COURT OF APPEAL FOR BRITISH COLUMBIA

Citation: *Eggertson v. Cascade Steel Rolling Mills Inc.,* 2024 BCCA 349

Date: 20241017
Docket: CA44223

In the MATTER OF THE BANKRUPTCY OF
Tudor Sales Ltd.

Between:

Tavi Eggertson

Appellant
(Applicant)

And

Cascade Steel Rolling Mills Inc.

Respondent
(Applicant)

Before: The Honourable Mr. Justice Willcock
The Honourable Justice Griffin
The Honourable Mr. Justice Voith

On appeal from: An order of the Supreme Court of British Columbia, dated January 25, 2017 (*Tudor Sales Ltd. (Re)*, 2017 BCSC 119, Vancouver Docket B131477).

Counsel for the Appellant:	T.C. Louman-Gardiner
Counsel for the Respondent:	C.R.J. Gallant
Place and Date of Hearing:	Vancouver, British Columbia May 28, 2024
Written Submissions Received:	July 31 and August 21, 2024
Place and Date of Judgment:	Vancouver, British Columbia October 17, 2024

Written Reasons by:
The Honourable Mr. Justice Willcock

Concurred in by:
The Honourable Justice Griffin
The Honourable Mr. Justice Voith

Summary:

The appellant claims to be a secured creditor of the bankrupt company. The orders appealed from subordinated his claims to those of other creditors and dismissed his application to have funds held by the bankrupt's trustee paid out to him. The appellant argues the chambers judge had no jurisdiction to make the order under s. 135(5) of the Bankruptcy and Insolvency Act because the provision requires the trustee to have first allowed a claim before a court can reduce or expunge it. He further argues the chambers decision was procedurally unfair and the judge erred in characterizing his advances to the bankrupt.

Held: Appeal dismissed. The chambers judge had jurisdiction to make the order as s. 135(5) empowers the court to reduce or expunge a claim whenever a trustee refuses to interfere; the trustee's allowance of a claim is not a prerequisite. There was no procedural unfairness or error in characterizing the payments made by the appellant to the bankrupt.

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Reasons for Judgment of the Honourable Mr. Justice Willcock:

Introduction

[1] This appeal is from two orders made in the bankruptcy of Tudor Sales Ltd. ("Tudor"). The first subordinated certain claims of Tavi Eggertson ("Eggertson"), a shareholder of Tudor and its sole officer and director, to the claims of other creditors. The second dismissed Eggertson's application to have funds held in trust by Tudor's trustee, Boale, Wood & Company Ltd. ("Boale, Wood"), paid out to him.

[2] In March 2006, Eggertson entered into a general security agreement (the "GSA") with Tudor which purported to secure repayment of all indebtedness owing from Tudor to Eggertson.

[3] Boale, Wood was appointed by Eggertson as Tudor's receiver under the GSA in November 2013. Its preliminary report to creditors indicated there would be a shortfall to the secured creditors and no funds available for distribution to the unsecured creditors. After payment of other secured claims, Boale, Wood paid out $500,000 to Eggertson in March 2014, apparently relying upon the GSA, while retaining $600,000 in trust. Shortly thereafter, Cascade Steel Rolling Mills Inc. ("Cascade"), Tudor's single largest unsecured creditor, with a claim of $1,367,746.25, advised Boale, Wood it was investigating the validity of and/or the amount secured by the GSA.

[4] Cascade obtained an order under s. 163(2) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 [*BIA*], pursuant to which it examined Eggertson. It then sought a ruling from Boale, Wood, in January 2015, that Eggertson's proof of security be disallowed under s. 135 of the *BIA*, and that the trustee demand the return of the previously distributed funds. Boale, Wood declined to do so, citing a lack of resources to investigate and address the issue.

[5] In June 2015, Cascade applied to the Supreme Court for an order, under s. 135(5) of the *BIA*, that Eggertson's proof of claim and proof of security be expunged, reduced, or subordinated to the claims of other creditors.

[6] In response, Eggertson applied for payment out of trust of the remaining funds, asserting a total claim, net of the $500,000 received in March 2014, of $2,781,359. That amount was derived from the sum of advances made by Eggertson to Tudor in 2005–06 and 2011–12:

a) 2005–06 Advances: recorded in Tudor's last (unaudited) pre-bankruptcy financial statements as $1,361,359 in shareholder loans from Eggertson; and

b) 2011–12 Advances: $1.92 million advanced by Eggertson, through Tudor, to an entity known as T.E. Steel. This figure was included in Eggertson's claim although Boale, Wood had advised him in December 2014 that the 2011–12 Advances should not form part of his claim against Tudor.

[7] The chambers judge held Eggertson's claim in respect of the 2005–06 Advances was a claim to equity, subordinated to all other creditor claims pursuant to s. 140.1 of the *BIA*. Even if those advances were loans, as asserted, the judge found they were non-arm's length transactions with an interest rate intended to vary with Tudor's profits. That was sufficient, in his opinion, to bring the loans within the ambit of s. 139 of the *BIA* which provides:

> **Postponement of claims of silent partners**
>
> **139** Where a lender advances money to a borrower engaged or about to engage in trade or business under a contract with the borrower that the lender shall receive a rate of interest varying with the profits or shall receive a share of the profits arising from carrying on the trade or business, and the borrower subsequently becomes bankrupt, the lender of the money is not entitled to recover anything in respect of the loan until the claims of all other creditors of the borrower have been satisfied.

