Court of King's Bench of Alberta

Citation: Essential Energy Services Ltd v Kos Corp Investments Ltd, 2023 ABKB 414

Date: 20230711
Docket: 1803 18388
Registry: Edmonton

Between:

Essential Energy Services Ltd

Plaintiff

- and -

Kos Corp Investments Ltd

Defendant

Memorandum of Decision
of the
Honourable Applications Judge B.W. Summers

Introduction

[1] This case concerns the interpretation of a guarantee and related documents. The Plaintiff seeks summary judgment for its claim with respect to the guarantee. The Defendant seeks summary dismissal of the Plaintiff's claim. The parties agree that this case should be decided summarily.

Factual Background

[2] The Plaintiff and a wholly owned subsidiary of the Defendant, namely Option Industries Ltd ("Option") were parties to a contract under which Option agreed to manufacture, assemble and sell to the Plaintiff components for six coil well service rigs and related equipment at a cost of approximately $22 million ("Contract"). Of the six rigs (collectively "Rigs"), two were completed, two were partially completed and the construction of the final two rigs was deferred by agreement of the parties.

[3] One of Option's suppliers, Edmonton Trailer Sales & Leasing Ltd ("Edmonton Trailer") registered liens against two components of the Rigs at the Personal Property Registry for the Province of Alberta ("PPR") ("Edmonton Trailer Liens").

[4] In the late fall of 2016 Option was experiencing financial difficulties and the Plaintiff was served with a Requirement to Pay ("RTP") by Canada Revenue Agency ("CRA") with respect to Option's liabilities to CRA. Due to the Plaintiff's concerns as to whether Option could complete the Contract, the Plaintiff and Option entered into a settlement agreement dated effective November 6, 2016 ("Settlement Agreement"). Key provisions of the Settlement Agreement included the following:

(a) The Plaintiff agreed to pay CRA, on behalf of Option, the amount then due to Option, being the sum of $431,470.00 ("Settlement Amount");

(b) Option agreed to deliver to the Plaintiff certain items ("Deliverables");

(c) Components for some of the Rigs which were located in a foreign country, called "mast rails" (the "Mast Rails"), were to be shipped to Option's yard in Alberta, where they would be inspected by and released to the Plaintiff;

(d) Option agreed to have the Edmonton Trailer Liens discharged from the PPR by April 30, 2018 failing which Option was to pay to the Plaintiff $250,000.00;

(e) "In order to secure discharge of the Edmonton Trailer Liens and/or payment as a result of payment set out above ... (Defendant), the majority shareholder of Option, will provide a corporate guarantee to ... (Plaintiff) in the amount of $250,000.00 in the form attached..." ("Guarantee"). (This quotation is from paragraph 10(b) of the Settlement Agreement).

[5] On November 6, 2016 Option's counsel delivered the executed Settlement Agreement and ancillary documents including the Guarantee ("Settlement Documents") to the Plaintiff's counsel on trust conditions including that no use be made of the Settlement Documents until Option's counsel had received confirmation that the Settlement Amount had been paid to CRA ("Trust Conditions").

[6] On November 7, 2016 Option's counsel sent two letters to the Plaintiff's counsel amending the Trust Conditions as follows:

(a) the Plaintiff's counsel make no use of the Settlement Documents until they confirmed in writing that the Settlement Amount had been paid into the trust account of the Plaintiff's counsel;

(b) the Settlement Amount could only be released to Option or CRA;

(c) the Settlement Amount shall be held in trust pending written confirmation from Option's counsel and satisfactory evidence from CRA that the RTP had been discharged, in whole or in part and the Settlement Amount may be paid, in whole or in part to Option; and

(d) should CRA not provide satisfactory evidence that the RTP had been discharged, in whole or in part, the Settlement Amount shall be released to CRA on the written instruction of Option's counsel.

("First Amended Trust Letter"); and later

(a) upon written confirmation from the Plaintiff's counsel to Option's counsel that the Settlement Amount had been deposited into the trust account of Plaintiff's counsel the Plaintiff may take possession of its equipment as per the Settlement Agreement;

(b) Plaintiff's counsel shall hold the Settlement Amount in its trust account pending written instruction from Option's counsel and CRA; and

(c) in all other respects the trust conditions in the First Amended Trust Letter remain the same....

("Second Amended Trust Letter")

[7] The change in trust conditions was brought about because Option was considering making a proposal to its creditors under the *Bankruptcy & Insolvency Act ("BIA").* Option did in fact file a Notice of Intention to Make a Proposal ("NOI") on November 9, 2016.

[8] Meanwhile the Plaintiff attended the premises of Option and removed the Deliverables on November 7 and 8, 2016.

