Date: 19980213 Docket: CA 141313

NOVA SCOTIA COURT OF APPEAL

Cite as: 3004876 Nova Scotia Ltd. v. Laserworks Computer Services Inc.,

1998 NSCA 42

Freeman, Pugsley and Cromwell, JJ.A.

BETWEEN:

3004876 Nova Scotia Limited	)	James A. Musgrave
	)	for the Appellant
Appellant	)	
	)	
- and -	)	
	)	
LASERWORKS COMPUTER SERVICES INC.	)	Roy F. Redgrave
	)	for the Respondent
Respondent	)	
	)	
	)	D. Bruce Clarke and Pamela J. Clarke-Priddle
	)	for the Respondent - Trustee
	)	
	)	Appeal Heard:
	)	December 9, 1997
	)	
	)	Judgment Delivered:
	)	February 13 , 1998

THE COURT: The appeal is dismissed, per reasons for judgment of Freeman, J.A.; Pugsley and Cromwell, JJ.A., concurring.

FREEMAN, J.A.:

The respondent LaserWorks Computer Services Inc., a dealer in supplies for laser printers, made a proposal to its creditors under the provisions of the **Bankruptcy and Insolvency Act**, R.S.C. 1985, c. B-3 (the **BIA**).

A competitor, Datarite, operating through the appellant 3004876 Nova Scotia Limited, acquired the claims of eighteen creditors and voted them over the objections of LaserWorks at the meeting of creditors, defeating the proposal. Only two of the remaining sixteen creditors opposed the proposal.

Acceptance required votes representing a majority in number and two-thirds in value of the class of unsecured creditors present in person or by proxy. The Registrar of Bankruptcy of the Supreme Court of Nova Scotia in Bankruptcy, Tim Hill, found:

> Upon the vote being taken, fourteen creditors with a total claim value of $206,531.65 voted in favour of the proposal. Twenty creditors with a total claim of $140, 370.00 voted against the proposal. Thus 41% of creditors representing 59% of the claims voted pro, and 59% of the creditors with 40.5% of the

> claims voted con. The proposal was defeated, subject to the resolution of the objections before the court today.

At the hearing into the objections the Registrar, after hearing evidence from the appellant's solicitor Victor Goldberg, who was not counsel on the appeal, disallowed the appellant's votes. He found the proposal had been accepted by the votes of the other creditors. His decision was upheld by Justice Stewart on an appeal to the Supreme Court of Nova Scotia in Bankruptcy.

Issues and Standard of Review

The overriding issue is whether the court's inherent supervisory jurisdiction should be invoked to interfere in a proposal to creditors under the **BIA** when it appears the statutory process is being used for purposes not contemplated by Parliament.

The appellant submits it was a true appeal before Justice Stewart, and not a hearing *de novo*, on the authority of **Re McCulloch Estate** (1992), 13 C.B.R. (3d) 201 (Tr. Div.) and **Cockfield Brown Inc. (Trustee of) v. Reseau de Television TVA Inc.** (1988), 70 C.B.R. (N.S.) 59 (Que. C.A.) On further

appeal to this court the grounds are whether Justice Stewart erred in:

1. Failing to reverse the Registrar's finding that 18 creditors of LaserWorks assigned their rights to the appellant;

2. Sustaining the Registrar's finding that Datarite engaged in an improper purpose in acquiring and voting the claims of the 18 creditors;

3. Sustaining the Registrar's finding that the Appellant's purpose in acquiring and voting the claims was relevant; and

4. Concluding that there was an abuse on a minority of a class of unsecured creditors and that a duty in this respect was owed by the appellant.

An appeal lies to this court under s. 193 of the **BIA** which reads in part:

> 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;
>
> ....
>
> (e) in any other case by leave of a judge of the court of appeal.

The appellants assert future rights are involved and no leave is necessary. The respondents take no issue with this. Neither is issue taken with the jurisdiction of the Registrar and Justice Stewart to deal with the matters in question pursuant to the **BIA**. The issue is whether they erred.

The appellant's submission with respect to the standard of review is that:

> . . . the Registrar's discretion will not be disturbed on appeal unless he failed to consider or misconstrued a material fact or violated a principle of law. If the Registrar did not appreciate the nature of the evidence before him, it was open to the Supreme Court to substitute its discretion for that of the Registrar. There is also authority that the Registrar's decision should not be disturbed unless it was clearly wrong: **Re Achilles** (1993), 23 C.B.R. (3d) 20 B.S.S.C.).

It cites **Industrial Acceptance Corp. v. Lalonde**, [1952] 2 S.C.R. 109 p. 120; **Re Gilmartin (a bankrupt)**, [1989] 2 All E.R. 835 (Ch. D.) p. 838; and **Re Barrick** (1980), 36 C.B.R. (N.S.) 286 (B.C.C.A.) p. 290. In **Industrial Acceptance** Estey J., writing for the Supreme Court of Canada, held at page 120 that:

> A judgment rendered in the exercise of a judicial discretion under s. 142 ought not to be disturbed by an appellate court, unless the learned judge, in arriving at his conclusion, has omitted the consideration of or misconstrued some fact, or violated some principle of law.

The respondent LaserWorks urges that this court should only substitute its own discretion when the Registrar is clearly wrong. Apparent failure by the Registrar to appreciate the nature of the evidence before him is too low a threshold:

> The court in **Re Barrick** ((1980), 36 C.B.R. (N.S.) 286 (B.C.C.A.)) substituted its discretion for that of the trial judge only after ruling that he misapplied a legal test. Justice Taggert, at page 290, gives three reasons the Court of Appeal should substitute its discretion for that of the trial judge:
>
> > In these circumstances, it would seem to me that the learned judge has not applied the correct test, has not given the effect that ought to be given to the trustee's report and has not appreciated the nature of the evidence which was before him. In these circumstances, I think we are justified for substituting our discretion for that of the trial judge.

