IN THE SUPREME COURT OF NOVA SCOTIA
IN BANKRUPTCY AND INSOLVENCY
Citation: Atlantic Ova Pro Ltd. (Re), 2006 NSSC 61

Date: 20060222
Docket: S.H. 257588
Registry: Halifax

In the Matter of the Bankruptcy of Atlantic Ova Pro Ltd.

D E C I S I O N

Registrar: Richard W. Cregan, Q.C.

Heard: January 24, 2006

Counsel: Colin D. Piercey representing Heritage Salmon Limited

Tim Hill representing Atlantic Ova Pro Ltd.

Introduction

[1] Heritage Salmon Ltd., (“HS2"), a corporation with an office at St. George, New Brunswick, has petitioned this court that Atlantic Ova Pro Ltd., (“AOPL”) a corporation with a registered office in the Wentworth Valley, Nova Scotia, and a place of operations in Advocate Harbour, Nova Scotia, be adjudged bankrupt and that a receiving order be made respecting its property.

[2] The petition asserts that AOPL is indebted to HS2 for $3,043,973.83, on account of money lent to AOPL by HS2. It also asserts security which it values at $250,000.00. It alleges two acts of bankruptcy:

> 1. the Debtor has ceased to meet its liabilities generally as they become due, and
>
> 2. the Debtor has made a fraudulent conveyance of certain of its real property located at Advocate Harbour, Nova Scotia.

[3] AOPL opposes the petition on the following grounds:

> 1. That Atlantic Ova Pro Ltd. is not indebted to the Petitioner, as alleged.
>
> 2. That Atlantic Ova Pro Ltd. has not committed any acts of bankruptcy, as alleged.
>
> 3. That the debt as alleged is subject to a *bona fide* dispute arising from a contract between Atlantic Ova Pro Ltd. and Heritage Salmon Limited (and not Heritage

Salmon Ltd.).

4. That the Petitioner has purchased the disputed debt upon which the within Petition is founded for the sole and improper purpose of ridding itself of a competitor in the marketplace.

Background

[4] Weston Food Inc. ("Weston") is the owner of an Ontario corporation which was named Heritage Salmon Limited ("HS1"). It was engaged in extensive aquaculture operations including salmon production in New Brunswick and other places.

[5] AOPL owned and operated a fish hatchery in Advocate Harbour. On June 21, 2002 it entered an agreement with HS1, (the "Aquaculture Contract").

[6] Under the Aquaculture Contract HS1 was to provide the financing for AOPL's operation through Weston and the Canadian Imperial Bank of Commerce ("CIBC") and sell feed to AOPL. AOPL was to purchase smolt salmon from HS1, grow them to maturity and sell the eggs produced to HS1. The eggs were to be sold at a fixed price. This would generate $1,200,000 per annum. AOPL's operation commenced with smolt delivered by HS1 sometime before the Aquaculture Contract was signed. HS1 was

throughout the only supplier of smolt to AOPL. Early in the operation it was found that the smolt were infected with Bacterial Kidney Disease ("BKD"). This significantly reduced egg production. The result was large financial losses for AOPL.

[7] There were three big "players" in the Atlantic Canada salmon industry, HS1, Cooke Aquaculture Inc. ("Cooke") and Stolt Sea Farms ("Stolt").

[8] Cooke negotiated with HS1 and Stolt to purchase their respective operations in Atlantic Canada. It completed its purchase of the operation of HS1 sometime in June of 2005 and the operation of Stolt on December 30, 2005. It now dominates the Atlantic Canada salmon industry.

[9] For the purposes of acquiring the operation of HS1, Cooke incorporated HS2, using the same name, except for the abbreviation of "Limited". Presumably the name of HS1 has since been changed. The same name was used for purposes of marketing continuity. The financing arrangements HS1 had through CIBC with AOPL and other parties with which it operated were assigned to HS2. This is the debt which is the basis of HS2's present

claim against AOPL.

[10] HS2 has not been purchasing ova under the Aquaculture Contract. Apparently it has been receiving adequate ova supply from a facility owned by Stolt or elsewhere. Also it has not wanted AOPL's ova because of the BKD infection problem.

