

SUPREME COURT OF NOVA SCOTIA

Citation: EBF Manufacturing Ltd. v. White, 2010 NSSC 225

Date: 20100610

Docket: Hfx No. 247580

Registry: Halifax

Between:

EBF Manufacturing Limited, Electrobraid Fence Limited
and Electrobraid Fence Inc.

Plaintiffs

and

Eric White and White Rhino Inc.

Defendants

DECISION on SET-OFF

Judge: The Honourable Justice Gerald R. P. Moir

Date of Hearing: May 31, 2010

Counsel: John Stringer, Q.C., Jane O'Neill, and Sara Mahaney, student, for the plaintiffs

Eric White acting on his own behalf

Gavin D.F. MacDonald, for BDO Canada Limited
as Trustee in Bankruptcy of Eric White

Moir, J.:

Introduction

[1] Shortly after this action was decided, but before an order was taken out, Mr. White made an assignment in bankruptcy. My decision awarded \$425,000 plus interest and costs against Mr. White for breaching an agreement under which he had given the exclusive use of a patented product to EBF in exchange for royalties. The decision included "I am prepared to declare that the judgment may be enforced...by set-off against royalties as they come due."

[2] EBF moves to lift the stay that comes automatically under the *Bankruptcy and Insolvency Act*, to settle the order, and, in particular, to verify its right of set-off. The trustee is concerned to draw to the court's attention:

- The possible effects of instruments executed by Mr. White and his spouse about the patent in 2002.
- The possibility that the question about set-off may be resolved better through the administration of Mr. White's estate.
- The need to exercise great care when allowing set-off in bankruptcy.

I am grateful to the trustee for drawing these concerns to my attention, and I thank Mr. MacDonald for presenting them with clarity and balance.

Grounds for Lifting Stay

[3] Sections 69 to 69.31 of the *Bankruptcy and Insolvency Act* provide various stays of proceedings when a person is in bankruptcy. Section 69.4 gives the bankruptcy court discretion to lift a stay when the judge is satisfied either that the person who applies to be relieved of the stay will suffer material prejudice because of it or that there are other equitable grounds for doing so.

[4] As will be seen, I am satisfied that there are very strong equitable grounds for lifting the stay.

Grounds for Equitable Set-off

[5] Legal set-off is not available on the facts of this case. Houlden & Morawetz state the principle of equitable set-off this way at Chapter F, part 237(9):

In determining whether equitable set-off should be allowed, it is necessary to first look at the connection between the claims involved and then consider the effect the set-off would have on the equities between the parties.

[6] As has been pointed out on behalf of the trustee, some authorities require a cautious approach toward allowing equitable set-off in bankruptcies. This is because equitable set-off has the effect of turning an unsecured claim into a secured one, to prefer one creditor over the general body of creditors: see *Husky Oil Operations Ltd. v. Minister of National Revenue*, [1995] S.C.J. 77 at para. 56 to 59. In that sense, equitable set-off may run counter to one of the two purposes of the bankruptcy statute: to distribute the debtor's assets equally among unsecured creditors.

[7] However, s. 97(3) of the *Bankruptcy and Insolvency Act* preserves the general law of set-off in bankruptcy. In the "limited sense" that set-off allows "a debtor of a bankrupt who is also a creditor of the bankrupt to refrain from paying the whole debt owing to the estate", a party who claims set-off has "Parliament's blessing for the 'reordering' of his priority": *Husky*, para. 62.

[8] There is an underpinning of the bankruptcy statute that is, it seems to me, as important as the dual purposes of equal distribution to general creditors and rehabilitation of the debtor. That underpinning is referred to as the principle in *Ex Parte James*, and it emphasizes the equitable nature of bankruptcy. It prevents the trustee from relying on law that would result in unfairness or injustice. There is no need to resort to *Ex Parte James* in this case, but it shows that, in preserving equitable set-off, s. 97(3) is consistent with this underpinning.

[9] So, I must consider two subjects in order to determine whether it is just to permit EBF to set-off damages owed to it for Mr. White's breach of the licence agreement against the royalties accruing each month:

- the connection between the two claims
- the effect set-off would have on the equities between the parties.

Close Connection Between Claims

[10] EBF agreed to pay the royalties to Mr. White in exchange for the exclusive use of his patent. The damages owed by Mr. White to EBF were the result of his

attempt to destroy the benefit upon which the royalties are founded. The claims are based upon the two sides of one contract. They are closely bound together.

[11] Indeed, Mr. White himself pleaded for equitable set-off of the royalties against damages.

Set-off Would Avoid Injustice

[12] I refer to my decision dated September 21, 2009 for its detailed findings. Unfortunately, the issue of the effect set-off would have on the equities between the parties requires some more general findings.

