June 25, 2024

Via Courier

Raffi A. Balmanoukian
Registrar in Bankruptcy
Supreme Court of Nova Scotia
The Law Courts
1815 Upper Water Street
Halifax, NS B3J 1S7

Dear Mr. Registrar:

Re: In the Matter of the Bankruptcy of Atlantic Sea Cucumber Ltd.
Hfx No. 45461
Estate No. 51 – 2939212
Motion by Correspondence: BIA ss. 38, and 37/119(2)

1. We write as counsel to Weihei Taiwei Haiyang Aquatic Food Co., Ltd. ("**WTH**").

2. WTH is a judgment creditor of the bankrupt, Atlantic Sea Cucumber Ltd. ("**Atlantic Sea**") as noted in its accepted Proof of Claim, enclosed as Exhibit A to the Solicitors' Affidavit of Gavin MacDonald filed with these materials (the "**MacDonald Affidavit**").

BACKGROUND

3. Atlantic Sea filed a Notice of Intention under the *Bankruptcy and Insolvency Act* (the "**BIA**") on May 1, 2023.

4. Atlantic Sea was deemed to have made an assignment in bankruptcy following a dismissal of its appeal by the Nova Scotia Court of Appeal in *Atlantic Sea Cucumber Ltd. v. Weihai Taiwei Haiyang Aquatic Food Co. Ltd.*, 2024 NSCA 35.[1]

5. Atlantic Golden Age Holding Inc. ("**AGAH**") is a related entity to Atlantic Sea. It is controlled by Mr. Gao, who is also the president of the bankrupt company, Atlantic Sea. It filed a proof of claim and security dated April 17, 2024, with confirmations of recordings of its security (Exhibit B, MacDonald Affidavit). Copies of the relevant

[1] The matter is now the subject of an Application for Leave to Appeal to the Supreme Court of Canada. However, there is no stay of proceedings in place pending appeal.

Gavin D.F. MacDonald | Partner
Direct 902 491 4464 *Main* 902 421-6262 *Fax* 902 421-3130 *Email* gmacdonald@coxandpalmer.com
Nova Centre | South Tower, Suite 1500, 1625 Grafton Street, Halifax, NS B3J 0E8
Correspondence PO Box 2380 Central Halifax NS B3J 3E5

security documents are Exhibits "D" and "E" to the Affidavit of Meaghan Kells filed July 11, 2023 in these proceedings. The proof of claim of AGAH states that it has a secured claim in the amount of $2,678,495 and that the assets charged by it are valued at the same amount, and that the balance of its claim is unsecured.

6. On April 18, 2024, the First Meetings of Creditors and Inspectors were held (Exhibits D and E, MacDonald Affidavit).

7. On May 8, 2024, the Trustee determined that the proof of claim submitted by AGAH was valid and released the estate's interest in the secured assets to AGAH (Exhibits F and H, MacDonald Affidavit).

8. A draft Sale and Investment Solicitation Process ("**SISP**") was circulated by the Trustee via email dated May 24, 2024, indicating a process that would occur between May 31, 2024 to July 17, 2024 (Exhibit I, MacDonald Affidavit), which would entail:

   (a) An en bloc sale of assets (assets, contracts, licenses);

   (b) Require a 20% deposit of the cash component of the bid;

   (c) Credit bidding will be allowed; and

   (d) Confirmation of financing to be provided for the full cash bid component.

9. We note that the Trustee's cover email of May 24, 2024 indicated that stalking horse bids would be allowed, however the terms of the SISP do not reference a stalking horse sales process.

10. On May 28, 2024, via email, counsel for WTH indicated to the Trustee that it had instructions to challenge AGAH's proof of claim and security and indicated its intention to bring a motion for an order pursuant to BIA s. 38 transferring the cause of action from the trustee to WTH (Exhibit G, MacDonald Affidavit).

11. On May 30, 2024, a meeting of inspectors was held, whereby the draft SISP was approved (Exhibit J, MacDonald Affidavit).

12. Given the timing, WTH brings this motion before the Registrar as an urgent matter, requesting an interim order to halt the sale process either under BIA section 119(2) or 37, pending the section 38 challenge.

13. All parties have consented to WTH's motions being heard by correspondence and consented to the jurisdiction of the Registrar to hear this matter.

ISSUES

14. The issues on this motion are:

    (a) Is WTH entitled to an order pursuant to section 38 of the BIA that would allow it to take proceedings to disallow AGAH's claim; and

    (b) Should this Court grant an order under section 119(2), or alternatively under section 37, varying the decision made at the May 30, 2024 Inspectors Meeting and temporarily halting the sales process of the bankrupt company?

LAW AND ARGUMENT

SECTION 38

15. WTH submits this is a clear case where a section 38 order should be granted. Section 38(1) of the BIA states:

> 38(1) Proceeding by creditor when trustee refuses to act
>
> Where a creditor requests the trustee to take any proceeding that in his opinion would be for the benefit of the estate of a bankrupt and the trustee refuses or neglects to take the proceeding, the creditor may obtain from the court an order authorizing him to take the proceeding in his own name and at his own expense and risk, on notice being given the other creditors of the contemplated proceeding, and on such other terms and conditions as the court may direct.

16. Per the Minutes of the Second Meeting of Inspectors (Exhibit J, MacDonald Affidavit), the Trustee does not object to this motion.

17. Although section 135(5) of the BIA allows the Court to expunge or reduce a proof of claim or proof of security on the application of a creditor, WTH submits section 38 is an equally appropriate mechanism and it should be permitted to proceed under that section in this case.

18. In utilizing section 38, WTH and other creditors who bear the risk and costs associated with the action will be entitled to the benefits of the action (if any).

19. Additionally, Courts in Canada have previously determined that a creditor seeking to disallow the claim of another creditor can do so by virtue of section 38 of the *BIA* (see for example, *Alberta Treasury Branches v Chocolaterie Bernard Callebaut Partnership*, 2012 ABQB 245, **Tab 1**).

WTH Meets the Test for Granting a Section 38 Order

20. The requirements of Section 38 and the threshold test were described by The Alberta Court of Appeal in *Smith v. Pricewaterhousecoopers Inc.*, 2013 ABCA 288 (**Tab 2**), as follows:

> [16] To obtain an order under section 38(1) an applicant must satisfy a court that four criteria are met:
>
> (1) the applicant must be a creditor of the bankrupt estate;
>
> (2) the applicant must have requested that the trustee undertake the proceeding which the applicant now seeks permission to undertake itself;
>
> (3) the trustee must have refused or neglected to undertake the requested proceeding; and
>
> (4) there is threshold merit to the proposed proceeding, i.e., it is not obviously spurious.

21. The Court continued, noting the first three criteria arise from the statutory language of section 38, that the threshold merit criterion "emanates from the implicit gatekeeper function assigned to the Court under section 38(1)" (*Smith v Pricewaterhousecoopers Inc.* 2013 ABCA 288, **Tab 2,** at paras 17 and 18).

22. In the case at hand, WTH submits there is no controversy over the first three criteria. It is an acknowledged creditor of the bankrupt estate, it has requested the Trustee disallow the claim and security of AGAH, and the Trustee has refused to disallow that claim and security (Exhibits F, G, H, and J, MacDonald Affidavit).

23. As such, WTH submits the only question for substantive consideration is whether there is threshold merit to its proposed proceeding.

24. Unsurprisingly, WTH states there is merit to its challenge of AGAH's debt and security. The Trustee based its decision upon the legal opinion of Marc Dunning when acknowledging AGAH's claim (Exhibit J, MacDonald Affidavit).

25. WTH has several concerns with the Dunning opinion, including but not limited to: (i) failure to consider the application of BIA s. 95, BIA s. 96, the *Assignment and Preferences Act*, and the *Statute of Elizabeth*, and (ii) failure to consider the application of BIA s. 137(1) given that this is related party debt.

26. Section 95 of the BIA provides:

> 95 (1) A transfer of property made, a provision of services made, a charge on property made, a payment made, an obligation incurred or a judicial proceeding taken or suffered by an insolvent person
>
> [...]
>
> (b) in favour of a creditor who is not dealing at arm's length with the insolvent person, or a person in trust for that creditor, that has the effect of giving that creditor a preference over another creditor is void as against—or, in Quebec, may not be set up against—the trustee if it is made, incurred, taken or suffered, as the case may be, during the period beginning on the day that is 12 months before the date of the initial bankruptcy event and ending on the date of the bankruptcy.
>
> [Emphasis added]

27. BIA s. 96 provides a similar remedy but requires an application by the Trustee and gives the option of judgment against the transferee as opposed to voiding the transfer.

28. With respect to Atlantic Sea, the date of the initial bankruptcy event is the filing of the notice of intention on May 1, 2023 (BIA s. 2). Therefore, the general security agreement dated March 5, 2023 and the collateral mortgage dated April 23, 2023 were executed within twelve months of the filing of the notice.

29. As the security clearly granted a preference to AGAH, a related party which was unsecured at that time, WTH submits the security is therefore invalid on its face.

30. Further, we submit that Atlantic Sea was insolvent at the time of the granting of the security agreement and collateral mortgage, and both are therefore subject to challenge under the *Assignment and Preferences Act* since they preferred a related party creditor over WTH during the period before WTH could record its judgment and charge Atlantic Sea's assets.

31. Given this preference, the security could also be challenged pursuant to the *Statute of Elizabeth* even if Atlantic Sea was not insolvent at the time of the grant of security (for a general discussion of this law, see *Wilson Equipment Ltd.* v. *Union Construction Ltd.* (1979), 41 N.S.R. (2d) 1 (NSSC(TD), **Tab 3**) at paras 7-8).

32. Additionally, the debt owed to AGAH may not be enforceable in this proceeding pursuant to BIA s. 137(1), which provides:

> 137(1) A creditor who, at any time before the bankruptcy of a debtor, entered into a transaction with the debtor and who was not at arm's length with the

> debtor at that time is not entitled to claim a dividend in respect of a claim arising out of that transaction until all claims of the other creditors have been satisfied, unless the transaction was in the opinion of the trustee or of the court a proper transaction.

33. In this case, AGAH advanced a substantial sum to Atlantic Sea without interest or terms of repayment. The alleged loan agreement matured long before the advances at issue were made. Security was not executed prior to the maturity of the loan agreement.

34. WTH submits that these are aspects much more closely associated with equity than with debt. As a result, we submit that the debt should not be considered a proper transaction and would therefore be subordinate to WTH and all other creditors of Atlantic Sea.

35. In summary, on a preliminary review of WTH's challenge, it more than satisfies the minimal requirement of threshold merit. Therefore, WTH requests it be grated the requested order under section 38.

SECTION 119(2) AND 37

36. WTH has asked that this Court review the May 30, 2024, decision made to proceed with the sale process of Atlantic Sea's Assets. Initially this motion was described as a review of a decision by the Trustee under section 37. However, upon review of the Minutes of the Second Meeting of Inspectors, this may be more properly brought as a motion under section 119(2), to review a decision made by the inspectors.

37. In either case, WTH submits that in light of its motion for a section 38 order and its underlying concerns respecting AGAH's debt and security, it is in the interest of justice to temporarily halt the sale process.

38. Sections 119(2) and 37 of the BIA, provide that the decisions and actions of inspectors, or the trustee as the case may be, are subject to review by the Court, and that the Court may revoke or vary any act or decision and may give such directions, permission or authority as it deems proper in the circumstances.

39. WTH acknowledges that it is a high bar for the Court to interfere with a decision made either by the Trustee or by the inspectors in a bankruptcy. However, it is open to the Court to utilize its discretion to ensure decisions are being made in the best interests of the bankrupt estate.

40. The Nova Scotia Court of Appeal in *Re Hoque (1996)*, 38 C.B.R. (3d) 133, (*sub nom. Hoque (Bankrupt), Re*) 148 N.S.R. (2d) 142, 429 A.P.R. 142, (**Tab 4**), at para 41

quoted the relevant law, noting: "In considering the conduct of a trustee it is well to keep in mind that the scheme of the Act is to allow the trustee to administer the estate under the supervision of the inspectors without interference unless there has been an excess of power, fraud, a lack of *bona fides*, or unless the actions of the trustee and the inspectors are unreasonable from the standpoint of the good of the estate."

41. Similarly, with respect to section 119(2), case law suggests the Court will overrule the actions and decisions of inspectors if the actions and decisions are commercially imprudent, unreasonable or lacking in commercial viability (see *Re Taylor Ventures Ltd. (1999),* 13 C.B.R. (4th) 146, 1999 CanLII 6056, **Tab 5**).

42. Based on the surrounding circumstances, WTH states that, although the bar is high, in this case the Court should exercise its discretion and pause the sales process.

43. In this case, AGAH's proof of claim and proof of security have been accepted by the Trustee. The value of the estate's assets do not exceed (or even come close to) the value of AGAH's accepted claim. As such, the estate will be left in a deficit, with no funds left for any unsecured creditors. WTH submits there is no reason for the estate to bear the costs and risks associated with a sales process in these circumstances.

44. Further, this process is highly unusual – AGAH as a secured creditor is not stayed by the bankruptcy. WTH submits the ordinary process would be for AGAH to apply for the Court to appoint a receiver to conduct the sale process.

45. Instead, the proposed method allows AGAH to circumvent the need for any judicial oversight or consideration of its debt and security, while causing the estate and general body of unsecured creditors to bear the risks associated with the sales process.

46. Further, WTH submits that without interference by this Court, the unsecured creditors of the estate will be subject to irreparable harm.

47. In reviewing a motion for an injunction, the Supreme Court of Canada in *RJR – MacDonald Inc. v. Canada (Attorney General)*, 1994 CanLII 117 (SCC), [1994] 1 SCR 311 ("***RJR-MacDonald***") (**Tab 6**) considered the concept of irreparable harm, stating at para 59, that "irreparable" refers to the nature of the harm rather than its magnitude. It is of no moment to judge the intensity of the harm at the injunction stage – only that the harm exists and is not merely compensable with damages awarded at common law.

48. If the SISP is allowed to go forward, finalizing on July 17, 2024, with AGAH's credit bid allowed, there is a strong likelihood that AGAH will be the successful bidder given the

stated value of its debt, which both AGAH and the Trustee agree exceeds the value of the assets of Atlantic Sea.

49. AGAH's proof of claim provides for an unsecured portion beyond what is secured by its charges. It was on this basis that AGAH had standing to appear and elect its counsel as an inspector of the estate – they should not now be able to argue the opposite. Similarly, the Trustee in its report to creditors and letter releasing the estate's interest has agreed that AGAH's debt exceeds the realizable value of the assets of Atlantic Sea.

50. In the event WTH's challenge to the debt and security of AGAH is successful and the sales process has concluded, the most probable outcome is that the assets of the bankrupt company will have been sold to AGAH and the remaining unsecured creditors (WTH and any creditors who have joined in WTH's challenge) will have no assets or funds of the bankrupt to realize upon. Instead, they would be left with only a cause of action as against AGAH. In addition, in the interim period, AGAH may have created third party rights of subsequent lenders, investors or purchasers that would impede any realization.

51. In the alternative, if the sales process were to be paused while the challenge is reviewed, the status quo would simply be maintained.

52. WTH submits that a balance of any prejudice strongly favours it and any unsecured creditors who may join its challenge through the section 38 process.

53. WTH repeats the foregoing and respectfully requests this Court order a stay of the sales process pending the resolution of its challenge to AGAH's debt and security.

All of which is respectfully submitted,

Gavin D.F. MacDonald
GDFM/MK

A. MEAGHAN KELLS
A Barrister of the Supreme
Court of Nova Scotia

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3.	*Wilson Equipment Ltd.* v. *Union Construction Ltd.* (1979), 41 N.S.R. (2d) 1 (NSSC(TD)
4.	*Hoque (1996)*, 38 C.B.R. (3d) 133, (*sub nom. Hoque (Bankrupt), Re*) 148 N.S.R. (2d) 142, 429 A.P.R. 142
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6.	*RJR – MacDonald Inc. v. Canada (Attorney General)*, 1994

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2012 ABQB 245
Alberta Court of Queen's Bench

Alberta Treasury Branches v. Chocolaterie Bernard Callebaut Partnership

2012 CarswellAlta 704, 2012 ABQB 245, [2012] A.W.L.D. 3424, [2012] A.W.L.D. 3508, 217 A.C.W.S. (3d) 10

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

In the Matter of Chocolaterie Bernard Callebaut Partnership

Alberta Treasury Branches, Plaintiff and Chocolaterie Bernard Callebaut Partnership, by Its Managing Partner, Chocolaterie Bernard Callebaut Ltd., 1013988 Alberta Ltd., Chocolaterie Bernard Callebaut Ltd., 1054796 Alberta Ltd., Bernard Callebaut and Francesca Callebaut, Defendants

B.E. Romaine J.

Judgment: April 13, 2012
Docket: Calgary 25-1395703, 1001-11456

Counsel: Kelly Bourassa, Ryan Zahara, for Plaintiff
Howard H. Gorman, Aaron Stephenson, for Plaintiffs
Peter Jull, Q.C., for Defendants
Bernard Callebaut, for himself

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

Introduction

1 The Trustee in bankruptcy of the Callebaut Partnership applies for advice and direction relating to the payment of fines levied against Benard Callebaut arising from a contempt hearing. In addition, a creditor of the Partnership applies pursuant to Section 38 of the *Bankruptcy and Insolvency Act* to be allowed to take proceedings in the place of the Trustee to disallow Mr. Callebaut's claim as an unsecured creditor in the bankruptcy.

Facts

2 Deloitte & Touche Inc. was appointed the receiver and manager of Chocolaterie Bernard Callebaut Partnership (the "Callebaut Partnership"), 1013988 Alberta Ltd., Chocolaterie Bernard Callebaut Ltd. and 1054796 Alberta Ltd. ("105") (collectively "Callebaut") on August 9, 2010.

3 Under the receivership, land owned by Callebaut was sold. In addition, the assets of the Callebaut chocolate business were sold to 1563181 Alberta Ltd., now known as Cococo Chocolatiers Inc. As a result of events that arose during the sale of the chocolate business, the Court granted an order dated March 24, 2011 declaring Bernard and Francesca Callebaut in contempt of the receivership order and ordering them to pay financial penalties and costs of $99,150 plus an additional $50,000 (the "Damages") for the benefit of unsecured creditors within six months of the order having been granted. The Callebauts have not paid these fines.

4 Pursuant to an order dated March 23, 2011, funds totalling $1,628,575 were transferred to the bankrupt estate of the Callebaut Partnership, representing the net proceeds of the sales of land and of the chocolate business after payments to Callebaut's secured creditors, Alberta Treasury Branch and Invesco Mortgage Inc.

5 Deloitte as Trustee in bankruptcy of the Callebaut Partnership now applies for the Court's approval:

a) to set off the amount of the fines owing under the contempt order from any dividend payable to Mr. Callebaut from the bankrupt estate;

b) to distribute funds remaining in the estate on account of the Damages portion of the contempt fines for the benefit of the unsecured creditors of the estate excluding Mr. Callebaut; and

c) to pay final dividends to the unsecured creditors, including the Callebaut dividend, within 30 days.

6 Mr. Callebaut has filed a proof of claim in the bankruptcy in the amount of $4,068,101. Invesco submits that it has priority with respect to any payment due to Mr. Callebaut pursuant to his unsecured claim by virtue of a general security agreement granted to it by Mr. Callebaut. Mr. Callebaut appeared at this application and confirmed that Invesco has the right to receive any dividend payable to him in the bankruptcy. I granted an order directing that any dividend that would otherwise be payable to Mr. Callebaut be paid to Invesco.

7 In the Receiver's third report, it advised that a potential claim may exist against the Callebauts as sole directors of 105 for breach of fiduciary duty under section 122 of the *Alberta Business Corporations Act* ("ABCA") or an oppression action under section 242 of the ABCA, since it appeared that the mortgage on the lands since sold was entered into in breach of 105's by-laws. The inspectors in bankruptcy approved a motion in February, 2011 to the effect that the Trustee would not pursue these potential claims, but would notify creditors of their ability to prosecute them pursuant to section 38 of the *BIA*. No creditor came forward to do so at that time.

8 Cococo, which had acquired the books and records of the chocolate business when it purchased the assets, expressed concern to the Trustee about the validity of Mr. Callebaut's unsecured claim in the bankruptcy. After reviewing information provided by Cococo, the Trustee issued a Notice on January 27, 2012 that disallowed $173,688 of the claim, but has admitted the balance of $3,894,441. Cococo has raised additional concerns with respect to the validity of the claim as follows:

a. Dividends may have been declared at a time when Callebaut was insolvent;

b. Dividends may have been declared at a time when the preferred shares of Callebaut were not fully redeemed;

c. Appropriate resolutions may not have been prepared for selected dividend transactions;

d. Transactions involving Francesca Callebaut may not have been differentiated from those involving Bernard Callebaut (collectively, the "Legal Issues"); and

e. Lapses in the overall accounting practices of Callebaut may call into question the validity of the entire shareholder loan (the "Accounting Issue").

9 The Trustee reviewed the Legal Issues and concluded that it had insufficient evidence to support any further disallowance of Mr. Callebaut's claim. The Trustee also reviewed the Accounting Issue and concluded that the cost of the Trustee undertaking further review of the books and records of Callebaut would be prohibitive, given the evidence provided.

10 The inspectors agreed with the Trustee that it should not take further action, and the Trustee advised Cococo that, should it wish to challenge the admitted portion of Mr. Callebaut's claim, it had the ability to undertake proceedings pursuant to section 38 of the *BIA*.

11 Cococo has now applied to be substituted for the Trustee in an action to disallow, wholly or partially, Mr. Callebaut's unsecured claim. Cococo also applies for an order directing the Trustee to postpone the payment of any further dividend to either Mr. Callebaut or Invesco pending the outcome of the creditor disallowance process. Invesco opposes Cococo's application.

12 Cococo opposes the Trustee's application to have the Damages portion of the contempt fines set-off from any dividend payable to Mr. Callebaut. However, it does not oppose the set-off of the costs portion of the contempt fines, and the distribution of that set-off amount to the appropriate parties as directed by the contempt order. Invesco supports the Trustee's application to set-off in its entirety.