On that basis the respondent submits the first three grounds of appeal fail.

The Trustee under the Proposal submits that "the Appellant has not satisfied the onus upon it in this appeal to overturn the decision of the Honourable Justice Stewart to decline to substitute her discretion for that of the Registrar."

The respondent also referred to the principles stated by McLachlin, J., in **Toneguzzo-Norvel (Guardian Ad Litem of) v. Savein and Burnaby Hospital** (1994), 1 S.C.R. 114 at page 121, which this court has followed consistently:

> It is by now well established that a Court of Appeal must not interfere with a trial judge's conclusions on matters of fact

> unless there is palpable or overriding error. In principle, a Court of Appeal will only intervene if the judge has made a manifest error, has ignored conclusive or relevant evidence, has misunderstood the evidence, or has drawn erroneous conclusions from it: see P. (D.) v. S. (C.), [1993] 4 S.C.R. 141, at pp. 188-89 (per L'Heureux-Dubé J.), and all cases cited therein, as well as **Geffen v. Goodman Estate**, [1991] 2 S.C.R. 353, at pp. 388-89 (per Wilson J.), and **Stein v. The Ship "Kathy K"**, [1976] 2 S.C.R. 802, at pp. 806-8 (per Ritchie J.). A Court of Appeal is clearly not entitled to interfere merely because it takes a different view of the evidence. The finding of facts and the drawing of evidentiary conclusions from facts is the province of the trial judge, not the Court of Appeal.

These principles apply in bankruptcy matters, and provide guidance when, as here, the Registrar's findings have been upheld by a judge of the Supreme Court.

The Registrar's Decision

The Registrar based his decision on the following findings:

> Before turning to deal with these submissions, it is essential that I make some findings of fact. In large part the facts are uncontested. No affidavits were filed, but counsel agree that I may rely on the minutes of the meeting of creditors, the testimony by Mr. Goldberg upon the section 163(2) examination, and the list provided by Mr. Goldberg in compliance with his undertaking on the examination.
>
> I find that Datarite through its solicitor approached some but not all of the creditors of Laserworks with the intention of obtaining an assignment of those creditors' claims and consequently rights to vote on the proposal. The claims were obtained and the votes utilized to defeat the proposal. This

> would have the effect under section 57(a) of the BIA of placing LaserWorks into bankruptcy by virtue of a deemed assignment.
>
> I can only conclude that the purpose of Datarite was to effect the bankruptcy of LaserWorks. It is a reasonable supposition that the purpose was to remove a competitor from the marketplace. I find that it was the intention of Datarite to put LaserWorks in bankruptcy.
>
> I further find that the motive was to lessen competition.
>
> In my view, Datarite was engaged throughout in an improper purpose not contemplated by the BIA, the purpose of which is far removed from the use to which Datarite put it.

It is apparent that the Registrar, in speaking of "purpose", included both motive or intent and the steps taken to give effect to that motive or intent. While the record is somewhat sparse, as counsel have remarked, there was evidence in support of these findings. I am not satisfied that the Registrar failed to appreciate the nature of the evidence before him or that he was clearly wrong, or alternatively that he omitted the consideration of or misconstrued some fact, or violated some principle of law. The questions before this court relate to the effect of these findings.

The Registrar disallowed the votes of the eighteen creditors represented by the appellant because he considered they had been cast for an improper

purpose. In the absence of authority specific to proposals to creditors, he applied jurisprudence related to bankruptcy petitions, stating:

> It has long been held that the court will not grant a petition in bankruptcy where the petition is filed for an improper purpose: **Re E. De La Hooke** (1934), 15 C.B.R. 485 (Ont. S.C.); **Re Pappy's Good Eats Limited** (1985), 56 C.B.R. (N.S.) 304 (Ont. S.C.); **Dimples Diapers Inc. v. Paperboard Industries Corporation** (1992), 15 C.B.R. (3d) 204 (Ont. G.D.); **Re Shepard** (1996), 40 C.B.R. (3d) 145 (Man. Q.B.).
>
> In **Hooke** the petitioner obtained an assignment of a judgment against the debtor for the sole purpose of filing a petition in bankruptcy and of removing the debtor as a business competitor. In that case, as is the situation in this case, there was no evidence that the debtor had any business dealings with the party seeking to place the debtor in bankruptcy. The petition was dismissed.
>
> In **Hooke** the court made extensive reference to the decision of the House of Lords in **King v. Henderson**, [1898] A.C. 720. The comments of James, L.J., at p. 732 are particularly germane here:
>
> > After what Lord Justice Cotton has said, in which I entirely agree, people will probably think twice before they buy debts for the purpose of taking bankruptcy proceedings.
>
> Lord Justice Cotton had commented that the proceedings in bankruptcy were not taken to obtain payment of the debt, but rather the debt was purchased for the purpose of taking the proceedings. I would simply add that in light of the decision I make here persons should certainly think twice before they purchase debts in order to defeat a proposal.
>
> It is my opinion that the eighteen creditors are tainted with the improper motive of Datarite. In **Pappy's Good Eats** the petition was filed by a creditor with a genuine claim. The creditor entered into an agreement with three franchisees of the debtor. This agreement provided that the creditor would

prosecute the bankruptcy proceedings while the franchisees financed the proceeding in exchange for a share of the dividends. The motive of the franchisees was to bring about a bankruptcy so as to terminate the franchise agreements between them and the debtor.

The court found that there had been an improper use of the bankruptcy legislation. The effect of the agreement was to embroil the creditor in the improper objectives of the franchisees who were intermeddling in the proceeding. This tainted the whole proceeding. Clearly where the object of the intermeddling party is to bring about the bankruptcy of the debtor an improper purpose is present. The court will act to prevent such an abuse of the legislation.

The other cases I have referred to, **Dimples Diapers Inc.** and **Shepard** also deal with bankruptcy petitions instigated for an improper collateral purpose. In **Dimples** that purpose was to recover a trademark and a business opportunity. In **Shepard** that purpose was to obtain control of certain shares.

