IN THE SUPREME COURT OF NOVA SCOTIA
IN BANKRUPTCY AND INSOLVENCY
Citation: *H &H Fisheries Ltd. (Re),* 2005 NSSC 346

Date: 20051219
Docket: SH B259148
Registry: Halifax

IN THE MATTER OF: H & H Fisheries Limited

DECISION

Judge:	The Honourable Justice Walter R.E. Goodfellow
Heard:	December 14, 2005 in Halifax, Nova Scotia
Counsel:	Victor J. Goldberg and Martha L. Mann for H & H Fisheries Limited Stephen J. Kingston and Bob Mann, articled clerk, for the Bank of Nova Scotia

By the Court:

BACKGOUND:

[1] H & H Fisheries Limited (HHFL) owns and operates a fish processing plant at Eastern Passage, Halifax, Nova Scotia, which is a somewhat seasonal operation and it presently employs seventy-five people which diminishes to approximately twelve people off-season.

[2] Reginald P. Hartlen is the president, a founding shareholder and director of HHFL and the company became a customer of the Bank of Nova Scotia (BNS) in May of 2003.

[3] HHFL and BNS secured a commitment letter December 2, 2004 with the stated purpose of BNS "to finance trade receivables and inventory". It provided that BNS would have a first charge over accounts receivable and inventory and set out the terms and conditions of their agreement including "for ongoing credit risk management purposes, all operating accounts of the borrower shall be maintained with the Bank as long as the borrower has any operating line facilities with the Bank". There were several additional terms and conditions dealing with reporting ratios of current assets to current liabilities, ratio of debt to tangible net worth, etc. The letter of commitment contained a clear outline of the general borrower reporting conditions. The letter of commitment made reference to two specific receivables outstanding; Emporio and Simone, upon which I will comment further.

[4] In November 2004 HHFL applied to increase its limit on its operating credit line from $400,000 to $1,100,000 and this increase was approved subject to confirmation as to the collection of the Emporio and Simone accounts.

[5] In December 2004 the Simone account was paid in full but Emporio remained outstanding. Because the lobster season was approaching, HHFL requested BNS to waive the condition relating to the Emporio account. BNS did not waive the requirement in relation to that account but did allow access to the full operating line of $1,100,000 to January 31, 2005 when the limit was reduced to $750,000.

[6] In February 2005, HHFL again requested access to the $1,100,000 credit limit to February 28, 2005 when again it would be reduced to $750,000 and this

was agreed upon by the parties. HHFL provided BNS with an update on the status of the Emporio account which continued to remain outstanding. BNS became increasingly concerned with respect to the impact of the potential write-off of the Emporio account and as a result in March 2005 conversations took place between BNS and Reginald Hartlen, who undertook April 7, 2005 to inject equity of $200,000 into HHFL by April 22, 2005. Mr. Hartlen did come up with $100,000 and endeavoured to obtain additional funds in relation to mortgaging his residence but unfortunately there was a lien/judgment against his property and his financing has not been possible.

[7] In June 2005 HHFL advised that as part of its 2005 fiscal year ending June 30, 2005, the company would write off the Emporio account which would give it an operating loss of $300,000 which would be partially set off by an SR&ED refund of $200,000, leaving a net loss of $100,000 for the fiscal year 2005.

[8] In September 2005 BNS received a copy of HHFL's unaudited financial statement for the year ending June 30, 2005 which showed a net loss of $596,043. This compared with a net loss of $21,003 for the year ending June 30, 2004.

[9] HHFL had problems with cash flow and operating and contrary to the letter of commitment started to deposit funds to its accounts with CIBC and this was acknowledged by the director of finance of the company in September 2005. There followed innumerable meetings, correspondence between the parties and Mark S. Rosen, a licensed trustee in bankruptcy, who has consented to act as trustee for any proposal in this matter.

LEGISLATION:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 1; 1992, c. 27, s. 2.

ss. 50.4(9):

Extension of Time for Filing Proposal

In order to obtain an extension, the debtor must establish the following three items

(a) that it is acting in good faith and with due diligence;

(b) that it would likely be able to make a viable proposal if an extension were granted; and

(c) that no creditor would be materially prejudiced.

s. 54(2.2)(3):

Related creditor - A creditor who is related to the debtor may vote against but not for the acceptance of the proposal.

