**SUPREME COURT OF NOVA SCOTIA**

**Citation:** Ellph.com Solutions Inc. v. Aliant Inc., 2011 NSSC 316

**Date:** 20110808
**Docket:** Hfx No. 259106
**Registry:** Halifax

**Between:**

Ellph.com Solutions Inc. and Ellph.com Technologies Incorporated — Plaintiffs

and

Aliant Inc., Aliant Telecom Inc. and Aliant Telecom Inc./ Telecommunications Aliant Inc. — Defendants

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DECISION

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**Judge:** The Honourable Justice Gerald R. P. Moir

**Heard:** June 20, 2011

**Counsel:** Alan V. Parish, Q.C. and David G. Hutt, for plaintiffs

Michael E. Dunphy, Q.C. and Michelle M. Kelly, for defendants

**Moir, J.**:

***Introduction***

[1] The defendant moves for security for costs. It proposes that the plaintiffs be required to post security in the form of personal guarantees from their shareholders.

[2] The shareholders say they are unwilling to provide the guarantees and, for this and other reasons, the plaintiffs submit it would be unfair to order security for costs.

***Facts***

[3] Aliant, through one of its predecessors, provided a service called “Software on Demand” to its internet customers. This was delivered through an application licensed from Novell Data Systems. Aliant became interested in delivering Software on Demand through a different system.

[4] Cameron Kelly and Andrew Barnes had developed a software application called "eWare" for a proposal they made to another party. Mr. Kelly, who Aliant contracted as an independent consultant, learned about Aliant's interest in switching from Novell. He saw that eWare could be adapted to deliver Software on Demand.

[5] Mr. Kelly and Mr. Barnes demonstrated eWare to Mr. Phil Harding, Mr. Sean Sears, and Mr. Chris Butt of Aliant. The Aliant representatives were interested. The five men discussed details of a business relationship and technical details. It would be necessary for Mr. Kelly and Mr. Barnes to form a company.

[6] After the meeting, Kelly and Barnes incorporated Ellph.com Solutions Inc. and conveyed eWare to it. Later, they incorporated Ellph.com Technologies Incorporated, and Ellph.com Solutions licensed it to distribute eWare to internet service providers by way of sublicences. Ellph.com Solutions was incorporated under the Nova Scotia *Companies Act*. Ellph.com Technologies is a *Canada Business Corporations Act* company.

[7] Ellph.com Solutions continued to improve eWare, and the Ellph.com companies gave Aliant opportunities to assess it. After a year of discussions, demonstrations, incorporations, further development, and assessment, Ellph.com Technologies and Aliant signed a contract. It is dated March 9, 2000 and it is titled "Sublicence Agreement".

[8] The agreement gave Aliant exclusive use of eWare in the Atlantic provinces for three years, and obligated Aliant to pay four dollars a month for each of its internet customers.

[9] Not long after the agreement was signed, Aliant asked to terminate it. Negotiations failed. Ellph.com alleges that Aliant then engaged in bad faith tactics to create apparent grounds for termination. In December of 2000, Aliant purported to terminate the agreement for deficiencies.

[10] As of 2001, the Ellph.com companies were insolvent.

[11] Aliant does not seek a conventional order for security for costs by which the plaintiffs would be required to post cash, or some other liquid security, in a fixed

amount to respond to a judgment for costs. Rather, it seeks a stay, unless Mr. Kelly and Mr. Barnes provide their personal guarantees. Aliant gave an estimate of potential party and party costs, and it suggested a limit of $1,500,000 in its written submissions. Unlimited liability was suggested in oral submissions.

[12] The shareholders of the Ellph.com companies refuse to guarantee the contingent liability for costs. They have personally financed the Ellph.com companies so the companies could pursue what the companies say is their just remedy. Mr. Kelly and Mr. Barnes do not have the assets to respond to a judgment anything near Aliant's $1,500,000 estimate. Neither want to make a promise he cannot perform.