Issues

A. *Is Cococo entitled to an order pursuant to s. 38 of the BIA that would allow it to take proceedings to disallow Mr. Callebaut's claim?*

B. *Should the Trustee be allowed to set-off the Damages portion of the contempt order made against Mr. Callebaut against any dividends that would be payable to him?*

Analysis

A. Cococo's application pursuant to section 38 of the BIA

13 Section 38(1) of the *BIA* allows a creditor to apply for an order authorizing it to take proceedings in its own name and at its own expense and risk where it has requested the trustee to take such proceedings that in its opinion would be for the benefit of the estate and the trustee has refused to do so.

14 The two pre-conditions to the application, being that the creditor has asked the trustee to act and the trustee has neglected or refused to do so, have been met.

15 In addition, an applicant must establish a threshold case sufficient on its merits to warrant the Court's approval to proceed. While what this means has varied from case to case, the courts in Alberta have adopted the test endorsed in *Jolub Construction Ltd., Re* (1993), 21 C.B.R. (3d) 313 (Ont. Bktcy.), being that the applicant must establish that the claim is not "obviously spurious": para. 19; see also *Tirecraft Group Inc., Re*, 2009 ABQB 281 (Alta. Q.B.) at paras 2 and 14; *Nesi Energy Marketing Canada Inc., Re*, 1998 ABQB 912 (Alta. Q.B.), at 22 . There must be evidence beyond mere allegations to support the claim: *Jolub* at para. 20, *Tirecraft* at para. 14.

16 Although Cococo has not filed an affidavit to support the threshold test, it relies upon the description of its case contained in the Trustee's first report put in evidence, particularly the particulars of its concerns as previously described. The report provides sufficient background and context to lift the issues raised by Cococo from the status of mere allegations. It is not necessary that an applicant provide a strong *prima facie* case, or that the Court embark on a searching review of the strength of the case at this stage of the proceedings. As noted in *Nesi* at para. 24, section 38 is not the forum to try the merits of the proposed litigation beyond the establishment of a threshold case.

17 Invesco submits that the fact that the Trustee has decided not to act is sufficient to establish that the claim has not passed the threshold test. However, the Trustee's report makes it clear that the Trustee is merely of the view that it had insufficient evidence to support a further disallowance with respect to the Legal Issues and that pursuing the Accounting Issue would be too expensive. It is precisely for these types of circumstances that section 38 exists: to provide a mechanism for creditors to proceed with an action when the trustee is not prepared to do so. Any abuse of the opportunity offered by section 38 to creditors can be addressed through use of the Court's discretion to refuse the application even if the threshold test has been met. The language of section 38 is permissive: the Court "may" grant the order, and may impose conditions on the proceedings": *Jolub* at para. 24.

18 Invesco notes that Cococo purchased its unsecured claim to pursue this application and that it is driven by competitive reasons to make this application. While these may be factors to be taken into account in the Court's exercise of discretion under section 38, they are not sufficient in this case to cause me to refuse the application. As in *Jolub* (at para. 27), there is nothing contrary to any principles of bankruptcy law or contrary to the integrity of the bankruptcy proceedings in allowing the proposed action to proceed. While Cococo is a competitor of Mr. Callebaut's new business, its purchase of the chocolate business was

an integral part of the bankruptcy proceedings, and it is not a stranger to the process who has stepped in for purely competitive reasons.

19 Invesco submits that section 38 requires that the proceedings have the potential to result in a monetary gain or increase in the assets of the bankrupt's estate, and that, since the proposed action if successful in whole or in part would only result in a greater recovery for the unsecured creditors other than Mr. Callebaut, the application does not fall within the strict confines of section 38: *ICI Canada Inc. v. Bishop Holdings Ltd.*, 2007 BCSC 635 (B.C. S.C.), citing *Bernard Motors Ltd., Re* (1958), 18 D.L.R. (2d) 528 (N.B. C.A.).

20 Interpreting section 38 in this manner restricts the use that creditors can make of it if they disagree with a decision of the Trustee. While a creditor may have statutory avenues to appeal the decision of the Trustee and/or the inspectors, an appeal, if successful, would force the Trustee to take action that it has concluded would be too expensive for the estate. Section 38 provides a method for direct action by a creditor or creditors at no risk of additional cost to the estate, and this is different in effect and scope from an appeal. There appears to be no good policy reason to restrict the scope of Section 38 in the way suggested.

21 While the right provided by section 38 is a statutory right, and thus a creditor must bring itself strictly within its provisions, the Alberta Court of Appeal in *Toyota Canada Inc. v. Imperial Richmond Holdings Ltd.*, [1994] A.J. No. 520 (Alta. C.A.) at para. 13 has endorsed the following comments of the Ontario Superior Court on the interpretation of the predecessor to the present section 38:

> Any interpretation to be given to the meaning and scope of sec. 35 should be a liberal one, and not a construction that would debar a creditor, if he is prepared to undertake the risk, of the right to proceed for his own benefit.
>
> *Andrew Motherwell of Canada Ltd., Re* (1924), 55 O.L.R. 294 (Ont. C.A.), at 298 .

22 The Court in *Toyota Canada* took a purposive approach to the notice provisions of section 38 and found that the section did not require that notice of the application be given before an action was commenced. At para. 12, Conrad, J.A. referenced the Supreme Court's general rule of interpretation of the *BIA* in *A. Marquette & fils Inc. v. Mercure* (1975), [1977] 1 S.C.R. 547 (S.C.C.), to the effect that using an "overly narrow legalistic approach" to interpretation of the *BIA* would be to misinterpret it.

23 It is noteworthy that section 38 does not on its face require that proceedings be for the benefit of the estate in the sense of an increase in assets, but merely that, in the opinion of the creditor making the application, the proposed proceeding "would be for the benefit of the estate". Cococo submits that the disallowance of Mr. Callebaut's claim would yield "an obvious benefit to the remainder of the general body of creditors, that is the estate": *Newman, Re*, [1990] O.J. No. 2753 (Ont. S.C.). While Cococo and other creditors who join with Cococo would be the primary beneficiaries of a successful section 38 proceedings, any surplus would enure to the estate generally. Given that Mr. Callebaut's unsecured claim is by far the largest in the estate, representing approximately 76% of total unsecured claims (and the estate will suffer a deficiency), a successful disallowance would have a major impact on the remainder of the unsecured creditors.

24 For these reasons and in the circumstances of this case, I accept Cococo's opinion of the benefits of the action to the estate.

25 I therefore direct as follows:

> (a) Cococo and any participating creditor at their own risk and expense are authorized to be substituted for the Trustee, with all of the rights, powers and entitlements of the Trustee, to disallow, wholly or partially, the unsecured claim of Mr. Callebaut in the bankruptcy proceedings or to apply for an order expunging or reducing Mr. Callebaut's Proof of Claim;
>
> (b) Any other creditors with proven claims in the bankruptcy are granted leave to join the creditor disallowance process as co-applicants on the condition that each such co-applicant bear a proportionate share of the costs of prosecuting the process; and
>
> (c) Any benefit derived from the creditor disallowance process (including any benefit arising from any further reduction in the claim of Mr. Callebaut) shall belong exclusively to Cococo and any other creditors who choose to join the creditor

disallowance process as co-applicants to the extent of their claims and costs, with any surplus belonging to the bankruptcy estate.

26 As suggested by the Trustee, other creditors will have 30 days from the date of this order to participate in the creditor disallowance process with Cococo.

27 In addition, I direct the Trustee to postpone the payment of any dividends or further dividends, as the case may be, to Mr. Callebaut or Invesco in its capacity as the holder of a general security agreement over the assets of Mr. Callebaut, pending the outcome of the creditor disallowance process or further order of this Court.

28 I direct the Trustee to provide Cococo and its counsel with copies of all materials submitted in support of or in the Trustee's possession related to Mr. Callebaut's unsecured claim in the bankruptcy, and grant Cococo the investigative power of the Trustee under the *BIA*, including the powers to examine witnesses under oath and compel production of documents. An order substantially in the form submitted by Cococo at the application shall be issued.

B. Set-off of the Damages Portion of the Contempt Fines

29 The Trustee submits that it would make sense to set-off the fines levied under the contempt order from any distribution that may be made to Mr. Callebaut as an unsecured creditor in the bankruptcy, given that Mr. Callebaut has not paid the fines as he was ordered to do within six months, and that this is a practical way of collecting the fines so that they can be distributed to cover costs and so that the Damages portion can be distributed to other unsecured creditors.

30 Cococo submits that it would be mathematically and morally inappropriate to allow payment of Mr. Callebaut's fines under the contempt order by allowing them to be set-off against any dividends that are payable to him.

31 In *Kushner v. Rocky Mountain Sportswear Ltd. (Trustee of)*, [2001] A.J. No. 1135 (Alta. Q.B.), Registrar Waller applied the rule in *Cherry v. Boultbee* in a bankruptcy case where the Trustee's right to setoff was at issue. The rule provides that where a person entitled to participate in a fund is also bound to make a contribution to that fund, that person will not be allowed to participate in the distribution of the fund until he has made good what is owing to the fund: Houlden, Morawitz and Sarra, 2011 Annotated Bankruptcy and Insolvency Act, citing *Cherry v. Boultbee* (1939), 4 My. & C. 442 (Eng. Ch. Div.). Master Waller noted that the ordinary effect of the rule would be to require the payment of the amount owed before the creditor was entitled to a dividend from the estate. However, he suggested that the practical effect would be to set-off the amount: *Kushner* at para. 27.

32 In *Taylor Ventures Ltd., Re*, [2011] B.C.J. No. 355 (B.C. S.C. [In Chambers]), Burnyeat, J. applied the rule in effect and allowed a trustee in bankruptcy to retain a dividend that would otherwise be payable to a creditor and apply it to a balance owing arising from an order for costs made against a corporation related to the creditor arising from litigation in the bankruptcy.

33 While the proposed set-off is a practical solution, and I would have no hesitation applying the rule by way of set-off had the debt owed by Mr. Callebaut been an ordinary debt, the issue is coloured by the fact that the debt arises from a contempt order, a sanction levied by the Court for conduct in breach of court orders. As I indicated at the hearing when I levied the Damages fine, contempt is not only a serious issue for the parties who are directly affected by the conduct of the party in contempt, but also for the Court and the administration of justice generally. It was important in considering and deciding upon an exemplary fine that the penalty be harsh enough to deter not only Mr. Callebaut but others in future insolvency proceedings who may be tempted to breach a court order for their own benefit.

34 Allowing the Trustee to set-off the Damages portion of the contempt order in the circumstances of this case would relieve Mr. Callebaut of the burden of the contempt order without any effort on his part to satisfy the order. While it is true that the set-off would ensure that funds that would otherwise be distributed to Mr. Callebaut would go into the estate, and while he thus would lose the benefit of funds that would be credited against his Invesco debt, the process would be offensive to the nature and purpose of a contempt order.

35 I must decline to allow the satisfaction of the Damages portion of the contempt order through set-off. Applying the rule in *Cherry v. Boultbee* in its strict sense, Mr. Callebaut is not entitled to participate in any dividends from the estate unless and until he pays the Damages portion of the contempt fines. This is not intended to limit additional available sanctions should a party bring a further application in the face of Mr. Callebaut's continuing contempt and failure to pay the fines in the time stipulated under the order.

36 The remainder of the contempt fines may be paid through set-off as proposed by the Trustee. These amounts were levied to cover costs and to reimburse Cococo for the theft of product and supplies, and it would be prejudicial to the estate and the unsecured creditors for these amounts to remain unpaid.

37 I appreciate that this decision affects the ability of Invesco to collect dividends that may be found to be owing to Mr. Callebaut through its assignment. However, Invesco as assignee of Mr. Callebaut's interest takes that interest "subject to all the equities and infirmities of the title of the assignor". *Taylor Ventures*at para. 9. As conceded by Invesco, it can be in no better position than Mr. Callebaut in terms of its entitlement to these dividends.

Conclusion

38 Cococo is entitled to an order pursuant to Section 38 of the *BIA*. Payment of any dividends to Mr. Callebaut or to Invesco by virtue of its assignment of Mr. Callebaut's interest is postponed pending the outcome of creditor disallowance proceedings. At any rate, Mr. Callebaut is not entitled to participate in any dividends from the estate unless and until he pays the Damages portion of his contempt fines. The remainder of the contempt fines may be paid through set-off as proposed by the Trustee once the creditor disallowance proceedings are concluded, or with the consent of the s. 38 parties.

Order accordingly.

2

2013 ABCA 288
Alberta Court of Appeal

Smith v. Pricewaterhousecoopers Inc.

2013 CarswellAlta 1520, 2013 ABCA 288, [2013] A.W.L.D. 3759, 232
A.C.W.S. (3d) 579, 245 A.R. 245, 3 Alta. L.R. (6th) 341, 584 W.A.C. 245

William Franklin Smith, Applicant and Pricewaterhousecoopers Inc. and Servus Credit Union Ltd., Respondents

Patricia Rowbotham J.A.

Heard: August 14, 2013
Judgment: August 22, 2013
Docket: Calgary Appeal 1301-0046-AC

Counsel: J.G. Hanley for Applicant
H.A. Gorman for Respondent, Pricewaterhousecoopers Inc.
R. Gurofsky for Respondent, Servus Credit Union Ltd.

***Patricia Rowbotham J.A.*:**

Introduction

1 The applicant wishes to commence an action on behalf of the estate of a bankrupt company. The respondent trustee did not consent to the commencement of the action. The applicant applied pursuant to section 38(1) of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-6 *(BIA)* for leave to commence the action. A bankruptcy judge refused to give leave. The applicant applies to this court for a declaration that he does not require leave to appeal, or, in the alternative for leave to appeal. For the reasons that follow I find that leave is required and I deny leave to appeal.

Background

2 The applicant is the founder of Caliber Systems Inc., a heavy construction company. It had entered into a credit facility with a credit union that has now merged to become Servus. Caliber found itself in financial distress during a downturn in the economy, and after nine months of violating the terms of its credit facility with Servus, became subject to a receivership order. Caliber was ultimately assigned into bankruptcy.

3 It was ultimately determined that Servus was not the first secured creditor, but that the first priority went to GE Capital, who was fully paid out once Caliber was liquidated. There were insufficient funds to pay out the remaining creditors, including Servus, who are now attempting to make up the shortfall through recourse to a guarantee provided by the applicant. The applicant alleges that Servus was negligent in failing to provide notice to the first secured creditor, and to engage in discussions on potential restructuring of Caliber with a view to pay the indebtedness.

4 The draft statement of claim pleads improvident realization, breach of fiduciary duty, negligence in relation to the appointment of the receiver, and a claim for economic loss. In response to a request for the trustee's consent to sue, the trustee's counsel replied in writing: "We are having trouble understanding the basis for such a claim in an instance where Caliber had consented to the receivership appointment and the realization was completed through a Court supervised and approved process."

5 At the leave application a preliminary issue arose as to the standing of Servus to address the application. The bankruptcy judge found that this was a situation where there is an:

> [I]nterested party who has evidence that is germane and relevant to the Court's determination with respect to whether or not there is an action here, to use your words, or a cause of action that might be accepted. That evidence is essential and vital to the Court's deliberation. The exceptions are present. There appear to be material at least omissions from your client's affidavit if not downright misrepresentations, so I would grant Servus the standing to enter their evidence, that being the affidavit of Mr. Tuchee and make submissions on it and other matters that may arise during the application.

6 Counsel agreed that the test for granting the application was whether the applicant could show that the claim is not obviously spurious.

Decision of the Bankruptcy Judge

7 The bankruptcy judge found that the claim was spurious. She said:

> There cannot be a better documented situation, in my view, of a company which was in financial difficulty that reached out to its lender, Servus, and through a series of nine months attempts were made to save Caliber which were not successful. That is the sum total of what happened here.
>
> I cannot see on any of the evidence that has been presented by Mr. Smith any of the causes of action that we outlined — that we went through that could possibly be framed or outlined in the statement of claim being anything more than spurious.
>
> This is very well documented, Mr. Hanley, through the forebearance agreements and through the e-mails, right up until the day of the taking of the consent order from Mr. Robinson. It did not work.
>
> . . .
>
> I see from one of the cases you had referred me to that there was a similar allegation made by counsel in front of the judge at that time, and that judge also took the position that the motivation was not relevant, the question is whether or not there is anything on the face of the — of the proposed action that would — that has the merest chance of success or, put differently, that it's not obviously spurious. This is to my mind obviously spurious. There just is such — it's so well documented what occurred, what happened here, that the possibility of a string of oral agreements in the face of the written agreements is just not — just — just to my mind is completely not possible.

Legislation

8 The appeal of an order under section 38(1) is governed by section 193 of the *BIA*. The appellant relies on section 193(c), or alternatively section 193(e):

> 193. Unless otherwise expressly provided, an appeal lies to the Court of Appeal from any order or decision of a judge of the court in the following cases:
>
> (a) if the point at issue involves future rights;
>
> (b) if the order or decision is likely to affect other cases of a similar nature in the bankruptcy proceedings;
>
> (c) if the property involved in the appeal exceeds in value ten thousand dollars;
>
> (d) from the grant of or refusal to grant a discharge if the aggregate unpaid claims of creditors exceed five hundred dollars; and
>
> (e) in any other case by leave of a judge of the Court of Appeal.

Analysis

Automatic Right of Appeal (Section 193(c))

9 This court has consistently held that appeals involving procedural rights that are not appreciable in monetary terms fall outside the scope section 193(c) of the *BIA*: *Elias v. Hutchison* (1981), 27 A.R. 1, 14 Alta. L.R. (2d) 268 (Alta. C.A.); *Simonelli v. Mackin*, 2003 ABCA 47, 320 A.R. 330 (Alta. C.A. [In Chambers]) at paras 13-27. *Elias* involved an appeal from the refusal to grant the appellant leave to sue the bankruptcy for allegedly wrongful acts in the course of his bankruptcy. *Simonelli* involved an appeal from an application to strike a statement of claim under former Rule 129 Alberta *Rules of Court*, Alta Reg 390/168. *Simonelli* and *Elias* were followed by the New Brunswick Court of Appeal in *Royal Bank v. Profor Kedgwick Ltée/Ltd.*, 2008 NBCA 69, 299 D.L.R. (4th) 727 (N.B. C.A.), in similar circumstances to this appeal. There, the appellant was a guarantor to a bankrupt company and sought to pursue a claim against a bank so that he might reduce any claim against him personally under the guarantee. As in the present appeal, the application for leave pursuant section 38(1) was unsuccessful. The court observed at para 21:

> [I]t is difficult to think of a case involving a corporate bankrupt in which the amount ultimately in issue would not exceed $10,000. Consequently, there would be little utility to the other four subsections under s. 193 if such cases were subject to an appeal as of right. Since the issue on appeal in this case does not directly involve an amount in excess of $10,000 there can be no appeal as of right under s. 193(c). The central issue in this case is whether or not the motion judge erred by failing to consider whether the appellant, as a guarantor, is a creditor of the bankrupt. Since the issue on appeal does not involve an amount in excess of $10,000, there can be no appeal as of right under s. 193(c).

10 I conclude that the applicant does not have an appeal as of right and must apply for leave to appeal.

Leave to Appeal (Section 193(e))

11 The test for leave to appeal involves consideration of the following five factors:

> (1) whether the point of appeal is of significance to the bankruptcy practice;
>
> (2) whether the point is of significance to the action itself;
>
> (3) whether the appeal is *prima facie* meritorious;
>
> (4) whether the appeal will unduly hinder the progress of the action; and
>
> (5) whether the judgment appears to be contrary to law, amounts to an abuse of judicial power, or involves an obvious error causing prejudice, for which there is no remedy.

(See *Alternative Fuel Systems Inc. v. Edo (Canada) Ltd. (Trustee of)* (1997), 206 A.R. 295 (Alta. C.A. [In Chambers]) at para 12; *Dykun v. Odishaw*, 1998 ABCA 220, 7 C.B.R. (4th) 151 (Alta. C.A.) at para 5; and *Simonelli* at para 28.)

12 It is acknowledged that as Caliber's estate has been fully liquidated and distributed to creditors, there is no further consequence to the bankruptcy proceedings. Accordingly, the fourth factor is met.

13 The applicant advances four grounds of appeal. He says that the bankruptcy judge erred:

> (1) in her application of the test for authorization to commence an action under section 38(1);
>
> (2) in rendering a decision on the merits without sufficient evidentiary basis to make that decision;
>
> (3) in granting standing to the defendant Servus; and
>
> (4) in taking into consideration submissions made by the trustee contesting the application.

Grounds One and Two - Application of the Test and the Evidentiary Basis

14 The applicant argues that the clarification of the test to be applied to applications under section 38(1) is of significance to bankruptcy practice. However, given that counsel agreed on the test to be applied, and that the bankruptcy judge adopted the test articulated in the authorities, I cannot find that test for a section 38(1) application requires clarification. Rather, the issue is one of the application of the test to a specific set of facts. While this is of potential significance to the bankruptcy itself, it is not an issue of significance to the bankruptcy practice.

15 Turning to the requirement that the appeal be *prima facie* meritorious, the applicant submits that the bankruptcy judge erroneously held him to the more onerous standard of demonstrating that Caliber would succeed on the merits of the proposed action. He says that she erred in considering the affidavit evidence tendered by the respondents and that she treated this as akin to an application for summary judgment.

16 To obtain an order under section 38(1) an applicant must satisfy a court that four criteria are met:

> (1) the applicant must be a creditor of the bankrupt estate;
>
> (2) the applicant must have requested that the trustee undertake the proceeding which the applicant now seeks permission to undertake itself;
>
> (3) the trustee must have refused or neglected to undertake the requested proceeding; and
>
> (4) there is threshold merit to the proposed proceeding, i.e., it is not obviously spurious.

17 The first three criteria arise from the statutory language of section 38(1), and it is acknowledged that the applicant met these criteria. The real issue was whether there was threshold merit to the proposed action.

18 The threshold merit criterion emanates from the implicit gatekeeper function assigned to the court under section 38(1). Without the authority to make an inquiry into the merits of a proposed action, the court would become a rubber stamp and there would be no utility in requiring a creditor to seek the court's permission when the statutory criteria are met: *Jolub Construction Ltd., Re*, 1993 CarswellOnt 235 (Ont. Bktcy.) at para 16, (1993), 21 C.B.R. (3d) 313 (Ont. Bktcy.).

