Court File No. CV-13-10370-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN THE MATTER OF THE BANKRUPTCY OF SHS SERVICES MANAGEMENT INC./GESTION DES SERVICES SHS INC AND SHS SERVICES LIMITED PARTNERSHIP

IN THE MATTER OF AN APPLICATION PURSUANT TO SECTION 243 OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, c. B-3, AS AMENDED

BOOK OF AUTHORITIES OF PAUL VERHOEFF AND STEPHEN VERHOEFF

Paliare Roland Rosenberg Rothstein LLP
155 Wellington Street West
35th Floor
Toronto, ON M5V 3H1

Massimo Starnino (LSUC No. 41048G)
Tel: 416.646.7431
Fax: 416.646.4301

Email: max.starnino@paliareroland.com

Lawyers for Paul Verhoeff and
Stephen Verhoeff

TO: SERVICE LIST ATTACHED

Last updated: August 12, 2014

ELECTRONIC SERVICE LIST

TO: **PRICEWATERHOUSECOOPERS INC.**
18 York Street, Suite 2600, PwC Tower
Toronto, ON M5J 0B2

Mica Arlette
Tel: 416.814.5834
Email: mica.arlette@ca.pwc.com

Tracey Weaver
Tel: 416.814.5735
Email: tracey.weaver@ca.pwc.com

Receiver of SHS Services Management Inc. and SHS Management Limited Partnership

AND TO: **McMILLAN LLP**
181 Bay Street, Suite 4400, Brookfield Place
Toronto, ON M5J 2T3

Wael Rostom
Tel: 416.865.7790
Email: wael.rostom@mcmillan.ca
LSUC# 43165S

Brett Harrison
Tel: 416.865.7932
Email: brett.harrison@mcmillan.ca
LSUC# 44336A

Stephen Eddy
Tel: 416.865.7226
Email: stephen.eddy@mcmillan.ca
LSUC# 62703F

Lawyers for the Receiver of SHS Services Management Inc. and SHS Management Limited Partnership

AND TO: **TORYS LLP**
Suite 3000, 79 Wellington Street West, TD Centre
Toronto, ON M5K 1N2

Attention: Scott Bomhof
Tel: 416.865.7370
Fax: 416.865.7380
Email: sbomhof@torys.com

Attention: Adam M. Slavens
Tel: 416.865.7333
Fax: 416.865.7380
Email: aslavens@torys.com

Lawyers for Sears Canada Inc.

AND TO: **FIELD LLP**
400 – 604 1 Street SW
Calgary, AB T2P 1M7

Attention: Douglas S. Nishimura
Tel: 403 260-8548
Email: dnishimura@fieldlaw.com

Lawyers for Alaris Income Growth Fund Partnership

AND TO: **BLANEY MCMURTRY LLP**
2 Queen Street East, Suite 1500
Toronto, Canada M5C 3G5

Attention: Lou Brzezinski
Tel: 416.593.2952
Email: lbrzezinski@blaney.com

AND TO: **SOTOS LLP**
180 Dundas Street West, Suite 1200
Toronto, ON M5G 1Z8

Attention: David Sterns
Tel: (416) 977-5229
Email: dsterns@sotosllp.com

Lawyers for Installation Services Org. Ltd., Paul Verhoeff and Stephen Verhoeff

AND TO: **DENTONS CANADA LLP**
77 King Street West, Suite 400
Toronto, ON M5K 0A1

Attention: John Salmas
Tel: (416) 863-4737
Fax: (416) 863-4592
Email: john.salmas@dentons.com

Lawyers for Hunter Douglas Canada Inc.

AND TO: **RDM LAWYERS LLP**
33695 South Fraser Way
Abbotsford, BC V2S 2C1

Attention: Les Armistead
Tel: (604) 855-5233
Fax: (604) 852-3829
Email: les.armitstead@rdmlawyers.com

Lawyers for Cedar Grove Building Products Ltd.

AND TO: **KATRICH HOLDINGS LTD. and 6343 47880 RDJ HOLDINGS LTD.**
P.O. Box 44148
Bedford, NS B4A 3X5

Attention: Richard Jardine
Tel: (902) 835-8079
Email: richard.jardine@eastlink.ca

AND TO: **DAOUST VUKOVICH LLP**
20 Queen Street West, Suite 3000
Toronto, ON M5H 3R3

Attention: Kenneth Pimentel
Tel: (416) 597-9306
Fax: (416) 597-8897
Email: kpimentel@dv-law.com

Attention: Gasper Galati
Tel: (416) 598-7050
Fax: (416) 597-8897
Email: ggalati@dv-law.com

Lawyers for Canadian Property Holdings (Alberta) Inc.

AND TO: **DUECK, SAUER, JUTZI & NOLL LLP**
403 Albert Street

Waterloo, ON N2L 3V2

Attention: Thomas Jutzi
Tel: (519) 884-2620
Fax: (519) 884-0254
Email: tomj@dsjnlaw.com

Lawyers for Reitzel Insulation Company Limited

AND TO: **CAW – CANADA LEGAL DEPARTMENT**
205 Placer Court
Toronto, ON M2H 3H9

Attention: Barry Wadsworth LSUC#: 42985H
Tel: (416) 495-3776
Fax: (416) 495-3786
Email: barry.wadsworth@unifor.org

Lawyers for Unifor Local 40

AND TO: **ROCKYVIEW ROOFING INC.**
112 Rockyledge Crescent
Calgary, AB T3G 5N1

Attention: Justin Tremblay
Email: info@rockyviewroofing.ca

AND TO: **MERCHANT LAW GROUP**
Suite 303-15127100 Ave
Surrey, BC V3R ON9

Attention: Victor Olsen
Email: volson@merchantlaw.com

Lawyers for Maria Lisa Code

AND TO: **COMMISSION DES NORMES DU TRAVAIL**
500, boulevard René-Lévesque Ouest, 26^{e} étage
Montréal (Québec) H2Z 2A5

Attention: Pascal Francoeur
Email: pascal.francoeur@cnt.gouv.qc.ca

AND TO: **G.N. JOHNSTON EQUIPMENT CO. LTD.**
5990 Avebury Road
Mississauga, ON L5R 3R2

Tel: (800) 668-5459 x 52281 or (90) 712-6006 x 52281

Attention: Yvon Touchette C.C.P.
Email: yvon.touchette@johnstonequipment.com

AND TO: **DE LAGE LANDEN FINANCIAL SERVICES CANADA INC.**
3450 Superior Court, Unit 1
Oakville, ON L6L 0C4

Tel: (905) 901-6534 or 1-855-732-2818

Attention: Faseeh Ahmad
Email: fahmad@leasedirect.com

AND TO: **SUN LIFE ASSURANCE COMPANY OF CANADA REPRESENTED BY ITS AUTHORIZED AGENT BENTALL KENNEDY (CANADA) LIMITED PARTNERSHIP (BY ITS GENERAL PARTNER), BENTALL KENNEDY (CANADA) G.P. LTD.**
6700 chemin Cote-de-Liesse, Suite 103
Saint-Laurent QC H4T 2B5

Tel: (514) 744-8544

Attention: Mireille Savard, Property Administrator
Email: msacard@bentallkennedy.com

AND TO: **CGI INFORMATION SYSTEMS AND MANAGEMENT CONSULTANTS INC.**
1350 Rene-Levesque Blvd. West, Floor 15
Montreal, Quebec H3G 1T4

Tel: (514) 415 - 3614

Attention: William Misiurak
Email: WilliamV.Misiurak@cgi.com

AND TO: **NORTHGATE PROPERTIES INC. C/O FENGATE PROPERTY MANAGEMENT LTD.**
3425 Harvester Road, Suite 105
Burlington, ON L7N 3N1

Tel: (289) 288-3822 x4325

Attention: Suzi Halfpenny, Property Manager
Email: suzi.halfpenny@fengate.com

AND TO: **ROYCOM 7 LIMITED PARTNERSHIP**
Compass Commercial Realty Ltd., Suite 110
3770 Kempt Road #110 Halifax, NS B3K 4X8

Tel: (902) 442-5510

Attention: Kendal Carter, Property Manager (Compass)
Email: kcarter@compassbroker.com

AND TO: **FRASMET HOLDINGS LIMITED**
16 Esna Park Drive, Suite 200
Markham ON L3R 5X1

Tel: (905) 513-2565

Attention: Elaine Rabang-Corpuz, Property Manager
Email: erabang-corpuz@parkprop.com

AND TO: **FUTUREMED GENERAL PARTNER INC.**
7000 Cardinal Place
Dublin, OH 43017

Tel: (614) 757-5000

Attention: Shelley Vincent
Email: Shelley.Vincent@cardinalhealth.ca

AND TO: **2281896 ONTARIO INC.**
1103 Wentworth Street West, Unit 1
Oshawa, ON L1J 8P7

Tel: (905) 725-5666 or (905) 432-0478

Attention: Harold Wotten, Landlord
Email: haroldwotten@bellnet.ca

AND TO: **PINNACLE INTERNATIONAL REALTY GROUP II INC.**
911 Homer Street, Unit 300
Vancouver, B.C. V6B 2W6

Tel: (604) 602-7747

Attention: Stasha Wasak, Property Management
Email: swasak@pinnacleinternational.ca

AND TO: **ICR COMMERICAL REAL ESTATE**
374 Albert St.
Regina SK S4R 2N7
c/o Dave Johnson Construction Ltd.
305 -12th Avenue
Regina, SK S4N 5T7

Tel: (306) 721-6118

Attention: David Kevill, ICR Director of Property Management
Email: David.Kevill@ICRCommercial.com

AND TO: **4063937 CANADA INC. c/o THE MOFFAT GROUP OF COMPANIES**
237 Argyle Avenue
Ottawa, ON K2P 1B8

Attention: Steve Moffat, Property Manager
Tel: (613)- 749 - 8000
Email: richard.jardine@eastlink.ca

AND TO: **CANADIAN PROPERTY HOLDINGS (ALBERTA) INC. c/o REIT MANAGEMENT LP**
140-4th Avenue SW, Suite 210
Calgary, AB T2P 3N3

Attention: Carla Fedele, Leasing Director
Tel: (403) 268-9203
Email: cfedele@creit.ca

AND TO: **TERRACON DEVELOPMENT LTD.**
1 Terracon Place
Winnipeg, MB R2J 4B3

Attention: Michael Falk, Leasing Administrator
Tel: (204) 233-4330
Email: mfalk@terracon.com

AND TO: **DAVIS AVIS MACEWEN LLP**
Ste. 201-156 Morison Avenue
P.O. Box 1600
Parksville, BC V9P 2H5

Attention: William Andrew MacEwen and Mary E. Nee Nee
Tel: (250) 248-5731
Email: will@davis-avis.com; mary@davis-avis.com

Lawyers for Roofco Roofing Corp. and Todd Bullock

AND TO: **DENTONS LLP**
77 King Street West, Suite 400
Toronto, ON M5K 0A1

Attention: Blake Moran
Tel: (416) 863-4495
Fax: (416) 863-4592
Email: blake.moran@dentons.com

Lawyers for International Comfort Products (ICP)

AND TO: **DEPARTMENT OF JUSTICE**
The Exchange Tower
130 King Street West
Suite 3400
Toronto, ON M5X 1K6

Attention: Diane Winters
Tel: (416) 973-3172
E-mail: diane.winters@justice.gc.ca

Lawyers for the Canada Revenue Agency

AND TO: **MINISTRY OF FINANCE LEGAL SERVICES BRANCH**
Michael Starr Building
6th Floor, 33 King Street West
Oshawa, ON L1H 8H5

Attention: Kevin O'Hara
Tel: (905) 433-6934
Email: kevin.ohara@ontario.ca

AND TO: **BORDEN LADNER GERVAIS LLP**
Scotia Plaza, 40 King St W
Toronto, ON M5H 3Y4

Attention: Derek Powers
Tel: (416) 367-6636
Fax: (416) 361-7353
Email: dpowers@blg.com

Lawyers for Reliance Comfort Limited Partnership

AND TO: **HER MAJESTY THE QUEEN IN RIGHT OF THE PROVINCE OF MANITOBA**
Manitoba Justice
Civil Legal Services
730 – 405 Broadway
Winnipeg, MN R3C 3L6

Attention: Brian Jones
Tel: 204-945-1409
Email: brian.jones@gov.mb.ca

AND TO: **HER MAJESTY THE QUEEN IN RIGHT OF THE PROVINCE OF ALBERTA AS REPRESENTED BY THE MINISTER OF FINANCE**
The Tax and Revenue Administration
9811 – 109th Street
Edmonton, AB T5K 2L5

Tel: 780-427-3044
Fax: 780-427-0348
Email: tra.revenue@gov.ab.ca

AND TO: **ALBERTA TREASURY BOARD AND FINANCE**
Oxbridge Place
Room 534, 9820 – 106 Street
Edmonton, AB T5K 2J6

Attention: Mary K. Brook
Tel: 780-422-7720
Email: mary-kay.brook@gov.ab.ca

Attention: Peter Thagard
Tel: 780-644-5259
Email: peter.thagard@gov.ab.ca

AND TO: **HER MAJESTY THE QUEEN IN RIGHT OF THE PROVINCE OF BRITISH COLUMBIA**
David J. Hatter
Ministry of the Attorney General, Legal Services Branch
PO Box 9290, Station Prov Govt
Victoria, BC V8W 9J7

Tel: 250-387-1274
Fax: 250-387-0700
Email: david.hatter@gov.bc.ca

AND TO: **CHAITONS LLP**
5000 Yonge Street - 10th Floor
Toronto, ON M2N 7E9

Attention: Philip Taylor
Tel: (416) 218-1125
Email: philip@chaitons.com

Lawyers for Century Services Inc.

