Court of King's Bench of Alberta

Citation: Bank of Montreal v 2093924 Ontario Inc, 2024 ABKB 457

Date: 20240726
Docket: 2303 22127
Registry: Edmonton

Between:

Bank of Montreal

Plaintiff

- and -

2093924 Ontario Inc., Hyeong Sik Kim and Hee Seon Kim

Defendants

Memorandum of Decision
of the
Honourable Justice N.J. Whitling

I. Introduction and Overview

[1] The Defendant 2093924 Ontario Inc. ("209") operates a truck wash in Edmonton called the "Wash Factory". MNP Ltd. was appointed as the Receiver of 209 on a consent basis by Order of Justice Dunlop of this Court dated January 12, 2024. The Receiver now applies pursuant to s. 243 of the *Bankruptcy and Insolvency Act*, RSC 1985 c B-3, for court approval of an Amended Asset and Real Estate Purchase Agreement dated April 10, 2024 (the "APA"), for the sale of substantially all of 209's assets to Klair Group Industries Ltd. ("Klair") as well as certain ancillary relief.

[2] The individual Defendants Hyeong Sik Kim and Hee Seon Kim are 50% shareholders of 209 (the "Shareholders") and Hee Seon Kim is the sole director. The Shareholders' son Jason Kim ("Jason") is the Wash Factory's operations manager.

[3] The Receiver's application is supported by the secured creditor, the Bank of Montreal, and by Klair. It is opposed by all three of the Defendants.

[4] Another interested party who appeared at the hearing of this application is 1643434 Alberta Ltd. ("164"). 164 is the owner of the registered trade name "Rock-N-Wash" and the

former owner of the lands comprising the Wash Factory facility. 164 is a competitor of Klair. A company related to 164, Slazs Investments Ltd. ("Slazs"), is the named holder of a patent which protects certain intellectual property which has been incorporated into the land and buildings comprising the Wash Factory (the "Patent").

[5] 164 opposes this application on the basis that the Patent would effectively prohibit Klair as the new owner of the Wash Factory from operating that facility as a truck wash given the absence of any licensing agreement with 164.

[6] The Shareholders oppose this application on the basis that, in their view, the Receiver has not made sufficient efforts to obtain the highest price for the Wash Factory, and has acted unfairly towards the Shareholders.

[7] Having considered all of the parties' submissions, I find that the Receiver's application must be granted. By operation of the doctrine of patent exhaustion, 164 is no longer entitled to control the sale or use of the land comprising the Wash Factory. Further, the Receiver has made sufficient efforts to obtain the highest price for the Wash Factory and has not treated the Shareholders unfairly. The terms of the APA are fair and reasonable to the stakeholders of 209's estate.

II. Facts

[8] The Receiver's appointment was made effective February 15, 2024. Since then, the Receiver has gathered information respecting the history of the Wash Factory and conducted a sales process which culminated in the APA with Klair. The following summary sets out the significant aspects of those events.

A. 209's Acquisition of the Wash Factory Facility in 2016

[9] The facility which comprises the Wash Factory is designed and operated in accordance with a certain "3 Door Car Wash Design" which is the subject of Canadian Patent 2,767,610. In addition to certain methods for washing and servicing vehicles, the Patent protects the physical design of the facility, and sets out a basic diagram of its layout. Since the Wash Factory facility was designed and built in accordance with the specifications in the Patent, the intellectual property protected by the Patent is physically incorporated into the building, and it is practically impossible to separate the patented design from the building without destroying it.

[10] The Patent identifies its holder as Slazs. At the hearing of this application, Mr. Sylvain Blouin purported to speak on behalf of 164, and he has sworn an Affidavit in opposition to this application. Mr. Blouin is not a lawyer and his materials do not provide a clear explanation of the relationships amongst himself, 164, and Slazs. Contrary to the copy of the Patent exhibited to his Affidavit, Mr. Blouin states at paragraph 1 of his Affidavit that it is 164 rather than Slazs that is the holder of the Patent. Given the absence of any contrary evidence, I accept that 164 is entitled to claim the benefit of the Patent, either as an owner of Slazs or by virtue of some manner of transfer of Slazs' patent rights that is not in evidence. In any event, as the Receiver reports, Mr. Blouin, Slazs, and 164 are all related entities and Mr. Blouin is the directing mind of Slazs and 164.

