certain types of coverage expressly required by the Cool Ocean Impex Leases, such as fire coverage and coverage of fixtures and chattels.

First Report, *supra* para. 3 at para. 4.0.16.

31. SK then provided the same revised insurance certificate. The Receiver immediately contacted SK's principal and expressly requested that SK provide a full copy of the commercial insurance policy to confirm, amongst other things, coverage types, amounts and exclusions.

First Report, *supra* para. 3 at para. 4.0.17.

32. On May 18, 2016, SK provided, for a third time, the same revised insurance certificate. Once again, the Receiver repeated its request, and reiterated that the form and content of the revised insurance certificate did not comply with the terms of the Cool Ocean Impex Leases.

First Report, *supra* para. 3 at para. 4.0.18.

33. On May 26, 2016, the Receiver served notice of termination in respect of the Cool Ocean Impex Leases as a result of repeated failures to respond adequately to the notices of default.

First Report, *supra* para. 3 at para. 4.0.20.

34. Like Scrap to Go, Cool Ocean Impex failed to vacate the Premises. On May 31, 2016, after providing notice, the Receiver and Chubb Insurance Company of Canada ("**Chubb**") attended at the Premises to conduct an inspection, but Scrap to Go refused to provide access to the portion of the Premises occupied by it. During the inspection, Chubb identified several hazards and deficiencies related to fire safety and electrical systems, as well as general issues with the overall state of the Premises, and the Receiver is proceeding to obtain inspections by the City of Toronto Building Department to determine if the items identified by Chubb constitute violations to the current building code.

First Report, *supra* para. 3 at paras. 4.0.19-4.0.21.

35. On June 16, 2016, SK finally provided the Receiver with a copy of a commercial insurance policy, which policy continues to raise questions of the nature outlined above, and as more fully set-out in the First Report.

First Report, *supra* para. 3 at para. 4.0.20.

36. Also in June 2016, it became apparent that SK had accumulated a hydro arrears for the period ending May 19, 2016 of \$47,065.22 in breach of the terms of the Leases then in effect.

First Report, *supra* para. 3 at paras. 5.0.6-5.0.17.

37. The Receiver's counsel therefore issued a further notice to SK on July 8, 2016, which, amongst other things:

- (a) addressed SK's failure to provide vacant possession of the premises occupied by Cool Ocean Impex and Scrap to Go (or, as applicable, its sub-lessee), despite the notices of termination served on May 13, 2016 and May 26, 2016;
- (b) addressed the issue of the hydro arrears; and
- (c) advised of the Receiver's intention to seek an Order for possession.

First Report, *supra* para. 3 at para. 4.0.23.

38. As of the date of the First Report, and notwithstanding the notices issued by the Receiver, both Cool Ocean Impex and Scrap to Go continue to be occupying the Premises (with what appears to be inadequate insurance, or, in the case of Scrap to Go, no insurance at all), and SK continues to owe the Receiver the sum of \$47,065.22 for hydro arrears. SK appears to be claiming that, despite the terms of the Leases, it is not responsible for hydro payable by its sub tenants.

First Report, *supra* para. 3 at paras. 4.0.15, 4.0.20 and 5.0.17.

Additional Facts

39. The current operating costs attributable to the Premises outweigh the revenues generated by current rent under the Leases, which makes it difficult to market the Premises for sale. As of the date of the First Report, the operational deficit incurred by the Receiver with respect to the Premises amounts to \$263,567.00. A Letter from Avison Young Commercial Real Estate (Ontario) Inc., Brokerage, is appended to the First Report, and further details how

the continued occupation of the Premises by the current occupants hampers the Receiver's ability to market and sell the Premises.

First Report, *supra* para. 3 at para. 6.0.1.

PART II: THE ISSUE

40. The issue for determination is whether the Court should issue an Order, which, in substance:

- (a) declares that any purchaser of the Premises from the Receiver shall be entitled to vacant possession, free and clear of the interests and claims, if any, of any and all occupants of the Premises; and
- (b) authorizes the Receiver to terminate the Leases and requiring any and all occupants of the Premises to deliver up vacant possession to the Receiver.

PART III: THE LAW AND ARGUMENT

41. Pursuant to the Receivership Order, the Receiver is expressly empowered and authorized to, amongst other things, "*apply for any vesting order or other orders necessary to convey the Property or any part or parts thereof to a purchaser or purchasers thereof, free and clear of any liens or encumbrances affecting such Property.*"

Receivership Order, *supra* para. 3 at 3(l).