AND TO: **WILDEBOER DELLELCE LLP**
Wildeboer Dellelce Place
Suite 800, 365 Bay Street
Toronto, ON M5H 2V1

Attention: Alfred Apps
Tel: (416) 361-6211
Fax: (416) 361-1790
Email: aapps@wildlaw.ca

Lawyers for ARCOR Windows & Doors Inc. and N.A.P. Windows & Doors Ltd.

AND TO: **MALO, PILLEY, LEHMAN LAWYERS**
3250 Bloor Street West
Suite 600, East Tower
Toronto, ON M8Z 2Z9

Attention: Brian P. Pilley
Tel: (416) 534-7543
Fax: (416) 534-7625
Email: brian.pilley@mpllaw.ca

Lawyers for Spar Roofing & Metal Supplies Limited

AND TO: **WILSON VUKELICH LLP**
60 Columbia Way, Suite 710
Markham, ON L3R 0C9

Attention: Douglas D. Langley LSUC#: 16909Q
Tel: (905) 940-8711 (ext. 2232)
Fax: (905) 940-8785
Email: brian.pilley@mpllaw.ca

Lawyers for 1233682 Ontario Inc., 1447000 Ontario Ltd., 1812731Ontario Inc., 1847135 Ontario Inc., 2177059 Ontario Inc., 3543978 Ontario Inc.,484081 BC Ltd., 70999 Alberta Ltd., 777911 Alberta Ltd., 977218 Ontario Inc., The Roaders

Holdings Co. Ltd., Stewarts Cleaning Service Inc., Gestion Cristofaro Ltee

AND TO: **PRÉVOST FORTIN D'AOUST**
Lawyers
3080, boul. Le Garrefour
Bureau 530
Laval, Québec H7T 2R5

Attention: Me Martin Laurendeau
Tel: (450) 681-2511
Fax: (450) 681-3342
Email: m.laurendeau@pfdadvocats.com

Lawyers for Hydrosolution, LP

AND TO: **WEIR FOULDS LLP**
66 Wellington Street West, Suite 4100
P.O. Box 35, Toronto-Dominion Centre
Toronto, ON M5K 1B7

Attention: Graham Brown
Tel: (416) 947-5073
Email: gbrown@weirfoulds.com

Lawyers for Beacon Roofing Supply Canada Company

AND TO: ***SHS – LIEN CLAIMANTS***

entreprisesblevesque@hotmail.com

toituresoleil@hotmail.com

climatisationsthubert@hotmail.com

cinannihvac@gmail.com

info@toituresalainforget.ca

marlenapac@shaw.ca

premierhandc@hotmail.com

big_top_tents@yahoo.com

info@confortlafrance.ca

neville@caruanainteriors.ca

simontoit@hotmail.com

installation.michelboivin@gmail.com

ace@aceplumbing.ca

rivercitiroofing@yahoo.ca

steve.bordt@apexgranite.com

aquarius.gen@accesscomm.ca

aspectroofing@ymail.com

lisa@affordableroofing.ca

lisa@affordableroofing.ca

bill.maclean@hotmali.com

thorsten@cgrs.ca

stevendgilroy@gmail.com

climatisationap@hotmail.com

rschuerbeke@convoy-supply.com

rschuerbeke@convoy-supply.com

DPondhomeinstallations@gmail.com

donatoelectricltd@gmail.com

bmelliott@sympatico.ca

bmelliott@sympatico.ca

emrangastech@hotmail.com

ericamostoiture@hotmail.com

ericamostoiture@hotmail.com

contact@four12roofing.com

mike.gentry@shaw.ca

mike.gentry@shaw.ca

dayne.lyn@gmail.com

canamcarpets@shaw.ca

sergeboisjoli@me.com

jdworks@shaw.ca

jetccinc@vianet.ca

jetstream@bell.net

kimrussell60@gmail.com

lenbrennan@rogers.com

info@renovationsrainbow.com

france@toituresdaniel.com

france@toituresdaniel.com

avocate@genevieveraymond.ca

toituresoleil@hotmail.com

lou-lcc-ltd@outlook.com

lessard2504@videotron.ca

mediesbourg@gmail.com

mmgentilin@hotmail.com

m.e.steinfort@xplornet.ca

mchdighasemi52@yahoo.com

warnock.alex@gmail.com

nikaroofing@gmail.com

middlebenchmechanical@gmail.com

pa.broadloom@gmail.com

randy@4trough.com

stokes@ovalsquare.com

prestigeinstallations@telus.net

sales@qualityhvac.net

rcthermopompe@videotron.ca

raisanenroofing@gmail.com

mardale1@telus.net

raymurphy@videotron.ca

Jimd@regionaldoors.com

junsharper@hotmail.com

rshubick@shaw.ca

macs.removal@hotmail.com

rightwaymech@live.ca

bloodworth@hotmail.com

dcook@rousseleavestrough.com

royalflush.ash@gmail.com

srobinsonmechanical@ns.aliantzinc.ca

beaulacn@videotron.ca

tapisrichard@hotmail.com

info@toiture640.com

totalblindcare@sympatico.ca

tbouchard@quickcontractors.com

cloutiermaintenance@hotmail.com

Aireservofkingston@gmail,com

abocking@repairware.ca

hamid@arianaheating.ca

lstpierre@gplegal.com

c.bouvrette@videotron.ca

jmelliott@sympatico.ca

claudine@nuancedesign.ca or jeanfrancois@nuancedesign.ca

simplyheatingottawa@gmail.com

thermosolutions@hotmail.com

x-services@live.ca

searscleaningbelleville@gmail.com

totalhomecomfort@bellnet.ca

jason@rousseleavestrough.com

2170291ont.inc@gmail.com

francoditrolio@gmail.com or jodyditrolio@gmail.com

deracehart@aol.com

air.legrand@videotron.ca

toiturefrv@hotmail.ca

xfinityroofing@gmail.com

adaminstallation@gmail.com

a_agarwal@aluminart.com

leo@theatticexperts.com

bregnier@becn.com

bdtrink@sourcecable.net

brucehomecomfort@sympatico.ca

inhomecleaning@shaw.ca

normdrabble@hotmail.com

pete-sharon.trudeau@sympatico.ca

classicdoors@rogers.com

classicsiding@eastlink.ca

desceltes@gmail.com

cuisinesummum@videotron.ca

derrick@dcookeheating-cooling.com

rafatiro@yahoo.ca

daveandrosanne@shaw.ca

dgmacisaac@hotmail.com

Dri@shaw.ca

sales@doordesign.ca

RoofingEasy@yahoo.com

edaninstallation@gmail.com

info@encoremechanical.ca

entreprisesplassonde@gmail.com

steeproofing@hotmail.com

steeproofing@hotmail.com

j.marengere99@videotron.ca

george@gibsoninstallation.com

heather@qualityexteriors.ca

cjhood@live.com

alain.la@videotron.ca

precisioninstallation@videotron.ca

installationsma@hotmail.com

jj_roofing@hotmail.com

kevin.benson@sympatico.ca

kuldip1973@hotmail.com

pwboutet@sympatico.ca

bluemountltd@hotmail.com

serious.43@hotmail.com

a_agarwal@aluminart.com

ohellwig@telus.net

lou@reitzel.ca or bolger19@rogers.com

rgs.refrigeration@gmail.com

kaysinstall@bell.net

william@roofingfx.ca

wood_chuck@shaw.ca

dleblond@live.ca

vanzellaj@hotmail,com

brian.pilley@mpllaw.ca

rushfan231@gmail.com

benoit@toitures24.ca

lestoituresjoel@hotmail.com

whiteblackninja@hotmail.com

albert@toprankroofing.ca

triltd@rogers.com

csterling@shaw.ca

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CITATION: Royal Bank of Canada v. Atlas Block Co. Limited, 2014 ONSC 1531
COURT FILE NO.: CV-13-10201-00CL
DATE: 20140310

SUPERIOR COURT OF JUSTICE – ONTARIO

COMMERCIAL LIST

RE: Royal Bank of Canada, Applicant

AND:

Atlas Block Co. Limited, Atlas Block (Brockville) Ltd. and 1035162 Ontario o/a Atlas Block Trucking, Respondents

BEFORE: D. M. Brown J.

COUNSEL: S. Babe, for the Applicant, Royal Bank of Canada

R. Fisher, for the Business Development Bank of Canada

S. Friedman, for the Receiver, KPMG Inc.

HEARD: February 13, 2014

REASONS FOR DECISION

I. Receiver's motion to allocate sales proceeds and its costs between two secured creditors

[1] By order made October 4, 2013, KPMG Inc. was appointed receiver of all of the assets and undertakings of Atlas Block Co. Limited, Atlas Block (Brockville) Ltd. and 1035162 Ontario Inc. o/a Atlas Block Trucking (the "Debtors"). Pursuant to orders of this Court the Receiver has sold most of the Debtors' assets. The Receiver moved for the approval of the distribution of the net sales proceeds from certain of the Debtors' assets between the two main secured creditors, the Royal Bank of Canada and the Business Development Bank of Canada, as well as the approval of its allocation of fees and costs as between RBC and BDC.

II. Background

[2] The Debtors manufactured a range of brick and concrete building and landscaping products for sale to industrial and commercial construction contractors. The head office of Atlas Block was located in Midland, Ontario, at what was called the Victoria Harbour Plant. Atlas operated manufacturing facilities at (i) the Victoria Harbour Plant, (ii) the Hillsdale Plant, and (iii) the Brockville Plant.

[3] The Hillsdale Plant was the major asset of Atlas Block. Its construction and equipping was financed with $17.5 million in loans from BDC, $4.8 million from the Ontario government, and $2.2 million in equipment financing from RBC.

[4] RBC and BDC provided other financing to Atlas Block.

[5] Production at the Brockville Plant ceased about two weeks prior to the appointment of the Receiver. The Receiver continued production at the Hillsdale and Victoria Habour Plants for a short period of time until the end of November, 2013.

[6] As a result of a sales and marketing process, the Receiver entered into two asset purchase agreements to sell the equipment, inventory and real estate of Atlas Block to Brampton Brick Limited ("BBL"). Those agreements received court approval on December 20, 2013. In my endorsement approving the BBL sale I wrote, in part:

> This motion is not opposed, however BDC reserves its rights with respect to distribution and my order is made subject to that reservation...

