Date: 2005 06 20
Docket: S-0001-BK2003104864

IN THE SUPREME COURT OF THE NORTHWEST TERRITORIES

IN BANKRUPTCY AND INSOLVENCY

IN THE MATTER OF THE BANKRUPTCY OF FRANK PERRY SMITH
of the City of Yellowknife, in the Northwest Territories

Appeal of Trustee in Bankruptcy's decision disallowing a proof of claim based on a U.S. judgment and other related applications.

Heard at Yellowknife, NT on March 15 and 16, 2005.

Reasons filed: June 20, 2005

REASONS FOR JUDGMENT OF THE HONOURABLE JUSTICE V.A. SCHULER

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Counsel for the Trustee, Browning Crocker Inc.:	Mr. Michael McCabe, Q.C.

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REASONS FOR JUDGMENT

[1] The applications before me involve the following parties. David R. Ruby is the Chapter 7 Bankruptcy Trustee for the estate of Public Access Technology.com, Inc. ("PAT"), an American company. Frank Perry Smith, a Canadian, was involved in PAT and is now in bankruptcy proceedings under Canada's *Bankruptcy and Insolvency Act* (*"BIA"*). Mr. Smith's trustee in bankruptcy is Browning Crocker Inc. ("the Trustee").

[2] The applications to be dealt with are as follows:

1. a preliminary application by Mr. Smith to strike some of the affidavit evidence;

2. an appeal by Mr. Ruby from the Trustee's disallowance of his claim based on a judgment obtained by PAT against Mr. Smith in the United States;

3. a motion by Mr. Smith to expunge or reduce the amount of Mr. Ruby's claim which was subsequently allowed by the Trustee;

4. miscellaneous related relief sought by Mr. Ruby.

Background

[3] The evidence consists of a number of affidavits and Mr. Smith's *viva voce* testimony. Most of the background is not in dispute, although the legal consequences of certain facts are.

[4] During the 1980's and early 1990's, Mr. Smith operated an amusement game business in Yellowknife through a company called Gorf Holdings Ltd. After becoming interested in the Internet, in 1995 Mr. Smith developed a restricted access computer system for use in Internet transactions ("the product"). He obtained a patent for the product in the United States and soon decided that he wanted to continue with research and development of it but have someone else take over the manufacturing and marketing.

[5] In July 1999, Mr. Smith sold the patent to PAT, an American company, for $580,000.00 (all amounts are in U.S. dollars unless otherwise indicated). As part of that transaction, Mr. Smith became a minority shareholder, a director and employed as Executive Vice President of PAT. Also as part of the transaction, Coynet International Corporation, a company owned by Mr. Smith, became a subsidiary of PAT but was to continue operating in Yellowknife. Mr. Smith and his wife were to resign as directors of Coynet, although he later discovered that the law firm he had retained for that purpose did not complete the requisite filings.

[6] The $580,000.00 purchase price was paid by a $60,000.00 immediate cash payment and the balance in monthly instalments of $30,000.00 each, secured by a promissory note. Mr. Smith did not retain a lawyer for the transaction and later learned that his security was not properly perfected in the United States.

[7] In January 2000, things started to go downhill. There was what Mr. Smith described as a "management shakeup" at PAT. The new management wanted the product on the market earlier than Smith felt was wise. At about the same time, Qualityclick.com, another American company, merged with PAT. The newly merged company continued under the name PAT. Mr. Smith, not particularly impressed with what he learned about Qualityclick, was not happy about the merger; although his view was sought, it did not carry the day. He ceased to be a director of PAT, but continued his employment as Executive Vice President.

[8] After the merger, Mr. Smith felt pressured by PAT to complete his work on the product. By December 2000, PAT was not financing Coynet as it had been earlier and Coynet was not making its payroll, although Mr. Smith was still getting his monthly payments for the patent. In February 2001, Mr. Smith was directed by PAT's chief operating officer to lay off all staff and shut down Coynet's operation. On February 1, 2001, Mr. Smith also received the last payment due for his patent.

[9] Mr. Smith also learned that PAT was filing for bankruptcy, which it did in February 2001.

[10] Since Mr. Smith and his wife were still on record as directors of Coynet, they ended up in litigation brought by the Labour Standards Office over the unpaid wages of some Coynet employees. Mr. Smith and Gorf had guaranteed payment to some of Coynet's service providers and were called on to make those payments.

[11] With Coynet shut down, Mr. Smith incorporated another company and, in October 2001, obtained a government contract to build and operate a liquor store.

[12] In February 2003, Mr. Ruby as PAT's bankruptcy trustee initiated proceedings against Mr. Smith in the U.S. Bankruptcy Court. He sought to recover $360,000.00 of the payments made to Mr. Smith for the patent as voidable preferential transfers to an insider by an insolvent company under the applicable American legislation.

[13] Mr. Smith obtained counsel in the U.S. to oppose the proceedings. He understood that there would eventually be a trial, at which he would have the opportunity to testify about his concerns about how PAT had treated him and Coynet. However, Mr. Ruby applied for summary judgment and a hearing was set for September 29, 2003. Mr. Smith received advice from his U.S. lawyer that he would be held liable for $90,000.00, but there were legal arguments to be made as to why he was not an insider at the relevant time and should not be held liable for the remaining $270,000.00.

[14] In the meantime, the new liquor store was doing well, with the result that it required more inventory than had been expected. Mr. Smith also had expenses for leasehold improvements and rent arising out of that endeavour. He testified that he foresaw a liquidity crisis if he had to pay Mr. Ruby the entire $360,000.00.

[15] Mr. Smith testified that his U.S. lawyer advised him that Mr. Ruby would aggressively enforce any judgment he obtained and that Mr. Smith should look into bankruptcy. Mr. Smith obtained counsel in the Northwest Territories and contacted the Trustee.