While this case does not involve a bankruptcy petition, it does involve the placing of Laserworks into bankruptcy. In my view, it would be wrong to allow Datarite to do in the proposal process what it cannot do by petition. Datarite's intention was to place Laserworks in bankruptcy. The motive was to remove a competitor. That motive reveals an improper purpose. The court will not allow to be done by the back door what cannot be done by the front.

By entering into this arrangement with the numbered company the eighteen creditors have tainted themselves and become embroiled in the improper purpose of Datarite. Their votes cannot stand. If Laserworks has the right to be free of this type of interference the Court must be able to fashion a remedy. This court does have the inherent jurisdiction to supervise the bankruptcy process and consequently the conduct of creditors where that conduct constitutes an abuse of the provisions of the BIA. While creditors can certainly vote in their own best interest, they may not collude with a third party to place a debtor in bankruptcy for an improper purpose. Such activity lacks commercial morality and offends the integrity of the bankruptcy process.

While Datarite was not permitted to vote the claims it had acquired, they remained debts of the insolvent debtor.

Justice Stewart

The first ground of appeal to this court, the issue of whether the claims of 18 creditors were actually assigned to Datarite, does not appear to have been a ground of appeal before Justice Stewart.

On the next two grounds of appeal, whether the Registrar failed to appreciate the evidence before him in concluding that Datarite's purpose in acquiring and voting the 18 claims was an improper one, and whether such purpose was a relevant consideration, Justice Stewart, in upholding the Registrar, took a different route to arrive at the same conclusion. She stated:

> Although stated in the context of voting by debenture holders when the majority had votes to modify the rights of the debenture holders in a clause, the statements of principle by Viscount Haldane of the Judicial Committee of the Privy Council in **British America Nickel Corporation v. M. J. O'Brien**, [1927] A.C. 369 at p. 371 are, no less, here applicable:
>
> > To give a power to modify the terms on which debentures in a company are secured is not uncommon in practice. The business interests of the company may render such a power expedient, even in the interests of the class of debenture holders as a whole. The provision is usually

> made in the form of a power, conferred by the instrument constituting the debenture security, upon the majority of the class of holders. It often enables them to modify, by resolution properly passed, the security itself. The provision of such a power to a majority bears some analogy to such a power as that conferred by s. 13 of the **English Companies Act** of 1908, which enables a majority of the shareholders by special resolution to alter the articles of association. There is, however, a restriction of such powers, when conferred on a majority of a special class in order to enable that majority to bind a minority. They must be exercised subject to a general principle, which is applicable to all authorities conferred on majorities of classes enabling them to bind minorities, namely, that the power given must be exercised for the purpose of benefitting the class as a whole, and not merely individual members only.

And later at p. 373, noting this to be a principle which does not depend on misappropriation or fraud, stated:

> . . . but their Lordships do not think that there is any real difficulty in combining the principle that while usually a holder of shares or debentures may vote as his interest directs, he is subject to the further principle that where his vote is conferred on him as a member of a class he must conform to the interest of the class itself when seeking to exercise the power conferred on him in his capacity of being a member.

The court, applying the principle stated by Viscount Haldane, should not sanction a scheme if it appears that the majority have not voted *bona fide* in the interests of the class as a whole.

Justice Quilliam in an unreported decision of the High Court of New Zealand, **Re: Farmers' Co-Operative Organization**

> **Society of New Zealand Limited** (M 12/97, 4 August 1987) in addressing the very issue of a company whose proposal had been defeated by the votes cast by some of its direct competitors, in circumstances where the majority had the right to bind the minority by statute relied on the principle enunciated in **British American Nickel Corp. Inc. v. O'Brien**, supra, during the objection to votes application before him. He concluded the votes should be discounted as their votes were cast out of self-interest and not in the interest of the class of creditors as a whole, or of the company. Unlike the present case, he did not determine there was specific activity of an improper purpose other than recognizing the votes were cast by creditors in direct commercial competition with the company.
>
> The Registrar, on his finding of facts, was not faced with a pre-existing creditor voting as it wished for whatever reason. He was faced with a unique set of circumstances where he found the appellant shelf company and Datarite, a competitor of Laserworks, involved a selective, secret arrangement with creditors against Laserworks, an arrangement that would hurt some creditors and favour other creditors, although as competitors rather than as creditors, given its purpose of removing Laserworks from the market place and diverting from it, its asset, the market share, so it could be available to Datarite, all of which would result in the balance of the creditors receiving little, if anything, and Laserworks having been deemed a bankrupt.

Justice Stewart found that Datarite was not entitled to use its votes for motives unrelated to the best interest of the creditor group and only pursuant to its own self interest in removing a potential competitor from the market place without regard to the interests of the other members of its class, the other voting creditors. She concluded:

> The Appellant is not entitled to use its votes to achieve this improper purpose. The Registrar's decision prevents an abuse on a minority of the class of unsecured creditors and in so doing upholds a fundamental and viable in the circumstances principle of class voting. He did not err in concluding improper purpose is relevant.

On the fourth ground she found that while there had been no collusion by the eighteen creditors sufficient to deprive them of the right to vote, the Registrar was justified in determining that in the circumstances Datarite controlled the way the claims were voted. She upheld the Registrar's decision and declined to interfere with it.

Assignment--The First Ground

The appellant submits that the judge erred when she declined to address and reverse the Registrar's finding that 18 unsecured creditors of LaserWorks assigned their rights to the appellant. On a proper appreciation of the evidence, it submits, no assignment took place. It states in its factum:

> The appellant did not take issue with the Registrar's finding that four of the 18 creditors received payment for them prior to the vote. . . . Each of the four creditors provided executed assignments and proxies to Mr. Goldberg, and each assignment was completed by payment. The 14 remaining creditors did not receive payment for their claims prior to the vote, and the appellant submits that the learned Registrar failed to appreciate the evidence in this regard when he concluded that the claims of these 14 creditors had been assigned to the appellant before

the vote was taken.