[11] Because of these changes and the domination of the industry by Cooke, which was not interested in dealing with AOPL, Paul Merlin, its President, decided that there was not a future for it in the salmon industry and that another use for the AOPL facility in the aquaculture industry should be found. To that end he incorporated Meraqua Marine Limited ("Meraqua"). AOPL and Meraqua entered into an agreement whereby the AOPL facility at Advocate Harbour was sold to Meraqua. The purchase price was $747,000. This is the valuation set by Ralph Taylor, AACI, P.Ag., of RHT Enterprises Ltd., Property Appraisers of Truro.

[12] The agreement is dated August 17, 2005. The purchase price was paid with a promissory note for $747,000, with interest at a commercially reasonable

rate, to be paid annually. The principal balance and accrued interest is payable on August 31, 2012. The note incorporates a provision in the agreement that the purchase price may be adjusted to reflect any determination by a court or the Canada Revenue Agency as to what the fair market value should be.

[13] The Petition was issued on October 31, 2005. The Notice of Contestation of Petition was filed December 1, 2005. Also on that date AOPL commenced an action in this court against Weston and HS1. It claims against HS1 as damages for breach of the Aquaculture Contract, $3,916,845 for losses sustained by AOPL for the years 2003, 2004, and 2005, and $1,808,262 for destroyed smolt, for a total of $5,725,107 and general damages.

[14] It also claims against Weston for special damages for inducing breach of the Aquaculture Contract of $1,808,262 with respect to the destroyed smolt and general damages.

Objection re Affidavits

[15] On short notice before the hearing, counsel for HS2 delivered to counsel for AOPL and to the court affidavits of Glenn Cooke, the President of HS2, Paul Fudge who had been Controller of HS1 and William D. Robertson who had been the Director of East Coast Operations of HS1.

[16] Counsel for AOPL objected to these affidavits being read in this application because they were not delivered within the time prescribed by the applicable rules and because Mr. Fudge and Mr. Robertson were not present to be cross examined. After a brief adjournment, by agreement the following procedure was followed: Mr. Cooke was cross examined on his affidavit; then Mr. Paul Merlin was cross examined on his affidavit. In the course of his cross examination a number of documents which are exhibits in the affidavits of Mr. Fudge and Mr. Robertson were presented to him for identification and for his responses to questions regarding them. Apart from their use for this purpose, these two affidavits are not before the court.

Contents of Petition

[17] The principles which must guide me in reviewing a petition under the *Bankruptcy & Insolvency Act*, R.S.C. 1985, c. B-3, as amended, (the "*Act*"),

are well stated by Henry J. in *Re Holmes and Sinclair* (1975) , 20 C.B.R. (N.S.) 111, at p 112:

> Under the jurisprudence - - the Bankruptcy Act, R.S.C. 1970, c. B-3, being a quasi-criminal statute - - the act of bankruptcy and every allegation in the petition must be strictly proved: *Re Elkind; Samuel Hart & Co. v. Elkind* (1966) 9 C.B.R. (N.S.) 274 (Ont.). This requires that evidence be placed before the court to prove all the allegations of fact made in the petition, whether or not they are put in issue by the debtor in his notice of dispute, including what might be regarded as merely formal facts. All elements necessary to found a receiving order must be pleaded in the petition and all allegations made therein must be strictly proved by the petitioning creditor.

[18] Looking then at the petition and referring to Subsection 43(1) of the *Act* the following must be proved:

1. The corporate identity and residence of both the petitioner, HS2, and the debtor, AOPL.

2. The amount owed by AOPL to HS2.

3. Whether within six months next preceding the filing of this petition AOPL has ceased to meet it liabilities generally as they become due, or whether AOPL has made a fraudulent conveyance of certain of its property.

[19] The identity of the parties clearly has been proved or admitted through the

affidavits and cross examination thereon.

[20] That money is owing is similarly proved. The assignment of the debt from HS1 to HS2 is documented. The amount in issue is said by Mr. Cooke in his affidavit to be $3,023,366.00 as of September 1, 2005. In the petition dated October 14, 2005, it is said to be $3,043,973.83. Presumably this is a matter of accrued interest or other minor adjustments. However, AOPL alleges that this debt is subject to a *bona fide* dispute it has against HS1, the equities of which may apply to the claim by HS2.

[21] HS2 alleges two acts of bankruptcy. One must be proved.