[8] Further, the chambers judge held the 2011–12 Advances were non-arm's length transactions made, through T.E. Steel, to cover the expenses of a tequila business owned by Eggertson, known as Casa de Tavi, that should not properly have been allocated to Tudor. He found there was insufficient evidence Tudor was regarded as being indebted to Eggertson for those advances, or that the flow of monies through Tudor's accounts to the tequila venture represented a *bona fide* investment on behalf of Tudor.

Grounds of Appeal

Jurisdiction

[9] The appellant says the chambers judge erred by conducting the hearing without a prior determination by the trustee that Eggertson had a provable claim of $2,781,359, or any amount, and that he therefore had no jurisdiction to make the order subordinating his claims to the claims of other creditors.

Procedural Fairness

[10] The appellant says the propriety of the 2011–12 Advances was not pleaded and ought not to have been considered by the chambers judge.

Improper Allocation of Onus

[11] He says the judge erred in law by requiring the appellant to discharge the onus of proving that the 2011–12 Advances were “proper” transactions.

Palpable and Overriding Error

[12] Finally, he says that if the judge had jurisdiction under s. 135(5) and if the propriety of the 2011–12 Advances was properly before him, the judge made palpable and overriding errors:

a) in finding the interest payments on the 2005–06 Advances varied with the profits of the Company; and

b) in finding the 2011–12 Advances were used to fund the operations of Casa de Tavi.

Jurisdiction

Can a s. 135(5) Order be Made Before a Trustee has Allowed a Claim?

[13] Cascade’s application was brought pursuant to s. 135(5) of the *BIA*. Section 135 reads as follows:

> **Trustee shall examine proof**
>
> **135 (1)** The trustee shall examine every proof of claim or proof of security and the grounds therefor and may require further evidence in support of the claim or security.
>
> **Determination of provable claims**
>
> **(1.1)** The trustee shall determine whether any contingent claim or unliquidated claim is a provable claim, and, if a provable claim, the trustee shall value it, and the claim is thereafter, subject to this section, deemed a proved claim to the amount of its valuation.
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> **Disallowance by trustee**
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> **(2)** The trustee may disallow, in whole or in part,
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> **(a)** any claim;
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> **(b)** any right to a priority under the applicable order of priority set out in this Act; or
>
> **(c)** any security.
>
> **Notice of determination or disallowance**
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> **(3)** Where the trustee makes a determination under subsection (1.1) [that a claim is provable and, if so, its value] or, pursuant to subsection (2), disallows, in whole or in part, any claim, any right to a priority or any security, the trustee shall forthwith provide, in the prescribed manner, to the person whose claim was subject to a determination under subsection (1.1) or whose claim, right to a priority or security was disallowed under subsection (2), a notice in the prescribed form setting out the reasons for the determination or disallowance.
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> **Determination or disallowance final and conclusive**
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> **(4)** A determination under subsection (1.1) or a disallowance referred to in subsection (2) is final and conclusive unless, within a thirty day period after the service of the notice referred to in subsection (3) or such further time as the court may on application made within that period allow, the person to whom the notice was provided appeals from the trustee's decision to the court in accordance with the General Rules.
>
> **Expunge or reduce a proof**
>
> **(5)** The court may expunge or reduce a proof of claim or a proof of security on the application of a creditor or of the debtor if the trustee declines to interfere in the matter.
>
> [Emphasis added.]

[14] When this appeal came on for hearing, the appellant argued the chambers judge lacked the jurisdiction to make the order under appeal. Relying upon *Re: Light's Travel Service Ltd*. (1985), 56 C.B.R. (N.S.) 175, 1985 CanLll 614 (B.C.S.C.), the appellant asserted that the court does not have jurisdiction under

s. 135(5) unless the trustee has *allowed* a claim and then declined to interfere by expunging it. (He also referred us in support of this proposition to *Royal Bank of Canada v. Insley*, 2010 SKQB 17; *Ted Leroy Trucking Ltd. (Re*), 2012 BCSC 178; and *Purdy (Re)* (1997), 44 B.C.L.R. (3d) 369, 1997 CanLll 2168 (S.C.).

[15] He contended:

> What happened in this proceeding is exactly what Mr. Justice MacDonald [in *Light's Travel Service*] said the Court has no jurisdiction to do: the Court expunged a proof of claim where the Trustee has failed to act beyond obtaining additional proof.
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> …
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> In this proceeding, there was no allowance or disallowance by the Trustee, nor was there any request by Cascade. The statutory pre-conditions are thus not met, and the Order was made without jurisdiction.
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> [Emphasis added.]

[16] We questioned whether he chambers judge's order *postponing* Eggertson's claim to the claims of other creditors of Tudor was made under s. 135(5), which empowers a court to "expunge or reduce" a proof of claim.

[17] In response to our request for additional submissions both parties agreed that the wide power to expunge or reduce a claim under s. 135(5) allows the court to postpone a claim or "reduce it" in priority and that a purposive reading of the *BIA* permits us to ascribe to the court jurisdiction under s. 135(5) to reduce a claim by postponing it in rank. The issue then remains whether a court has jurisdiction to do so before the trustee has allowed a claim.

