

NATIONAL CREDITOR DEBTOR REVIEW

General Editor: Steven J. Weisz
Blake, Cassels & Graydon LLP

VOLUME 28, NUMBER 1

Cited as 28 N.C.D. Rev.

MARCH 2013

• **INDALEX DECISION: INSOLVENCY LAW v. PENSION LAW, ROUND THREE** •

Mary Buttery, Donald Cooper, Rachel Hamilton, Veronica Monteiro, and David Stratton QC
Davis LLP

The Supreme Court of Canada's decision in the case of *Sun Indalex Finance, LLC v. United Steelworkers*¹ does not, as one national newspaper put it, place "creditors before pensioners." The *Decision* that overturned the Ontario Court of Appeal's decision in *Indalex Ltd. (Re)*² reinforces the constitutional doctrine of paramountcy, which is the legal principle that federal law regarding priority of creditors in bankruptcy and

insolvency prevails over other priority rights that may be created by provincial law, such as creating a deemed trust in favour of members of a pension plan. A number of provinces have deemed trust provisions in their pension benefits legislation. By example, in Ontario, the legislation provides that where a pension plan is wound up, the employer is deemed to hold in trust for the beneficiaries of its pension plan an amount equal to the employer contributions accrued to the date of the wind-up but not yet due under the pension plan or the regulations to the *Ontario Pension Benefits Act*.³

The *Decision* confirms that, where an employer in a single-employer defined benefit pension plan takes on and continues to hold the dual roles of both the "administrator" and the "employer" of that pension plan, the employer has and retains fiduciary obligations to the pension plan members. The scope of that fiduciary duty divided the members of the Supreme Court of Canada, resulting in three different views on how that duty should be discharged.

IN THIS ISSUE

INDALEX DECISION: INSOLVENCY LAW v. PENSION LAW, ROUND THREE

Mary Buttery *et al.* 1

PRODUCTION OF DOCUMENTS FROM COURT-APPOINTED RECEIVERS—LIMITS ON DISCLOSURE OBLIGATIONS

Norm Emblem and Chloe Snider 7

INADVERTENTLY DISCHARGED PPSA FINANCING STATEMENT SAVED BY EQUITY (BUT CAUTION, THIS WILL NOT ALWAYS OCCUR)

Howard S. Silverman 9



NATIONAL CREDITOR/DEBTOR REVIEW

The **National Creditor/Debtor Review** is published quarterly by LexisNexis Canada Inc., 123 Commerce Valley Drive East, Suite 700, Markham, Ontario L3T 7W8

Design and Compilation © LexisNexis Canada Inc. 2013. Unless otherwise stated, copyright in individual articles rests with the contributors.

All rights reserved. No part of this publication may be reproduced or stored in any material form (including photocopying or storing it in any medium by electronic means and whether or not transiently or incidentally to some other use of this publication) without the written permission of the copyright holder except in accordance with the provisions of the *Copyright Act*.

ISBN: 0-409-91077-5 ISSN: 0829-2019

Publications Mail Registration No. 180831

ISBN: 0-433-44391-X (Print & PDF)

ISBN: 0-433-44689-7 (PDF)

Subscription rates: \$360/year (Print or PDF)
\$400/year (Print & PDF)

Please address all editorial inquiries to:

Boris Roginsky, Journals Editor

LexisNexis Canada Inc.

Tel. (905) 479-2665; Toll-Free Tel. 1-800-668-6481

Fax (905) 479-2826; Toll-Free Fax 1-800-461-3275

Internet e-mail: ncdr@lexisnexis.ca.

EDITORIAL BOARD**GENERAL EDITOR**

Steven J. Weisz, Blake, Cassels & Graydon LLP, Toronto

EDITORIAL BOARD MEMBERS

• **Françoise Belzil**, Belzil Law Office, Edmonton
• **D. Bruce Clarke**, Burchell Green Hayman Parish, Halifax • **Bertrand Giroux**, Brouillette Charpentier Fournier, Montréal • **John Sandrelli**, Fraser Milner Casgrain, Vancouver • **Rick Schwartz**, Scurfield Tapper Cuddy, Winnipeg

Note: This newsletter solicits manuscripts for consideration by the General Editor, who reserves the right to reject any manuscript or to publish it in revised form. The articles included in *National Creditor/Debtor Review* reflect the views of the individual authors. This newsletter is not intended to provide legal or other professional advice and readers should not act on the information contained in this report without seeking specific independent advice on the particular matters with which they are concerned.