[16] On September 25, 2003, Mr. Ruby received a letter from Canadian counsel for Mr. Smith. In that letter, Mr. Smith offered to pay $90,0000.00 in full satisfaction of Mr. Ruby's claims as trustee of PAT. The letter went on to say:

> Should you fail to respond or refuse this offer - we will file a Notice of Intention to make a proposal ("Notice") at the office of the Superintendent in Bankruptcy at or after 11:00 in the morning tomorrow Friday September 26, 2003. This will invoke a stay of proceedings against you and all creditors of Mr. Smith pursuant to the *Bankruptcy and Insolvency Act* of Canada.
>
> We understand from [Mr. Smith's American] attorney that the said stay will be recognised by the US Court. We would then proceed with the proposal, in which case you will be required to prove your claim as an unsecured creditor in the proposal. This will obviously take a long time and be expensive and unpredictable for you, depleting any recovery that you may otherwise receive by accepting this offer.

[17] On September 26, Mr. Ruby rejected the offer. On that same day, the Friday before the Monday on which the summary judgment hearing was to proceed, Mr. Smith filed a Notice of Intention to File a Proposal (the "NOI") under the *BIA*. Mr. Smith testified that the purpose of filing the NOI was to give him time and a more orderly process within which to deal with Mr. Ruby's claim than if Mr. Ruby were to come to Canada armed with a judgment.

[18] On September 29, Mr. Ruby and Mr. Smith's U.S. lawyer attended at the summary judgment hearing in the United States Bankruptcy Court. Mr. Smith's lawyer argued that the Court should defer to the stay under the *BIA*. The Court, noting that Mr. Ruby's claim would have to be adjudicated at some point, decided to proceed. On October 1, 2003, Mr. Ruby was granted judgment for the full $360,000.00 plus interest from November 1, 2002 (the date of demand) until payment.

[19] Mr. Smith testified that he was outraged by the judgment and felt that he had been used as a "fall guy" by his colleagues in PAT. He believed that PAT used him and Coynet and that PAT essentially arranged matters such that it could recoup the payments for the patent from him under the insider preference legislation. He appealed the judgment to the United States District Court ("the appeal court").

[20] In the Canadian bankruptcy proceedings, apart from Mr. Ruby, Mr. Smith had two creditors, one for $1595.00 (Cdn.) and one for $1200.00 (Cdn.). (At a later point Mr. Smith's spouse also filed a proof of claim based on an interest in his assets.) At the first meeting of creditors, Mr. Smith made a proposal which was not satisfactory to Mr. Ruby because of lack of financial disclosure and its payment terms. Mr. Ruby voted against the proposal and it was defeated, with the result that on December 30, 2003, Mr. Smith was deemed to have made an assignment in bankruptcy under s. 57 of the *BIA*.

[21] In the spring of 2004, there were discussions about settling Mr. Ruby's claim. By mid-March, Mr. Smith was in a position to make a proposal within the bankruptcy proceedings to pay Mr. Ruby $250,000.00. That proposal was not accepted.

[22] On April 6, 2004, the appeal court released its judgment on Mr. Smith's appeal. I note here that the Trustee was aware that Mr. Smith was pursuing an appeal. In the result, judgment was confirmed in the amount of $270,000.00, but a trial ordered for the remaining $90,000.00.

[23] In May 2004, Mr. Smith's Canadian lawyer wrote to the Trustee indicating that he was holding $270,000.00 in an interest bearing trust account "representing the potential value of the Ruby claim". The money was specified to be "provided by Gorf by way *(sic)* indemnity for the purpose of enabling Mr. Smith to pay whatever amount is found owing to Mr. Ruby, if any". The letter stated that because of the money, there is no need for further expenditures for financial statements or other items that would normally be needed to investigate Mr. Ruby's claim in the bankruptcy proceedings, although it added that if Mr. Smith must provide financial information, that would be done "within reason".

[24] At a creditors' meeting in June 2004, Mr. Ruby nominated and elected Mr. Klaray as the sole inspector in Mr. Smith's bankruptcy proceeding. Reports from the inspector heightened Mr. Ruby's concerns about the lack of financial information.

Mr. Ruby filed a formal notice of objection to any automatic discharge of Mr. Smith from bankruptcy and continued to seek further financial disclosure.

[25] Mr. Ruby had filed his proof of claim in the bankruptcy proceedings based on the judgment obtained in the United States. On June 22, 2004, the Trustee disallowed that claim. The Notice of Disallowance of Claim refers to s. 69(1)(a) of the *BIA* and then states, "The proof of claim submitted is based upon a judgment granted October 1, 2003, after the date and with full knowledge of the Stay of Proceedings". Mr. Ruby appealed that decision, which is one of the applications before me.

[26] The Trustee then indicated that it was prepared to consider an amended proof of claim based on the cause of action underlying the judgment, but pointed out that it would consider not only the information that was before the U.S. Court but any other information pertinent to the claim. It had information from Mr. Smith about his dealings with PAT and his concerns about the failure of PAT and Qualityclick to disclose financial information to him. In late July 2004, Mr. Ruby filed an amended proof of claim based on preferential payments made by PAT to Mr. Smith while PAT was insolvent.

[27] Meanwhile, the portion of Mr. Ruby's claim that had been sent to trial by the appeal court was scheduled to be tried in the U.S. Bankruptcy Court on July 28, 2004. Approximately ten days before the trial, the lawyer who had represented Mr. Smith throughout the proceedings in the United States advised the Court and Mr. Ruby that he had been instructed by Mr. Smith not to appear at trial or take any further action. In his testimony at the hearing before me, Mr. Smith said that he had decided to pick Canada as the venue to have the claim determined as he did not have the resources to fight on all fronts. Therefore, he decided not to continue with the new trial in the U.S. Court.

[28] Mr. Ruby went ahead with the trial as scheduled and the original judgment for the entire $360,000.00 was affirmed.

[29] Mr. Ruby continued, through the inspector, Mr. Klaray, to seek more financial disclosure. By August of 2004, it was clear that Mr. Smith was not responding to the Trustee's requests or demands for financial statements and related material. Documents were eventually provided in February 2005. Mr. Smith testified that he had been behind with his financial statements before the NOI was filed and because of

internal staff problems at his accountants' firm, he was not able to get all the statements he needed in a timely fashion.