[13] Aliant distinguishes between a promise to pay and personal liability. It argues against Kelly's and Barnes' reasons. It even suggests that they might change their minds, especially if the court imposed a substantially reduced limit.

[14] It is not for me to agree or disagree with the shareholder's reasons. I heard them cross-examined. Their position seems more reasonable than Aliant submits.

[15] I find that Mr. Kelly and Mr. Barnes decided against providing a guarantee and that it is unlikely they will change their minds. The Ellph.com companies have no other source for securing its contingent liability. So, the stay would inevitably lead to a dismissal.

***Principles of Security for Costs***

[16] Rule 45.02(1) states the grounds for ordering security for costs. It provides:

> A judge may order a party who makes a claim to put up security for the potential award of costs in favour of the party against whom the claim is made, if all of the following are established:
>
> (a) the party who makes a motion for the order has filed a notice by which the claim is defended or contested;
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> (b) the party will have undue difficulty realizing on a judgment for costs, if the claim is dismissed and costs are awarded to that party;
>
> (c) the undue difficulty does not arise only from the lack of means of the party making the claim;
>
> (d) in all the circumstances, it is unfair for the claim to continue without an order for security for costs.

[17] In light of the rebuttable presumption in Rule 45.02(3)(c), Mr. Hutt submits that the only ground in question is 45.02(1)(d), the fairness of letting the claim continue without the security.

[18] Mr. Dunphy referred me to *Emmanuel v. Sampson Enterprises Ltd.*, 2007 NSSC 278, in which Associate Chief Justice Smith summarized principles applicable under the old security for costs rule. She introduced the topic at para. 8 by saying that the court must balance two competing principles: "ensure that people of modest means are not prevented from having access to the court as a result of their financial statutes" and "the interests of justice are not served if a Plaintiff is artificially insulated from the risk of a costs award".

[19] The Associate Chief Justice, at para. 9, wrote about more detailed principles and referenced her summary to *Motun (Canada) Ltd. v. Detroit Diesel - Allison Canada East*, [1998] N.S.J. 17 (C.A.) and *Wall v. Horn Abbott Ltd.*, [1999] N.S.J. 124 (C.A.). Omitting her references, the Associate Chief Justice said:

> (1) Civil Procedure Rule 42.01 gives the Court a broad discretion whether to order security for costs. There is no automatic entitlement to security if the case falls within one of the examples set out in Civil Procedure Rule 42.01. Conversely, security can be ordered even if the case does not fall within one of the examples set out in the Rule.

> (2) Even where the Defendant is *prima facie* entitled to security, the courts are reluctant to order it if the Plaintiff establishes that the Order will, in effect, prevent the claim from going forward.
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> (3) The Court must be cautious not to turn the power to order security for costs into the imposition of a means test for access to the courts. Further, Orders for security for costs should not be used to keep persons of modest means out of court.
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> (4) Where impecuniosity is relied upon to defend against an Order for security for costs there must be more than a "blanket and empty assertion of impecuniosity." A Plaintiff who alleges impecuniosity and who suggests that an Order for security for costs will stifle the action must establish this by detailed evidence of its financial position including not only its income, assets and liabilities, but also its capacity to raise security.
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> (5) Where an Order for security for costs will prevent a Plaintiff from proceeding with its claim, the Order should only be made where the claim obviously has no merit, bearing in mind the difficulties of making that assessment at an interlocutory stage.
>
> (6) The granting of an Order for security for costs is subject to the judge being satisfied that "it is just" to make the Order in the circumstances of the case. The factors that will enter into this consideration may vary depending on the circumstances of each case.

[20] The old rule provided categories, or examples, and a catch-all. The new rule abandons that approach. It provides an analytical framework of grounds in Rule 45.02(1), a factor in Rule 45.02(2), rebuttable presumptions in Rule 45.02(3), and special grounds in Rule 45.02(4). That said, the changes require only modest modifications to the Associate Chief Justice’s statement of principles.