Eight Things Employers Need to Know about Decision

1. The Supreme Court has not changed pension law.

The Supreme Court recognizes that the legislature (in this case the Ontario Legislative Assembly) can and should set out what is intended for the obligations of an employer on the winding up of a pension plan and to what extent the deemed trust legislative provision affects those obligations. The Supreme Court was clear that, because the Executive Plan had not been wound up, the legislation did not provide for a deemed trust for contributions in the future (that is, before wind-up commences). Three of the seven Supreme Court Justices examined in detail the legislative history of the deemed trust provisions of the *Act*. They noted that, in 1983, the Minister told the Ontario legislature that the statutory deemed trust under the *Act* was not intended to include the future potential liability of an employer on wind-up of a pension plan.⁴

2. In an insolvency, federal legislation such as the *Companies' Creditors Arrangement Act*⁵ will prevail over provincial legislation to the extent there is a conflict where the priority of creditors is concerned, including creditors who are members of a pension plan.

All seven Justices agree on that point. It is up to Parliament to decide whether changes should be made to the *Bankruptcy and Insolvency Act*⁶ or to the *CCAA* to address this issue.

3. Pension legislation can and does differ from province to province on this and other issues.

By way of example, the provinces of Ontario and Alberta have similar provisions on the creation of the deemed trust for pension plan contributions, but the legislation of each province is not as similar on other aspects of what is the deemed trust obligation of an employer. That

was a crucial point in the *Indalex* decision as between the Salaried Pension Plan and the Executive Pension Plan.

4. Pension law and insolvency law can be difficult to rationalize.

In *Indalex*, the Ontario Superior Court of Justice ruled in favour of super-priority for debtor-in-possession (“DIP”) lenders, the Ontario Court of Appeal (with a Justice on that court with substantial pension law experience) ruled in favour of the priority of the pension plans, and the Supreme Court was unanimous on the priority issue of the Appeal but divided on what should be the remedy for the breach of fiduciary duty by *Indalex*.

5. In an insolvency, the interest of the lenders can trump the interest of other parties (e.g., those of pension plan members).

The Supreme Court noted that the “harsh reality” is that lending to an insolvent entity is governed by the “commercial imperatives of the lenders [and] not by the interest of the plan members or the policy considerations that lead provincial governments to legislate in favour of pension fund beneficiaries.”⁷

6. An employer who is the administrator of its pension plan has a fiduciary duty to the pension plan members, and that duty does not end if the employer becomes insolvent.

The Supreme Court unanimously found that *Indalex* had a fiduciary duty to the pension plan members, even when *Indalex* was insolvent and seeking to restructure. The Supreme Court found a conflict of interest will exist where the employer has the dual responsibility of being both the employer and administrator of the pension plans. How that fiduciary duty is to be satisfied in a case like *Indalex*, varies. The way the court should recognize the interest of the pension plan members demonstrates this difference. Three Justices asserted that the Judge hearing

the application to approve the DIP financing and the priorities for the DIP lenders should have been advised of *Indalex*’s fiduciary duty to the pension plan members, so that the pension plan members could have “the opportunity to present their arguments.”⁸ Four Justices went further and asserted that, at that time, the role of administrator should have been given to an independent person.

7. Independent representation is needed for pension plan members in an insolvency.

Employers that retain the dual responsibility of the Employer and Pension Plan Administrator, when applying for protection under the *CCAA*, and indeed DIP lenders and their advisors, as well, will need to take into account that four Justices, to one extent or another, noted the need for the court hearing the initial application under the *CCAA* to not only be made aware of, but to assess whether an independent Administrator or an independent lawyer is needed for the pension plan members and whether there ought to be limits on the DIP facility (and presumably its priority) until pension plan members can be represented by legal counsel.⁹

8. A breach of fiduciary duty by an employer to the pension plan members may result in a constructive trust for the pension plan members on the assets of the employer.

Two Justices agreed with the Ontario Court of Appeal that the seriousness of the breach by *Indalex* of its obligations to the pension plan beneficiaries justified the Court of Appeal to impose a constructive trust on the proceeds of the eventual sale of the *Indalex* assets. If there had been enough proceeds of the sale of the *Indalex* assets to pay the DIP lender, and if the Supreme Court had upheld the constructive trust, would the constructive trust then have had priority over other secured lenders to *Indalex*? That may be an issue of concern to secured lenders to employers with a pension plan.

