Court of Appeal File No. M38120

**COURT OF APPEAL FOR ONTARIO**

IN THE MATTER OF the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended

AND IN THE MATTER OF a Plan of Compromise or Arrangement of Grant Forest Products Inc., Grant Alberta Inc., Grant Forest Products Inc., and Grant U.S. Holdings GP

Applicants

# FACTUM OF THE MONITOR

November 3, 2009

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**FACTUM OF THE MONITOR**

## PART I - NATURE OF THE PROCEEDING

1. On June 25, 2009, Grant Forest Products Inc., Grant Alberta Inc., Grant Forest Products Sales Inc. and Grant U.S. Holdings GP (collectively, "Grant" or the "Company") applied for, and obtained, protection from their creditors pursuant to the *Companies' Creditors Arrangement Act,* R.S.C. 1985, c. C-36, as amended ("CCAA"). Justice Newbould granted an Initial Order which, *inter alia,* appointed Ernst & Young Inc. as the Monitor of Grant in these CCAA proceedings (the "Monitor").

2. Peter Grant Sr. ("Grant Sr.") is the Chairman and Chief Executive Officer of Grant Forest Products Inc. ("GFPI"). On October 5, 2009, Grant Sr. brought a motion seeking an order declaring that he is entitled to a certain US$10 million tax refund (the "2009 Tax Refund") pursuant to a Tax Refund Purchase and Sale Agreement between Grant Sr. and GFPI dated March 31, 2008 (the "Agreement"). The Toronto-Dominion Bank ("TD"), as agent for the first lien lenders of Grant (the "First Lien

Lenders"), opposed the motion on the basis that Grant Sr. was not entitled to the relief sought as certain contractual terms in the Agreement had never been satisfied entitling Grant Sr. to the 2009 Tax Refund and to find otherwise would amount to Grant Sr. receiving preferential treatment over other creditors. The Monitor supported TD's motion.

3. The Monitor supports TD's motion for leave to appeal and submits that the criteria for leave to appeal are met in this case. The issue on appeal is of real significance to the profession. The order appealed from raises significant issues of general importance including:

(a) whether an unsecured creditor can utilize principles of trust law or equity to avoid the requirements of the *Personal Property Security Act*, R.S.O. 1990, c. P-10 (the "PPSA") and the notice and registration requirements therein; and

(b) whether equity can impose a remedy which has the effect of creating a preference that would otherwise be subject to being set aside under s.95 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("BIA")?

4. The result of the decision appealed from is that a claim which was admittedly and by its terms an unsecured claim in respect of purely past consideration on December 31, 2008 became a priority equitable or trust claim on January 2, 2009 without any fresh consideration and equity considered "done" a sale transaction which, if completed in circumstances where the vendor was then (on January 2, 2009)

insolvent, would have been a preference. It is submitted that equity cannot consider that any debtor has a duty to prefer one secured creditor over another.

**PART II - THE FACTS**

**The Tax Refund Purchase and Sale Agreement**

5. The facts are summarized in the endorsement of Newbould J. and in the factum of TD and are not repeated at length here.

6. Grant Sr. and GFPI are parties to a Tax Refund and Sale Agreement dated March 31, 2008 (the "Agreement"). The Agreement was carefully constructed to comply with prohibitions in GFPI's agreements with TD that limited sales out of the ordinary course to $10 million per year and prohibited the creation of further security interests. As such, the 2008 Refund was to be "purchased" for $10 million paid at closing (March 31, 2008) while held in trust until actually received. The 2009 refund, on the other hand, was treated quite differently. The full purchase price of $10 million was paid on March 31, 2008 but treated as a "deposit" only. Under the Agreement, the sale would not occur until January 2, 2009 and no interest - in trust or otherwise - would arise in the refund before that time.