[30] In November 2004, the Trustee allowed Mr. Ruby's amended proof of claim, subject to Mr. Ruby not pursuing the interest rate which had been awarded on the judgment. Counsel for Mr. Smith next advised that he was holding the Canadian equivalent of $360,000.00 U.S. in trust with instructions that "it is security for the value of [Mr. Ruby's] claim". Mr. Smith also applied to have the Trustee's allowance of the amended proof of claim expunged, which is another application before me.

1. Preliminary application to strike evidence

[31] Mr. Smith made a preliminary application to strike certain affidavit evidence filed on Mr. Ruby's behalf. He objected to numerous paragraphs in the affidavits of Mr. Ruby and Mr. Klaray on the grounds that neither was certified, nor could be certified, as an expert witness pursuant to Rule 278; he also submitted that the paragraphs at issue are scandalous, irrelevant and otherwise oppressive (Rule 375).

[32] The affidavits in question contain opinion evidence. Mr. Klaray, a chartered accountant and licensed Canadian bankruptcy trustee, is the only inspector appointed by creditors in Mr. Smith's bankruptcy. Although much of Mr. Klaray's affidavit simply recounts his involvement in the bankruptcy proceedings and reviews documents pertinent to Mr. Smith's situation, he also gives the opinion that at the time Mr. Smith filed the NOI in September 2003, he did not come within the definition of "insolvent person" in s. 2(1) of the *BIA*. Mr. Klaray also comments adversely on Mr. Smith's *bona fides* in filing the NOI and making a proposal.

[33] The objection that Mr. Klaray's opinion evidence does not comply with Rule 278 has no merit. Rule 278 deals with court-appointed experts and is not applicable to this case. There is no bar against a party retaining its own expert witness.

[34] Another objection was that Mr. Klaray's services as an inspector were paid for by Mr. Ruby, based on Mr. Klaray's regular fees as an insolvency professional. Counsel for the Trustee advised that while not common, this sort of arrangement is not unheard of. None of the parties alleged that the arrangement would contravene s. 201(2) of the *BIA*, which makes it an offence for an inspector to accept certain kinds of fees.

[35] In my view, the fact that Mr. Klaray was paid by Mr. Ruby goes to the weight of his evidence; it does not disqualify him as an expert witness. Counsel for Mr. Smith effectively conceded this in the end. Mr. Klaray's qualifications were not objected to on any other basis.

[36] The remaining objections about portions of Mr. Klaray's affidavit being scandalous, irrelevant and oppressive were not pursued and it was conceded that any deficiencies in that regard also go to weight.

[37] Turning to Mr. Ruby's affidavit, Mr. Ruby is a member of the Virginia State Bar with a primary area of practice in U.S. bankruptcy law. As noted, he is the Chapter 7 Trustee in Bankruptcy of PAT, thus directly interested in these proceedings. Mr. Ruby's affidavit sets out his involvement in Mr. Smith's bankruptcy proceedings and the proceedings in the U.S. courts. It goes into detail about Mr. Ruby's concerns about lack of financial disclosure by Mr. Smith and lack of action by Mr. Smith's Trustee. It comments adversely on Mr. Smith's *bona fides* in invoking the *BIA* provisions.

[38] Mr. Smith objected to Mr. Ruby's affidavit on the basis that, as a party to these proceedings, Mr. Ruby is not impartial and should not be permitted to give opinion evidence. In the end, it was conceded that Mr. Ruby's status in the proceedings goes to the weight, and not the admissibility, of his opinion. The Rule 375 objections were not pursued and, again, any issues in that regard were acknowledged by counsel to go to weight only.

[39] Accordingly, none of the paragraphs specified in Mr. Smith's notice of motion were struck out.

2. Mr. Ruby's appeal from the Trustee's disallowance of his claim based on the U.S. judgment

[40] As set out above, Mr. Ruby filed a proof of claim in Mr. Smith's bankruptcy proceedings based on the U.S. judgment granted October 1, 2003. On June 22, 2004, the Trustee disallowed the claim in whole, pursuant to s. 135(2) of the *BIA*, on the basis that the proof of claim was based on a judgment given after the date of the s. 69(1)(a) *BIA* stay of proceedings and with full knowledge of the stay.

[41] Mr. Ruby seeks to have the disallowance set aside and a declaration that Mr. Smith is indebted to Mr. Ruby in an amount in Canadian currency equivalent to $360,000.00 U.S. at the date of bankruptcy, that is, $469,188.00, plus interest.

[1] This appeal falls under s. 135(4) of the *BIA*. Case law indicates that such an appeal is a trial *de novo*: *Re Eskasoni Fisheries Ltd.* (2000), 16 C.B.R. (4th) 173 (N.S.S.C.).

[2] I think it is appropriate to consider first the nature of a stay under the *BIA*. In this case, the stay arises from s. 69(1)(a), which provides that, subject to certain other provisions that are not at issue here, on the filing of a notice of intention under section 50.4 by an insolvent person, no creditor has any remedy against the insolvent person or the insolvent person's property, or shall commence or continue any action, execution or other proceedings, for the recovery of a claim provable in bankruptcy.

[3] In general, the purpose of bankruptcy is to allow a debtor to provide for the orderly payment of his creditors through the orderly liquidation of his assets. The stay must logically assist in that process.

[4] In *KPMG Inc. v. Alberta Dental Association*, 2005 ABCA 101, the Alberta Court of Appeal considered the effect on professional disciplinary proceedings of a stay under s. 69.1(1)(a) of the *BIA*. That stay is identical in effect to the stay under s. 69(1)(a), but arises on the filing of a proposal. The Court noted that the stay is directed at attempts at recovery, where such attempts would work against or undermine the objectives of a comprehensive and consistent system of distribution of the bankrupt's property among his or her creditors. In *KPMG*, the argument before the Court was that a disciplinary suspension for failure to comply with other disciplinary measures was a remedy barred by s. 69.1(1)(a). The Court dismissed the argument, saying that the disciplinary suspension does not affect property available for distribution among creditors, does not reorder the distribution among creditors and is not a scheme to obtain preferential payment.