[9] On November 16, 2016 CRA sent a letter to the Plaintiff stating that since filing the NOI resulted in a stay of legal proceedings, the RTP was suspended until further notice in regard to payments coming due on or after the date of filing the NOI.

[10] Counsel for Option sent two more letters amending its trust conditions to request release of the Settlement Amount to Option.

[11] On February 8, 2017 counsel for Option sent a further letter to counsel for the Plaintiff directing that the Settlement Amount be paid to CRA. That never happened. Option effected a seizure of the Deliverables.

[12] Option proceeded with its proposal and as part thereof Option paid CRA. A Certificate of Full Performance was issued on July 7, 2017.

[13] Option made further attempts to have the Settlement Amount released from the trust account of Plaintiff's counsel, without success.

[14] In June of 2017 the Plaintiff sued Option for breaches of the Settlement Agreement (in what the parties call "the Main Action").

[15] On November 30, 2017 this court granted an order in the Main Action allowing the Settlement Amount to be paid into court.

[16] On or about September 4, 2018 the Plaintiff entered into an agreement with Edmonton Trailer that provided the Plaintiff paying $45,000 in consideration for the discharge of the Edmonton Trailer Liens from the PPR.

[17] Option was placed into bankruptcy on December 6, 2018. PricewaterhouseCoopers Inc ("PWC") was appointed as trustee. Approximately six weeks later, PWC was also appointed as Receiver for Option.

[18] In July of 2019 this court granted an order in the Main Action paying the Settlement Amount out of court as follows:

to the Plaintiff, $276,740 plus interest;

to PWC, (as Receiver), $105,000; and

to the law firm of Ogilvie LLP, then counsel for Option, the sum of $50,000.

("Consent Order").

[19] The Consent Order was amended to correct the payout amount to the Plaintiff, being $276,470.

Legal Issue

[20] The sole issue in this case is whether the Defendant is liable to the Plaintiff under the Guarantee. The Defendant argues that no consideration was given for the Guarantee and since it was not given under seal, it is not enforceable. The Defendant also argues in the alternative that Option's obligations to the Plaintiff have been satisfied as the Edmonton Trailer Liens have been discharged and the Plaintiff was paid $276,470 pursuant to the Consent Order.

[21] I note that the Plaintiff also sought rectification of the Guarantee as the Defendant was incorrectly described as "Kos Corp Inc". There is no such entity and the Defendant takes no issue with the Plaintiff's request for rectification.

Discussion

Is the Guarantee unenforceable due to a lack of consideration?

[22] The Defendant argues that the Guarantee is unenforceable because the Guarantee was not executed under seal and there was no consideration given for the Guarantee, as Option never did receive the Settlement Amount.

[23] The Plaintiff admits that the Guarantee was not executed under seal but argues that consideration was provided to Option in two forms: firstly, Option was given the forbearance of 18 months to get Edmonton Trailer Liens discharged from the PPR; and secondly, Option did receive, indirectly, payment of part of the Settlement Amount pursuant to the Consent Order. The Plaintiff states that the sum of $276,470 received by the Plaintiff and the sum of $105,000 received by Option's Receiver were payments for the benefit of Option that went to creditors of Option. Although not specifically stated, it would appear that the payment of $50,000 to the law firm of Ogilvie LLP was also a payment to a creditor of Option.

[24] I agree with the Plaintiff that this is good consideration for the Guarantee. Furthermore, I note that the Second Amended Trust Letter only required that Option's counsel receive confirmation in writing that the Settlement Amount had been deposited into the trust account of the Plaintiff's counsel before the Plaintiff could take possession of its equipment per the Settlement Agreement and that Option's counsel must hold the Settlement Amount in trust pending receipt of written instructions from Option's counsel and CRA. The Plaintiff did pay the Settlement Amount as required and the Plaintiff's counsel did hold the Settlement Amount as instructed. The fact that the Consent Order intervened to provide that the Settlement Amount be paid to Option's creditors does not derogate from the fact that consideration was provided to Option.

[25] The Guarantee is not unenforceable due to a lack of consideration.

Have the Defendant's obligations under the Guarantee been satisfied?

[26] The terms of the Guarantee are critical. Relevant provisions include the following:

