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Blaney McMurtry
BARRISTERS & SOLICITORS LLP

# Commercial Litigation Update

This newsletter is designed to bring news of changes to the law, new law, interesting decisions and other matters of interest to our commercial litigation clients and friends. We hope you will find it interesting, and welcome your comments.

Feel free to contact any of the lawyers who wrote or are quoted in these articles for more information, or call the head of our Commercial Litigation group, Lou Brzezinski at 416.593.2952 or lbrzezinski@blaney.com

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FEATURED SEMINAR:

Our ACES Group presents: **"QUICK HITS IN CONSTRUCTION: Opportunities & Challenges for '08"**

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*"The recent decision of Mr. Justice Spence...should be of interest to our institutional, particularly banking, clients and generally any clients who suspect they may have been the victim of fraud."*

## FAST RELIEF: PRE-TRIAL REMEDIES Part I – Norwich Orders

**John Polyzogopoulos**

The recent decision of Mr. Justice Spence in *Isofoton S.A. v. The Toronto-Dominion Bank* should be of interest to our institutional, particularly banking, clients and generally any clients who suspect they may have been the victim of fraud. In that case, Justice Spence granted an order in favour of the applicant to obtain the banking records of a party suspected of defrauding the applicant of over $3 million. The unique nature of the disclosure order was that it was directed not to the alleged fraudster, but to the fraudster's bank, in this case TD. The disclosure order was made to assist the applicant in investigating the fraud and determining what happened to its funds.

The applicant, Isofoton, contracted with AES for the purchase of silicon. As part of the contract, Isofoton paid AES a deposit of approximately $3.2 million. The deposit was wired to AES's bank account with TD. Subsequent to the payment of the deposit, AES failed to deliver the product as promised and began making excuses for its failure to honour the contract, including blaming its supplier. Repeated communications between Isofoton and AES and AES' alleged efforts to obtain the product led nowhere. Isofoton demanded the return of its money, and AES ceased responding to Isofoton's communications.

Isofoton then hired a private investigator, who determined that AES did not even exist as a legal entity, and that its office was a residential address.

Armed with these facts, Isofoton sought a court order requiring TD to disclose AES's banking records in order to show what happened to Isofoton's $3.2 million deposit. This would assist Isofoton in its efforts to establish its claim against AES and locate and preserve the funds. The application before the court was brought without notice to either TD or AES.

Justice Spence granted the order requested. In doing so, he set out the facts a party must establish in order to obtain such court relief. The factors are:

- whether the applicant has provided evidence sufficient to raise a valid and reasonable claim;
- whether the applicant has established a relationship with the third party (TD) from whom the information is sought such that it establishes that the third party is somehow involved in the acts complained of;

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*"It is important to consult with counsel at the very earliest stages of the discovery of a potential fraud, as counsel can be very useful in assisting in the investigative process..."*

John Polyzogopoulos provides counsel in a variety of matters including breach of contract, tort claims, shareholder disputes, product liability, professional negligence, debt and security enforcement claims and insolvency matters.

John is a current member of The Advocates' Society, the Ontario Bar Association, the Toronto Lawyers' Association and is a Past President of the Hellenic Canadian Lawyers' Association.

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- whether the third party is the only practicable source of the information available;
- whether the third party can be indemnified for costs to which the third party may be exposed because of the disclosure; and
- whether the interests of justice favour the obtaining of disclosure.

Justice Spence found that Isofoton met all of these factors. Based on the evidence, it appeared Isofoton had been defrauded, or at the very least, that its funds had been converted. Although TD was not involved in the fraud in the sense of actively and knowingly participating, it was involved in receiving the funds on behalf of AES and to the extent funds left that account, in disbursing them from AES's account. TD was the only practical source of the information (in the circumstances it was not likely AES would comply with a request for the information on a timely basis!). Isofoton agreed to pay TD's reasonable costs of gathering and disclosing the information.

Accordingly, in the interest of justice, Justice Spence granted the order sought, which is called a Norwich order, named after the first case in which such an order was made.

Our institutional clients, particularly banks, ought to be aware of this decision. If and when they are faced with a Norwich order, they should immediately retain counsel to assist them in complying. They are entitled to their costs, and if a provision to that effect is missing from the order or there is a dispute over the amount of costs claimed by the party complying with the order, counsel can assist in resolving this issue with opposing counsel or seeking the court's directions on the issue of costs. As well, counsel can assist the client in determining if there is any possibility that the institution's customer will commence a claim against it for complying with a court order and if such a concern exists, can seek the court's directions prior to compliance.

