



Superior Court of Justice

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FROM: The Honourable Mr. Justice P. B. Hockin

PAGES: 11 pages

DATE: October 21, 2008

RE: IN BANKRUPTCY – Ledco Limited

FILE NO: 35-1032513

MESSAGE: Please see attached Reasons for Order of Justice P. B. Hockin and attached 2-page handwritten Endorsement.

COURT FILE NO.: 35-1032513**ONTARIO
SUPERIOR COURT OF JUSTICE****IN BANKRUPTCY****IN THE MATTER OF THE BANKRUPTCY OF
LEDCO LIMITED
OF THE CITY OF KITCHENER,
IN THE REGIONAL MUNICIPALITY OF WATERLOO
IN THE PROVINCE OF ONTARIO**

COUNSEL: Timothy C. Hogan for the Trustee
James Fisher for the Toronto Dominion Bank
Isabelle Ryder for 87261 Canada Limited
Lewis N. Gottheil for CAW-Canada

HEARD: April 9, 2008 at London, Ontario

REASONS FOR ORDER

[1] The bankrupt, Ledco Limited, made an assignment in bankruptcy January 24, 2008. Deloitte and Touche Inc. was appointed its trustee. Deloitte has moved quickly to convert Ledco's estate but now requires the direction of the court with respect to the disposition of the real property of Ledco. This motion involves a determination as to whether the equitable doctrine of marshalling is available to a closely related creditor of the bankrupt and if it is, whether the bankrupt's employees may assert a claim in equal rank for wages, vacation pay and severance pay.

[2] The material facts are not in dispute.

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[3] Ledco was a manufacturer of tools and dies for the automotive industry. It carried on business at a plant in Kitchener. Its work force was represented by CAW-Canada. There was a collective agreement in place at the time of the assignment. The CAW-Canada has filed a proof of claim in the bankruptcy and correctly, is a party to this motion.

[4] The other two parties to the motion are the Toronto Dominion Bank and the bankrupt's related creditor, 82761 Canada Limited.

[5] The Toronto Dominion Bank holds a valid, enforceable, secured claim against the personality of Ledco by way of a general security agreement dated April 11, 2001. The personality consisted of inventory and accounts receivable and has been quickly converted to cash. As well, the Bank holds a valid and enforceable charge against Ledco's real property; it is dated February 8, 2001. The extent of the Bank's claim is approximately \$2,840,000.

[6] The claim of 82761 is a secured claim but it stands against only the personality and behind the Bank's interest. 82761 has no security interest in the bankrupt's real property. The extent of Ledco's debt to 82761 is \$10 million.

[7] 82761 and Ledco are related. Two directors of 82761 are related to a vice-president of Ledco. A director of Ledco resides at the head office address for 82761.

[8] The CAW-Canada for Ledco's employees has filed a proof of claim for wages and vacation pay; for pension or RSP monies deducted or owing; and for severance and termination pay under the *Employment Standards Act*, 2000, S.O. 2000, C. 41. The extent of the employees' claim is approximately \$2,012,000.

[9] The trustee, by the collection of accounts receivable and the sale of inventory and equipment, now holds \$777,000 (Can.) and \$1,581,000 (U.S.). The claim of Toronto Dominion, all agree, must be paid. The doctrine of marshalling in its long history has

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always recognized the right of a first mortgagee to pursue its remedy against either of the two estates of the mortgagor. This is conceded by 82761 and by agreement, the Toronto Dominion now has that order. It is an order, however, which did not concede the right of 82761 to enforce its interest, by assignment or subrogation of the Bank's charge against the real property of the bankrupt. Whether that can be accomplished is the subject of this motion. It is a matter of importance to Ledco's employees. If marshalling does apply, it is unlikely that the employees will recover any amount in the bankruptcy. The trustee expects to receive on the sale of the real estate substantially less than Ledco's debt to 82761 of \$10 million.