[18] While a plain reading of s. 135(5) appears to give the court jurisdiction to reduce a proof of claim or proof of security whenever a trustee has "declined to interfere in the matter", some jurisprudence suggests that the jurisdiction is otherwise constrained.

[19] There is no doubt that courts have been reluctant to hear applications under s. 135(5) in circumstances where there is uncertainty with respect to whether the trustee has discharged the obligations imposed by s. 135(1) and (2), or where the

trustee has not clearly refused to disallow the claim. That reluctance stems from recognition of the trustee's expertise and privileged position to make the determinations and assessments required by s. 135.

[20] What is unclear, in my view, is whether the *BIA* only permits a court to make an order under s. 135(5) where the trustee has *allowed a claim* or whether, as its plain reading suggests, the court may act on the application of a creditor or of the debtor when a trustee neither allows nor disallows a claim but has unequivocally declined to interfere in a matter.

[21] The authors of *The 2016-2017 Annotated Bankruptcy and Insolvency Act*, (Thomson Reuters, 2017), Lloyd W. Houlden, Geoffrey B. Morawetz, and Janis P. Sarra ("Houlden, Morawetz, & Sarra"), note that a s. 135(5) application may be brought in two circumstances: (a) when the claim has been allowed; or (b) when the trustee has not allowed the claim, the applicant has requested the trustee to disallow the claim and the trustee has refused to do so: G§110, p. 724.

[22] The second circumstance described in that passage appears to be applicable in this case. The trustee has not allowed the appellant's claim (other than implicitly, by making the March 2014 $500,000 payment in apparent recognition of the priority afforded by the GSA), but has refused to disallow it; the applicant has requested the trustee to disallow the claim, and the trustee has refused to do so.

[23] The appellant contends the trial court in *Light's Travel* (addressing the predecessor s. 106(5)) correctly described the circumstances in which a court has jurisdiction to hear a s. 135(5) application. In that case, Justice Macdonald was of the view that the court could only expunge or reduce a claim under the provision where a trustee had either expressly allowed a claim or delayed so long in considering it without disallowing it that the court could deem the claim to have been allowed. Either way, jurisdiction hinged upon the allowance of a claim. He held:

> [10] As I understand s. 106(5) it states that in the event the trustee allows a claim, then a creditor can apply to the court to expunge the claim. I would hold that before the court would have jurisdiction to hear an application under s. 106(5) there would be two requirements: (1) that the trustee must have

> allowed the claim; and (2) that the trustee must have declined to interfere in the sense that he declined to apply to expunge the claim himself.
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> ...
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> [12] The notice of motion seeks an order that the proof of claim … be expunged pursuant to s. 106(5) and s. 95(2) of the *Bankruptcy Act* and R. 94 of the *Bankruptcy Rules*. I would rule that a creditor can make an application under s. 106(5) of the Act to, in essence, expunge a proof of claim allowed by the trustee, and this would apply where the trustee has allowed the claim. The court would have no power to expunge a proof of claim under s. 106(5) where the trustee has failed to act beyond obtaining additional proof of [the] claim. The court has no power to expunge under s. 95(2) of the *Bankruptcy Act* and R. 94 of the *Bankruptcy Rules*. With respect, I do not feel, in the circumstances of this case, the trustee can take the steps he did and decline to interfere in the matter. He is required first under s. 106 to examine the proof of claim and if necessary, require proof, and he has done this. He is then required … to consider whether or not the claims are contingent or unliquidated. In the event he finds they are contingent or unliquidated, then he must apply to the courts to have the court determine if it is provable. In the event the trustee should decide that the proof of claim is not contingent or unliquidated, but an ordinary claim, he either allows same or disallows it. I would find on the basis of the material before me on this application, that up until the time of filing of this motion, the trustee had not taken the above steps. … Had there been a longer period of time between the last filing of the additional evidence by Morrison and the date this motion was filed, the court could have held that the trustee had admitted the proof of claim in this regard: *Re Russell; Ex parte Kemp* (1873), 42 L.J. Bcy. 26, 28 L.T. 487 (C.A.).
>
> [Emphasis added.]

[24] This passage in *Light's Travel* is the strongest expression cited to us of the view that the court's jurisdiction under s. 135(5) is founded upon the *allowance* of a claim by the trustee.

[25] The issue before the court in *Light's Travel* bore some resemblance to that we are addressing: the application to expunge or reduce the proof of claim was brought before the claim had been allowed by the trustee. It was not clear, however, that the trustee would refuse to address the claim in issue. The trustee had required further proof of the claims in issue, and the required proof was filed on October 9, 1984. The motion for an order under the then equivalent of s. 135(5) was filed on December 17,1984, and judgment on the motion was pronounced on March 7, 1985.

[26] The court noted:

> [9] It was apparent from the material filed that the trustee had taken steps under s. 106 and required further evidence in support of Morrison's claim. …[H]owever the trustee does not appear to have taken any further step under s. 106. He did not disallow the claim under s. 106(2). Section 106(5) allows the court to expunge a claim upon application of creditors if the trustee declines to interfere.