[7] The sales to BBL were completed on January 6, 2014, however they did not include the sale of the real property at the Victoria Harbour Plant. On January 14, 2014, BBL informed the Receiver it that it would not be acquiring the real property at Victoria Harbour.

III. The BBL Asset Purchase Agreement

[8] Under the November 29, 2013 Asset Purchase Agreement (the "Atlas Block APA") BBL purchased the following land and equipment:

(i) Hillsdale: (a) the Hillsdale Real Property, (b) certain molds and forklift equipment; (c) manufacturing equipment; and (d) inventory;

(ii) Victoria Harbour: (a) office furniture and equipment; (b) certain manufacturing equipment; and, (c) inventory; and,

(iii) The interest of Atlas Block in RBC Equipment Leases, which included some leased equipment at the Hillsdale Plant, as well as at the Brockville Plant.

[9] Section 2.7 of the Atlas Block stated that the purchase price would be allocated amongst the purchased assets as set forth on Schedule "K" to the APA, in part, as follows:

Asset	Allocated Amount
Hillsdale Real Property	$1,000,000
RBC Equipment Leases	$2,611,539

Hillsdale and Victoria Harbour Equipment	$7,638,458

[10] In the Atlas APA BBL agreed to assume the obligations under the RBC Equipment Leases and the allocated $2.61 million represented the remaining obligations due under those leases.

[11] Under the December 12, 2013 Asset Purchase Agreement (the "Brockville APA"), BBL agreed to purchase from the Receiver (i) the Brockville Real Property, (ii) the Brockville Equipment, (iii) the Brockville office furniture and equipment, and (iv) the Brockville Inventory. The purchase price of $600,000 was allocated pursuant to section 2.6 of the Brockville APA amongst the purchased assets, in part, as follows:

Asset	Allocated Amount
Brockville Real Property	$100,000
Brockville Equipment and office equipment	$100,000
Brockville Inventory	$400,00

IV. The Receiver's proposed distribution of the sales proceeds

A. The Receiver's proposal

[12] In its Third Report dated January 31, 2014 the Receiver stated that under the two APAs BBL had allocated about $8.2 million of the purchase price to assets subject to the security held by BDC. It continued:

> The Receiver has no basis on which to consider the allocation by BBL to be unreasonable and therefore has used the BBL allocation set out in the Purchase and Sale Agreements as the basis for determining the proceeds to be paid to BDC and RBC.

Observing that it had incurred certain costs and fees on behalf of BDC during the Receivership, the Receiver proposed to deduct those costs from the Gross BDC Proceeds to arrive at a net figure payable to BDC. Appendix "O" to the Third Report set out the Receiver's calculations. Based on those calculations, the Receiver proposed to distribute to BDC proceeds of $7.7 million.

[13] The Receiver reported that the majority of the remaining funds in its receivership accounts related to proceeds from RBC's security. The Receiver proposed to make a distribution to RBC of $3.46 million.

[14] RBC supported the distribution proposed by the Receiver.

B. BDC's position

[15] BDC objected to the Receiver's proposed distribution on the grounds set out in the February 5, 2014 affidavit of Lori Matson, Director, BDC Business Restructuring Unit. As of October, 2013, the Debtors owed BDC approximately $17.39 million.

[16] Matson confirmed that BDC had received from the Receiver a draft of the Atlas APA as early as November 7, 2013, some three weeks prior to its execution, and BDC had understood at that time that part of the purchase price involved BBL assuming about $2.6 million in RBC Equipment Leases. According to Matson, BDC did not take issue with the BBL purchase price, but did have concerns about the allocation of the purchase price:

(i) Matson alleged that RBC had engaged in discussions with BBL before the execution of the APAs which had influenced the allocation of the purchase price;

(ii) BDC contended that by assuming the remaining obligations under the RBC Equipment Leases, BBL was "factoring in the transaction structure (i.e.: assumption of capital leases), into its allocation rather than the value of the assets being obtained thereunder. The result is a purchase price allocation that is not reflective of the value of the various assets being acquired based upon appraisals...the allocation becomes arbitrary as it does not distinguish the financing aspect from the underlying value of the assets being acquired". BBL allocated the purchase price based on the amount of the debt being assumed which bore no relationship to the value of the underlying assets. Matson described the situation as an "over-allocation relative to the capital leased assets"; and,

(iii) BBL's allocation of the purchase price did not reflect historic appraised values of the purchased assets.

It was Matson's evidence that the Receiver should distribute $10,644,360 to BDC based upon appraised values, not the $7.7 million it proposed based on the purchase price allocation in the APAs.

[17] At my request, the Receiver filed a supplementary document which compared the calculation of its proposed distributions to the distributions proposed by BDC.

V. Analysis: Allocation of sales proceeds

A. Allegation of pre-execution discussions between BBL and RBC

[18] Matson alleged that "negotiations took place between the Purchaser and RBC as part of the Purchaser's due diligence process in advance of the bidding that had the effect of creating an opportunity for the Purchaser to finance part of this purchase and as well creating expectations relative to the allocation of the sale proceeds on the part of RBC".

[19] Matson did not disclose in her affidavit any source or basis for her allegation.

[20] Mark Swanson, a Manager in RBC's Special Loans and Advisory Services Department, deposed, in his February 6, 2014 affidavit, that RBC had no communication with BBL prior to being told by the Receiver that BBL's offer included, amongst its terms, the assumption of the RBC Equipment Leases on an undiscounted basis. Swanson stated that the Receiver had asked RBC whether it would support a motion to approve a transaction under which BBL assumed the leases, rather than paying cash for them, but Swanson deposed that there had been no discussion between RBC and the Receiver of a discount or reduction of payments under the leases.

[21] In the Second Supplement to its Third Report the Receiver responded to Matson's allegations:

> ...BDC suggests that negotiations took place between BBL and RBC prior to the submission of BBL's offer. The Receiver provided all potential purchasers who signed the Receiver's confidentiality agreement with information on Atlas' various leases and fixed assets through the Receiver's online data room so that they could perform their due diligence. BDC was also provided access to the Receiver's data room and was therefore aware of the information available to all purchasers. The Receiver is not aware of any other information supplied to BBL nor any negotiations between RBC and BBL prior to the submission of BBL's offer. The Receiver notes that BDC has not provided any evidence to support their allegations.

[22] Given the failure of BDC to disclose the evidence upon which it based its allegation of the pre-execution negotiations between BBL and RBC and in light of the strong direct evidence to the contrary from the Receiver and RBC, I give no effect whatsoever to BDC's allegation that RBC had engaged in discussions with BBL before the execution of the APAs which had influenced the allocation of the purchase price. BDC's allegation was without any evidentiary foundation foundation.

B. The RBC Equipment Leases

[23] There was no dispute that part of the consideration offered by BBL under the Atlas APA was its agreement to assume the obligations of Atlas Block under the RBC Equipment Leases. The amount allocated for that consideration under the Atlas APA was the amount of the remaining obligations under those leases.

[24] I do not accept BDC's submission that such an allocation of consideration was somehow arbitrary or unfair. To the contrary, the consideration allocated for BBL's assumption of that liability corresponded exactly to the monetary amount of the remaining obligations under those leases. There was nothing arbitrary about such an allocation. The crux of BDC's complaint really related to the amount of the purchase price allocated to other assets, in particular the Hillsdale Real Property, so I turn now to that issue.

C. The relationship between allocations of the purchase price to the Hillsdale Real Property and the appraised values of that asset

C.1 The positions of the parties

[25] The crux of BDC's complaint about the proposed distribution of sales proceeds was that in the APAs BBL's allocation of the purchase price did not reflect historic appraised values of some of the purchased assets, in particular the Hillsdale Real Property.

[26] In section 1.1.7 of its Second Report dated December 12, 2013, the Receiver observed that "the construction of the Hillsdale Plant unfortunately coincided with the start of the 2008/2009 economic downturn..." Schedule "K" to the Atlas APA allocated $1 million of the purchase price to the Hillsdale Real Property. BDC submitted that $3 million should have been allocated to that property.

[27] Matson attached to her affidavit extracts from two appraisals of the Hillsdale Real Property performed in 2008 and 2011. The first extracts were from a June, 2008 appraisal that had been prepared by Katchen Appraisals Inc. for BDC. By its terms the Katchen Appraisal was intended to assist for financing purposes only and was "to serve as a benchmark for establishing the projected value of the property *as improved with a completed concrete block manufacturing facility*, in fee simple, assuming a market exposure of twelve months prior to sale under forced sale conditions on June 17, 2008..." Katchen valued the property at $4.5 million.

[28] Matson also attached extracts from a second appraisal, one prepared by Appraisers Canada Inc. with an effective date of December, 2011. The appraisal stated that it was intended only "for an accounting function and for no other use" and that its purpose was "to estimate a current hypothetical market value of the subject property, as if unimproved, as at the effective date". Appraisers estimated that value as in a range between $2.162 to $2.883 million, with a "value tendency" of $2.5 million.

[29] Pointing to the extracts from both appraisals, Matson deposed that BBL's price allocation "seriously undervalues the land and building" and "allocating $1,000,000 to the real property is not reasonable".

[30] In its Second Supplement to the Third Report the Receiver noted that the appraisals relied upon by BDC were prepared at different dates and used different appraisal assumptions:

> The Receiver does not believe that this amalgamation of estimated values is a superior method of allocating the purchase price as compared to the allocation of a third party purchaser of assets.

The Receiver also observed that the Hillsdale Plant was a special purpose asset, remotely located, which was difficult and perhaps cost prohibitive to relocate.

[31] Although RBC did not comment directly on the valuations, Swanson did depose that back in August, 2013, just after RBC had commenced this application, it had been asked by the Debtors' financial advisor to adjourn the application to enable the Debtors to work out a refinancing with BDC. A signed memorandum of understanding between the Debtors and BDC provided to RBC disclosed that BDC's existing loan in excess of $17 million would be replaced by a $5 million loan to a Newco which would acquire the Debtors' assets and business. Newco would issue preferred shares to BDC. In the result, that transaction did not proceed and a receiver was appointed. Swanson deposed:

> The history of this matter therefore shows that the Receiver, who RBC drove to appoint, successfully increased BDC's anticipated recovery by over $3 million and reduced BDC's risk by even more. The Receiver has therefore significantly reduced the shortfall that BDC was otherwise willing to incur.

C.2 Analysis

[32] In *Bank of America Canada v. Willann Investments Ltd.*[1] Farley J. commented that when examining a receiver's proposed sale of assets in light of the principles set out in *Royal Bank of Canada v. Soundair*,[2] a court might well refrain from approving a sale that proposed an allocation of the purchase price which was significantly different from the latest valuation of the assets because such an allocation would not fairly consider the interests of all creditors.[3] From that it follows that the time for objecting to an allocation of the purchase price in a proposed sale is when the sale is brought before the Court for approval. If the Court agrees with the objection, it can decline to approve the sale, which may or may not result in further negotiations with the proposed purchaser, depending upon the significance to it of the purchase price allocation.

[33] Once a court approves a sale agreement, however, as occurred here, it becomes more difficult for a creditor to advance an objection about the fairness of the term of the sales agreement allocating the purchase price because such an objection, in essence, constitutes an objection to a material term of the now-approved sale agreement. Put another way, not having opposed the approval of a sales transaction, thereby securing the benefit of that sale of the

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[1] 1992 CarswellOnt 1743 (Gen. Div.)
[2] (1991), 4 O.R. (3d) 1 (C.A.)
[3] *Bank of America Canada, supra.*, para. 5.

debtor's assets, a creditor faces difficulty in objecting subsequently to a material term of the agreement which it did not oppose.

[34] In the present case BDC did not oppose the approval of the BBL APAs – no doubt because the BBL offers were far, far superior to any other offer obtained by the Receiver – but BDC did put a "reservation of rights" on the record, without filing evidence at the time about the nature of its objections. A receiver's distribution motion should not turn into a debate about the fairness of the term in the approved sale agreement which allocates the purchase price to particular assets. The proper time for such a debate is at the hearing of the approval motion. I will consider the objections made by BDC, but their timing weakens the weight to be given to them.