[5] Although it dealt with very different facts, *KPMG* is relevant in that it points out that the real goal of a stay is to ensure that distribution of the debtor's assets among creditors is fair and orderly. In this case, the judgment obtained by Mr. Ruby did not purport to say anything about enforcement of the judgment or distribution of

Mr. Smith's property. It simply settled the amount owed by Mr. Smith under the U.S. insider preference legislation.

[6] Both Mr. Smith and the Trustee took the position that an orderly gathering in and distribution of Smith's assets required that all actions against Mr. Smith, including Mr. Ruby's, be stayed. There was no evidence about any other pending actions, so I need only deal with the lawsuit in the United States.

[7] Mr. Ruby's action was based on Mr. Smith's liability for payments made to him by an American company by which he was employed and in which he held positions as a director and Executive Vice-President. Whether the payments could be recovered from Mr. Smith depended on whether, at the relevant times, Smith would be considered an "insider" under the applicable American legislation. That legal issue had to be resolved in accordance with American law. No one on this application disputed that the U. S. Bankruptcy Court was the appropriate forum in which that question should be answered (although, as I will explain further on, Mr. Smith did argue that from his point of view, Canada was a more appropriate forum). Mr. Smith attorned to the jurisdiction of the U.S. Court and also availed himself of the appeal procedures from that Court. The question decided by the lawsuit was simply how much Mr. Smith owed, not when or how Mr. Ruby could realize on the judgment. I do not see how the staying of that action before judgment would contribute to an orderly gathering in and distribution of Mr. Smith's assets. Surely the U.S. Bankruptcy Court is in a better position than the Canadian Trustee to resolve the legal issue of Mr. Smith's insider status.

[8] Notwithstanding my view that application of the stay to the proceedings in the U.S. Court would not contribute to the orderly gathering in and distribution of Mr. Smith's assets, the question remains whether the U.S. Court should have deferred to the stay rather than proceeding with the summary judgment application.

[9] It is evident from the transcript of the proceedings before the U.S. Bankruptcy Court that the nature of the stay was not fully explained to the presiding judge. Nevertheless, the judge was made aware by Mr. Smith's American lawyer that Mr. Smith had availed himself of the bankruptcy laws of Canada, had listed Mr. Ruby's claim in those proceedings and that there was a stay against Mr. Ruby from proceeding against Mr. Smith. The lawyer also submitted to the judge that while the U.S. Court was not obliged to defer to the stay, since Mr. Ruby's claim was against a

Canadian citizen resident in Canada, the U.S. proceedings should be deferred until Mr. Ruby had taken steps in Canada.

[10] The U.S. Bankruptcy Court judge decided to proceed, taking the view that the claim "needs to be liquidated one way or another for both courts".

[11] The appellate judgment resulting from Mr. Smith's appeal of the U.S. Bankruptcy Court decision also addressed this issue:

> [Smith] does not explain how the determination of this preference avoidance action by the bankruptcy court will impede the Canadian Bankruptcy Court's disposition of Smith's assets. When this preference avoidance action is resolved, the trustee will still be obligated to seek enforcement of his claim before the Canadian Bankruptcy Court. The decision here merely determines the amount of that claim based on United States bankruptcy preference law. In so doing, the bankruptcy court here assists, rather than impedes, the Canadian Bankruptcy Court in deciding the ultimate disposition of Smith's assets. ...

[12] From the above, it is clear that the U.S. courts did not simply ignore or refuse to recognize the stay, but instead made the decision that proceeding notwithstanding the stay would be helpful to, rather than impede, the bankruptcy proceedings in Canada.

[13] Although the position taken by Mr. Smith's lawyer before the U.S. Court was that the Court had a discretion whether to defer to the *BIA* stay, some of the argument before me centred on whether s. 69(1)(a) *BIA* actually has extra-territorial effect.

[14] In *Society of Composers, Authors and Music Publishers of Canada v. Canadian Assn. of Internet Providers*, [2004] 2 S.C.R. 427, 2004 SCC 45, the Supreme Court of Canada stated that while Parliament has the legislative competence to enact laws having extra-territorial effect, it is presumed not to intend to do so, in the absence of clear words or necessary implication to the contrary.

[15] Nothing in s. 69(1)(a) or any other related provision of the *BIA* expressly states that it applies extra-territorially. The Trustee relied on s. 17(2) of the *BIA* as implying extra-territorial effect. Section 17(2) provides that for the purpose of obtaining possession of and realizing on the property of the bankrupt, a trustee has power to act

as such anywhere. Section 2(1) of the *BIA* includes in the definition of "property" things "situated in Canada or elsewhere". In my view, those sections cannot be taken to imply that Parliament intended s. 69 to have extra-territorial effect. The trustee simply steps into the shoes of the bankrupt and ownership of the bankrupt's assets vests in him, including property located outside Canada. His power to act in that capacity outside Canada does not give rise to the necessary implication that Parliament intended to interfere in a foreign court's right to conduct its proceedings or a foreign creditor's right to take or maintain proceedings in a foreign court.

[16] Mr. Smith argued that even if s. 69(1)(a) does not have extra-territorial effect, principles of international comity require that the U.S. Bankruptcy Court should have deferred to the stay. This is also the conclusion in the legal opinion that was obtained by the Trustee for purposes of deciding whether to disallow the Ruby claim based on the U.S. judgment.

[17] The argument about international comity involves two considerations. The first is whether the U.S. Court should have deferred to the stay on the basis of international comity; the second is whether, since the U.S. Court did not defer to the stay, public policy requires that the U.S. judgment not be accepted as proof of Mr. Ruby's claim.

[18] According to the principles of international comity, the courts of one jurisdiction will give effect to the laws and judicial decisions of another jurisdiction, not as a matter of obligation, but out of mutual deference and respect. It is for the court that is asked to extend comity to decide whether to defer to the legislation or judicial acts of another nation, having due regard to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws. The objectives sought by the doctrine of international comity are order and fairness: *Holt Cargo Systems Inc. v. ABC Containerline N.V. (Trustees of)*, [2001] S.C.R. 907, [2001] S.C.J. No. 89, 2001 SCC 90.