[27] The court adjourned the s. 135 application, directed the trustee to apply for a ruling with respect to contingent and unliquidated claims, and directed the trustee to decide whether or not to allow or disallow the claims that were not contingent or unliquidated. In doing so, however, the court, as noted, left open the possibility of making an order where the trustee could be deemed by inactivity to have allowed a claim. Because the trustee in *Light's Travel* does not appear to have unequivocally refused to take further action (in fact the trustee had relatively recently sought additional information), and because the court contemplated the use of s. 135(5) in the event of long inactivity on the part of a trustee, it is only weak authority for the proposition now advanced by the appellant, and is distinguishable from this case where the trustee has expressly refused to allow or disallow that impugned claim.

[28] The appellant says *Light's Travel* was followed in *Roberts v. E. Sands & Associates Inc.*, 2013 BCSC 902, and recently affirmed by the Quebec Court of Appeal in *Krespil c. Nathalie Brault Syndic inc*., 2017 QCCA 523 at paras. 30–33.

[29] While, in *Roberts*, Justice Burnyeat repeated the rule that on an application pursuant to s. 135(5) there must first be a request to the trustee to disallow or expunge claims *that have been allowed*, and the trustee must then decline to interfere (citing *Insley*; *Ted Leroy Trucking*; *Purdy*; and *Light's Travel*), there was no controversy in that case with respect to whether the claims had been allowed. The central question in the case was whether there had been a request for reconsideration and whether it had been established that the trustee had declined to interfere. The chambers judge was satisfied that the prerequisites of an application pursuant to s. 135(5) of the *BIA* had been met.

[30] The cases cited by Burnyeat J. are not particularly helpful in answering the question before us. The court in *Purdy* had simply observed (at para. 2) that s. 135(5) provides creditors with a means to "deal with proofs of claim where those proofs have been admitted by the trustee". The proofs had been admitted. The court did not consider whether there might be jurisdiction to hear an application if the trustee simply refused to disallow a claim.

[31] Similarly, in *Ted Leroy Trucking*, there was no doubt that the impugned claim had been allowed by the trustee and the trustee had then declined to interfere.

[32] *Insley* contains a helpful description of the statutory scheme for examining and allowing or disallowing proofs of claim and for challenging decisions by the trustee. Within that description of the process is the following description of s. 135(5):

> [24] Following examination, the trustee either allows the claim or disallows it in whole or in part. A disallowance is final and conclusive unless appealed by the aggrieved creditor within the time permitted for doing so under s. 135(4). Section 135(5) is the flip side of a disallowance. Where a claim is admitted, s. 135(5) permits creditors or the bankrupt to apply to expunge or reduce the claim *if the trustee declines to interfere in the matter*.
>
> [25] An application to expunge pursuant to s. 135(5) has been characterized by the courts as an *appeal* against allowance. "In effect, the motion under section 135(5) is an appeal by a creditor or the debtor against an allowance by the trustee of a proof of claim or proof of security" (Houlden and Morawetz, vol. 2, p 5-205 (cites omitted); see also s. 192(1)(n) *BIA*).
>
> [Emphasis in original.]

[33] That conception of s. 135(5) as the "flip side" of an appeal from disallowance, and an alternate avenue of appeal, appears to have led some jurists and commentators to regard the express allowance of a claim as a prerequisite to engaging in a s. 135(5) review (that view is also found in *Lamont Hi-Way Service Ltd. v. Bunning*, 2003 ABQB 297 at paras. 20–21).

[34] However, in *dicta* in the judgment of this Court in *Ted LeRoy Trucking Ltd. (Re)*, 2012 BCCA 511, Justice Lowry referred to the trustee's refusal to interfere in a

matter as the only prerequisite to hearing a s. 135(5) application, and he clearly concluded that such an application is not an appeal:

> [16] … I do consider s. 135(5) of the *BIA,* which provides that a court may expunge or reduce a proof of claim, effectively provides for applications such as made by the government here to be heard *de novo*. A s. 135(5) application is brought where, as here, a trustee declines to interfere in the matter at issue as opposed to instances where a trustee determines a claim is proven or disallows a claim, which determination or disallowance is, by virtue of s. 134(4), final subject to an appeal. An application under s. 135(5) to expunge or reduce a proof of claim is not an appeal.
>
> [Emphasis added.]

[35] In *Krespil*, the Quebec Court of appeal cited Burnyeat J.'s description of the prerequisites in *Roberts* before finding that they were not met. Importantly, for our purposes, though, the issue was not whether the impugned claim had been allowed:

> [31] In the case at hand, prior to requesting the intervention of the Court pursuant to the terms of subsection 135(5), the Appellant had to ask the Trustee to revise its decision. He did not do so. In fact, there is not even an allegation, let alone evidence, that the Appellant asked the Trustee to rescind or modify its decision to deem the Respondent's claim …

[36] The case is clearly affirmation of the proposition that resort to s. 135(5) is only available to a creditor or debtor who cannot obtain relief from the trustee. It is not intended to afford parties an opportunity to do an end-run around the trustee. The case, in my view, is not authority for the proposition that, in some cases, there will be no means of challenging a claim where the trustee is unequivocally refusing to intervene.

[37] The respondent says s. 135, on its face, does not require that a trustee allow a claim before a creditor can bring an application pursuant to s. 135(5). It says there are only two mandatory obligations imposed upon the trustee by s. 135: first, the trustee must examine every proof of claim or proof of security and the grounds therefor; and, second, the trustee must determine whether any contingent claim or unliquidated claim is a provable claim, and, if so, the value of the claim.