Background on Supreme Court of Canada's *Indalex* Decision

Briefly, *Indalex* was the sponsor of two registered defined benefit pension plans known as the Executive Plan and the Salaried Plan. *Indalex* took on and retained the dual role of being both the employer and what pension law calls the “Administrator” of the pension plans. *Indalex* sought protection from creditors under the *CCAA*. At that time, the Salaried Plan was in the process of being wound up but the Executive Plan had not started its winding-up process. Both plans had wind-up deficiencies.

During a series of applications to the Ontario Superior Court of Justice heard by a Judge who is very experienced in reorganization and insolvency law, the court authorized *Indalex* to enter into DIP financing in order to allow *Indalex* to operate during its proposed reorganization. DIP financing allows a corporation in financial difficulty to raise funds on a super-priority secured basis, provided that the court in the *CCAA* proceedings has approved that financing. The court granted to the DIP lenders super-priority for the DIP financing over the claims of all other creditors of *Indalex*. Ultimately, and with the approval of the court, *Indalex* sold its business, but the purchaser did not assume the wind-up liabilities of the two pension plans, and proceeds of sale were not sufficient to pay back the DIP lenders. The court then ordered an amount to be held back from the sale proceeds until the Executive and Salaried pension plan members could make their case whether the proceeds of sale should be used to pay the wind-up deficits in the pension plans.

The plan members argued that a deemed statutory trust under the *Act* gave priority to the wind-up deficiencies in the two pension plans over the court-mandated super-priority of the DIP loan. Additionally, the pension plan members claimed a “constructive trust” over the sale proceeds,

which the pension plan members asserted arose from the breach of fiduciary duty of *Indalex* as the “Administrator” of the pension plans.

The Judge held that the deemed trust provisions in the *Act* did not apply to wind-up deficiencies and that the plan members were unsecured creditors of *Indalex*. The Judge gave the DIP lenders priority over the pension plan claims. The Ontario Court of Appeal reversed that ruling and held that pension plan wind-up deficits are subject to a deemed trust under the *Act* and also to a constructive trust by virtue of a breach of fiduciary duty by *Indalex*. The Court of Appeal held that those trusts resulted in the pension plan deficiency having priority over the DIP lenders and all other secured creditors of *Indalex*.

The appeal to the Supreme Court of Canada included the lawyers acting for the DIP lenders and the pension plan members. It also included, as intervenors, the Superintendent of Financial Services of Ontario, the Insolvency Institute of Canada, the Canadian Labour Congress, the Canadian Federation of Pensioners, the Canadian Association of Insolvency and Restructuring Professionals, and the Canadian Bankers Association, thereby reflecting the importance of this issue to both insolvency and pension law.

Does Provincial Pension Legislation or Federal Insolvency Legislation Prevail?

The appeal was heard by seven Justices of the Supreme Court of Canada. The court examined four issues. We discuss three of those issues here. The fourth issue related to costs is beyond the scope of this article.

1. Extent of the deemed trust provisions.

The first issue was whether the statutory deemed trust for contributions to a pension plan, which is provided for in s. 57(4) of the *Act*, extends to the wind-up deficiency payments required when a pension plan is wound up.

The Supreme Court took note that the situation was different for the Executive Plan as it had not commenced to wind up. Firstly, four Justices agreed that the wind-up deficiency payments due to a pension plan are included within the deemed statutory trust in the *Act*. Secondly, they agreed that the time of the calculation of the wind-up contributions required to the pension plans is not relevant to that determination as long as the liabilities are assessed as of the date of the wind-up. Those four Justices agreed with the Ontario Court of Appeal that Indalex was deemed to hold in trust the money necessary to satisfy the wind-up deficits of the Salaried Plan but not the Executive Plan, as the deemed trust had not come into existence as the Executive Plan had not begun to be wound up at the date when the Order was granted to give Indalex protection under the *CCAA*. Three Justices came to a different conclusion on this first issue and, by examining the legislative history of the deemed trust provisions of s. 57 of the *Act*, concluded that there was never an intention on the part of the Ontario Legislature to provide a deemed trust for future liabilities of an employer that arise if a pension plan is wound up. Rather, those three Justices concluded that the legislative intent is to exclude from the deemed trust provision those liabilities that arise only upon a wind-up. Except for the second issue that the Supreme Court examined, the deemed trust provision contained in s. 57 of the *Act* would have covered the wind-up liabilities of the Salaried Plan.