[35] Turning to the submission of BDC that the allocated purchase price for the Hillsdale Real Property was far below its appraised value, I have five comments. First, any appraisal must be read in its entirety to understand the methodology used and the assumptions employed. On this motion BDC only filed portions of the reports from which it was not possible to ascertain the methodologies and information used by the appraisers to arrive at their estimates. Failing to file the entire reports significantly undermined their evidentiary value. Second, the reports gave opinion values as of June, 2008 and December, 2011. The reports therefore were quite dated, the last expressing a value some two years prior to the appointment of the Receiver. Since the actions of the Receiver must be assessed at the time taken, stale valuation reports are of little assistance in ascertaining how the market perceived the value of the Hillsdale Real Property as of November, 2013, the date of the Atlas APA.

[36] Which leads me to my third point. In the December 12, 2013 Supplement to its Second Report the Receiver stated:

> BDC also has a mortgage on the real property at Hillsdale...Both the Receiver and BDC agreed that an appraisal of the Hillsdale Real Property would not be cost beneficial as the value of the Hillsdale Real Property is intrinsic to the manufacturing plant and could not be separately assessed. It was agreed that an appraisal of the market value of the Hillsdale Real Property on a standalone basis would be theoretical at best, and not provide useful information in assessing offers.

It is difficult to understand how BDC now relies on stale valuation reports to support its submissions on the allocation of net sale proceeds in light of that agreement.

[37] Fourth, the material deficiencies in the evidentiary utility of the two appraisal reports referred to by Matson brings one back, then, to the general principle that where a receiver markets a property, appraisals cease to have much significance in the valuation process[4] – a sale

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[4] *B & M Handelman Investments Ltd. v. Mass Properties Inc.* (2009), 56 C.B.R. (5th) 313 (Ont. S.C.J.), para. 13; *Bank of America Canada v. Willann Investments Ltd.*, 1992 CarswellOnt 1743 (Gen. Div.), para. 5.

is always a better indication of value of a particular property than a valuation. In the present case, the Receiver contacted 83 different interested parties, 36 of which signed confidentiality agreements, and 8 of which submitted offers. The BBL offer accepted by the Receiver was far, far superior to any other offer.

[38] Fifth, and finally, in the Second Supplement to its Third Report the Receiver provided the following evidence:

> [T]he Hillsdale building was a sole purpose building, built for the purpose of block production only. Accordingly, it is likely that the building would only have value in a going concern sale. If the assets were liquidated and removed, the building would at best have scrap value and may have been a liability for a purchaser of the real property as it would likely have to be demolished. Therefore, the allocation of the $1.0 million to the real property is likely superior to liquidation value.

I accept that evidence.

[39] Accordingly, I see no reason to interfere with the Receiver's recommendation to distribute the net sales proceeds using a methodology based on the allocation of the purchase price found in the approved Atlas APA and Brockville APA. I therefore grant the relief sought in paragraph (g) of the Receiver's February 3, 2014 notice of motion.

VI. Allocation of the Receiver's costs

[40] The Receiver sought approval of its fees and disbursements of $196,882.73 for the period December 1, 2013 to January 15, 2014, as well as for those of its counsel for the same period in the amount of $147,503.13. Recognizing the competing security interests in the receivership, the Receiver and its counsel had tracked their time and expenses in three separate categories: (i) those directly related to BDC asset realization activities; (ii) those directly related to RBC asset realization activities; and, (iii) those shared between BDC and RBC realization activities.

[41] BDC took no issue with the direct expenses attributed by the Receiver to BDC assets ($67,598). The Receiver tracked shared expenses totaling $510,782. It proposed allocating $357,159 of those expenses to BDC on the basis that BDC recovered 69.92% of the total sales proceeds. RBC supported the Receiver's proposed allocation. BDC objected to the amount of the fees and to their allocation, contending that only 50% of the shared costs should be allocated to it, or the sum of $255,391. BDC complained that "a significant portion of these costs were expended in the collection of accounts receivable and the production and sale of inventory which clearly solely benefitted RBC. In addition, there are significant Receiver and legal fees relative to the trust claims of Holcim and Tackaberry".

[42] This Court approved the Receiver's fees and legal fees for the period up to November 30, 2013 in its December 20, 2013 order. As to the fees incurred after that date, in paragraph 21 of her affidavit Matson "sought clarification" of certain work performed by the Receiver and its counsel. In section 3.1 of the Second Supplement to its Third Report the Receiver provided

detailed clarification. In light of that clarification, I conclude that the fees for which the Receiver sought approval were reasonable in the circumstances.

[43] As to the allocation of the fees, the general principles governing the allocation of receiver's costs can be briefly stated:

(i) The allocation of such costs must be done on a case-by-case basis and involves an exercise of discretion by a receiver or trustee;

(ii) Costs should be allocated in a fair and equitable manner, one which does not readjust the priorities between creditors, and one which does not ignore the benefit or detriment to any creditor;

(iii) A strict accounting to allocate such costs is neither necessary nor desirable in all cases. To require a receiver to calculate and determine an absolutely fair value for its services for one group of assets vis-à-vis another likely would not be cost-effective and would drive up the overall cost of the receivership;

(iv) A creditor need not benefit "directly" before the costs of an insolvency proceeding can be allocated against that creditor's recovery;

(v) An allocation does not require a strict cost/benefit analysis or that the costs be borne equally or on a *pro rata* basis;

(vi) Where an allocation appears *prima facie* as fair, the onus falls on an opposing creditor to satisfy the court that the proposed allocation is unfair or prejudicial.[5]

[44] The Receiver responded to BDC's complaint about the allocation of certain time by reporting that it had only charged time for accounts receivable collections and the Holcim/Tackaberry claims to RBC. That addressed that complaint.

[45] As to the allocation methodology for shared fees, the Receiver reported that as early as October 18, 2013, it had provided BDC with its allocation method for professional fees and expenses incurred in the estate. Its email to RBC of that date stated:

> The shared time will be allocated on realizations of the secured creditor assets so the exact breakdown of those fees will not be known until the assets are realized.

The Receiver provided BDC with requested weekly reports allocating those fees amongst the three time categories. The Receiver responded to periodic inquiries about the fees and their

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[5] See the cases cited by C. Campbell J. in *Re Hunjan International Inc.* (2006), 21 C.B.R. (5th) 276 (Ont. S.C.J.) and Cameron J. in *JP Morgan Chase Bank N.A. v. UTCC United Tri-Tech Corp.* (2006), 25 C.B.R. (5th) 156 (Ont. S.C.J.).

allocation from BDC, and it was not aware that BDC took issue with the allocation until February 4, 2014.

[46] I find it difficult to place must credence in an "11th hour" objection by a creditor to the receiver's proposed allocation of fees when the Receiver disclosed the proposed methodology at the start of the administration of the receivership estate, the creditor did not object, and the Receiver provided on-going, transparent reporting to the creditor of the fees incurred.

[47] The Receiver also stated:

> The Receiver believes that BDC derived a significant benefit from the Receiver's operations and eventual sale to BBL. As discussed previously the DSL Appraisal makes it clear that the realizable values of Atlas' assets would have been significantly impaired absent a going concern sale when one compares the appraised value of $6.5 million in a going concern type sale versus a value of $1.5 million in a liquidation sale...The Receiver agrees with BDC that BBL paid more for all of the Atlas assets, and most notably the Hillsdale Equipment (as the Hillsdale plant is the only plant of the two sold in the First BBL Sale that BBL is operating), because of the Receiver's preservation of the Atlas customer base through continued operations during the receivership. This was of great benefit to BDC, perhaps more so than to RBC.

[48] The allocation methodology proposed by the Receiver for shared costs based *pro rata* on realizations was *prima facie* reasonable in the circumstances of this case. The Receiver disclosed that methodology to BDC at the start of its administration, and BDC did not object until the 11th hour. BDC has not demonstrated any unfairness in the methodology proposed by the Receiver.

[49] Consequently, I grant the orders sought by the Receiver in paragraphs (h) and (i) of its notice of motion dated February 3, 2014.

VII. Costs

[50] I would encourage the parties to try to settle the costs of this motion. If they cannot, any party seeking costs may serve and file with my office written cost submissions, together with a Bill of Costs, by March 21, 2014. Any party against whom costs are sought may serve and file with my office responding written cost submissions by March 28, 2014. The costs submissions shall not exceed three pages in length, excluding the Bill of Costs.

D. M. Brown J.

Date: March 10, 2014

TAB

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Ontario Superior Court of Justice
Hunjan International Inc. (Re)
Date: 2006-05-03

Docket: 05-CL-5886

Frederick Myers, L. Joseph Latham for KPMG Inc.

Ashley John Taylor, Diana Juricevic for GE Capital Canada Leasing Services Inc., GE Capital Equipment Financing C.P., GE Capital Canada Leasing Trust and GE Capital Leasing Services Company

Paul R. Basso for Canadian Imperical Bank of Commerce

S. Harvey Starkman, Q.C., Kevin W. Fisher for En-Plas Inc.

E. Peter Auvinen, Arthi Sambasivam for CIT Financial Ltd.

Edmond Lamek for Expost Development Canada

Kenneth Dekker for Hunjan Holdings

C. Campbell J.:

[1] The issue before the Court concerns the allocation and apportionment of the costs arising from failed *Companies Creditors' Arrangements Act* ("CCAA") proceedings, which evolved into a receivership sale by auction of assets of the Hunjan Group, held November 30 and December 7, 2005.

[2] At issue is the allocation of actual disbursements incurred to keep the debtor companies operating during the CCAA proceedings, plus the fees, disbursements and expenses incurred during the receivership proceedings to preserve, protect and realize on the debtors' assets.

[3] The recommended allocation of costs by the Receiver as contained in its Tenth Report is challenged by different first-ranking secured creditors on different issues (the "Opposing Creditors.")

[4] Canadian courts have recognized that the allocation of costs arising from insolvency proceedings must be done on a case-by-case basis and is a task involving a receiver's or trustee's discretion. It has also been recognized that a strict accounting to allocate costs is neither necessary nor desirable in all cases and that a creditor need not benefit "directly" before the costs of an insolvency proceeding can be allocated against that creditor's recovery. See *Robert F. Kowal Investments Ltd. v. Deeder Electric Ltd.* (1975), 9 O.R. (2d) 84 (Ont. C.A.) at 89; *Ontario (Securities Commission) v. Consortium*

Construction Inc. (1992), 9 O.R. (3d) 385 (Ont. C.A.); *Hunters Trailer & Marine Ltd., Re* (2001), 30 C.B.R. (4th) 206 (Alta. Q.B.) at 209-210.

[5] Costs should be allocated in an equitable manner and in a manner that does not readjust the priorities between creditors. When determining what is an equitable allocation of costs, the Court in *Hunters Trailer & Marine Ltd., Re* noted that it would be unfair to ignore the degree of potential benefit that each creditor might derive, but also recognized that "any means of calculating that percentage will be arbitrary. A strict accounting on a cost-benefit basis would be impractical."

[6] The facts necessary for the determination of the issues that have arisen are largely not in dispute and are set out in the Tenth Report.

[7] Pursuant to the Order of this Honourable Court dated May 4, 2005 (the "Initial Order"), the Hunjan Group and Hunjan Holdings Ltd. (the "CCAA Applicants") obtained protection from their creditors under the CCAA. Under the Initial Order, Deloitte & Touche Inc. was appointed to act as Monitor.

[8] The Initial Order allowed the CCAA Applicants to borrow money from Canadian Imperial Bank of Commerce ("CIBC") pursuant to a special loan facility known as "debtor-in-possession" or "DIP" financing. The Initial Order and the May 16 Order contain specific provisions that deal with certain aspects of the Court-approved DIP financing. In the Initial Order, the CCAA Applicants were limited in the amount that they could borrow by way of DIP financing to $1 million in the aggregate. This amount would allow the CCAA Applicants to continue operations for a period of ten days, during which time it was anticipated that they would attempt to secure the necessary financing and other arrangements with their customers to allow them to continue to operate while they attempted to restructure over a longer period of time.