[11] 209 first acquired the land and buildings that comprise the Wash Factory from 164 pursuant to a Real Estate Purchase Contract executed on November 29, 2016.

[12] Although the Real Estate Purchase Contract of November 29, 2016, between 164 and 209 does not specifically contemplate the creation of a licensing agreement for the intellectual property protected by the Patent, a related Trademarks & Patent License Agreement respecting the Patent was entered into between Slazs as licensor and 209 as licensee on April 10, 2017. Article 3 of that agreement grants 209 a non-exclusive license to use the "Marks" which are defined to include the "3 Door Car Wash Design". Article 4 prohibits 209 from assigning or sub-licensing the Marks:

> **4. Assignment Prohibited**
>
> Licensee's rights under this Agreement to use the Marks shall not be assigned or licensed to any third party by the Licensee without the prior written approval of the Licensor, and an attempted assignment by the Licensee may, at the sole discretion of the Licensor, be sufficient cause for termination of this Agreement. In addition, Licensor may at its sole discretion terminate this Agreement upon a corporate merger or other consolidation by the Licensee.

[13] 164 now argues that the above language of the licensing agreement between Slazs and 209 prohibits the Receiver, on behalf of 209, from assigning, sub-licensing, or otherwise transferring 209's license to use the patented methods and facilities to Klair pursuant to the APA of April 10, 2024, for which court approval is now sought.

B. The Defendants' Efforts to Market and Sell the Wash Factory in 2023

[14] Prior to the Receiver's appointment on February 15, 2024, Jason and the Shareholders had engaged a realtor, Sheryl Leskiw of Diamond Realty & Associates Ltd. (the "Realtor") to market the Wash Factory. The Realtor specializes in the sale of car washes in and around Alberta and has 17 years of experience in this area. She has a database of over 4,000 clients that often enables her to secure a sale without the need for public advertising.

[15] Pursuant to Jason's instructions, the Realtor discreetly sourced potential buyers from market contacts rather than list the Wash Factory publicly. The Realtor solicited offers in this manner for four months and spoke to many players in the industry. She found that there was little to no pool of buyers for a used facility at the price sought by Jason given the business's declining revenues and given the presence of competition from a newly built facility nearby.

[16] Jason received two offers to purchase the facility from prospective purchasers prior to the appointment of the Receiver, but those offers did not come to fruition as conditions were not satisfied.

C. The Receiver's Efforts to Market and Sell the Facility

[17] Following the Receiver's appointment on February 15, 2024, it was agreed amongst the interested stakeholders that it was in the best interests of the estate for Jason to remain in his position as operations manager throughout the receivership to allow the Wash Factory to be sold as a going concern.

[18] On February 19, 2024, the Realtor contacted the Receiver and advised that Klair, being one of the prospective purchasers who had been working with Jason, wished to resubmit an offer to the Receiver for consideration, which Klair did, on February 20, 2024.

[19] Klair, who operates and is known under the name "Klarity Wash", has operated as a premier truck wash service in Alberta since 2002. Klarity Wash has four locations across Alberta

and with over 20 years' experience in the industry is well positioned to integrate the Wash Factory into its existing portfolio. Klair boasts a loyalty program with over 8000 members.

[20] The Receiver entered into negotiations with Klair which resulted in the signing of an Asset Purchase Agreement on March 13, 2024, for the purchase of the Wash Factory (the "Initial APA"). The Initial APA contained a due diligence and financing condition for the benefit of the buyer.

[21] The purchase price offered in the Initial APA was comprised of a cash component (subject to financing) as well as a vendor takeback component, which was negotiated with and agreed to by Jason, on behalf of the Shareholders.

[22] As a condition of the Initial APA, the Receiver provided Klair with additional information it requested to complete its due diligence, including the January 1, 2024, year-end financial statements for the Wash Factory.