Ceasing to meet liabilities

[22] First I shall consider whether AOPL has ceased to meet its liabilities generally as they became due (Paragraph 42 (1)(j)).

[23] No evidence was tendered by HS2 as to the outstanding liabilities of AOPL apart from its own claim. The only evidence on this point is that found in paragraph 37 of Mr. Merlin's affidavit:

> AOPL has few creditors, and they are all being paid in accordance with existing terms of payment.

[24] At best what is proved is that there is a substantial debt owed to HS2 and there are other debts the specifics of which are not before the court that are being paid according to terms which I infer are acceptable to the particular creditors. As well I infer they are small in comparison to the claim of HS2. The use of the word "generally" implies that one must have regard to not just the petitioner's debt but to the other debts as well. A collectivity is implied. With AOPL's other debts and liabilities being attended to on terms satisfactory to their respective creditors, it cannot be said that AOPL has ceased to meet them generally as they become due. At most only the liability owed to HS2 is not being paid as it becomes due.

[25] I am fortified in this conclusion by the comments of Saunders J. in *Re Tysak Limited* (1981), 38 C.B.R. (NS) 142 (Ont. S.C.). The debtor owed money to several creditors. Some of the debts were disputed; sometimes the debtor was slow with payments having cash flow problems; some creditors were not pressing payment; and some creditors continued usual business with the debtor. Saunders J. thought these factors were relevant to whether the

debtor had ceased to meet its liabilities. In light of these events he found that the creditor had failed to prove that the debtor had ceased to meet its liabilities generally as they became due. AOPL's other liabilities being attended to on terms, its situation is not unlike that of this debtor.

[26] I must also in this context review the jurisprudence regarding whether the failure to pay a single creditor constitutes an act of bankruptcy under this paragraph of the *Act.* A leading case is *Re Holmes and Sinclair*, referred to above. In it Henry J. after reviewing a number of cases said beginning at paragraph 5 the following:

> 5 I have carefully considered these decisions and it is clear that the Courts, in Ontario at least, have granted a receiving order on the basis of a default to one creditor in special circumstances. These circumstances are:
>
> 6 (a) The creditor is the only creditor of the debtor; and the debtor has failed to meet repeated demands of the creditor; in these circumstances he should not be denied the benefits of the Bankruptcy Act by reason only of his unique character; or
>
> 7 (b) The creditor is a significant creditor and there are special circumstances such as fraud on the part of the debtor which make it imperative that the processes of the Bankruptcy Act be set in motion immediately for the protection of the whole class of creditors; or
>
> 8 (c) the debtor admits that he is unable to pay his creditors generally, although they and the obligations are not identified.

and in paragraph 10:

> In the non-exceptional case, as in the case at bar, that situation cannot be ordinarily proved by having regard to the experience of one creditor only, even though he may be a major creditor. Resort to the statutory machinery of the Bankruptcy Act, rather than to the remedies to enforce a debt or claim in the ordinary courts, is intended by Parliament to be for the benefit of the creditors of a debtor as a class, and the act of bankruptcy described in s.24(1)(j) is, in my judgment, an act that singles out the conduct of the debtor in relation to the class, rather than to the individual (as is the case under s. 24(1) (e)). It is for this reason that the court must be satisfied that there is sufficient evidence from which an inference of fact can fairly be drawn that creditors generally are not being paid. This requires as a minimum some evidence that liabilities other than those incurred towards the petitioning creditor have ceased to be met. The court ought not to be asked to draw inferences with respect to the class on the basis of one creditor's experience where evidence of the debtor's conduct towards other members of the class could, with reasonable diligence, be discovered and produced. The court's intuition is no substitute for the diligence of the petitioning creditor.

[27] This question was also reviewed by the Nova Scotia Court of Appeal in *Toronto-Dominion Bank v. Langille*, (1983), 45 C.B.R. (N.S.) 49, 55 N.S.R. (2d) 629.