LaserWorks submits that the Registrar did not decide whether or not the claims voted by Datarite were assigned:

> The conclusion of the Registrar with respect to the assignment issue is:
>
> > Given my findings with respect to the intent and motive of Datarite, I find it unnecessary to consider whether Datarite should have exercised 1 vote or 18.
>
> The reference to 1 vote or 18 relates to the assignment of claims. If the 18 claims had been assigned to the Appellant, the authorities establish that only one vote could be cast on the proposal. The Registrar found it “unnecessary to consider” this issue. We submit that the Registrar would need to consider the issue before making a decision.

It seems reasonable that the Registrar did not intend to decide whether the claims were assigned because it would not determine the question before him. Even if the appellant were restricted to voting as one creditor, leaving a majority of creditors in favor of the proposal, the value of the claims voted by the appellant was sufficient to defeat the proposal and thus achieve the appellant's objective.

If the claims had been assigned to the appellant, the voting rights would

have been merged and the appellant could only cast one vote for the value of the claims it had acquired. If the creditors retained their own claims, the appellant could have voted once for each creditor for whom it held a proxy. There is authority for this proposition and the parties seem in agreement with it. The rationale is clear. Each creditor has a vote, to be exercised in person or by proxy. If the claim is assigned, the assignor ceases to be a creditor. It loses its right to vote in person or to control the vote of the proxy. The assignor becomes a creditor and is able to vote its claim, no matter the amount of the claim. If it acquires the claims of other creditors the amount of its claim increases, but it does not pluralize itself. It remains one creditor, entitled to one vote.

The appellant referred to **Toia v. Cie de Cautionnement Alta Inc.** (1989), 77 C.B.R. (N.S.) 264 (Que. S.C.). The respondent insurance company paid out 19 claims against a bankrupt under a performance bond; each claimant signed a release and subrogated its claims to the respondent, which filed 19 proofs of claim. The Official Receiver permitted 19 votes but the Quebec Supreme Court reversed this, allowing only one vote. The appellant purports to distinguish **Toia** because “there the respondent completed the

assignments by payment prior to the vote."

In my view it is of small importance whether the appellant bought for cash or on credit. The situation seems clear when creditors authorize votes on their behalf by proxy: each creditor is entitled to its vote and the proxy may cast votes for several creditors. It is equally clear when a creditor assigns its claim to another creditor: the assignee creditor has only one vote. This was the case with the four creditors whose assigned claims were accepted and paid for by the appellant. It is less clear with respect to the remaining fourteen creditors who had executed assignments to the appellant. The appellant says they had not yet been accepted, pending proof of the claims. However they had to be proven before they could be voted, and their values were proved for the purpose of calculating their percentage of the total of the unsecured claims. Any condition on the assignment would appear to have been met.

The intention of the parties must be determined: did the appellant vote those claims on its own behalf, or as an agent exercising the rights of the original creditors by proxy? If it had been necessary for the Registrar to decide this question, there was evidence before him that the original creditors had

given control over their claims to the appellant by entering into enforceable contracts to assign them. That is, while the appellant voted the claim in the form of proxies, in fact it had acquired sufficient interest in the claims to vote them in its own right, as assignee, as though the assignments had been fully executed. It is clearly an improper practice for an assignee to purport to vote as the proxy of a creditor which has assigned its claim, thereby ceasing to be a creditor. If Datarite was otherwise entitled to vote at the creditor's meeting, it had one vote for the full value of the claims it had acquired. It was not justified in voting by proxy.

I would dismiss this ground of appeal.

Evidence of Datarite's purpose--the second ground

Mr. Goldberg testified as follows to Datarite's purpose in buying claims and voting against the proposal:

> Q. Can you tell me the benefit the numbered company will get in the bankruptcy of LaserWorks?
>
> A. Well, the purpose of the numbered company hopefully in buying the claims is that it'll buy the claims at a reduced price and get full payment one day.

The appellant states that Mr. Goldberg's evidence was uncontradicted, and submits:

> It is respectfully submitted that the Registrar was clearly wrong in his appreciation of the evidence. The learned Judge concluded that the Registrar made a finding of credibility with respect to Victor Goldberg's evidence on this issue. However, the Registrar's decision does not indicate that Mr. Goldberg's evidence on this key issue was even considered. The Registrar simply failed to address Mr. Goldberg's evidence on this issue at all. It is therefore open to this Honourable Court to substitute its discretion for that of the Registrar. It is submitted that the Registrar could only find an improper purpose on the record by overlooking the only piece of direct evidence before him on Datarite's intentions.

Mr. Goldberg was obviously only stating his client's ostensible intentions, not its true ones. The Registrar in fact had commented on Mr. Goldberg's evidence after quoting a passage from the minutes indicating how he had responded to certain questions. He said:

> It is not unfair to say that Mr. Goldberg was obtuse to a very great degree. While this does not necessarily confirm suspicion as to the motives of his client, it does explain the concern expressed by the principals of LaserWorks.

The evidence before the Registrar included the proposal itself, which shows total liabilities of $585,459 of which $247,651 was unsecured, $334, 838 secured and $2,970 preferred. Assets totaled $306,158 including book debts

of $170,000, leased vehicles $ 95,958, stock in trade $18,500, cash in the bank (which was the principal secured creditor) $8,000 plus fixtures, furnishings and equipment. Virtually all of the assets would be subject to security. The overall deficiency is shown as $279,301. It is difficult to see a basis for Mr. Goldberg's client's optimism that it might get full payment for the claims it bought at reduced value, or indeed, to see any significant source of dividends for unsecured creditors, on a bankruptcy.

Datarite had not been a creditor of LaserWorks before the proposal. There was evidence, however, that it had been a competitor. The Registrar was entitled to consider the evidence as a whole in making findings of fact and drawing inferences that led him to the conclusion that:

> ... Datarite's intention was to place Laserworks in bankruptcy. The motive was to remove a competitor. That motive reveals an improper purpose...