[23] After review of the financial information, Klair advised the Receiver that it was seeking to reduce its purchase price as the financial reporting of the Wash Factory showed evidence of consistent declining revenues year-over-year for a period of three years.

[24] In response, the Receiver commissioned an updated appraisal of the business which was received on April 3, 2024.

[25] Meanwhile, one of the potentially interested parties with whom the Receiver was communicating was Mr. Blouin on behalf of 164. Mr. Blouin notified the Receiver of the intellectual property protected by the Patent and expressed the view that no license to use the facility would pass to any purchaser of the Wash Factory. In an email to the Receiver of April 2, 2024, he wrote: "I am assuming you made the prospective purchaser aware of the requirement for a Patent License agreement."

[26] Despite Mr. Blouin's stated assumption, the Receiver did not advise Klair or any other prospective purchasers as to the existence of any requirement for a license agreement respecting the intellectual property identified in the Patent and incorporated into the design of the Wash Factory facility.

[27] After further negotiation between the Receiver and Klair, those parties agreed to a reduced purchase price and entered into an amended agreement, being the APA of April 10, 2024. The APA remained subject to financing and due diligence conditions, in addition to a condition requiring the court approval now sought.

[28] The Receiver consulted Jason, on behalf of the Shareholders, in respect of the APA prior to the Receiver agreeing to the amended terms and its execution. Jason provided his written agreement to the amended terms, including the reduced purchase price.

[29] Two days following the execution the APA, Jason, on behalf of the Shareholders, rescinded their support. By this time, the APA was a legally binding agreement, albeit subject to the purchaser's conditions and court approval. The Receiver was and is of the view that it would have been unfair and a breach of the APA to terminate the APA prior to prior to the purchaser's conditions being satisfied.

[30] After the execution of the APA, Klair sought a number of extensions to remove the purchaser's conditions, mainly to provide additional time for their lender to underwrite the

financing. The Receiver provided a number of extensions, and in exchange, the Receiver was authorized to negotiate with other parties to secure back-up offers.

[31] During the currency of the extensions, the Receiver received one back-up offer from another purchaser. That offer was for a quantum well below the purchase price in the APA.

[32] The persons with whom the Receiver communicated during the currency of the extensions included Mr. Blouin. In the context of those communications, Mr. Blouin continued to invoke 164's rights under the Patent and advised the Receiver that he objected to any use of 164's intellectual property by a competitor. In an email to the Receiver of April 30, 2024, Mr. Blouin wrote: "At the bare minimum, your prospect buyer needs to be informed that I plan to enforce our IP rights with a compensation ahead of them removing their conditions."

[33] The Receiver elected not to advise Klair as to the existence of Mr. Blouin's claim to intellectual property rights respecting the Wash Factory. In an email to Mr. Blouin dated May 2, 2024, counsel for the Receiver wrote: "We have reviewed the Trademarks & Patent License Agreement ("Agreement") and we are aware of no legal basis justifying your stated position below and therefore we decline to engage in this discussion with the proposed buyer."

[34] Following one final extension of time, Klair removed its conditions on June 5, 2024.

III. The Parties' Positions

[35] 164 opposes the Receiver's application for court approval of the APA. Klair is a competitor of 164 and Mr. Blouin objects to Klair's use of its patented facilities and methods absent a licensing agreement. Not being a lawyer, Mr. Blouin asks the court to order Klair to enter into a licensing agreement with 164 containing a royalty rate of 4% of all revenues. Of course, that relief is not available since a licensing agreement cannot be foisted upon Klair. However, if I were to conclude that the Patent effectively prohibits Klair from operating the lands as a truck wash absent an accord with 164, I could deny approval of the sale transaction out of fairness to both 164 and Klair.

[36] In response to 164's objection, the Receiver submits that by operation of the doctrine of patent exhaustion the intellectual property rights protected by the Patent were extinguished in November, 2016, when the land was sold by 164 to 209. Following that transaction, the Receiver says, 209 was free to convey the land to Klair without any restriction as to its use.

