CITATION: DBCD Spadina Ltd et al v. Norma Walton et al, 2015 ONSC 870

COURT FILE NO.: CV-13-10280-00CL

DATE: 20150209

SUPERIOR COURT OF JUSTICE – ONTARIO
COMMERCIAL LIST

BETWEEN:

DBDC SPADINA LTD. and THOSE CORPORATIONS LISTED ON SCHEDULE A HERETO,

Applicants

AND:

NORMA WALTON, RONAULD WALTON, THE ROSE & THISTLE GROUP LTD. and EGLINTON CASTLE INC,

Respondents

AND

THOSE CORPORATIONS LISTED ON SCHEDULE B HERETO, TO BE BOUND BY THE RESULT

BEFORE: Newbould J.

COUNSEL: *Mark Dunn and Michel Shneer*, for Schonfeld Inc., the Manager

Lisa Corne and Michael J. Brzezinski, for Florence Leaseholds Limited, Beatrice Leaseholds Limited and Ada Leaseholds Limited

HEARD: February 4, 2015

ENDORSEMENT

[1] On November 5, 2013 Schonfeld Inc. was appointed the Manager of all of the real property owned by 32 companies listed in schedule B. These were real-estate development corporations which were joint ventures between Dr. Bernstein and his corporations listed in Schedule A and Norma and Ronauld Walton. Previously Schonfeld Inc. had been appointed an

Inspector of the schedule B corporations and it was evidence that came to light after that order that led to Schonfeld Inc. being appointed Manager.

[2] My reasons of November 5, 2013 set out fully the wrong doing of Norma Walton that led to the appointment of the Manager. Included in those reasons were that the Waltons had placed mortgages on some of the properties without the consent of Dr. Bernstein, had co-mingled funds from all of the projects contrary to the joint venture agreements through accounts of the Waltons' corporation Crown & Thistle Group Limited and had improperly taken funds invested by Dr. Bernstein for the joint ventures for their personal use.

[3] The November 5, 1013 order appointing the Manager stayed proceedings against the properties and granted (i) a Manager's charge for the fees and disbursements of the Manager and its counsel, to rank as the first charge on the properties in priority to any other charges on the properties and (ii) a Manager's borrowing charge that ranked subordinate to the Manager's charge but in priority to all other charges on the properties (together the "Manager's charges"). The intention of the Manager was to sell the properties and 21 properties have been sold.

[4] The Manager has moved for approval of its fees and disbursements and for approval of a methodology for the allocation of the Manager's fees and disbursements among the schedule B corporations[1].

[5] One of the schedule B corporations is Dupont Developments Limited which owns property at 1485 Dupont Street in Toronto. Florence Leaseholds Limited, Beatrice Leaseholds Limited and Ada Leaseholds Limited hold a first mortgage on the Dupont property ("the Dupont mortgagees"). The Dupont mortgagees now move for an order amending the November 5, 2013 order to provide that the Manager's charges rank behind their mortgage and to dismiss the Manager's motion for allocation of part of its fees and disbursements to the Dupont property.

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[1] The Manager also seeks to allocate some of its fees and disbursements to the Schedule C properties.

[6] The Manager takes the position that the Dupont mortgagees are too late to now attempt to have their mortgage rank prior to the Manager's charges. For the reasons that follow, I agree with the Manager.

[7] The motion to appoint the Manager was not made on notice to the mortgagees of the various properties. Once the order was served on the mortgagees, some of them took the position that they wanted to take control of the properties under their mortgage and conduct sale proceedings, and consent orders were made discharging the Manager for those properties and terminating the stay of proceedings against them.

[8] Millwood Management Limited administers the mortgages on the Dupont property on behalf of the Dupont mortgagees. Mr. Jack Brudner is the manager of Millwood. He was a solicitor until his retirement in January 2010. The November 5, 2013 order appointing the Manager and creating the Manager's charges was received by Millwood on November 22, 2013 with a letter from Goodmans LLP, the solicitors for the Manager, that referred to the paragraphs of the order granting charges and stated they ranked ahead of pre-existing security interests in the properties[2].

[9] Mr. Brudner had discussions with Mr. Schonfeld in early February, 2014 during which he said the Dupont mortgagees wished to take power of sale proceedings. The position of the Manager with all mortgagees of properties that wished to act under their mortgages was that they were entitled to orders permitting that so long as the Manager was discharged from all responsibilities for the particular property, and as stated, consent orders were made in several instances to achieve that. However, as will be seen, Mr. Brudner did not want the manager to be discharged from responsibilities for the Dupont property.

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[2] In his affidavit of January 22, 2015, Mr. Brudner swore that the November 5, 2013 order was not enclosed with the Goodmans letter. I do not accept that assertion. Mr. Brudner swore in his affidavit of May 14, 2014 that the November 5, 2013 order was enclosed with the letter.