> 2.1 Guarantee
>
> The Guarantor irrevocably and unconditionally guarantees to the Creditor the due and punctual payment to the Creditor of the Obligations when due in accordance with their terms, to the limited amount of $250,000.
>
> 2.2 Indemnity
>
> If any or all of the Obligations are not paid or duly performed by the Obligor for any reason whatsoever, the Guarantor will, as a separate and distinct obligation, indemnify and save harmless the Creditor from and against all losses from its failure to pay such Obligations.
>
> 2.3 Primary Obligation
>
> If any or all of the Obligations are not duly performed by the Obligor and are not paid by the Guarantor under section 2.1 of this Guarantee, in each case, for any reason whatsoever, such Obligations will, as a separate and distinct obligation, be paid and performed by the Guarantor as primary Debtor.
>
> 2.4 Absolute Liability
>
> The Guarantor agrees that the liability of the Guarantor under Section 2.1 and 2.3, and for greater certainty, under Section 2.2, is absolute and unconditional irrespective of, as applicable:
>
> > ...
> >
> > (j) Any other matter, act, omission, circumstance, development or thing of any and every nature, kind and description whatsoever, whether similar or dissimilar to the foregoing (other than due payment and performance in full of the Obligations) that might in any manner (but for the operation of this Section) operate (whether by statute, at law, in equity or otherwise) to release, discharge, diminish, limit, restrict or in any way affect the liability of, or otherwise provide a defence to, a guarantor, a surety, or a principal debtor, even if known by the Creditor.

[27] The Guarantee states that "Obligations means a limited guarantee of $250,000 to secure the discharge of the Edmonton Trailer Liens by the Obligor on or before April 30, 2018, as referred to in subparagraph 10(b) of the Settlement Agreement".

[28] The Defendant argues that the Obligation of the Edmonton Trailer Liens being discharged has been satisfied. The principal of the Defendant, Artie Kos provided sworn evidence that the sole reason he was prepared to have the Defendant give the Guarantee was to provide assurance that the Edmonton Trailer Liens would be discharged so that the Plaintiff could enjoy utilization of the Rigs free and clear of any claims from third parties. The Defendant further notes that the Plaintiff did not provide any evidence contradicting this evidence.

[29] The Defendant also refers to the decision of the Supreme Court of Canada in ***Sattva Capital Corporation v. Creston Moly Corporation,* 2014 SCC 53 ("*Sattva*")** stating that the overriding concern of a court is to determine "the intent of the parties and the scope of the understanding" which requires a decision maker to read the contract as a whole, giving the words used an ordinary and grammatical meaning consistent with the surrounding circumstances known to the parties at the time of the formation of the contract. Furthermore, the factual matrix in which the bargain is made must be considered when coming to an understanding of the bargain.

[30] ***Sattva*** does not allow the decision maker to consider the evidence of a party or parties as to what they think the contract means. I give no weight to the evidence of Artie Kos as to what his intention was.

[31] The Settlement Agreement provided that the Edmonton Trailer Liens were to be discharged by April 30, 2018. That was the Obligation that Option failed to do and fell upon the Defendant. I agree with the Plaintiff that based upon the wording of the Guarantee that the Obligation became a "separate and distinct obligation" of the Defendant. The Defendant breached the terms of the Guarantee and did not meet the Obligation imposed upon it.

[32] The Defendant makes the alternate argument that the Obligation under the Guarantee is a penalty and the Court should not enforce this penalty, since the actual damage suffered by the Plaintiff was its payment of $45,000 to obtain the discharge of the Edmonton Trailer Liens. The Court does have authority to provide relief from paying a penalty pursuant to s 10 of the *Judicature Act* which states:

> **10** Subject to appeal as in other cases, the Court has power to relieve against all penalties and forfeitures and, in granting relief, to impose any terms as to costs, expenses, damages, compensation and all other matters that the Court sees fit.

[33] Although this statutory provision is wide, there is ample case authority as to how a court should exercise its discretion. From the case of ***32262 BC Ltd v See-Rite Optical Ltd,* 1998 ABCA 89** provided by counsel for the Defendant the Court of Appeal stated:

> [11] The principles applicable to determining whether a clause is a penalty or a genuine pre-estimate of damages are long-standing and relatively free of controversy. The difficulty in this case (as in many others) is the result to be achieved when those principles are applied to particular facts.
>
> [12] In ***Dunlop Pneumatic Tyre Company Ltd. v. New Garage and Motor Company Ltd.*** [1915], A.C. 79, Lord Dunedin is quoted at 86 as follows:
>
> The essence of a penalty is a payment of money stipulated as in terrorem of the offending party; the essence of liquidated damages is a genuine covenanted pre-estimate of damage.
>
> [13] More recently, in ***H. F. Clarke Ltd. v. Thermidaire Corp. Ltd.*** (1974), 1974 CanLII 30 (SCC), 54 D.L.R. (3d) 385, Chief Justice Laskin commented on the role of the courts in interpreting contractual provisions as damages or penalty clauses. He noted at 392 that the concern of the courts is one of fairness and reasonableness in the surrounding circumstances. He suggested at 397 that judicial interference would be justified if the contractual result would otherwise be " a grossly and punitive response to the problem to which it was addressed"

> and, at 398, quoting from ***Snell's Principles of Equity***, 27th ed. (1973), p. 535, that a sum would be held to be a penalty if it is "extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach." An emphasis on the need to show oppression is apparent. ***Elsley et a*****l v. *J. G. Collins Insurance Agencies Ltd.*** (1978), 1978 CanLII 7 (SCC), 83 D.L.R. (3d) 1, [1978] 2 S.C.R. 916.

