SUPREME COURT OF NOVA SCOTIA
Citation: Scanwood Canada Ltd. (Re), 2011 NSSC 468

Date: 20111220
Docket: Hfx. No. 342377
Registry: Halifax

IN THE MATTER OF: The *Bankruptcy and insolvency Act*, R.S.C. 1985, c. B-3, as amended

AND IN THE MATTER OF: The *Judicature Act*, R.S.N.S. 1989, c. 240

AND IN THE MATTER OF: Scanwood Canada Limited (in Receivership)

D E C I S I O N

Judge: The Honourable Justice Suzanne M. Hood

Heard: October 31, 2011 in Halifax, Nova Scotia

Written Decision: December 20, 2011

Counsel: **Stephen Kingston, Q.C. and John Stringer, Q.C.** for Green Hunt Wedlake
Brian W. Stilwell and **Brett Harison** for IKEA Supply AG
James MacNeil and **Tracy Smith (AC)** for Royal Bank of Canada

By the Court:

[1] Scanwood Canada Limited ("Scanwood") was placed into receivership by order dated April 18, 2011. IKEA Supply AG ("IKEA") seeks to have monies returned to it from the Receiver on the basis that it has a valid right to set off any amounts it owed to Scanwood against any amounts owed by Scanwood to IKEA or any of its affiliates.

ISSUES

1. Was privilege waived with respect to a letter from Thomas O. Boyne, Q.C. to the Royal Bank of Canada? ("RBC")?

2. Does IKEA have a valid right of setoff against monies paid by IKEA into Scanwood's bank account on April 18, 2011?

3. Does IKEA have a valid right of setoff against monies paid by IKEA to the Receiver on June 24, 2011?

4. Are the above amounts subject to priority charges granted by prior court orders?

5. If any monies are to be repaid to IKEA, what interest should be paid?

FACTS

[2] Scanwood was granted creditor protection pursuant to the *Companies' Creditors Arrangement Act,* R.S.C. 1985, c. C-36, by court order of February 4, 2011. That order, in paragraph 32, provided for an administration charge as follows:

> 32. **THAT** the Monitor, counsel to the Monitor, if any, and the Applicant's counsel, shall be entitled to the benefit and are hereby granted a charge (the 'Administration Charge') on the Property, which charge shall not exceed an aggregate amount of $400,000.00 as security for their professional fees and disbursements incurred at the standard rates and charges of the Monitor and such counsel, both before and after the making of this Order, in respect of these proceedings. The Administration Charge shall have the priority set ut in Paragraphs 34 and 36 hereof.

'Property' is defined in para. 4 of the Initial Order as (in the relevant part):

> 4. **THAT** THE Applicant shall remain in possession and control of its current and future assets, undertakings and properties of every nature and kind whatsoever, and wherever situated including all proceeds, improvements and replacements thereof including, without limitation, all of its equipment, accounts receivable, inventory or the proceeds thereof ('Property'). ...

[3] Paragraph 36 of the Initial Order gave priority to the administration charge as follows:

> 36. **THAT** each of the Directors' Charge and the Administration Charge (all as constituted and defined herein) shall constitute a charge on the Property and such Charges shall rank in priority to all other security interests, trusts, liens, charges and encumbrances, statutory or otherwise (collectively referred to as the 'Encumbrances') in favour of any Person.

[4] By order dated February 25, 2011, Scanwood was granted Debtor-In-Possession (DIP) financing. That order, in para. 12, gave the DIP lender a first priority charge as follows:

> 12. Except as expressly stated in paragraph 22 herein, the DIP Lender is hereby granted a first priority charge, mortgage and security interest in all present and after-acquired real and personal property of the Company ('Property'), as security (referred to in this Order as the 'DIP Charge') for repayment of all amounts advanced or owing pursuant to the DIP Commitment Letter, the DIP Credit Documentation and this Order (or any of them) together with all interest, fees, expenses, charges and other amount payable in respect thereof (collectively, the 'DIP Liabilities').

[5] The DIP Order also provided in paragraph 14:

> 14. The DIP Security and the DIP Charge, when executed, shall immediately attach to all present and after-acquired Property of the Company with respect to all advances made and to be made under the DIP Facility.

[6] Paragraph 22 of the DIP Order states:

> 22. Advances made under the DIP Facility shall be made to the Company as required for the operations of the Company, as determined by the Monitor and approved by the DIP Lender. The DIP Charge resulting from any such advance has priority over all other mortgages, charges, security interests, liens and encumbrances of any kind or nature (collectively, the 'Encumbrances' and individually, an 'Encumbrance') in or against any and all of the Property of the Company, subject to: (i) the Administration Charge created by the Initial Order; (ii) applicable prior statutory liens, and (iii) the security to be taken by the Province of Nova Scotia, Economic and Rural Development and Tourism as described in paragraph 24 hereof.