[10] On April 14, 2014 Dickinson Wright, the solicitors for the mortgagees, wrote to Goodmans, the solicitors for the Manager, and said that the Dupont mortgagees intended to bring a motion to lift the stay of proceedings ordered in the November 5, 2013 order and to subordinate the Manager's charges to their mortgage. Mr. Brudner states in his affidavit that negotiations then began between the solicitors but that the Dupont mortgagees had no interest in taking possession of the Dupont property and sought to have the property remain under the Manager's administration while the mortgage was enforced by the Dupont mortgagees. The Manager understandably refused to agree to those terms.

[11] The Dupont mortgagees then served a notice of motion dated May 21, 2014 returnable June 16, 2014 requesting an order to amend or vary the November 5, 2013 order by lifting the stay of proceedings, subordinating the Manager's charges to their mortgage or alternatively excluding the Dupont property from the November 5, 2013 order. In response to the motion, the Manager brought a cross-motion to be relieved of its obligations for the control and management of the Dupont property.

[12] Before these motions were to be heard, the Manager entered into an agreement to sell the Dupont property for $9 million. There was a 75 day due diligence period and a further 30 day closing period. Mr. Brudner stated in his affidavit "In order to allow the June APS to play itself out" the Dupont mortgagees agreed to adjourn their motion to lift the stay pending the due diligence period. After that period the purchaser elected not to close the deal.

[13] The motions of the mortgagees and of the Manager were brought on for hearing on October 9, 2014. The Manager did not oppose the order lifting the stay of proceedings in the November 5, 2013 order to permit the mortgagees to enforce their security and the order also discharged the Manager from all responsibilities with respect to the Dupont property.

[14] Rule 37.14(1) provides that a party affected by an order obtained on motion without notice may move to set it aside or vary it by a motion "that is served forthwith after the order comes to the person's attention and names the first available hearing date that is at least three days after the service of the notice of motion". As the November 5, 2013 order was received by Mr. Brudner on November 22, 2013, any motion to vary it was required to be served "forthwith"

thereafter. No such motion was served for six months and it was not brought on for hearing for another five months. Counsel for the mortgagees concedes rule 37.14 is a problem but one that can be overcome by particular case law, which I shall deal with shortly.

[15] In *Muscletech Research and Development Inc. (Re)* (2006), 19 C.B.R. (5th) 54 in discussing a comeback motion relating to a CCAA Initial Order, Farley J. stated "Comeback relief, however, cannot prejudicially affect the position of parties who have relied *bona fide* on the previous order in question." I agree entirely with that statement and in my view it is equally applicable to a motion to vary a receivership order, which is essentially what the November 5, 2013 order was, the word Manager instead of Receiver being used in an attempt to put a better face on the order to the marketplace.

[16] The same reasoning underlies the dictates of rule 37.14 that requires a motion to vary to be brought "forthwith" after the affected party learns of the rule. A court can vary the strict provisions of the rule in appropriate circumstances, but should be loath to do so if in the interval persons relying on the order would be materially prejudiced.

[17] In this case, Mr. Brudner knew that the Manager was spending time and money on the Dupont property to preserve it and to attempt to sell it. He nevertheless admittedly wanted the property to remain under the Manager's administration. To sit back and let that happen and now afterwards contend that the Manager's charges should be subordinate to the Dupont mortgage and the Manager should not be allowed to allocate part of its fees and disbursements to the Dupont property would not be equitable or fair to the Manager and to the other stakeholders. They would be prejudiced.

[18] The Dupont mortgagees could at any time have had the Dupont property carved out of the November 5, 2013 order, as other mortgagees of other properties had done, but chose not to do so because it wanted the Manager to remain in possession of the property and administer it. Having chosen that route, they should not now be permitted to go back as they wish to do.

[19] The mortgagees rely on the case of *Terra Nova Management Ltd. v. Halycion Health Spa Ltd.* (2005), 13 C.B.R. (5th) 273 (B.C.S.C.); aff'd (2006), 25 C.B.R. (5th) 199 (B.C.C.A.). In that

case, Madam Justice Stromberg-Stein held that fees of a receiver did not take priority over a secured creditor although the order appointing the receiver had provided a first charge securing the receiver's fees. She referred to principles discussed by Houlden J.A. in *Robert F. Kowal Investments Ltd. et al. v. Deeder Electric Ltd.* (1975), 21 C.B.R. (N.S.) 201 (Ont. C.A.) and applied the principles to the facts before her. I do not see the *Terra Nova* case as establishing any principle but merely is a decision on the facts of that case applying legal principles from *Kowal*.