Endorsement of Newbould J., dated October 5, 2009 at para. 10

**Grant Sr. Acquired No Interest in the 2009 Tax Refund**

7. Section 5.02 of the Agreement states as follows:

> No Interest of Purchaser in Sold 2009 Refund Until 2009 Closing
>
> The parties agree, notwithstanding any other provision of this Agreement or any other right or purported right of the Purchaser, that the Purchaser does not acquire any right, title or interest in the

> Sold 2009 Refund, and the Vendor does not sell, assign or transfer any right, title or interest in the Sold 2009 Refund until the Vendor delivers to the Purchaser at the 2009 Closing, the transfer referred to in Section 7.04(a). [emphasis added]

Endorsement of Newbould J., dated October 5, 2009 at para. 14

8. The "2009 Closing" is defined in the Agreement to mean the closing of the purchase and sale of the 2009 Tax Refund on January 2, 2009.

Endorsement of Newbould J., dated October 5, 2009 at para. 17

9. The transfer referred to in section 7.04(a) of the Agreement is a written document from GFPI which acknowledges transfer of the 2009 Tax Refund from GFPI to Grant Sr.

Endorsement of Newbould J., dated October 5, 2009 at para. 14

10. It was necessary for the closing of the 2009 Tax Refund to take place in the 2009 calendar year in order for GFPI to remain in compliance with terms of the Credit Agreements, in particular the fact that GFPI was not entitled to dispose of assets greater in value than $10 million per calendar year.

11. As noted by Justice Newbould, the 2009 Closing did not occur on January 2, 2009 or at any time thereafter. Section 5.06 of the Agreement states,

> Sold 2009 Refund Held in Trust by Vendor
>
> The Vendor shall hold in trust for Purchaser, keep segregated from any other funds, accounts or assets of the Vendor and pay to Purchaser any amount of the Sold 2009 Refund received by the Vendor after the completion of the 2009 Closing. [emphasis added]

Endorsement of Newbould J., dated October 5, 2009 at para. 16

12. Pursuant to Sections 5.02 and 5.06 of the Agreement, as GFPI has failed to deliver the necessary transfer document to complete the 2009 Closing, Grant Sr. has not acquired any present or future right, title or interest in the 2009 Tax Refund – by trust or otherwise.

Endorsement of Newbould J., dated October 5, 2009 at paras.14, 16

13. Prior to Closing, any interest that Grant Sr. had in the 2009 tax refund under the Agreement was also on an unsecured basis. Sections 5.07 and 5.08 of the Agreement state,

> Section 5.07 <u>No Security, Interest or Fee</u>
>
> The <u>Vendor shall not grant to the Purchaser any security</u> for the Vendor's obligations to the Purchaser with respect to the Sold 2008 Refund or the Sold 2009 Refund and shall not pay to the Purchaser any interest on the 2009 Purchase Price Deposit paid to the Vendor on March 31, 2008 with respect to the Sold 2009 Refund or any fee related to the refund sales.
>
> Section 5.08 <u>No Security Interest</u>
>
> <u>The Purchaser agrees that it does not acquire and shall not acquire any security interest in any of the Purchased Assets</u> and, for greater certainty, hereby discharges any present or future security interest it now or hereafter acquires in any of the Purchased Assets; provided that the foregoing shall not affect the Purchaser's ownership of any Purchased Assets acquired by the Purchaser by the transfers referred to in sections 7.02(a) and 7.04(a) hereof. [emphasis added].

Tax Refund Purchase and Sale Agreement, dated March 31, 2008, sections 5.07 and 5.08

## PART III - QUESTIONS TO BE ADDRESSED

14. The question for determination by this Honourable Court is as follows:

(a) whether the maxim "equity considers done that which ought to be done" is applicable in circumstances of a possible fraudulent preference transaction; and ;

(b) whether equity and trust principle may be resorted to in such fashion as to circumvent notice and registration requirements under the PPSA or the scheme of distribution under s.136 of the BIA.

## PART IV - LAW AND ARGUMENT

### Test for Leave to Appeal under the CCAA

15. The criterion for consideration where leave to appeal is being sought in a CCAA proceeding is that there must be "serious and arguable grounds that are of real and significant interest to the parties". Subsumed within this criterion are four factors that must be considered by the Court. The four factors or elements are: (a) Whether the point on appeal is of significance to the practice; (b) Whether the points raised are of significance to the action; (c) Whether the appeal is prima facie meritorious; and (d) Whether the appeal will unduly hinder the progress of the action.