2. Does a provincial deemed trust apply in federal *CCAA* proceedings?

The second issue, and what turned out to be the issue that formed the *Decision*, was whether the statutory deemed trust under the *Act*, which is created by provincial legislation, continues to apply in *CCAA* proceedings, which is federal legislation like the *BIA*. All the Supreme Court Justices held that *CCAA* proceedings and the

CCAA legislation governs because of the legal doctrine of paramountcy stating that, when in conflict, federal legislation will prevail over provincial legislation. Because the *CCAA* and the *Act* were in conflict with respect to creditor priority rights, the federal *CCAA* prevailed. Thus, the DIP lenders had priority. And since there were insufficient monies from the sale of the assets of Indalex to satisfy the loans made by the DIP lenders, there were no monies left for any other creditors, including the pension plan members.

3. Does a breach of a fiduciary obligation by an employer create a “constructive trust” in favour of the pension plan members in priority to other creditors?

The third issue relating to pension law and, to a lesser extent, insolvency law, is whether, as the Ontario Court of Appeal found, the breach by Indalex of its fiduciary duties to the pension plan members was such that a constructive trust should be found by the court, which would have resulted in payment to the pension plans of the amount of the purchase price that the Ontario Superior Court ordered to be held back while the priority dispute between the pension plans and the DIP lenders was determined. All the Supreme Court Justices found that Indalex breached its fiduciary duty to the plan members in the course of the *CCAA* proceedings. The existence of the conflict of interest between Indalex’s duties as the Administrator of the pension plans and its duties to other stakeholders in Indalex, such as its shareholders, did not by itself constitute Indalex’s breach of its fiduciary duty. However, the failure of Indalex to take the necessary steps to deal with that conflict of interest was the breach. As the Supreme Court’s panel put it “in short, the difficulty was not the existence of the conflict, but the failure to address it.”¹⁰ The Supreme Court did not resolve how that failure should be addressed and what the remedy should be.

What Now?

The Supreme Court's *Decision* reinforces the doctrine of paramountcy; where provincial legislation, including but not limited to pension benefits legislation, creates different priorities than that under federal insolvency legislation, federal legislation prevails.

An employer who acts as both the plan sponsor and the administrator of a pension plan—particularly, a defined benefit pension plan, will need to carefully assess whether it should assign its obligation as the Administrator of the pension plan to an independent party prior to, or at the time of, seeking protection under the *CCAA*.

As the Ontario Court of Appeal and two of the Supreme Court Justices determined, lenders to such an insolvent employer may, or will, want to reduce the risk of a constructive trust being applied to the eventual sale proceeds of the employer's assets. That risk can be reduced by having the employer cease to be the Administrator, arranging for legal counsel for the pension plan members, or both. Interestingly, both groups of the Supreme Court Justices—one that would have found a constructive trust and another that didn't—refer to the same earlier decision of the Supreme Court of Canada (*Soulos*)¹¹ as support for each coming to a different conclusion on whether a constructive trust on the employer's assets may exist for pension plan wind-up deficiencies where the employer has breached its fiduciary duty to the pension plan members.

[Editor's note: **Mary Buttery** is the co-chair of Davis LLP's national Bankruptcy, Insolvency & Restructuring Law Group and the lead partner in the Vancouver office's insolvency group. Recognized in the area of commercial insolvency, Mary represents financial institutions, debtors and creditors, receivers and trustees in matters related to debt restructuring, corporate reorganizations, loan workouts, fraudulent preference actions, bankruptcy and receiverships.

Mary has experience in many different sectors—most notably, retail, real estate, forestry, and natural resources. **Donald Cooper** is a partner at Davis LLP. He practises general corporate and commercial law with emphasis on real estate, commercial leasing, trusts, pension and benefits, mortgage funds, developments, and hotels and financing matters. **Rachel Hamilton** is a partner at Davis LLP. Her practice in the area of corporate/commercial law is focused on pensions and benefits law, real estate, mergers and acquisitions, as well as complex commercial matters and disputes. **Veronica Monteiro** is an associate at Davis LLP where she practises in the Corporate Commercial, Real Estate, and Pensions & Benefits Law Groups. In the area of pensions and benefits trust law, she assists in providing advice to the governing bodies and administrators of pensions. **David Stratton QC** is a partner at Davis LLP. He practises in the area of pensions and benefits trust law, where he acts for, and provides comprehensive advice to, the sponsors, governing bodies, and administrators of pensions and other forms of benefit plans. He also practises in corporate/commercial law with an emphasis on mergers and acquisitions, complex commercial matters and disputes, as well as partnership and shareholder relationships and disputes.]

¹ [2013] S.C.J. No. 6 (S.C.C.) [*Decision*].

² [2011] O.J. No. 1621 [*Indalex*].

³ R.S.O. 1990, c. P.8 [*Act*].

⁴ *Supra* note 1 at para. 168.