[9] After the Initial Order was granted, the CCAA Applicants began negotiations with CIBC, the CCAA Applicants' principal first-ranking secured lender, and five of their largest customers (the "Participating Customers"). As a result of those negotiations, an accommodation agreement was entered into on or about dated May 13, 2005 (the "Accommodation Agreement.")

[10] The Accommodation Agreement provided, among other things:

(i) that the Participating Customers would continue to order product from the CCAA Applicants (sections 2-6);

(ii) the basis upon which CIBC would provide additional DIP financing to allow the CCAA Applicants to operate during the CCAA Proceedings (the "Amended DIP Facility"), which financing was anticipated to peak at approximately $8.8 million (paragraph 7);

(iii) that the Amended DIP Facility was to be secured by a first ranking charge (subject only to the Administrative Charge contained in the Initial Order) and that all "Post-Filing Receipts" (monies received from operations or production after the Filing Date) would be first used to repay the Amended DIP Facility. This preserved to CIBC's existing secured claims the proceeds of receipts that arose from the operations of the CCAA Applicants prior to May 3, 2005 (the "Pre-Filing Receipts") (section 7); and

(iv) that certain of the Participating Customers' rights of setoff as against pre-CCAA receivables were limited (paragraph 2).

[11] The Receiver understands that, when the Accommodation Agreement and DIP Term Sheet (as herein defined) were negotiated and the May 16 Order was issued, it was anticipated that there would be a shortfall of approximately $4.0 million between the DIP financing advances and the estimated Post-Filing Receipts to be generated by the CCAA Applicants to repay those advances. CIBC and the Participating Customers agreed, as set out in section 9 of the Accommodation Agreement, that the Participating Customers would be responsible for fifty percent (50%) of any Amended DIP Deficiency (the "Customer Contribution"), with such Customer Contribution not to exceed $2.0 million. To secure that obligation, the Participating Customers paid $2.0 million to CIBC to be held in trust pending the outcome of the CCAA proceedings and the quantification of the Amended DIP Deficiency.

[12] The Amended DIP Facility was set out in the Amended DIP Credit Agreement, dated May 13, 2005 (the "DIP Term Sheet")[which provided, among other things, that CIBC was entitled to recover as part of its DIP loan the full amount of the costs it incurred in respect of the Amended DIP Facility.]

[13] The May 16 Order approved the Accommodation Agreement and the DIP Term Sheet, and also ordered that the Amended DIP Facility would be secured by the DIP Charge (as defined in paragraph 32 of the Initial Order). There has been no amendment, variation, or appeal of the May 16 Order.

[14] Furthermore, paragraph 6 of the May 16 Order sets out the means by which the Amended DIP Facility and the Amended DIP Deficiency, if any, was to the repaid. Paragraph 6 of the May 16 Order provides that the Amended DIP Facility is to be repaid:

> (i) first from Post-Filing Receipts; and
>
> (ii) to the extent there is a shortfall (that is, if there is an Amended DIP Deficiency), from the proceeds of any unencumbered assets (of which there are none); and
>
> (iii) "the remaining balance, if any, from the net realizations of the collateral which is the subject matter of the security created and issued by the Applicants or any of them to any of their secured lenders prior to the Filing Date and over which such lender or lenders hold a first ranking security interest, charge, mortgage or other encumbrances, pro rata in the proportions that the Applicants or any of them were indebted to each such secured lender as at the Filing Date."

[15] What is not at issue is the rationale for the DIP financing. It has become accepted in restructuring in the automotive manufacturing industry that to determine whether the company can succeed and even if it does not, there needs to be a collaborative effort between the debtor's major financiers and its principal customers.

[16] The reason for this need for co-operation is that those customers (being other automotive parts manufacturers or automotive assembly companies themselves) are part of a highly integrated "just-in-time" supply chain. A shut-down or failure of one manufacturer in the supply chain can cause a chain reaction shutting down the operations of manufacturers further up or down the supply chain. Such shut-downs affect thousands of jobs and cause millions of dollars in losses. Accordingly, customers have incentive to participate in facilitating a debtor's effort to obtain financing to prevent a sudden shut-down of the debtor.

[17] The incentive for the Participating Customers to agree to be responsible for a portion of any Amended DIP Deficiency arose from the fact that they, for a specified maximum cost, were able to secure the timely delivery of necessary inventory during the CCAA Proceedings, and were permitted to have excess inventory banks built to give them an assurance that they would have sufficient time to arrange for alternative suppliers and a smooth transition to such new suppliers if a restructuring failed.

[18] There is an incentive for both Participating Customers and major creditors to cooperate even in a very likely bankruptcy, again to maximize the value of the inventory and return from its sale in the ordinary course.

[19] During the CCAA proceedings, the CCAA Applicants, with the assistance of the Monitor, carried out a marketing and sales process. However, no restructuring or going-concern sale was achieved.

[20] As a result of the failure of the CCAA proceedings, on July 18, 2005, CIBC applied for, and was granted, an Order by the Honourable Justice Stinson terminating the CCAA proceedings and appointing KPMG as the interim receiver and receiver of the Hunjan Group pursuant to Section 47 of the *Bankruptcy and Insolvency Act* (Canada) and Section 101 of the *Courts of Justice Act* (Ontario) (the "Receivership Order.") Pursuant to the terms of paragraph 37 of the Receivership Order, the Amended DIP Facility was terminated going forward but remained available to fund the finalization of certain matters that arose during the CCAA proceedings.

[21] The Hunjan Group had ceased all operating activities before the Receivership Order was granted. As a result, there were no on-going revenues generated with which to fund either the Receiver's fees or the disbursements required to fund the costs to be incurred during the Receiver's mandate, such as rent, maintenance, insurance, utilities, and other costs incurred for the preservation, protection and administration of the assets of the estate.

[22] Furthermore, pursuant to paragraphs 22 to 30 of the Receivership Order, the terms of the May 16 Order regarding the repayment of the Amended DIP Facility (and any Amended DIP Deficiency) were preserved, such that all Post-Filing Receipts are to be first applied to the Amended DIP Deficiency, and not used to fund the receivership proceedings. Pre-Filing Receipts remain pledged to CIBC's pre-existing secured claims.

[23] However, paragraph 22 of the Receivership Order provides that any expenditure or liability that is made or incurred by the Receiver, including the fees and disbursements of its legal counsel, are protected by a court-ordered charge referred to as the "Receiver's Charge".

[24] Furthermore, paragraph 25 of the Receivership Order authorized the Receiver to borrow up to $2.0 million for the purpose of funding the exercise of its powers, which

borrowings were to be protected by a court-ordered charge referred to as the "Receiver's Borrowing Charge".

[25] Both the Receiver's Charge and the Receiver's Borrowing Charge are a charge on all of the assets of the Hunjan Group, except the Pre-Filing Receipts. Both the Receiver's Charge and the Receiver's Borrowing Charge enjoy first-ranking priority over the Amended DIP Deficiency, except in respect of Post-Filing Receipts which, as stated above, are to be applied first to the Amended DIP Facility.

[26] On October 7, 2005, with the permission of the Court, the Receiver assigned each member of the Hunjan Group into bankruptcy.

[27] On November 30, 2005 and December 7, 2005, the Remaining Assets of the Hunjan Group were auctioned by CIA CPCC Inc. pursuant to an auction services agreement approved by Justice Ground on November 7, 2005.

[28] As a result of negotiations on July 18, 2005, paragraph 3A of the Receivership Order granted GE the right to exclude assets over which it had a first-ranking security from the Receiver's auction process. However, over time, the Receiver extended this same option to each secured creditor whose security the Receiver acknowledged was first ranking or was confirmed as first ranking by court order. GE availed itself of this option, as did CIT to a lesser extent.

Allocation of the DIP Financing Costs

[29] As anticipated at the time it was put in place, there is a deficiency associated with the DIP financing estimated by the Receiver to be between $3.4 and $3.9 million, *after* applying a $2.0 million customer contribution described below.

[30] The Opposing Creditors (other than CIBC) take issue with the Receiver's calculation of the Amended DIP Deficiency and the basis of allocating the Receiver's Charge and the Receiver's Borrowing Charge among Opposing Creditors.

[31] The Order of Ground J. dated May 4, 2004 (the "Initial Order") allowed the CCAA Applicants to borrow money from Canadian Imperial Bank of Commerce ("CIBC") The calculation of the Amended DIP Deficiency is a product of the Accommodation Agreement (defined herein), which was approved by the May 16 Order, and paragraph 6 of the May 16 Order, which sets out an incomplete waterfall for the repayment of the Amended DIP Deficiency.

[32] Paragraph 6 of the May 16 Order reads as follows:

> THIS COURT ORDERS AND DECLARES that the Amended DIP Facility shall be secured by the DIP Charge (as defined in paragraph 32 of the May 4, 2005 Order herein) and the DIP Charge shall have the relative priority set out in paragraph 65 of such Order, provided however and without in any way limiting the force and effect of the DIP Charge, the DIP Lender shall apply the Post-Filing Receipts first in payment of the Applicants' obligations pursuant to the Amended DIP Facility and in the event any balance remains outstanding thereon following such application (the "Amended DIP Deficiency"), the Amended DIP Deficiency shall be repaid to the DIP Lender, firstly, from any Property (as defined by paragraph 3(a) of the May 4, 2005 Order) which was not subject to any security created and issued by the Applicants on or prior to the Filing Date, and the remaining balance, if any from the net realizations of the collateral which is the subject matter of the security created and issued by the Applicants or any of them to any of their secured lenders prior to the Filing Date and over which such lender or lenders hold a first ranking security interest, charge, mortgage or other encumbrances, pro rata in the proportion that the Applicants or any of them were indebted to each such secured lender as at the Filing Date.

[33] The Accommodation Agreement is a complicated agreement to which in addition to the Participating Customers, CIBC and Export Development Canada ("EDC") are both party. (For the purpose of this decision it is not necessary to distinguish between the different interests of CIBC and EDC. They will jointly be referred to as "CIBC")

[34] Paragraph 7 of the Accommodation Agreement, entitled Forbearance and Funding by Lenders, sets out in detail the basis on which CIBC was prepared to forbear from exercising its rights and remedies. At the time of execution of the Accommodation Agreement and the DIP Credit Facility, the cash needs of Hunjan were projected to be somewhat in excess of $3.5 million. In fact, they turned out to be the maximum provided for of $8,800,000.

[35] The Opposing Creditors who object to the proposed allocation of the Receiver with respect to the shortfall rely on the wording of Paragraph 9 (b) of the Accommodation Agreement:

> Each Participating Customer will fund its proportionate share of the lesser of (x) 50% of Hunjan's total net funding losses incurred over the period from May 4, 2005 to and including the Termination Date (taking into account any accrued liabilities as at the Termination Date that will be funded by CIBC under the CIBC DIP Credit Facilities), and (y) $2,000,000 (such share, the "Customer Loss Share.") Each Participating Customer's "proportionate share" of such losses shall be as set out on Schedule B. For certainty, the obligation of each Participating Customer under this Section 9 shall continue notwithstanding such Participating Customer may have re-sourced all of its parts production and tooling prior to the expiry or termination of the Funding Period.
>
> CIBC and EDC will each be responsible for their respective shares of the lesser of (x) 50% of Hunjan's total net funding losses over the Funding Period, and (y) $2,000,000. The shares of each of CIBC and EDC shall be as agreed between them.

[36] The complaint of the Opposing Creditors is that in the Receiver's calculation of the DIP Deficiency to be borne by the Opposing Creditors pursuant to paragraph 6 of the May 16 Order, the Receiver applied the full amount of the Participating Customers 50% share ($2,000,000) but failed to omit the contribution that they assert was agreed to by CIBC by Section 9(b) of the Accommodation Agreement.

[37] Both the Accommodation Agreement and the May 16 Order were preceded by the Amended DIP Credit Agreement dated May 13, 2005 (the "DIP Term Sheet") between CIBC and Hunjan, which INSERT para 15 of Receivers

[38] The position of the Opposing Creditors is that Paragraph 9(b) of the Accommodation Agreement calls on CIBC to take into account in determining the obligation to contribute, $2,000,000, which was not advanced but which as between it and the Participating Customers was to be taken into account.