[38] The respondent says s. 135(5) permits the court to consider an application whenever a trustee refuses to interfere, either by refusing to disallow the claim after

adjudicating it or refusing to resolve it at all. It says Macdonald L.J.S.C in *Light's Travel* "artificially inserted" preconditions, including the condition that there must have been "a previous ruling in favour of the claim" into s. 135(5)'s predecessor "without providing a valid basis in law for doing so".

[39] The respondent contends that Parliament anticipated that applications could be brought once the aggrieved creditor had failed to get the trustee to disallow the claim. It says: "Viewed purposively, to read any more stringent requirements into the legislation undermines the object of the regime – it would be all too easy for a trustee to frustrate an aggrieved creditor seeking to expunge or reduce a claim by not ruling on it at all, thereby preventing any access to the court." It suggests this case demonstrates the mischief a narrow reading of s. 135 will bring about, because it was Eggertson who refused to allow the trustee to draw on the resources in the estate to permit it to investigate the claim.

[40] The respondent says there was no practical impediment to the chambers judge deciding whether the impugned claims should be reduced in rank without the benefit of a determination by the trustee. A s. 135(5) application results in a hearing *de novo*. The court does not require the kind of record from the trustee that would form the basis of an appeal. Both parties had access to the accounting records held by the trustee. Eggertson was Tudor's directing mind. It was open to him to lead additional evidence on the applications. If there were any significant evidentiary gaps, they were his doing.

[41] Finally, the respondent says, in the alternative, that the trustee effectively allowed the claim when it determined that the security was valid and paid out $500,000 to Eggertson in March 2014.

[42] In my view, the respondent is correct to say that there is no reason to read into s. 135(5) a precondition that there be a "a previous ruling in favour of the claim" before the court may consider a creditor's application to expunge or reduce a proof of claim.

[43] Section 135 should provide for all outcomes that may follow the delivery of a proof of claim by a creditor to the trustee, but it does not do so. For that reason, its interpretation is problematic. In the event the claim is allowed in part, or disallowed, the creditor who receives notice of the determination or disallowance has an appeal to a court under the *Bankruptcy and Insolvency General Rules,* C.R.C., c. 368 [*General Rules*] (s. 135(4)). Subsection 135(5) appears to provide that a trustee's decision to decline to interfere in a matter may be addressed by way of an application to expunge or reduce a claim by a creditor or the debtor. However, s. 135 does not provide a complete code, because it does not provide for applications by a creditor to have the court allow a claim where the trustee declines to interfere in a matter; it only provides for applications to "expunge or reduce a proof of claim or a proof of security", not to allow claims.

[44] Should the *BIA* be interpreted in such a manner as to permit a creditor or debtor to apply to a court to expunge or reduce a claim the trustee is not willing or able to determine, but not to permit a creditor to apply to have the court allow a claim the trustee is not willing or able to determine? In either case it might be argued that the approach taken in *Light's Travel* should be followed: the court should direct the trustee to make the determination called for by s. 135. However, the legislature has made express provision for an application to the court in the former circumstances and not the latter, and I can see no reason not to give effect to the plain words of s. 135(5) and to say they are applicable here.

[45] In my opinion, clear distinctions between the procedures prescribed in s. 135(4) and s. 135(5) demonstrate an intention to permit applications to expunge claims that have not been allowed by the trustee. Subsection 135(3) requires the trustee to give notice to affected creditors of decisions determining that claims are provable and valuing them or disallowing them. The notice must set out the reasons for the determination or disallowance. Subsection (4) provides for appeals to the court in accordance with the *General Rules*, by the persons to whom the notice was provided within a limited window. Such appeals, obviously, must follow and cannot precede a determination by the trustee.

[46] The time for bringing an application under s. 135(5), on the other hand, does not run from the receipt of notice of a determination from the trustee. The application need not be brought by the recipient of a notice. It is not, therefore, necessarily brought by a person who has received reasons for a determination or disallowance.

[47] In *Roberts*, Burnyeat J. cited with approval the words of Justice Topolniski in *Re Residential Warranty Company of Canada Inc. (Bankrupt),* 2006 ABQB 236:

> [27] Solutions to *BIA* concerns require consideration of the realities of commerce and business efficacy. A strictly legalistic approach is unhelpful in that regard. What is called for is a pragmatic problem-solving approach which is flexible enough to deal with unanticipated problems, often on a case-by-case basis. As astutely noted by Mr. Justice Farley in *Canada (Minister of Indian Affairs and Northern Development) v. Curragh Inc.* [(1994), 114 D.L.R. (4th) 176 at 185, 27 C.B.R. (3d) 148 (Ont. Ct. (Gen. Div.)]:
>
> > While the *BIA* is generally a very fleshed-out piece of legislation when one compares it to the *CCAA*, it should be observed that s. 47(2)(c): "The court may direct an interim receiver ... to ... (c) take such other action as the court considers advisable" is not in itself a detailed code. It would appear to me that Parliament did not take away any inherent jurisdiction from the court but in fact provided, with these general words, that the court could enlist the services of an interim receiver to do not only what "justice dictates" but also what "practicality demands". It should be recognized that where one is dealing with an insolvency situation one is not dealing with matters which are neatly organised and operating under predictable discipline. Rather the condition of insolvency usually carries its own internal seeds of chaos, unpredictability and instability.
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> [Footnotes omitted.]