[10] The marshalling rule is often cited in the words of Orde J. in *Ernst Bros. Co. v. Canada Permanent Mortgage Corp.* (1920), 47 O.L.R. 362 (aff'd 48 O.L.R. 407) at pp. 367-8 as follows:

The doctrine of marshalling in its application to mortgages or charges upon two estates or funds, may be stated as follows: If the owner of two estates mortgages them both to one person, and then one of them to another, either with or without notice, the second mortgagee may insist that the debt of the first mortgagee shall be satisfied out of the estate not mortgaged to the second, so far as that will extend. This right is always subject to two important qualifications: first, that nothing will be done to interfere with the paramount right of the first mortgagee to pursue his remedy against either of the two estates; and, second, that the doctrine will not be applied to the prejudice of third parties: Fisher on Mortgages, 6th ed. pp. 694 et seq.; Coote on Mortgages, 8th ed., p. 804 et seq.; Halsbury, vol. 13, paras. 164 et seq.; White & Tudor's Leading Cases in Equity, 7th ed., p. 56 at seq.

The general principle is stated in Halsbury in these words (vol. 13, para. 164): 'Where one claimant, A., has two funds, X and Y, to which he can resort for satisfaction of his claim, whether legal or equitable, and another claimant, B., can resort to only one of these funds, Y, equity interposes so as to secure that A. shall not by resorting to Y disappoint B.' That is exactly the position here. There are two estates mortgaged to the Canada Permanent for the one debt, for which Jeremiah McAsey is liable, not only directly by virtue of his covenant, but also as between himself and Frank by virtue of his agreement to assume Frank's share of the debt, and there is the second charge or mortgage in favour of the plaintiffs, upon only

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one of the estates given, it is true, by Frank, but which Jeremiah has agreed to pay.

[11] The position of the CAW-Canada is that the second qualification to the rule, that the “doctrine will not be applied to the prejudice of third parties”, applies to the employees and that the marshalling rule should not be applied in favour of 82761. The CAW-Canada points out that the monies that are subject to the rule are subject to a statutory trust or a common law trust and that it would be inequitable to pay over the funds from the sale of the real estate to the bankrupt’s *alter ego* when it has no legal interest in the real estate.

[12] The employees’ argument is a compelling one but it is four square against the case law and must fail. Who may be considered a “third party” was reviewed by Saunders J. in *Re: Breadman Inc.* (1978), 89 D.L.R. (3d) 59. After quoting Orde J. from *Ernst Bros. Co., supra*, at pp. 601, 602, he repeated the marshalling rule by stating: “that if a first mortgagee has already been paid out of a fund then the court may apply the marshalling doctrine and allow the second mortgagee to stand in his place with respect to the other fund”. At p. 602, he dealt with whether unsecured creditors are “third parties” as follows:

Second, the trustee says that the doctrine should not be applied against the unsecured creditors because they are “third parties” (see the foregoing statement of Orde, J. in *Ernst Bros. Co. v. Canada Permanent Mortgage Corp.*) and because the *Bankruptcy Act* does not permit such an application. In 16 Hals., 4th ed., p. 962, para. 1427, it is stated that three conditions must be satisfied in order for the doctrine of marshalling to be applied as regard claims by creditors. One of these conditions is that the two funds must be at the debtor’s disposal. In *Flint v. Howard*, [1893], 62 L.J. Ch. 804 at p. 813 (U.K.C.A.), Kay, L.J., said:

The right of a subsequent mortgagee of one of the estates to marshal – that is, to throw the prior charge on both estates upon that which is not mortgaged to him – is an equity which is not enforced against third parties – that is, against any one except the mortgagor and his legal representatives claiming as volunteers under him. It is not enforced against a mortgagee or purchaser of the other estate. If both

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estates are subject to separate second mortgage, the Court apportions the first mortgage between them.