[7] Paragraph 29 provides:

> 29. The beneficiaries of the DIP Charge may, but shall not be required to file, register, record or perfect the DIP Charge, notice thereof or any financing statement with respect thereto an the DIP Charge shall be valid and enforceable for all purposes against all existing and after acquired property for any purpose with priority over any right, title or interest filed, registered, recorded or perfected prior or subsequent to the DIP Charge coming into existence despite any failure to file, register, record or perfect the DIP Charge, notice thereof, or any financing statement with respect thereto. Despite anything in this Order, the beneficiaries of the DIP Charge may take such steps as they deem necessary or appropriate to register, record or perfect the DIP Charge, notice thereof or any financing statement with respect thereto, if they deem it advisable to do so.

[8] Subsequently, on April 18, 2011, Green Hunt Wedlake Inc. was appointed Receiver of Scanwood. The Receivership Order provided for certain charges to rank in priority to the claims of creditors. Paragraph 17 provided for a "Receiver's Charge" as follows:

> 17. Any expenditure or liability which shall properly be made or incurred by the Receiver, including the fees of the Receiver and the fees and disbursements of its legal counsel, incurred at the standard rates and charges of the Receiver and its counsel, shall be allowed to it in passing its accounts and shall, subject to outstanding amounts owed to TCE Capital Corporation pursuant to the DIP Financing Order, and any Administration Charge and Directors' Charge amounts outstanding as of April 18, 2011, form a first charge on the Property in priority to all security interests, liens, charges and encumbrances, statutory or otherwise, in favour of any Person, to the extend permitted by law (the 'Receiver's Charge').

[9] Property is defined in para. 2 of the Receivership Order as:

> 2. Green Hunt Wedlake Inc. is hereby appointed Receiver, without security, of all of the present and future assets, undertakings and properties of every nature and kind whatsoever, including without limitation any shares in any corporation and wherever situate and including all proceeds thereof (the 'Property') of Scanwood.

[10] In addition, the Receivership Order in para. 20 provided for a "Receiver's Borrowings Charge":

> 20. The Receiver be at liberty and it is hereby empowered to borrow by way of a revolving credit or otherwise, such monies from time to time as it may consider necessary or desirable, provided that the outstanding principal amount does not exceed $250,000 (or such greater amount as this Court may by further Order authorize) at any time, at such rate or rates of interest as it deems advisable for such period or periods of time as it may arrange, for the purpose of funding the exercise of the powers and duties conferred upon the Receiver by this Order, including interim expenditures. The whole of the Property shall be and is hereby charged by way of a fixed and specific charge (the 'Receiver's Borrowings Charge') as security for the payment of

> the monies borrowed, together with interest and charges thereon, in priority to all security interests, trusts, liens, charges and encumbrances, statutory or otherwise, in favour of any Person, but subordinate in priority to the Receiver's Charge.

The Receiver's borrowing was increased to $750,000 by court order on June 29, 2011.

[11] In an oral ruling on April 18, 2011, I directed that any party having set-off claims against money otherwise owed to Scanwood pay the amount in question to the Receiver to be held pending this decision.

[12] On April 18, 2011, IKEA deposited to Scanwood's bank account at RBC, by wire transfer, the sum of $606,934.40. On May 17, 2011, the Royal Bank of Canada paid $533,113.12 to the Receiver, being the balance in the Scanwood bank account at the Royal Bank of Canada as of the effective date of the Receivership Order.

[13] After IKEA made the wire transfer on April 18, certain transactions occurred in the Scanwood bank account in the normal course of operating the bank account. These are referred to at Exhibit 5 of the Seventh Report of the Receiver and include

such things as payroll. Accordingly, on May 17, 2011, $533,113.12 was the balance. IKEA does not take issue with that amount and reduces its set-off claim accordingly. Subsequently, on June 24, 2011, IKEA paid $695,942.19 directly to the Receiver to be held pending the result of this decision.

IKEA and Scanwood Agreements

[14] IKEA had many agreements with Scanwood. One of these which is relevant to the set-off issue is the Purchase Agreement dated December 14, 2009 which included as an exhibit an Agreement on Sales and Purchase Volumes. Periodically, IKEA and Scanwood revised their agreement. Two such revisions were made on January 21, 2011 and March 28, 2011. Each of these agreements incorporates by reference IKEA's General Purchasing Conditions which provides in clause 11.3:

> 11.3 IKEA may set-off any amount payable to Seller under any agreement between IKEA or any affiliate of IKEA and Seller, where a default or breach has occurred on behalf of Seller.

[15] Affiliated companies provided components to Scanwood. These included IKEA Components AG and IKEA Components s.r.o. ("ICOMP"). ICOMP and

Scanwood had a sales agreement dated October 23, 2009. The General Sales Conditions which are an appendix to that agreement provide in Clause 9.2:

> 9.2 Seller may set-off any amount due by Seller or any affiliate of Seller to Buyer under any agreement between Seller or any affiliate of Seller and Buyer.