19 An applicant seeking leave under section 38(1) must demonstrate a *prima facie* case, which must be supported by evidence and not mere allegations: Houlden and Morawetz*, Bankruptcy and Insolvency Law of Canada* (looseleaf) at 1-236.1; *Polar Products Inc. v. Hongkong Bank of Canada* (1992), 14 C.B.R. (3d) 225 (B.C. S.C.); *Jolub Construction Ltd., Re* at para 20. The threshold is not particularly high, and requires the applicant to show that the claim is not "obviously spurious": *Nesi Energy Marketing Canada Inc., Re*, 1998 ABQB 912 (Alta. Q.B.) at para 22, (1998), 233 A.R. 347 (Alta. Q.B.); *Alberta Treasury Branches v. Chocolaterie Bernard Callebaut Partnership*, 2012 ABQB 245 (Alta. Q.B.) at para 15).

20 The applicant swore an affidavit in which he deposed not only to the statutory requirements but also described the background to the proposed statement of claim. This included evidence about the trustee's actions and, in particular, that the trustee had failed to meet with the applicant or consider an offer by the applicant and others to purchase certain assets. The respondents swore brief affidavits attaching documents and correspondence relating to the meetings and the offer. The purpose of the affidavits was to give the court a complete picture and to address certain material omissions in the applicant's narrative.

21 In his memorandum on the leave application the applicant submits that there is no requirement under section 38(1) for an applicant to provide evidence as to the merits of the proposed action. He relies on *Dominion Trustco Corp., Re*, 1997 CanLII 12398, (1997), 45 C.B.R. (3d) 25 (Ont. Bktcy.) at para 16, aff'd (1997), 50 C.B.R. (3d) 84, 1997 CarswellOnt 4901 (Ont. C.A.), where the court stated, in respect of section 38(1) applications, "...I see no requirements that the [applicant's] affidavit must deal with the merits of the proposed action." However, the application in *Dominion Trustco Corp., Re* proceeded with the consent of the trustee, and there was no issue raised as to the merit of the proposed action during the section 38(1) hearing.

22 There is ample authority requiring an applicant to provide some evidence in support of the merits of its claim. In *Nesi Energy Marketing Canada Inc., Re*, the court commented that in addition to meeting the procedural requirements of section 38(1) of the *BIA*, an applicant must demonstrate a *prima facie* case which amounts to a requirement that "some evidence needs to be presented which is sufficient to persuade the court that the claim is not 'obviously spurious'": at para 22. In *Jolub Construction Ltd., Re* the court stated that some screening of creditors' claims was clearly contemplated by section 38(1) and that an applicant must establish a "sufficient case on the merits...to warrant the Court's approval to proceed": at para 19. Recently, in *Alberta Treasury Branches v. Chocolaterie Bernard Callebaut Partnership* the court stated that "an applicant must establish a threshold case sufficient on its merits to warrant the Court's approval to proceed... [t]here must be evidence beyond mere allegations to support the claim": at para 15.

23 Moreover, the applicant acknowledged at the hearing that he bore the onus to demonstrate that his proposed action was not obviously spurious. This onus necessarily required him to demonstrate, through evidence, at least the barest merit to his claim. This was particularly so in this case where the threshold merit of the proposed claim was contested.

24 Before this court the applicant submitted that the bankruptcy judge was not entitled to receive evidence from the respondents, and that in so doing she delved into the merits of the claim and overstepped her gate-keeping function. The applicant was unable to point to any authority which would deny the respondents the opportunity to put in evidence. Indeed, given the bankruptcy judge's comments that there appeared to be material omissions if not downright misrepresentations in the applicant's affidavit, it was important to the court's function that it have that evidence.

25 I am not satisfied that there is any *prima facie* merit to the applicant's contention that the bankruptcy judge erred in permitting the respondents to adduce evidence. I am not persuaded that her decision was contrary to the law or that her decision amounted to an abuse of power or involved an obvious error causing prejudice.

26 The applicant also contends that the bankruptcy judge held him to a more onerous standard than was required. A bankruptcy judge's decision under section 38(1) is discretionary, and would attract deference on appeal: *Decock v. Alberta*, 2000 ABCA 122 (Alta. C.A.) at para 13, (2000), 255 A.R. 234 (Alta. C.A.). The bankruptcy judge went through each of the causes of action and inquired of the applicant what evidence he had in support of those causes of action. She concluded that "I cannot see on any of the evidence that has been presented by Mr. Smith any of the causes of action that we outlined — that we went through that could possibly be framed or outlined in the statement of claim being anything more than spurious."

27 The transcript of the hearing reveals several bases upon which to conclude that the bankruptcy judge correctly applied the test for section 38(1). First, she adopted the correct test, and confirmed that test with the applicant's counsel. And, the applicant's counsel repeatedly reminded the bankruptcy judge that she was not to render a decision on the merits of the proposed claim. The bankruptcy judge specifically canvassed each potential cause of action disclosed by the proposed statement of claim and invited the applicant's counsel to highlight the factual foundation for those causes of action. This avenue of inquiry is consistent with a proper application of the correct legal test. A review of the transcript reveals that the bankruptcy judge was merely asking the applicant to show the location of the supporting facts, not that she was demanding that he show that his evidence was persuasive or that he would ultimately prevail.

28 When discussing the cause of action plead as improvident realization, the bankruptcy judge inquired about the elements of the cause of action. Improvident realization has been recognized as a defence available to a guarantor, and may obviate the guarantor's obligations to the debtor if it is demonstrated that the debtor's manner of selling the collateral was improvident and the debtor's failure to act in a commercially reasonable manner resulted in the recovery of less money than would otherwise have been the case: *Bank of Montreal v. Tolo-Pacific Consolidated Industries Corp.*, 2012 BCSC 1785 (B.C. S.C.) at para 98, (2012), 97 C.B.R. (5th) 56 (B.C. S.C.), citing *J. & W. Investments Ltd. v. Black* (1963), 38 D.L.R. (2d) 251 (B.C. C.A.), at 264 and *HSBC Bank Canada v. Kupritz*, 2011 BCSC 788 (B.C. S.C.) at para 35. See also *Alberta Treasury Branches v. New Hatchwear Co.*, 2012 ABQB 788, 97 C.B.R. (5th) 227 (Alta. Q.B.). The applicant conceded that it was the court appointed receiver who conducted all realizations of Caliber's assets, not Servus, the only named defendant in the proposed statement of claim. Further, there was evidence from the respondents that all sales were conducted with court supervision and approval and

that the total realization of Caliber's assets yielded a higher return than their appraised value. Accordingly, it was reasonable for the bankruptcy judge to have concluded that there was no factual basis to allege an improvident realization claim against Servus.

29 She also considered the fiduciary duty claim. The applicant alleged that Servus' actions to appoint a receiver was an improper breach of an oral agreement or oral promise that amounted to a breach of a fiduciary duty. In discussing this claim with counsel the bankruptcy judge stated:

> Okay. And - and again, I - I - I agree with you, Mr. Hanley, it's a many splendored thing, fiduciary duties. They seem to continuously be evolving. That still doesn't mean that you - that you just - it's not magic. You can't just say "fiduciary duty" in a statement of claim and hope that the Court finds one. You need to set up a foundation of facts giving rise to a fiduciary duty. Do - I don't see that here, but I may just be missing it

30 The bankruptcy judge was not requesting proof of the breach of the alleged fiduciary duty. She merely asked that he identify the factual foundation for the claim, which she did not see on the face of the applicant's material.

31 The draft statement of claim also alleged that Servus acted negligently or unreasonably and in bad faith in putting Caliber into receivership at the time that it did. The applicant failed to identify any evidence that could support his allegations. He acknowledged that Caliber was in "a cash flow crisis." It was never seriously disputed that Caliber had been in a constant state of default for the nine-month period leading up to the receivership. The terms of the final forebearance agreement executed between Caliber and Servus, which the applicant personally signed on behalf of Caliber, made it explicit in clauses 3.4 and 3.5 that Servus was at liberty to make immediate use of the Consent Receivership Order that had previously been signed by Caliber's legal counsel on the company's behalf. The applicant's counsel conceded that it would have been easy to undo the receivership order if any of Caliber's other creditors or another third party would have come forward to rescue the company. It was demonstrably false that the trustee and Servus refused to meet with the restructuring group as alleged in the proposed statement of claim. Accordingly, it was reasonable for the chambers judge to have concluded, as she did, that the negligence claim was spurious.

32 The bankruptcy judge also attempted to identify the factual foundations of Smith's economic loss claim. These were not apparent.

33 In conclusion on this ground, the bankruptcy judge articulated the proper test, and in analyzing the proposed action found that it was spurious. I am not persuaded that there is *prima facie* merit to the contention that she set the threshold any higher than that of a spurious case. Nor am I persuaded that the decision was contrary to law, an abuse of judicial power or involved any obvious errors. Accordingly, the applicant has failed to satisfy the test for granting leave to appeal on these grounds.

Standing of the Respondent Servus

34 As a general rule prospective defendants, do not by virtue of that status alone, have standing to oppose a section 38(1) application: *Nesi Energy Marketing Canada Inc., Re* at paras 18-19. There are exceptions to this rule including for the purpose of preventing the court's process "being used so as to perpetuate a fraud": see *Coroban Plastics Ltd., Re* (1994), 52 B.C.A.C. 214 (B.C. C.A.) at para 13, (1994), 10 B.C.L.R. (3d) 52 (B.C. C.A.); *Tirecraft Group Inc., Re*, 2009 ABQB 281, 470 A.R. 113 (Alta. Q.B.) at para 34 citing *Shaw Estate (Trustee of) v. Nicol Island Development Inc.*, 2009 ONCA 276 (Ont. C.A.) at para 45. There is also an exception where there is a procedural irregularity in the bankruptcy proceeding: *Tirecraft Group Inc., Re* at para 34.

35 In my view, the discretionary decision of a chambers judge to grant standing to a proposed defendant within the ambit of the recognized exceptions to the general rule precluding standing is not of particular significance to the bankruptcy practice. No party is challenging the validity of the general rule, and Servus relied on recognized exceptions to the general rule to establish standing. There is no novel point of law or interpretation being advanced on this issue, simply an application of the existing law to the circumstances of this case.

36 However, I do find that this issue is of significance to the action. If Servus was improperly granted standing, a significant portion of the evidence that was before the bankruptcy judge should not have been admitted. Without Servus' evidence a different outcome on the application may have resulted.

37 I am not satisfied that there is *prima facie* merit to this ground. This was a discretionary decision which would be accorded significant appellate deference. The grant of standing to Servus was within the ambit of the existing exceptions to the general rule denying standing to proposed defendants to oppose section 38(1) applications. The bankruptcy judge was concerned about material omissions in the applicant's affidavit. There were also irregularities in the proceedings. The applicant conceded the existence of a procedural irregularity. The application had initially been made within Smith's personal bankruptcy action, rather than Caliber's bankruptcy action where it properly belonged.

38 As the applicant has not satisfied the test for leave to appeal on this ground, leave is denied.

Submissions by the Trustee

39 The applicant contends that the bankruptcy judge erred in hearing submissions and admitting evidence from the trustee. He says that it was improper for the trustee to actively oppose the application. While of significance to the action itself and even potentially to the practice, I am not persuaded that there is *prima facie* merit to this ground.

40 The applicant did not object to the trustee's participation at the section 38(1) hearing. In any event there does not appear to be any authority for the proposition that considering a trustee's submissions on a section 38(1) application can amount to an error in law. What the authorities do say is that a trustee should not oppose a creditor's section 38(1) application where it is clear on the basis of materials provided to the trustee from the creditor that the proposed action is not frivolous and vexatious: Houlden and Morawetz, *Bankruptcy and Insolvency Law of Canada*, 4th ed (looseleaf) at 1-204; *Halsbury's Laws of Canada*, 1st ed (Canada: LexisNexis, 2009) - Bankruptcy & Insolvency, V.62(c), at para HBI-200; see also *Mutual Trust Co. v. Scott, Pichelli & Graci Ltd.* (1999), 11 C.B.R. (4th) 54 (Ont. Bktcy.) at para 27, [1999] O.J. No. 2659 (Ont. Bktcy.). Further, these same authorities establish that where a trustee opposes a section 38(1) application in circumstances where it was clear the proposed action was not frivolous, the trustee is subject to having costs awarded against it.

41 Moreover, it does not appear that the trustee acted improperly. From the outset the letter from the trustee's counsel made it plain that the trustee did not see the basis for the proposed action. At the very least it was arguable the claim was frivolous, and the bankruptcy judge's ultimate conclusion that Smith's proposed action was obviously spurious supports the reasonableness of the trustee's decision to oppose the application.

42 In conclusion on this ground, the applicant has failed to satisfy the test for granting leave to appeal.

Conclusion

43 Leave to appeal from an application under *BIA* section 38(1) is required in this case. Leave to appeal is denied.

Application dismissed.

3

1979 CarswellNS 326
Nova Scotia Supreme Court (Trial Division)

Wilson Equipment Ltd. v. Union Construction Ltd.

1979 CarswellNS 326, [1979] 3 A.C.W.S. 341, 31 C.B.R. (N.S.) 208, 41 N.S.R. (2d) 1, 76 A.P.R. 1

Wilson Equipment Limited, Verdon Sales Limited and Atmus Equipment Limited, Plaintiffs and Union Construction Limited, Defendant

Wilson Equipment Limited, Verdon Sales Limited and Atmus Equipment Limited, Plaintiffs and Bank of Montreal, Defendant

Burchell, J.

Heard: July 6, 1979
Judgment: August 8, 1979
Docket: (S.T. No. 0082)

Counsel: *Mr. James W. Stonehouse*, for Plaintiffs
Mr. S.J. Khattar, Q.C., for Defendants

***Burchell, J.*:**

1 The two above entitled matters were tried before me at the same time pursuant to a consolidation order dated April 3, 1979.

2 The applicants seek an order declaring void as against them a demand debenture in the principal sum of $600,000 created and issued by the defendant, Union Construction Limited in favour of the defendant, Bank of Montreal, on the 15th day of February, 1978.

3 Union Construction Limited (herein called "Union") was a customer of the Bank of Montreal (herein called the "Bank") and on the security of an assignment of accounts receivable, the cross-guarantee of a related company and the personal guarantee of a principal shareholder, had operated a current account overdraft with the Bank over a period of years. As the name implies, Union was in the construction business and required overdraft accommodation as an operating commodity. From time to time additional security in the form of specific assignments of construction contracts was provided to the Bank. On February 15, 1978, the major pre-occupation of Union was a substantial subcontract valued at 1.5 million dollars with Lundrigans Limited relative to the construction of facilities at Lingan, Nova Scotia. The Bank held a specific assignment of this contract. Because of progress payment delays, the overdraft had risen to $81,421.51 by February 15, 1978 and in proceeding days the manager of the Bank had refused to honour a number of Union's cheques aggregating approximately $54,000. The evidence of the bank manager, Mr. Chaffey, is that if these cheques were honoured under the existing security, the authorized limits of the account would be exceeded.

4 In negotiations between the principal shareholder of Union and Mr. Chaffey that ensued, it was arranged that additional security in the form of the subject debenture would be provided. The debenture carried fixed charges on machinery and equipment having a value of nearly $500,000 and a first floating charge on all the assets and undertaking of Union. In accordance with an understanding between Mr. Chaffey and the principal shareholder, certain assets having a value of less than $10,000 per item were excluded from the schedule of assets subject to the fixed charge. The evidence of Mr. Chaffey is that not only was this the only additional security available but it seemed appropriate that it be provided since substantial sums permitted by way of overdraft had been devoted to the purchase of capital equipment. It is also his evidence that after looking into the affairs of the company he was satisfied that its problem was one of liquidity and not one of solvency. He says that the purpose

of the debenture was to enable Union to complete the Lingan contract on which there were substantial sums yet to be earned. Mr. Chaffey's further evidence is that in his opinion it was in the best interests of the Bank and the other creditors that further accommodation be provided so that the Lingan contract could be completed.

5 Although there were immediate extensions of the overdraft of approximately $1,800 there was no other advance of funds at that time. In ensuing days the cheques which had been turned back were honoured and in following months the overdraft fluctuated as progress payments were deposited and cheques issued while the Lingan contract was being brought to substantial completion. On August 18, 1978 the Bank crystallized its debenture and appointed a receiver, H.R. Doane & Company whose nominee, Mr. Roger Reid, has since liquidated the assets subject to the fixed charge in the debenture and the receiver, at the time of trial, was still pursuing several very large claims against the general contractor, Lundrigans Limited.

6 On February 15, 1978 the applicants were creditors of Union Construction Limited and they have since obtained judgments which total approximately $54,000. The applicants claim that the debenture transaction was a transfer of property made by an insolvent person with an intent to defeat, hinder, prejudice or delay their rights as creditors and it is submitted that the transaction is void in such circumstances by reason of the provisions of the *Assignments and Preferences Act*, R.S.N.S., 1967, Chapter 16, Section 3. It is also asserted on behalf of the applicants that the transaction was carried out with intent to delay, hinder or defraud the creditors of Union and that the transaction is void as against them by reason of the provisions of the Statute (1570), 13 Eliz., Chapter 5.

7 The relevant law was summarized by Morrison, J. in *Liberty Mutual Insurance Co., Fuhrer & Fuhrer v. MacDonald & MacDonald* (1978) 26 N.S.R. (2d) 396, at pp. 400-401, para. 10-14:

> 10 Section 3(1) of the *Assignments and Preferences Act*, R.S.N.S. 1967, c. 16, reads as follows:
>
> > 3(1) Every transfer of property made by an insolvent person,
> >
> > > (a) with intent to defeat, hinder, delay or prejudice his creditors, or any one or more of them; or
> >
> > > (b) to or for a creditor with intent to give such creditor an unjust preference over other creditors of such insolvent person, or over any one or more of such creditors;
> >
> > shall as against the creditor or creditors injured, delayed, prejudiced or postponed, be utterly void.
>
> 11 The Act defines "insolvent person" as follows:
>
> > 1 In this Act,
> >
> > > (a) 'insolvent person' means any person who is in insolvent circumstances, or is unable to pay his debts in full, or knows himself to be about to become insolvent;
>
> 12 The *Statute of Elizabeth* provides in effect that all conveyances and dispositions of property, real or personal made with the intention of delaying, hindering or defrauding creditors should be null and void as against them, their heirs, etc., and assigns.
>
> 13 One distinction between the requirements of the *Assignments and Preferences Act* of Nova Scotia and the *Statute of Elizabeth* is that there is no requirement under the *Statute of Elizabeth* that the applicant establish as a condition precedent the insolvency of the debtor at the time of the conveyance.
>
> 14 The applicability of this statute in the Province of Nova Scotia has received judicial support in *Rimco Ltd. v. Leon Developments Ltd.* (1973), 4 N.S.R. (2d) 592; *Traders Group Ltd. v. Mason and Mason* (1975), 10 N.S.R.(2d) 135; 2 A.P.R. 135; *Emberley v. Wambolt* (1941-43), 16 M.P.R. 224 (N.S.C.A.), and *Royal Bank of Canada v. Kirkpatrick and Kirkpatrick* (1977), 20 N.S.R.(2d) 458; 27 A.P.R. 458.

8 Although intent is a factor under both Statutes it appears that insolvency must be established under the Nova Scotia legislation.

9 The applicants rely on an analysis of certain financial information supplied by the defendants in the course of discovery proceedings. This analysis filed as Exhibit No. 4 indicates that on February 28, 1978 (the date nearest the date of the debenture for which information was available) Union had a net deficiency of assets in the amount of $27,461.50. On the basis of this information, supported as it is by the financial data supplied by Union, it is submitted on behalf of the applicants that Union was insolvent at the time the debenture was given and accordingly the provisions of the Nova Scotia Statute apply. At the hearing Mr. Roger Reid testified that he had acted as auditor of the firm for several years and was familiar with the books and records of the company. He further testified that the information previously supplied as a result of the discovery proceedings was incomplete and his recalculation based upon an investigation of the books and records of Union indicated a surplus of $55,000 as at February 28, 1978, chiefly because of the omission from the previous information of an account receivable in the order of $71,000. I also note that this calculation did not take into account a disputed claim or contingent asset on which the defendant, Union Construction Limited places a value of $200,000. On the basis of this evidence I am of the opinion that the applicants cannot succeed under the *Assignments and Preferences Act of Nova Scotia* because they have not met the burden of proving that Union was insolvent at the relevant time. In this connection I also accept the evidence of Mr. Chaffey that when the debenture was created and issued, Union's problem was one of liquidity and not one of solvency.

10 The applicants might nevertheless be able to succeed under the ancient Statute if it could be established that the intent of the defendants was to delay, hinder or defraud the creditors of Union. In this connection the following commentary of Cowan, C.J.T.D. in *Royal Bank of Canada v. Kirkpatrick & Kirkpatrick* (1977) 20 N.S.R. (2d) 458 at p. 468 is relevant:

> 23 With regard to the burden of proof that the transfer of the property in question was made with intent to defeat, hinder, delay or prejudice the plaintiff creditor, it is clear that, if the effect of the transfer might be expected to be, and has, in fact, been to defeat, hinder, delay or prejudice the creditor, the Court will attribute the fraudulent intention to the settlor. See the cases of *Traders Group Limited v. Mason & Mason* (1973), 10 N.S.R. (2d) 135, Gillis, J. (N.S.S.C.), (appealed on another point, 10 N.S.R. (2d) 115); *Vasey v. Kreutzweiser* (1965), 8 C.B.R. (N.S.) 225 (Ont. H.C.); *Traders Trust Co. v. Cohen* (1927), 8 C.B.R. 513 (Man. K.B.); *Leighton v. Muir et al* (1962), 4 C.B.R. (N.S.) 137 (N.S.S.C., Coffin, J.); *Re Dougmor Realty Holdings Limited; Fisher v. Wilgoun Investments Limited* (1966), 10 C.B.R. (N.S.) 141, 59 D.L.R. (2d) 432 (Leiff J., Ont. H.C.); *Knox v. Shaw*, [1927] 3 D.L.R. 1185, [1927] 2 W.W.R. 494 (Sask. C.A.); *Re Demery Ex Parte Trustee*, [1926] 2 D.L.R. 1207, [1926] C.B.R. 271, 29 O.W.N. 487 (Ont. H.C.).

