Court of King's Bench of Alberta

Citation: Smith v Rutledge, 2023 ABKB 571

Date: 20231017
Docket: 2308 00161
Registry: Medicine Hat

Between:

Aaron Smith

Plaintiff

- and -

Rockford Roy Rutledge, Canadian Gunhub Inc., and Rockford Industries Corp.

Defendants

Reasons for Judgement of the Honourable Justice N.E. Devlin

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[1] The Consent Judgment ending these parties' first lawsuit did little to settle their differences. The plaintiff, Aaron Smith ["Smith"], claims that the defendant, Rockford Rutledge ["Rutledge"], intended to frustrate the settlement from the outset, has engaged in fraudulent transfers to improperly shield assets from enforcement under it, and should be held personally liable for the judgment debt of his former corporation, Canadian Gunhub Inc. ["CGH"]. Rutledge denies any wrongdoing and seeks shelter from these claims under the Release previously executed in his favour.

[2] This second chapter in their dispute proceeded as a one-day summary trial. For the reasons that follow, Smith's action is allowed in part.

Procedural History and Background

[3] Smith and Rutledge entered a partnership with the aim of building a shooting range and handgun sales business under the trade name "Canadian Gunhub". Smith made financial and sweat-equity contributions to advance CGH's construction and operation of a shooting range just outside Medicine Hat, Alberta, and to fund its business as an online retailer of restricted firearms.

[4] This business relationship deteriorated, resulting in the two men levying legal claims against one another and CGH. The parties' reciprocal claims were settled through a judicial dispute resolution process in June 2022. The negotiated resolution resulted in a Consent Judgement in favour of Smith, against CGH, in the amount of $70,000. That amount was ordered to be paid in monthly cash instalments, retroactive to October 15, 2021.

[5] The Consent Judgement contained a term by which CGH would become liable for judgement interest if it defaulted on the payment schedule. It also specified that:

> 4. Upon repayment of the $70,000 to Smith, the parties mutually agree that Smith has no legal interest whatsoever in Canadian Gun Hub Inc., or any assets owned by it.

[6] The Consent Judgement also specified that Smith would discontinue against CGH only upon completion of the repayments. In respect of Rutledge personally, however, the Consent Judgement required Smith to discontinue and execute a mutual release within 10 days of the Order ["the Release"]. These steps were completed.

[7] The Release between Smith and Rutledge provided as follows:

> The parties, each on behalf of themselves and on behalf of their representative heirs, legal representatives, officers, directors, employees, agents, successors and assignees, release each other from all actions, causes of action, claims, demands, damages, lawyer fees, costs, and matters of any kind, in law, equity, or otherwise, that any of them individually or in any representative capacity has or has ever had against the others because of or arising out of the matters alleged between the parties in the Court of Queen's bench of Alberta action bearing action number 1808 – 00131, at any events actions or claims related thereto.
>
> It is acknowledged that the settlement is a compromise of a disputed claim that the settlement represents and is upon as given upon the understanding that it is not an admission of liability nor a waiver.
>
> [emphasis added]

[8] CGH rapidly defaulted on the Consent Judgement, making only a single payment of $2,000 to Smith in July 2022. Rutledge caused CGH's assets and liabilities to be "sold" to another corporation controlled by him, Rockford Industries Corp. ["RIC"], for a small amount in October of 2022. He dissolved CGH shortly thereafter.

[9] After an unproductive exchange of angry correspondence following the default, Smith brought this second action, asking that the release be set aside, the transfer of CGH's assets declared a fraudulent conveyance, and Rutledge ordered to make Smith whole for the original settlement amount. The parties agreed to conduct a one-day summary trial on this second phase of the dispute.

Facts at trial

[10] The restrictions on the sale, transference, and ownership of restricted handguns, enacted by regulation of the federal government in August 2022, lie at the root of this dispute. As a result of this "handgun ban", CGH was no longer permitted to transfer, much less sell, handguns in its inventory: the ban essentially decimated CGH's core business. Rutledge testified that this is why

he chose to dissolve that corporation. The evidence established that CGH was unable to meet its ongoing obligations, and thus was legally insolvent, at the time of the Purchase Agreement in October 2022.