[48] In my view, given that there was no prospect that the trustee would determine the claim, the chambers judge had jurisdiction under s. 135(5) of the *BIA* to reduce a proof of claim on the application of a creditor where the trustee had declined to interfere in the matter.

[49] Not only was that a course of action that appeared to clearly be permitted by the plain wording of s. 135(5), it was also consistent with the evident policy objectives embodied in s. 135. While the policy justification for declining to hear premature applications is the choice to leave assessment of the validity of claims in the hands of the most qualified expert, that choice is inapplicable in cases where the

trustee is clearly unable or unwilling to make a determination. That is particularly the case where, as here, the trustee is unable to discharge its obligations as a result of the position taken by the appellant.

[50] In summary, I would not accede to the argument that a court has no jurisdiction to expunge or reduce a claim before the claim is expressly allowed by a trustee. The single prerequisite to hearing a s. 135(5) application is a clear refusal on the part of the trustee to interfere. There may be other discretionary obstacles facing creditors seeking such orders under this provision, but no other prerequisite that may be said to limit the court's jurisdiction. I would not give effect to the rule described in *Light's Travel* that the court has no power to reduce a proof of claim under this provision where the trustee has failed to act. I would, rather, adopt the statement in Houlden, Morawetz, & Sarra that a s. 135(5) application may be brought when the trustee has not allowed the claim, the applicant has requested the trustee to disallow the claim and the trustee has refused to do so. I would not accede to the appellant's argument that the chambers judge had no jurisdiction under s. 135(5) to postpone the appellant's claim.

Procedural Fairness

[51] The appellant submits that the question whether the 2011–12 Advances were "proper" debt transactions was not pleaded "with any precision such that the appellant would be on notice that the issue would be decided". He says that while the notice of application refers to s. 137 of the *BIA*, it does not specify what transactions are said to be improper or constitute debt or equity. He says he was denied the opportunity to adduce evidence as to the Company's use of the 2011–12 Advances, which was not necessary on the pleadings as they stood when the application was heard.

[52] The respondent contends Eggertson had ample notice that the propriety of the 2011–12 Advances was in issue. He was put on notice and asked for his position on those advances by the trustee. Cascade's letter to the trustee sought to have "Eggertson's claim" expunged. That claim included the 2011–12 Advances.

Eggertson's notice of application specifically referred to the 2011–12 Advances as part of his claim. Cascade's response sets out in the factual basis section various advances Tudor made to the related parties and then goes on to note that the advances made to parties related to Eggertson amounted to $1,273,186.49, while Tudor owed $1,433,626.95 to Eggertson in purported shareholder loans. The 2011–12 Advances are included in these numbers.

[53] In my view, there is no merit in the argument that the question whether the 2011–12 Advances were made to a related party was not properly before the chambers judge. In support of his own application the appellant sought to establish that the advances were made to Tudor. He was aware of Boale, Wood's position that the 2011–12 Advances should not form part of Eggertson's claim against Tudor; he had been examined on the use of the funds advanced to Tudor in 2011–12; and he knew that Cascade would rely upon s. 137 of the *BIA* to challenge the claim.

[54] I would not accede to the appellant's argument that the question whether the 2011–12 Advances were "proper" debt transactions was not adequately pleaded.

The Evidentiary Burden or Onus

[55] The chambers judge understood it to be the evidence of Eggertson that the 2011–12 Advances were used to fund the operations of T.E. Sales Inc. (formerly T.E. Steel Sales Inc.), a company controlled by the appellant's wife. That company, in turn, used the advances to fund a tequila importation venture in which Eggertson had an interest. The tequila venture, Tavi Tequila, was in its infancy, but he hoped to build the brand and eventually repay Tudor out of profits. He regarded this as an investment by Tudor. He intended to gift Tudor all rights to Tavi Tequila, once the venture began consistently generating revenue.

[56] Cascade, relying upon s. 137 of the *BIA*, argued these were not "proper transactions". Tudor's financial statements reported advances made to "related parties" that were not in fact related to Tudor but were ventures controlled by Eggertson. In its view, Eggertson was attempting to shelter payments made through

Tudor under the GSA, and thereby defeat the legitimate commercial interests of Tudor's trade creditors.

[57] The judge concluded Eggertson did not have any legitimate claim arising out of the 2011–12 Advances. He held there was "simply no justification for allowing Mr. Eggertson the luxury of securing his investment in the [tequila] venture through the mechanism of the GSA" (RFJ at para. 47). Eggertson had presented no accounting evidence that the tequila business expenses ought properly to have been allocated to Tudor. Nor was there any evidence that Tudor was regarded as being indebted to him for those advances, or that the flow of monies through Tudor's accounts to T.E. Steel and then to the tequila venture represented a *bona fide* investment on behalf of Tudor. Tudor was not a shareholder in Casa de Tavi; Mr. Eggertson was.

[58] While the judge agreed with Cascade's submission that Eggertson, as a non-arm's length party, bore the onus of proving the transactions were "proper", he regarded it "as proven on the evidence" that the 2011–12 Advances were not proper debt transactions. In my view, the judge's conclusion that the impropriety of the transactions was established is a compete answer to the contention that the chambers judge erred in reversing the evidentiary burden.