[16] ICOMP and Scanwood also entered into a Netting Agreement dated April 14, 2010. It provided as follows:

> The parties hereby irrevocably agree that IKEA Trading and Design AG, or any other company within the IKEA Group of Companies, may at any time deduct and offset, from any invoice payable by such company to Scanwood Canada Ltd an amount equivalent to any amount payable at any time by Scanwood Canada Ltd to IKEA Components AB, Almhult, and/or IKEA Components s.r.o., Malacky, and to forward such amount to IKEA Components AB and/or IKEA Components s.r.o. as valid payment under any invoice.

[17] On August 27, 2009, IKEA and Scanwood executed a Loan Agreement whereby IKEA loaned 2.9 million dollars to Scanwood. Scanwood was to begin to repay the loan on March 24, 2011 by making monthly payments of $125,800. Scanwood defaulted on the loan by commencing CCAA proceedings and by failing to make the March 24, 2011 payment. Pursuant to para. 10.1 (i) of the Loan Agreement, the entire loan balance then became due and owing. The Loan Agreement also provided as follows:

> 5.2 The repayment as stipulated above including any interest accrued hereunder may, at IKEA's sole discretion, be executed by deductions from invoices issued by Borrower to IKEA, or any other company within the IKEA group of companies, for deliveries of goods ordered in accordance with any agreement for purchase of goods, IKEA shall issue debit notes for any such deductions made by IKEA or any other company within the IKEA group of companies.
>
> 5.5 Borrower hereby unconditionally and irrevocably grants to IKEA a right to set-off its claims against claims due, or which at any time may become due, which Borrower might have toward IKEA or any company within the IKEA group of companies.

[18] IKEA says that $3,088,084.41 (including interest) was due and owing on the loan as of August 31, 2011.

Analysis

Privilege Issue

[19] IKEA received from Scanwood a letter sent to it by RBC which was an opinion letter from RBC's counsel, Thomas O. Boyne, Q.C. IKEA says that this letter, as well as other material, shows that all parties accepted the validity of IKEA's set-off claims. RBC says that the letter to it from its counsel is privileged solicitor/client communication for which it has not waived privilege with respect to

IKEA. The letter is attached to an email to Ross Backman, Manager, Special Loans and Advisory Services for RBC. The email from Mr. Backman to Mr. Steve MacFarlane, Scanwood President, simply says "refer attached."

[20] In his Affidavit sworn on October 21, 2011, Ross Backman says in paras. 15,16 and 17:

> 15. On May 18, 2010, I received a letter via e-mail attachment from my counsel, Mr. Thomas O. Boyne, which is subject to a claim privilege.
>
> 16. On May 18, 2010, I forwarded the letter received from Mr. Boyne, of same date, via e-mail to Mr. Steve MacFarlane, at Scanwood.
>
> 17. I provided Mr. MacFarlane the letter from Mr. Boyne for the sole purpose of assisting Scanwood in negotiating a resolution with IKEA and did not intend to waive privilege over the letter sent to me by my counsel on May 18, 2010.

[21] It is clear that the letter from Thomas O. Boyne, Q.C. to RBC was subject to solicitor/client privilege. No one says otherwise. The question is whether the solicitor/client privilege was waived by RBC with respect to IKEA.

[22] In Nova Scotia *(Department of Transportation and Infrastructure Renewal) v. Peach*, 2011 NSCA 27, Oland, J.A. dealt with the issue of waiver of

solicitor/client privilege. At para. 10, she referred to the Chambers Judge having cited *S & K Procurers Ltd. v. Campbell Ave. Herring Producers Ltd.*, [1983] B.C.J. No. 1499 (S.C.). The chambers judge quoted McLachlin, J. (as she then was) at para. 6:

> **6** Waiver of privilege is ordinarily established where it is shown that the possessor of the privilege (1) knows of the existence of the privilege, and (2) voluntarily evinces an intention to waive that privilege. However, waiver may also occur in the absence of an intention to waive, where fairness and consistency so require.

[23] The chambers judge concluded that the government official "evinced an intention to waive solicitor/client privilege." (para. 33 of the *Peach* decision).

[24] In *Philip Services Corporation (Receiver of) v. Ontario (Securities Commission)*, [2005] O.J. No. 4418 (Divisional Court), privileged information had been provided to one person who then disclosed it to a third party. In para. 92, the Court said:

> **92** In summary, I conclude that all of the Disputed Documents were prima facie privileged; that the provision of copies to Deloitte in its capacity as auditor did not waive the privilege for all purposes, but only to the extent necessary to enable Deloitte to carry out its audit functions; that delivery by Deloitte to Staff of those documents received from Philip was unauthorized and incapable of defeating the privilege; that Staff has not established any implied waiver by Philip . . .