⁵ R.S.C. 1985, c. C-36 [*CCAA*].

⁶ R.S.C. 1985, c. B-3. [*BIA*]

⁷ *Supra* note 1 at para. 59.

⁸ *Ibid.* at para. 73.

⁹ *Ibid.* at para. 216.

¹⁰ *Ibid.* at para. 215.

¹¹ *Soulos v. Korkontzilas*, [1997] S.C.J. No. 52 (S.C.C.).

• PRODUCTION OF DOCUMENTS FROM COURT-APPOINTED RECEIVERS—LIMITS ON DISCLOSURE OBLIGATIONS •

Norm Emblem and Chloe Snider
Fraser Milner Casgrain LLP

Introduction

In its recent decision, *SA Capital Growth Corp. v. Mander Estate*,¹ the Ontario Court of Appeal considered whether the appellant, who was facing proceedings before the Ontario Securities Commission (the “OSC”), was entitled to production of documents and information from the court-appointed receiver who had been appointed to investigate a Ponzi scheme in which the appellant was allegedly involved. Justice Pattillo, the application judge, ordered production of some, but not all, of the documents sought by the appellant, Peter Sbaraglia.² Sbaraglia appealed from Pattillo J.’s decision, seeking further production, and the receiver cross-appealed, arguing that no production should have been ordered.

The Court of Appeal dismissed Sbaraglia’s appeal and granted the receiver’s cross-appeal. In doing so, the Court of Appeal considered two important issues: (i) the circumstances in which a party involved in a receivership can obtain production of documents from a court-appointed receiver and (ii) the appropriateness (or lack thereof) of seeking an order from the Ontario Superior Court of Justice, tantamount to an interlocutory procedural order in an ongoing regulatory proceeding. This case comment outlines the Court of Appeal’s reasons on these two issues after providing a brief background of the relevant facts.

The Receivership and OSC Proceeding

On March 17, 2010, the court appointed RSM Richter Inc. (the “Receiver”) as receiver over the assets and property of E.M.B. Asset Group Inc. (“EMB”) and Robert Mander. It was al-

leged that Mander, through EMB, operated a Ponzi scheme, which defrauded investors of tens of millions of dollars. As a result of its preliminary investigations, the Receiver recommended to the court that Sbaraglia, his wife, and their companies—CO Capital Growth and 91 Days Hygiene Inc.—also be investigated. On July 14, 2010, the Receiver obtained an order authorizing it to conduct such further investigation. The Receiver subsequently reported, *inter alia*, that Sbaraglia and his companies knew or ought to have known that they were not generating returns sufficient to repay their obligations to investors and that they had misled the OSC.

The OSC subsequently commenced proceedings against Sbaraglia, alleging that he had breached the Ontario *Securities Act*³ by engaging or participating in acts he knew or ought to have known constituted fraud and that he had misled OSC staff. In the course of the OSC proceeding, Sbaraglia sought to obtain production of documents and information from the Receiver, which it had obtained in the course of its investigations. Sbaraglia’s OSC motion was heard by a single commissioner who ruled that the OSC did not have the authority to order production from the Receiver, an independent officer of the court.

Having been unsuccessful before the OSC, Sbaraglia sought to obtain production of documents from the Receiver via other means. He applied to the Ontario Superior Court of Justice for an order requiring the Receiver to produce the materials that, he argued, were necessary for him to make full answer and defence to the OSC proceeding against him. While, as noted, Sbaraglia was partially successful at first

instance, the Court of Appeal held that he was not entitled to any production from the Receiver. We address the Court of Appeal's reasoning in the two sections below.

Production by Court-Appointed Receivers

The Court of Appeal recognized that, in some circumstances, a party involved in a receivership can insist upon the production of documents and materials that have been obtained by a court-appointed receiver and that a receiver owes a duty to make full disclosure of information to all interested persons.

However, the term "interested person" does not include parties who seek production of documents for a purpose unrelated to the receivership itself, even where that person has an interest in the subject matter of the receivership. A court-appointed receiver cannot be compelled to produce documents obtained in the exercise of its mandate for some collateral purpose, including for use in separate proceedings (in this case, for use in proceedings before the OSC).

The OSC proceedings against Sbaraglia were, on the Court of Appeal's view, "clearly separate and distinct from the receivership," and the appellant did not seek production for the purpose of advancing any legal claim or interest in the receivership.⁴ Rather, Sbaraglia sought such documents and information for the purpose of his defence before the OSC, which the Court of Appeal considered to be a collateral purpose. Accordingly, Sbaraglia was not considered to be an "interested person" and, as a consequence, was not entitled to production from the Receiver in this instance.