11 It will be appreciated that whether or not an improper intention existed is a question of fact that must be determined on the particular circumstances of each case.

12 In addressing the question of intent I have been obliged to look closely at the circumstances surrounding the creation and issue of the debenture. Counsel for the applicants points to the fact that substantially all of the assets of Union were pledged by the debenture, that there was a mere continuation of a pre-existing overdraft and that it was increased by a small amount when the debenture was given and at no time was there an actual advance of funds. It is also stressed that the overdraft had been higher before February 15, 1978 than it was at that time. The submission on behalf of the applicants is that if fraud is not directly evident, it must be imputed to the defendants from the circumstances. In this connection the applicants rely on the decision of Coffin, J. in *Leighton v. Muir and Windsor Supply Company Limited* (1962) 34 D.L.R. (2d) 332. In that case the inadequacy of the consideration for an absolute transfer of property was the main hinge on which the transaction was turned aside. It is my opinion that the present case is distinguishable from the *Leighton* case both on the facts and on the fundamental difference between an absolute conveyance and a security transaction. Although the face amount of the debenture was $600,000, the amount secured at no time exceeded the actual amount of overdraft extensions made pursuant to the debenture and the creditors retained a latent interest in any surplus that might have been realized from the security. In any event I have reached the conclusion that the debenture was not created and issued for the purpose of hindering, delaying or defrauding the creditors of Union. The relevant testimony of Mr. Chaffey has already been reviewed and I accept his evidence that the purpose of the debenture was to permit an extension of credit that would enable Union to complete the Lingan contract which then appeared

to be profitable. The evidence indicates that there were numerous overdraft extensions granted after the dishonoured cheques amounting to $54,000 were recalled, and I accept Mr. Chaffey's evidence that, in all, these extensions totaled approximately $700,000 although the balance outstanding from time to time was kept well below that level by reason of deposits on the part of Union. It is nevertheless true that at one point the overdraft rose to $162,787 in March of 1978.

13 On the question of whether a fraudulant intent may be imputed to the defendants because of the actual effects of the transaction, it is not clear from the evidence that the creation and issue of the debenture did in fact have any delaying or hindering effect on the applicants. It is a fair assumption that if Union had not been accommodated in mid-February 1978 and had been therefore obliged to terminate its operations, there would have been substantial losses under the Lingan contract and there is a very real question as to what would have been available for distribution among the creditors in that event. It is significant that the applicants acknowledge that they received payments aggregating $19,000 subsequent to the creation and issue of the debenture and I am inclined to accept the evidence of Mr. Chaffey that there was a further payment to Wilson Equipment Limited in the amount of $10,000. Although the evidence is not clear as to the present net position of Union, it is a matter of record that the receiver is still pursuing very substantial claims under the Lingan contract and the evidence does not preclude the possibility that the applicants will eventually recover more money than would have been the case if the Bank had not extended Union's credit under the debenture. Against this background I have reached the conclusion that the applicants have not met the burden of proving that the intention of the defendants was to defraud, delay or hinder the creditors of Union and I am of the opinion that the evidence does not warrant that such intent be imputed on the basis of the effects of the transaction. I have therefore reached the conclusion that the applicants cannot succeed under the "Statute of Elizabeth."

14 In reaching the foregoing conclusions I have had a good deal of difficulty with a related submission on behalf of the applicants on the authority of *Re David*, [1925] 4 D.L.R. 1046. On the basis of that case the applicants' submission is that the main reason for providing the debenture was to secure past indebtness. The *David* case is authority for the proposition that a conveyance for a past consideration is *prima facie* preferential. On February 15, 1978, the balance of the overdraft was $81,421.51. The evidence is that there had been no pre-existing agreement that debenture or any other additional security would be provided in relation to that pre-existing debt. The submission is that the debenture secured that pre-existing overdraft as well as subsequent increases. The relevant paragraph of the debenture reads as follows:

> This debenture is created and issued for the purpose of providing to the Bank collateral security for loans or advanced, revolving or otherwise, now made or hereinafter to be made to the company by the bank to the amount of $600,000. The following charges created herein, or for who's creation provision is hereby made, shall be effective whether the money secured thereby or any part thereof is advanced before or after or at the time of the issue of this indenture.

15 I suspect that on occasion bankers rely on language of this kind as being sufficient to secure pre-existing indebtness but, whatever may have been the collateral intent of the Bank in the present case, I am of the opinion that the language of the debenture does not avoid basic contract principles regarding the inefficacy of past consideration and it is my opinion that, notwithstanding the reference to prior advances, the debenture did not secure the pre-existing overdraft of $81,421.51. An examination of the current account ledger filed as an exhibit reduces the resulting problem of mingled funds in the circumstances of the present case. As noted, the level of the overdraft on February 15, 1978 was $81,421.51. With fluctuations it had risen to $162,787.00 in March of 1978. By August 15, 1978 it had been reduced to $2,063.98 although it subsequently rose again to hit another peak of $59,791.41 in October of 1978. Without inquiring into the question of whether the Bank is entitled to treat intervening deposits as having been first applied to the pre-existing overdraft, the inescapable conclusion is that by August 15, 1978 the indebtness represented by the pre-existing overdraft could not have been greater than $2,063.98 and it follows that the subsequent increases must have been fresh accommodations which were clearly secured by the debenture. It will be seen that some of the foregoing questions lie outside the scope of the present application in view of my basic finding regarding the intent of the parties. I should add, however, that I have concluded in the present case that any *prima facie* presumption of improper intent arising from the existance of past indebtness has been rebutted by the evidence concerning the conduct of the defendants both before and subsequent to the creation and issue of the debenture.

16 The issue of surprise was raised by counsel for the applicants when counsel for the defendants sought to qualify Mr. Reid as an accounting expert, no notice having been given that he would be called as an expert witness or that opinion evidence would

be offered. In the face of this objection counsel for the defendants stated that Mr. Reid would only be questioned concerning his direct knowledge of the affairs of Union based upon his previous relationship as auditor of the firm and his current service as nominee of the receiver under the debenture. In the normal course Mr. Reid's expert qualifications were in fact put forward when he stated his professional standing as a chartered accountant. It also transpired that, in the course of his evidence, Mr. Reid offered an analysis of transactions of the company, the product of which was an affirmation of asset values assembled by the in-house accountant of the firm. This aspect of Mr. Reid's evidence was clearly in the nature of expert testimony but I should add that the data thus corroborated was not otherwise disputed and my ruling was that I would treat the whole of Mr. Reid's evidence as admissible. At the same time I indicated to counsel for the applicants that I would give favourable consideration to a motion on his part for an opportunity to prepare for cross-examination or to arrange for rebuttal evidence. Counsel for the applicants did not avail himself of that opportunity.

17 There was however a more serious issue of surprise that developed during the hearing and here I refer to the disclosure that the information provided in the course of discovery was incomplete because of the omission of a very substantial account receivable. I think this omission must be viewed in the light of the quibbling evasions of Mr. Lloyd MacAulay, the principal shareholder of Union, whose discovery evidence was submitted to me as an exhibit. In view of the fact that the applicants' case was mainly grounded upon the appearance of insolvency which was derived from the information submitted before the trial, the applicants were placed at a very serious disadvantage. My conclusion is that the application might have been withdrawn if there had been proper disclosure. The damage was already done when the disclosure was made and counsel for the applicants did not take up my offer to grant an adjournment on the basis of this second issue of surprise. I can only assume that counsel for the applicants took this position because he accepted (as I have done) the evidence of a respected professional as true. I have reached the conclusion that the matter can only be redressed on the issue of costs. As already noted this proceeding was a consolidation of two originating notices which originally were separately directed against each of the defendants. Although the same counsel represented both defending parties, there is no suggestion that he played a role in the transmission of incomplete information such as might impute responsibility to the defendant, Bank of Montreal. At the same time the relationship of the defendants is such that there should be a single bill of costs. I have therefore reached the conclusion that the defendants shall be entitled to tax a single bill of costs but the same shall not include any charges in relation to the defence on behalf of Union Construction Limited arising in respect of the discovery of Mr. Lloyd MacAulay or at any subsequent stage in the proceedings.

4

1996 NSCA 30
Nova Scotia Court of Appeal

Hoque, Re

1996 CarswellNS 51, 1996 NSCA 30, [1996] N.S.J. No. 55, 148 N.S.R. (2d) 142, 38 C.B.R. (3d) 133, 429 A.P.R. 142, 61 A.C.W.S. (3d) 19

MONTREAL TRUST COMPANY OF CANADA v. COOPERS & LYBRAND LIMITED (trustee in bankruptcy of estate of DR. KHANDKER SHAMSUL HOQUE)

Hallett, Jones and Roscoe JJ.A.

Heard: January 17, 1996
Judgment: February 5, 1996
Docket: Doc. C.A. 119215, 119873

Counsel: *Alan V. Parish*, for appellant.
Victor J. Goldberg, for respondent.
D. Bruce Clarke, for Khandker S. Hoque.

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

1 This is an appeal by Montreal Trust Company of Canada from a decision of Justice Michael MacDonald dismissing Montreal Trust's application under s. 37 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 for an order that a right of action of Dr. Hoque, the bankrupt, against his secured creditors remained in his estate in bankruptcy and had not been transferred to him by Coopers & Lybrand Limited, the trustee in bankruptcy of the estate of Dr. Hoque. Alternatively, Montreal Trust sought an order that if the right of action had been transferred that the conveyance and assignment ought to be declared null and void and of no force and effect.

2 Section 37 of the *Bankruptcy and Insolvency Act* provides:

> Where the bankrupt or any of the creditors or any other person is aggrieved by any act or decision of the trustee, he may apply to the court, and the court may confirm, reverse or modify the act or decision complained of and make such order in the premises as it thinks just.

3 In short, Montreal Trust asserts that the trustee acted unreasonably by failing to offer to Montreal Trust an opportunity to either settle the claim Dr. Hoque proposed to make against Montreal Trust or offer to assign the cause of action to Montreal Trust for a price.

4 The facts disclose that the trustee agreed to assign the cause of action to Dr. Hoque without considering that Montreal Trust might have been a potential purchaser. Montreal Trust asserts that the trustee accordingly failed to perform the duties required of a trustee to realize on the assets in a way that would be most beneficial to the general body of creditors. Justice MacDonald found that the trustee, with the approval of the inspectors, acted reasonably in disposing of the cause of action by agreeing to transfer it to Dr. Hoque for valuable consideration.

5 There were several issues raised on the application to Justice MacDonald but this appeal has been narrowed to one issue and that is whether the trustee acted reasonably in failing to contact Montreal Trust as a potential purchaser of the cause of action.

The Facts

6 Dr. Hoque had very substantial real estate holdings. A number of buildings owned by his companies were mortgaged to Montreal Trust. Through one of his companies he became involved in the development of a condominium project which caused a considerable drain on his cash resources. There were problems with the construction and the condominiums were not selling due to a general down turn in the economy and in the real estate market in particular. Dr. Hoque had been a guarantor of loans made by Montreal Trust to his various companies. The mortgages went in arrears. Over a period of time Dr. Hoque attempted to refinance properties but eventually all avenues of refinancing seemed to be closed and in early 1993 he made an assignment in bankruptcy. Montreal Trust commenced foreclosure proceedings.

7 It is clear from the extensive affidavit evidence that was filed before Justice MacDonald that by November 1993 the trustee was preparing his formal Report to the Registrar in Bankruptcy in connec tion with Dr. Hoque's application for discharge. The trustee, with the approval of the inspectors, was recommending to the Registrar of Bankruptcy that Dr. Hoque only be discharged on the condition that, if he were to be successful in his lawsuits, particularly the one contemplated against Montreal Trust, he would be required to pay the lesser of 20% of his net recovery or $200,000 to the trustee for the benefit of the creditors. Dr. Hoque supported this recommendation. It is clear from the evidence that earlier in the year the trustee and the inspectors had given consideration to either defending the foreclosure proceedings that had been commenced by Montreal Trust or commencing a separate proceeding against Montreal Trust based on the allegations made by Dr. Hoque that Montreal Trust's manner of dealing with his mortgages was the cause of the collapse of his real estate ventures. The trustee and inspectors had taken advice from counsel; he advised them that the costs of pursuing the matter would be in the order of $200,000 to $250,000. There were no funds in the estate. None of the major creditors were prepared to fund the lawsuit and the decision was made that the best way to recover anything for the creditors would be to assign the causes of action to Dr. Hoque and to make the recommendation that was eventually made by the trustee to the Registrar.

8 On November 9th, 1993, the Registrar in Bankruptcy heard the application for discharge. It was opposed by Montreal Trust on the ground that there were missing funds which the police were investigating and, accordingly, Dr. Hoque should not be discharged. Alternatively, if he were to be discharged, Montreal Trust took the position that it should be conditional upon his being required to pay the lesser of 60% of recovery on potential lawsuits or $600,000.

9 The Registrar in Bankruptcy did not agree with the recommendation of either the trustee or Montreal Trust. He ordered that Dr. Hoque would be granted an absolute discharge provided he consented to judgment in the amount of $68,000 which was to be paid over a period of five years. Dr. Hoque agreed and on December 15, 1993, an absolute order of discharge was signed by the Registrar.

10 On March 29th, 1994, Mr. Bruce Clarke, the solicitor acting for Dr. Hoque with respect to the dealings with the trustee, wrote the trustee advising that if the trustee transferred the causes of action to Dr. Hoque he would agree to pay out the consent judgment as soon as he received funds from the litigation. Subsequent to this the trustee contacted the inspectors who authorized the trustee to agree to the assignment to Dr. Hoque. As a result the trustee requested from Mr. Clarke that he be provided with a letter signed by Dr. Hoque confirming his agreement that if he received funds from the litigation he would pay out the consent judgment prior to the expiry of the five year period.

11 In September of 1994, another solicitor acting for Dr. Hoque commenced an action on his behalf against Montreal Trust. Dr. Hoque had not provided the requested letter to the trustee and, accordingly, the formal assignment of the causes of action had not been executed.

12 On or about December 20th, 1994, Mr. Clarke advised the trustee that Dr. Hoque intended to bring an application under s. 172(3) of the *Act* for a modification of the discharge Order.

13 On February 9th, 1995, the trustee was asked by counsel for Montreal Trust to advise them of the status of the purported transfer to Dr. Hoque of the causes of action. The trustee advised counsel for Montreal Trust that, although a resolution had been passed authorizing the assignment to Dr. Hoque, the assignment documents had not been executed.

14 On March 1st, 1995, counsel for Montreal Trust requested the trustee to revoke what counsel referred to as the offer to assign the causes of action to Dr. Hoque. The letter also advised the trustee that Montreal Trust was prepared to pay an amount (to be negotiated) for any rights of action which were vested in the estate.

15 The trustee and the inspectors met and discussed the contents of this letter with the solicitor for the bankrupt estate. The solicitor was instructed to write Montreal Trust advising that the estate did not wish to become embroiled in a dispute between Montreal Trust and Dr. Hoque.

16 On March 7th Montreal Trust applied to the Registrar in Bankruptcy for an order declaring that the assignment and conveyance from the trustee to Dr. Hoque of certain causes of action was of no force and effect and requested that Dr. Hoque's application for variation of the order for discharge be moved to the Supreme Court of Nova Scotia. The Registrar refused to transfer the matter to the Supreme Court.

17 On March 8th the trustee received the letter from Dr. Hoque confirming his agreement with respect to the immediate payment of the net proceeds from the lawsuit.

18 On March 21st, Justice Bateman, then of the Supreme Court, refused Montreal Trust's application to determine the status and ownership of the causes of action and refused to grant an order that the variation hearing with respect to the earlier discharge Order be heard in the Supreme Court and refused to stay the application before the Registrar for a variation. The application by Dr. Hoque to vary the terms of the discharge Order was heard by the Registrar. Montreal Trust and the trustee successfully opposed the variation.

19 Montreal Trust continued to pursue its application in the Supreme Court to determine the status and ownership of the causes of action and the matter was set down for hearing.

20 On July 12th, 1995, Justice MacDonald heard the application. Extensive affidavit evidence was filed, in particular, the affidavits of the trustee representative, Mr. Mark Rosen, who was the chartered accountant administering the estate; the affidavits of counsel and associate counsel for Montreal Trust which set out relevant facts that were not in dispute; the affidavit of Dr. Hoque and the affidavit of Herb A. MacIntosh setting out that as of July 5th, 1995, Montreal Trust was owed $3,905,126 as a creditor of the estate in bankruptcy of Dr. Hoque. *Viva voce* evidence of Mr. Rosen and Dr. Hoque was heard by Justice MacDonald.

The Decision Appealed From

21 Justice MacDonald directed his mind to the issue raised by Montreal Trust that the trustee breached its duty to the creditors of the bankrupt estate by failing to contact Montreal Trust with respect to either settling the potential lawsuit or paying for an assignment of it before agreeing to assign the cause of action to Dr. Hoque. On the application, counsel for Montreal Trust argued that it was unreasonable for the trustee to have so acted. Justice MacDonald concluded that the decision of the trustee (with the approval of the inspectors) to assign the cause of action to Dr. Hoque was a legitimate business decision; that the trustee and the inspectors acted reasonably and that the sale was not contrary to the interests of the creditors generally. He dismissed the application and ordered that Montreal Trust pay to Dr. Hoque party and party costs which he fixed in the amount of $1,500 plus disbursements of $294.05 and that Montreal Trust pay the trustee's solicitor/client costs of $3,400 plus disbursements of $38. He did not agree that Montreal Trust should pay the trustee's fees of $3,043.08 but directed that they be paid from the estate.

The Position of the Appellant on the Appeal

22 On this appeal Montreal Trust asserts that Justice MacDonald erred in finding that the trustee had acted reasonably in the disposition of the cause of action to Dr. Hoque and erred in law when he found that the disposition was not contrary to the interests of the creditors generally. The notice of appeal further asserts that Justice MacDonald erred by failing to order that the trustee liquidate the cause of action and consider Montreal Trust as a potential purchaser when liquidating that asset. It is further asserted in the notice of appeal that Justice MacDonald erred in mixed law and fact in finding that the trustee and/or

the inspectors took into account business considerations in reaching their decision when the evidence disclosed that the cause of action was not offered to Montreal Trust because the trustee found such a proposition to be morally repugnant. Finally and alternatively, the notice of appeal asserts that Justice MacDonald erred in law in finding that the principles set out in *Re Katz* (1991), 6 C.B.R. (3d) 211 (Ont. Bktcy.) do not apply to the circumstances of the case.

23 Montreal Trust requests that the judgment of MacDonald J. be reversed and that this Court find that the causes of action which lay against the secured creditors of Dr. Hoque remain vested in Dr. Hoque's estate in bankruptcy and that the trustee conduct a sale of the cause of action against Montreal Trust and that each of Dr. Hoque and Montreal Trust shall be entitled to purchase the asset from the estate and further that the trustee have its costs paid out of the estate and Montreal Trust have its costs against Dr. Hoque.

24 Montreal Trust also appeals the manner in which Justice MacDonald decided the cost issues asserting that he erred in law in ordering Montreal Trust to pay the costs of the estate's solicitor on a solicitor/client basis and erred in law in awarding a fixed sum for solicitor/client costs rather than requiring the taxation of the account. Montreal Trust requests that this aspect of the judgment be reversed and that the Court order that the cost of the estate solicitor be paid out of the estate or, alternatively, that Montreal Trust pay the costs of the estate solicitor on a party and party basis in an amount to be fixed by taxation or otherwise agreed to by the parties.

25 In summary, counsel for Montreal Trust argues that the trustee ought to have realized that Montreal Trust might be interested in either settling the potential action or be prepared to pay for an assignment of it simply to avoid the cost of having to defend and, therefore, the trustee did not give careful consideration to the disposition of the cause of action. With respect to the award of costs, counsel argues that there was no basis for Justice MacDonald departing from the general principle that party and party costs be awarded as Montreal Trust had raised a legitimate issue that needed to be resolved.

The Position of the Respondent Trustee

26 Counsel for the trustee argues that Justice MacDonald gave careful consideration to the evidence and the law in finding that the trustee acted reasonably in disposing of the cause of action. Counsel asserts it was a legitimate business decision and considering all the circumstances there was no reason for the trustee to believe that Montreal Trust might be interested in paying for an assignment of the cause of action not having exhibited any interest in doing so until March 1st, 1995. He asserts that this Court should not interfere with the findings of the trial judge (*Stein v. "Kathy K" (The) ("Storm Point") (The)*), [1976] 2 S.C.R. 802). He also asserts that costs are in the discretion of the trial court and the exercise of that discretion should be left alone by an appeal court.

The Position of Dr. Hoque

27 On behalf of Dr. Hoque it is argued that this was a reasonable business decision and that the law dictates that a court, reviewing a decision made by a trustee in bankruptcy with the approval of the inspectors, should show deference to the business acumen of the trustees and the inspectors who are familiar with the practicalities of administering the bankrupt estate.

Disposition of the Appeal

28 As early as January 1993 Montreal Trust, as a result of having received correspondence from Dr. Hoque's Toronto solicitor, was well aware of the potential lawsuit against it by Dr. Hoque.

29 It is clear from the evidence that the trustee did not think of Montreal Trust as a potential purchaser of the lawsuit when, later in 1993, the trustee worked out the agreement with Dr. Hoque whereby the latter would obtain an assignment of the cause of action and would support the trustee's recommendation to the Registrar that he be discharged from bankruptcy on the condition that 20% of the proceeds of the litigation or $200,000, whichever was the lesser, would, if recovered by Dr. Hoque, be paid to the trustee.

30 There is no evidence that, at the time the decision was made to make a deal with Dr. Hoque, the trustee was influenced by his subsequently stated opinion that the sale of lawsuits to defendants was morally repugnant.

31 As noted in the recitation of the facts, Montreal Trust opposed the discharge but, as an alternate position, supported the concept that Dr. Hoque would be able to proceed with any potential lawsuits provided he pay 60% of any net recovery or $600,000 whichever was the lesser, to the trustee. Montreal Trust did not indicate any interest in acquiring the lawsuit at that time yet it was well aware of the intention of the trustee to assign the cause of action to Dr. Hoque.