[28] The evidence was that all ordinary creditors were being paid with the exception of the bank. Further no part of the obligations to the bank was yet due under the banking agreement. No act of bankruptcy had therefor occurred. The petition was dismissed. The court said at paragraph 19:

> I might add that even if the bank were able to establish that some of its advances or interest accruing thereon had become due and payable as of 20th August 1980, there is some doubt whether a petition in bankruptcy was a suitable means of enforcing the bank's claim. The Bankruptcy Act is not usually available to a single creditor to assist in the resolution of a commercial dispute with the debtor. The state only steps in when acts of bankruptcy can be established which place the general body of creditors in jeopardy and require the intervention of a trustee for the orderly recovery, disposition and distribution of the bankrupt's assets for the benefit of his creditors as a whole.

[29] The first and third special circumstances do not apply to the facts of the present case.

[30] HS2 is a significant creditor. However, I do not see that there is fraud on the part of AOPL. I discuss this in the immediately following paragraphs. Furthermore nothing has been put to me to suggest the imperative need of bankruptcy proceedings to protect the creditors. Therefore the second special circumstance also does not apply. It follows that it cannot be said that AOPL has ceased to meet its liabilities generally as they become due. I conclude that HS2 has failed to prove the first alleged act of bankruptcy.

Fraud

[31] The alternative act of bankruptcy, that is the fraudulent conveyance of

property, relates to the transfer to Meraqua by AOPL of its facility at Advocate Harbour. (Paragraphs 42(1)(b), (c) and (g))

[32] Mr. Merlin in his affidavit tells the relevant history of his dealings with Mr. Cooke and his companies. I quote paragraphs 30 to 36 thereof in which he reviews his course of action after Cooke acquired HS1's assets.

> 30. I have a history of conflict with Glen Cooke and his companies. In 2004 we were engaged in a particular bitter dispute over Merlin Fish Farms Limited.
>
> 31. Given Cooke's domination of the Atlantic salmon industry, it quickly became apparent to me that there was little future for AOPL in that industry, as the only significant purchaser of smolt would be Cooke. Cooke is not disposed to deal with me or my companies, and his companies likely have an adequate supply of ova.
>
> 32. In order to put the facilities owned by AOPL to productive use in another facet of the aquaculture industry where the business could not be interfered with by Cooke, on August 17, 2005, AOPL entered into an Agreement of Purchase and Sale with Meraqua Marine Limited ("Meraqua"), another Company of which I am Principal, for the sale of the AOPL facility in Cumberland County to Meraqua. A copy of that Agreement of Purchase and Sale is attached to this my affidavit as Exhibit "J".
>
> 33. The amount set out in the Agreement of Purchase and Sale was $747,000.00.
>
> 34. Prior to the sale, AOPL obtained a Market Valuation from RHT Enterprises Limited, and a copy of that Market Valuation is attached to this my affidavit as Exhibit "K". The Appraisal showed a total value of $747,000.00.
>
> 35. As a result of the sale, Meraqua executed a Promissory Note on August 31, 2005, a copy of which is attached to this my Affidavit as Exhibit "L".

> 36. This sale was made for fair market value, and was made for the express purpose of putting the asset to use in a part of the industry not dominated by Cooke.

[33] Mr. Merlin viewed this reorganization as the appropriate response to the situation. It was clear that there was no future for him in the salmon business now that Cooke dominates it. Yet he had a facility which can be used for other aquaculture activities. It would not make sense to carry on such through AOPL with its indebtedness. One is not obliged to direct profits from new activities to pay off old debts. The prudent thing was to incorporate a new company for these new activities and transfer the facility to it at its fair market value. To assure that the creditors of AOPL were not being prejudiced, he had a professional appraisal of the facility prepared. The transfer was at the fair market value supported by this appraisal. The note was given in payment. Its terms appear reasonable in the circumstances.

This is the consideration. I see nothing wrong with its adequacy. I do not see any merit in the submission of HS2's counsel that there is no consideration.

[34] Counsel for HS2 drew attention to the right contained in the note to alter the purchase price suggesting that this could be done arbitrarily for ulterior

purposes. The agreement contains the usual terms found in most sale of assets agreements to allow for an alteration in the price to reflect what the Canada Revenue Agency might determine is the proper price. I see nothing untoward about it. Apparently the assets may be subject to security which HS2 would want to enforce. The security agreement is not before the court. Mr. Merlin was asked whether he sought permission of the security holder to make this transfer. He replied that he did not. Although it is not unusual for a security agreement to have such a requirement, there was no evidence of its existence nor the consequence of non compliance.