It seems to me that the third parties who may not be prejudiced by the application of doctrine do not include unsecured creditors of the debtor. It is logical that *bona fide* subsequent purchasers and mortgagees of the property without notice should be protected for their interest in the property would be seriously affected by the application of the doctrine. In most cases, they would have no way to anticipate the possible exposure to marshalling: see *Victoria & Grey Trust Co. v. Brewer et al.*, [1970] 3 O.R. 704, 14 D.L.R. (3d) 28 (O.H.C.). It is also logical that unsecured credits of debtors should not be protected for in the absence of a statutory provision, they should have no better right to the fund than the debtor himself. I find some comfort in the words of Ruttan, J., in *Williamson v. Loonstra et al.* (1973), 34 D.L.R. (3d) 275 (B.C.S.C.), where he said, at pp. 278-9, in referring to the doctrine of marshalling:

The doctrine does not extend to all creditors of equal degree, it does not apply in favour of an unsecured creditor and it does not apply in favour of a judgment creditor unless he has obtained a charge on the estate that he seeks to have marshalled in his favour. The judgment creditors in the present case claim only as against the remaining interest of the mortgagor. But the second mortgagee has a higher interest than that of the mortgagor. He claims against the property itself, while the mortgagor's claim is only to any residue that is left. The execution creditors take only the same right that remains to the mortgagor or prime debtor. In *Fisher and Lightwood's Law of Mortgages*, 7th ed. (1931), at p. 574, the learned authors, in discussing against whom the doctrine of marshalling is applied, has this to say:

“...it does not apply in favour of unsecured creditors, or in favour of a judgment creditor; unless he has obtained a charge on the estate.”

[13] I take *Re Breadman* to mean that in the absence of a statutory provision which protects the employees' interest in the fund from the sale of Ledco's real estate, the employees are unsecured creditors and so may enjoy no greater right to the real estate than Ledco. The issue then is whether there is a statutory provision which qualifies the employees as “third parties”. In my view, there is not. It is clear from the language from the *Employment Standards Act* that the best the employees can do is to say that for vacation pay, there is a statutory trust created against the *assets* of the bankrupt. See s. 40(1) and (2) of the Act. This is not enough, in my view. Beyond this there is not a “true

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trust" or common law trust because the benefits and pay have not been segregated from the bankrupt's general estate.

[14] *Re Breadman*, as well, stands for the proposition that marshalling is a rule which may be invoked by a secured creditor in a bankruptcy proceeding. There is this statement by Saunders J. at pp. 603-4:

It is submitted that the rights of secured creditors preserved by s. 50(5) are limited to those rights set out in the *Bankruptcy Act* and do not extend to permit the invocation of the doctrine of marshalling: see *Eastern Canada Savings & Loan Co. v. Campbell et al (No. 2)* (1971), 19 D.L.R. (3d) 231, 16 C.B.R. (N.S.) 75, 1 N & P.E.I.R. 448 *sub nom. Eastern Canada Savings & Loan Co. v. MacLauchlan, Trustees and Homeplan Realty Ltd.*, where consolidation was refused. With respect I do not think the rights of secured creditors can be so confined. Section 133 of the *Bankruptcy Act* gives the Bankruptcy Court jurisdiction in both law and equity and s. 50(6) states that:

50(6) The provision of this Act shall not be deemed to abrogate or supersede the substantive provisions of any other law or statute relating to property and civil rights that are not in conflict with this Act, and the trustee is entitled to avail himself of all rights and remedies provided by such law or statute as supplementary to and in addition to the rights and remedies provided by this Act.

Section 50(6) would apply to the rights of secured creditors and other persons as well as the trustee. While s. 49 puts some limitation on the ability of a secured creditor to realize and deal with his security, it is silent with respect to the exercise of other rights such as the innovation of the doctrine of marshalling.

There is nothing in the *Bankruptcy Act* or any other statute of which I am aware which is in conflict with the exercise of such a right and on the basis of the general principle that the unsecured creditor should be in no better position than the debtor, I can see no reason for not applying the doctrine. It has been applied in Ontario in a bankruptcy case: see *Re Harrison* (1992), 51 O.L.R. 634, 69 D.L.R. 658, 2 C.B.R. 360 (O.H.C.). The trustee further submits that under the *Bankruptcy Act*, Maple Leaf is but an unsecured creditor because it has no security on the Alderwood assets and the other assets on which it had security have been realized. The claim by Maple Leaf is as a secured credit on the Don Mills assets and the Kipling assets and, as indicated above, its rights to marshalling cannot be defeated by the

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realization of such security by the Bank. It is entitled to be subrogated to the Bank with respect to the Alderwood assets as against the trustee.