[37] Klair agrees with the Receiver's position that it is entitled to acquire the land free of any restriction as to its use. In addition to the doctrine of exhaustion, Klair relies upon the fact that when it entered into the APA, there was nothing registered on the title to the land which claimed to restrict the manner in which the land could be used.

[38] I agree with the Receiver and Klair. By operation of the doctrine of exhaustion, 209 was entitled to sell the land to Klair free and clear of 164's intellectual property rights. For this reason, 164's Patent does not provide a valid basis for the court to deny the Receiver's application to approve the APA. Given this conclusion it is unnecessary to determine whether Klair is also entitled to acquire title to the land free of any restriction as to its use by operation of s. 203(2) of the *Land Titles Act*, RSA 2000, c L-4.

IV. The Doctrine of Patent Exhaustion

[39] The “doctrine of patent exhaustion”, sometimes referred to as the “first sale doctrine”, has long been recognized. In ***Adams v Burke***, 84 US 453 (1873), Miller J. described the doctrine in the following terms:

> …[I]n the essential nature of things, when the patentee, or the person having his rights, sells a machine or instrument whose sole value is in its use, he receives the consideration for its use and he parts with the right to restrict that use. The article, in the language of the court, passes without the limit of the monopoly… That is to say, the patentee or his assignee having in the act of sale received all the royalty or consideration which he claims for the use of his invention in that particular machine or instrument, it is open to the use of the purchaser without further restriction on account of the monopoly of the patentees.

[40] The leading Canadian case on this subject is ***Eli Lilly & Co. v Novopharm Ltd***., [1998] 2 SCR 129. At para. 99, Iacobucci J. adopted the following statements of Pratte J.A. at the Court of Appeal level of that case ((1996), 66 CPR (3d) 329 (Fed CA) at p. 343):

> If a patentee makes a patented article, he has, in addition to his monopoly, the ownership of that article. And the ownership of a thing involves, as everybody knows, "the right to possess and use the thing, the right to its produce and accession, and the right to destroy, encumber or alienate it".... If the patentee sells the patented article that he made, he transfers the ownership of that article to the purchaser. This means that, henceforth, the patentee no longer has any right with respect to the article which now belongs to the purchaser who, as the new owner, has the exclusive right to possess, use, enjoy, destroy or alienate it. It follows that, <u>by selling the patented article that he made, the patentee impliedly renounces, with respect to that article, to [sic] his exclusive right under the patent of using and selling the invention. After the sale, therefore, the purchaser may do what he likes with the patented article without fear of infringing his vendor's patent.</u>
>
> <u>The same principles obviously apply when a patented article is sold by a licensee who, under his licence, is authorized to sell without restrictions</u>. It follows that, if Apotex were to purchase bulk Nizatidine manufactured or imported by Novopharm under its licence, Apotex could, without infringing Lilly's patents, make capsules from that substance or use it in any other possible way.
>
> [Emphasis added [by Iacobucci J.].]

[41] Iacobucci J. in ***Eli Lilly*** continued as follows:

> **100** Perhaps the principles underlying this well-founded statement of the law merit some brief elaboration at this stage. As I have already noted in connection with the distinction between a sublicence and an ordinary agreement of purchase and sale of a patented or licensed article, the sale of a patented article is presumed to give the purchaser the right "to use or sell or deal with the goods as the purchaser pleases": see *Badische Anilin und Soda Fabrik v. Isler*, [[1906] 1 Ch 605] at p. 610. Unless otherwise stipulated in the licence to sell a patented article, the licensee is thus able to pass to purchasers the right to use or resell the article without fear of infringing the patent. Further, any limitation imposed upon a

> licensee which is intended to affect the rights of subsequent purchasers must be clearly and unambiguously expressed; restrictive conditions imposed by a patentee on a purchaser or licensee do not run with the goods unless they are brought to the attention of the purchaser at the time of their acquisition: see *National Phonograph Co. of Australia, Ltd. v. Menck*, [1911] A.C. 336 (P.C.).
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> **101** Therefore, it is clear that, in the absence of express conditions to the contrary, a purchaser of a licensed article is entitled to deal with the article as he sees fit, so long as such dealings do not infringe the rights conferred by the patent…

[42] Surprisingly little Canadian case authority has considered the doctrine of patent exhaustion since ***Eli Lilly***.