The Court of Appeal commented that, if production was granted, it could lead to "serious mischief," undermining the ability of the Receiver to perform its functions and duties as an officer of the court.⁵

Not the Right Forum

The Court of Appeal also considered Pattillo J.'s application of *R. v. O'Connor*,⁶ which stands for the proposition that a criminally accused may compel production from third parties not involved in a criminal prosecution in order to make full answer and defence to criminal allegations. Sbaraglia argued that he was similarly entitled to production from the Receiver in order to make full answer and defence in the OSC proceeding.

The Court of Appeal held that Pattillo J. had erred in his application of *R. v. O'Connor* on the facts of the case and in ordering production by the Receiver on the basis that Sbaraglia was entitled to the material in order to make full answer and defence to the allegations he faced before the OSC. That said, however, the Court of Appeal noted that, in fairness, it had not been clearly articulated before Pattillo J. that the OSC had already determined that Sbaraglia was not entitled to the documents and information requested.

The Court of Appeal held that it was "inappropriate for the Superior Court to make what amounted to an interlocutory procedural order in relation to a proceeding pending before the OSC."⁷ Procedural issues, such as disclosure, third-party production, and other matters relating to procedural fairness within the context of the OSC proceeding, were matters to be dealt with by the OSC in that particular proceeding. The OSC has the final say over such procedural issues, and it does not lie with the Superior Court to intervene.

The Court of Appeal emphasized the importance of orderly decision making by the tribunal. Sbaraglia's approach in this case—to apply to the Superior Court upon being unsuccessful on his motion before the OSC—was disruptive of such orderly decision making. The Court of Appeal noted that Sbaraglia had not challenged the OSC commissioner's ruling by way of an

appeal but instead commenced his Superior Court application for third-party production from the Receiver.

The Court of Appeal also addressed the argument that Rule 30.10 of the *Rules of Civil Procedure*⁸ entitled Sbaraglia to the production sought. The court held, however, that Rule 30.10 could have no application to Sbaraglia's request. That Rule provides orders for third-party production "on motion by a party" for a document that is "relevant to a material issue in the action." The Rule does not confer jurisdiction on the Superior Court to make freestanding production orders for production of documents sought in relation to proceedings before agencies or tribunals such as the OSC.⁹

Conclusion

This case is important because of the protection it affords both to court-appointed receivers and to the procedural integrity of regulatory tribunals. Receivers are to be protected from requests for information and documents for purposes collateral to the receivership, and the orderly decision making of tribunals is to be protected from collateral attacks.

The Court of Appeal's decision is particularly important for those facing allegations before the OSC who seek production from court-appointed officers. Those facing proceedings before the OSC are not entitled to rely on the obligation of a court-appointed receiver to produce documents and information to those interested in a receivership. Rather, they should pursue such

production within the OSC proceeding itself and should take steps to appeal any unfavourable decision. As the Court of Appeal has made clear in the *Mander Estate Appeal*, an application to the Superior Court is not the proper avenue for obtaining such production.

[*Editor's note:* **Norm Emblem** is a senior partner with FMC's Litigation and Dispute Resolution Group with 25 years of experience in commercial litigation and advocacy. He has acted for and advised some of Canada's "Big 4" accounting firms and some of their affiliated member firms in securities-related class actions in Canada, the U.S., and the Commonwealth of the Bahamas, as well as in related regulatory proceedings involving the Ontario Securities Commission, the Securities and Exchange Commission, and the Institute of Chartered Accountants of Ontario. Mr. Emblem is a Director of The Advocates' Society. **Chloe Snider** is an associate with FMC's Litigation and Dispute Resolution Group. Her practice involves a variety of commercial and civil litigation matters.]

¹ [2012] O.J. No. 4711 (Ont. C.A.)
[*Mander Estate Appeal*].

² *SA Capital Corp. v. Mander Estate*, [2012] O.J. No. 2279 (Ont. Sup. Ct.).

³ R.S.O. 1990, c. S.5.

⁴ *Mander Estate Appeal*, *supra* note 1 at para. 9.

⁵ *Ibid.* at para. 10.

⁶ [1995] S.C.J. No. 98 (S.C.C.).

⁷ *Mander Estate Appeal*, *supra* note 1 at para. 13.

⁸ R.R.O. 1990, Reg. 194.

⁹ *Mander Estate Appeal*, *supra* note 1 at para. 19.