[11] Rutledge continues to operate the shooting range and it is branded as the "Canadian GunHub". As the shooting range is handgun-oriented, its business has also been diminished since 2022. Rutledge still works at the range essentially full time and is able to draw a modest salary from it. The range is located in a building owned by third party, with Rutledge as the head lessee in his personal capacity. His position is that this business is run by RIC, which is an active corporation controlled solely by Rutledge.

[12] "Canadian Gunhub" is a registered trademark, formerly owned by CGH. Rutledge caused to be transferred from CGH to RIC in December 2021. As part of an Agreed Statement of Facts it was stipulated that, by the end of its existence, CGH dealt solely with the sale of restricted firearms, specifically handguns. It became clear that Smith did not understand or appreciate this 'fact', but rather believed that CGH was the operator of the entire retail and shooting range venture at all relevant times and was unaware of RIC's existence or involvement in the business at the time the first action was settled.

[13] At no point did Rutledge ever tell Smith that another corporate entity was operating the gun range, other than CGH. Similarly, Rutledge made no mention of the prospective sale-out of CGH's assets, nor its dissolution, to Smith prior to taking these steps. Smith was never offered any of CGH's assets to satisfy his judgement.

[14] A Purchase of Business Agreement ["the Purchase Agreement"] was created between CGH and RIC in October 2022, prior to the former's dissolution. While the Purchase Agreement was never formally executed, Rutledge has acted upon it and clearly intended for both companies, which he solely controlled, to be bound by it.

[15] The intention of this transaction was that RIC buy all CGH's assets and assume all its liabilities. CGH's core assets were the handguns it held in inventory and the physical infrastructure of the shooting range (towards some part of Smith's investment had gone). That infrastructure includes a significant quantity of ballistic steel to create the backstop for the shooting range, target retrieval systems, and a modified sea-container that contains the individual shooting bays.

[16] The values of the assets and liabilities were specified in the Purchase Agreement as follows:

Inventory and packaging	$22,000
Shooting Range	$73,000
Liability – shooting range abatement, destruction & removal	– $48,000
2016 Dodge Ram	$17,633
Liability - 2016 Dodge Ram loan	– $24,103
Liability – Gift Cards Outstanding	– $39,411.06
Purchase Price	**$1118.94**

[17] Rutledge testified that the nominal purchase price was in fact paid by RIC and went towards retiring CHB's GST account balance.

[18] The dollar values specified in the Purchase Agreement were qualified by the evidence at trial. Ownership of the Dodge Ram by CGH is questionable, as it is registered to Rutledge personally. He is presently on the lease for the shooting range premises and personally liable for range cleanup and abatement at lease-end. As regards the gift cards, if CGH had truly only been in the business of selling handguns, as opposed to being involved in range operation, there would be no obvious reason why these would not have been left to die as unsecured debt of the insolvent corporation. Rutledge's wish to continue honouring them demonstrates his financial interest in maintaining the goodwill of the Canadian Gunhub brand under which he continues to operate the shooting range.

[19] Rutledge believed that he enjoyed immunity, if not impunity, as a result of the Release he had obtained from Smith in June 2022. When confronted with the allegation that he had entered the June 2022 settlement with the intention of defaulting on it, Rutledge denied this. Rather, he explained that he considered the settlement a very good strategic business outcome. He testified that CGH could "easily" have paid the judgement if its gun sales business had continued but knew that, if the then-looming handgun ban materialized, CGH would be insolvent, and he would bear no personal responsibility for the then dead-letter Consent Judgement.

[20] At the same time, Rutledge candidly admitted that, if the physical infrastructure of the range were removed, RIC would cease to be a viable business. His own accounting and the Purchase Agreement acknowledge, however, that CGH owned those items. RIC holds the guns formerly owned by CGH in its inventory and rents them to range users. In sum, Rutledge acknowledged that he is better off with the former CGH assets being available for RIC's use.

Position of the parties

[21] Smith alleges that Rutledge entered into the Consent Judgement on CGH's behalf with the intention of dishonouring it, rendering the settlement, and resulting release of Rutledge personally, outcomes obtained by fraud. He further argues that the transfer-out of assets from CGH to RIC amounted to a fraudulent conveyance pursuant to the *Fraudulent Preferences Act*, RSA 2000 c. F-24 ["*FPA*"].