[43] Meanwhile, in the United States, it has been held that the doctrine applies equally to method patents as to patented articles. In ***Quanta Computer, Inc. v L.G. Electronics, Inc.***, 553 US 617, 628-29 (2008), Thomas J. wrote:

> It is true that a patented method may not be sold in the same way as an article or device, but methods nonetheless may be "embodied" in a product, the sale of which exhausts patent rights. Our precedents do not differentiate transactions involving embodiments of patented methods or processes from those involving patented apparatuses or materials. To the contrary, this Court has repeatedly held that method patents were exhausted by the sale of an item that embodied the method.

[44] In the article J de Beer and R Tomkowicz, "Exhaustion of Intellectual Property Rights in Canada" (2009), 25 CIPR 3, the authors express the view at p. 14 that ***Monsanto Canada Inc. v Schmeiser***, 2004 SCC 34 "puts into question [the] existence of the exhaustion doctrine in Canadian patent law" since the Court in that case enforced the right of the patentee to control the use of patented canola seeds by a farmer who had acquired the seeds from an unknown source.

[45] With respect, I do not agree with the authors that ***Schmeiser*** puts the existence of the patent exhaustion doctrine into question. Since patent exhaustion is an affirmative defence, it must be asserted and proven by the defendant, and it does not appear to have been raised at any level of court in that case. Given that ***Eli Lilly*** is not mentioned in ***Schmeiser***, it is highly unlikely that the Court intended to overrule that case.

[46] Further, the defence of patent exhaustion requires the defendant to prove that the patentee surrendered the monopoly through an "authorized sale" of the article: Theodore Z. Wyman, "What Is "Authorized" Sale Sufficient to Support Patent Exhaustion", 66 A.L.R. Fed. 3d Art. 7 (2021) at §§2-3. Since the source of the seeds at issue in ***Schmeiser*** was not proven by the defendant (see para. 6), such an authorized sale was not established.

[47] Returning to the present case, the Receiver relies upon the doctrine of patent exhaustion in relation to a parcel of land. I have been unable to find any case in which the doctrine has been applied to realty as opposed to personalty. However, I see no reason in principle why the rule should operate differently in this context. Where the intellectual property protected by a patent has been incorporated into a parcel of land, a patentee who sells that land must impliedly renounce the exclusive right to use and sell the invention with respect to that land. After the first sale, the monopoly conferred by a patent must yield to common law principles against restraints

on alienation. *A fortiori*, a patentee cannot expect to exert indefinite control over the use of land as against subsequent purchasers for value without notice of the patent.

[48] Applying the doctrine of patent exhaustion to the facts of the present case, I find that 164's right to control the facilities and methods comprising the Wash Factory was exhausted by its sale of that facility to 209 on November 29, 2016. 164 received consideration in exchange for its intellectual property in that first sale and in the related licensing agreement, and the Patent confers no further right upon 164 to control the use of the facility by subsequent purchasers.

[49] Further, nothing in the contractual agreements between 164 and 209 purported to oust or otherwise restrict 209's right to sell the facility to a future purchaser free of the rights protected by the Patent. The sale of a patented article is presumed to give the purchaser the right to sell the goods as the purchaser pleases (***Eli Lilly*** at paras. 69 and 100). Although the licensing agreement of April 10, 2017, prohibits 209 from assigning or sub-licensing 209's license, an outright sale is not a license (***Eli Lilly*** at paras. 70-79). Consequently, 209 was free to sell the Wash Factory facility to Klair.

[50] For these reasons, I find that 164's Patent would not restrict or otherwise affect Klair's right to operate the facility currently owned by 209 as a truck wash, and that 209 is not prohibited by any contractual obligation from selling the facility to Klair free of any restraint as to its use. Therefore, the existence of the Patent is not a valid basis for denying approval of the APA pursuant to the *Bankruptcy and Insolvency Act*.