[25] Although factually a very different matter from this, the Divisional Court concluded that waiver of privilege to one does not mean that it was waived with respect to all.

[26] I must consider whether, when Mr. Backman provided the privileged opinion to Scanwood, he had the intent to disclose it to IKEA. It is not at all clear from the email between Mr. Backman and Mr. MacFarlane that Mr. Backman intended to waive privilege. All he said to Mr. MacFarlane was "refer attached." He did not say "Tell IKEA this" or "Send this to IKEA." Mr. Backman says in his affidavit that he was attempting to help Scanwood to negotiate with IKEA. In my view, something more would be needed before RBC can be said to have waived privilege with respect to IKEA.

[27] The Court can imply intent in some circumstances. I conclude there is not enough evidence here upon which I could imply intent to waive privilege. I do not agree that by saying nothing Mr. Backman intended to waive privilege beyond providing the letter to Scanwood.

[28] Is it necessary in the interests of "fairness and consistency" to waive privilege in this case? I conclude it is not. The comment of Thomas O. Boyne, Q.C. in the letter on the subject of set-off is brief and is given in the context of why IKEA's agreements "do not work from the Bank's perspective." Mr. Boyne did not comment otherwise on the validity of the set-off.

[29] Throughout the course of the CCAA proceeding, reference has been made on a number of occasions to IKEA's claim of set-off. At no time did any party agree that it was a valid right.

[30] In my view, it does not have an adverse effect on the issue in this proceeding. The Court is to make its own finding with respect to the validity of the set-off claim.

Set-off in Receiverships

[31] IKEA claims set-off against all the funds paid to the Receiver which originated from it.

[32] *In Associated Investors of Canada Ltd. (Re)*, 1989 Can LII 3199 (Alta. Q.B.), Berger, J. at para. 2 cited Halsbury's Laws of England, 4th ed. (1983) and then set out the legal principles he concluded guided the application of set-off in a receivership as follows:

> 1. There must be a 'mutuality of debts'. This would mean that at the point an investment contract holder claims the right of set-off, the corporation against whom he is claiming the right must owe him a debt, and he, in turn, must owe that corporation a debt. If one of the debts is actually owed to a third party, there is not mutuality of debts and set-off cannot apply:
>
> 2. With respect to set-off, the same principles apply to a court-appointed receiver as a receiver under a debenture instrument. The principles that are applicable are those that relate to the right of set-off against an equitable assignee:
>
> 3. If the relationship between the parties is such that a right of set-off exists prior to the order appointing the receiver, the receiver takes subject to the pre-existing right. Thus set-off definitely applies to liquidated crossclaims existing at the date of the order:
>
> 4. A debtor can set off a debt which accrues due before the date of receivership, but is not payable until after:
>
> 5. If a debt is not due or has not accrued due at the time of the receivership order, set-off at law will generally not be permitted:
>
> 6. For debts to be set off, both debts must be enforceable by action at he time when set-off is set up:

> 7. A debtor is entitled to set off debts against obligations accruing due after the receivership order if those obligations arise as a consequence of a receiver and manager honouring contracts entered into before the order was granted:
>
> 8. Equitable set-off applies to cross-claims that accrue due even after the receiving order; however, equitable set-off will only apply to a claim that is directly connected to the contract giving rise to the debt or closely related to it: (all citations omitted)

He then said in paragraph 4:

> [4] Three types of set-off apply: contractual, legal and equitable.

[33] There are two separate sums at issue in this matter: 1) $533,113.12 which was remaining in Scanwood's bank account from $606,934.40 wired transferred into that account from IKEA on April 18 and which was paid by RBC to the Receiver on May 17, 2011; and 2) $695,942.19 paid by IKEA directly to the Receiver on June 24, 2011. Separate issues arise with respect to each.

[34] IKEA claims it has a valid right of set-off against the amounts held by the Receiver. It says its right of set-off arises in each of three ways: legal, equitable and contractual.

[35] A valid right of set-off can continue during CCAA protection proceedings. Section 21 of the CCAA provides:

> **21.** The law of set-off or compensation applies to all claims made against a debtor company and to all actions instituted by it for the recovery of debts due to the company in the same manner and to the same extent as if the company were plaintiff or defendant, as the case may be.

[36] This provision was considered in *Canadian Airlines Corp*., 2001 ABQB 146. Paperny, J. said in para. 6:

> [6] The Alberta Court of Appeal recently considered this section in **Blue Range Resource Corp. (Re)**, 2000 ABCA 200 and confirmed that notwithstanding the application of the section may have the result of preferring one creditor over others, Parliament, by enacting s. 18.1, made the decision that the general law of set-off is to apply in CCAA proceedings.