In my view the Registrar did not fail to appreciate the evidence nor otherwise err in arriving at this conclusion. Neither did Justice Stewart err in upholding him. I would dismiss this ground of appeal.

Is Purpose Relevant? The Third Ground.

(i) The Statute

The appellant submits that the trial judge erred in upholding the Registrar's decision that Datarite engaged in an improper purpose in acquiring and voting the claims of the 18 creditors, and that its purpose was relevant. In view of the conclusion on the second ground that the Registrar did not err in finding improper purpose, the appellant is left with the relevancy argument. It argues that the authority relied on by the Registrar, **De La Hooke**, **Pappy's Good Eats**, **Dimples Diapers** and **Shepard**, arises under s. 43(7) of the **BIA** which deals only with bankruptcy petitions:

> 43(7) Where the court is not satisfied with the proof of the facts alleged in the petition or of the service of the petition, or is satisfied by the debtor that he is able to pay his debts, or that for *other sufficient cause* no order ought to be made, it shall dismiss the petition. (emphasis added.)

It cites the discussion of the discretion thus created in Houlden & Morawetz, **Bankruptcy and Insolvency Law of Canada** (3d) at p. 2-50:

> Section 43(7) permits the court to dismiss a petition if it concludes "that for any other sufficient cause no order ought to be made". Section 43(7) confers a discretion; the exercise of that discretion must be founded on sound judicial reasoning based on credible evidence and must be exercised judicially according to common sense and justice in a manner which does

> not occasion a miscarriage of justice.

Section 43(7) clearly does not create the supervisory jurisdiction of the court over the bankruptcy regime; it is simply a concrete application of a discretionary power inherent in the scheme of the BIA. Each step in the bankruptcy process, whether initiated by a creditor's petition for a receiving order or a debtor's assignment for the benefit of creditors, is supervised by court officials or the court itself. For example s. 108 in Part V, the Administration of Estates, relates to "any meeting of creditors". At the meeting which gave rise to this appeal the chairman applied s. 108(3):

> 108(3) Where the chairman is in doubt as to whether a proof of claim should be admitted or rejected, he shall mark the proof as objected to and allow the creditor to vote subject to the vote being declared invalid in the event of the objection being sustained.

Section 187(9) provides a broad directive:

> 187(9) No proceeding in bankruptcy shall be invalidated by any formal defect or by any irregularity, unless the court before which an objection is made to the proceeding is of opinion that substantial injustice has been caused by the defect or irregularity and that the injustice cannot be remedied by any order of that court.

The short answer to the question raised by this ground of appeal is that motive or purpose is relevant to a court authorized to remedy substantial

injustice.

The appellant takes the narrow position that proposals are outside the discretionary supervisory jurisdiction of the court because they are not specifically included in s. 43(7) or some equivalent provision. This submission cannot be sustained.

There is a similarity between a creditor's petition for a receiving order under s. 43 and refusal of a proposal. In either case it is something done by a creditor or creditors that places the debtor in bankruptcy, likely against its will. But a proposal is also similar to an assignment: the debtor has itself resorted to protection under the **BIA** and its proposal will be deemed to be an assignment unless it succeeds in persuading its creditors to accept it in their own best interests.

The appellant submits that s. 54 is the provision in the proposals Part of the **BIA** which corresponds with s. 43(7). S. 54 provides:

> 54(1) The creditors may, in accordance with this section, resolve to accept or may refuse the proposal as made or as altered at the meeting or any adjournment thereof.

While s. 43(7) provides an occasion for the exercise of the court's supervisory jurisdiction, an examination focused on the merits of the petition itself, s. 54(1) does not. Such an examination of a proposal is not necessary at that stage. The validity of the claims voted at the creditor's meeting at which the proposal is accepted or refused is subject to the court's scrutiny under s. 108(3). If the proposal is refused by a regular vote of creditors it vanishes and further examination is unnecessary; the debtor is deemed under s. 57(a) to have made an assignment in bankruptcy and the matter proceeds as on an actual assignment. If the creditors approve the proposal, it is then examined on its merits under s. 59, which provides:

> 59. (1) The court shall, before approving the proposal, hear a report of the trustee in the prescribed form respecting the terms thereof and the conduct of the debtor, and, in addition, shall hear the trustee, the debtor, any opposing, objecting or dissenting creditor and such further evidence as the court may require.
>
> (2) Where the court is of the opinion that the terms of the proposal are not reasonable or are not calculated to benefit the general body of creditors, the court shall refuse to approve the proposal, and the court may refuse to approve the proposal whenever it is established that the debtor has committed any one of the offences mentioned in sections 198 to 200.

Proposals are therefore just as much a part of the bankruptcy regime, and

just as subject to the supervision of the court exercising an equitable jurisdiction under the statute, as petitions and assignments. In **Whiteman v. UDC Finance Ltd.,** [1992] 3 NZLR 684, Hardie Boys J., writing for the New Zealand Court of Appeal with respect to the New Zealand **Insolvency Act**, which varies in detail but not in principle from our own, said at p. 691 that proposals are merely

> . . . the other side of the coin to a petition for adjudication.

The only distinction between petitions and proposals in the exercise of the court's supervisory jurisdiction is that under the scheme of the **BIA** occasions for judicial scrutiny occur at different stages of the process. In the present appeal, court intervention was occasioned by objections to proofs of claims affecting the right to vote at the creditors' meeting considering the proposal. The correct procedure was followed, and the objections were considered by the Registrar who had jurisdiction under s.187(9) to remedy substantial injustice.