> *Canadian Airlines Corp. Re* (2000), 19 C.B.R. (4th) 33 at para 32- 36, 41 (Alta. C.A.), Monitor's Book of Authorities Tab 1.
>
> *Country Style Food Services Inc., Re* (2002), 158 O.A.C. 30 at para 15 (Ont. C.A. [In Chambers]), Monitor's Book of Authorities Tab 2.

16. It is submitted that Justice Newbould was in error when he applied the equitable maxim "that equity considers done what ought to be done", without

considering whether this may result in according Grant Sr. a preference over other creditors.

17. The BIA at section 95 states,

> 95. (1) Every transfer of property, every charge made on property, every payment made, every obligation incurred and every judicial proceeding taken or suffered by any insolvent person in favour of any creditor or of any person in trust for any creditor with a view to giving that creditor a preference over the other creditors is, when it is made, given, incurred, taken or suffered within the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date the insolvent person became bankrupt, both dates included, deemed fraudulent and void as against, or in the Province of Quebec, may not be set up against, the trustee in the bankruptcy.
>
> When view to prefer presumed
>
> (2) If any transfer, charge, payment, obligation or judicial proceeding mentioned in subsection (1) has the effect of giving any creditor a preference over other creditors, or over any one or more of them, it shall be presumed, in the absence of evidence to the contrary, to have been made, incurred, taken, paid or suffered with a view to giving the creditor a preference over other creditors, whether or not it was made voluntarily or under pressure and evidence of pressure shall not be admissible to support the transaction. [emphasis added]

*Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 section 95.

18. The Agreement clearly demonstrates that as of December 31, 2008, Grant Sr. had no interest whatsoever in the 2009 Refund. By the express terms of the Agreement there was neither an existing trust nor a security interest as of that date. On the other hand, Grant Sr. had paid by way of deposit the full $10 million that would become payable upon completion of the sale and had no further obligations to perform. The deposit was not held separate and apart nor was it required to be. Had

bankruptcy ensued on that date, there can be no doubt but that Grant Sr. would have been an unsecured creditor with nothing more than a claim for a return of the deposit paid. Had GFPI decided for some reason to return the deposit on that date, the transfer would undoubtedly have been open to attack under s.95 of the BIA.

19. Indeed, a bankruptcy petition was in fact filed on March 17, 2009 and the present CCAA proceedings intervened on June 25, 2009 shortly before the scheduled hearing of that petition. As such, had a transaction occurred on December 31, 2008, any trustee in bankruptcy of GFPI that may eventually be appointed could also challenge such a transaction since the "date of the initial bankruptcy event" is March 17, 2009.

*Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, s. 2, s, 95.

20. The gist of the Monitor's intervention in this leave to appeal application is this: if on December 31, 2008, Grant Sr. had an entirely unsecured claim arising purely in respect of past consideration (i.e. the deposit paid on March 31, 2008) on what basis could that unsecured claim be transformed into a trust claim on January 2, 2009 without further action of any kind thereby preferring one theretofore unsecured creditor over all other secured creditors despite

(i) the failure to comply with notice and registration requirements under the PPSA; and

(ii) the existence of fraudulent preference rules in s.95 of the BIA?

21. The Monitor submits that nothing happened between December 31, 2008 and January 2, 2009 (the date on which, by the Agreement, the "sale" of the 2009 refund was to have occurred but did not) other than the failure of GFPI to close as required. No fresh consideration was paid or payable. However, had GFPI closed on that date as it was required to do, the transfer of an interest in the 2009 Refund would have been a transaction that could undoubtedly have been challenged on behalf of unsecured creditors as a preference under s.95 of the BIA and it is highly probable that a good case can be made that GFPI was insolvent on that date given that the CCAA filing makes no allegations of later causes. Justice Newbould's order does not appear to have considered the prejudice to unsecured creditors occasioned by ordering the Company to complete a transaction which, once completed, would potentially be a preference. Equity cannot be said to consider that any debtor company has an <u>obligation</u> to prefer one unsecured creditor over others and in this respect the Monitor submits the decision was in error.