V. The Sale Process and the Resulting Terms of the APA

[51] I turn now to my assessment of the sale process followed by the Receiver, and the resulting APA.

[52] The Shareholders submit that the Receiver has made negligible efforts to market the facility. In his Affidavit, Jason states that he continues to be contacted by prospective purchasers, who he refers to the Receiver, but that the Receiver has refused to engage with them. Jason also complains that the Receiver has failed to market the facility to the general public.

[53] In its reports to the Court, the Receiver expresses the view that although the process it followed in reaching the APA with Klair was not a traditional sales and investment solicitation process ("SISP") the APA is fair and reasonable in the circumstances and in the best interests of the receivership estate for the following reasons, among others:

- Jason, on behalf of the Shareholders, had been marketing and attempting to sell the Wash Factory as a going concern for four months prior to the Receiver's appointment, and therefore the business was exposed to the market for a reasonable period of time;
- Although the purchase contracts entered into in the pre-receivership sales process consisted of offers that were at or near the fair market value arrived at in the appraisal obtained by the Receiver, the Receiver believes that those values were not attainable, as evidenced by the inability of the prospective purchasers to remove their conditions;

- the APA is within the value ranges arrived at in the appraisal and while the purchase price in the APA is less than the full fair market value, it is well above the forced sale value provided for in the same appraisal;
- administering a SISP would take time and the estate would incur additional costs which would substantially increase the interest accrued on the secured debt;
- the sale proceeds from the APA will be sufficient to pay the priority debt of 209 and most of the secured debt, and the APA is supported by 209's senior secured lender, who would likely bear the increased costs of administering a SISP; and
- the Amended Klair Group APA was initially supported by the Shareholders, though they rescinded their support after the Receiver had entered into the APA with Klair.

[54] In a supplemental report, the Receiver also responds to the complaints in Jason's Affidavit by explaining that it was Jason who insisted that the facility not be publicly marketed, and that the prospective purchasers referred to the Receiver by Jason were not responsive to the Receiver's correspondence.

[55] Having considered the factors identified in ***Royal Bank of Canada v Soundair Corp.*** (1991), 83 DLR (4^{th}) 76 (Ont CA) and ***Pricewaterhousecoopers Inc v 1905393 Alberta Ltd.***, 2019 ABCA 433 at paras. 10-11, and having accorded an appropriate degree of deference to the conclusions of the Receiver, I find the terms of the APA to be fair and reasonable to the stakeholders of the estate.

[56] The Receiver has made sufficient efforts to get the best price and has not acted improvidently. Although the facility was not marketed publicly, the process followed was not unfair to the Shareholders given that it was the Shareholders, through Jason, who insisted upon a private marketing process. The private process that was followed by the Receiver benefited from the four months of pre-receivership efforts of Ms. Leskiw, who specializes in the sale of car washes in and around Alberta. Read in light of the contents of the independent appraisal obtained by the Receiver, the terms of the APA are reasonable. Finally, I conclude that it would be unreasonable to require the Receiver to embark upon a SISP, since such a process would most likely result in unjustified costs to the estate as well as further delays.

VI. Conclusions and Order Granted

[57] For the reasons above, the Receiver's application is granted, the APA is approved, the Receiver is authorized to complete the transaction, the APA will vest the property in Klair free and clear of all claims, and it is declared that 164's rights under the Patent are exhausted as they relate to the property.

[58] As is often the case in applications of this nature, the Receiver seeks certain ancillary relief, including an Order deeming service good and sufficient, approving the Receiver's activities to date, deeming certain late notices good and sufficient, and a restricted court access order respecting certain commercially sensitive information. Given that these points of relief are not opposed, they are granted, and do not find it necessary to provide further reasons with respect to them.

[59] The form of Order submitted by the Receiver will be signed and issued to counsel for the parties and to Mr. Blouin.

Heard on the 24th day of June, 2024.
Dated at the City of Edmonton, Alberta this 26th day of July, 2024.

N.J. Whitling
J.C.K.B.A.

Appearances:

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