[21] The need remains for a balance between access to justice and artificial insolation from an award of costs. On the more detailed principles:

1. Rule 45.02 provides a broad discretion. The limit on discretion commented on by Justice Goodfellow in *Flewelling v. Scotia Island Property Ltd.,* 2009 NSSC 94 at para. 19 is not severe. The judge has a free hand to do what is just, so long as the defendant files a defence, shows undue difficulty, and either shows that security would not be unfair, see Rule 45.02(1), or establishes special grounds under Rule 45.02(4).

2. The new rule does not change the principle that the court should be reluctant to order security for costs if the plaintiff establishes that doing so will prevent the claim from going forward.

3. The principles that courts should avoid security for costs being used as a means test for access to justice and that the discretion should not be used to exclude persons of modest means from court are reinforced by the ground prescribed by Rule 45.02(1)(c).

4. The new rule does modify the principles about impecuniosity. Now, the burden is on the defendant under Rule 45.02(c) if the plaintiff is an ordinary individual rather than a nominal plaintiff or a corporation under Rule 45.02(3)(c). For nominal plaintiffs and corporations, the burden remains as stated by the Associate Chief Justice.

5. The principle about foreclosing the suit, that an order should not be made that prevents the plaintiff from proceeding unless the claim obviously has no merit, remains unchanged. Indeed, it is enhanced by Rule 45.02(1)(d).

6. The principle that the judge must be satisfied about the justice of ordering security for costs is reflected specifically in the new rule by the express requirement for fairness. The requirement for a circumstantial inquiry into fairness is expressly ("in all the circumstances") preserved.

[22] The *Companies Act* contains its own provision about security for costs: s. 152. I do not think that the discretion under that section is governed by considerations different than those under Rule 45 - Security for Costs. In any

event, the main plaintiff is Ellph.com Technologies and, as I said, it is a *CBCA* company.

***Other Generalizations About Security for Costs***

[23] To go beyond the rule, the fundamental principle of fairness, and the other principles summarized in *Emmanuel* could diminish the discretion and lead to disregard for the circumstantial assessment of fairness. That is my concern with some of the other authorities to which counsel have referred me.

[24] Mr. Dunphy refers me to authorities from the Alberta courts holding that the plaintiff's status as a closely held, impoverished corporation is a factor in favour of security for costs and that the possibilities for security should include shareholder guarantees: *Terra Energy Ltd. v. Kilborn Engineering Alberta Ltd.*, [1995] A.J. 1159 (Q.B.) and the decisions cited in it.

[25] If these authorities only say that one possible source for the security is guarantees from "the creditors or shareholders, or whoever else is pressing and might benefit from the suit" (para. 58) then I have no difficulty with them. The

question remains: Is it fair to ask for the security? However, if these authorities suggest that it is always, usually, or often fair to turn to the shareholders or creditors, I respectfully disagree.

[26] The cases seem to go beyond merely recognizing the possibility of calling for shareholder guarantees. They turn on the apparently compelling observation that the ultimate beneficiaries of success in the suit should pay the party and party costs of failure, an observation that is sometimes made in reference to nominal plaintiffs: *52868 Newfoundland and Labrador Ltd. v. Newfoundland and Labrador*, 2006 NLTD 102. The appearance disappears when we recognize that the alleged wrong was done to the company and compensation is due to the company for whatever uses it determines.

[27] It is fundamental to company law that courts recognize the personality of a corporation distinct from its members. Commerce depends on our doing so. Mr. Dunphy speaks of shell corporations. At para. 57, *Terra Energy* says of the plaintiff's sole shareholder, "He's the real plaintiff." I suppose that it may be fair to demand a shareholder guarantee in these circumstances.