[19] In *Holt*, the Supreme Court of Canada was asked, in the context of an international bankruptcy, to change the "plurality approach" to which Canada had adhered, to a more "universalist" approach. The plurality approach recognizes that different jurisdictions may have a legitimate and concurrent interest in the conduct of an international bankruptcy and that interests asserted in Canadian courts may, not must, be deferred to a foreign bankruptcy regime after due consideration of all relevant circumstances. On the other hand, the universalist approach proposes that

where insolvency proceedings are instituted in a primary place, such as the debtor's domicile, foreign jurisdictions, where there may be creditors interested in the debtor's assets, should recognize and defer to those proceedings. The Supreme Court held that, "Given the almost infinite variations in circumstances that can occur in an "international bankruptcy", the pragmatism of the "plurality" approach continues to recommend itself".

[20] Although different legislation was at issue in *Holt*, the Supreme Court's reasoning is helpful in considering whether the U.S. Bankruptcy Court should have deferred to the stay under the *BIA*. It is legitimate to ask whether a Canadian court would, or should, defer in similar circumstances to a stay mandated by U.S. legislation. The following passages from *Holt* suggest that a Canadian court should not necessarily defer in these circumstances:

> Where a stay is sought of Canadian proceedings in deference to a foreign bankruptcy court, the Canadian court before which the stay application is made ... ought to be mindful of the difficulties confronting the bankruptcy trustees in the fulfilment of their public mandate to bring order out of financial disorder and the desirability of maximizing the size of the bankrupt estate. These objectives are furthered by minimizing the multiplicity of proceedings, and the attendant costs, and the possibility of inconsistent decisions in relation to the same claims or assets.
>
> Nevertheless, courts must have regard to the need to do justice to particular litigants who come before them as well as to the public interest in the efficient administration of bankrupt estates. It would be inappropriate to elevate any one consideration to a controlling position in the exercise of a bankruptcy court's discretion ... . Discretion should not be thus predetermined. The desirability of international coordination is an important consideration. In some cases, it may be the controlling consideration. The courts nevertheless have to exercise their discretion to stay or not to stay domestic proceedings according to all the relevant facts of a particular case.

[21] The passages above make it clear that a Court has discretion when asked to defer to a foreign bankruptcy and that a number of considerations should be taken in exercising that discretion, including the need to do justice to particular litigants who come before it. In the case at bar, one of the considerations taken by the judge in the

U.S. Bankruptcy Court was that on the date the stay was raised before him, the parties were scheduled to proceed with the summary judgment application. Another was that the claim would have to be liquidated at some point. Exactly as suggested in the above excerpt from *Holt*, the U.S. Bankruptcy Court judge was exercising his discretion based on the facts before him. In my view, the decision he made was a reasonable one in all the circumstances.

[22] The Trustee relied on the United States Court of Appeals for the Third Circuit's judgment in *Remington Rand Corporation v. Business Systems, Inc.* (1987), 830 F.2d 1260, for the proposition that comity is a two way street and that since Mr. Ruby obtained his judgment despite the Canadian stay, he ought not be allowed to come to Canada and seek to have that judgment recognized. The facts and issues in that case were complex and involved conflicts between Dutch and American law. The Court found that because of the unusual circumstances of the case, comity had to be a two way street. And although it stated that American policy favoured comity for foreign bankruptcy proceedings, it also acknowledged that a court should be permitted to make the appropriate order under all the circumstances of each case. I do not understand the case to say that U.S. courts will or should in all circumstances extend comity in cases of foreign bankruptcy or that any particular procedure should be followed in dealing with such cases.

[23] In one of the cases cited by the Trustee, *Sefel Geophysical Ltd. (Re)*, [1988] A.J. No. 917 (Q.B.), Forsyth J. reviewed the principles of comity in relation to bankruptcy proceedings and said:

> That is the context in which comity principles operate. They provide for the recognition of foreign liquidation proceedings in the interest of distributing the assets of a debtor in a manner that is orderly, efficient and fair. Comity itself does not allow the judicial re-wording of local bankruptcy statutes to adapt pieces of legislation to the demands of international trade.

[24] Forsyth J. also referred to the goal in such situations being "to deal with liquidations in an orderly fashion in one country by virtue of deference shown by competing nations".

[25] It should be pointed out that unlike *Sefel Geophysical* and some of the other cases cited, this is not a case of a corporation in bankruptcy or liquidation proceedings with claims pending against it in multiple countries. In this case, Mr. Ruby's was the only foreign claim, and it was the eve of the trial of his claim, when Mr. Smith filed his notice of intention. In the circumstances, the decision of the U.S. Bankruptcy Court to proceed to adjudicate the claim and resolve how much Mr. Smith owed did not in any way impede the orderly unfolding of the bankruptcy proceedings.

[26] Accordingly, I find that the U.S. Court was not required by the principles of international comity to defer to the *BIA* stay. Since the decision of the U.S. Bankruptcy Court judge not to defer was a reasonable exercise of his discretion in all the circumstances, that decision itself is not sufficient reason to refuse to recognize the judgment. There is no public policy rationale for holding that merely because the U.S. Court exercised its discretion against deference to the stay, the Court or the Trustee in Canada should refuse to recognize the judgment.

[27] Had there been no bankruptcy proceedings in Canada, Mr. Ruby would have had to sue on his U.S. judgment in a Canadian court since there is no reciprocal enforcement of judgments legislation providing for the summary registration in the Northwest Territories of judgments of American courts. The *BIA* stay would be effective against proceedings for that purpose in the Northwest Territories, subject to any application that might be made to lift the stay. With the bankruptcy proceedings, the only question is whether the judgment should not be recognized because of one or more of the defences traditionally available to a domestic defendant contesting recognition of a foreign judgment. These defences are fraud, lack of natural justice and public policy. Mr. Smith relied on all three in arguing that the Trustee was correct not to recognize the judgment and that this Court should not recognize the judgment or the underlying claim, or that there should be a trial of the defences raised by Mr. Smith in this Court.