Others should be aware that a Norwich order can be a powerful and useful tool to assist in information gathering prior to commencing costly and lengthy legal proceedings. Together with Anton Piller orders (civil search and seizure orders) and Mareva injunctions (orders freezing assets prior to trial), a Norwich order is a very useful pre-trial remedy available to parties who believe they have been defrauded. It is important to consult with counsel at the very earliest stages of the discovery of a potential fraud, as counsel can be very useful in assisting in the investigative process, both in terms of getting information and ensuring that such information is properly obtained so that it will be admissible in court.

A second part of this series of articles will focus on Anton Piller orders and their effectiveness as investigative tools and to preserve evidence. The last in the series will deal with Mareva injunctions, which preserve assets pending trial so that a plaintiff can later collect on any judgment obtained. ■

COMMERCIAL LITIGATION UPDATE

*"Lenders and other members of the factoring community should be aware of the potential impact of a recent ruling on a priority fight over the accounts receivable of a bankrupt company."*

Domenico's commercial litigation practice focuses on shareholder disputes, real property litigation and contract disputes. While Domenico has considerable experience in the courtroom, his strength is working with clients in achieving common sense solutions to complex business problems.

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## FACTORING AGREEMENTS: SECURITY OR SALE OF ASSETS?

**Domenico Magisano**

Lenders and other members of the factoring community should be aware of the potential impact of a recent ruling on a priority fight over the accounts receivable of a bankrupt company. One of the issues that the court had to consider was the application of a factoring agreement. Canadian courts have always struggled with factoring agreements. Are they security agreements, or are they merely a sale of accounts receivable?

The latest chapter in this debate occurred in *2811472 Canada Inc. (C.O.B. Acorn Partners) v. Royal Bank of Canada*. In this case, the Royal Bank of Canada ("**RBC**") lent money to Molnar Industrial Maintenance Ltd. ("**Molnar**") and took security by way of General Security Agreement (the "**RBC Security**"). Prior to Molnar's bankruptcy, and after the Bank had demanded payment of its loans, Molnar entered into factoring agreements with 2811472 Canada Inc. ("**Acorn Partners**") under which Molnar purported to assign its accounts receivable to Acorn Partners. Acorn Partners never sought, and RBC never agreed, to subordinate the RBC Security to that of Acorn Partners. Once Molnar became bankrupt, a priority dispute arose between RBC and Acorn Partners with respect to Molnar's accounts receivable.

First Acorn Partners argued that its factoring agreements were merely a purchase of Molnar's accounts receivable. But Acorn Partners subsequently argued that its factoring agreements constituted security arrangements, pursuant to which Acorn Partners acquired a Purchase Money Security Interest ("**PMSI**") in Molnar's accounts receivable.

The court was skeptical about Acorn Partners position that it either entered into an agreement of purchase and sale or, alternatively, had a PMSI in Molnar's account receivable. But the court gave an opinion on Acorn Partners' argument that it had a properly perfected PMSI in the accounts receivable. In dismissing Acorn Partners' motion, the Honourable Justice Forget made the following findings:

- Acorn Partners could not have a properly perfected PMSI, since the funds advanced by Acorn Partners to Molnar were not used to acquire or create the collateral over which Acorn Partners claimed its PMSI; and
- irrespective of point (1), the pre-existing RBC Security already encumbered all of Molnar's "accounts and book debts". Absent a subordination agreement with RBC, Molnar was therefore not in a position to assign its accounts receivable to Acorn Partners.

Acorn Partners appealed the Honourable Justice Forget's decision to the Ontario Court of Appeal. In a unanimous decision, the appeal was dismissed and the Court of Appeal confirmed that RBC had priority over Molnar's accounts receivable.

When considered in conjunction with the Supreme Court of Canada decision in *First Vancouver Finance v. Minister of National Revenue*, it appears that this decision has clarified the nature of factoring agreements under the *Personal Property Security Act* (Ontario). Specifically, factoring companies must recognize:

- when an existing creditor has security in the present and after acquired accounts receivable of the debtor, then absent a subordination

COMMERCIAL LITIGATION UPDATE

*"A recent decision of the Canadian International Trade Tribunal (CITT) opens the door for foreign bidders to launch procurement bid protests against the federal government..."*

Lisa has diverse litigation and corporate risk management and resolution experience. She has significant experience acting for large and small corporations, institutional clients and individuals in commercial and government contract litigation, class proceedings, and environmental and employment disputes.

Lisa has spoken at conferences, written articles and conducted seminars on issues relating to public procurement and environmental law.