62(1.2)(2):

On whom approval binding - A proposal accepted by the creditors and approved by the court is binding on creditors in respect of

(a) All unsecured claims, and

(b) the secured claims in respect of which the proposal was made and that were in classes in which the secured creditors voted for the acceptance of the proposal by a majority in number and two thirds in value of the secured creditors present, personally or by proxy, at the meeting and voting on the resolution to accept the proposal.

but does not release the insolvent person from the debts and liabilities referred to in section 178, unless the creditor assents thereto. (S.C. 1992, c. 27, s. 26).

Interpretation Act, R.C.C. 1985, c. I-21

Law Always Speaking

Law always speaking

10. The law shall be considered as always speaking, and where a matter or thing is expressed in the present tense, it shall be applied to the circumstances as they arise, so that effect may be given to the enactment according to its true spirit, intent and meaning.

Enactments Remedial

Enactments deemed remedial

> 12. Every enactment is deemed remedial, and shall be given such fair, large and liberal construction and interpretation as best ensures the attainment of its objects.

APPLICATION:

[10] HHFL filed a Notice of Intention dated November 3, 2005 under ss. 50.4(1) to make a Proposal of H & H Fisheries Limited. An order was granted extending the time to file a proposal November 29, 2005 to December 8, 2005. Unfortunately, the Chambers' docket was so heavy that the Justice presiding on December 8, 2005 was unable to address the matter and I was asked to deal with it and it was put over by consent to December 14, 2005. The application is comprised of several affidavits and both parties declined cross-examination of the other sides' supporting affidavits. On December 14th I heard almost four hours of argument and reserved my decision in order to thoroughly review the extensive material filed by both parties and arrive at a determination.

ONUS:

[11] The court, as directed by s. 50.4(9) above, must be satisfied on each application that:

> (a) the insolvent person has acted, and is acting, in good faith and with due diligence;
>
> (b) the insolvent person would likely be able to make a viable proposal if the extension being applied for were granted; and
>
> (c) no creditor would be materially prejudiced if the extension being applied for were granted.

[12] The onus is upon the applicant, in this case HHFL), to satisfy the court on a balance of probabilities that all three prerequisites of s. 50.4(9) have been established on the application.

[13] This is so because of the use of the "semi-colon" and the use of the word "and" in (b), rendering the requirements conjunctive. This requires the court to consider each of the subsections as to whether the applicant has established the prerequisite contained in the subsection on a balance of probabilities. For the application to be successful the court must be satisfied that all three prerequisites

of the application have been established on a balance of probabilities before extending the time for filing a proposal. It is, in essence, a three part test and if the applicant fails on any part the court would not then be satisfied, requiring the application to be dismissed.

[14] **Has HHFL satisfied the court that it has acted in good faith and exercised due diligence?**

[15] There is some merit to the arguments advanced by BNS and the court is particularly concerned about a party HHFL signing a commitment letter with the clear undertaking noted above that all its operating accounts were to be maintained with BNS. This is for the obvious purpose of providing BNS with an opportunity to monitor and protects its interests as a creditor and clearly HHFL in moving all its trading, operating business to its CIBC accounts has committed a breach of contract, a breach of the commitment it made in the original committal letter executed by both parties December 2, 2004.

[16] Does a breach of contract automatically constitute bad faith? The answer is, "not necessarily", but it is evidence that must be weighed very carefully and the evidence here does show a deliberate failure to notify BNS of this redirection of operating funds and at one point a signed invoice or record which was somewhat misleading with respect to the possibility of some relatively minor accounts having been directed to the CIBC in error.

[17] The converse of good faith is bad faith and bad faith requires a motivation and conduct that is unacceptable. If, for example, the diversion of operating/trading proceeds had been diverted to the CIBC for the purposes of personal gain for any officer, director or shareholder of HHFL, an example of which would be payment to ones family or a pay-down on a mortgage or judgment on ones home, etc., or to enhance the third level of a secured creditor being Mr. Hartlen's company, R. Hartlen Investments Inc., then clearly such would amount to bad faith and quite possibly fraud. It is clear that the motivation for moving the funds to the CIBC account was, in one word, for the purpose of "survival". Funds were essential in that I accept the view expressed by HHFL that had it continued to direct its operating/trading funds to BNS the probability is almost a certainty that BNS would have utilized such funds to pay-down its advances precluding the company from having any operating funds and the door to the plant would have been shut. This result would not have been, and is not at this time, in the best

interest of either party and coincidentally the seventy-five employees who are at the moment gainfully employed by HHFL. I make it clear that it is not necessary that there be fraud for the conduct to fall short of good faith. HHFL have also fallen behind in many other aspects of the original commitment letter but they have responded and provided documentation, bank records, reconciliation of invoices with cash withdrawals. Its recent conduct probably directed by the trustee entirely mitigates against any suggestion of the diversion being for personal gain other than as I have said, a course of conduct taken for the benefit of both parties some other ninety-six outstanding creditors and the seventy-five employees. In some cases a breach of contract may be such of itself that it precludes acceptance on a balance of probabilities that the overall conduct meets the good faith requirement.