Motive or purpose is not relevant to objections to proofs of claim based on statutory exceptions under the **BIA.** These are established in several sections, including s.109(1), persons who had not duly proved and lodged a claim;

s.54(3), a relative of the debtor (who may vote against but not for a proposal); 109(4), the debtor as proxy for a creditor; s.109(6), a creditor who did not deal with the debtor at arm's length (with exceptions); s.110(1), a person with a claim acquired after the bankruptcy unless the entire claim is acquired; s.111, a creditor with a claim on or secured by a current bill of exchange (subject to conditions); s.112, a creditor holding security (subject to conditions); and s. 113(2), a trustee as proxy (subject to restrictions). See also s. 109, the trustee as creditor.

(It will be noted that many of these exceptions arise from circumstances that could give rise to conflict of interest. This will be considered further under the fourth ground of appeal.)

However the statutory exceptions are not a code exhausting the forms in which substantial injustice may manifest itself. Objections will be sustained under s. 108(3) if they result from a crime or a tort against the debtor or a crteditor. In the present appeal, and in the authorities cited by the Registrar, the substantial injustice assumes the guise of tortious behavior, to which motive is relevant. In the s. 108(3) context the commonest torts, or instances of

substantial injustice arising from tortious behavior, relate to abuse of process and fraud. However conspiracy to harm was also found in **Dimples Diapers.**

Tortious or tort-like behavior falling short of a fully developed tort susceptible of formal proof or definition can nevertheless result in substantial injustice, particularly for persons at a point so vulnerable they must resort to insolvency protection. (See **Shepard**.) In my view that is why Parliament chose the language it did in s.187(9): to create a discretionary jurisdiction in courts that is not fettered, for example, by the high standards required for establishing such torts as abuse of process in other contexts. What remains to be considered is the threshold level of the substantial injustice which will result in remedial action by the court.

(ii)The Authorities

The four cases cited by the Registrar establish that the threshold is crossed when the **BIA** is used for an improper purpose. An improper purpose is any purpose collateral to the purpose for which the bankruptcy and insolvency legislation was enacted by Parliament.

Farley J. held in **Dimples Diapers** that:

> . . . the **Bankruptcy Act**, R.S.C. 1985, c. B-3 has as its purpose the provision of "the orderly and fair distribution of the property of a bankrupt among its creditors on a pari passu basis". (L.W.Houlden and C.H.Morawetz, **Bankruptcy Law of Canada**, 3rd ed. (looseleaf) (Toronto: Carswell, 1989) at p. 1-3 [A&4]....

In the cases cited the improper purpose takes the form of abuse of process or tortious behavior closely analogous to abuse of process. In each case the court reacted to what could be seen as substantial injustice. The remedy of choice arising under s. 43(7) is refusal of the petition. The appropriate remedy in the present case is rejection of the tainted votes.

In a vigorous judgment in **Dimples Diapers** Farley J. dismissed the bankruptcy petition because it was brought for an improper purpose, to recover the diaper trademark and business opportunity, and awarded damages for abuse of process and conspiracy against three creditors. He held at p. 219:

> ...The tort of abuse of process consists in the misuse of a legal process for any purpose other than that which it was designed to serve. It is immaterial in establishing abuse of process that the process was properly commenced or founded by the defendants and it does not matter that the process be concluded in the instigator's favour. The improper purpose is the gravamen of liability. See **Unterreiner v. Wilson** (1982), 40 O.R. (2d) 197, 24 C.C.L.T. 54, 142 D.L.R. (3d) 588 (H.C.), at p. 203 [O.R.], appeal dismissed (1983), 41 O.R. (2d) 472, 146 D.L.R. (3d) 322 (C.A.),

> and J.G.Fleming, **The Law of Torts**, 7th ed. (Sydney: Law Book, 1987) at pp. 591-592.
>
> Potts J. In **R. v. Cholkan & Co. v. Brinker** (1990), 71 O.R. (2d) 381, 1 C.C.L.T. (2d) 291, 40 C.P.C. (2d) 6 (H.C). at p. 8 [C.P.C.] said:
>
> > Most recently, Montgomery J. writing for the divisional Court in **Bentham v. Rothbart** (1989), 36 O.A.C. 13 (Div. Ct.), stated:
> >
> > The constituent elements of the tort of abuse of process are: (a) a collateral improper purpose such as extortion; and (b) a definitive act or threat in furtherance or a purpose not legitimate in the use of the process.

Montgomery J. was clearly using "extortion" as an example only. Any crime or tort would be an improper purpose.

In **de la Hooke** the petition was dismissed when petitioning creditors, who had had no business dealings with the debtor, obtained an assignment of a judgment debt he owed for the sole purpose of filing a petition in bankruptcy to remove him as a business competitor who was using a similar trade name. Registrar Cook cited a number of leading English cases relevant to the circumstances of the present appeal. These included **King v. Henderson**, [1898] A.C. 720 at p. 731 which considered abuse of process or fraud on the court; **Ex Partre Griffin; in re Adams** (1879), 12 Ch. Div. 480 in which a

worthless debt was purchased to take proceedings in bankruptcy to force the debtor to give up a just debt, causing Brett L.J. to remark, “a viler fraud I have never heard of”; **Ex parte Harper; In re Pooley** (1882), 20 Ch. D. 585 at p. 692 in which buying a debt to force a bankruptcy in order to get rid of a trustee was found “a gross abuse of the bankruptcy laws;” and **In re a Debtor** [1928] 1 Ch. 199 at p. 211 in which the bankruptcy laws were used for the collateral purpose of extortion.

In **Pappy's Good Eats** a petition was denied when three franchisees of the debtor, who were not creditors, contracted with the petitioning landlord , who had a $65,000 unsatisfied judgment against the debtor, to pay the landlord's costs to petition the debtor into bankruptcy so they would be relieved of obligations under their franchise agreements. Henry J. held the effect of the agreement was to "embroil the petitioning creditor in the improper objective of the purchasers who as non-creditors have no status in these proceedings and are intermeddling in it. The whole proceeding is inescapably tainted; the petition must be dismissed." He found that “the abuse occurred when the parties agreed or arranged improperly to use the facility of the Act to advance the objectives of the franchisees to cause injury to the debtor.”