42. In turn, the Court is authorized to vest out leasehold interests in a receivership context provided that it is appropriate to do so after reviewing the equitable considerations supporting the respective positions of the parties.

Romspen Investment Corp. v. Woods Property Development Inc., 2011 ONSC 3648 [Comm. List], [2011] O.J. No. 1163 at paras. 63-66 [*Romspen*], tab 1 of Receiver's Brief of Authorities.

Meridian Credit Union Ltd. v. 984 Bay Street Inc., [2006] O.J. No. 3169 (S.C.J.) at para. 19 [*Meridian*], tab 2 of Receiver's Brief of Authorities.

E. Patrick Shea, *Halsbury's Laws of Canada – Receivers and Other Court Officers* (Markham: LexisNexis Canada, 2014) at HRC-70 (authority of court to vest out a lease), tab 3 of Receiver's Brief of Authorities.

43. Uneconomical and/or otherwise undesirable leases are significant equitable considerations supporting a receiver's request that they be vested out, particularly where, as in this case, they were never consented to by the mortgagee. Moreover, unless there is clarity in a sale process for real property that a purchaser would be entitled to take ownership free and clear of such undesirable leases, the sale process may need to be recommenced in order to ensure that the marketplace is properly canvassed and that the proposed sale price represents current fair market value.

Meridian, supra para. 42 at para. 20.

Romspen, supra para. 42 at paras. 198-200.

44. In the present case, assurances of free and clear title are required to run an effective and efficient sale process given the multiple concerns with the physical state of the occupied portion of the Premises, the operations of the occupants and the uneconomical nature of the Leases. It is respectfully submitted that, given the conduct of the occupants as outlined above and as further set-out in the First Report, the equities do not lie in their favour.

Meridian, supra para. 42 at para. 20.

Romspen, supra para. 42 at paras. 198-200.

First Report, supra para. 3.

45. Moreover, the Receiver has already issued valid notices of termination in respect of the Leases based on repeated defaults thereunder, as any landlord would be entitled to do. It is trite law that purported tenants in existence at the outset of receivership proceedings are required to attorn to the receiver on the terms of their purported tenancies, which, it is submitted, did not occur in the present case. The Receivership Order expressly empowers and authorizes the Receiver to manage, operate and carry on the Debtor's business, which includes, amongst other things, the right to terminate the Leases for repeated and ongoing breaches thereunder.

Receivership Order, supra para. 3 at 3(c).

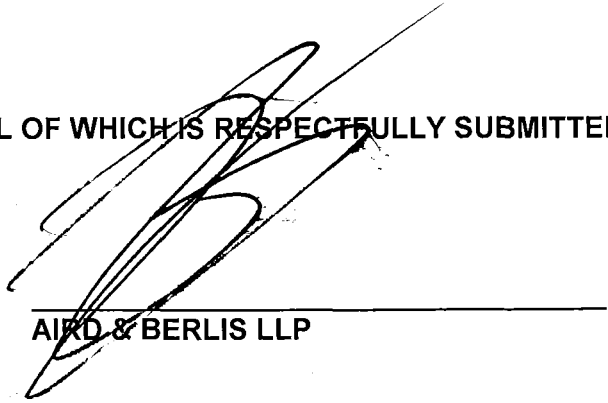
PART IV: CONCLUSION AND ORDER SOUGHT

46. The remaining occupants of the Premises breached the Leases, failed to comply with notices of default, failed to comply with notices of termination, continue to occupy the Premises and continue to be in breach of the Leases – and all despite economic terms in the Leases that were very favourable for the occupants and very unfavourable for the Debtor's estate.

47. It is therefore respectfully submitted that the relief requested by the Receiver ought to be granted.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

July 22, 2016

A large, stylized handwritten signature in black ink, consisting of several overlapping loops and lines, positioned above a horizontal line.

AIRD & BERLIS LLP

Lawyers for the Receiver

Tab A

SCHEDULE A

1. *Romspen Investment Corp. v. Woods Property Development Inc.*, 2011 ONSC 3648 [Comm. List], [2011] O.J. No. 1163.
2. *Meridian Credit Union Ltd. v. 984 Bay Street Inc.*, [2006] O.J. No. 3169 (S.C.J.).
3. E. Patrick Shea, *Halsbury's Laws of Canada – Receivers and Other Court Officers* (Markham: LexisNexis Canada, 2014) at HRC-70 (authority of court to vest out a lease).

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