

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN THE MATTER OF THE COMPANIES CREDITORS
ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR
ARRANGEMENT OF THE MANDERLEY CORPORATION,
1310500 ONTARIO INC., AND LEO BEAL LTD.

(the Applicants)

**FACTUM & AUTHORITIES OF
ROYAL BANK OF CANADA**

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A	Draft Order
B	<i>The Bank Act</i> , R.S.C. 1985, c. B-2, as amended, ss. 15, 16, 427, 428(14) and 988.
C	B. Crawford, <i>Crawford and Falconbridge, Banking and Bills of Exchange: A treatise on the Law of Banks, Banking, Bills of Exchange and the Payment System in Canada</i> , 8th ed., Vol. 1. (Toronto: Canada Law Book, 1986)
D	<i>Re Victor Varnish Co.; Clare's Clam (1908)</i> , 16 O.L.R. 338 (H.C.J.)
E	<i>Chesley Furniture Co. Ltd. v. Krug (1914)</i> , 18 D.L.R. 486 (Ont. H.C.)
F	I.F.G. Baxter, <i>The Law of Banking</i> , 4th ed., (Toronto: Carswell, 1992)
G	J.D. Falconbridge, <i>Banking and Bills of Exchange</i> , 6 th ed. (Toronto: Canada Law Bank Company Limited, 1956)
H	J. J. MacLaren, <i>Banks and Banking: The Bank Act, Canada</i> , 5th ed., (Toronto: The Carswell Company, Limited, 1928)

PART I – NATURE OF THE APPLICATION

1. This is an application brought by Royal Bank of Canada ("RBC") for an order substantially in the form appended hereto as Schedule "A" (the "Draft Order"), declaring that RBC has a valid and enforceable security interest in all sod crops of The Manderley Corporation ("Manderley") pursuant to s. 427(1) of the *Bank Act*, R.S.C. 1985 c.B-2, as amended (the "*Bank Act*").

PART II – OVERVIEW

2. In the course of refinancing certain credit facilities provided to Manderley by The Bank of Nova Scotia ("BNS"), RBC took an assignment of the s. 427 *Bank Act* security held by BNS. The Monitor has raised a question as to whether, as a matter of law, RBC can rely on and enforce the *Bank Act* security taken on assignment from BNS, in light of s. 428(14) of the *Bank Act*. That section lists the kinds *Bank Act* security that can be assigned by a bank to "any person" and does not include security in crops among that list.
3. RBC says that s. 428(14) of the *Bank Act* has no effect on RBC's rights because:
 - (a) Section 428(14) of the *Bank Act* is irrelevant to inter-bank transfers of security. The case law that motivated the enactment of s. 428(14) and learned commentary make it clear that section 428(14) is intended to address transfers of security from banks to non-banks.
 - (b) Even if the effect of s. 428(14) is thought to limit certain inter-bank transfers of security, relatively recent amendments to the *Bank Act* expressly provide that actions taken by a bank are not invalidated or rendered ineffective merely because they are contrary to a provision of the *Act*.

PART III – FACTS

4. Manderley is a corporation engaged in the business of farming sod crops in the provinces of Ontario and Alberta.¹
5. Between June 2000 and March 2002, BNS acted as Manderley’s banker and extended certain credit facilities to Manderley (the “BNS Credit Facilities”).²
6. BNS registered notice with the Bank of Canada, of Manderley’s intention to give BNS security pursuant to section 427 of the *Bank Act* on:
 - (a) May 12, 2000, in Ontario; and,
 - (b) May 16, 2000, in Alberta.³
7. Subsequently, on June 2, 2000, as continuing security for the payment of all loans and advances made or that may be made by BNS to Manderley and all substitutions therefore and for any interest on such loans or substitutions, Manderley executed an assignment of security under s.427(1) of the *Bank Act* pursuant to which Manderley granted to BNS a security interest in, among other things, all of Manderley’s sod crops (the “BNS Bank Act Security”).⁴
8. On or about March 11, 2002, RBC agreed to provide financing to Manderley in substitution for the BNS Credit Facilities (the “Refinancing”).⁵
9. In furtherance of the Refinancing, RBC acquired the operating debt owing to BNS and, by assignment of security interest made the 12th day of April 2002, BNS assigned the BNS Bank Act Security to RBC (the “Assignment”).⁶

¹ Motion Record, Tab 2, Affidavit of Linda Fletcher, sworn May 23, 2005 (the “Fletcher Affidavit”) at para 3.

² *Ibid.* at para. 4.

³ *Ibid.* at para. 5, Exhibit A.

⁴ *Ibid.* at para. 6, Exhibit B.

⁵ *Ibid.* at para. 7.

⁶ *Ibid.* at para 8, Exhibit C.