[28] The Ellph.com companies are not shell corporations, except in the sense that they are shells of their former selves. They carried on a business, they held apparently valuable contracts with Aliant and between themselves, and they employed people with apparently valuable expertise.

[29] People incorporate companies for reasons. Usually it is not done just to create a shell. I do not see how it is possible to find that security for costs in the form of shareholder guarantees is fair without delving into the reasons for incorporation and details about the corporate operations.

[30] With respect, the weakness in the approach advocated for Aliant is glimpsed in the phrase "closely held private company" at para. 2 of *Sylvester Import & Export Enterprises Ltd. v. Re/Max Real Estate Ltd.*, [1993] A.J. 91 (C.A.) as quoted from in para. 58 of *Terra Energy*. Why distinguish between impoverished, closely held, private companies and impoverished, widely distributed, public companies? In my view, a tendency to treat closely held corporations as partnerships, or sole proprietorships, should be avoided. Otherwise, the policies underlying distinct legal status for corporations are ignored.

[31] There appears to be some controversy in Ontario about whether an impoverished corporate plaintiff can be ordered to post security for costs on the premise of guarantees from shareholders. See the discussion, and the other authorities referred to in, *Printing Circles Inc. v. Compass Group Canada Ltd.*, [2007] O.J. 2682 (S.C.J.). The weight seems to be with the view that security can be ordered on such a premise, but I do not read any of the Ontario authorities to suggest a predisposition to do so.

[32] Evidence about an impoverished corporate plaintiff's capacity, or incapacity, to raise security from shareholders, or other interested parties, is relevant on a motion for security for costs: the fourth point in *Emmanuel*. However, the court still has to consider all of the circumstances to determine whether ordering the security is just: *Emmanuel*, sixth point.

[33] Mr. Parish and Mr. Hutt refer me to authorities about delay in making a motion for security for costs including Judge Sullivan's decision in *Re MacNeil*, [1977] N.S.J. 645 (Co. Ct.).

[34] It seems to me that timing is relevant to the fairness of ordering security for costs in two ways. First, a defendant may be at fault for a long delay and be less deserving of a remedy. Second, the timing may prejudice a plaintiff. Master Graham puts the prejudice plainly in *Pelz v. Anderson,* [2006] O.J. 4726 (S.C.J., Master) at para. 23: "having to post security for costs after having incurred considerable expense in advancing the lawsuit".

[35] Again we see in some decisions a tendency to make rules out of mere relevancies. Respectfully, *Pelz* does that. I think it is more faithful to the broad discretion and to the need for a circumstantial assessment of fairness to say that delay by the defendant is relevant, and prejudice to the plaintiff is relevant, and leave it at that.

[36] I have been treated to much argument about delay. The case is set for trial, the possibility of a motion for security for costs was only communicated by Aliant to the Ellph.com companies during the date setting process, and the action has been outstanding for six years. On the other hand, Aliant says it only learned of the plaintiffs' impoverishment at discoveries and there was no serious delay afterwards. I accept Aliant's position.

[37] It remains a relevant fact that, with financing from their shareholders, the plaintiff companies invested large amounts without considering the possibility of having to raise security to cover the contingent liability for party and party costs.

[38] Mr. Parish and Mr. Hutt have directed me to authorities holding that an impoverished plaintiff should not be ordered to put up security for costs when the subject of the plaintiff's claim is the cause of its impoverishment. See, *1149426 Ontario Ltd. v. Forgione*, [2005] O.J. 2483 (S.C.J., Master) and the decisions to which it refers.

[39] This is a relevant consideration because of the principles about access to justice in point three of *Emmanuel* and the need to access fairness in all the circumstances.

[40] With the lessons in relevancy provided by these authorities in mind and the summaries in *Emmanuel* in mind, let us decide the question required to be answered by Rule 45.02(1)(d).

***Is it Unfair for the Case to Continue Without Security for Costs?***

[41] The case is about a business relationship protected by law. It is about a contract. For me, that fact colours the assessment of fairness.