In **Shepard** it was found that the purpose of the petitioner was to gain control over certain shares of the debtor, an important business advantage. "It is not appropriate or indeed, correct in law, to have the courts facilitate such an objective when the objective is very clearly the main purpose of the application." This finding is consistent with a finding of substantial injustice resulting from abuse of process.

(**iii) The Present Case**

It is most significant that the appellant was not a creditor of LaserWorks prior to the proposal. Intermeddling by strangers to the pre-existing debtor creditor relationship for an improper purpose was a determinative factor in **Pappy's Good Eats**. The practice of buying dubious claims against an insolvent for purposes foreign to the bankruptcy process was denounced in the English cases cited in **de la Hooke**. The Registrar in the present case understandably looked askance at it. Few legitimate reasons come to mind for buying into a bankrupt estate. When somebody does so, it is a matter of common sense to assume, subject to correction, they intend to use the bankruptcy process for some purpose it was not meant for. In the present case it was readily apparent that mischief was afoot.

The "orderly and fair distribution of the property of a bankrupt among its creditors on a pari passu basis" was not the purpose behind the acts of the appellant. The appellant made separate approaches to each of the eighteen creditors whose claims it succeeded in acquiring. It negotiated a separate deal with each for varying considerations presumably seen to be more advantageous to the creditor than reliance on the proposal. From most of them it obtained an agreement, an executed assignment and a proxy. It purported to vote the proxies of former creditors whose claims had been assigned to it. Its purpose was not an orderly recovery of debts from the debtors assets but to limit competition by the debtor in its own marketplace by rejecting the debtor's proposal and forcing it into bankruptcy.

The appellant was acting on its own making sharp use of the provisions of the **BIA** for its own advantage. There was no evidence that the co-operating creditors were part of a conspiracy with the appellant to injure the debtor. Otherwise the tort of conspiracy to injure could be found where the predominant purpose of the appellant's conduct is to cause injury to the plaintiff, whether the means used by the defendants are lawful or unlawful: **Canada Cement LaFarge Ltd. v. British Columbia Lightweight Aggregate Ltd.**, [1983] 1 S.C.C. 452.

It is undeniable that the appellant caused injury to the debtor not negligently but deliberately. The debtor made its proposal to avoid bankruptcy; bankruptcy therefore must have been seen by Laserworks as a more injurious alternative than acceptance of the proposal by the creditors. Laserworks had the heavy burden of persuading its creditors that their best interests lay in approving the proposal; it did not have the impossible burden of dissuading a financially stronger competitor bent on using the provisions of the **BIA** to destroy it as a competitor. The appellant derailed the proposal procedure to force the debtor into bankruptcy. Using bankruptcy to cause injury, thereby eliminating the debtor as an entity capable of competing in the marketplace, is abusive of the purpose of the BIA. It does not qualify as "the orderly and fair distribution of (its) property." Annihilation of an individual business or a company may be an unfortunate consequence of a bankruptcy, an unavoidable side-effect, but it is not the purpose of the **BIA**. Use of the **Act** to accomplish such an objective is in my view so abusive of the purpose of the legislation as to engage the supervisory jurisdiction of the courts under s. 187(9). It is a substantial injustice to be remedied.

No distinction in principle is possible between the present case and the

four cited by the Registrar. He identified the problem and he applied the remedy. He was upheld on appeal in the Supreme Court. I would dismiss this ground of appeal.

Class voting--The Fourth Ground

In upholding the Registrar Justice Stewart added a string to his bow by introducing the class voting analysis of Viscount Haldane in **British American Nickel**. In light of the holdings respecting the second and third grounds of appeal, it is not necessary to the outcome to decide this ground.

The appellant submits that the trial judge was wrong in concluding there was an abuse on a minority of a class of unsecured creditors and that a duty in this respect was owed by the appellant:

> . . . There was no abuse on a minority of the unsecured creditors and no duty was imposed on the Appellant to cause votes to be cast in the best interest of the class. Without such a duty the learned Judge was without authority to consider Datarite's motives and the votes in question should have been allowed.

In **British America Nickel** Viscount Haldane stated that where a power is conferred on a special class, a majority in exercising a power to modify the

rights of a minority must exercise that power in the interests of the class as a whole.

> . . . But their Lordships do not think that there is any real difficulty in combining the principle that while usually a holder of shares or debentures may vote as his interest directs, he is subject to the further principle that where his vote is conferred on him as a member of a class he must conform to the interest of the class itself when seeking to exercise the power conferred on him in his capacity of being a member...

In the present case the minority creditors saw their alternative of furthering their best interests by voting in favour of the proposal disappear when the votes amassed by the appellant were exercised, not in the interest of making the most favourable recovery from a combination of a distribution of the assets of LaserWorks and its continuance in business as a customer or potential customer, but in the interests of removing a competitor of Datarite. Justice Stewart was concerned that the other creditors, as well as the debtor, suffered from the abusive use of the provisions of the **BIA**. Of the sixteen creditors who did not assign their claims to Datarite, fourteen voted in favour of the proposal.

The rationale for Viscount Haldane's conclusion in **British America Nickel** was carefully reviewed by Hardie Boys J. in **Whiteman v. UDC Finance Ltd.** The court found it should not intervene in the refusal of a proposal by creditors

including several who were being sued by the debtor, and who therefore had a collateral interest in seeing him out of business.

Hardie Boys J. cited the same passage quoted above by Justice Stewart from Vicount Haldane's judgment. It concludes that there is a restriction on powers conferred on a majority of a special class in order to enable that majority to bind a minority:

> ...They must be exercised subject to a general principle, which is applicable to all authorities conferred on majorities of classes enabling them to bind minorities; namely, that the power given must be exercised for the purpose of benefiting the class as a whole, and not merely individual members only.