[59] Further, however, in my opinion it was not an error to ask whether the appellant had discharged the onus placed upon him by the *BIA* in the circumstances. A party seeking to expunge a claim bears the onus of doing so: *Purdy* and *Roberts.* However, a party may discharge that burden by identifying a non-arm's length transaction and satisfying the court that the presumption created by s. 137(1) has not been rebutted. It is appropriate to say that in such circumstances the evidentiary burden shifts to the non-arm's length creditor to establish the propriety of the transaction. It must be borne in mind that s. 137 provides:

> **Postponement of claims – creditor not at arm's length**
>
> **137 (1)** A creditor who, at any time before the bankruptcy of a debtor, entered into a transaction with the debtor and who was not at arm's length with the debtor at that time is not entitled to claim a dividend in respect of a claim

> arising out of that transaction until all claims of the other creditors have been satisfied, unless the transaction was in the opinion of the trustee or of the court a proper transaction.

[60] It was not an error for the chambers judge to consider whether evidence had been adduced by the non-arm's length creditor to establish that the impugned transaction was proper.

[61] I note that the chambers judge's decision on onus has been cited with approval by Justice Romaine in *Alberta Energy Regulator v. Lexin Resources Ltd.*, 2018 ABQB 590 at para. 72, and by Houlden, Morawetz, & Sarra in *Bankruptcy and Insolvency Law of Canada*, 4th ed (Toronto: Thomson Reuters, 1992) (loose-leaf updated 2024) at §6:395. I can find no contrary authority and none has been cited to us. I would not accede to this argument.

Palpable and Overriding Errors

2005–06 Advances

[62] Eggertson's evidence was that there were two 2005–06 Advances: $890,000 advanced on October 29, 2005, and $500,000 advanced in December 2006:

a) The first was the amount of a bonus taken on the advice of accountants which was declared as taxable income but left in the company as a loan. It was described in Tudor's October 31, 2005 financial statements as "unsecured, non-interest bearing and … no fixed terms of repayment".

b) The second was made because the money was "needed for growth" or "to buy product".

[63] After taking into account payments made to him, he says his total shareholder loan amounted to $1,361,359.

[64] After the GSA was executed in March 2006, notes in the financial statements described his shareholder loans as interest-bearing. Notes in the financial statements referred to the loans as "unsecured" until 2011.

[65] The chambers judge noted there was no written documentation of the loans, no fixed interest rate, or formula by which the interest rate could be determined, and no schedule for repayment. The loans are described in the October 31, 2012 financial statements of Tudor under a note that reads:

> Advances, secured by a general security agreement over all present and future personal property, bears interest of 8% (October 31, 2011 – 8%; November 1, 2010 – 36%) per annum with no fixed terms of repayment.

[66] The chambers judge described Eggertson's evidence as follows:

> [24] … [T]he interest rate at which he was paid each year in respect of his shareholder loans fluctuated with the fortunes of the company, depending on advice received from his accountants. At times, when the company was doing well, the interest rate was as high as 36%. At other times – in particular, for the fiscal year 2009 – the interest rate set by the accountants would turn out to have been too high relative to the company's performance, and the financial statements would record him as having partially forgiven interest payment.

[67] Cascade says the 2005–06 Advances were properly characterized as equity, and must be subordinated to the claims of Tudor's creditors. Before the chambers judge it submitted, in the alternative, that if the 2005–2006 Advances were loans, they were repaid in full by payment of an exorbitant salary to Eggertson and the payment of exorbitant interest rates.

[68] The judge accepted the former submission and did not have to address the latter. He adopted the description of the court's role in characterizing, or re-characterizing, non-arm's length payments of Justice Wilton-Siegel at paras. 167–68 in *U.S. Steel Canada Inc. (Re)*, 2016 ONSC 569, and Dr. John Finnerty's explanation of the difference between equity and debt referred to at para. 183 of that case.

[69] He held at para. 37 that the 2005–06 Advances were equity and not debt, a conclusion "most strongly supported" by the fact payments on the "loan" were variable with the company's profitability, determined each year after all liabilities to secured and unsecured creditors had been satisfied. He regarded the fact that

Tudor's payments to Eggertson appeared to have been treated as subordinated to all current liabilities as inconsistent with his claim to secured creditor status.

[70] While he made note of the fact that there was no schedule for repayment of these advances, he placed no weight upon that fact, or the lack of documentation. His judgment hinged upon the fact that payments were discretionary, based on the advice of the accountants, and varying with Tudor's profitability. He held at paras. 38–39:

> ... The ability to draw payment in this manner is not normally incidental to the rights of a creditor; instead, it is a hallmark of ownership.
>
> …. It is, instead, the nature of those interest payments that reveals the true substance of the transaction.

[71] While that finding alone was sufficient to conclude that the 2005–06 Advances were equity, the chambers judge found support for his conclusion in the fact that Eggertson became a shareholder shortly after the first advance, when his father transferred nine of his 100 Class A common shares to him without any recorded consideration. Similarly, after the second advance, Eggertson's common shares were exchanged for Class D redeemable preferred shares. The chambers judge agreed with Cascade's submission that Eggertson's acquisition of a shareholder interest and the increase in value of that interest at the time the advances were made "strongly implies that his advances were in substance consideration paid for his ownership stake, making them equity contributions" (RFJ at para. 42).