[39] The position of CIBC and the Receiver is that the May 16 Order is compatible with the position that the May 16 Order approved the Accommodation Agreement and the DIP Term Sheet, and also ordered that the Amended DIP Facility would be secured by the DIP Charge (as defined in paragraph 32 of the Initial Order). There has been no amendment, variation, or appeal of the May 16 Order.

[40] The Receiver calculated the Amended DIP Deficiency as set out in Schedule "K" of the Tenth Report on the basis that, as a result of the last paragraph of subsection 9(b) of the Accommodation Agreement, CIBC must bear the second half of the first $4.0 million of the Amended DIP Deficiency, which would reduce the amount to be allocated among secured creditors by $2.0 million. The Opposing Creditors allege that pursuant to that paragraph, CIBC agreed to fund or write-off up to an additional $2.0 million towards any Amended DIP Deficiency that arose.

[41] The Opposing Creditors submit that the obligation of CIBC completely mirrors the obligation of the Participating Customers to fund $2.0 million of any Amended DIP Deficiency. It should be noted that the Opposing Creditors were not parties to the Accommodation Agreement. Among other matters, they complain they were not made aware of it until sometime after July 1, 2005.

[42] The position of CIBC and the Receiver rejects the submission of the Opposing Creditors on the following basis:

[43] First, CIBC knew in advance that it would be providing the full amount of the Amended DIP Facility. Second, it agreed to provide the Amended DIP Facility knowing that there was projected to be a shortfall and negotiated the Customer Contribution to assist in reducing that loss. Third, the language referred to in paragraph 9(b) states, in respect of CIBC, that it will be responsible for its respective share of the Amended DIP Deficiency, and the numbers referred to in that paragraph reflect the Hunjan Group's projections of a $4.0 million deficiency, and not a cap. Finally, CIBC negotiated language for paragraph 6 of the May 16 Order to ensure that the balance of the Amended DIP Deficiency would be shared by the secured creditors should it exceed $4.0 million.

[44] The Receiver reads paragraph 9(b) of the Accommodation Agreement and paragraph 6 of the May 16 Order as working together to first reduce the Amended DIP Deficiency by the Customer Contribution and then allocating the remaining balance, whatever that may be, among the first ranking secured creditors on a percentage of debt basis.

[45] The Opposing Creditors question why Paragraph 9(b) above would refer to the Participating Customers funding 50% of the Funding Losses if CIBC were not agreeing to fund the other 50%.

[46] In support of the argument, the Opposing Creditors urge that at the very least, to the extent that the Court concludes that there is inconsistency between the Accommodation Agreement and the provisions of the May 16 Order, the former should prevail since it was incorporated into the May 16 Order and by implication had the approval of the Court.

[47] In support of its position that the Accommodation Agreement clearly provides for CIBC providing funding of $2,000,000 of $4,000,000, the Opposing Creditors point to two references to the issue in reports provided to the Court by the Receiver. The first reads as follows:

> The total cash burn pursuant to the Accommodation Agreement is shared 50%/50% between the Participating Customers and the [Opposing] Creditors to a maximum of $4 million. Any excess of over $4 million is to be assumed by the [Opposing] Creditors.

[48] The second reference is in Schedule N3 to the Tenth Report as originally filed, and reads as follows:

> Pursuant to the Accommodation Agreement, the DIP deficit is to be shared 50%/50% between the Participating Customers and CIBC to a maximum of $4 million. Any excess of over $4 million is to be allocated between all [Opposing] Creditors.

[49] Schedule N3 was amended at the oral hearing to provide as follows:

> Pursuant to the Accommodation Agreement, the Participating Customers were responsible to contribute 50% of the Amended DIP Deficiency, with their maximum contribution being $2 million.

[50] While I respect the reasons behind the position advanced on behalf of the Opposing Creditors, I am not prepared to accept the references in the Receiver's reports as determinative. The Opposing Creditors were not parties to the Accommodation Agreement. None of the Participating Customers, the Receiver or CIBC support the meaning now being advanced.

[51] I do not find the May 16 Order in any way ambiguous even though it does make reference to the Accommodation Agreement. The closing words of paragraph 6 read, "pro rata in the proportion that the Applicants or any of them were indebted to each such secured lender as at the Filing Date."

[52] At the time of the Accommodation Agreement, the representation in effect of Hunjan was that the DIP Deficiency would be between $3.5 and $4.0 million. I accept the submission on behalf of the Receiver and CIBC that it is not likely that the latter would have provided the DIP financing if it were aware that in the event the deficiency that it financed exceeded the anticipated amount by 100%, that it would in effect have contributed an additional $2 million.

[53] In this as well as many allocation cases, the effect of a decision can be said to operate disproportionately on one or more creditors to the benefit of others or even only one.

[54] The first principle of priority is to allocate in the manner prescribed by the Order. [See *Ontario (Registrar of Mortgage Brokers) v. Matrix Financial Corp.* (1993), 106 D.L.R. (4th) 132 (Ont. C.A.) at 137.]

[55] Each case is to be considered on its own facts with the exercise of discretion and without the necessity to allocate on a direct "benefit" basis. *Robert F. Kowal Investments Ltd. v. Deeder Electric Ltd., supra.*

[56] The conclusion at which I have arrived might well have been different had the other Opposing Creditors been parties to the Accommodation Agreement and the surrounding

facts and matrix clearly pointed to an understanding of all parties that CIBC would in effect be responsible for an additional $2 million regardless of the DIP Deficiency. That is not the case on the material before me.

[57] The test for the allocation proposed by the Receiver is that it be in a manner that is fair and equitable. This exercise of discretion, while it must not ignore benefit or detriment to any creditor, does not require a strict accounting on a cost benefit basis or that the costs be borne equally or on a pro rata basis [see *Hunters Trailer & Marine Ltd., Re* (2001), 30 C.B.R. (4th) 206 (Alta. Q.B.) pp 209-212.]

[58] The position advanced by the Opposing Creditors has not met the onus of satisfying me that the allocation prepared by the Receiver is unfair or unreasonable in all the circumstances.

[59] I have considered carefully the submission made on behalf of the opposing creditors. Each has some merit. The assertion by CIT is that given its exposure ($20 million), CIBC had more incentive to invest more money in the DIP financing.

[60] Counsel for En-Plas made much the same point, suggesting that the parties (CIBC) that take the risk should bear the cost on the basis that no one thought the DIP Financing Deficit would exceed $4 million and the DIP Financing did not particularly benefit En-Plas given its particular position. The DIP Financing did permit the opportunity for improvement of their position by all creditors.

[61] The response from counsel for CIBC is simply that it is not equitable for his client to advance $8 million and not have a charge on the DIP Financing simply doesn't make sense.

[62] In my view, the reason the cases referred to emphasize the discretion in the presiding judge is that between competing creditors, there is often competing equitable claims. I accept that if one result would work a manifest unfairness, that fact will likely be determinative where as I found here, that there is no manifest unfairness in permitting the creditor (CIBC) with the largest exposure some recovery from the DIP Financing Deficit.

[63] As I have concluded on the language of the Accommodation Agreement and the May 16 Order, there is no express restriction on recovery by CIBC. I am not persuaded that there is any manifest unfairness to the Opposing Creditors in accepting the position advanced by the Receiver, CIBC.

Allocation of Receiver's Expenses

[64] Not all the issues dealt with in the Receiver's Tenth Report were dealt with on this motion. The one that requires determination at this stage is that submitted on behalf of some creditors, which urge that the general administration expenses should be based on the percentage of pre-filing debt of each of the Opposing Creditors, rather than recovery.

[65] The Receiver reports that in allocating costs, it took into consideration the following factors:

(a) these proceedings evolved from the CCAA Proceedings to the Receivership Proceedings and, as such, proceeds of realizations can be attributed to three different time periods, which may affect the entitlement to the proceeds from such assets and consequent costs allocations:

(i) *Pre-Filing Period* — The period prior to the Filing Date (being the commencement of the CCAA proceedings);

(ii) *Post-Filing Period* — The period between the Filing Date and the commencement of the Receivership Proceedings; and

(iii) *Receivership Period* — The period after the commencement of the Receivership Proceedings;

(b) the May 16 Order already mandates how the Amended DIP Deficiency is to be allocated;

(c) the Receiver's Charge and the Receiver's Borrowing Charge were generally incurred for the benefit of all creditors with assets in the Receivership; and

(d) there were some circumstances in which specific costs could be fairly allocated to one or more particular creditors as a result of a clear and direct link between the cost and the benefit derived therefrom.

[66] Those creditors who urge that the allocation of costs should be on the basis of pre-filing debt do so on the basis that in their view CIBC derived a benefit from a significant amount of recovery pre-filing that should be taken into account and not just the amount that was recovered post-filing.

[67] The total amount of the Receiver's Borrowing and expenses is set out in Schedule W to the Report of the Receiver and totals some $2,087.629.00. On the basis of realization

based on security and the allocation, relative cost to CIBC is at a level of 42.7%, that of GE at 38.3%, EnPlas at 14.3% and CIT at 4.5%.

[68] The response by the Receiver submits that while CIT's gross realizations were $612,663, of that amount it has already received free of any deduction an account of costs the sum of $300,000, leaving only $312,663 against which CIT's total share of the costs must be charged.

[69] There is some evidence of what each of the creditors recognized might be its share of anticipated costs at the time of the May 16, 2005 order, which makes the Receiver's allocation reasonable in relation.

[70] I have considered the submissions of those objecting creditors, as well as those of the Receiver.

[71] I am mindful that each creditor from its own particular perspective will have a view of what is or is not fair in terms of allocation. There is unlikely to be one specific method that can objectively point to absolute fairness to all parties. The exercise is inevitably one of viewpoint for the creditor and exercise of discretion for the Court.

[72] I am satisfied that the Receiver has to the extent possible attempted to apply costs in a reasonable and fair manner and has taken into account to the extent possible a distinction between those costs that could be said to benefit all creditors with assets in the Receivership and those where it was possible, where specific costs could be fairly allocated to one or more particular creditors as a result of a clear and direct link between cost and benefit derived.

[73] I also accept that where the allocation is *prima facie* fair, the onus should be on an opposing creditor to satisfy the Court that they are unfair or prejudicial. (See *Canadian Imperial Bank of Commerce v. Acchione Construction Co.* (1989), 36 C.L.R. 144 (Ont. S.C.) [Master] 146.

[74] I recognize that there are other bases of allocation and have no issue with the general principles set out by Hall J. in *Hickman Equipment (1985) Ltd., Re,* [2004] N.J. No. 299 (N.L. T.D.)

[75] Having considered the submissions of all creditors, I am not persuaded that the onus has been met. The Receiver's cost allocation is therefore approved.

[76] Counsel may obtain a further appointment to deal with any issues remaining on the motion and the fixing of costs, if required.

Order accordingly.

TAB

3

COURT FILE NO.: 06-CL-6326
DATE: 20060725

SUPERIOR COURT OF JUSTICE - ONTARIO

RE: JP MORGAN CHASE BANK N.A. v. UTTC UNITED TRI-TECH CORP.

BEFORE: Justice Cameron

COUNSEL: Larry Crozier and Stephanie Fraser, for the Receiver, Ernst & Young Inc.

Brett Harrison, for JP Morgan Chase Bank N.A.