32 The decision of the Registrar in Bankruptcy in December of 1993 impacted on the agreement between the trustee and Dr. Hoque. In March 1994 Dr. Hoque's solicitor wrote the trustee putting forward a proposition for earlier payment of the $68,000 provided the lawsuits were assigned to Dr. Hoque. This offer was eventually accepted by the trustee, with the authorization of the inspectors, in the latter part of the summer of 1994. After that, there only remained a matter of formalizing the agreement which required that Dr. Hoque provide the letter requested, evidencing his obligation, and upon receipt of that letter the trustee would execute the formal assignment. The trustee had not imposed a deadline on Dr. Hoque for delivery of the requested letter. It was not until the letter of March 1st, 1995, that Montreal Trust indicated any interest in purchasing the cause of action. When asked by Montreal Trust in this letter to revoke the offer to Dr. Hoque, an agreement had already been made, and the trustee was in no position to resile from that agreement. It must be remembered that Dr. Hoque supported the trustee's recommendation on the discharge hearing on the understanding the cause of action against Montreal Trust would be assigned to him. And that in 1993 the trustee had made a decision, in consultation with the inspectors and the solicitor, not to pursue the cause of action against Montreal Trust but to assign it to Dr. Hoque. While it is correct that once Dr. Hoque consented to the judgment in the amount of $68,000 the subsequently agreed upon consideration for the assignment (the possible acceleration of payment of the judgment) was not substantial. However, Dr. Hoque would not likely have consented to the judgment had he not the reasonable expectation that the trustee would assign the cause of action.

33 One must look at all of the foregoing in assessing the reasonableness or lack of the same of the decision of the trustee to conclude an agreement with Dr. Hoque in the summer of 1994.

34 There seemed to be an issue before Justice MacDonald as to whether the duties of a trustee in bankruptcy were as set out in *Katz* (supra) or those set out in *Re Keppoch Development Ltd.* (1992), 15 C.B.R. (3d) 228 (N.S. T.D.). It is my opinion this ought to have been a non-issue. The tests to be applied by a court reviewing the decision of a trustee appointed under the *Bankrupty and Insolvency Act* or a receiver appointed by the court respecting the sale of an asset are substantially the same. Both a trustee under the *Bankruptcy and Insolvency Act* and a receiver appointed by the court must act in a reasonable and competent manner in the performance of their duties to the creditors. A difference between a trustee acting under the provisions of the *Bankruptcy and Insolvency Act* and a receiver appointed pursuant to a court Order, is that the trustee is governed by the *Act* and the receiver by the common law and the terms of the court Order. In addition, the trustee has the benefit of a group of experienced creditors' representatives acting as inspectors who can bring their experience to bear on proposed dispositions of assets by the trustee. These differences do not alter the requirement that both trustees and receivers respectively act with integrity in a competent and reasonable manner.

35 When it comes to making business decisions relating to the sale of the bankrupt's assets, a trustee, with the authorization of the inspectors, must exercise reasonable business judgment. The trustee must provide advice to the inspectors equivalent to the advice one would expect from a reasonably competent trustee in the circumstances. Both the trustee and the inspectors are entitled to rely on legal advice from counsel for the estate. And, of course, a trustee must act with honesty and integrity. Finally, the courts should show deference to business decisions made by those entrusted by the creditors and authorized by the *Act* to make such decisions.

36 I agree with counsel for Montreal Trust that it had no obligation to indicate to the trustee it was interested in either paying a sum of money to acquire the causes of action or settling it. However, the fact that Montreal Trust was well aware of the intent of Dr. Hoque to commence action against it, yet it never exhibited any interest in acquiring the cause of action until March 1st, 1995, is a relevant consideration in reviewing the reasonableness of the trustee's action in failing to offer the cause

of action to Montreal Trust prior to concluding that it would be in the best interest of the creditors to assign the cause of action to Dr. Hoque and hopefully derive a benefit for the estate if he were to succeed in his potential action. Absent evidence that it is common place for the trustees to peddle potential lawsuits that a bankrupt may have to the defendants in those potential lawsuits, it is difficult to conclude that the failure of the trustee to consider Montreal Trust as a potential purchaser of the asset (particularly where the trustee considered it to be of nebulous value and Montreal Trust had shown no interest) was a failure to act reasonably in the circumtances.

37 It cannot be disputed that a defendant might be prepared to pay a sum of money to avoid even a lawsuit that the defendant is satisfied is without merit simply to save the costs of defending which would not likely be recovered from a discharged bankrupt if the trustee transferred the cause of action to the bankrupt or caused the right of action to be returned to the bankrupt as an unrealized asset. This would be particularly so where the costs of defending would be high.

38 The lawsuit which Dr. Hoque commenced against Montreal Trust in September of 1994, which blames Montreal Trust for the collapse of his real estate ventures is complex and will be expensive to defend. That trustees do sell lawsuits to the defendants in those suits is clear from *Re Katz* (supra). How prevalent this somewhat unseemly method of realizing on an asset of nebulous value is not disclosed in the evidence. Although a bare assignment of a right of action was at one time illegal, an assignment of a bare right of action by a trustee in bankruptcy was not (*Halsbury's Laws of England*, volume 9, (4th) at para. 401).

39 An advertisement by a trustee, for either a public auction or a call for the submission of tenders to purchase a potential claim against one of the bankrupt's creditors, while lawful, would be unusual in the absence of a situation such as confronted the trustee in *Re Katz* (supra) where the trustee had an expression of interest from more than one party. The nature of the asset does not lend itself to these traditional methods of realization by a trustee. The issue, however, is whether the trustee ought to have invited a bid from Montreal Trust. Even in hindsight it is not known whether Montreal Trust would have been prepared to pay anything for the lawsuit had an offer been made to Montreal Trust in 1993 or 1994.

40 Mr. Rosen did not think of this method of disposing of this so-called asset; apparently it did not occur to him that he could more or less intimidate Montreal Trust into paying a substantial sum for what the trustee considered to be a lawsuit of questionable value. Had Montreal Trust ever indicated an interest before the agreement was made with Dr. Hoque, the trustee would have been in a very different situation.

41 I agree with the comments of Mcfarlane J. in *Re Groves-Raffin Construction Ltd. (No. 2)*, [1978] 4 W.W.R. 451, 28 C.B.R. (N.S.) 104 (B.C. S.C.) where he stated at (C.B.R.) 112:

> In considering the conduct of a trustee it is well to keep in mind that the scheme of the *Act* is to allow the trustee to administer the estate under the supervision of the inspectors without interference unless there has been an excess of power, fraud, a lack of bona fides, or unless the actions of the trustee and the inspectors are unreasonable from the standpoint of the good of the estate.

42 Justice MacDonald had before him all the affidavit evidence that is before us. In addition, he heard the *viva voce* testimony of the trustee and Dr. Hoque. Justice MacDonald clearly understood the issue and made a judgment call that the trustee, in the circumstances, acted reasonably and in the interest of the creditors generally, despite the trustee having failed to consider a sale of the cause of action to Montreal Trust.

43 The trial judge did not apply an incorrect test in assessing the conduct of the trustee and his decision is justified on the evidence. I would not interfere with his finding. In fact, I agree with his conclusion. (*Stein v. "Kathy K" (The)* (supra)).

44 I would make one further point, although it was not raised in argument. Having made an agreement with Dr. Hoque to assign the cause of action to him, the trustee's hands were tied when he received the March 1st, 1995, letter from counsel for Montreal Trust. A Court would be hard pressed to conclude that it ought to set aside the agreement made with Dr. Hoque on the ground that the trustee ought to have also offered to sell the lawsuit to Montreal Trust. Dr. Hoque was entitled to insist on the agreement being completed by the exchange of the documents contemplated. Section 37 of the *Bankruptcy Act*, while it gives the Court broad power to confirm, reverse or modify a decision complained of and make such order as it thinks just,

ought not to lightly set aside an agreement that the other party (in this case Dr. Hoque) was entitled to have performed. The only ground asserted in requesting this Court to declare the agreements null and void is that the trustee ought to have disposed of the asset in a different manner. While s. 37 of the *Act* gives the Supreme Court in Bankruptcy power to set aside the trustee's decision, it would only be in exceptional circumstances that the Court would set aside a valid and enforceable agreement. There is no evidence of what amount Montreal Trust was prepared to pay for the assignment of the cause of action. To set aside an agreement made by the trustee in good faith would, in the eyes of those persons acquiring assets from time to time from trustees, impinge on the integrity of the bankruptcy process.

45 In an article entitled "*Sale of Assets by a Trustee; The Fundamental Pragmatics*" by Al Lando, C.A., Senior Vice-President of Price Waterhouse Limited, Toronto published in (1991) 3 C.B.R. (3d) 179, the author draws a distinction between what might be a sharp but acceptable practice by businessmen to enhance their "bottom line" with the standard of conduct expected of a trustee in bankruptcy in realizing on assets of the bankrupt. The author states at p. 181:

> The trustee in bankruptcy, however, is governed by standards that go beyond those which determine the business behaviour of the entrepreneur. As an officer of the Court, the trustee must always be concerned about the integrity of the insolvency process. There are times when "reasonable" business principles are not easy to reconcile with the determinants for standards of behaviour that govern an officer of the Court. The businessman is playing in his own game, and must do what is fair and reasonable, no less, but not necessarily more. The stakes are greater for the trustee; his actions are measured against a higher test, a test of not only being right and fair but that of appearing to be right and fair. The dilemma arises when doing what is right, when conducting an administration from the "highest moral ground", does not necessarily produce the best commercial result.
>
> All of that said, the insolvency process (the *Bankruptcy Act*, the Courts, the office of the superintendent in bankruptcy, members of the Bar who specialize in bankruptcy law, and trustees) manages, for the most part, to satisfy its intended purposes in a practical sense. This paper will talk about basic principles, focusing on the practical considerations that influence the manner in which a trustee wheels and deals with the assets of a bankrupt.

46 The author then condemns the practice of trustees "wheeling and dealing" in assets to maximize recovery. He concludes his article by stating that there are certain assets that are difficult to deal with but the trustee should be governed by the same fundamental principles that govern the treatment of all assets and principles that will always enhance and never offend the integrity of the process. He concludes stating:

> What are these principles? Among those described or alluded to are: fairness, equity, good faith, order (as opposed to "chaos" referred to in the last case cited), honesty, integrity, due care, and sound commercial practice. Of equal importance, the trustee's actions must be perceived to be governed by these standards. That the process functions effectively, is a manifestation of the symbiosis between the practices and procedures as they are articulated in the *Act*, superintendent directives, and the case law, on the one hand, and their practical application in the business world, on the other hand.

47 A trustee in bankruptcy has a broader range of duties than simply getting the best possible price at any cost.

48 In *Re Pachal's Beverages Ltd.* (1969), 13 C.B.R. (N.S.) 160 the Saskatchewan Court of Appeal had to deal with the provisions of s. 15 of the *Bankruptcy Act*, R.S.C. 1952, c. 14. That section is essentially the same as the present s. 37 of the *Bankruptcy and Insolvency Act*. The Court stated at p. 163:

> While s. 15 gives to the court a wide discretionary power: *Imperial Bank of Canada v. Barber* (1921), 50 O.L.R. 380, 1 C.B.R. 485, 59 D.L.R. 523; and *Re Hancock; Ex part Spraggett*, [1952] O.R. 121, 32 C.B.R. 96, [1952] 1 D.L.R. 785; that power must be judicially exercised. To obtain relief under this section, the onus rests upon the applicant to show that it has been aggrieved by the decision of the trustee, or has suffered damage or prejudice as a result of the trustee's action: *Re Gareau (English and Scotch Woollen Company); Ex part Joseph Brothers Limited* (1922), 3 C.B.R. 76.

49 The only affidavit filed by Montreal Trust was that of Mr. MacIntosh setting out the amount owing to Montreal Trust. There is nothing stated to show that Montreal Trust has been aggrieved by the decision of the trustee to assign the lawsuit to

Dr. Hoque other than the argument by counsel that an action has been started and that Montreal Trust will incur costs to defend the action. Possibly it goes without saying that they are aggrieved and to that extent have or will suffer damages.

50 The decision in *Pachal's Beverages* (supra) is relevant as it makes clear that the burden of proof is on the applicant to show that the trustee's decision was unreasonable and not on the trustee to show that it was right. In the absence of evidence to prove that, as a general practice, trustees in bankruptcy offer to sell causes of action which the bankrupt may have to the potential defendants in those lawsuits who also happen to be creditors of the bankrupt, it is difficult to conclude that the trustee's conduct in this instance was a failure to meet the acceptable standards for a trustee in realizing on assets of the bankrupt.

51 In summary, on the principal issue, I would dismiss the appeal on two grounds. The trial judge did not err in concluding on the facts that the trustee acted reasonably, and in the interests of the creditors generally, notwithstanding the failure to ask Montreal Trust if it would like to bid to acquire the lawsuit; and, secondly, it would be unjust in the circumstances to grant the relief sought by Montreal Trust as Dr. Hoque was entitled to have the agreement he made with the trustee finalized; in short, it would not be a judicial exercise of the power given the court by s. 37 of the *Act*. To grant the relief sought, even if it were concluded that the trustee acted unreasonably, would also offend the integrity of the bankruptcy process.

The Costs Issue

52 We were advised at the hearing of this appeal that the estate in bankruptcy has no assets. I assume counsel meant no assets other than judgment against Dr. Hoque, the value of which is very dependent on Dr. Hoque succeeding in his action against Montreal Trust.

53 With one exception, I would not interfere with Justice MacDonald's decision on costs. I agree with counsel for Montreal Trust that the application was not frivolous; there were issues to be resolved and s. 37 is in the *Act* to allow decisions of the trustee to be reviewed by the Court. However, on the facts, Justice MacDonald, even if he had found that the trustee had not acted reasonably in failing to offer the lawsuit to Montreal Trust, would not likely have granted the relief sought by Montreal Trust. As already noted, it would not be just to declare the agreement with Dr. Hoque null and void. There is no allegation of fraud nor any reason to warrant depriving Dr. Hoque of the benefit, if any, of the agreement he made with the trustee to have the lawsuit assigned to him.

54 Under the circumstances, Justice MacDonald did not err in awarding solicitor and client costs to the trustee to be paid by Montreal Trust notwithstanding that an award of solicitor and client costs is only made in exceptional circumstances as is an order that such costs be paid other than out of the estate.

55 An award of solicitor and client costs should not be limited as was held in *Stiles v. British Columbia (Workers' Compensation Board)* (1989), 39 C.P.C. (2d) 74 (B.C. C.A.) to situations where the party ordered to pay the costs was guilty of reprehensible conduct. In this instance, the conduct of Montreal Trust could not be categorized as reprehensible.

56 Solicitor and client costs were awarded against the s. 37 applicant in *Re Groves-Raffin Construction Ltd. (No. 2)* (supra) where on the cost issue the Court concluded:

> There is no reason, in my opinion, why the trustee or the estate should bear any part of the costs of an application brought solely for *the benefit of one creditor*. The costs of the trustee are therefore awarded against Fred Welsh Ltd. on a solicitor and client basis. Different considerations apply with respect to Fidelity. In essence, this has been a dispute not between Fred Welsh Ltd. and the trustee, but with Fidelity. The latter will have its costs on a party and party basis against Fred Welsh Ltd.

57 The application of Montreal Trust is essentially for its sole benefit. There appears to be case law that the words of s. 37 are broad enough to permit the court to set aside a sale even if the sale has been completed (See *Houlden and Morawetz Bankruptcy and Insolvency Law of Canada*, 3rd Edition, Volume 1, p. 1-87. The authority cited for that statement is *Re H. Packer & Son Ltd.* (1936), 17 C.B.R. 207 (Que. S.C.). A review of that case shows a very different fact situation that we have under consideration. In *Re H. Packer* (supra) one of the inspectors of the estate was the president of a company which purchased the estate assets

without the prior approval of the Court to the sale. The Court declared the sale null and void; the prior approval of the Court being necessary in such a case under s. 103(6) of the *Bankruptcy Act* that was in force at the time. The Court stated at p. 208:

> ... There are now concerns [businesses] who make a business of buying bankrupt assets, and to allow insiders to take advantage of their knowledge to put in a bid at a few dollars more than the highest bidder is an unfair practice, which, if allowed to prevail, would discourage bidding by outsiders and militate against obtaining the best possible price, and, therefore, should not be countenanced:

58 The same reasoning dictates that on the facts we have under consideration the sale to Dr. Hoque should not be set aside; it would be unfair to do so in the circumstances of this case.

59 Costs are in the discretion of the Supreme Court in Bankruptcy. I would not interfere with the exercise by Justice MacDonald of his discretion to award solicitor and client costs but I am of the opinion that under the circumstances he ought to have ordered that the solicitor and client costs of the trustee be taxed so as to enable Montreal Trust to make representations as to the amount of the account.

60 Montreal Trust has not appealed the award of costs to Dr. Hoque.

61 On this appeal the trustee, by notice of contention, argues that Justice MacDonald ought to have ordered Montreal Trust to pay the trustee for its time in preparing for the application. I disagree. The time spent by the trustee in these circumstances was exactly the same as the time spent by any litigant who is unfortunately involved in legal proceedings. There is no legal basis for requiring the losing party to a lawsuit or legal proceeding to pay a sum of money to the other side to compensate the winning party for time spent in preparing for and attending the proceedings.

62 In summary, Montreal Trust's appeal ought to be dismissed other than requiring that the solicitor and client costs awarded to the trustee be taxed.

63 The trustee and Dr. Hoque shall each have costs of this appeal against Montreal Trust which I would fix at $1,000 each plus disbursements.

Appeal dismissed.

5

1999 CarswellBC 821
British Columbia Supreme Court [In Chambers]

Taylor Ventures Ltd., Re

1999 CarswellBC 821, 10 B.C.T.C. 191, 13 C.B.R. (4th) 146, 87 A.C.W.S. (3d) 627

Taylor Ventures Ltd., 402847 B.C. Ltd., 387325 B.C. Ltd., 512046 B.C. Ltd. and 512048 B.C. Ltd., Petitioners and All Investors Set Forth on Schedule "A" Attached to the Petition, Respondents

In the Matter of the Bankruptcy of Taylor Ventures Ltd., 402847 B.C. Ltd., 387325 B.C. Ltd., 512046 B.C. Ltd. and 512048 B.C. Ltd.

Burnyeat J.

Heard: April 1, 1999
Judgment: April 15, 1999
Docket: Vancouver A980224, Vancouver 185695/VA98, 185403/VA98

Counsel: *P.D. Le Dressay*, for Inspectors.
G. Thompson, for Hong Kong Bank of Canada.
M.A. Fitch, Q.C., for Trustee, PricewaterhouseCoopers Inc.

***Burnyeat J.*:**

1 The Trustee applies pursuant to ss.119(2) and 197(7) of the *Bankruptcy and Insolvency Act* and the inherent jurisdiction of the court for an order that the total legal costs exclusive of disbursements may exceed 10% of the gross receipts in the estate less amounts paid to secured creditors. On March 9, 1999, the five Inspectors of the Bankrupt unanimously defeated a resolution that the legal costs rendered to or to be rendered to the Trustee could exceed 10%. Accordingly, the application on behalf of the Trustee is to obtain an order revoking that decision.

Applicable Statutory Provisions

2 Sections 119(2) and 197(7) of the *Bankruptcy and Insolvency Act* provide:

> 119(2) The decisions and actions of the inspectors are subject to review by the court at the instance of the trustee or any interested person and the court may revoke or vary any act or decision of the inspectors and it may give such directions, permission or authority as it deems proper in substitution thereof or may refer any matter back to the inspectors for reconsideration.
>
> 197(7) Notwithstanding anything in this section, the total legal costs exclusive of disbursements for all legal services ... shall not exceed ten per cent of the gross receipts less amounts paid to secured creditors, except with the approval of the inspectors and the court, ...

Background

3 Using borrowed funds and using funds received from "Project Investors", Taylor Ventures Ltd. purchased, sometimes developed and sometimes sold properties throughout the Province of British Columbia. At the time of its Bankruptcy, there were approximately 300 properties registered in the name of Taylor, in the name of related companies or in the name of third parties. In the case of third party properties, it was thought that no proper consideration had been received by Taylor when the properties were transferred to those third parties.

4 Coopers & Lybrand Limited was appointed the Receiver-Manager of Taylor on January 22, 1998. At that time, a Steering Committee of Investors was appointed. On October 22, 1998, PricewaterhouseCoopers Inc. was affirmed by the creditors as the Trustee in Bankruptcy of Taylor. Messrs. Russell & DuMoulin has provided legal advice to the Receiver-Manager and to the Trustee, PricewaterhouseCoopers since January, 1998. This application deals with approximately $80,000 in legal fees for services rendered to date to the Trustee.

5 One of the issues dealt with by the Receiver-Manager, the Trustee and their solicitors arises out of the claims of the "Project Investors" of Taylor. An October 21, 1998 Order provided that the Project Investors could vote as unsecured creditors at the first meeting of creditors "without prejudice to the right of any party to apply for a determination of the rights of the Project Investors in this bankruptcy" and "without effect on the right of Project Investors with respect to a determination as to whether they are trust claimants as against the property of the bankrupt."

6 As yet, there has been no determination of whether certain properties are held in trust for Project Investors. If some properties or the proceeds from the sale of such properties are subsequently determined to be property held in trust for some of the Project Investors, those properties would not form part of the "gross receipts" of the estate of the bankrupt. Until there has been a determination of that issue, it will not be possible to ascertain the "gross receipts" of the Estate.

Position of the Parties

7 In support of its application, the Trustee states:

> The effect of this decision is that any legal counsel doing work for the estate is potentially at risk for their fees, given that the aggregate amount of legal fees when compared to net recoveries is uncertain and will not be known until the conclusion of the estate. In those circumstances it is not possible for the Trustee to obtain legal advice for the estate and I therefore ask that the Court overrule the position taken by the Inspectors.