[28] The Supreme Court of Canada had occasion to review the requirements of each of the defences in *Beals v. Saldanha*, 2003 SCC 72. I will attempt to relate the requirements to Mr. Smith's allegations about the way he was treated by PAT and the U.S. court proceedings. At this stage, it seems to me that Mr. Smith has the burden of showing that there is an air of reality to at least one of the defences in accordance with the legal requirements the Supreme Court has described. In other words, that is the hurdle he must overcome to show there are grounds upon which to challenge

recognition of the U.S. judgment. The obligation to show that there is an air of reality to a defence simply means that Mr. Smith must demonstrate that there is some evidence to support the defence.

[29] With respect to the defence of fraud, the Court in *Beals* said that the defence must rest on fraud going to the jurisdiction of the court that rendered the judgment. Fraud in connection with the merits of the case is a defence only where the allegations are new and were not the subject of prior adjudication. Although a domestic court may decline recognition of a judgment because of facts that challenge the evidence before the foreign court, the defendant has the burden of demonstrating that the facts he wishes to raise could not have been discovered by the exercise of due diligence prior to the foreign judgment being obtained.

[30] Mr. Smith takes the position that a fraud was perpetrated on him by others involved in the PAT and Qualityclick merger. He says that Qualityclick attempted to hide its history of insolvency and that the other directors of PAT and Qualityclick failed to disclose to him the true state of the companies' finances. He also says that others involved in PAT made sure that the money paid to him for his patent could be recovered under the insider preference legislation. He attributes fault to others for not telling him to get a lawyer to ensure his security for the patent payments was properly registered.

[31] It is not clear whether the fraud allegations were actually raised by Mr. Smith in the U.S. action. However, it is clear to me from his evidence that Mr. Smith had concerns about Qualityclick as early as 2000, when it merged with PAT. Those concerns were heightened at the time of PAT's bankruptcy in February 2001. There is no evidence that any facts underpinning the fraud allegations were discovered only after the U.S. Bankruptcy Court issued its judgment in October 2003. Mr. Smith has not satisfied the burden of showing that the facts on which he bases the allegation of fraud were not discoverable prior to the U.S. judgment date. I assume that Mr. Smith could also have raised those concerns at the re-trial that took place in July 2004, in which he instructed his counsel not to participate. The fraud alleged clearly does not go to the jurisdiction of the U.S. Court. In my view, therefore, the defence of fraud has no air of reality.

[32] The second defence is lack of natural justice. In *Beals* the Supreme Court said that a condition precedent to that defence is that the party seeking to impugn the

foreign judgment prove, on a balance of probabilities, that the foreign proceedings were contrary to Canadian notions of fundamental justice. Again, this does not relate to the merits of the case, but the procedure and whether, even if valid in the foreign state, it does not accord with Canada's concept of natural justice.

[33] Mr. Smith's complaint is that a summary judgment procedure was used in the U.S. Bankruptcy Court. However, a similar procedure is available in this jurisdiction under the Northwest Territories Rules of Court 174 to 184. Other provinces and territories have summary trial or summary judgment procedures as well. While they may not be identical to the U.S. procedure, they provide a summary, that is, quicker and less complex, way of obtaining judgment on undisputed facts than a full trial. Mr. Smith has not shown that there was anything about the U.S. procedure that is unusual or different from the procedures in Canada in a way that would affect due process. It is also worth noting that when his appeal was partially successful and he did have recourse to a trial for part of the claim, he withdrew from the proceedings. I find that there is no air of reality to the defence of lack of natural justice in these circumstances.

[34] Finally, there is the defence of public policy, which prevents enforcement of a foreign judgment which is contrary to the Canadian concept of justice. As Major J. said in *Beals*, this defence turns on whether the foreign law is contrary to the Canadian view of basic morality. In this case, it was asserted that the insider preference issue would have been decided differently in Canada, but no basis for that assertion was put forward. Even if, under Canadian corporations or bankruptcy law, the consequences of Mr. Smith holding the positions he did in PAT would not have been the same as in the U.S., it would not come as a surprise to anyone that holding a position in a foreign company might well entail different financial consequences. This is not a matter of basic morality.

[35] Mr. Smith relied on *Lloyd's v. Meinzer*, [2001] O.J. No. 3403 (C.A.)(application for leave to appeal to the Supreme Court of Canada dismissed in *Society of Lloyd's v. Saunders*, [2001] S.C.C.A. No. 527). In that case, decided before *Beals*, the Ontario Court of Appeal said that while the trend is to emphasize the concept of comity among nations when addressing the issue of enforcement of judgments and choice of law, the role of the public policy concept was left as a safety valve to prevent anomalies. To prevent possible unfairness to a defendant sued out of the jurisdiction, the enforcing court has a discretion not to recognize a judgment in conflict with the public policy of that jurisdiction. As did the Supreme Court in *Beals*,

however, the Ontario Court of Appeal noted that the public policy exemption is to be narrowly construed and rarely applied.

[36] It was argued that Mr. Smith's case is an anomaly and the public policy defence should, therefore, be available. However, I do not see it as an anomaly any more than the facts in *Beals*. There, a Florida jury had awarded damages against Canadian residents arising out of a land transaction they entered into in that state. It was argued on the basis of public policy that the judgment should not be enforced because the amount of damages far exceeded what a litigant could expect in Canada. The Court rejected the argument, finding that there was no evidence that the Florida procedure would offend the Canadian concept of justice. The same can be said of this case: there is no evidence that the U.S. law relating to insider preferences would offend the Canadian concept of justice.

[37] Counsel for Mr. Smith submitted that the anomaly in this case is the fact that PAT, a U.S. company, left liabilities in Canada through its failure to cover Coynet's debts. Whether this is an anomaly or not, it does not fall within the public policy defence as described by Major J. in *Beals*.

[38] Accordingly, I find that there is no air of reality to the public policy defence.

[39] I conclude, therefore, that there is no air of reality to any of the three defences to enforcement of the judgment in Canada.