22. The Monitor leaves to TD, the applicant on the motion for leave to appeal, to consider and review the remaining criteria for granting leave but notes:

(i) the ability to use a "future trust" to circumvent PPSA and BIA requirements is an issue of obvious importance to the practice;

(ii) preserving the right of a trustee in bankruptcy to pursue the 2009 refund for the unsecured estate should TD be unsuccessful for any reason in establishing its own claim is of obvious significance to the unsecured creditors of GFPI;

(iii) given the express terms of the Agreement denying the existence of a trust or security interest and the provision of s.95 of the BIA, the proposed appeal is prima facie meritorious; and

(iv) the proposed appeal, involving as it does a discrete issue, will have no material impact on the progress of the CCAA proceedings which are proceeding to complete an orderly liquidation of the business.

## PART V - ORDER REQUESTED

23. Granting of TD's motion for leave to appeal the order of Justice Newbould with respect to a motion heard October 5, 2009 and decided October 13, 2009.

**ALL OF WHICH IS RESPECTFULLY SUBMITTED**

November 3, 2009

Sean Dunphy & Kathy Mah
Stikeman Elliott LLP

Counsel for the Monitor, Ernst & Young Inc.

**SCHEDULE "A"**
**LIST OF AUTHORITIES**

1. *Canadian Airlines Corp. Re* (2000), 19 C.B.R. (4th) 33 (Alta. C.A.)

2. *Country Style Food Services Inc., Re* (2002), 158 O.A.C. 30 (Ont. C.A.)

## SCHEDULE "B"
## RELEVANT STATUTES

*Companies' Creditors Arrangement Act,* **R.S.C. 1985, c. C-36**

**13.** Except in Yukon, any person dissatisfied with an order or a decision made under this Act may appeal from the order or decision on obtaining leave of the judge appealed from or of the court or a judge of the court to which the appeal lies and on such terms as to security and in other respects as the judge or court directs.

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

**2. Definitions**

[...[ "date of the initial bankruptcy event", in respect of a person, means the earliest of the day on which any one of the following is made, filed or commenced, as the case may be:

(a) an assignment by or in respect of the person,

(b) a proposal by or in respect of the person,

(c) a notice of intention by the person,

(d) the first application for a bankruptcy order against the person, in any case

(i) referred to in paragraph 50.4(8)(a) or 57(a) or subsection 61(2), or

(ii) in which a notice of intention to make a proposal has been filed under section 50.4 or a proposal has been filed under section 62 in respect of the person and the person files an assignment before the court has approved the proposal,

(e) the application in respect of which a bankruptcy order is made, in the case of an

application other than one referred to in paragraph (d), or

(f) proceedings under the Companies' Creditors Arrangement Act;

**Section 95 Preferences**

**95(1)** Every transfer of property, every charge made on property, every payment made, every obligation incurred and every judicial proceeding taken or suffered by any insolvent person in favour of any creditor or of any person in trust for any creditor with a view to giving that creditor a preference over the other creditors is, when it is made, given, incurred, taken or suffered within the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date the insolvent person became bankrupt, both dates included, deemed fraudulent and void as against, or in the Province of Quebec, may not be set up against, the trustee in the bankruptcy.

When view to prefer presumed

**95(2)** If any transfer, charge, payment, obligation or judicial proceeding mentioned in subsection (1) has the effect of giving any creditor a preference over other creditors, or over any one or more of them, it shall be presumed, in the absence of evidence to the contrary, to have been made, incurred, taken, paid or suffered with a view to giving the creditor a preference over other creditors, whether or not it was made voluntarily or under pressure and evidence of pressure shall not be admissible to support the transaction.

*Personal Property Security Act, R.S.O 1990, c. P-10*

**Application of Act, general**

2. Subject to subsection 4 (1), this Act applies to,

(a) every transaction without regard to its form and without regard to the person who has title to the collateral that in substance creates a security interest including, without limiting the foregoing,

(i) a chattel mortgage, conditional sale, equipment trust, debenture, floating charge, pledge, trust indenture or trust receipt, and

(ii) an assignment, lease or consignment that secures payment or performance of an obligation;

(b) a transfer of an account or chattel paper even though the transfer may not secure payment or performance of an obligation; and

(c) a lease of goods under a lease for a term of more than one year even though the lease may not secure payment or performance of an obligation. R.S.O. 1990, c. P.10, s. 2; 2006, c. 34, Sched. E, s. 2.

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