IKEA Payment to Scanwood - April 18, 2011

[37] RBC and the Receiver say that the payment IKEA made by wire transfer into Scanwood's bank account on April 11, 2011 was paid in the ordinary course of business during the time when Scanwood had CCAA protection.

[38] It was not paid directly by IKEA to the Receiver as occurred with respect to the June 24th payment. It was not paid subject to any conditions. Once in Scanwood's bank account, part was used to pay Scanwood's ordinary business expenses, leaving a balance at the end of that day of $533,113.12.

[39] In my view, it became Scanwood property when placed in the Scanwood bank account on April 18.

[40] RBC also says the payment was made before the receivership occurred. The parties were in court on April 18. On that date, Scanwood was seeking an order extending CCAA protection. The previous order was due to expire on April 18.

[41] When the extension was not granted, Business Development Corporation of Canada brought a motion to put Scanwood into receivership. That motion was granted. It took effect when the CCAA protection ended at midnight on April 18. The receivership therefore took effect as of 12:01 a.m. on April 19.

[42] Since the receivership did not take effect until April 19, the payment made by IKEA on April 18 was not a payment made pursuant to the Receivership Order.

It was not a payment made to the Receiver. The remaining balance was paid to the Receiver by RBC on May 17, 2011.

[43] Article 5.5 of the IKEA Scanwood Loan Agreement refers only to setting off IKEA's claims against "claims due" to Scanwood. If the Loan Agreement set-off provision applies, it applies only to claims due to Scanwood. Once the payment was made by IKEA on April 18, it was no longer a claim due to Scanwood but one that had been paid.

[44] For all these reasons, I conclude that IKEA has no right of set-off with respect to the sum of $533,113.12 held by the Receiver.

$695,942.19 paid by IKEA to the Receiver on June 24, 2011

[45] It is clear that a valid set-off can apply during a receivership. Section 97(3) of the *Bankruptcy and Insolvency Act* provides:

> **97.** (3) The law of set-off or compensation applies to all claims made against the estate of the bankrupt and also to all actions instituted by the trustee for the recovery of debts due to the bankrupt in the same manner and to the same extent as if the bankrupt were plaintiff or defendant, as the case may be, except in so far

> as any claim for set-off or compensation is affected by the provisions of this Act respecting frauds or fraudulent preferences.

[46] IKEA says that, although it owes Scanwood $695,942,19, that amount is to be off-set against the outstanding balance on Scanwood's loan from IKEA. It refers to the set-off agreement provision in the Loan Agreement. If this is a valid set-off provision, it affects the entire $695,942.19 held by the Receiver since IKEA is owed more than $3 million on its loan to Scanwood.

[47] I will deal first with the claim for set-off under the Loan Agreement and the issue of contractual set-off.

[48] RBC says the set-off provision in the Loan Agreement does not affect the $695,942.19 account receivable of Scanwood.

[49] In *Parsons v. The Soverign Bank of Canada*, [1913] A.C. 160 (P.C.), Viscount Haldane, L.C. concluded at p. 171 that there could be a set-off for damages suffered by various suppliers of the debtor company against the claims of the Receiver for product delivered to it. He concluded the contracts at issue were entered into prior to the appointment of the Receivers.

[50] In *Re McMurtry & Co. Limited*, [1924] O.J. No. 176, (Ont. S.C. in Bankruptcy), the debtor and the claimant had entered into an agreement:

> 4 ... by which the claimants were to furnish advertising and printing to the debtor-company, and the amount owing from time to time was to be paid for by furnishing the individual members of the firm with goods equivalent in price to the amounts owing.

[51] The trustee in bankruptcy refused to honour the agreement and the claimant appealed. Fisher, J. said in paras. 7, 8 and 9:

> **7** ... The claim of the debtor-company against the claimants vested, with the other assets of the debtor-company, in the trustee, but subject to the terms of the agreement.
>
> **8.** The doctrine of mutual dealings and right of set-off did not apply, as there was a bona fide agreement between the parties as to how they should deal, and the debtor-company's estate was bound by its terms. There was no suggestion that the claimants had notice of any available act of bankruptcy when goods were supplied and credits given. The set-off agreed to was equivalent to payment, and no more than the balance could be claimed on either side.
>
> **9** It would be highly inequitable to permit the trustee to intervene and contend that, as the dealings were not mutual, there was no right of set-off.

[52] In ***Law of Set-Off in Canada***, [Canada Law Book Inc., Aurora, Ontario, 1993], the author comments on contractual set-off at p. 263 as follows:

> Contractual set-off is, not surprisingly, more a matter of contract law than a separate application of set-off. consequently, the normal rules of set-off regarding mutuality, liquid debts and connected debts do not apply: within the bounds of legality and public policy, parties are free to contract whatever result they wish. Accordingly, agreements to set-off which would, aside from the agreement, not be granted relief due to the absence of the requirements of set-off, will be upheld.