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agreement, the courts will find that the factoring agreement does not have priority to the pre-existing security;

- it is difficult for a factoring company to prove that its factoring arrangement and by extension, the security taken in the debtor's accounts receivable, forms a PMSI, since the factoring company first must prove that its proceeds were used to create or acquire the collateral that is subject to the PMSI; and
- should a factoring company attempt to purchase accounts receivable that have previously been encumbered by the debtor, it does so at its peril, since a pre-existing secured creditor with a properly perfected security interest has priority to these proceeds.

Factoring agreements have a role to play in corporate finance (particularly with companies facing a liquidity crisis), however, their priority will be subject to pre-existing creditor rights in that same security. ■

## FOREIGN BIDDER GETS GO-AHEAD TO PROTEST UNDER TRADE AGREEMENT

**Lisa Bolton**

*This article previously appeared in the November 23, 2007 edition of the Lawyers' Weekly.*

A recent decision of the Canadian International Trade Tribunal (CITT) opens the door for foreign bidders to launch procurement bid protests against the federal government under the Agreement on Internal Trade (AIT), a domestic intergovernmental trade agreement between the federal and provincial governments aimed at fostering inter-provincial trade.

In *Northrop Grumman Overseas services Corporation v. the Department of Public of Works and Government Services* (CITT File No. PR-2007-008), Grumman, a US-based company, filed a complaint with the CITT in relation to a procurement for the supply of infrared sensor targeting pods for the Department of National Defence's CF-18 fighter aircraft. Grumman alleged in its complaint that the government's evaluation of Grumman's bid was not performed in accordance with the specified bid evaluation methodology. Grumman complained that the government failed to award it certain evaluation points and incorrectly awarded evaluation points to the winning bidder, Lockheed Martin, another foreign bidder. Grumman requested that the contract awarded to Lockheed be terminated, that the government re-evaluate the bids, and that Grumman be selected as the winning bidder.

Before considering the merits of Grumman's complaint, the CITT asked the government to file submissions addressing whether the CITT had jurisdiction to investigate the complaint given that Grumman was a foreign company and the only applicable trade agreement was the AIT. Typically, complaints received by the CITT from foreign bidders involve procurements subject to the North American Free Trade Agreement (NAFTA), under which standing of foreign bidders is well established. However, NAFTA did not apply to the procurement in this case.

In response to the request for submissions, the government took the position that Grumman did not have standing to make a complaint involving a procurement under the AIT alone

and requested the CITT dismiss Grumman's complaint. The government's position was consistent with several previous decisions in which the CITT concluded that to have standing to bring a complaint under the AIT, a complainant must be a "Canadian supplier" as defined by the AIT.

In its decision released September 12, the CITT brought much needed clarity to the question of standing of foreign bidders and determined that Grumman was not precluded from bringing a complaint before the CITT merely because of its nationality.

In arriving at its decision the CITT examined the CITT Act, its Regulations, and the AIT. The CITT Regulations set out three specific criteria which must be met before the tribunal can accept a complaint: first, the complainant must be a "potential supplier"; second, the complaint must be in respect of a contract designated under one of the applicable trade agreements; and third, the complaint must disclose a reasonable indication that the procurement has not been carried out in accordance with the procurement requirements set out in the trade agreement governing the designated contract. In this case, Grumman argued the government did not comply with the bid evaluation requirements under article 506 of the AIT.

The tribunal had no difficulty determining that Grumman was a "potential supplier" as required to satisfy the first criterion. The CITT found there was no nationality requirement in the definition of potential supplier in either the Act or the Regulations. Nor did it find any prohibition against foreign suppliers in the provisions of the AIT on which Grumman based its complaint. The tribunal also found that the contract was designated under the AIT and that Grumman's complaint met the threshold for investigation required by the third criterion.

The CITT rejected the government's argument that the guiding principles set out in articles 101(3) and 501 of the AIT, which speak of removing barriers for "Canadian suppliers" and fostering trade "within Canada", imply a general exclusion of foreign bidders. The tribunal instead interpreted these provisions as merely expressions of broad objectives rather than substantive provisions mandating how those objectives are to be met.

The Tribunal confirmed that if the government procuring entity wants to restrict a procurement governed by the AIT to Canadian suppliers, the procuring entity may do so if the procurement meets certain additional requirements set out in article 504 of the AIT. The CITT viewed the permissive nature of this nationality exclusion as support for its conclusion that foreign suppliers are not intended to be restricted from bidding on all procurements under the AIT and likewise they are not intended to be excluded from accessing the AIT's dispute resolution mechanisms on the basis of nationality.