[22] By way of remedy, Smith asks that Rutledge be found personally liable for the amount of the Consent Judgement, that RIC be ordered to transfer assets to satisfy the Consent Judgement, for an order directing Rutledge to make payments personally until the Consent Judgement is satisfied, and an order that 50% of shooting ranges revenue be paid to Smith until the Consent Judgement is satisfied, along with other and ancillary relief.

[23] For his part, Rutledge seeks to have the action dismissed with costs. He asserts that he is protected personally by the Release, that the Consent Judgement was a risky bargain that Smith took knowing that CGH might well become insolvent in the near term if a handgun ban was enacted, and that Smith was not prejudiced as a creditor by the Purchase Agreement because the aggregate liabilities it transferred to RIC were greater than the value of the countervailing assets.

Analysis and Findings

i. Does the Release foreclose Smith's claims?

[24] First off, the Release provides no shelter for RIC from any of the claims in this case, as it was not a party to that release, which was personal to Rutledge and narrowly drafted: ***Kothke v Ekblad***, 1999 ABCA 176 at para 5. Indeed, RIC's existence was unknown to Smith at the time of the settlement and he could not have intended for RIC to be covered by it. Second, Rutledge was also not released from obligations he had as the sole director and operating mind of CGH. Third, the Release is worded retrospectively and does not purport to release Rutledge from as-of-yet uncommitted wrongful acts. A release of future wrongful conduct would have to be very explicit: ***Chopak v Patrick***, 2020 ONSC 5431 at para 28. Even assuming such a release would survive from a public policy perspective, that is not what is found in this case. It would, in any event, be highly problematic to produce a release that expressly contemplated absolving liability for future acts designed to frustrate the very settlement that it is part of.

[25] For these reasons, the Release does not foreclose any part of Smith's present claim.

ii. Was the Consent Judgment and Release obtained by fraud?

[26] Smith bears the onus to show that Rutledge intended to perpetrate a fraud when he caused CGH to enter into the settlement agreement. The evidence does not establish on balance of probabilities that he did. While Rutledge was smugly self-satisfied about the tactical benefits of the settlement, the evidence demonstrates only that he was perfectly happy to receive a personal release from liability in exchange for a judgement against his financially tenuous corporation. He genuinely believed that Smith openly and knowingly accepted the risk attached to CGH's ability to pay being contingent on the continuing regulatory viability of its business.

[27] Smith's claim that Rutledge came to the table in June 2022, knowing that his company would default is not without circumstantial support. Rutledge's transfer of the Canadian Gunhub trademark to his new company, together with the timely and undisclosed stripping-out of CGH's assets, would be consistent with such an intention. However, I accept Rutledge's evidence that CGH could and would have paid the judgement amount if its firearm sales business had continued. His high degree of candour regarding his thoughts and intentions surrounding the settlement and subsequent dissolution of CHG, even when his evidence undermined his legal position, contributes to my confidence in his forthrightness. On balance of probabilities, I find that Rutledge would have caused CGH to pay Smith if the handgun ban had not precipitated.

[28] Moreover, I find merit in Rutledge's assertion that Smith knew that CGH faced very significant business uncertainly by June 2022, when the possibility of the handgun ban was well known in the public sphere, and particularly within the firearms community of which Smith was a part. Similarly, reliance on an opposing party continuing to own and use certain assets, and operate as a going concern, can and should be covered by representations and warranties in a settlement agreement. In this case, the drafting of the Consent Judgement and Release reflect that Smith accepted the risk that CGH could be left in a very difficult financial position by changes to the regulatory environment, and do not contain assurances that CGH was still in the shooting range business or owned specific trademark assets.

[29] I do not find that the Consent Judgment or Release are vitiated by fraud.

iii. Was the Purchase Agreement a fraudulent conveyance?