The text continues at p. 264:

> Once an agreement to set-off has been reached, it has a great deal of staying power under Canadian law. Such agreements will survive the passage into receivership, bankruptcy and winding up ...

The author cites *Re McMurtry*, *supra*, for this proposition.

[53] The question then is whether a contractual set-off has been established.

[54] RBC says it has not for several reasons. It says the wording of the Loan Agreement, properly interpreted, does not permit IKEA to set off the loan payments against Scanwood's accounts receivable. It says it is not a commercially reasonable interpretation to place on the Loan Agreement. It also says IKEA had notice of RBC's security interest.

Contractual Interpretation

[55] In *Consolidated Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co.*, [1979] S.C.J. No. 133, Justice Estey said:

> ... the normal rules of construction lead a court to search for an interpretation which, from the whole of the contract, would appear to promote or advance the true intent of the parties at the time of entry into the contract. Consequently, literal meaning should not be applied where to do so would bring about an unrealistic result or a result which would not be contemplated in the commercial atmosphere in which the insurance was contracted. Where words may bear two constructions, the more reasonable one, that which produces a fair result, must certainly be taken as the interpretation which would promote the intention of the parties. Similarly, an interpretation which defeats the intentions of the parties and their objective in entering into the commercial transaction in the first place should be discarded in favour of an interpretation of the policy which promotes a sensible commercial result.

[56] With respect to set-off provisions, Rothstein, J. in *Caisse populaire Desjardins de l'Est de Drummond v. Canada*, [2009] SCC 29 said in para 22:

> 22 ... Both a contract providing for a right of compensation in Quebec and a contract providing for a right of set-off in common law provinces are to be interpreted by a court in a manner that gives effect to the intentions of the parties are reflected in the words of the contract.

[57] In *Canada (Attorney General) v. Reliance Insurance Co.*, [2008] O.J. No. 795 (S.C.J. Commercial List), Pepall, J. interpreted several re-insurance treaties.

The set-off claims in the relevant agreements are set out in para. 5. They use the words “under this Agreement” and “under this Agreement or any other contract previously, now or later in force.” The question for the court was whether all four treaties permitted set-off.

[58] Pepall, J. concluded set-off was permitted under two treaties and not permitted under two others. The latter simply referred to “this agreement” and Pepall, J. said at para. 14:

> **14** ... set-off is for amounts due under these treaties. That is what the agreements expressly state . . . As such, Swiss Re may not offset funds due by it to Reliance Canada against amounts due to it by Reliance outside of these treaties. ...

[59] With respect to the two treaties which had broader wording, she said at para. 15:

> **15** ... There is nothing that limits the set-off rights to amounts due to Swiss Re under these two treaties. Amounts due under any other contact between Reliance and Swiss Re are subject to offset. While the origin of one amount must be the contract, that of the offsetting amount need not be.

[60] RBC says the wording of the Loan Agreement is similar to that of the two treaties where set-off was allowed only for amounts due under each treaty but not for amounts owed "outside of these treaties."

[61] IKEA, on the other hand, says its contracts and, specifically, the Loan Agreement, use broad language. The wording of the Loan Agreement is "claims due . . . which [Scanwood] might have toward IKEA or any company within the IKEA group of companies" (clause 5.5).

[62] RBC says to give effect to IKEA's argument that it has a valid right of set-off would be to interpret the contracts in a commercially unreasonable way.

[63] In *Lauren International, Inc. v. Reichert*, 2008 ONCA 382, MacPherson, J.A., writing for the Court, said in para. 16:

> **16** The core principles for interpreting a commercial contract are well-known. They were recently summarized in this court by *Blair J.A. in Ventas, Inc. v. Sunrise Senior Living Real Estate Investment Trust* (2007), 85 O.R. (3d) 254 at para. 24:
>
> > Broadly stated ... a commercial contract is to be interpreted,

> (a) as a whole, in a manner that gives meaning to all of its terms and avoids an interpretation that would render one or more of its terms ineffective;
>
> (b) by determining the intention of the parties in accordance with the language they have used in the written document and based upon the 'cardinal presumption' that they have intended what they have said;
>
> (c) with regard to objective evidence of the factual matrix underlying the negotiation of the contract, but without reference t the subjective intention of the parties; and (to the extent there is any ambiguity in the contract),
>
> (d) in a fashion that accords with sound commercial principles and good business sense, and that avoid a commercial absurdity.

[64] RBC focuses on the last of the four principles. It says it is not commercially reasonable that the Loan Agreement would be tied to the other agreements such that there would be a set-off of accounts receivable against loan payments.