8 On the other hand, the Inspectors say that the fees of Messrs. Russell & DuMoulin are "excessive and unjustified", the "fees are simply too high", "the results achieved by the trustee and its counsel in this estate do not ... justify such fees" and, if the fees are paid, "there will likely be little or nothing to pay a substituted trustee and counsel to carry on the administration and proper realization on the estate of Taylor...". In this latter regard, counsel for the Inspectors submits that the question of whether or not the 10% ceiling should apply should be left until after there can be a further meeting of creditors as the Inspectors hope that a new Trustee will be appointed instead of PricewaterhouseCoopers. If there is a new Trustee, it is anticipated that the new Trustee will not continue to retain Messrs. Russell & DuMoulin. However, counsel for the Inspectors was candid to admit that it would be unlikely that any new solicitors would act unless the Inspectors agree to waive the 10% maximum. If the Inspectors passed such a resolution, Messrs. Russell & DuMoulin would then be in a position to render accounts even though the total amount of those accounts plus the accounts of the new solicitors might exceed 10% of the gross receipts in the Estate.

9 Counsel for the Inspectors submits that the 10% limit is a statutory provision which represents the status quo and that the court should be reticent to overrule the unanimous vote of the Inspectors relating to such a statutorily imposed maximum. Counsel for the Inspectors also submits that Messrs. Russell & DuMoulin knew the risk they were taking when they agreed to be the solicitors for the Estate and that there should be no determination of whether legal fees should be in excess of 10% until there can be a determination of the question of what constitutes the "gross receipts" of the Estate.

Case Authorities and Discussion

10 It was clear from the beginning that the major issue regarding the distribution of any receipts in the Estate would be the question of the status of the claims of Project Investors of Taylor. The Receiver-Manager and the Trustee have concentrated their efforts on realizing on the assets of Taylor and on attempting to produce an accounting of the receipt and distribution of funds from the Project Investors. The efforts to date has been complicated by the nature of the records maintained by Taylor.

11 The Inspectors and the court should not place a Trustee in the position where it may be impossible for the Trustee to have access to legal counsel. Where claimants in an Estate are comprised largely of people like these Project Investors, it is clear that a great deal of work will have to be done by the Trustee and its legal counsel even though that work may be performed for the benefit of the claimants who are trust claimants and even though the creditors of the Estate will not benefit. It would be inequitable to allow the Project Investors to have the benefit of those efforts but later take the position that the fees of that legal counsel should not exceed 10% of the gross receipts of the Estate even though the satisfaction of the trust claims advanced by the Project Investors has reduced the gross receipts of the Estate below what is required to pay for the appropriate services rendered by the solicitors for the Estate. In this Estate, four out of the five Inspectors are Project Investors. It would inequitable to require any solicitors to wait until the conclusion of an Estate before knowing whether they will be paid for all of their services rendered to the Estate.

12 In this Estate, a resolution pursuant to s.197(7) of the Act is inevitable. On the assumption that there is a substitution of Trustees, the new Trustee will not be in a position to retain legal counsel unless that counsel receives some assurance that their fees will be paid out of the Estate. If there is not a substitution of Trustees and/or if Messrs. Russell & DuMoulin continue as the Estate solicitors, they will seek assurances that their fees will be paid. It is not appropriate that Estate solicitors be asked to undertake work when their ability to obtain payment of their account is contingent almost solely on the question of the determination of the issue of who are trust claimants and who are creditors in the Estate. The Estate solicitors should not be required by the Inspectors to have their own economic interests conflict with their obligation to advise the Trustee in accordance with their professional obligation to provide the Trustee with the best possible advice when legal questions arising in the Estate.

13 There has been an evolution in dealing with the question of when the court will interfere in a decision reached by, Inspectors. Early decisions indicated that it was necessary to show that the Inspectors were acting either fraudulently or not in good faith. For instance, in *Re Feldman* (1932), 13 C.B.R. 313 (Ont. C.A.), the court concluded:

> In other words the whole scope and foundation of The Bankruptcy Act is that in the practical administration of the estate of the bankrupt the governing principle shall be the inspectors and the court, the inspectors being practical men named by the creditors, and unless it is shown they are acting fraudulently or in some way not in good faith for the benefit of the estate, the administration of the affairs of the estate is to be governed according to their directions. (at p.314)

14 Similarly, in *Re Adam Burwash Ltd.* (1977), 24 C.B.R. (N.S.) 81 (Ont. S.C.), Registrar Ferron stated:

> The court will not likely interfere with a decision taken by the inspectors within the ambit of their authority. Inspectors, as representatives of the creditors, are under the scheme of the Bankruptcy Act supposed to administer the estate, and although the full potential of that scheme has not been realized their authority in matters under their jurisdiction must not be lightly disturbed. The reason for overriding a decision of the inspectors must be very cogent indeed.
>
> In *Potato Distributors Inc. v. Eastern Trust Co.* (1955), 35 C.B.R. 161 (P.E.I. C.A.) at 165-66, ... the Prince Edward Island Court of Appeal pointed out that the whole scope of the Act placed the governing authority in the administration of an estate in the hands of the inspectors and went on to say:
>
> > If, however, the Act fraudulently or in bad faith and not for the benefit of the estate, the court may interfere, but otherwise the policy of the Act is to leave the matter entirely in their hands. (at p. 82)

15 Later decisions have provided broader criteria. In *Re Melnitzer* (1991), 9 C.B.R. (3d) 30 (Ont. Bktcy.), Killeen J. dealt with a decision of the inspectors to allow a secured creditor to proceed under its power of sale in order to sell a matrimonial home. The wife of the bankrupt brought a motion seeking an order directing that the sale of the former matrimonial home be immediate and that the trustees and inspectors cooperate in that sale. Killeen J. had the following comment regarding s. 119(2) of the Act and the *Re Feldman* and *Re 418216 Ontario Ltd.* decisions:

> While these sections appear, at first blush, to give a broad discretionary power to the court to review any "act or decision" of the trustee or inspectors, the case law seems to have limited that power of review to very narrow proportions. (at p. 35)

16 Killeen J. then comments:

> While I must express, with respect, some misgivings about the narrow reading which has been given to the review powers of the court in the jurisprudence, I do not feel that I should disturb the decisions made by the trustee and inspectors in this instance.... In sum, I cannot say that the decision was commercially imprudent when made and it does not seem commercially imprudent today. It may be that the trustee and inspectors might reconsider their decision now that it is abundantly clear that Ms. Baltman will be fully cooperative in joint efforts to list the property for sale and provide access to the property, but that is a decision for the trustee and inspectors to make in a conscientious, prompt and fair-minded way in the immediate future. (at p. 35)

17 In *Re Public Eyecare Management Inc.* (1998), 7 C.B.R. (4th) 255 (Ont. Gen. Div. [Commercial List]), Greer J. dealt with the decision of Inspectors to ignore the decision of the Trustee to accept "a commercially reasonable offer" which had been received before another offer which the Inspectors wished to have approved was received. Greer J. noted that "the court seldom intervenes in decisions made by Inspectors" but also noted "it clearly has the power to do so." (at para. 21) Greer J. described the decision of the Inspectors as "clearly unreasonable" (at para. 20) and, in reversing the decision reached by the Inspectors, concluded:

> While the Court intervenes in decisions made by Inspectors, it clearly has the power to do so.... In Feldman, supra, the Court noted that unless it can be shown that the Inspectors acted fraudulently or in some way not in good faith for the benefit of the estate, their decision should not be overturned. In my view more recent commercial cases such as Soundair, supra, have expanded the Feldman test to include that of reasonableness and commercial viability. (at para.21)

18 A more recent case and one which was referred to by Greer J. in *Re Public Eyecare Management Inc.* supra, was the Ontario Court of Appeal decision in *Re Rizzo & Rizzo Shoes Ltd.* (1998), 38 O.R. (3d) 280 (Ont. C.A.) where the court dealt with a situation where the Inspectors had rejected an offer by a creditor to purchase a cause of action which was available to the bankrupt. This decision reverts to the narrow test set out in *Re Feldman*, supra:

> In the absence of evidence of fraud or bad faith, the decision was still one within the ambit of Inspectors to make. (at p.286)

19 In dealing with all situations where the court is asked to overturn a decision reached by Inspectors, I am satisfied that the present standard of review should be whether it can be said that the decision was "commercial imprudent", "unreasonable" or lacking "commercial viability." However, it is necessary to distinguish between resolutions of Inspectors dealing with the day to day commercial questions which face the Trustee and the Inspectors and resolutions of Inspectors dealing with the fundamental question of whether or not the Trustee will have available to it the legal advice which is required if the Trustee is in a position to perform the functions required of it. Even in the most simple of estates, it is often necessary for the Trustee to retain legal counsel. The Trustee and that legal counsel should have the assurance of payment and neither should have to gamble on the question of whether the Inspectors will pass a resolution pursuant to s.197 (7) of the Act in due course.

20 In this case, I am satisfied that the Inspectors have not acted in a way which can be described as "conscientious" and "fair minded." They have allowed their views about the services rendered and their disappointment about what now appears to be the likely recovery in the Estate to influence the question of whether or not they should pass such a resolution. I am satisfied that they have acted in a way which can be described as "unreasonable." I am also satisfied that the appropriate' test is whether the Inspectors have acted with "reasonableness and commercial viability." However, I am also satisfied that the Inspectors have acted in a way which can be described as "clearly unreasonable" if I am in error in setting out the test to be applied. While Greer J. describes the decision of the Inspectors in Public Eyecare, supra, as being "clearly unreasonable", it is clear that he is satisfied that the test in Feldman, supra, has been expanded to include that of "reasonableness and commercial viability." I am similarly satisfied.

21 Any unhappiness that the present Inspectors have with the fees and disbursements of Messrs. Russell & DuMoulin can be expressed and taken into account at the assessment of the account before the Registrar. In the interim, the uncertainty of whether or not the Trustee will have legal counsel should be resolved on the side of having legal counsel. Inspectors of an

Estate should never place the Trustee in the position where the Trustee will not have available to it legal counsel to advise on matters which arise from time to time. The complications which arise on this and similar Estates makes access to legal advice a necessity. Because of that, legal counsel must receive assurances that they will be compensated for the work that they are undertaking and have undertaken.

Conclusion

22 In the circumstances, it is appropriate to revoke the decision of the Inspectors reached on March 9, 1999 and substitute a decision allowing the total legal costs exclusive of disbursements to exceed 10% of the gross receipts of the Estate less amounts paid to secured creditors.

Application granted.

6

1994 CarswellQue 120
Supreme Court of Canada

RJR — MacDonald Inc. v. Canada (Attorney General)

1994 CarswellQue 120F, 1994 CarswellQue 120, [1994] 1 S.C.R. 311, [1994] A.C.S. No. 17, [1994] S.C.J. No. 17, 111 D.L.R. (4th) 385, 164 N.R. 1, 46 A.C.W.S. (3d) 40, 54 C.P.R. (3d) 114, 5 W.D.C.P. (2d) 136, 60 Q.A.C. 241, J.E. 94-423, EYB 1994-28671

RJR — MacDonald Inc., Applicant v. The Attorney General of Canada, Respondent and The Attorney General of Quebec, Mis-en-cause and The Heart and Stroke Foundation of Canada, the Canadian Cancer Society, the Canadian Council on Smoking and Health, and Physicians for a Smoke-Free Canada, Interveners on the application for interlocutory relief

Imperial Tobacco Ltd., Applicant v. The Attorney General of Canada, Respondent and The Attorney General of Quebec, Mis-en-cause and The Heart and Stroke Foundation of Canada, the Canadian Cancer Society, the Canadian Council on Smoking and Health, and Physicians for a Smoke-Free Canada, Interveners on the application for interlocutory relief

Lamer C.J. and La Forest, L'Heureux-Dubé, Sopinka, Gonthier, Cory, McLachlin, Iacobucci and Major JJ.

Judgment: October 4, 1993
Judgment: March 3, 1994
Docket: 23460, 23490

Proceedings: Applications for Interlocutory Relief

Counsel: *Colin K. Irving* , for the applicant RJR — MacDonald Inc.
Simon V. Potter , for the applicant Imperial Tobacco Inc.
Claude Joyal and *Yves Leboeuf* , for the respondent.
W. Ian C. Binnie, Q.C. , and *Colin Baxter* , for the Heart and Stroke Foundation of Canada, the Canadian Cancer Society, the Canadian Council on Smoking and Health, and Physicians for a Smoke-Free Canada.

The judgment of the Court on the applications for interlocutory relief was delivered by *Sopinka and Cory JJ.*:

I. Factual Background

1 These applications for relief from compliance with certain *Tobacco Products Control Regulations, amendment* , SOR/93-389 as interlocutory relief are ancillary to a larger challenge to regulatory legislation which will soon be heard by this Court.

2 The *Tobacco Products Control Act* , R.S.C., 1985, c. 14 (4th Supp.), S.C. 1988, c. 20, came into force on January 1, 1989. The purpose of the Act is to regulate the advertisement of tobacco products and the health warnings which must be placed upon tobacco products.

3 The first part of the *Tobacco Products Control Act* , particularly ss. 4 to 8, prohibits the advertisement of tobacco products and any other form of activity designed to encourage their sale. Section 9 regulates the labelling of tobacco products, and provides that health messages must be carried on all tobacco packages in accordance with the regulations passed pursuant to the Act.

4 Sections 11 to 16 of the Act deal with enforcement and provide for the designation of tobacco product inspectors who are granted search and seizure powers. Section 17 authorizes the Governor in Council to make regulations under the Act. Section 17(*f*) authorizes the Governor in Council to adopt regulations prescribing "the content, position, configuration, size and prominence" of the mandatory health messages. Section 18(1)(*b*) of the Act indicates that infringements may be prosecuted

by indictment, and upon conviction provides for a penalty by way of a fine not to exceed $100,000, imprisonment for up to one year, or both.

5 Each of the applicants challenged the constitutional validity of the *Tobacco Products Control Act* on the grounds that it is *ultra vires* the Parliament of Canada and invalid as it violates s. 2(*b*) of the *Canadian Charter of Rights and Freedoms* . The two cases were heard together and decided on common evidence.

6 On July 26, 1991, Chabot J. of the Quebec Superior Court granted the applicants' motions, [1991] R.J.Q. 2260, 82 D.L.R. (4th) 449 , finding that the Act was *ultra vires* the Parliament of Canada and that it contravened the *Charter* . The respondent appealed to the Quebec Court of Appeal. Before the Court of Appeal rendered judgment, the applicants applied to this court for interlocutory relief in the form of an order that they would not have to comply with certain provisions of the Act for a period of 60 days following judgment in the Court of Appeal.

7 Up to that point, the applicants had complied with all provisions in the *Tobacco Products Control Act* . However, under the Act, the complete prohibition on all point of sale advertising was not due to come into force until December 31, 1992. The applicants estimated that it would take them approximately 60 days to dismantle all of their advertising displays in stores. They argued that, with the benefit of a Superior Court judgment declaring the Act unconstitutional, they should not be required to take any steps to dismantle their displays until such time as the Court of Appeal might eventually hold the legislation to be valid. On the motion the Court of Appeal held that the penalties for non-compliance with the ban on point of sale advertising could not be enforced against the applicants until such time as the Court of Appeal had released its decision on the merits. The court refused, however, to stay the enforcement of the provisions for a period of 60 days following a judgment validating the Act.

8 On January 15, 1993, the Court of Appeal for Quebec, [1993] R.J.Q. 375, 102 D.L.R. (4th) 289 , allowed the respondent's appeal, Brossard J.A. dissenting in part. The Court unanimously held that the Act was not *ultra vires* the government of Canada. The Court of Appeal accepted that the Act infringed s. 2(*b*) of the *Charter* but found, Brossard J.A. dissenting on this aspect, that it was justified under s. 1 of the *Charter* . Brossard J.A. agreed with the majority with respect to the requirement of unattributed package warnings (that is to say the warning was not to be attributed to the Federal Government) but found that the ban on advertising was not justified under s. 1 of the *Charter* . The applicants filed an application for leave to appeal the judgment of the Quebec Court of Appeal to this Court.

9 On August 11, 1993, the Governor in Council published amendments to the regulations dated July 21, 1993, under the Act: *Tobacco Products Control Regulations, amendment* , SOR/93-389. The amendments stipulate that larger, more prominent health warnings must be placed on all tobacco products packets, and that these warnings can no longer be attributed to Health and Welfare Canada. The packaging changes must be in effect within one year.

10 According to affidavits filed in support of the applicant's motion, compliance with the new regulations would require the tobacco industry to redesign all of its packaging and to purchase thousands of rotogravure cylinders and embossing dies. These changes would take close to a year to effect, at a cost to the industry of about $30,000,000.

11 Before a decision on their leave applications in the main actions had been made, the applicants brought these motions for a stay pursuant to s. 65.1 of the *Supreme Court Act* , R.S.C., 1985, c. S-26 (ad. by S.C. 1990, c. 8, s. 40) or, in the event that leave was granted, pursuant to r. 27 of the *Rules of the Supreme Court of Canada* , SOR/83-74. The applicants seek to stay "the judgment of the Quebec Court of Appeal delivered on January 15, 1993", but "only insofar as that judgment validates sections 3, 4, 5, 6, 7 and 10 of [the new regulations]". In effect, the applicants ask to be released from any obligation to comply with the new packaging requirements until the disposition of the main actions. The applicants further request that the stays be granted for a period of 12 months from the dismissal of the leave applications or from a decision of this Court confirming the validity of *Tobacco Products Control Act* .

12 The applicants contend that the stays requested are necessary to prevent their being required to incur considerable irrecoverable expenses as a result of the new regulations even though this Court may eventually find the enabling legislation to be constitutionally invalid.

13 The applicants' motions were heard by this Court on October 4. Leave to appeal the main actions was granted on October 14.

II. Relevant Statutory Provisions

Tobacco Products Control Act, R.S.C., 1985, c. 14 (4th Supp.), S.C. 1988, c. 20, s. 3:

14

> *3.* The purpose of this Act is to provide a legislative response to a national public health problem of substantial and pressing concern and, in particular,
>
> (*a*) to protect the health of Canadians in the light of conclusive evidence implicating tobacco use in the incidence of numerous debilitating and fatal diseases;
>
> (*b*) to protect young persons and others, to the extent that is reasonable in a free and democratic society, from inducements to use tobacco products and consequent dependence on them; and
>
> (*c*) to enhance public awareness of the hazards of tobacco use by ensuring the effective communication of pertinent information to consumers of tobacco products.

Supreme Court Act, R.S.C., 1985, c. S-26, s. 65.1 (ad. S.C. 1990, c. 8, s. 40):

15

> *65.1* The Court or a judge may, on the request of a party who has filed a notice of application for leave to appeal, order that proceedings be stayed with respect to the judgment from which leave to appeal is being sought, on such terms as to the Court or the judge seem just.

Rules of the Supreme Court of Canada, SOR/83-74, s. 27:

16

> 27. Any party against whom judgment has been given, or an order made, by the Court or any other court, may apply to the Court for a stay of execution or other relief against such a judgment or order, and the Court may give such relief upon such terms as may be just.

III. Courts Below

17 In order to place the applications for the stay in context it is necessary to review briefly the decisions of the courts below.

Superior Court, [1991] R.J.Q. 2260, 82 D.L.R. (4th) 449

18 Chabot J. concluded that the dominant characteristic of the *Tobacco Products Control Act* was the control of tobacco advertising and that the protection of public health was only an incidental objective of the Act. Chabot J. characterized the *Tobacco Products Control Act* as a law regulating advertising of a particular product, a matter within provincial legislative competence.

19 Chabot J. found that, with respect to s. 2(*b*) of the *Charter* , the activity prohibited by the Act was a protected activity, and that the notices required by the Regulations violated that *Charter* guarantee. He further held that the evidence demonstrated that the objective of reducing the level of consumption of tobacco products was of sufficient importance to warrant legislation restricting freedom of expression, and that the legislative objectives identified by Parliament to reduce tobacco use were a pressing and substantial concern in a free and democratic society.

20 However, in his view, the Act did not minimally impair freedom of expression, as it did not restrict itself to protecting young people from inducements to smoke, or limit itself to lifestyle advertising. Chabot J. found that the evidence submitted by the respondent in support of its contention that adver tising bans decrease consumption was unreliable and without probative value because it failed to demonstrate that any ban of tobacco advertising would be likely to bring about a reduction of tobacco consumption. Therefore, the respondent had not demonstrated that an advertising ban restricted freedom of expression as little as possible. Chabot J. further concluded that the evidence of a rational connection between the ban of Canadian advertising and the objective of reducing overall consumption of tobacco was deficient, if not non-existent. He held that the Act was a form of censorship and social engineering which was incompatible with a free and democratic society and could not be justified.

Court of Appeal (on the application for a stay)

21 In deciding whether or not to exercise its broad power under art. 523 of the *Code of Civil Procedure of Québec* to "make any order necessary to safeguard the rights of the parties", the Court of Appeal made the following observation on the nature of the relief requested:

> But what is at issue here (if the Act is found to be constitutionally valid) is the suspension of the legal effect of part of the Act and the legal duty to comply with it for 60 days, and the suspension, as well, of the power of the appropriate public authorities to enforce the Act. To suspend or delay the effect or the enforcement of a *valid* act of the legislature, particularly one purporting to relate to the protection of public health or safety is a serious matter. The courts should not lightly limit or delay the implementation or enforcement of *valid* legislation where the legislature has brought that legislation into effect. To do so would be to intrude into the legislative and the executive spheres. [Emphasis in original.]

The Court made a partial grant of the relief sought as follows:

> Since the letters of the Department of Health and Welfare and appellants' contestation both suggest the possibility that the applicants may be prosecuted under *Sec. 5* after December 31, 1992 whether or not judgment has been rendered on these appeals by that date, it seems reasonable to order the suspension of enforcement under *Sec. 5* of the Act until judgment has been rendered by this Court on the present appeals. There is, after all, a serious issue as to the validity of the Act, and it would be unfairly onerous to require the applicants to incur substantial expense in dismantling these point of sale displays until we have resolved that issue.
>
> We see no basis, however, for ordering a stay of the coming into effect of the Act for 60 days following our judgment on the appeals.
>
> . . . . .
>
> Indeed, given the public interest aspect of the Act, which purports to be concerned with the protection of public health, if the Act were found to be valid, there is excellent reason why its effect and enforcement should not be suspended (*A.G. of Manitoba v. Metropolitan Stores (MTS) Ltd.*, [1987] 1 S.C.R. 110 , 127, 135). [Emphasis in original.]