[40] Finally, it was also argued that the Canadian bankruptcy process would permit Mr. Smith to deal with Mr. Ruby's claim in an orderly fashion, which the American process would not. This argument does not seem to fall within any of the three defences to enforcement of judgments. It was not demonstrated how the Canadian bankruptcy process would permit Mr. Smith to deal with the claim in a more orderly fashion than the American litigation process. With his judgment from the U.S. Bankruptcy Court, Mr. Ruby still had to come to Canada and then defer to the bankruptcy process rather than go on to enforce that judgment in the usual way. Without the judgment, it would be left to the Trustee to evaluate Mr. Ruby's claim. This would likely make things more difficult because of the application of American law. That might well give Mr. Smith more time to get his affairs in order, but apart from that it has not been shown how it would make the process more orderly. And the

point of the *BIA* is not just to give a debtor all the time he wants to deal with creditors, it is also to ensure that creditors are fairly treated.

[41] For all of the above reasons, I find that the claim based on the U.S. Bankruptcy Court's decision should not have been disallowed by the Trustee. Mr. Ruby's appeal of the disallowance is granted. Mr. Smith is therefore indebted to Mr. Ruby in the amount of $469,188.00 (Cdn.) plus interest.

3. Motion by Mr. Smith to expunge the claim accepted by the Trustee

[42] Since I have decided that the Trustee should have allowed the claim based on the judgment, it is not strictly necessary to deal with this motion but in the event that I have erred with respect to the judgment, I will do so. Most of what I said above also applies to this issue as well.

[43] Mr. Smith applies under s. 135(5) of the *BIA*, which allows the Court to expunge or reduce a proof of claim on the application of the debtor, if the trustee declines to interfere in the matter. He seeks to have the proof of Mr. Ruby's claim expunged altogether or at least reduced to $90,000.00 or, alternatively, to have the issue whether Mr. Smith received a preference tried in this Court. This is the claim that was accepted by the Trustee after disallowing the judgment-based claim; it is based on the facts and cause of action underlying the judgment. Case law indicates that the same procedure should be followed as on a s. 135(4) appeal: *Re Marsuba Holdings Ltd.* (1998), 8 C.B.R. (4th) 268 (B.C. Master); in other words, the appeal is by way of trial *de novo*.

[44] The arguments made by Mr. Smith are dealt with below. I will assume for present purposes that the defences available to recognition of a foreign judgment would also be available to recognition of a foreign claim.

1. The U.S. Bankruptcy Court did not consider all the evidence, but allowed Mr. Ruby's claim to proceed in a summary fashion. This is irrelevant to whether the claim should have been accepted based on the facts underlying the judgment. It also amounts to an argument that there was a lack of natural justice. I have already dealt with that argument above. The real thrust of Mr. Smith's argument is that he would like a trial in a Canadian court because the events involving Coynet occurred in

Canada and had repercussions in this country and might be given more significance than they would in an American court. This is speculation, of course; it also ignores the fact that the United States was the proper forum for Mr. Ruby's claim.

2. It would be against public policy to let the claim stand because PAT, an American company, left creditors in its wake in Canada. This argument was dealt with in connection with the judgment. It is tantamount to saying that because a foreign company owes money to one or more Canadian residents, it, or its trustee, should not be allowed to collect money owed to it by another Canadian resident. No authority was cited for this proposition, nor was it shown how this could be a matter of public policy under the test in *Beals*.

3. It was suggested that the insider preference claim would or should be decided differently in Canada. However, since PAT is an American company operating in the United States, American law would apply. No authority was presented for the proposition that Canadian law would apply simply because Mr. Smith is a Canadian. If the argument is that a Canadian Court would decide differently based on American law, that is mere speculation. To the extent that this argument invokes the public policy defence, I repeat my comments about it in the section above on recognition of the U.S. judgment.

4. It was submitted that Mr. Ruby has exerted pressure on the Trustee to deal with Mr. Smith's bankruptcy the way he wants and therefore the claim should not be allowed. In my view, even if true, this is irrelevant, but in any event the evidence falls short of portraying Mr. Ruby as anything other than simply aggressive. If Mr. Ruby is doing anything wrong, the Trustee can take appropriate action to deal with the problem.

5. Mr. Smith testified that he was not told the true state of affairs on the merger between PAT and Qualityclick. This is really the fraud argument, which I have dealt with above in the section on recognition of the judgment. The proper forum for a trial of the fraud allegations would be the United States, where those against whom the allegations are made are located. They should have been raised in the context of the U.S.

> bankruptcy proceedings, subject to whatever the relevant U.S. rules are. Or it may be that they should have been raised in other proceedings in the United States. I cannot think of any basis upon which it would be proper to deal with them in Canada.

[45] In my view, none of the above grounds can justify reducing or expunging the claim. The motion is dismissed.

4. Other relief claimed by Mr. Ruby

[46] Mr. Ruby claims interest on the amount owing. All counsel agreed that if interest is to be awarded, it should be 5% as per s. 143 of the *BIA*. It will be payable at that rate until such time as the amount owing as indicated above is paid.

[47] Mr. Ruby also asks for a declaration *nunc pro tunc* that the stays of proceedings imposed by ss. 69, 69.1 and 69.3 of the *BIA* do not operate in respect of the litigation between Mr. Ruby and Mr. Smith in the American courts. In light of my decision that the U.S. judgment will be recognized, this declaration is not necessary. Should anything further arise that makes the *BIA* stays a concern, Mr. Ruby can apply on the basis of the circumstances at that time.

[48] Mr. Ruby also seeks a declaration that Mr. Smith's initiation and continuation of the proposal process under the *BIA* was an abuse of process. It was argued that the Trustee aided and abetted Mr. Smith in the abuse of process.

[49] Characterization of the filing of the NOI and the subsequent proposal as an abuse of process was put forward in Mr. Ruby's brief as a basis upon which to reject the Trustee's rationale for disallowing Mr. Ruby's judgment-based claim. As I have already decided that the claim should be allowed, there is no need for a declaration as to whether there was an abuse of process and so I decline to make a declaration in that regard.