[18] It is argued by HHFL that only its conduct since the filing of the Notice of intention November 3, 2005 should be considered and with respect, I am inclined to disagree. The manner in which a party conducts itself in the past, particularly the immediate past, is often an indicator of likely conduct in the immediate future. In addition, what you have here is a breach of the contract/commitment letter which occurred before November 3, 2005 and continued and overlapped the date of the filing of the Notice of intention.

[19] The court does have the opinion of a respected trustee whose sworn testimony by affidavit has not been challenged and Mark S. Rosen, LLB, FCIRP, has been involved for some time and very active in endeavouring to come to grips with the challenge and has met with and communicated with officials of BNS, BDC and many of the unsecured creditors. After reciting in detail the extent of such activity he deposes in paragraph 14 of his affidavit of December 1, 2005 as follows:

> 14. I have been working with and receiving information from Messrs. Hartlen and Limpert as well as Harley Hiltz, the director of marketing and production for the Company, who at all times have been fully co-operative. From my experience and dealings with the Company, I believe that the Company has acted and is acting in good faith and with due diligence in working towards formulating a viable proposal. I believe that the Company would likely be able to make a viable proposal if the extension is granted.

My finding on this prerequisite is that by a relatively small margin HHFL has satisfied the court on a balance of probabilities that it has been and is likely to act in good faith. In reaching this conclusion I have not taken into account the

representation made in oral argument that Mr. Hartlen has probably advanced $90,000 to $95,000 to HHFL recently because I do not recall seeing anything in the evidence, particularly documentation confirming this infusion and therefore I am unable to give it any weight.

[20] The second wing of subparagraph (a) is in relation to due diligence and while the company has not acted in quite the timely manner it ought to have acted its deficiency in this regard is not severe and the cumulative evidence before me including the summary contained in Mr. Rosen's affidavit of December 1, 2005 and the volume of response which has been made to the BNS's requests and entitlement for documentation, combined with the efforts being made by the trustee in bankruptcy, Mark S. Rosen, to address a resolution constitutes satisfaction on a balance of probabilities of due diligence to this date.

[21] **Would HHFL likely to be able to make a viable proposal if the extension being applied for were granted?**

[22] "Viable" in this context means a proposal which seems reasonable on its face to a reasonable creditor (*Re Baldwin Valley Investors Inc.*, [1994] 23 C.B.R. (3rd) 219). Again, the court must be satisfied on a balance of probabilities that HHFL **would likely**. This at the very least means that a reasonable level of effort dictated by the circumstances must have been made that gives some indication of the likelihood a viable proposal will be advanced within the time frame of the extension applied for.

[23] Lack of detail and assurance of this kind was considered in *St. Isidore Meats Inc. v. Paquette Fine Foods Inc.* [1997] O.J. No. 1863. In dismissing an application for an extension of time, Justice Chadwick stated (at para. 16):

> "...[T]he debtors have not been able to put forth any meaningful financial plan which would support a proposal. There is a vague reference in the affidavit material that they have approached at least two prospective purchasers, however there is no evidence that any of these parties are interested in assisting the debtor either now or in the future."

[24] The BNS points to a number of specifics of what it considers a lack of effort that should result in a finding that there is little likelihood of HHFL making a viable proposal. BNS notes the fact that it has stated clearly that it no longer has any interest of being involved in the affairs of HHFL which will necessitate, in all

probability, an alternate financial institution and to date no inquiries have been made by HHFL or the Trustee of any financial institution. The absence of this step will take on weight depending upon the totality of the circumstances that exist at the time of the Notice of intention and that have developed since the Notice of intention was filed.