Hardie Boys J. considered **Re Farmers' Co-operative**, which was also cited by Justice Stewart, in which votes of several creditors who were competitors of the debtor were disallowed.

> ...In a later development of the same matter, but not now involving the Court's sanction under s. 205, Gallen J. accepted that the Court has an overriding control, not limited to the approval stage under s. 205, and may restrict a right to vote where the equities of a particular situation require it: see [1992] 1 NZLR 348. It is unnecessary for present purposes to decide whether these cases were correctly decided, for even if they were, the principle is not of unlimited application, and does not apply to the exercise of voting rights generally. This is clear from what Viscount Haldane said in the **British America Nickel** case.

Immediately after the passage already quoted, his Lordship said

> Subject to this, the power may be unrestricted. It may be free from the general principle in question when the power arises not in connection with a class, but only under a general title which confers the vote as a right of property attaching to a share.

Thus in **Pender v. Lushington** (1877) 6 Ch. D. 70, 75-76 Jessel MR said there is:

> . . . no obligation on a shareholder of a company to give his vote merely with a view to what other persons may consider the interests of the company at large. He has a right, if he thinks fit, to give his vote from motives or promptings of what he considers his own individual interest.

While the voting rights conferred by Part XV of the **Insolvency Act** are not akin to a "right of property attaching to a share", they are rights conferred without reservation. There is no requirement for class voting; there is instead a general right conferred equally on all creditors. The rationale of the principle does not apply. It is well settled that the motive (short of fraud) of a petitioning creditor, no matter how reprehensible, is irrelevant to his right to obtain an order of adjudication: **King v. Henderson** [1898] AC 720, **Re King, ex parte Commercial Bank of Australia Ltd.** (No. 2) [1920] VLR 490. The motive of a creditor voting on a proposal, really the other side of the coin to a petition for adjudication, can be no different. That is not to say that there may be no remedy in an extreme case, such as fraud or mistake. But certainly where, as here, there are perfectly legitimate reasons for opposing the proposal, a creditor is not to be denied that right because he may have some other motive as well...

If the exception made for fraud is broadened to "substantial injustice" I would take Hardie Boys J.'s conclusions to be a fair statement of the law in Canada as well, as applied by Canadian courts in the cases cited by the

Registrar. The New Zealand court included mistake as well as fraud as an exception. A creditor is not to be deprived of the right to vote for wrongful motives alone; motive must be coupled with a tortious act to support a finding of improper purpose.

A Canadian case supporting a broad interpretation of the right of creditors to vote on proposals is **Re Bedard Louis Inc**. (1991) 22 C.B.R. (3d) 218. The debtor sued three creditors who had sought to seize his goods before judgment for amounts far exceeding their claims against him. One creditor petitioned for a receiving order, and the Quebec Superior Court rejected the debtor's argument that the petitioner was not a creditor because of the large undecided actions. The debtor was declared bankrupt and later filed a proposal. The trustee refused to let the three creditors vote at a creditors' meeting considering the proposal because of a possible conflict of interest. The Superior Court allowed an appeal against the trustee's decision, and the Quebec Court of Appeal upheld the Superior Court, holding (headnote) that:

> No provision of the Act authorizes the trustee to exclude a creditor whom he considers to have a conflict of interest. The debtor's action for damages against the creditors, which constituted a debt not yet payable, did not strip the creditors of their status of ordinary creditors. By the proposal, the debtor presented the creditors with terms of payment which were different from those provided legally by contract.

> The Act was intended to allow the voting of all duly acknowledged creditors. Exceptions to that rule were properly specified in the Act and none of them pertained to a creditor against whom a debtor had filed legal proceedings.

The Proposals Part of the **BIA** recognizes only two classes of creditors, secured creditors who are presumably protected by the security they hold, and unsecured creditors, all the others. This does not appear to meet Viscount Haldane's criterion of a special class bound to exercise its voting rights for the benefit of the class as a whole. That concept seems surplus to and difficult to reconcile with the scheme of the **BIA** where, as the Quebec Court of Appeal found in **Bedard**, all duly acknowledged creditors are entitled to vote as they please, subject to exceptions set out in the **Act** (and the exception for tortious or criminal behavior.)

As remarked above, those exceptions reflect the manner in which Parliament dealt with conflicts of interest which might arise in the context of voting on proposals. Parliament has obviously legislated on the subject and cannot be assumed to have created by implication an exception for general, unspecified, conflicts of interest. The mere fact that a creditor is also a competitor of the debtor or otherwise in a conflict of interest with the debtor does not give

rise to a statutory exception. The scheme for protecting minority creditors adopted under the BIA was not a class voting concept but rather a system of specific exceptions coupled with a discretionary power in the courts to remedy substantial injustice.

It is not necessary to make a final determination on this point. The rational of Justice Stewart's decision is found in her adoption of the Registrar's conclusions as to improper purpose in the following passage:

> The applicant is not entitled to use its votes to achieve this improper purpose. The Registrar's decision prevents an abuse on a minority of the class of unsecured creditors and in so doing upholds a fundamental and viable in the circumstances principle of class voting. He did not err in concluding improper purpose is relevant.

That is, while the Registrar's decision was consistent with considerations of class voting, he was upheld on his findings of improper purpose.

I would dismiss the fourth ground of appeal.

Conclusion

The appellant attempted to abuse the provisions of the **BIA** by using them to intermeddle for an improper purpose with the proposal of a debtor to its

creditors, giving rise to a substantial injustice. This affected not only the debtor but the remaining creditors who supported the proposal. The Registrar made no error in discerning this from the evidence and in exercising the court's discretionary jurisdiction to remedy substantial injustice. He was upheld on appeal to the Supreme Court. The appellant's actions are not to be condoned. I would dismiss the appeal with costs which I would fix costs at $3,000 plus disbursements to the Respondent and $3,000 plus disbursements to the Trustee.

Freeman, J. A.

Concurred in:

Pugsley, J.A.

Cromwell. J.A.