Court of Appeal (on the validity of the legislation), [1993] R.J.Q. 375, 102 D.L.R. (4th) 289

1. LeBel J.A. (for the majority)

22 LeBel J.A. characterized the *Tobacco Products Control Act* as legislation relating to public health. He also found that it was valid as legislation enacted for the peace, order and good government of Canada.

23 LeBel J.A. applied the criteria set out in *R. v. Crown Zellerbach Canada Ltd.*, [1988] 1 S.C.R. 401 , and concluded that the Act satisfied the "national concern" test and could properly rest on a purely theoretical, unproven link between tobacco advertising and the overall consumption of tobacco.

24 LeBel J.A. agreed with Brossard J.A. that the Act infringed freedom of expression pursuant to s. 2(*b*) of the *Charter* but found that it was justified under s. 1 of the *Charter* . LeBel J.A. concluded that Chabot J. erred in his findings of fact in failing to recognize that the rational connection and minimal impairment branches of the *Oakes* test have been attenuated by later

decisions of the Supreme Court of Canada. He found that the s. 1 test was satisfied since there was a possibility that prohibiting tobacco advertising might lead to a reduction in tobacco consumption, based on the mere existence of a [Translation] "body of opinion" favourable to the adoption of a ban. Further he found that the Act appeared to be consistent with minimal impairment as it did not prohibit consumption, did not prohibit foreign advertising and did not preclude the possibility of obtaining information about tobacco products.

2. Brossard J.A. (dissenting in part)

25 Brossard J.A. agreed with LeBel J.A. that the *Tobacco Products Control Act* should be characterized as public health legislation and that the Act satisfied the "national concern" branch of the peace, order and good government power.

26 However, he did not think that the violation of s. 2(*b*) of the *Charter* could be justified. He reviewed the evidence and found that it did not demonstrate the existence of a connection or even the possibility of a connection between an advertising ban and the use of tobacco. It was his opinion that it must be shown on a balance of probabilities that it was at least possible that the goals sought would be achieved. He also disagreed that the Act met the minimal impairment requirement since in his view the Act's objectives could be met by restricting advertising without the need for a total prohibition.

IV. Jurisdiction

27 A preliminary question was raised as to this Court's jurisdiction to grant the relief requested by the applicants. Both the Attorney General of Canada and the interveners on the stay (several health organizations, i.e., the Heart and Stroke Foundation of Canada, the Canadian Cancer Society, the Canadian Council on Smoking and Health, and Physicians for a Smoke-Free Canada) argued that this Court lacks jurisdiction to order a stay of execution or of the proceedings which would relieve the applicants of the obligation of complying with the new regulations. Several arguments were advanced in support of this position.

28 First, the Attorney General argued that neither the old nor the new regulations dealing with the health messages were in issue before the lower courts and, as such, the applicants' requests for a stay truly cloaks requests to have this Court exercise an original jurisdiction over the matter. Second, he contended that the judgment of the Quebec Court of Appeal is not subject to execution given that it only declared that the Act was *intra vires* s. 91 of the *Constitution Act, 1867* and justified under s. 1 of the *Charter* . Because the lower court decision amounts to a declaration, there is, therefore, no "proceeding" that can be stayed. Finally, the Attorney General characterized the applicants' requests as being requests for a suspension by anticipation of the 12-month delay in which the new regulations will become effective so that the applicants can continue to sell tobacco products for an extended period in packages containing the health warnings required by the present regulations. He claimed that this Court has no jurisdiction to suspend the operation of the new regulations.

29 The interveners supported and elaborated on these submissions. They also submitted that r. 27 could not apply because leave to appeal had not been granted. In any event, they argued that the words "or other relief" are not broad enough to permit this Court to defer enforcement of regulations that were not even in existence at the time the appeal judgment was rendered.

30 The powers of the Supreme Court of Canada to grant relief in this kind of proceeding are contained in s. 65.1 of the *Supreme Court Act* and r. 27 of the *Rules of the Supreme Court of Canada* .

Supreme Court Act

31

> *65.1* The Court or a judge may, on the request of a party who has filed a notice of application for leave to appeal, order that proceedings be stayed with respect to the judgment from which leave to appeal is being sought, on such terms as to the Court or the judge seem just.

Rules of the Supreme Court of Canada

32

27. Any party against whom judgment has been given, or an order made, by the Court or any other court, may apply to the Court for a stay of execution or other relief against such a judgment or order, and the Court may give such relief upon such terms as may be just.

33 Rule 27 and its predecessor have existed in substantially the same form since at least 1888 (see *Rules of the Supreme Court of Canada* , 1888, General Order No. 85(17)). Its broad language reflects the language of s. 97 of the Act whence the Court derives its rule-making power. Subsection (1)(*a*) of that section provides that the rules may be enacted:

97. ...

(*a*) for regulating the procedure of and in the Court and the bringing of cases before it from courts appealed from or otherwise, and for the effectual execution and working of this Act and the attainment of the intention and objects thereof;

Although the point is now academic, leave to appeal having been granted, we would not read into the rule the limitations suggested by the interveners. Neither the words of the rule nor s. 97 contain such limitations. In our opinion, in interpreting the language of the rule, regard should be had to its purpose, which is best expressed in the terms of the empowering section: to facilitate the "bringing of cases" before the Court "for the effectual execution and working of this Act". To achieve its purpose the rule can neither be limited to cases in which leave to appeal has already been granted nor be interpreted narrowly to apply only to an order stopping or arresting execution of the Court's process by a third party or freezing the judicial proceeding which is the subject matter of the judgment in appeal. Examples of the former, traditionally described as stays of execution, are contained in the subsections of s. 65 of the Act which have been held to be limited to preventing the intervention of a third party such as a sheriff but not the enforcement of an order directed to a party. See *Keable v. Attorney General (Can.)*, [1978] 2 S.C.R. 135 . The stopping or freezing of all proceedings is traditionally referred to as a stay of proceedings. See *Battle Creek Toasted Corn Flake Co. v. Kellogg Toasted Corn Flake Co.* (1924), 55 O.L.R. 127 (C.A.) . Such relief can be granted pursuant to this Court's powers in r. 27 or s. 65.1 of the Act.

34 Moreover, we cannot agree that the adoption of s. 65.1 in 1992 (S.C. 1990, c. 8, s. 40) was intended to limit the Court's powers under r. 27. The purpose of that amendment was to enable a single judge to exercise the jurisdiction to grant stays in circumstances in which, before the amendment, a stay could be granted by the Court. Section 65.1 should, therefore, be interpreted to confer the same broad powers that are included in r. 27.

35 In light of the foregoing and bearing in mind in particular the language of s. 97 of the Act we cannot agree with the first two points raised by the Attorney General that this Court is unable to grant a stay as requested by the applicants. We are of the view that the Court is empowered, pursuant to both s. 65.1 and r. 27, not only to grant a stay of execution and of proceedings in the traditional sense, but also to make any order that preserves matters between the parties in a state that will prevent prejudice as far as possible pending resolution by the Court of the controversy, so as to enable the Court to render a meaningful and effective judgment. The Court must be able to intervene not only against the direct dictates of the judgment but also against its effects. This means that the Court must have jurisdiction to enjoin conduct on the part of a party in reliance on the judgment which, if carried out, would tend to negate or diminish the effect of the judgment of this Court. In this case, the new regulations constitute conduct under a law that has been declared constitutional by the lower courts.

36 This, in our opinion, is the view taken by this Court in *Labatt Breweries of Canada Ltd. v. Attorney General of Canada*, [1980] 1 S.C.R. 594 . The appellant Labatt, in circumstances similar to those in this case, sought to suspend enforcement of regulations which were attacked by it in an action for a declaration that the regulations were inapplicable to Labatt's product. The Federal Court of Appeal reversed a lower court finding in favour of Labatt. Labatt applied for a stay pending an appeal to this Court. Although the parties had apparently agreed to the terms of an order suspending further proceedings, Laskin C.J. dealt with the issue of jurisdiction, an issue that apparently was contested notwithstanding the agreement. The Chief Justice, speaking for the Court, determined that the Court was empowered to make an order suspending the enforcement of the impugned

regulation by the Department of Consumer and Corporate Affairs. At page 600, Laskin C.J. responded as follows to arguments advanced on the traditional approach to the power to grant a stay:

> It was contended that the Rule relates to judgments or orders of this Court and not to judgments or orders of the Court appealed from. Its formulation appears to me to be inconsistent with such a limitation. Nor do I think that the position of the respondent that there is no judgment against the appellant to be stayed is a tenable one. Even if it be so, there is certainly an order against the appellant. *Moreover, I do not think that the words of Rule 126, authorizing this Court to grant relief against an adverse order, should be read so narrowly as to invite only intervention directly against the order and not against its effect while an appeal against it is pending in this Court.* I am of the opinion, therefore, that the appellant is entitled to apply for interlocutory relief against the operation of the order dismissing its declaratory action, and that this Court may grant relief on such terms as may be just. [Emphasis added.]

37 While the above passage appears to answer the submission of the respondents on this motion that *Labatt* was distinguishable because the Court acted on a consent order, the matter was put beyond doubt by the following additional statement of Laskin C.J. at p. 601:

> Although I am of the opinion that Rule 126 applies to support the making of an order of the kind here agreed to by counsel for the parties, I would not wish it to be taken that this Court is otherwise without power to prevent proceedings pending before it from being aborted by unilateral action by one of the parties pending final determination of an appeal.

Indeed, an examination of the factums filed by the parties to the motion in *Labatt* reveals that while it was agreed that the dispute would be resolved by an application for a declaration, it was not agreed that pending resolution of the dispute the enforcement of the regulations would be stayed.

38 In our view, this Court has jurisdiction to grant the relief requested by the applicants. This is the case even if the applicants' requests for relief are for "suspension" of the regulation rather than "exemption" from it. To hold otherwise would be inconsistent with this Court's finding in *Manitoba (Attorney General) v. Metropolitan Stores (MTS) Ltd.*, [1987] 1 S.C.R. 110 . In that case, the distinction between "suspension" and "exemption" cases is made only after jurisdiction has been otherwise established and the public interest is being weighed against the interests of the applicant seeking the stay of proceedings. While "suspension" is a power that, as is stressed below, must be exercised sparingly, this is achieved by applying the criteria in *Metropolitan Stores* strictly and not by a restrictive interpretation of this Court's jurisdiction. Therefore, the final argument of the Attorney General on the issue of jurisdiction also fails.

39 Finally, if jurisdiction under s. 65.1 of the Act and r. 27 were wanting, we would be prepared to find jurisdiction in s. 24(1) of the *Charter* . A *Charter* remedy should not be defeated due to a deficiency in the ancillary procedural powers of the Court to preserve the rights of the parties pending a final resolution of constitutional rights.

V. Grounds for Stay of Proceedings

40 The applicants rely upon the following grounds:

> 1. The challenged *Tobacco Products Control Regulations, amendment* were promulgated pursuant to ss. 9 and 17 of the *Tobacco Products Control Act* , S.C. 1988, c. 20.
>
> 2. The applicants have applied to this Court for leave to appeal a judgment of the Quebec Court of Appeal dated January 15, 1993. The Court of Appeal overturned a decision of the Quebec Superior Court declaring certain sections of the Act to be beyond the powers of the Parliament of Canada and an unjustifiable violation of the *Canadian Charter of Rights and Freedoms* .
>
> 3. The effect of the new regulations is such that the applicants will be obliged to incur substantial unrecoverable expenses in carrying out a complete redesign of all its packaging before this Court will have ruled on the constitutional validity

of the enabling legislation and, if this Court restores the judgment of the Superior Court, will incur the same expenses a second time should they wish to restore their packages to the present design.

4. The tests for granting of a stay are met in this case:

(i) There is a serious constitutional issue to be determined.

(ii) Compliance with the new regulations will cause irreparable harm.

(iii) The balance of convenience, taking into account the public interest, favours retaining the status quo until this court has disposed of the legal issues.

VI. Analysis

41 The primary issue to be decided on these motions is whether the applicants should be granted the interlocutory relief they seek. The applicants are only entitled to this relief if they can satisfy the test laid down in *Manitoba (Attorney General) v. Metropolitan Stores (MTS) Ltd., supra* . If not, the applicants will have to comply with the new regulations, at least until such time as a decision is rendered in the main actions.

A. Interlocutory Injunctions, Stays of Proceedings and the Charter

42 The applicants ask this Court to delay the legal effect of regulations which have already been enacted and to prevent public authorities from enforcing them. They further seek to be protected from enforcement of the regulations for a 12-month period even if the enabling legislation is eventually found to be constitutionally valid. The relief sought is significant and its effects far reaching. A careful balancing process must be undertaken.

43 On one hand, courts must be sensitive to and cautious of making rulings which deprive legislation enacted by elected officials of its effect.

44 On the other hand, the *Charter* charges the courts with the responsibility of safeguarding fundamental rights. For the courts to insist rigidly that all legislation be enforced to the letter until the moment that it is struck down as unconstitutional might in some instances be to condone the most blatant violation of *Charter* rights. Such a practice would undermine the spirit and purpose of the *Charter* and might encourage a government to prolong unduly final resolution of the dispute.

45 Are there, then, special considerations or tests which must be applied by the courts when *Charter* violations are alleged and the interim relief which is sought involves the execution and enforceability of legislation?

46 Generally, the same principles should be applied by a court whether the remedy sought is an injunction or a stay. In *Metropolitan Stores* , at p. 127, Beetz J. expressed the position in these words:

> A stay of proceedings and an interlocutory injunction are remedies of the same nature. In the absence of a different test prescribed by statute, they have sufficient characteristics in common to be governed by the same rules and the courts have rightly tended to apply to the granting of interlocutory stay the principles which they follow with respect to interlocutory injunctions.

47 We would add only that here the applicants are requesting both interlocutory (pending disposition of the appeal) and interim (for a period of one year following such disposition) relief. We will use the broader term "interlocutory relief" to describe the hybrid nature of the relief sought. The same principles apply to both forms of relief.

48 *Metropolitan Stores* adopted a three-stage test for courts to apply when considering an application for either a stay or an interlocutory injunction. First, a preliminary assessment must be made of the merits of the case to ensure that there is a serious question to be tried. Secondly, it must be determined whether the applicant would suffer irreparable harm if the application were refused. Finally, an assessment must be made as to which of the parties would suffer greater harm from the granting or

refusal of the remedy pending a decision on the merits. It may be helpful to consider each aspect of the test and then apply it to the facts presented in these cases.

B. The Strength of the Plaintiff's Case

49 Prior to the decision of the House of Lords in *American Cyanamid Co. v. Ethicon Ltd.*, [1975] A.C. 396 , an applicant for interlocutory relief was required to demonstrate a "strong *prima facie* case" on the merits in order to satisfy the first test. In *American Cyanamid* , however, Lord Diplock stated that an applicant need no longer demonstrate a strong *prima facie* case. Rather it would suffice if he or she could satisfy the court that "the claim is not frivolous or vexatious; in other words, that there is a serious question to be tried". The *American Cyanamid* standard is now generally accepted by the Canadian courts, subject to the occasional reversion to a stricter standard: see Robert J. Sharpe, *Injunctions and Specific Performance* (2nd ed. 1992), at pp. 2-13 to 2-20.

50 In *Metropolitan Stores* , Beetz J. advanced several reasons why the *American Cyanamid* test rather than any more stringent review of the merits is appropriate in *Charter* cases. These included the difficulties involved in deciding complex factual and legal issues based upon the limited evidence available in an interlocutory proceeding, the impracticality of undertaking a s. 1 analysis at that stage, and the risk that a tentative determination on the merits would be made in the absence of complete pleadings or prior to the notification of any Attorneys General.

51 The respondent here raised the possibility that the current status of the main action required the applicants to demonstrate something more than "a serious question to be tried." The respondent relied upon the following *dicta* of this Court in *Laboratoire Pentagone Ltée v. Parke, Davis & Co.*, [1968] S.C.R. 269 , at p. 272:

> The burden upon the appellant is much greater than it would be if the injunction were interlocutory. In such a case the Court must consider the balance of convenience as between the parties, because the matter has not yet come to trial. In the present case we are being asked to suspend the operation of a judgment of the Court of Appeal, delivered after full consideration of the merits. It is not sufficient to justify such an order being made to urge that the impact of the injunction upon the appellant would be greater than the impact of its suspension upon the respondent.

To the same effect were the comments of Kelly J.A. in *Adrian Messenger Services v. The Jockey Club Ltd. (No. 2)* (1972), 2 O.R. 619 (C.A.) , at p. 620:

> Unlike the situation prevailing before trial, where the competing allegations of the parties are unresolved, on an application for an interim injunction pending an appeal from the dismissal of the action the defendant has a judgment of the Court in its favour. Even conceding the ever-present possibility of the reversal of that judgment on appeal, it will in my view be in a comparatively rare case that the Court will interfere to confer upon a plaintiff, even on an interim basis, the very right to which the trial Court has held he is not entitled.

And, most recently, of Philp J. in *Bear Island Foundation v. Ontario* (1989), 70 O.R. (2d) 574 (H.C.) , at p. 576:

> While I accept that the issue of title to these lands is a serious issue, it has been resolved by trial and by appeal. The reason for the Supreme Court of Canada granting leave is unknown and will not be known until they hear the appeal and render judgment. There is not before me at this time, therefore, a serious or substantial issue to be tried. It has already been tried and appealed. No attempt to stop harvesting was made by the present plaintiffs before trial, nor before the appeal before the Court of Appeal of Ontario. The issue is no longer an issue at trial.

52 According to the respondent, such statements suggest that once a decision has been rendered on the merits at trial, either the burden upon an applicant for interlocutory relief increases, or the applicant can no longer obtain such relief. While it might be possible to distinguish the above authorities on the basis that in the present case the trial judge agreed with the applicant's position, it is not necessary to do so. Whether or not these statements reflect the state of the law in private applications for interlocutory relief, which may well be open to question, they have no application in *Charter* cases.

53 The *Charter* protects fundamental rights and freedoms. The importance of the interests which, the applicants allege, have been adversely affected require every court faced with an alleged *Charter* violation to review the matter carefully. This is so even when other courts have concluded that no *Charter* breach has occurred. Furthermore, the complex nature of most constitutional rights means that a motions court will rarely have the time to engage in the requisite extensive analysis of the merits of the applicant's claim. This is true of any application for interlocutory relief whether or not a trial has been conducted. It follows that we are in complete agreement with the conclusion of Beetz J. in *Metropolitan Stores* , at p. 128, that "the *American Cyanamid* 'serious question' formulation is sufficient in a constitutional case where, as indicated below in these reasons, the public interest is taken into consideration in the balance of convenience."

54 What then are the indicators of "a serious question to be tried"? There are no specific requirements which must be met in order to satisfy this test. The threshold is a low one. The judge on the application must make a preliminary assessment of the merits of the case. The decision of a lower court judge on the merits of the *Charter* claim is a relevant but not necessarily conclusive indication that the issues raised in an appeal are serious: see *Metropolitan Stores, supra* , at p. 150. Similarly, a decision by an appellate court to grant leave on the merits indicates that serious questions are raised, but a refusal of leave in a case which raises the same issues cannot automatically be taken as an indication of the lack of strength of the merits.

55 Once satisfied that the application is neither vexatious nor frivolous, the motions judge should proceed to consider the second and third tests, even if of the opinion that the plaintiff is unlikely to succeed at trial. A prolonged examination of the merits is generally neither necessary nor desirable.

56 Two exceptions apply to the general rule that a judge should not engage in an extensive review of the merits. The first arises when the result of the interlocutory motion will in effect amount to a final determination of the action. This will be the case either when the right which the applicant seeks to protect can only be exercised immediately or not at all, or when the result of the application will impose such hardship on one party as to remove any potential benefit from proceeding to trial. Indeed Lord Diplock modified the *American Cyanamid* principle in such a situation in *N.W.L. Ltd. v. Woods*, [1979] 1 W.L.R. 1294 , at p. 1307:

> Where, however, the grant or refusal of the interlocutory injunction will have the practical effect of putting an end to the action because the harm that will have been already caused to the losing party by its grant or its refusal is complete and of a kind for which money cannot constitute any worthwhile recompense, the degree of likelihood that the plaintiff would have succeeded in establishing his right to an injunction if the action had gone to trial is a factor to be brought into the balance by the judge in weighing the risks that injustice may result from his deciding the application one way rather than the other.

Cases in which the applicant seeks to restrain picketing may well fall within the scope of this exception. Several cases indicate that this exception is already applied to some extent in Canada.

57 In *Trieger v. Canadian Broadcasting Corp.* (1988), 54 D.L.R. (4th) 143 (Ont. H.C.) , the leader of the Green Party applied for an interlocutory mandatory injunction allowing him to participate in a party leaders' debate to be televised within a few days of the hearing. The applicant's only real interest was in being permitted to participate in the debate, not in any subsequent declaration of his rights. Campbell J. refused the application, stating at p. 152:

> This is not the sort of relief that should be granted on an interlocutory application of this kind. The legal issues involved are complex and I am not satisfied that the applicant has demonstrated there is a serious issue to be tried *in the sense of a case with enough legal merit* to justify the extraordinary intervention of this court in making the order sought without any trial at all. [Emphasis added.]

58 In *Tremblay v. Daigle*, [1989] 2 S.C.R. 530 , the appellant Daigle was appealing an interlocutory injunction granted by the Quebec Superior Court enjoining her from having an abortion. In view of the advanced state of the appellant's pregnancy, this Court went beyond the issue of whether or not the interlocutory injunction should be discharged and immediately rendered a decision on the merits of the case.

59 The circumstances in which this exception will apply are rare. When it does, a more extensive review of the merits of the case must be undertaken. Then when the second and third stages of the test are considered and applied the anticipated result on the merits should be borne in mind.