[34] The Plaintiff has provided evidence as to the greatest loss that it might have suffered if the Edmonton Trailer Liens were not discharged. In his Affidavit, the Plaintiff's representative Jeff Newman states that Dustin Kos (son of Artie Kos) told him in October of 2016 that the amount owing to Edmonton Trailer on the liens was approximately $300,000 and "the [Plaintiff] and Option then negotiated an appropriate figure of $250,000 for the purposes of the Guarantee.... Mr. Newman also provided the Statement of Claim issued by Edmonton Trailers on May 28, 2016 wherein Edmonton Trailers claimed the sum of $239,000 from the Defendant.

[35] I find that the Defendant's covenant under the Guarantee to pay $250,000 arises from a genuine pre-estimate of damages and is not a penalty. Consequently, the covenant is enforceable.

[36] The final argument made on behalf of the Defendant is that the Guarantee was satisfied by the payment of $276,470 to the Plaintiff pursuant to the Consent Order. The Defendant says that Option's only obligation to the Plaintiff after the Settlement Agreement was entered into was in paying the sum of $250,000 if the Edmonton Trailer Liens were not discharged prior to April 30, 2018. In response to that position, the Plaintiff provided a Supplementary Affidavit of Jeff Newman that provided evidence of an action that the Plaintiff had commenced against Option earlier than this action filed against the Defendant (called the "Essential-Option Action" and also called the "Main Action") in which the Plaintiff claimed against Option, among other things, a liquidated damage claim of $1.38 million for breach of something called the "Mast Rail Agreement" ("Mast Rail Debt"). In short, Option did not provide the Mast Rails for which the Plaintiff had paid, and the Plaintiff claimed for the amount it had paid, as well as other damages.

[37] It is clear on the evidence before me that Option's obligation to pay the sum of $250,000 if the Edmonton Trailer Liens were not discharged by April 30, 2018 was not the only monetary obligation that Option had to the Plaintiff.

[38] When the sum of $276,470 was paid to the Plaintiff pursuant to the Consent Order, there was no direction given by Option, or its Receiver or Trustee in Bankruptcy that the money was paid in satisfaction of any particular indebtedness of Option to the Plaintiff. The Plaintiff cites the case of ***Sawchuk v Bourne,*** 2005 ABCA 382 for the proposition that the common law "rules of appropriation" apply in Alberta to determine which debt of Option's the payment should be appropriated. In that case Justice Ritter stated (with respect to which loan of the defendants had been paid):

> [17] Even if the common law rule applies, both the first and third loans would survive leaving only the second loan as barred. The common law rule is that a debtor, when facing multiple debts, may elect how a payment will be allocated: ***Cory Bros. & Co. v. "The Mecca"***, [1897] A.C. 286 (H.L.). If the debtor does not elect, the right to designate the payment falls to the creditor who enjoys this right "up to the very last moment": ***St. John v. Rykert*** (1884), 1884 CanLII 7 (SCC), 10 S.C.R. 278. If no election is made, the payment is allocated to the first debt incurred: ***Clayton's Case*** (1816), 35 E.R. 781; ***Mt. View Charolais***

> ***Ranch Ltd. v. Haverland***, 1973 ALTASCAD 64 (CanLII), [1974] 2 W.W.R. 289 (Alta. C.A.); ***Polish Combatants' Association Credit Union Ltd. v. Moge*** (1984), 1984 CanLII 3013 (MB CA), 9 D.L.R. (4th) 60 (Man. C.A.). Neither the Bournes nor Sawchuk communicated an election. Therefore the default rule applies and the July 2000 payment is allocated to the first loan.

[39] The Mast Rail Debt was incurred by Option earlier than Option's obligation with respect to the Edmonton Trailer Liens. The Mast Rail Debt became owing on February 28, 2017 when Option failed to have shipped the Mast Rails to its yard for inspection and receipt by the Plaintiff. Option's obligation (as well as the Defendant's Obligation) to pay $250,000 did not arise until after April 30, 2018.

[40] I grant the Plaintiff's application for summary judgment and dismiss the Defendant's application for summary dismissal.

[41] If the parties cannot agree on costs, they may be spoken to in morning chambers within 30 days of this decision.

Heard on the 1st day of June, 2023.
Dated at Edmonton, Alberta this 11th day of July 2023.

B.W. Summers
A.J.C.K.B.A.

Appearances:

Jeremy H. Hockin KC
Parlee McLaws LLP
for the Plaintiff

Darren R. Bieganek KC
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for the Defendant