• INADVERTENTLY DISCHARGED PPSA FINANCING STATEMENT SAVED BY EQUITY (BUT CAUTION, THIS WILL NOT ALWAYS OCCUR) •

Howard S. Silverman
Borden Ladner Gervais LLP

A recent Supreme Court of British Columbia decision in *KBA Canada, Inc. v. 3S Printers Inc.*¹ held that, where a B.C. *Personal Property*

Security Act [PPSA]² financing statement has been inadvertently discharged and there is no prejudice to subordinate creditors, the court can

make an order giving priority to the discharged creditor. This should provide comfort to lenders that a court will impose equity where doing so is consistent with the B.C. *PPSA*. But given the limits of equitable intervention and that financing statements can be discharged without confirmation of authority, lenders should consider periodically checking the status of their registrations in conjunction with appropriate credit events.

In this case heard before Justice Kelleher of the Supreme Court of British Columbia, the B.C. *PPSA* financing statement on which a creditor relied to provide it with a purchase money security interest (“PMSI”) in certain equipment was inadvertently discharged. A dispute arose with other creditors regarding whether the priority of the security interests held by those other creditors was enhanced as a result of the discharge or, given that the discharge was innocent and the other creditors were not prejudiced, the priorities would remain as if the financing statement had not been discharged. The court held that, because the discharge was innocent and the other creditors were not prejudiced, the priorities remained as if there had been no discharge.

Facts

Wells Fargo Equipment Financial Corporation (“WF”) leased certain equipment to 3S Printers Inc. (“3S”). WF had purchased the equipment from KBA Canada Inc. (“KBA”). KBA agreed with WF that if 3S defaulted under the lease, KBA would repurchase the equipment. 3S granted WF a security agreement collateral to the lease, and WF registered a financing statement in the B.C. Personal Property Registry in respect of the security agreement.

CIT Financial Ltd. (“CIT”) and Supreme Graphics Ltd. (“Supreme Graphics”) had each previously provided credit to 3S and secured the indebtedness owed to them by obtaining general security agreements, which charged all of 3S’s

present and after-acquired property. Each of CIT and Supreme Graphics registered a financing statement in respect of its general security agreement. There was no dispute at this point that the WF security interest had priority over the security interests of CIT and Supreme Graphics by way of a PMSI.

Subsequently, 3S defaulted in its lease payments to WF and WF exercised its right to require KBA to repurchase the equipment. WF transferred the equipment, all rights under the lease, the security agreement, and the financing statement to KBA. Although KBA was substituted for WF as secured party on the financing statement, WF, in error and without the knowledge or approval of KBA, discharged the financing statement.

A discretionary procedure was in place under the B.C. *PPSA*, whereby the B.C. Registry Services sends notices of the discharge of financing statements to the secured party being discharged. But in this case, KBA did not learn of the discharge until more than two months after it occurred. At that point, WF registered a new financing statement and attempted to obtain waivers of priority from CIT and Supreme Graphics without success. KBA then seized and sold the equipment, placing the proceeds of sale in trust, pending the outcome of the case.

Plaintiff’s Argument

KBA argued that s. 70 of the B.C. *PPSA* permits the court to correct the error made by WF.

Section 70 provides that

On application of an interested person, a court may

- (a) make an order determining questions of priority or entitlement to collateral, or
- (b) direct an action to be brought or an issue to be tried.

Section 35(7) of the B.C. *PPSA* permits the error to be corrected as of right within 30 days.³

Section 35(7) provides that

If registration of a security interest lapses as a result of failure to renew the registration or if a registration has been discharged without authorization or in error, and the secured party re-registers the security interest not later than 30 days after the lapse or discharge, the lapse or discharge does not affect the priority status of the security interest in relation to a competing perfected security interest that immediately before the lapse or discharge had a subordinate priority position, except to the extent that the competing security interest secures advances made or contracted for after the lapse or discharge and before the re-registration.

If the error is not corrected within 30 days (as here), KBA asserted, on application to the court, the error can be corrected pursuant to s. 70 (quoted above) and on the basis of the rules of equity as provided in s. 68, which states:

The principles of the common law, equity and the law merchant, except insofar as they are inconsistent with the provisions of this Act, supplement this Act and continue to apply.

KBA argued that if the court exercised its jurisdiction to correct the error, KBA would be protected from an innocent mistake and CIT and Supreme Graphics would not be prejudiced. KBA noted that no further advances were made by CIT or Supreme Graphics after the discharge. KBA also argued that it should succeed on the basis of unjust enrichment: if KBA did not maintain priority, CIT and Supreme Graphics would be enriched, KBA would suffer a deprivation, and there would be no juristic reason for it.