[30] The *FPA* deems certain transfers of property to be unenforceable against creditors who are unfairly prejudiced by them. Specifically, it provides that:

> **Fraudulent transfers**
>
> **1** Subject to sections 6 to 9, every gift, conveyance, assignment, transfer, delivery over or payment of goods, chattels or effects or of bills, bonds, notes or securities or of shares, dividends, premiums or bonus in any bank, company or corporation, or of any other property, real or personal, made
>
> (a) by a person at a time when the person is in insolvent circumstances or is unable to pay the person's debts in full or knows that the person is on the eve of insolvency, and
>
> (b) with intent to defeat, hinder, delay or prejudice the person's creditors or any one or more of them,
>
> is void as against any creditor or creditors injured, delayed or prejudiced.
>
> [emphasis added]

[31] CGH was, by Rutledge's admission, insolvent and incapable of paying its debts under the Consent Judgement at the time it transferred its remaining assets to RIC. The requirements of s. 1(a) are therefore met. The real question is whether this transaction was entered into with the requisite intent to prejudice Smith as a judgement creditor of CGH. On its face, the Purchase Agreement looks exactly like a fraudulent preference, as it preserves the assets held by CGH for use by its sole director and shareholder, by moving them to another of his corporate entities that is unencumbered by a judgment is favour of Smith.

[32] Rutledge's main line of defence is that CGH had greater net debt than assets. He argues that, as an unsecured judgment creditor, Smith was not prejudiced by a distribution of CGH's assets in exchange for resolution of its *Excise Tax Act* liabilities, as these would have taken precedence to other creditors' claims in any event. Essentially, he argues that Smith was not defeated, hindered, or prejudiced because there was no value in CGH that he could have enforced against in any event.

[33] That position is untenable for two reasons. First and foremost, the handguns and range infrastructure self-evidently have value. These are tangible items, free of encumbrances, which are being actively used to generate revenue. Second, the outstanding liabilities are all somewhat questionable. It appears that these may be Rutledge's liabilities more than those of CGH. The gift card liability matters only because RIC wants to carry on with the shooting range and not compromise its goodwill, which has nothing to do with CGH's purported business.

[34] No matter how the pie is sliced, I find as a fact that there was value in CGH at the time of the purchase agreement. Rutledge's own actions definitively attest to this, and he effectively acknowledged so in evidence. That value may be limited and hard to extract, but this practical reality does not excuse sidelining Smith. Every creditor has the right to decide whether enforcing against limited assets is worthwhile.

[35] In this case, it is clear that Rutledge intended to prefer his own interests over those of Smith. In addition to his silent and self-directed dissipation of CGH, Rutledge explicitly admitted

that he was preferring his own interests in taking that step, describing his state of mind around the Purchase Agreement in the following terms: "Since the liabilities were a higher aggregate than the value, I was worried about what I could get first before Mr. Smith. So no, I did not consider Mr. Smith at all."

[36] This forthright statement is a literal admission of preferring his own interests over whatever interests Mr. Smith may have had in the remains of CHG.

[37] For all these reasons, I am satisfied that the Purchase Agreement was fraudulent transfer within the meaning of s.1 of the of *FPA.*

iv. What remedies are available?

[38] The *FPA* itself provides little in the way of remedies. It simply declares that an impugned transaction is void as against a prejudiced creditor. Therefore, at a minimum, the assets of CHG listed in the Purchase Agreement are available to Smith for enforcement of his judgment. The nature of those assets may make enforcement impractical. For example, Smith may face significant regulatory impediments in taking possession of the handguns, and the range infrastructure may be of very limited value outside its present utilization. These practical considerations should inform how the parties proceed going forward, but do not change the basic legal fact that CHG's former assets are exigible by Smith.

[39] Given the potentially hollow nature of this core remedy, Smith asks this Court to find Rutledge personally liable for the amount of Consent Judgment for having caused the fraudulent preference. He was, however, unable to point to a jurisdictional pathway to this result in the absence of a finding of fraud *ab initio*.