[15] See also *Textron Financial Canada Ltd. v. Beta Land* (2008), 37 B.C.R. (5th) 107 at para. 28:

The law is well established that the change in priorities that is created by the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the "BIA") supersedes the priorities established by the relevant provincial legislation. Section 136 of the BIA establishes the priority of claims on a bankruptcy. Application of this provision creates a result in which the vacation pay claims of Beta Brands' former employees characterized as either a lien or a trust ranks subordinate to the claims of Beta Brands' secured creditors, but would have priority over the claims of Beta Brands' unsecured creditors. The ESA as provincial legislation cannot alter priorities established by the BIA. Thus, the priority in respect of the deemed trust established by s. 30(7) of the PPSA (assuming the applicant did not have a PMSI in inventory and its proceeds) would not be effective in a bankruptcy (see *British Columbia v. Henfrey Samson Belair Ltd.* (1989), 75 C.B.R. (N.S.) 1 (S.C.C.) and *Husky Oil Operations Ltd. v. Minister of National Revenue*, 1995 CanLII 69 (S.C.C.), [1995] 3 S.C.R. 453). Local 242G quite properly acknowledged that if the priority rules in bankruptcy are relevant, then s. 30(7) of the PPSA is inoperative.

[16] Counsel for the CAW-Canada makes a compelling case but without federal statutory sanction by amendment to the bankruptcy legislation, the court may only conclude that the employees' status is that of an unsecured creditor. The employees do not have a special or equal claim with 82761 to the real estate. An order may therefore issue declaring that marshalling applies to the benefit of 82761 and that in the result, 82761 is entitled to enforce the charge of the Bank on the realty of Ledco to the full amount of that charge and by its terms and conditions.

[17] Absent agreement on costs, I will receive short, written submissions through the office of the trial coordinator at London before November 30, 2008.

DATE: October 21, 2008



Justice P. B. Hockin

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COURT FILE NO.: 35-1032513

**ONTARIO
SUPERIOR COURT OF JUSTICE**

**IN BANKRUPTCY
IN THE MATTER OF THE BANKRUPTCY OF
LEDCO LIMITED
OF THE CITY OF KITCHENER
IN THE REGIONAL MUNICIPALITY OF WATERLOO
IN THE PROVINCE OF ONTARIO**

REASONS FOR ORDER

HOCKIN, J.

Released: October 21, 2008

IN THE MATTER OF THE BANKRUPTCY OF LEDCO LIMITED
OF THE CITY OF KITCHENER, IN THE REGIONAL MUNICIPALITY OF WATERLOO,
IN THE PROVINCE OF ONTARIO

Court File No. 35-1032513

ONTARIO
SUPERIOR COURT OF JUSTICE
IN BANKRUPTCY

Proceeding commenced at LONDON

MOTION RECORD

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135357 : ama

SUPERIOR COURT OF JUSTICE
IN BANKRUPTCY
FILED
FEB 27 2008
COUR SUPERIEURE DE JUSTICE
EN MATIERE DE FAILLITE
DEPOSE

MAR 04 2008

To a special opp ~~of~~
April 9, 2008 - 2 hours
Joe Pensa

October 21, 2008

Order to go in terms of
signed orders attached;
and as follows:

1. that notwithstanding opinion
to assist 82761 Canada
limited
2. that 82761 Canada limited
may enforce by assignment
the charge of the trustee

Dominion Bank
 against the reality
 of the bankruptcy
 to the extent of its
 interest under its
 charge.

02/29/2008 9:47AM 000000 #4972

0001	
BANKRUPTCY	\$50.00
TOTAL	\$50.00
CHECK1	\$50.00
CHANGE	\$0.00

3. costs: if no agreement,
 I will determine liability
 and quantum after
 further submissions
 not later than
 November 30, 2008,

D. Horley