Defendants' Argument

CIT and Supreme Graphics (joined by the Minister of National Revenue) argued that the B.C. *PPSA* contains a complete and comprehensive code governing the creation, perfection, and enforcement of security interests. The B.C. *PPSA* supplants all previous statutory and common law rules relating to such matters.

The defendants said there is only one provision for the revival of discharged registrations in the B.C. *PPSA*, s. 35(7). Once 30 days have passed,

KBA lost the priority it had by virtue of the discharged financing statement. The defendants said that any equitable jurisdiction exercisable by the court pursuant to s. 68(1) is limited by s. 35(7). The court could not invoke s. 68(1) in this case, as to do so would be inconsistent with s. 35(7).

The Court's Decision

The court determined that KBA was entitled to the priority of its security interest in the equipment on the basis of (a) an order under ss. 68 and 70 of the B.C. *PPSA* and (b) unjust enrichment.

The court cited cases supporting the view that interfering with the perfection system by resort to equitable principles would defeat the certainty and predictability intended by the B.C. *PPSA*. The court recognized this as a sound principle but felt the B.C. *PPSA* cannot completely oust the court's equitable jurisdiction. This was an appropriate case to invoke its equitable jurisdiction, (*i.e.*, where the discharge of the financing statement was due to an innocent mistake and there was no prejudice to other creditors). The court was bolstered in its view as there was no mandatory requirement under the B.C. *PPSA* to provide notice to the creditor whose financing statement is discharged. From a statutory perspective, the court held that s. 35(7) does not address the consequences of failing to re-register within 30 days and that s. 70 does not indicate that the discretion provided by that provision is subject to other priority provisions. As the court said, "[s]uch an approach does not offend the Act's policy by imposing fairness over certainty and predictability. Certainty and predictability are furthered by an order based on equity that prevents a creditor from losing its priority position due to an innocent mistake where there is no prejudice to other creditors."⁴

The court indicated that a claim in unjust enrichment involves three elements: (a) an enrich-

ment (here, the defendants' enhanced priority), (b) a corresponding deprivation (here, KBA's loss of priority), and (c) the absence of any juristic reason for the enrichment. Quoting prior case law, the court found that, "... in an appropriate case a court may give effect to the principle of unjust enrichment despite the terms of a statute."⁵ In this case, CIT and Supreme Graphics always knew their security interests were subordinate to that of KBA and neither suffered any prejudice. Accordingly, the court found no juristic reason for CIT and Supreme Graphic's enrichment.

Discussion and Recommendation

Lenders can take some comfort from this case. It provides support for a court, in appropriate circumstances, to correct innocent errors relating to the *Personal Property Security Act* in Canadian jurisdictions where there is no prejudice to other parties.

However, the converse is also true. Where there is prejudice to other parties—such as if another creditor made an advance on the basis of the error—absent other factors, presumably, the court would not intervene. Given that in almost all Canadian jurisdictions no proof of authorization is required to discharge financing statements, it may therefore be prudent for lenders, in addition to diarizing critical dates, to periodically check the status of their *Personal Property Security Act* registrations. Clearly, this would be appropriate in situations where a borrower has defaulted or the lender is contemplating enforcement action. But among other circumstances, it may also be prudent to do so when a credit facility is being amended or amended and restated.

[*Editor's note:* **Howard Silverman** is a partner in the Financial Services Group of the Toronto office of Borden Ladner Gervais LLP. His practice focuses on representation of lenders as well as borrowers in a variety of loan transactions and restructurings. He has particular expertise in asset-based lending and in cross-border lending transactions. © 2012 Borden Ladner Gervais LLP. No part of this article may be reproduced without prior written permission of Borden Ladner Gervais LLP.]

¹ [2012] B.C.J. No. 1528 (B.C.S.C.).

² R.S.B.C. 1996, c. 359.

³ All other Canadian *PPSAs*, except the Ontario *PPSA*, R.S.O. 1990, c. P.10, include a provision substantially the same as the B.C. *PPSA*, s. 35(7). Section 30(6) of the Ontario *PPSA*, as follows, does not contain any period within which the new registration must be made: "Where a security interest that is perfected by registration becomes unperfected and is again perfected by registration, the security interest shall be deemed to have been continuously perfected from the time of first perfection except that if a person acquired rights in all or part of the collateral during the period when the security interest was unperfected, the registration shall not be effective as against the person who acquired the rights during such period." Accordingly, had the case occurred in Ontario, the same issues would not have arisen.

⁴ *Supra* note 1 at para. 82.

⁵ *Ibid.* at para. 95.