[65] In *Inex Pharmaceuticals Corp. (Re)*, 2006 BCSC 244 (In Bankruptcy and Insolvency), Satanove, J., at para. 8, said:

> [8] Inex submits that clause 6(g) must be read in the context of the Notes as a whole to give it a commercially viable interpretation. The only reasonable interpretation of 6(g) is that it applies to insolvency situations, not the internal restructuring of Inex. If it were otherwise, clauses 4(a) (iii) and clause 10(a) of the Notes would be rendered meaningless.

[66] In para. 9, she quoted the passage I have quoted above from *Consolidated Bathurst*. She also referred to Côté's An Introduction to the Law of Contracts (Edmonton: Juriliber, 1974) and said the author "stresses the importance of perusing the contract as a whole." (para. 10) She then reviewed the wording of the contract and concluded in para. 18:

> 18 ... Thus all three clauses can live in harmony and promote a commercially reasonable result. In my opinion, this is the preferable interpretation and I find that clause 6(g) applies to insolvency situations only.

[67] The only claims Scanwood could have due against any IKEA company would be claims for payment for the supply of goods to IKEA (or possibly a claim against the ICOMP suppliers for such things as components returned because of defect.)

[68] IKEA is not a lender. Its only relationship with Scanwood was as the buyer of finished product produced by Scanwood. Its affiliated companies' only relationship with Scanwood was as suppliers of the components used in making the product to be sold to IKEA.

[69] Deverani Isemeyer says in her Affidavit of September 29, 2011 at para. 35:

> 35. ISAG entered the ISAG Loan Agreement to support Scanwood's continued operations and plant modernization strategy.

[70] Scanwood supplied dressers to IKEA for resale in its stores. According to Ms. Isemeyer, in 2009 Scanwood needed money to continue to operate and to modernize its plant. IKEA loaned money to Scanwood for these purposes. No one has suggested otherwise.

[71] RBC argues that it was unnecessary for IKEA to have a set-off provision in the Loan Agreement because the Loan Agreement gave IKEA security. IKEA says it is not unusual for there to be a number of provisions which ensure that a loan is repaid.

[72] RBC points out that the other IKEA agreements (including agreements with ICOMP) all post-dated the Loan Agreement and do not refer to it. IKEA says the wording of those subsequent agreements is broad enough to include the Loan Agreement. I agree.

[73] The wording which is quoted above is, in my view, similar to the wording of the treaties which Pepall, J. said allowed for set-off. The words used are "any

agreement between IKEA or any affiliate of IKEA and Seller [Scanwood]" (clause 11.3 of IKEA General Purchasing Conditions). The ICOMP Agreement in clause 9.2 refers to "any agreement between Seller [Scanwood] or any affiliate of Seller or Buyer."

[74] The Netting Agreement provides for set-off:

> IKEA Trading and Design AG [now ISAG], or any other company within the IKEA Group of Companies. ...

It also refers to "any amounts payable at any time by Scanwood ..."

[75] These provisions are, I conclude, broad enough to include set-off with respect to the Loan Agreement even though it is not specifically mentioned.

[76] RBC also says that, if IKEA believed the Loan Agreement gave it a valid right of set-off against Scanwood's accounts receivable, it questions why IKEA did not assert that right as soon as the defaults occurred. The first default was seeking CCAA protection in February 2011 and the second was failing to make the first required loan payment in March 2011.

[77] For whatever reason, IKEA did not assert its right of set-off at that time. I cannot, however, conclude that by its forbearance in not claiming set-off when it made the April 18, 2011 payment, IKEA gave up its right to do so. In fact, the record is clear that IKEA, from its earliest appearance on this matter, referred to its right of set-off and specifically did so in the court hearing on April 18.

[78] RBC says the Loan Agreement, properly interpreted in a commercially reasonable way, does not give IKEA a right of set-off.

[79] IKEA was Scanwood's only customer. IKEA is not in the business of commercial lending. Any monies Scanwood would receive would be paid by IKEA for Scanwood's production of dressers. How was Scanwood going to repay the loan? By making dressers and selling them to IKEA. What does the Loan Agreement provide? It provides that IKEA could set-off against the payments to Scanwood for the dressers (Scanwood's only revenue source) the claims IKEA had against Scanwood arising from the loan.

[80] In my view, it is commercially reasonable that IKEA and Scanwood would agree to put a set-off provision in the Loan Agreement. Scanwood could only have been able to pay off the loan from revenue paid to it by IKEA.

[81] I cannot conclude there can be any other interpretation of that clause in the Loan Agreement. Scanwood could have argued that the agreement should be interpreted *contra proferentem* against IKEA. However, it is clear from *Eli Lilly & Co. v. Novopharm Ltd.*, [1998] Can LII 791, [1998] 2 S.C.R. 129, that a third party like RBC cannot use the doctrine in this case. The court said in para. 53:

> 53 ... Indeed, a third party has no basis at all upon which to rely upon *contra proferentem*. . ...

[82] I therefore conclude that IKEA has a valid contractual right of set-off arising from the Loan Agreement.