60 The second exception to the *American Cyanamid* prohibition on an extensive review of the merits arises when the question of constitutionality presents itself as a simple question of law alone. This was recognized by Beetz J. in *Metropolitan Stores* , at p. 133:

> There may be rare cases where the question of constitutionality will present itself as a simple question of law alone which can be finally settled by a motion judge. A theoretical example which comes to mind is one where Parliament or a legislature would purport to pass a law imposing the beliefs of a state religion. Such a law would violate s. 2(*a*) of the *Canadian Charter of Rights and Freedoms* , could not possibly be saved under s. 1 of the *Charter* and might perhaps be struck down right away; see *Attorney General of Quebec v. Quebec Association of Protestant School Boards*, [1984] 2 S.C.R. 66 , at p. 88. It is trite to say that these cases are exceptional.

A judge faced with an application which falls within the extremely narrow confines of this second exception need not consider the second or third tests since the existence of irreparable harm or the location of the balance of convenience are irrelevant inasmuch as the constitutional issue is finally determined and a stay is unnecessary.

61 The suggestion has been made in the private law context that a third exception to the *American Cyanamid* "serious question to be tried" standard should be recognized in cases where the factual record is largely settled prior to the application being made. Thus in *Dialadex Communications Inc. v. Crammond* (1987), 34 D.L.R. (4th) 392 (Ont. H.C.) , at p. 396, it was held that:

> Where the facts are not substantially in dispute, the plaintiffs must be able to establish a strong *prima facie* case and must show that they will suffer irreparable harm if the injunction is not granted. If there are facts in dispute, a lesser standard must be met. In that case, the plaintiffs must show that their case is not a frivolous one and there is a substantial question to be tried, and that, on the balance of convenience, an injunction should be granted.

To the extent that this exception exists at all, it should not be applied in *Charter* cases. Even if the facts upon which the *Charter* breach is alleged are not in dispute, all of the evidence upon which the s. 1 issue must be decided may not be before the motions court. Furthermore, at this stage an appellate court will not normally have the time to consider even a complete factual record properly. It follows that a motions court should not attempt to undertake the careful analysis required for a consideration of s. 1 in an interlocutory proceeding.

C. Irreparable Harm

62 Beetz J. determined in *Metropolitan Stores* , at p. 128, that "[t]he second test consists in deciding whether the litigant who seeks the interlocutory injunction would, unless the injunction is granted, suffer irreparable harm". The harm which might be suffered by the respondent, should the relief sought be granted, has been considered by some courts at this stage. We are of the opinion that this is more appropriately dealt with in the third part of the analysis. Any alleged harm to the public interest should also be considered at that stage.

63 At this stage the only issue to be decided is whether a refusal to grant relief could so adversely affect the applicants' own interests that the harm could not be remedied if the eventual decision on the merits does not accord with the result of the interlocutory application.

64 "Irreparable" refers to the nature of the harm suffered rather than its magnitude. It is harm which either cannot be quantified in monetary terms or which cannot be cured, usually because one party cannot collect damages from the other. Examples of the former include instances where one party will be put out of business by the court's decision (*R.L. Crain Inc. v. Hendry* (1988), 48 D.L.R. (4th) 228 (Sask. Q.B.)); where one party will suffer permanent market loss or irrevocable damage to its business reputation (*American Cyanamid, supra*); or where a permanent loss of natural resources will be the result when a challenged

activity is not enjoined (*MacMillan Bloedel Ltd. v. Mullin*, [1985] 3 W.W.R. 577 (B.C.C.A.)). The fact that one party may be impecunious does not automatically determine the application in favour of the other party who will not ultimately be able to collect damages, although it may be a relevant consideration (*Hubbard v. Pitt*, [1976] Q.B. 142 (C.A.)).

65 The assessment of irreparable harm in interlocutory applications involving *Charter* rights is a task which will often be more difficult than a comparable assessment in a private law application. One reason for this is that the notion of irreparable harm is closely tied to the remedy of damages, but damages are not the primary remedy in *Charter* cases.

66 This Court has on several occasions accepted the principle that damages may be awarded for a breach of *Charter* rights: (see, for example, *Mills v. The Queen*, [1986] 1 S.C.R. 863 , at pp. 883, 886, 943 and 971; *Nelles v. Ontario*, [1989] 2 S.C.R. 170 , at p. 196). However, no body of jurisprudence has yet developed in respect of the principles which might govern the award of damages under s. 24(1) of the *Charter* . In light of the uncertain state of the law regarding the award of damages for a *Charter* breach, it will in most cases be impossible for a judge on an interlocutory application to determine whether adequate compensation could ever be obtained at trial. Therefore, until the law in this area has developed further, it is appropriate to assume that the financial damage which will be suffered by an applicant following a refusal of relief, even though capable of quantification, constitutes irreparable harm.

D. The Balance of Inconvenience and Public Interest Considerations

67 The third test to be applied in an application for interlocutory relief was described by Beetz J. in *Metropolitan Stores* at p. 129 as: "a determination of which of the two parties will suffer the greater harm from the granting or refusal of an interlocutory injunction, pending a decision on the merits". In light of the relatively low threshold of the first test and the difficulties in applying the test of irreparable harm in *Charter* cases, many interlocutory proceedings will be determined at this stage.

68 The factors which must be considered in assessing the "balance of inconvenience" are numerous and will vary in each individual case. In *American Cyanamid* , Lord Diplock cautioned, at p. 408, that:

> [i]t would be unwise to attempt even to list all the various matters which may need to be taken into consideration in deciding where the balance lies, let alone to suggest the relative weight to be attached to them. These will vary from case to case.

He added, at p. 409, that "there may be many other special factors to be taken into consideration in the particular circumstances of individual cases."

69 The decision in *Metropolitan Stores* , at p. 149, made clear that in all constitutional cases the public interest is a 'special factor' which must be considered in assessing where the balance of convenience lies and which must be "given the weight it should carry." This was the approach properly followed by Blair J. of the General Division of the Ontario Court in *Ainsley Financial Corp. v. Ontario Securities Commission* (1993), 14 O.R. (3d) 280 , at pp. 303-4:

> Interlocutory injunctions involving a challenge to the constitutional validity of legislation or to the authority of a law enforcement agency stand on a different footing than ordinary cases involving claims for such relief as between private litigants. The interests of the public, which the agency is created to protect, must be taken into account and weighed in the balance, along with the interests of the private litigants.

1. The Public Interest

70 Some general guidelines as to the methods to be used in assessing the balance of inconvenience were elaborated by Beetz J. in *Metropolitan Stores* . A few additional points may be made. It is the "polycentric" nature of the *Charter* which requires a consideration of the public interest in determining the balance of convenience: see Jamie Cassels, "An Inconvenient Balance: The Injunction as a Charter Remedy", in J. Berryman, ed., *Remedies: Issues and Perspectives* , 1991, 271, at pp. 301-5. However, the government does not have a monopoly on the public interest. As Cassels points out at p. 303:

> While it is of utmost importance to consider the public interest in the balance of convenience, the public interest in *Charter* litigation is not unequivocal or asymmetrical in the way suggested in *Metropolitan Stores* . The Attorney General is not

the exclusive representative of a monolithic "public" in *Charter* disputes, nor does the applicant always represent only an individualized claim. Most often, the applicant can also claim to represent one vision of the "public interest". Similarly, the public interest may not always gravitate in favour of enforcement of existing legislation.

71 It is, we think, appropriate that it be open to both parties in an interlocutory *Charter* proceeding to rely upon considerations of the public interest. Each party is entitled to make the court aware of the damage it might suffer prior to a decision on the merits. In addition, either the applicant or the respondent may tip the scales of convenience in its favour by demonstrating to the court a compelling public interest in the granting or refusal of the relief sought. "Public interest" includes both the concerns of society generally and the particular interests of identifiable groups.

72 We would therefore reject an approach which excludes consideration of any harm not directly suffered by a party to the application. Such was the position taken by the trial judge in *Morgentaler v. Ackroyd* (1983), 150 D.L.R. (3d) 59 (Ont. H.C.) , per Linden J., at p. 66.

> The applicants rested their argument mainly on the irreparable loss to their potential women patients, who would be unable to secure abortions if the clinic is not allowed to perform them. Even if it were established that *these women* would suffer irreparable harm, such evidence would not indicate any irreparable harm to *these applicants* , which would warrant this court issuing an injunction at their behest. [Emphasis in original.]

73 When a private applicant alleges that the public interest is at risk that harm must be demonstrated. This is since private applicants are normally presumed to be pursuing their own interests rather than those of the public at large. In considering the balance of convenience and the public interest, it does not assist an applicant to claim that a given government authority does not represent the public interest. Rather, the applicant must convince the court of the public interest benefits which will flow from the granting of the relief sought.

74 Courts have addressed the issue of the harm to the public interest which can be relied upon by a public authority in different ways. On the one hand is the view expressed by the Federal Court of Appeal in *Attorney General of Canada v. Fishing Vessel Owners' Association of B.C.*, [1985] 1 F.C. 791 , which overturned the trial judge's issuance of an injunction restraining Fisheries Officers from implementing a fishing plan adopted under the *Fisheries Act* , R.S.C. 1970, c. F-14, for several reasons, including, at p. 795:

> (b) the Judge assumed that the grant of the injunction would not cause any damage to the appellants. This was wrong. When a public authority is prevented from exercising its statutory powers, it can be said, in a case like the present one, that the public interest, of which that authority is the guardian, suffers irreparable harm.

This dictum received the guarded approval of Beetz J. in *Metropolitan Stores* at p. 139. It was applied by the Trial Division of the Federal Court in *Esquimalt Anglers' Association v. Canada (Minister of Fisheries and Oceans)* (1988), 21 F.T.R. 304 .

75 A contrary view was expressed by McQuaid J.A. of the P.E.I. Court of Appeal in *Island Telephone Co., Re* (1987), 67 Nfld. & P.E.I.R. 158 , who, in granting a stay of an order of the Public Utilities Commission pending appeal, stated at p. 164:

> I can see no circumstances whatsoever under which the Commission itself could be inconvenienced by a stay pending appeal. As a regulatory body, it has no vested interest, as such, in the outcome of the appeal. In fact, it is not inconceivable that it should welcome any appeal which goes especially to its jurisdiction, for thereby it is provided with clear guidelines for the future, in situations where doubt may have therefore existed. The pub lic interest is equally well served, in the same sense, by any appeal....

76 In our view, the concept of inconvenience should be widely construed in *Charter* cases. In the case of a public authority, the onus of demonstrating irreparable harm to the public interest is less than that of a private applicant. This is partly a function of the nature of the public authority and partly a function of the action sought to be enjoined. The test will nearly always be satisfied simply upon proof that the authority is charged with the duty of promoting or protecting the public interest and upon some indication that the impugned legislation, regulation, or activity was undertaken pursuant to that responsibility. Once these

minimal requirements have been met, the court should in most cases assume that irreparable harm to the public interest would result from the restraint of that action.

77 A court should not, as a general rule, attempt to ascertain whether actual harm would result from the restraint sought. To do so would in effect require judicial inquiry into whether the government is governing well, since it implies the possibility that the government action does not have the effect of promoting the public interest and that the restraint of the action would therefore not harm the public interest. The *Charter* does not give the courts a licence to evaluate the effectiveness of government action, but only to restrain it where it encroaches upon fundamental rights.

78 Consideration of the public interest may also be influenced by other factors. In *Metropolitan Stores* , it was observed that public interest considerations will weigh more heavily in a "suspension" case than in an "exemption" case. The reason for this is that the public interest is much less likely to be detrimentally affected when a discrete and limited number of applicants are exempted from the application of certain provisions of a law than when the application of certain provisions of a law is suspended entirely. See *Black v. Law Society of Alberta* (1983), 144 D.L.R. (3d) 439 ; *Vancouver General Hospital v. Stoffman* (1985), 23 D.L.R. (4th) 146 ; *Rio Hotel Ltd. v. Commission des licences et permis d'alcool*, [1986] 2 S.C.R. ix .

79 Similarly, even in suspension cases, a court may be able to provide some relief if it can sufficiently limit the scope of the applicant's request for relief so that the general public interest in the continued application of the law is not affected. Thus in *Ontario Jockey Club v. Smith* (1922), 22 O.W.N. 373 (H.C.) , the court restrained the enforcement of an impugned taxation statute against the applicant but ordered him to pay an amount equivalent to the tax into court pending the disposition of the main action.

2. The Status Quo

80 In the course of discussing the balance of convenience in *American Cyanamid* , Lord Diplock stated at p. 408 that when everything else is equal, "it is a counsel of prudence to ... preserve the status quo." This approach would seem to be of limited value in private law cases, and, although there may be exceptions, as a general rule it has no merit as such in the face of the alleged violation of fundamental rights. One of the functions of the *Charter* is to provide individuals with a tool to challenge the existing order of things or status quo. The issues have to be balanced in the manner described in these reasons.

E. Summary

81 It may be helpful at this stage to review the factors to be considered on an application for interlocutory relief in a *Charter* case.

82 As indicated in *Metropolitan Stores* , the three-part *American Cyanamid* test should be applied to applications for interlocutory injunctions and as well for stays in both private law and *Charter* cases.

83 At the first stage, an applicant for interlocutory relief in a *Charter* case must demonstrate a serious question to be tried. Whether the test has been satisfied should be determined by a motions judge on the basis of common sense and an extremely limited review of the case on the merits. The fact that an appellate court has granted leave in the main action is, of course, a relevant and weighty consideration, as is any judgment on the merits which has been rendered, although neither is necessarily conclusive of the matter. A motions court should only go beyond a preliminary investigation of the merits when the result of the interlocutory motion will in effect amount to a final determination of the action, or when the constitutionality of a challenged statute can be determined as a pure question of law. Instances of this sort will be exceedingly rare. Unless the case on the merits is frivolous or vexatious, or the constitutionality of the statute is a pure question of law, a judge on a motion for relief must, as a general rule, consider the second and third stages of the *Metropolitan Stores* test.

84 At the second stage the applicant must convince the court that it will suffer irreparable harm if the relief is not granted. 'Irreparable' refers to the nature of the harm rather than its magnitude. In *Charter* cases, even quantifiable financial loss relied upon by an applicant may be considered irreparable harm so long as it is unclear that such loss could be recovered at the time of a decision on the merits.

85 The third branch of the test, requiring an assessment of the balance of inconvenience, will often determine the result in applications involving *Charter* rights. In addition to the damage each party alleges it will suffer, the interest of the public must be taken into account. The effect a decision on the application will have upon the public interest may be relied upon by either party. These public interest considerations will carry less weight in exemption cases than in suspension cases. When the nature and declared purpose of legislation is to promote the public interest, a motions court should not be concerned whether the legislation actually has such an effect. It must be assumed to do so. In order to overcome the assumed benefit to the public interest arising from the continued application of the legislation, the applicant who relies on the public interest must demonstrate that the suspension of the legislation would itself provide a public benefit.

86 We would add to this brief summary that, as a general rule, the same principles would apply when a government authority is the applicant in a motion for interlocutory relief. However, the issue of public interest, as an aspect of irreparable harm to the interests of the government, will be considered in the second stage. It will again be considered in the third stage when harm to the applicant is balanced with harm to the respondent including any harm to the public interest established by the latter.

VII. Application of the Principles to these Cases

A. A Serious Question to be Tried

87 The applicants contend that these cases raise several serious issues to be tried. Among these is the question of the application of the rational connection and the minimal impairment tests in order to justify the infringement upon freedom of expression occasioned by a blanket ban on tobacco advertising. On this issue, Chabot J. of the Quebec Superior Court and Brossard J.A. in dissent in the Court of Appeal held that the government had not satisfied these tests and that the ban could not be justified under s. 1 of the *Charter* . The majority of the Court of Appeal held that the ban was justified. The conflict in the reasons arises from different interpretations of the extent to which recent jurisprudence has relaxed the onus fixed upon the state in *R. v. Oakes*, [1986] 1 S.C.R. 103 , to justify its action in public welfare initiatives. This Court has granted leave to hear the appeals on the merits. When faced with separate motions for interlocutory relief pertaining to these cases, the Quebec Court of Appeal stated that "[w]hatever the outcome of these appeals, they clearly raise serious constitutional issues." This observation of the Quebec Court of Appeal and the decision to grant leaves to appeal clearly indicate that these cases raise serious questions of law.

B. Irreparable Harm

88 The applicants allege that if they are not granted interlocutory relief they will be forced to spend very large sums of money immediately in order to comply with the regulations. In the event that their appeals are allowed by this Court, the applicants contend that they will not be able either to recover their costs from the government or to revert to their current packaging practices without again incurring the same expense.

89 Monetary loss of this nature will not usually amount to irreparable harm in private law cases. Where the government is the unsuccessful party in a constitutional claim, however, a plaintiff will face a much more difficult task in establishing constitutional liability and obtaining monetary redress. The expenditures which the new regulations require will therefore impose irreparable harm on the applicants if these motions are denied but the main actions are successful on appeal.

C. Balance of Inconvenience

90 Among the factors which must be considered in order to determine whether the granting or withholding of interlocutory relief would occasion greater inconvenience are the nature of the relief sought and of the harm which the parties contend they will suffer, the nature of the legislation which is under attack, and where the public interest lies.

91 The losses which the applicants would suffer should relief be denied are strictly financial in nature. The required expenditure is significant and would undoubtedly impose considerable economic hardship on the two companies. Nonetheless, as pointed out by the respondent, the applicants are large and very successful corporations, each with annual earnings well in excess of $50,000,000. They have a greater capacity to absorb any loss than would many smaller enterprises. Secondarily,

assuming that the demand for cigarettes is not solely a function of price, the companies may also be able to pass on some of their losses to their customers in the form of price increases. Therefore, although the harm suffered may be irreparable, it will not affect the long-term viability of the applicants.

92 Second, the applicants are two companies who seek to be exempted from compliance with the latest regulations published under the *Tobacco Products Control Act* . On the face of the matter, this case appears to be an "exemption case" as that phrase was used by Beetz J. in *Metropolitan Stores* . However, since there are only three tobacco producing companies operating in Canada, the application really is in the nature of a "suspension case". The applicants admitted in argument that they were in effect seeking to suspend the application of the new regulations to all tobacco producing companies in Canada for a period of one year following the judgment of this Court on the merits. The result of these motions will therefore affect the whole of the Canadian tobacco producing industry. Further, the impugned provisions are broad in nature. Thus it is appropriate to classify these applications as suspension cases and therefore ones in which "the public interest normally carries greater weight in favour of compliance with existing legislation" (p. 147).

93 The weight accorded to public interest concerns is partly a function of the nature of legislation generally, and partly a function of the purposes of the specific piece of legislation under attack. As Beetz J. explained, at p. 135, in *Metropolitan Stores* :

> Whether or not they are ultimately held to be constitutional, the laws which litigants seek to suspend or from which they seek to be exempted by way of interlocutory injunctive relief have been enacted by demo cratically-elected legislatures and are generally passed for the common good, for instance: ... *the protection of public health* .... It seems axiomatic that the granting of interlocutory injunctive relief in most suspension cases and, up to a point, as will be seen later, in quite a few exemption cases, is susceptible temporarily to frustrate the pursuit of the common good. [Emphasis added.]

94 The regulations under attack were adopted pursuant to s. 3 of the *Tobacco Products Control Act* which states:

> *3.* The purpose of this Act is to provide a legislative response to a national public health problem of substantial and pressing concern and, in particular,
>
> (*a*) to protect the health of Canadians in the light of conclusive evidence implicating tobacco use in the incidence of numerous debilitating and fatal diseases;
>
> (*b*) to protect young persons and others, to the extent that is reasonable in a free and democratic society, from inducements to use tobacco products and consequent dependence on them; and
>
> (*c*) to enhance public awareness of the hazards of tobacco use by ensuring the effective communication of pertinent information to consumers of tobacco products.

95 The Regulatory Impact Analysis Statement, in the *Canada Gazette* , Part II, Vol. 127, No. 16, p. 3284, at p. 3285, which accompanied the regulations stated:

> The increased number and revised format of the health messages reflect the strong consensus of the public health community that the serious health hazards of using these products be more fully and effectively communicated to consumers. Support for these changes has been manifested by hundreds of letters and a number of submissions by public health groups highly critical of the initial regulatory requirements under this legislation as well as a number of Departmental studies indicating their need.

96 These are clear indications that the government passed the regulations with the intention of protecting public health and thereby furthering the public good. Further, both parties agree that past studies have shown that health warnings on tobacco product packages do have some effects in terms of increasing public awareness of the dangers of smoking and in reducing the overall incidence of smoking in our society. The applicants, however, argued strenuously that the government has not shown and cannot show that the specific requirements imposed by the impugned regulations have any positive public benefits. We do not think that such an argument assists the applicants at this interlocutory stage.

97 When the government declares that it is passing legislation in order to protect and promote public health and it is shown that the restraints which it seeks to place upon an industry are of the same nature as those which in the past have had positive public benefits, it is not for a court on an interlocutory motion to assess the actual benefits which will result from the specific terms of the legislation. That is particularly so in this case, where this very matter is one of the main issues to be resolved in the appeal. Rather, it is for the applicants to offset these public interest considerations by demonstrating a more compelling public interest in suspending the application of the legislation.

98 The applicants in these cases made no attempt to argue any public interest in the continued application of current packaging requirements rather than the new requirements. The only possible public interest is that of smokers' not having the price of a package of cigarettes increase. Such an increase is not likely to be excessive and is purely economic in nature. Therefore, any public interest in maintaining the current price of tobacco products cannot carry much weight. This is particularly so when it is balanced against the undeniable importance of the public interest in health and in the pre vention of the widespread and serious medical problems directly attributable to smoking.

99 The balance of inconvenience weighs strongly in favour of the respondent and is not offset by the irreparable harm that the applicants may suffer if relief is denied. The public interest in health is of such compelling importance that the applications for a stay must be dismissed with costs to the successful party on the appeal.

Applications dismissed.

Solicitors of record:
Solicitors for the applicant RJR — MacDonald Inc.: *Mackenzie, Gervais* , Montreal.
Solicitors for the applicant Imperial Tobacco Inc.: *Ogilvy, Renault* , Montreal.
Solicitors for the respondent: *Côté & Ouellet* , Montreal.
Solicitors for the interveners on the application for interlocutory relief the Heart and Stroke Foundation of Canada, the Canadian Cancer Society, the Canadian Council on Smoking and Health, and Physicians for a Smoke-Free Canada: *McCarthy, Tétrault* , Toronto.