Cassels

Ontario Court Relies on the Duty of Good Faith and Awards Full Indemnity Costs

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Overview

On May 13, 2021, Justice Koehnen of the Ontario Superior Court of Justice (Commercial List) (the Court) released a decision[1] in the receivership proceeding of Mill Street & Co, Inc. (Mill Street) holding that the former officers and directors of Mill Street had not acted in good faith in respect of the receivership proceedings. The Court found the conduct was contrary to section 4.2 of the *Bankruptcy and Insolvency Act*, R.S.C., 1985, c. B-3 (the BIA) and awarded full indemnity costs of over $150,000 in favour of the receiver.

Background

In May 2020, A. Farber & Partners Inc. was appointed receiver (the Receiver) over the assets of Mill Street being primarily of shares in various portfolio companies operated by members of a single family (the Former D&Os). The Former D&Os had continuously taken steps to impede the receivership proceeding, raising "one obstacle after another"[2] forcing the Receiver to bring multiple motions to the Court for relief. The most recent motion was brought by the Receiver to facilitate the closing of a sale transaction of Mill Street's shares in a portfolio company- Lumbermens Credit Group Ltd. (Lumbermens).

The Receiver had conducted a sales process for the Lumbermens' shares and an entity related to the Former D&Os had been selected as the winning bidder, however that purchaser failed to close the transaction contrary to the terms of the sale agreement. The Receiver entered into an alternative sale agreement with another buyer, but the Former D&Os obstructed and delayed the closing of the alternative transaction by: (i) arguing that another entity owned the intellectual property required to operate the Lumbermens business (a questionable license agreement to support this position was produced); (ii) establishing a competing business and contacting current Lumbermens' clients and contract counter-parties to solicit business; and (iii) acquiring secured debt owing by Lumbermens and seeking to appoint a receiver over the assets of Lumbermens based on that newly acquired secured debt.

The Decision

The Court granted the relief sought by the Receiver to allow the sale to close. The order (i) precluded the Former D&Os from enforcing their newly acquired security until further order of the Court; (ii) declared that the intellectual property is owned by Lumbermens and not the alternate entity; and (iii) prohibited the Former D&Os from operating a competing business for two years.

Justice Koehnen relied on section 4.2 of the BIA which states that an interested person in a proceeding under the BIA shall act in good faith with respect to the proceedings, failing which, a court may make any order it considers appropriate. Relying on the principles articulated by Justice Mah in *CWB Maxium Financial Inc v 2026998 Alberta Ltd*.,[3] he found that the Former D&Os had acted with an "oblique motive" and "improper purpose" in violation of section 4.2 and the intent and policy objectives of the BIA.

Justice Koehnen emphasized the importance of the overall background of the receivership and the Former D&Os' obstructionist behaviour as reflected in prior Court endorsements. He noted that the Former D&Os relied on a forged license agreement and failed to file any responding materials after seeking adjournments for that stated purpose. Furthermore, he found that there was no evidence of prejudice to the Former D&Os if the relief requested by the Receiver was granted.

Justice Koehnen awarded full indemnity costs of approximately $150,000 against the Former D&Os noting, at paragraph 33 of his decision, that

… at each step in the Receivership [the Former D&Os] have taken positions which, characterized charitably, amount to studied ambiguity which they then used to defeat the purposes of the Receivership. In certain cases, that studied ambiguity goes beyond ambiguity into outright lies.

The Court found that such conduct amounted to a deliberate attempt to frustrate the receivership proceedings by fraud or deception and responding to such conduct forced the Receiver to incur unnecessary time and expense to the detriment of creditors. Justice Koehnen specifically noted that the reliance on a forged document should not be sanctioned by the Court.

The Former D&Os have filed a Notice of Appeal.

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[1] Order May 13, 2021 dated in Court File No. Cv-20-00639312-00CL

[2] See para 2 of the reasons of Justice Koehnen

[3] 2021 ABQB 137

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