Personal Property Security Act

[83] RBC says sections 42 and 48 of the *Personal Property Security Act* ("PPSA") S.N.S. 1995-96, c. 13 apply. They provide:

42 (1) In this section,

(a) account debtor' means a person who is obligated under an intangible or chattel paper;

(b) 'assignee' includes a secured party and a receiver.

(2) Unless the account debtor on an intangible or chattel paper has made an enforceable agreement not to assert defenses or claims arising ut of a contract, the rights of an assignee of the intangible or chattel paper are subject to

(a) the terms of the contract between the account debtor and the assignor and any defense or claim arising from the contract or a closely connected contract; and

(b) any other defense or claim of the account debtor against the assignor that accrues before the account debtor acquires knowledge of the assignment.

48 Registration of a financing statement in the Registry by itself does not constitute notice or knowledge to any person of the existence or contents of the financing statement or of the existence of the security interest or the contents of any security agreement to which the registration relates.

[84] RBC says IKEA had knowledge of RBC's interest in the accounts receivable of Scanwood because of the correspondence of May 20, 2010 (Tab 0 of the Isemeyer Affidavit of Septembr 29, 2011. Accordingly, it says that IKEA's claim

or defence of set-off can only apply to accounts accrued prior to IKEA having knowledge of RBC's interest.

[85] Firstly, I have concluded that the set-off provision in the Loan Agreement gives a valid claim of set-off of the outstanding loan balance against the $695,942.19 account receivable. That Loan Agreement pre-dates the date on which RBC says IKEA had knowledge of its interest. Therefore, this argument cannot succeed.

[86] IKEA says the May 20 e-mail does not refer to an "assignment" but only says "... the Bank has Trade Receivables ... ." Furthermore, the document IKEA received was not given to it by RBC but was referred to in an email to IKEA from Steve MacFarlane of Scanwood.

[87] I therefore conclude that the May 20 email does not constitute notice to or knowledge by IKEA.

[88] RBC had a general security agreement with Scanwood dated August 21, 2000. It is Exhibit "A" to the Ross Backman Affidavit. RBC agrees that s. 42 of

the PPSA makes RBC's interest in Scanwood's account receivable subject to any valid contractual set-off provision. RBC subsequently offered "Credit Facilities" to Scanwood, the last of which is dated March 26, 2009 (Tab "F", Ross Backman Affidavit). It provides, in part, under the heading of "security":

> SECURITY
>
> Security for the Borrowings and all other obligations of the Borrower to te Bank (collectively, the 'Security'), shall include:
>
> a) General security agreement on the Bank's form 924 signed by the Borrower constituting a first ranking security interest in all personal property of the Borrower;
>
> (b) General Assignment of Book Debts;
>
> . . .

[89] No Assignment of Book Debts was in evidence. IKEA therefore says its right of set-off under the Loan Agreement takes priority. In the absence of evidence of the existence of an Assignment of Book Debts, I agree with IKEA.

[90] I have concluded there is a valid contractual right of set-off contained in the Loan Agreement. The amount due as a result of default under that agreement

exceeds the amount IKEA is claiming from the Receiver. For that reason, I do not need to consider the set-off provisions in the other agreements. For the same reason, I do not need to consider the issues of legal or equitable set-off.

Priority Charges

[91] These charges apply to the property of Scanwood held by the Receiver. Since I have concluded that IKEA has no right of set-off against the sum of $533,113.12, it is the property of Scanwood in Receivership. Therefore, priority charges apply to it.

[92] With respect to $695,942.19 held by the Receiver, IKEA says, because it has a valid right of set-off, it never was the property of Scanwood. I agree.

[93] Scanwood owed IKEA in excess of that amount. Applying its right of set-off against that amount, IKEA would not, in the normal course, have paid Scanwood's account receivable. Money would not have flowed to Scanwood and the Receiver can be in no better position. The Receiver holds Scanwood's interest in its account

receivable and Scanwood would have received nothing from IKEA in payment of that account receivable.

[94] In *Associated Investors*, *supra*, Berger, J. set out the principles with respect to set-off in a receivership (quoted above). I repeat part of the third principle:

> 3. If the relationship between the parties is such that a right of set-off exists prior to the order appointing the receiver, the receiver takes subject to the pre-existing right.

[95] In this case, the Receiver takes subject to the set-off, receiving the net amount. Because the set-off amount exceeds what is due, the Receiver receives nothing. Priority charges can attach only to the amount to which the Receiver is entitled.

Interest

[96] Originally, IKEA claimed interest on the money in the Receiver's hands pursuant to CPR 70.07. It agreed at the hearing to claim only the interest the

Receiver had actually earned while funds were held by him. I so order with respect to $695,942.19.

COSTS

[97] There has been mixed success. I therefore conclude that IKEA and RBC should each bear their own costs.

Hood, J.