[35] The agreement provides that the purchase price would be abated by secured debts charged on the property. Thus it was acknowledged that a secured creditor could follow the assets. Nothing is lost in this regard. The equity in the assets was transferred, but it was replaced with a commercially reasonable note for its fair market value. A creditor would be able to execute directly on the note instead of the assets. A judgment resulting from an action on the note would be enforceable against all the assets of Meraqua. It will be suggested that the creditor is at the mercy of what Meraqua may do with the assets, let them depreciate, encumber them, dispose of them. On the other

hand the creditor would have the benefit of other unencumbered assets of Meraqua to answer to the note. There is no way of knowing for sure whether a creditor would be worse off or better off because of the transfer.

[36] The submission of HS2 is that this transfer is covered by the following acts described in Subsection 42(1):

> A debtor commits an act of bankruptcy in each of the following cases:
>
> ...
>
> (b) if in Canada or elsewhere the debtor makes a fraudulent conveyance, gift, delivery or transfer of the debtor's property or of any part of it;
>
> (c) if in Canada or elsewhere the debtor makes any transfer of the debtor's property or any part of it, or creates any charge on it, that would under this Act be void or, in the Province of Quebec, null as a fraudulent preference;
>
> ...
>
> (g) if he assigns, removes, secretes or disposes of or attempts or is about to assign, remove, secrete or dispose of any of his property with intent to defraud, defeat or delay his creditors or any of them;

[37] These require that proof be made that there was a fraudulent conveyance, a fraudulent preference, or that the transfer was with intent to defraud, defeat or delay. The fraudulent preference is not applicable because Meraqua was not a creditor.

[38] Counsel for HS2 submits that all he need do is prove that the transfer is *prima facie* fraudulent, thereby shifting the burden to AOPL to rebut the finding. He cites *Re Walsh* (1984), 53 C.B.R. (N.S.) 186 (Ont. Sup. Ct.) where the following is said in paragraph 4:

> The circumstances under which the impugned conveyance was made and the nature of the conveyance itself cast upon the debtor the onus of establishing the bona fides of the transaction.

[39] He also cites *Re Optical Recording Laboratories Inc.* (1989), 75 C.B.R. (N.S.) 216 (Ont. Sup. Ct.), where there was a sale of assets for a stated consideration. It was considered inadequate, as there was no evidence to show that the assets had depreciated to the extent indicated by the sale. This can be distinguished from the present case because the consideration was determined by a professional appraisal. However, the case further says that, if the consideration was adequate, the sale would still be fraudulent as the parties to it had a fraudulent intent. The fraudulent intent was found because the purpose of the asset sale was to protect the assets from attack from certain creditors. In the present case, there is no evidence of such intent. The transfer was not to protect assets, rather it was to make the assets available so that Mr. Merlin could make use of them in a new business, having been driven away from the Atlantic salmon industry. They remained available

indirectly to creditors.

[40] Counsel for HS2 speaks of "badges of fraud" listed in Houlden and Morawetz, Bankruptcy and Insolvency Law of Canada (3rd Ed Scarborough: Thompson Carswell, 2004) at pages 4-27. They include:

1. The financial situation of the grantor;

2. The transaction occurs between near relatives, or is made between parties not dealing at arm's length or related parties;

3. The result of the transaction is to substantially denude the grantor of all his property that would otherwise be available to his creditors;

4. The secrecy of the transaction;

5. Unusual haste in closing the transaction; and

6. The inadequacy of the consideration, or no consideration.

[41] AOPL has a peculiar financial situation. It owes substantial money, but it may have a substantial cause of action against others, including HS2. It has commenced an action for this purpose . Its other creditors are being attended to in accordance with agreed terms. The transaction is between two companies controlled by Mr. Merlin. However, his intention is clearly to use the assets in a new business having been effectively removed from the business carried on by AOPL. He is following what is standard commercial

practice.

[42] The transfer removes the assets from AOPL but replaces them with a commercially reasonable promissory note for their independently and professionally established fair market value. Considering all the possible twists which may happen and considering the risks, the creditors of AOPL may be no worse off. I see nothing in what Mr. Merlin has done to suggest any intent on his part to adversely affect them. I see nothing untoward about the notoriety of the transaction nor about the timing. The question of adequacy of consideration is addressed elsewhere.