Aubrey Kauffman, for Laurentian Bank of Canada and Business Development Bank of Canada

DATE HEARD: July 12, 2006

ENDORSEMENT

[1] Ernst & Young Inc. ("Receiver"), in its capacity as court appointed Interim Receiver and Receiver and Manager of all the assets, undertaking and property ("Property") of UTTC United Tri-Tech Corporation ("UTTC") moves for an Order:

1. approving the activities of the Receiver as described in the Fifth Report of the Receiver dated July 6, 2006 ("Fifth Report");

2. authorizing the Receiver to distribute certain net proceeds from the sale of the Property to JP Morgan Chase Bank, N.A. ("JPM") and to Laurentian Bank of Canada and Business Development Bank (the "Banks") subject to execution of a mutually satisfactory reimbursement agreement from each of JPM and the Banks;

3. approving the fees and disbursements of the Receiver and its lawyers;

4. providing for the allocation of the Receiver's Charge pursuant to the Appointment Order dated March 10, 2006

    i) in respect of the professional fees and disbursements of the Receiver (including legal fees) ("Fees"), the sum of $182,000 to be allocated to the Banks and the balance of some $1.4 million to be allocated to JPM;

ii) in respect of claims against the Receiver in connection with the receivership, other than those resulting from willful misconduct or gross negligence ("General Claims"), JPM and the Banks shall reimburse the Receiver on a *pro rata* basis relative to their distributions from the proceeds of sale of the Property; and

iii) in respect of claims by a party who had an interest in the Personal Property or the Real Property, or proceeds therefrom, that is established to have priority over the respective interests of JPM or the Banks ("Specific Claims"), as the case may be, each of JPM and the Banks shall be individually responsible to reimburse the Receiver for claims ranking in priority to their respective secured positions.

[2] The parties are agreed on items 1 and 3 above. The respondent says that the Receiver's Charges:

1. should be allocated in accordance with a "fair and equitable" principle, and

2. should not be liable to a reimbursement agreement.

FACTS

[3] On July 8, 2005, the Banks and JPM entered into a priority agreement and a creditors agreement.

[4] Pursuant to the Priority Agreement:

1. the Banks would rank first on the Cornwall property, and

2. JPM would rank first on the personal property, other than certain listed equipment on which the Banks would rank, without regard to any priority granted by any principle of law or statute, including the *Personal Property Security Act*.

[5] They also agreed that any proceeds in respect of collateral would be dealt with according to the provisions of the Priority Agreement.

[6] On the same date the parties entered into a Creditors Agreement which provided, in part:

> 2. The Bank [**JPM**] or any of its officers, employees and agents and its representatives and invitees, including any receiver, receiver manager, interim receiver or other similarly appointed official, (each, a "**Representative**") may, provided it gives reasonable notice ("**Access Notice**") to the Creditor [**the Banks**], have access to the Immovable, the Listed Equipment and the Excluded Assets at anytime for the purpose of, amongst others, performing an inspection or removing any of the Bank's Property, holding an auction sale, a private sale or submit bids thereat, the whole without any obstruction or opposition on part of the

Creditor, and subject to the priority of the Creditor's rights in respect of the Listed Equipment and the Excluded Assets pursuant to the Priority Agreement.

3. The Creditor hereby agrees that the Bank Property may be stored and/or utilized at the Immovable and shall not be deemed a fixture or part of the Immovable, but shall at all times be considered personal property. Without limiting the generality of the provisions contained herein, and subject to the provisions of Section 4 hereof, the Bank will have the same rights as of the Borrower, following the giving of an Access Notice in writing to the Creditor, to use the Immovable, the Listed Equipment and/or the Excluded Assets without interference from Creditor, including to handle inventory, process inventory, complete raw materials and work-in-process handle and ship finished goods and sell inventory and equipment (including, without limitation, by public auction or private sale (and the Lender or any of its Representatives may advertise and conduct such auction or sale at the Immovable and shall use reasonable efforts to notify the Creditor of its intention to hold any such auction or sale) and to take any action to foreclose or realize upon or enforce any of the Bank's Security, and will have the right to perform any operation relating to the Bank's Property, including to dispose of, to sell, to remove, to store temporarily, etc. the Bank's Property, as it may deem useful or necessary, subject to the priority of the Creditor's rights in respect of the Listed Equipment and Excluded Assets, and for a period of time deemed reasonably necessary by the Bank, but in any case not exceeding 120 days (the "**Period**") and provided that during the Period, the Bank shall keep safe and in good order and repair, subject to normal wear and tear, the Immovable, the Listed Equipment and Excluded Assets. If any injunction or stay is issued (including an automatic stay due to a bankruptcy proceeding) that prohibits the Bank and the Creditor from exercising any rights under this Agreement, commencement of the Period shall be deferred until such injunction or stay is lifted or removed. At any time after the Creditor takes action to foreclose or realize upon the Immovable, the Listed Equipment and the Excluded Assets in accordance with the terms of this Agreement and the Priority Agreement, the Creditor may deliver a notice to the Bank requiring that the Period commence on the date of the receipt by the Bank of such notice.

4. During the Period (for greater certainty, regardless of whether the notice commencing the Period was given by the Creditor, the Bank or a Representative), the Bank shall pay to the Creditor, on a *per diem* basis for the period of actual occupancy of the Immovable by the Bank:

(a) Any portion of current interest due and payable under the Creditor's Loans at a rate not in excess of the rate of interest payable as of the date hereof in connection with the aforesaid Loans, with the exception of any amount due and payable on account of arrears of the Borrower or as a result of a default of the Borrower under the terms of the aforesaid loans;

(b) All current utilities, municipal property taxes and similar expenses related solely to the occupation of the Immovable, in amounts consistent with past amounts payable by the Borrower in connection with the Immovable and which, for greater certainty, shall not include any amount due and payable on account of arrears of the Borrower; and

(c) Insurance costs in order to maintain in full force and effect insurance policies relating to the Immovable, the Listed Equipment and the Excluded Assets, as the case may be.

...

7. Subject to the Creditor's obligations during the Period under this Agreement and provided that it does not interfere with the Bank's rights during the Period under this Agreement, (1) nothing in this Agreement shall be construed as to prevent the Creditor from having reasonable access to the Immovable during the Period to inspect and evaluate the Listed Equipment and Excluded Assets or from commencing any action to foreclose or realize upon or enforce any of its rights as a secured party with respect to the Immovable, the Listed Equipment and Excluded Assets and (2) the Creditor shall be entitled to have access to the Immovable to inspect and evaluation the Listed Equipment and Excluded Assets at the commencement of the Period. Creditor may sell the Immovable and the Listed Equipment during the Period, provided that the purchasers of the Immovable and the Listed Equipment shall have expressly agreed in writing to be bound by the obligations of Creditor under this Agreement with respect to the purchased Immovable and the Listed Equipment until the expiration of Period and the items purchased shall remain in place and shall remain subject to the rights of use and occupancy the Bank and any of its Representatives, in accordance with this Agreement. (Underlining and descriptions added).

[7] Thus, under the Creditor's Agreement, JPM could occupy the Cornwall Property for the purpose of carrying on the business of UTTC and selling JPM's collateral. Such occupation would be at JPM's expense and could not exceed 120 days. The Banks could sell the Cornwall Property during this period, as long as the purchaser agreed to respect the 120 day occupation period.

[8] As security for its loans JPM held a first charge over substantially all the personal property of UTTC and a second charge over the real property of UTTC.

[9] The Banks held a first charge against the real property, consisting of land in Cornwall, Ontario containing a manufacturing facility used by UTTC.

The Receivership Motion

[10] On March 7, 2006, counsel to JPM served a Notice of Application and supporting affidavit seeking the appointment of a Receiver over the assets and undertaking of UTTC upon the solicitors for the Banks. The application was returnable on March 10, 2006. Goodman and Carr LLP ("G&C") was retained as counsel on behalf of the Banks.

[11] JPM filed an affidavit of William H. Canney Jr., of JPM in support of the receivership application.

[12] At paragraph 34 Mr. Canney deposes:

> JP Morgan believes that JP Morgan's collateral position is declining. Recent borrowing base certificates submitted to JP Morgan by UTTC show a steady decline in the value of JP Morgan's collateral. It is not clear whether this is a result of the discovery of additional errors or misstatements made by UTTC prior to January 31, 2006, a deterioration in the value of the collateral, or both. The borrowing base certificate submitted to JP Morgan on March 3, 2006 indicated that the borrowing base had declined resulting in the Revolving Facility exposure exceeding the borrowing base by approximately US$6,218,308.36; however, the certificate reflected a calculation error which if corrected, would have indicated an exposure of CDN$5,793,308.36. JP Morgan is concerned that, unless an interim receiver is appointed immediately, the value of UTTC's business and operations may decline further as suppliers and customers become aware of UTTC's instability. (*Underlining added*)

[13] At the time of the Receivership Appointment order, UTTC was indebted to JPM in a principal amount exceeding $12 million (U.S.) and to the Banks in an aggregate amount of $2.2 million (Can.).

[14] In proceeding by way of court appointed receivership, JPM was deviating from the terms of the Creditors Agreement. For example, the stay of proceedings prohibited the Banks from selling the Cornwall Property in accordance with paragraph 7 of the Creditors Agreement.

[15] On March 9, 2006 G&C sent the following e-mail to Brett Harrison of McMillan Binch Mendelsohn ("MBM"):

> Thank you for sending the material.
>
> With respect to the charges in the order, it is my view that my client's collateral should not be subject to the Receiver's Charge or the Receiver's Borrowing Charge. My client's security is on real property and related fixtures. My client does not need a receiver to realize on its collateral. Similarly my client does not require that the business carry on and incur the costs to be financed by the receiver's borrowings. Thus I would ask for a provision carving out Laurentian's collateral from the Charges.

> Aside from the above issues, my client supports the receivership. (*Underlining Added*)

PROVISIONS OF THE APPOINTMENT ORDER

[16] The Appointment Order contains numerous protections for the court appointed Receiver including:

> (i) a prohibition against proceedings against the Receiver without consent or leave of the Court (para. 7);
>
> (ii) protection against liability for employee related claims (para. 13); and
>
> (iii) limitation on environmental liabilities (para. 15).

[17] In addition, the Appointment Order contains a general limitation on the Receiver's liability at paragraph 17 as follows:

> THIS COURT ORDERS that the Receiver and its officers, directors, employees, agents and other representatives acting on behalf of the Receiver in its administration of the receivership shall incur no liability or obligation as a result of its appointment or the carrying out the provisions of this Order, save and except for any gross negligence or willful misconduct on its part. Nothing in this Order shall derogate from the protections afforded the Receiver by section 14.06 of the BIA or by any other applicable legislation.

[18] RECEIVER'S ACCOUNTS

> 18. THIS COURT ORDERS that 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 form a first charge on the Property in priority to all security interests, trusts, liens, charges and encumbrances, statutory or otherwise, in favour of any Person (the "Receiver's Charge").

[19] It is clear that paragraph 18, read in context and as a whole, makes reference to expenditures and liabilities, including, fees, properly incurred in the administration of the estate which would be allowed in a passing of accounts. There is no general indemnity of the Receiver with respect to General Claims or Specific Claims arising from the Receiver's conduct or actions.

[20] The Appointment Order does not contain an indemnity in favour of the Receiver, secured by assets of UTTC with respect to General Claims or Specific Claims (as those terms are defined in the Receiver's Factum), as claimed in paragraph 23 of the Receiver's Factum.

[21] The terms of paragraph 24A of the Receivership Agreement were negotiated to maintain the provisions of the Creditors Agreement:

> 24A. THIS COURT ORDERS that notwithstanding any other provisions herein, but subject to further order of the Court, the Receiver's Borrowing Charge shall be subordinate to the charges held by Business Development Bank of Canada and Laurentian Bank of Canada with respect to the collateral defined as the "Immovable" and "Excluded Assets" as defined in the creditor agreement made as of July 8, 2005 amongst Business Development Bank of Canada, and Laurentian Bank of Canada and JP Morgan (the "Creditor's Agreement"). The allocation of the said charges to "Listed Equipment", as defined in the Creditors Agreement and the allocation of the Receiver's Charge with respect to the Immovable and Excluded Assets is to be undertaken by the Receiver, subject to further order of the Court. The Receiver shall pay an amount equal to the current interest due and payable under the Creditor's Loans (as defined in the Creditors Agreement) together with all current utilities, municipal property taxes and similar expenses related solely to the occupation of the Immovable and insurance costs in order to maintain in full force and effect insurance policies relating to the Immovable, and the Excluded Assets, all as defined in the Creditors Agreement.