[50] I will say, however, that the evidence does give rise to concerns. Some emphasis was placed by Mr. Ruby on the initial letter from Mr. Smith's counsel saying that unless the $90,000.00 offer was accepted, the NOI would be filed. The tone of that letter is very unfortunate, but I think it could be interpreted as reflecting

Mr. Smith's belief that he was liable for only $90,000.00 and could not pay the full amount claimed without ending up in a liquidity crisis and that he should file a NOI to avoid that. On the other hand, the affidavit evidence of Mr. Klaray casts some doubt on whether it was reasonable for Mr. Smith to believe that he would face a liquidity crisis and Mr. Smith adduced no independent evidence supporting his contention. In addition to these concerns, there is the fact that, having invoked the bankruptcy process, Mr. Smith has dealt with his assets outside it. Instead of the Trustee taking Mr. Smith's assets in hand, for example, his shares in Gorf, Mr. Smith has used those assets to raise money. His counsel now holds the equivalent of $360.000.00 U.S. which, on the evidence, was provided pursuant to an indemnification agreement whereby Gorf agreed to pay all Mr. Smith's creditors in the amounts required by law, which I take to mean as determined by the Court. Mr. Smith owns 99 percent of Gorf's shares. Yet this money, though it would appear to be under Mr. Smith's control, has not been given to his Trustee. All of this indicates that Mr. Smith has access to substantial funds that are being maintained outside the bankruptcy proceedings, out of the hands of his creditors.

[51] In his testimony, Mr. Smith described the inspector's involvement in the bankruptcy as a "program of persecution" and said he did not see why Mr. Ruby should see the financial statements when he, Smith, had raised money as security for the Ruby claim. At one point during the hearing, the question was put to him, "Did you not want Ruby to know the value of Gorf and the liquor company?", to which he gave no answer; although in answer to a later question he did not agree that he was trying to conceal that information. The logical inference is, however, that he did not want Mr. Ruby to have the full financial picture. This is clear also from the correspondence from Mr. Smith's counsel in May 2004, which I have referred to in the background section of these reasons. In that correspondence, it was stated that because Mr. Smith had raised $270,000.00 at that point, there was no need for further expenditures for financial statements. The picture all of this paints is that Mr. Smith wanted time to deal with the Ruby claim without having to provide the financial information that a bankrupt is obliged to provide.

[52] Since Mr. Smith has raised money to address the Ruby claim and has therefore indicated his intention to satisfy that claim as determined by the Court, I do not feel it is necessary to rule on whether there has been an abuse of process at this time, especially in light of the way that issue was raised in Mr. Ruby's brief as set out above. Without deciding the issue, I simply note that this case may be an illustration

of how fine the line may be between gaining some breathing room so as to deal with creditors and intentionally placing obstacles in the way of creditors: see *Janodee Investments Ltd. v. Pellegrini*, [2001] O.J. No. 1388 (S.C.J.).

[53] Counsel for Mr. Ruby also sought a declaration that Mr. Ruby is qualified to give opinion evidence regarding U.S. bankruptcy law and procedure and that Mr. Klaray is qualified to give opinion evidence regarding insolvency and accounting matters, as per their respective affidavits. As I pointed out earlier, no objection was taken to their qualifications; the objection was that opinion evidence should not be received from them because of their status in the proceedings, although it was eventually conceded that their status went to the weight, rather than the admissibility, of their opinions. Had either Mr. Ruby or Mr. Klaray been called as a witness at the hearing, their qualifications would no doubt have been more fully canvassed than they are in the affidavits. However, since the qualifications were not challenged on their merits, I have accepted that they are qualified to give opinions in the areas referred to above.

[54] Mr. Ruby also sought a declaration that the money held in trust by Mr. McNiven, counsel for Mr. Smith, in respect of this matter is subject to a trust for the benefit of Mr. Ruby and a direction that it be paid to Mr. Ruby's counsel or, alternatively, that the money be paid to the Trustee who should then be directed to hold it pending further order of the Court. Mr. Smith took no position on this, while the Trustee took the position that there should be not be a direction to pay the money to Mr. Ruby's counsel as this would amount to an impermissible side deal with one creditor.

[55] I direct that Mr. McNiven pay the money he is holding in trust, including interest earned on it, to the Trustee for the Trustee to deal with in the bankruptcy proceedings, along with any other money and assets of which it takes possession. Since there are only two other minor creditors, and subject to the issue of Mrs. Smith's claim, which was not argued before me, I expect that the Trustee should be able to deal with the money and any other assets without much further delay.

[56] With respect to Mr. Ruby's request that the fees he has paid Mr. Klaray be reimbursed by Mr. Smith, I agree with counsel for the Trustee and Mr. Smith that those fees should be restricted to what is provided for under the *BIA* and I will leave them to be dealt with by the Trustee in the usual fashion.

[57] As to the remaining relief sought in Mr. Ruby's notice of motion, the evidence does indicate that Mr. Smith has not been diligent in complying with the Trustee's requests for documents and information. If this continues to be an issue, application may be made to me for a specific direction. I expect that both Mr. Smith and the Trustee will henceforth ensure that all matters pertaining to the bankruptcy are dealt with in a timely way.

[58] Counsel may address the costs of this application by written submissions filed within 45 days of the date these reasons are filed. Should they not be in agreement that written submissions will suffice, they are to submit to the registry, within three weeks of the date these reasons are filed, their available dates to argue the issue of costs.

[59] If clarification of any of the orders and directions is required, counsel may arrange to speak to the matter before me.

V.A. Schuler
J.S.C.

Dated at Yellowknife, NT, this
20th day of June 2005

Counsel for Frank Perry Smith:	Mr. Doug McNiven
Counsel for David R. Ruby:	Mr. Gary Draper and Ms. Cynthia Levy
Counsel for the Trustee, Browning Crocker Inc.:	Mr. Michael McCabe, Q.C.

S-0001-BK2003104864

IN THE SUPREME COURT OF THE NORTHWEST TERRITORIES

IN BANKRUPTCY AND INSOLVENCY

IN THE MATTER OF THE BANKRUPTCY OF FRANK PERRY SMITH of the City of Yellowknife, in the Northwest Territories

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REASONS FOR JUDGMENT OF THE HONOURABLE JUSTICE V.A. SCHULER