[43] In effect I do not see that Mr. Merlin and his companies wear the badges of fraud alleged by counsel. I do not see that there has been *prima facie* proof of fraud . If there is, it has been adequately rebutted. One must always remember in the discussion of fraud that a special strictness must characterize the way it is proved.

[44] I therefore find that the alleged acts of bankruptcy based on fraud have not been proved. The Petitioner HS2 has thus failed to prove an act of

bankruptcy on the part of AOPL. This is enough to deny the petition. However, should I be wrong, let me deal with other issues raised.

Wrongful Purpose

[45] Counsel for AOPL says that the petition should be denied because it is submitted for an improper purpose.

[46] He refers to the general principle stated in Houlden & Morawetz at D§ 13

> A petition must not be filed for the purpose of obtaining some improper collateral advantage, such as putting a competitor out of business, and if it is, it will be dismissed under s.43(7).

[47] As well he refers to *Re Laserworks Computer Service Inc.* (1998), 165 N.S.R. (2d) 297 (C.A.). A competitor of the debtor who had filed a proposal under the *Act* went about buying up the debts owed by the debtor and then as a creditor with the purchased debts attended the creditors' meeting, voted against the proposal and effectively destroyed the debtor by driving it into bankruptcy.

[48] The Registrar disallowed the votes on the grounds that they were cast for an

improper purpose and were an abuse of the *Act.* The Court of Appeal held that the Registrar had properly exercised the court's discretionary jurisdiction to remedy substantial injustice.

[49] Cooke by buying the assets of HS1 and Stolt in 2005 and thereby substantially taking control of the salmon industry in Atlantic Canada was clearly in an acquisitive mode. It acquired a financial relationship with AOPL and the several other contributors to the industry who had been financed by CIBC through HS1.

[50] Cooke through HS2 is a creditor and is entitled to make use of the remedies available to creditors, assuming that it can prove its claims appropriately.

[51] This is much different from the competitor in *Laserworks*. It had no business relationship with the debtor. It was a third party who happened to be a competitor. It found creditors gladly willing to sell their debts and obtain immediate payment. In effect the competitor used the machinery of the *Act* for a personal purpose abhorrent to the purpose of the *Act.* It went far beyond anything which might now be imputed to Cooke and HS2.

[52] I therefore do not think that the submission of using the *Act* for a wrongful purpose can be substantiated.

Bona fide Dispute

[53] If I am wrong in all my reasons for dismissing the petition, there would be the question of whether there is a *bona fide* dispute between HS2 and AOPL which would justify a stay of proceedings provided by Subsection 43(10) or (11).

[54] The applicable principle is stated in Houlden and Morawetz at D§14(10)

> If a debt on which the petition is founded is disputed, and the court after hearing the evidence is satisfied that the dispute is **bona fide**, it will usually adjourn or stay the petition to permit the parties to settle the dispute in the ordinary civil courts.

[55] Mr. Merlin in his affidavit details the difficulties he has had with BKD in the smolt acquired from HS1 and the various amounts in issue. On cross examination he listed several persons associated with HS1 with whom he discussed the problem. It seems to me that this is enough to find that AOPL has a *bona fide* dispute with someone. The Statement of Claim states causes of action against HS1 and Weston Foods Inc. Without going into detail it

seems clear that it would be *bona fide* on AOPL's part to press claims against them.

[56] It has been suggested that a claim may be pursued against HS2. This would be based presumably on an argument that in taking an assignment from HS1 of the loans, it was taking them subject to the equities or with a right of set off, most likely of an equitable nature. Counsel have provided me with authorities respecting equities and set offs.

[57] The application of the relevant law on these points can be difficult. For the present purposes it is enough for me to say that there is a sufficient factual background for it to be an honest and reasonable course for AOPL to want to explore setting off possible claims against HS2.

[58] I think there is a *bona fide* dispute between HS2 and AOPL. Consequently, if I had ruled that HS2 was otherwise entitled to having its petition granted, I would nevertheless, have granted a stay of proceedings to allow them to resolve the dispute in the usual way before the civil courts.

Conclusion

[59] The petition for a receiving order against AOPL is denied.

[60] AOPL is entitled to costs for opposing the petition. If the parties cannot agree on an amount I shall hear them.

R.

Halifax, Nova Scotia
February 22, 2006