[25] There has been a considerable degree of activity before and since the Notice of intention was filed November 3, 2005. It seems in the total evidence available to the court through the affidavits filed that it is a reasonable inference to draw that it is highly unlikely that any financial institution would show any interest in filling the shoes of BNS until a determination is made with respect to this application for an extension of time to January 30, 2006. Since the Notice of intention has been filed the evidence is that HHFL has made a profit for November 2005 greater than that was anticipated. It had been anticipated that the profit would have been $7,000 and it appears to be approximately $19,600. There is an indication that the company is operating a new business model as a processing facility and there is evidence of the projected sales. In addition, there is evidence of a company, Pesca Pronta, having entered into a contract which by now would have had two substantial deliveries of lobster and in response to my inquiry during argument it appears that the first delivery has been paid for. HHFL advances the affidavit of Francesco Amoruso of Rome, Italy as to a possible solution and substitution by financial injection from that company, however, at this stage all that affidavit establishes is that an effort is being made by HHFL to address their situation. It further confirms that this is a busy, crucial period for HHFL but it does not at this point provide any comfort to be BNS or the court as to being a probable element of a viable proposal.

[26] Paragraph 5 of Francesco Amoruso's affidavit merely states:

> I have had discussions with Mr. Hartlen with respect to a potential share investment in H & H by Pesca Pronta in the approximate amount of $400,000.00 Cdn. I am very interested in pursuing the investment opportunity but will require 30 days to discuss the situation with my brothers/partners. I am hopeful that the transaction can be finalized. In the meantime, my company will continue to deal with H & H.

[27] To this point the court has not been advised nor has BNS of any further developments, inquiries or progress with respect to Amoruso's affidavit which can only be classified as a statement of interest.

[28] HHFL has made a concerted effort to secure government financing by way of a grant. The company has spent $6,000 for the services of a consultant in the preparation of its grant application and on December 9, 2005 a science officer who is preforming the due diligence for the grant indicated her satisfaction with the scientific basis of the claim and that she would be making a positive recommendation. The only weight that can be given at this stage to the grant application is that it is another example of the efforts being made by HHFL and its proposed trustee but until the grant reaches the stage of being a balance sheet item it can be given no further weight.

[29] BNS raises an objection to a determination that HHFL can satisfy the requirement pointing out that BNS and BDC as one class of secured creditor represent a substantial majority position of the secured claims. R. Hartlen Investments Inc. is bound by s. 54.2.2(3) as noted above.

[30] BNS takes the position that it has a clear veto over any proposal that may be advanced and that it will not be supporting any proposal to secured creditors that might be filed by HHFL.

[31] In *Re Cumberland Trading Inc.*, [1994] O.J. No. 132, wherein Farley J. stated at para. 4:

> Cumberland's Notice of Intention to File a Proposal acknowledges that Skyview is owed $750,000. On that basis, Skyview has 95% in value of Cumberland's admitted secured creditors' claims and 67% of all creditors' claims of whatever nature. No matter what, Skyview's claim is so large that Skyview cannot be swamped in any class in which it could be put. Clearly, Skyview would have a veto on any vote as to a proposal, at least so far as the secured class, assuming the secureds are treated as a separate class. This leaves the interesting aspect that under BIA regime, one could have a proposal turned down by the secured creditor class but approved by the unsecured creditor class and effective vis-a-vis this latter class, but with the secured class being able to enforce their security. One may question the practicality of a proposal affecting only unsecured creditors becoming effective in similar circumstances to this situation.

[32] In that case Farley, J. held that Skyview's position was satisfactory proof that the company would not likely be able to make a proposal that would be accepted by the creditors. In that case Skyview had 95% in value of Cumberland's admitted secured creditors and here the math appears to give BNS a virtual veto.

HHFL counters that when you look at the funds in the company's bank accounts at the end of November 2005 of approximately $170,000 that such reduces the debt outstanding of BNS and again reiterates that BNS has since the Notice of intention being filed received approximately $90,000 U.S. on its account. BNS is correct in that the mere presence of money in a debtor's bank account does not reduce indebtedness unless it is applied to the indebtedness. Since the notice of intention was filed HHFL has paid the required interest to BNS for November 2005. In this case, it is clear from the evidence before me and particularly the affidavit of the Trustee that there is a recognition of the proposal providing either alternate financing, such as speculated in Mr. Amoruso's affidavit or approaching alternate financial institutions. It would seem reasonable to assume that the proposal that will be advanced if it has a means of essentially paying out by substitution injection of capital of BNS indebtedness then the proposal presumably would be acceptable. It is inconceivable that if the BNS indebtedness were satisfied that BNS should retain the right to apply a guillotine effect to the extreme prejudice of itself and all other interested parties including the probable closure of the plant. The second largest secured creditor is the Business Development Corporation and they are in agreement to the granting of an extension to HHFL.