After deciding Grumman had standing to file its complaint, the tribunal allowed Grumman's complaint in part and recommended that the government re-evaluate all the bids.

The government has declined to comply with the CITT's recommendation pending the outcome of an application for judicial review filed in the Federal Court filed in early October, 2007. ■

COMMERCIAL LITIGATION UPDATE

*"In a decision that has spawned a great deal of discussion within the construction industry, the Court of Appeal has upheld a lower court ruling that the installation of an assembly line in an auto manufacturing plant did not give rise to construction lien rights."*

Howard Krupat advises owners, general contractors, subcontractors, suppliers and design professionals in litigation and other dispute resolution proceedings relating to many facets of construction law including contract claims, construction liens, mortgage priorities, bidding and tendering, professional negligence, bond claims, construction trusts and delay claims. Howard also provides advice to his clients on environmental and general commercial litigation disputes

Howard is a member of the Executive of the Ontario Bar Association, Construction Law Section and the Allied Professions & Owners Division Committee of the Toronto Construction Association. He has spoken on a variety of construction law issues and his articles have been included in numerous construction law publications.

Howard may be reached directly at 416.593.2998 or hkrupat@blaney.com

## KENNEDY ELECTRIC: ASSEMBLY LINE INSTALLER DENIED LIEN RIGHTS

**Howard Krupat**

In a decision that has spawned a great deal of discussion within the construction industry, the Court of Appeal has upheld a lower court ruling that the installation of an assembly line in an auto manufacturing plant did not give rise to construction lien rights.

In *Kennedy Electric* ("Kennedy") *v. Dana Canada Corporation* ("Dana"), Dana was retained to manufacture frames for F-150 Ford trucks. Dana in turn hired Rumble Automation Inc. ("Rumble") to design and install the assembly line that would be used for the manufacturing process. The assembly line was to be housed in a new addition being constructed for an existing Dana plant.

Kennedy was retained by Rumble as a subcontractor for some of this work. In particular, Kennedy was required to disassemble the assembly line at offsite locations where it was being tested and then install the line in Dana's plant. The assembly line to be installed was not insignificant. It included 100 mezzanine platforms and 165 robots. It was bolted to the floor with 2,000 to 3,000 bolts. It weighed 500,000 tons, was 20 feet high and covered 100,000 square feet of space.

Following a dispute between Rumble and Kennedy, Kennedy was locked out of the site. Kennedy and its subcontractors then registered construction liens and sued Rumble and Dana. Rumble's subsequent bankruptcy meant that the only remedy available to Kennedy was its construction lien claim against Dana's interest in the lands upon which the manufacturing plant was located.

At the trial level and then again following an appeal by Kennedy to the Divisional Court, it was held that Kennedy did not have lien rights since the assembly line was not an "improvement" to the lands, as that term is defined by the *Construction Lien Act* (the *"Act"*). Some of the important findings made by the trial judge included the observations that: (a) Kennedy had no involvement in the connection of the assembly line to the building; (b) Kennedy had no involvement in the construction of the new addition; (c) the construction of the new addition and the installation of the assembly line did not comprise one "integrated construction project"; and (d) the assembly line was portable, and fully capable of being disassembled, removed and installed at another site (although the cost of doing so was estimated to be in the range of ten million dollars).

In a unanimous decision, the Ontario Court of Appeal upheld the ruling that Kennedy's installation of the assembly line did not give rise to construction lien rights. Significantly, the court noted that whether the services at issue qualify as an "improvement" is a "fact-finding exercise" and that it was open to the trial judge to find that no lien arose on the basis of the findings of fact made. For the construction industry, this means that the determination of lien rights will continue to be based on the unique facts of each case.

But the following statement from the Court of Appeal, which made its ruling after a careful review of a number of cases dealing with similar issues, gives an indication of when lien rights are likely to be found:

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With three decades of experience in litigating commercial and insurance-related disputes at the trial and appellate levels, Rod Winsor continues to specialize in high level, high profile cases nationally and internationally.

Rod has been awarded an AV ranking, the highest rating possible by Martindale-Hubbell, the prestigious international lawyer ranking service.

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> "Each case will depend on its facts. In most cases, the installation or repair of machinery used in a business operated in a building, particularly where the machinery is portable, will not give rise to lien rights under the CLA. On the other hand, where machinery is installed in a building for the use of a business and is completely and permanently integrated into the building, a lien claim will arise."