[22] Essentially, paragraph 24A:

> (i) recognizes the priority of the Bank's real property security over borrowings of the receiver for the purpose of operating the business of UTTC;
>
> (ii) recognizes the requirement to allocate the Receiver's Charge by the Receiver subject to further order of the Court; and
>
> (iii) reflects JPM's obligation to make the payments referred to in paragraph 4 of the Creditor's Agreement.

Receivership Proceedings

[23] On April 18, 2006 an Order was granted by the Court approving the "going concern" sale by the Receiver to a single purchaser or its affiliates of substantially all the Real Property and all the Personal Property.

[24] The Receiver operated the UTTC business for an extended period, prepared a comprehensive confidential information memorandum with respect to the business, dealt with numerous potential purchasers with respect to the business, attended on various motions and, ultimately, succeeded in selling the business as going concern on May 1, 2006. The Receiver received net proceeds of approximately $7.1 million for the Personal Property and $2.2 million (Can.) from the sale of Real Property.

[25] Most of the work done by the Receiver and its counsel would not have been necessary in order to sell the Cornwall Property alone.

[26] The Banks have no complaint with respect to the purchase price secured by the Receiver for the Cornwall Property. The gross sale proceeds slightly exceed the indebtedness owed to the Banks.

[27] However, the largest beneficiary of the sale of the real property is JPM as the sale of the Cornwall Property allowed for the sale of the UTTC business as a going concern. It is the understanding of the Banks that if the operating assets of UTTC (i.e. inventory, receivables and equipment) were sold on a liquidation basis, JPM would have recovered less.

[28] The Banks were free to sell the Cornwall Property after 120 days independent of JPM's realization on its security. It is a moot point whether they would have received more or less on a separate sale.

[29] At present the Receiver is not aware of any General Claims. The Receiver intends, upon further motion to this Court, to seek direction with respect to a claims bar procedure for the purpose of identifying, contesting and resolving any General Claims or Specific Claims. However, pending the outcome of that process, the Receiver is concerned that its rights to indemnification pursuant to the Receiver's Charge from the proceeds be maintained notwithstanding any distribution that may be made to JPM or the Banks. Absent a reimbursement agreement, the only recourse of the Receiver is to the proceeds of sale in accordance with the Appointment Order and the Approval and Vesting Orders made by this Court.

NATURE OF DISPUTE

[30] The Appointment Order provided that the allocation of the Receivers Charges would be subject to further order of the Court. The parties agree that the Receivers Charge ranks in priority to their respective interests in the Sale Proceeds.

[31] The Receivers Charge proposed by the Receiver and agreed to by JPM but not by the Banks, is:

> i) In respect of the professional fees and disbursements by the Receiver (including legal fees), $175,000 (CAD) plus GST plus an additional $7,000 (CAD) plus GST in respect of Excluded Equipment should be paid by the Banks and the balance allocated to JPM;
>
> ii) In respect of General Claims against the Receiver, JPM and the Banks should reimburse the Receiver on a *pro rata* basis relative to their respective distributions from the proceeds of sale; and
>
> (iii) In respect of Specific Claims, each of JPM and the Banks should be individually liable to reimburse the Receiver.

For these purposes:

a) a "General Claim" is a claim made against the Receiver in connection with the receivership (other than one resulting from its willful misconduct or gross negligence); and

b) a "Specific Claim" is a claim by a party who had an interest in the Personal Property, the Real Property, or proceeds that is established to have a priority over the respective interests of JPM or the Banks.

[32] The Banks say that their liability for Receivers Charges should be limited to $100,000 plus GST and that they should not be liable to reimburse for anything as all claims for real estate priorities were settled prior to the closing.

[33] In addition, it would allow JPM to do an "end run" around the priorities agreed to in the Priority Agreement and Creditors Agreement.

[34] JPM appointed Ernst & Young the Receiver and any indemnity with respect to the operating assets should flow from JPM. However, the Banks agreed to the Receivership subject to priority for the Receiver's Charge.

DISCUSSION

[35] The Receiver's allocation of Fees to the Banks is based upon a reasonable calculation of that portion of the fees of the Receiver and its advisors that can be attributed to the sale of the Real Property and the administration of the receivership up to the completion of the sale. The warehouse operation of UTTC carried on from the Real Property were closely integrated into the business operations of UTTC. The Real Property and Personal Property were jointly marketed by the Receiver and sold in linked transactions which closed simultaneously. Therefore, while it is impossible to segregate and calculate with precision the professional fees attributable solely to the administration of the receivership in relation to Real Property, the Receiver is satisfied that the amount of $175,000 is reasonable in the circumstances.

[36] It is well-settled that at common law, a court-appointed receiver is personally liable for its acts as a receiver but has a correlative right to indemnification on a priority basis out of any assets under its administration. See Kerr & Hunt on *Receivers and Administrators*, 18th ed. (Sweet & Maxwell: London, 2005).

[37] This principle is reflected in the Receiver's Charge as defined in paragraph 18 of the Appointment Order.

[38] The Receiver submits that pursuant to the Receiver's Charge indemnification from the assets of UTTC (in this case the Sale Proceeds) is permitted for three categories of claims. These are as follows:

(a) The Fees;

(b) General Claims; and

(c) Specific Claims.

[39] It is submitted that, as the Receiver was authorized to realize on the assets of UTTC for the benefit of JPM and the Banks pursuant to a consensual sales process, that the Fees, General Claims and Specific Claims are subject to the Receiver's Charge and properly allocated to these creditors for satisfaction from the Sale Proceeds: *Robert F. Kowal Investments Ltd.* v. *Deeder Electric Ltd.* (1975), 59 D.L.R. (3d) 492 (Ont. C.A.) at pp. 3-5.

[40] In *Kowal Investments*, the Ontario Court of Appeal considered whether a Receiver has priority over a mortgagee with respect to its expenses. In its decision, the Court relied upon a passage from *Clark on Receivers*, which began as follows:

> When a court appoints a general receiver of the property of an individual or a corporation, at the instance of a creditor other than a mortgage lienholder, part or all of this property may be covered by liens or mortgages. The general purpose of a general receivership is to preserve and realize the property for the benefit of the creditors in general. No receivership may be necessary to protect or realize the interests of the lienholders. In such cases the mortgagees and lienholders cannot be deprived of their property nor of their property rights and the receivership property cannot as a rule be used nor the business carried on and operated by the receiver in such a way as to subject the mortgagees and lienholders to the charges and expenses of the receivership. A court under such circumstances has no power to authorize expenses for approving or making additions to the property or carrying on the business of the defendant at the expense of prior mortgagees or lienholders without the sanction of such mortgagees or lienholders.

[41] The excerpt from *Clark on Receivers* relied upon by the Court of Appeal in the *Kowal Investments* decision goes on to highlight three exceptions to this general rule, which may be summarized as follows:

(a) Where the Receiver has been appointed at the request of or with the consent of the Mortgagee, the Receiver will be given priority over the security holder;

(b) If the Receiver has been appointed to preserve and realize assets for the benefit of all interested parties, including the mortgagee; and

(c) If the Receiver has expended money for the necessary preservation or improvement of the property.

[42] The obligation on a Receiver in allocating costs from an insolvency proceeding is to exercise its discretion in an equitable manner that does not readjust the priorities between creditors. The allocation:

(a) should be fair and equitable; and

(b) not ignore the benefit or detriment to any creditor.

There is however no requirement that the Receiver be obliged to conduct a strict accounting on a cost-benefit basis as between the creditor classes: *Hunjan International Inc. (Re)* (2006), Carswell Ont. 2718 (Ont. S.C.) at p. 2 and p. 8.

[43] The Receiver submits that the Proposed Allocation is reasonable and in accordance with general principles established by Canadian insolvency courts.

[44] The Receiver submits that the allocation of the Fees is reasonable in the circumstances. Moreover, it has been held that "to require the Receiver to calculate and determine an absolutely fair value for its services for one group of assets vis-à-vis another would likely not be cost effective, would drive up the overall receivership cost and would likely be a fool's errand in any event: *Hickman Equipment (1985) Ltd.*, [2004] N.J. No. 299 at p. 6.

[45] Where as in this case, the Receiver was appointed for the benefit of interested parties to ensure that all creditors were treated fairly and to ensure a fair process to deal with the assets, there is no valid reason for a secured creditor to avoid paying its fair share of the receivership costs: *Bank of Nova Scotia* v. *Norpak Manufacturing Inc.*, [2003] O.J. No. 4818 (Ont. C.A.) at p. 2.

[46] Although every case is different, the case most directly on point is *Re Hunters Trailer & Marine Ltd.*, [2001] A.J. No. 1638 where UMC held mortgages on property and claimed it was a passive creditor. While the risk of loss was greater for the other secured creditors, UMC benefited from the proceedings in that it continued to receive interest and received principle on the sale. However it would be unfair to ignore differences in the type of security held by various creditors and the degree of potential benefit that might be derived by them from the proceedings.

[47] In this case, the receivers fees were $1.67 million. Of the sale proceeds, $175,000 and $7,000 were allocated to the Mortgages for their $2.2 million recovery including $28,000 for personalty. Approximately $1.5 million was allocated to the personal property creditor, JPM, for its $7M recovery. Most of the effort was devoted to running the business and arranging for sale, some indefinable part of which was for the benefit of the Banks.

[48] The court appointed Receiver's Order cancelled the prior Credit and Priority Agreements. The need for a receivership on short notice resulted from a rapidly depreciating value of the business.

[49] The Banks agreed to be responsible for a portion of the receivership costs applicable to the realization on the real property, failing agreement by court determination.

[50] The complexity of the receivership was due not to the real property but the sale on a going concern basis of the manufacturing business.

[51] There were significant issues relating to employees, suppliers, and customers which devolve on the personalty rather than the real estate.

[52] On the other hand, the sale of the real estate was dependent on the sale of personalty, and vice-versa. If either had fallen through, JPM and the Banks would be left to their own devices. There is no guarantee the real estate would have realized its value.

[53] The Receiver paid to the Banks interest on the loans and other realty costs in accordance with s. 24A of the Receivership Order pending sale.

[54] The Banks did not have to bear the risks of a private sale, including real estate commission.

CONCLUSION

[55] In these circumstances, after weighing all the circumstances, I cannot say that $183,000 out of $1,670,000 was an unfair or inequitable burden for the Banks to bear.

[56] Nor can I say that the allocation as between General and Specific Claims is unfair or inequitable. Each will be liable for its respective Specific Claims and will share *pro rata* in General Claims in accord with the amount received. There should be little, if any, General Claims to devolve on the Banks. Operating expenses will be for the account of JPM unless they can be said to rank ahead of the mortgages of the Banks.

ORDER

[57] I grant the motion of the Receiver approving the activities in the Fifth Report, authorizing distribution of the Sale Proceeds subject to a mutually satisfactory reimbursement agreement, approving the fees and disbursements of the Receiver and its lawyer and providing for the allocation of the Receiver's Charge as proposed.

COSTS

[58] If the parties cannot agree, costs may be addressed in writing. The Receiver's submissions shall be made within 15 days of the release of this order. The Banks shall respond within 10 days thereafter.

CAMERON J.

DATE: July 25, 2006

IN THE MATTER OF THE BANKRUPTCY OF SHS SERVICES MANAGEMENT INC./GESTION DES SERVICES SHS INC AND SHS SERVICES LIMITED PARTNERSHIP

IN THE MATTER OF AN APPLICATION PURSUANT TO SECTION 243 OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, c. B-3, AS AMENDED

Court File No. CV-13-10370-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

PROCEEDING COMMENCED AT
TORONTO

BOOK OF AUTHORITIES OF PAUL VERHOEFF AND STEPHEN VERHOEFF

Paliare Roland Rosenberg Rothstein LLP
155 Wellington Street West
35th Floor
Toronto, ON M5V 3H1

Massimo Starnino
Tel: 416.646.7431
Fax: 416.646.4301

Email: max.starnino@paliareroland.com

Lawyers for Paul Verhoeff and Stephen Verhoeff