[33] In these circumstances, again by the a fairly narrow margin, I conclude that HHFL has met this prerequisite on a balance of probabilities. In doing so, I am not overlooking the considerable debt of HHFL that, while the projections for the next couple of months are favourable, clearly, the proposal will require addressing BNS.

[34] The third step is: **Will any creditor be materially prejudiced if the extension being applied for were granted?** As noted, there has been some improvement in the position of BNS since the Notice of intention was filed in that it has received approximately $95,000 U.S. which the Bank's solicitor points out came direct to it and not through any exercise of direction by HHFL. BNS has also received the November 2005 interest. In this case there are only two significant unrelated secured creditors, BNS and BDC. BDC consents to the extension of time but I am mindful of the fact that its security is a first charge over the fixed assets which are by themselves not likely to significantly decrease in value but on the other hand would probably have some measure of increased value by virtue of an operating going concern and also there is an indication of additional land being acquired from government by HHFL. I do agree with BNS that additional land, even if the obtaining of it is imminent, does not by itself provide any comfort to the

Bank which has as its security a first charge on trade receivables and inventory. What does come through from the totality of the evidence is that this is a busy and likely profitable time for the industry and Mr. Rosen, in his affidavit, deposes at paragraphs 11 and 12:

> 11. I believe that the forty five day extension for filing the proposal is critical to the operations of the Company. It is my opinion that no creditor would be materially prejudiced if the extension is granted. The security of BNS would actually be enhanced during the extension period because of the profitable time of year and increase in inventory and receivables. BDC would have an opportunity to add to their security the land which I understand is to be conveyed to the Company by the government.
>
> 12. In the event the Company were to become bankrupt, it is my opinion that both BDC and R. Hartlen Investments Inc., which has a third charge on the assets would be severely prejudiced. It is also my opinion that the unsecured creditors would lose any opportunity of recovery.

[35] I struggle with what constitutes material prejudice and there is some guidance in *Re Cumberland Trading Inc.* above. In that case the creditor under the BIA applied to have a stay, etc. In paragraph 11 Justice Farley stated:

> Is Skyview entitled to the benefit of s. 69.4(a) BIA? I am of the view that the material prejudice referred to therein is an objective prejudice as opposed to a subjective one- ie., it refers to the degree of the prejudice suffered vis-a-vis the indebtedness and the attendant security and not to the extent that such prejudice may affect the creditor *quo* person, organization or entity. If it were otherwise then a "big creditor" may be so financially strong that it could never have the benefit of this clause. ...

[36] In the case before the court, the accounts receivables as of November 31, 2005 amounted to $956,532.16, almost double the indebtedness outstanding to BNS. HHFL certainly has as great if not greater motive in pursuing and collecting receivables as does BNS and I do not think there need be any concern as to the attempts in the short run for collection. Arguably, if an accounts receivable is uncollectible now its position cannot be any worse a few weeks from now. Extending the time period obviously creates some risk and some possibility of benefit. Provided a proper monitoring scheme is in effect, what normally should follow an extension is a flowing of proceeds from existing accounts receivables, new sales and new accounts receivables into the operating costs in an operation where in the immediate future a degree of profitability is projected.

[37] This section of the *Act* contemplates some prejudice to creditors and I am of the view that the prejudice must be of a degree that raises significant concern to a level that it would be unreasonable for a creditor or creditors to accept. Overall, I am satisfied that HHFL has met the requirement of establishing on the balance of probabilities that the granting of an extension will not materially prejudice any of the creditors and in particular BNS.

CONDITIONS:

[38] During the course of argument I indicated if an extension was granted that BNS at the very least was entitled to have timely full disclosure of the utilization of funds for the continued operation of the company. This could be achieved by requiring HHFL to return to the commitment of having all operating funds passed through its accounts with BNS but it will also require a direction that other than interest entitlement, if not paid, BNS would not be able in the intervening period to encroach upon the trading funds which are absolutely necessary for the continued operation and survival chances of the business. The direction would probably also require any outstanding documentation, possibly requiring HHFL to produce the invoices in the reconciliation it provided for cash withdrawals for cash purchases from Pacmar Norway, etc. There would be a requirement of timely disclosure. There are a number of other possible conditions that come to mind. However, as both counsel indicated if the extension was granted they requested the opportunity to address possible conditions, I readily accede to their offer of assistance. Counsel, if they agree, may take some time to consult with each other and put their views in writing or alternatively address the matter orally and, in any event, I will, as scheduled be available at 2:00 p.m. this afternoon unless both counsel agree on the appropriate terms and conditions of the order of extension.

J.