[40] That result is consistent with the fundamental nature of fraudulent preferences as a concept. The doctrine exists to prevent the bad-faith transfer/concealment of a debtor's assets, and to obviate such transactions against a creditor's rights, not to make the creditor whole for the underlying debt obligation. As the British Columbia Supreme Court recognized in ***Cabaniss v Cabaniss***, 2010 BCSC 513 at para 15:

> Unlike tort, where the purpose is to put the injured party back into the same position as had the tort not occurred, the purpose of the *Fraudulent Conveyance Act*, R.S.B.C. 1996, c. 163, is to prevent debtors from moving property out of the hands of creditors. The Act does not speak of compensating for other injuries sustained as a result of a fraudulent conveyance.
>
> [emphasis added]

[41] Neither the *FPA*, nor its predecessor/parallel the *Statute of Elizabeth* (*Fraudulent Conveyances Act*, 1571 (U.K.), 13 Eliz. 1, c. 5), create or extend new or additional legal rights to aggrieved creditors against individuals who engage in or cause such transactions. In ***Suncorp Realty Inc v PLN Investments, Inc***, 1985 CanLII 3103 at paras 41-42, the Manitoba Court of King's Bench held that:

> The main relief to be obtained in an action to set aside a conveyance as fraudulent, is a declaration to that effect. (It is to be noted that the declaration will not go so far as to declare that the transfer should be set aside, as it would be valid between the parties, although void as against creditors.) See *Merchants Bank of*

> *Canada v. Hoover* (1907), 5 W.L.R. 516. In some instances an injunction will be granted to restrain further transfers of the property: see *Fairchild v. Elmslie* (1909), 1909 CanLII 400 (AB KB), 2 Alta. L.R. 115. As well, it would seem that where the transferee has sold the property and has the proceeds of the sale in his hands, the court may order that the sale proceeds are held in trust for the debtor so that the moneys will then become available to pay the creditors. There is no claim for damages. The whole idea of the proceeding is to simply avoid the transaction as against the creditors so they can have access to the property in question to satisfy their claims.
>
> Because of the absence of a possible claim for unliquidated damages — or any damages at all — I would not be prepared to classify a fraudulent conveyance as a tort.
>
> [emphasis added]

[42] This view was specifically adopted in ***Chan v Stanwood***, 2002 BCCA 474 at para 37, and I agree that it correctly expresses the law. The fact that Rutledge caused a fraudulent preference to occur, to benefit himself, does not make him liable for the underlying judgment against CGH — it simply undoes the fraudulent transfers.

[43] If Rutledge had taken personal control over CGH's property and converted it, he might have been held liable for of the associated value: *FPA* s.11; ***Rogers Realty Ltd v Prysiazny***, 1996 CanLII 19959 (AB KB) at para 36. The evidence, however, does not show such a flow of value in this case.

[44] I am sympathetic to Smith's position. It is clear he entered litigation against Rutledge with a deeply held sense of being wronged. The fact that his judgment against CGH has turned out to be largely unenforceable is understandably frustrating. A judgment, however, is only worth as much as the debtor. The law of fraudulent preferences can preserve that value to the creditor, but there is no legal basis upon which Smith is entitled to be put into a better position by virtue of the fraudulent preference having occurred than he would have been in its absence.

Conclusion

[45] The assets transferred from CGH to RIC under the Purchase Agreement are declared to be assets of CGH for the purposes of enforcing Smith's Consent Judgment. For clarity, this includes all physical infrastructure of the Canadian Gunhub range, and the firearms transferred from CGH to RIC. CGH is declared to be in default of the Consent Judgment to the extent of $68,000, plus judgment interest. Smith may enforce the Consent Judgment in the ordinary manner against those assets.

[46] Mr. Wight proposed a number of creative solutions by which the judgement could be satisfied without decimating the shooting range business' ongoing viability. It may well make sense for Smith and Rutledge to proceed cooperatively to maximize the value of these assets on a forward-going basis. This would be fair and sensible. In particular, the best solution may be for Mr. Rutledge to continue operating the range and make modest payments to Mr. Smith. This would require mutual openness about the financial situation of RIC and realism about their shared problem.

[47] The Court, however, does not have the coercive jurisdiction to impose common sense upon these parties to work within the commercial and regulatory realities they face. It is hoped that practical good faith will prevail, notwithstanding the personal hurt that has arisen between these parties in the past.

[48] The parties are encouraged to settle costs as part of a global negotiated resolution. However, if agreement cannot be reached, they may make an appointment to speak to costs.

Heard on the 22th day of September, 2023.
Dated at the City of Medicine Hat, Alberta this 16th day of October, 2023.

N.E. Devlin
J.C.K.B.A.

Appearances:

Darin Wight
for the Applicant

Rockford Roy Rutledge
Self-Represented Litigant