[13] Mr. Bryson invested large sums of money and much energy and time in exchange for one half of the shares in EBF Manufacturing. Then, Ms. Fried and Mr. White sold the other half to Mr. Bryson at a significant price. The value of EBF Manufacturing depends on the exclusive use of ElectroBraid, the product patented by Mr. White.

[14] For the past ten years, Mr. White has waged a campaign to deprive Mr. Bryson of the rights Mr. White and Ms. Fried sold to him. He did this in bad faith.

[15] My finding of bad faith is founded on these points, which are evidenced by the more detailed record:

- In the trial before Justice McDougall, Mr. White attempted to use failures in performance to permit him to terminate the licence agreement. Justice McDougall found them to be too minor to amount to fundamental breach.
- Even while Justice McDougall was hearing evidence and determining whether the exclusive licence remained enforceable, Mr. White secretly set up in competition. His breach of the exclusive licence agreement was kept hidden until Mr. White and his co-venturers were ready to spring their version of electrobraid on the market.
- Mr. White pocketed the royalties all the while he was setting up in competition and, until Justice MacAdam enjoined him, even while he competed in the market.
- Mr. White attempted to use minor failures by EBF in performance to destroy the licence agreement again in the trial before me.

[16] The finding of bad faith is also founded on the documents brought to my attention by the trustee. Incidentally, I am not hesitating for any right of Ms. Fried evidenced by the documents. She is welcome to come forward on her own, but she

should be prepared to explain why she is not bound by my findings through collateral estoppel.

[17] Mr. Bryson acquired half of EBF from Mr. White and Ms. Fried in 1997. Their relationship went down hill in 1999 and it dissolved in 2000. That year, White and Fried sold their half of EBF to Mr. Bryson.

[18] The documents shown to me by the trustee were generated in 2002, well after Mr. White and Ms. Fried had sold their interest in EBF, with its exclusive licence for the ElectroBraid patent, to Mr. Bryson and well before the trials of the first action before Justice McDougall in 2003 and the second action before me in 2009. Although they were highly relevant to the issues before Justice McDougall, and to those before me, the documents were kept secret.

[19] Here is what the documents show. In 2002, Mr. White and Ms. Fried signed an agreement purporting to sell "the Electrobraid Fencing Concept and patents" to a numbered company controlled by them. They obtained a valuation of their business from a qualified business values on the basis that the exclusive licence agreement did not exist. They accepted a note from their company for the

valuation amount, \$160,000, less ten dollars. Mr. White purported to assign the patent to the company.

[20] These documents show, once again, Mr. White's propensity to secrecy. This time the propensity is to the point of contempt for the *Nova Scotia Civil Procedure Rules*. These documents show, once again, that Mr. White is prepared to go to great lengths to deprive Mr. Bryson of the benefits of the exclusive licence agreement despite accepting Mr. Bryson's initial investments of labour and money, despite taking the purchase price for the other half of the shares, despite pocketing the royalties, and despite incessant demands, some justified and some not, for recalculations and payments of the royalties.

[21] The bankruptcy itself is a cause for concern, and the concern is very much connected to the theme of avoidance.

[22] The assignment was made just days after the case was decided. The documents, which had been kept secret for nine years, were then shown to the trustee.

[23] This is a single creditor bankruptcy. Total debt is \$785,001. The amount Mr. White put in his statement of affairs for the EBF debt is \$652,000. Except for what he owes to his lawyers and an unquantified debt to Revenue, the other debts are small ones owed on credit cards.

[24] There are no significant assets, unless the royalties are payable to the estate. The statement of affairs suggests that half of the royalties may be payable to the estate through the numbered company.

[25] So, without equitable set-off, the effects of the bankruptcy would be that, instead of recouping from the royalties the losses for Mr. White's breach of the exclusive licence agreement, the royalties go first to the trustee and the Superintendent, then to Revenue, and then to EBF equally with Mr. White's lawyers and credit card issuers. In my assessment, that result fits too well with Mr. White's ten year campaign to deprive Mr. Bryson of the benefits of the agreement under which he pays the royalties.

[26] Justice demands set-off. Firstly, it puts a stop to ten years of bad faith. Secondly, it upholds the contract that is the source of the royalties.

Conclusion

[27] I will grant the order prepared by Ms. O'Neill last November with necessary changes to the paragraph about who spoke for whom on the motion for the order.

The order may include \$2,500 for costs and disbursements due by the defendants to the plaintiffs on the motion and that amount may be included in the set-off. The order may also provide that the trustee recover solicitor and client costs from the estate, if the trustee wishes that such a provision be included.

J.