[72] The appellant argues that the judge was in error in finding that the interest payments on the 2005–06 Advances varied with Tudor Sales' profits. He argues that while there are other factors the judge considered, it is clear from the reasons that the "variable" nature of the interest payments was determinative.

[73] First, he contends, the interest rate only changed once in 2011 (in 2009 the appellant forgave some interest but there was no recorded change in the rate) and did not vary with Tudor's profitability. A table prepared from the 2006 to 2012 financial statements recording net income, interest rates and interest payments was

in evidence. It recorded a decline in Tudor's net income from an amount that generated a profit of $1.5 million in 2006 to an amount resulting in a net loss of almost $465,000 in 2012. During the same period, the recorded interest rate on the loans was reduced only once, from 36% to 8% per annum in 2011. The appellant says "while there was some change, it is not accurate to say that the interest *varied* with the Company's profitability. That finding, which underpins the characterization of the 2005 Advance and the 2006 Advance as equity, was in error."

[74] Further, the appellant says the chambers judge erred in fact when he concluded that interest payments on shareholders' loans were being treated as subordinated to current liabilities. Tudor's 2011 statements show a decrease in Tudor's accounts payable. At this point, only the 2005 Advance was reflected in the Company's financial statements, not the 2006 Advance. As set out in the 2010 statements, the appellant forgave $231,914 in interest that year, and accrued liabilities of $38,584, but, in that same year, the company paid interest in the amount of $372,691. If the payments were on account of capital, one would not expect to see payments in years the Company's net revenues were negative. That payments were made in such years is characteristic of debt, not equity.

[75] The respondent says the finding that interest payments related to the 2005–06 Advances varied with the profits of Tudor was well supported by the evidence. Eggertson himself testified on his examination for discovery (extracts of the transcripts of which were in evidence) that the interest rate paid on his shareholder loans varied with the fortunes of Tudor. When Tudor was profitable, from 2006 to 2008, interest ran at 36%. However, when there was a downturn in 2009, and Tudor's net income was negative, Eggertson forgave nearly half of the interest on his shareholder loans. As a result, the effective interest rate in 2009 was approximately 19%. Eggertson testified that interest was forgiven in 2009 because the higher interest rate was not on par with the performance of the Company.

[76] In 2010, Eggertson was paid 36% again. In 2011, when it became clear that the fortunes of Tudor were not recovering, the interest rate fell from 36% to 8%, and stayed at 8% in 2012, following which the fortunes of Tudor continued to decline.

[77] I agree with the respondent's submission that the finding that the interest paid to Eggertson varied with the profits of Tudor was available to the chambers judge on the evidence and not palpably wrong.

2011–12 Advances

[78] The appellant contends the chambers judge's finding that the 2011–12 Advances were not "proper transactions" as defined in s. 137(1) was unfounded on or inconsistent with the evidence.

[79] The appellant takes issue with the finding, at para. 15, that "the trustee identified documentation ... that the 2011–12 Advances had been recorded in Tudor's books as being due from 'TE Steel', a related company whose expenses Tudor had funded," He contends the trustee did not conclude that the 2011–12 Advances should not be part of the appellant's secured claim. On the contrary, he says the trustee advised all parties that it had not completed its investigation.

[80] The respondent says while Eggertson is correct that the trustee had not completed its investigation of the secured claim, the trustee had expressed the view that the 2011–12 Advances should not form part of Eggertson's claim, and that all of the 2011–12 Advances appeared to be for reimbursement of expenses of Eggertson's related companies. The trustee asked for Eggertson's position on these matters, without a response.

[81] The appellant says the finding that the 2011–12 Advances were used by the company to fund T.E. Steel's tequila importation venture was unfounded. He points to financial records that show that most of the advances to T.E. Steel were made before the 2011–12 Advances, and to some evidence of the use of the 2011–12 Advances to fund Tudor operations, including payments to Cascade.

[82] The respondent says Tudor needed funds to operate its main business, which necessitated paying its main supplier, Cascade, to which it was continuously indebted, precisely because of the expenses it incurred and advances it thereby made to related parties, which stripped Tudor of its operating funds. The funds that formed the 2011–12 Advances were used to replenish capital taken by Eggertson from Tudor to fund the tequila venture. In short, there was evidence upon which the judge could find that Mr. Eggertson had "secur[ed] his investment in the [tequila] venture through the mechanism of the GSA granted by Tudor, and thereby defeat[ed] the legitimate interests of trade creditors" (RFJ at para. 47).

[83] In my view, the appellant has not demonstrated that the conclusion that the 2011–12 Advances were not proper transactions was unsupported by evidence or amounted to palpable error.

Conclusion

[84] I would dismiss the appeal. In my opinion, the judge was not without jurisdiction. He did not determine issues that were not pleaded. There was evidence upon which the judge could properly conclude that the interest payments on the 2005–06 Advances varied with Tudor's profitability. His conclusion that the 2011–12 Advances were not made for a "proper purpose" did not hinge upon the placement of the onus of proving that the transaction was proper upon the appellant. That conclusion was not affected by a palpable error.

"The Honourable Mr. Justice Willcock"

I AGREE:

"The Honourable Justice Griffin"

I AGREE:

"The Honourable Mr. Justice Voith"