[20] In *Kowal*, Houlden J.A. stated a number of principles regarding the right of a receiver of a debtor to have security over property of a secured creditor. In sum, he stated:

(i) A receiver's right to an indemnity is restricted to assets under his control and as a general rule, will have no power to subject the security of secured creditors to liability for disbursements made by the receiver.

(ii) There are certain exceptions to the general rule. Without being exhaustive, and listing the exceptions relevant to the case before him, Houlden J.A. referred to three exceptions.

(iii) The first exception is if a receiver has been appointed at the request of or with the consent or approval or acquiescence of the security holder, the receiver will be given priority over the security holder.

(iv) The second exception is if a receiver has been appointed to preserve and realize assets for the benefit of all interested parties, including secured creditors, the receiver will be given priority over the secured creditors for charges and expenses properly incurred by the receiver. In such a case, one would expect that an order permitting borrowing by the receiver would make it clear before the fact, not after the fact, that the receiver could give as security for his borrowing a charge upon the assets in priority to the security of the secured creditors. When an order is sought for this type of borrowing, notice will ordinarily be given to the secured creditors whose rights will be affected.

(v) The third exception is if the receiver has expended money for the necessary preservation or improvement of the property, he may be given priority for such expenditure over secured creditors.

[21] In *Terra Nova*, although the secured creditor was aware of the order granting the receiver security ahead of secured creditors, it sat back and did nothing because it thought the equity in the property was enough to protect its loan. Justice Stromberg-Stein held that the secured creditor did not have notice of the order because service on its lawyer was not notice to it. She also stated that the receiver had to establish that the secured creditor consented to, approved of, or acquiesced to the appointment of the receiver, and that there was no evidence of acquiescence. Each case depends on its own facts, but I was invited to make the same finding in this case because of the similar circumstances. I decline to do so. I must say I have some question with the finding in *Terra Nova* that the secured creditor did not acquiesce in the appointment of the receiver. In the Court of Appeal, Donald J.A. thought it an error to say that service on the lawyer for the secured creditor was not notice to the secured creditor, but held that in spite of that error, there was no palpable and overriding error in the inference of fact found by Justice Stromberg-Stein.

[22] Apart from the fact that the Dupont mortgagees failed to act promptly under rule 37.14 and for that reason are not entitled to the relief they seek, in my view the first of the two exceptions enunciated by Houlden J.A. in *Kowal* permitted the order granting the Manager's charges.

[23] While it would have been desirable in a perfect world for the secured creditors on all of the properties to have been given notice of the motion, it was understandable with the terrible state of the books and records maintained by the Waltons and the urgency to stop unauthorized use of money that notice was not given to them. At that time, the Inspector was not able to know what money might be owed on the various mortgages on the various properties. But notice was given shortly after the order was made and the various mortgagees had all of the rights of objecting to the Manager's security as they would have had had they been given notice of the motion before the order was made.

[24] The Dupont mortgagees not only acquiesced in the order appointing the Manager once they learned of it but took the position that it wanted the Manager to continue administering the Dupont property under that order. They knew that the Manager was incurring fees and relying on the priority of the Manager's charges. They could hardly take that position but expect the Manager not to be paid for its fees and disbursements or to have security for those fees and disbursements as provided for in that order. They were in no position to pick and choose which provisions of the order they liked.

[25] Moreover, the receiver was necessary to preserve and realize the property of all of the schedule B corporations, including the Dupont property, for the benefit of all interested parties, including secured creditors. All of the properties were in chaos at the time the Manager was appointed and the subject of wrongful conduct, including co-mingling of funds, a lack of records and unauthorized use of funds. If the Waltons had been left unchecked, the adverse effects would undoubtedly have been worse. The Manager undertook sales efforts for all of the properties, including the Dupont property.

[26] I do not think the Dupont mortgagees are entitled to focus only on their property in these circumstances. In any event, the diversion of funds by the Waltons that had been invested in the Dupont property by Dr. Bernstein deprived the Dupont Corporation of resources that it required to complete the renovations commenced before the Manager was appointed, and the Walton's failure to pay creditors resulted in numerous liens being registered against the Dupont property. The appointment of the Manager was absolutely required for all of the schedule B corporations and their property, including the Dupont property, to preserve the properties.

[27] In the circumstances, the motion by the Dupont mortgagees is dismissed. What amount of fees and disbursements of the Manager that may be allocated to the Dupont property will be dealt with on the return of the motion by the Manager to approve a methodology for the allocation of its fees and disbursements among the schedule B corporations.

[28] The Manager is entitled to its costs of the motion. If costs cannot be agreed, brief written submissions may be made along with a cost outline within 10 days and brief reply written submissions may be made within a further 10 days.

Newbould J.

Date: February 9, 2015