There is no doubt that this case will continue to be a hot topic of discussion and that the lien rights of various suppliers will continue to be debated from project to project. However, the court's decision must be given careful consideration when assessing the lienability of services and materials supplied to projects in Ontario. ■

## PUBLICATIONS AND SEMINARS

### Implied Obligation of Good Faith in Contracts - by Rod Winsor

In recent years commercial clients have been forced to address the possible implications of an implied obligation of good faith in contract. The apparent simplicity of the subject masks a number of difficult issues and considerations. While many jurisdictions have mandated at least limited obligations of good faith in contracts, the issues remain highly controversial in Canada.

In light of this, it is important that all parties entering into contracts have an understanding of the issues and their potential effect on their contractual rights and obligations.

Canada Law Book has just published a text on the subject written by Rod Winsor, a partner in our Commercial Litigation Group.

Some of the questions addressed include:

- whether an implied obligation of good faith in contract exists in Canada;
- what qualifications should in any event apply to such an obligation;
- to whom is such a duty owed;
- the standard of care required to constitute good faith; and
- the additional obligations which a contracting party may face in the absence of good faith.

In *Good Faith* Rod has identified the underlying questions, summarized and analyzed the existing Canadian law and provided an outline of how the law may evolve. He also addresses in detail the practical consequences for contracting parties.

**January 28 & 29, 2008**

**Geza Banfai** will be co-chairing Osgoode Hall Law School's CLE program, *The Intensive Course in Construction Law* on January 28 and 29, 2008 in Toronto. **Howard Krupat** will be speaking at the same conference on the topic, "Avoiding and Handling Construction Disputes".

**February 7, 2008**

**Andrew Heal** be speaking this February 7, 2008 at the 14th Canadian Institute Provincial/ Municipal Government Liability Conference on "Successful Strategies for Defending Against Negligent Building Inspection Claims"

**February 21, 2008**

**Howard Krupat** will be speaking at the Halton Construction Institute's seminar for the Ontario Road Builders Association, being held

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February 19th through 21st, 2008. Howard's topic will be "Interpreting and Applying Construction Contracts on the Jobsite".

**March 7, 2008**

**John Wolf** will be a guest panel member at the Canadian Shopping Centre Law Conference of the International Council of Shopping Centers (ICSC) to be held in Toronto on March 7, 2008. John will be speaking about "Managing the Tenant Default Process".

**April 29, 2008**

**Geza Banfai** will be co-chairing the "Negotiating Construction Contracts" program, sponsored by Canadian Institute, in Edmonton, Alberta. He will also be running the workshop "Effective Negotiating Styles for Construction Projects: Finding the Right Fit For You" at the same conference.

**May 29, 2008**

**Andrew Heal** will be a speaker on May 29, 2008 at the Ontario Bar Association's seminar, "Construction Remedies, Beyond the Lien". Andrew's topic will be "A Novel Alternative: Section 34 of the *Personal Property Security Act*". **Howard Krupat** will be speaking at the same seminar on "Pursuing the Insolvent Construction Company: Acting for a Lien Claimant or Trust Claimant in Bankruptcy and CCAA Proceedings".

## "QUICK HITS IN CONSTRUCTION Opportunities & Challenges for '08"

The firm's Architectural/Construction/Engineering Services (ACES) Group will be presenting this important information session for clients at our offices on Thursday, February 28, 2008.

Speakers will include: Geza Banfai, Michele Hecke, Bill Anderson, Andrew Heal, Howard Krupat, Lea Nebel, Robert Taylor, Mala Joshi, Janet Bobechko, Robert Muir and Tanya Litzenberger.

Thursday, February 28, 2008
8:30 a.m. – 12:00 noon
To be held at the Offices of Blaney McMurtry LLP
2 Queen Street East, 15th Floor, Toronto

### REGISTRATION

**Telephone**
Call our RSVP line at 416.593.3974

**Online**
Register at www.blaney.com/register.htm

**For the full agenda and registration information:**
www.blaney.com/register.htm

*Commercial Litigation Update* is a publication of the Commercial Litigation Group of Blaney McMurtry LLP. The information contained in this newsletter is intended to provide information and comment, in a general fashion, about recent cases and related practice points of interest. The information and views expressed are not intended to provide legal advice. For specific legal advice, please contact us.

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We welcome your comments. Address changes, mailing instructions or requests for additional copies should be directed to Chris Jones at 416.593.7221 ext. 3030 or by email to cjones@blaney.com. Legal questions should be addressed to the specified author.

EXPECT THE BEST

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