[42] The fairness of security for costs in cases of alleged breach of contract involves a unique consideration. In that field, the parties define their legal obligations, often in great detail. In that field, the court usually cannot alter, or add to, the agreed terms. When a procedural discretion available in all cases is invoked in a contracts case, the judge should be mindful of fundamental policies sometimes summed up in the phrases “freedom of contract” and “sanctity of contract”. That is to say, we should be cautious about exercising the discretion for a result that is inconsistent with the rights and obligations the parties freely set for themselves.

[43] Likely, when Aliant retained Mr. Kelly as a consultant it contracted personally with him. He was providing a professional and technical service. Likely, he was on the hook to provide services carefully. Also, a consulting contract lends itself to individual/corporate relationships. Sometimes business

relationships involve complexities that make incorporation advisable, sometimes even necessary.

[44] Aliant chose to contract for eWare solely with Ellph.com Technologies Inc.

[45] Aliant did not obtain, maybe it did not even seek to obtain, guarantees of Ellph.com's performance under the contract. Indeed, it did not even obtain security from the actual owner of eWare. It contracted with a licencee whose purpose was to insulate the owner from the internet provider. It contracted with Ellph.com Technologies Inc. without obtaining the liability of Mr. Kelly, Mr. Barnes, or Ellph.com Solutions.

[46] I mean no criticism of Aliant. I mean to correctly characterize the nature of the relationship between the parties.

[47] It was a relationship in which a large corporation was to pay a small, new company for technology. Security from the small, new company was not called for. If it failed to perform, Aliant only needed to stop paying and to settle accounts by agreement or in court. Indeed, it seeks to do just that by counterclaim.

[48] The circumstances of Ellph.com Technologies known to Aliant when the contract was negotiated, the terms the parties contracted for, and the obligations they did not contract for are such that Aliant could never have had a reasonable expectation of recovery against shareholders of Ellph.com for liabilities of Ellph.com Technologies. In this contracts case, that is a strong reason for not ordering security for costs on the premise that Ellph.com must raise the security from its shareholders.

[49] There would be a further injustice in ordering the Ellph.com companies to post security for costs. They had two apparently valuable assets: the technology of eWare and the sublicencing agreement with Aliant. The suit is about Aliant's termination of one of those assets. There is also evidence that Ellph.com could not market eWare after the termination.

[50] The termination is a cause, perhaps the cause, of Ellph.com's poverty. The issue in Ellph.com's suit is whether Aliant wrongfully caused that poverty. Aliant concedes that Ellph.com's position has merit, in the sense that summary judgment is not available.

[51] If the security requested by Aliant is granted, Mr. Kelly and Mr. Barnes will not post it. Aliant will have escaped responsibility for the termination on account of the very thing it did.

[52] There would be yet a further serious injustice. Alaint is a large company that dominates telecommunications in the Maritimes. It has tremendous resources with which to defend this suit.

[53] Ellph.com was a small company when it operated. Now it is insolvent and out of operation. It depends on its shareholders, and perhaps its counsel, to finance the suit.

[54] Aliant intends to make full use of its financial resources. It plans to spend so much, according to its submissions, as would justify a staggering award of party and party costs. The shareholders are ordinary people of ordinary means. In all the circumstances, it would be unjust to add to their burden of financing Ellph.com a further burden of responsibility for the contingent liability.

***Conclusion***

[55] It would not “in all of the circumstances” be “unfair for the claim to continue without an order for security for costs”, as Rule 45.02(1)(d) requires. Indeed, it would be unjust to order Ellph.com to post security to cover its contingent liability for Aliant’s costs.

[56] I will grant an order dismissing the motion. The hearing took a half day, but the affidavits were extensive. I am inclined to the view that a just and appropriate award of costs would be $2,000 plus disbursements payable by Aliant to Ellph.com when the order is issued.

J.