10. In connection with the Refinancing, RBC took other security. However, for the purposes of this motion, the Monitor and RBC acknowledge that RBC is relying on its claims under the BNS Bank Act Security to establish its claim to Manderley's sod inventory.
11. Concurrently with the Assignment, Manderley executed a certificate addressed to RBC and its counsel acknowledging and confirming that the BNS Bank Act Security constituted continuing collateral security for the payment and satisfaction to RBC of all obligations, debts and liabilities, present and future, direct and indirect, absolute or contingent, matured or not, extended or renewed at any time owing by Manderley to RBC (the "Certificate").⁷
12. Following the completion of the Assignment, RBC extended credit to Manderley in reliance on the BNS Bank Act Security, with the result that Manderley is presently indebted to RBC in the approximate amount of \$3.6 million.⁸
13. The Monitor has reviewed RBC's security in the sod crops of Manderley and has informed RBC, through its counsel, that, provided that the Assignment is not rendered ineffective as a result of section 428(14) of the *Bank Act*, the Monitor takes no issue with the validity and enforceability of RBC's security interest in the sod crops of Manderley.⁹
14. Section 428(14) of the *Bank Act* stipulates as follows:

Bank may assign its rights – A bank may assign to any person all or any of its rights and powers in respect of any property on which security has been given to it under paragraph 427(1)(i), (j), (k), (l), (m), (n), (o) or (p), whereupon that person has all or any of the assigned rights and powers of the Bank under that security.
15. The Monitor is concerned that, insofar as the BNS Bank Act Security was not taken pursuant one of the provisions expressly enumerated in section 428(14), the BNS Bank Act Security may not have been assignable, and RBC may not be able to rely on either the Assignment or the BNS Bank Act Security.

⁷ *Ibid.* at para. 9, Exhibit D.

⁸ *Ibid.* at para. 10.

⁹ *Ibid.* at para. 11.

PART IV – ISSUES AND LAW

16. The Monitor has raised the following issue:

Can RBC rely on and enforce the Bank Act Security taken on assignment from BNS, in light of s. 428(14) of the Bank Act?

17. As noted above, section 428(14) of the *Bank Act*, provides as follows:

Bank may assign its rights – A bank may assign to any person all or any of its rights and powers in respect of any property on which security has been given to it under paragraph 427(1)(i), (j), (k), (l), (m), (n), (o) or (p), whereupon that person has all or any of the assigned rights and powers of the Bank under that security.

18. Section 428(14) of the *Bank Act* does not affect or limit RBC's rights under the BNS *Bank Act* Security for two reasons:

- (a) First, section 428(14) of the *Bank Act* is intended to prescribe the types of *Bank Act* security that can be assigned by banks to *non-banks*. It is not intended to restrict the assignment of *Bank Act* security among banks.
- (b) Second, relatively recent amendments to the *Bank Act* expressly give Banks all the rights and powers of a natural person and expressly provide that actions taken by a bank are not invalidated or rendered ineffectual merely because they are contrary to a provision of the Act.

Purposive Interpretation of Section 428(14)

19. Section 428(14) was intended to remedy the effect of the decision rendered by this Court, in the cases of *Re Victor Varnish Co.*; *Clare's Claim* (1908), 16 O.L.R. 338 (H.C.J.) and *Chesley Furniture Co. Ltd. v. Krug* (1914), 18 D.L.R. 486 (Ont. H.C.) Those cases stand for the proposition that, contrary to the usual law, in the absence of any express enabling

provision in the *Bank Act*, a non-bank could neither subrogate to nor take an assignment of *Bank Act* security.¹⁰

20. In the *Victor Varnish* and *Chesley Furniture* cases, the court reasoned that in light of the exceptional nature of the rights accorded to banks by virtue of their unique commercial role and status to take security under the *Bank Act*, subrogation or assignment to other individuals should not be permitted in the absence of a clear legislative intent.¹¹
21. A helpful summary of the ratio of the *Victor Varnish* case, upon which the court deciding *Chesley Furniture* subsequently relied, is found in Baxter's text on the law of banking,

It was decided in *Re Victor Varnish Company* that the rights accorded to a bank under section 88 of the 1906 Bank Act were not transmissible to the benefit of a third party, and that a guarantor who had discharged the debt was not subrogated to the bank's rights under the section 88 security... The Bank Act of 1906, however, contained no express provision as to assignment or subrogation and there was then no requirement as to registration of section 88 [now s. 427] securities. The court considered that being excused from registration was in the nature of a privilege to banks which should not be transferred to third parties unless the legislature expressly provided this. [Underlining added]¹²

22. It follows from the concern expressed by the court in *Victor Varnish* and *Chesley Furniture*, regarding the extension of the privileges accorded to banks to *non-banks*, and from the reference in s. 428(14) to "any person", that the section is intended to specify the kinds of *Bank Act* security that are open to be assigned to *non-banks*. Section 428(14) is not intended to limit the ability of banks to take the benefit of *Bank Act* security, whether by assignment, subrogation or otherwise.¹³

¹⁰ B. Crawford, *Crawford and Falconbridge, Banking and Bills of Exchange: A treatise on the Law of Banks, Banking, Bills of Exchange and the Payment System in Canada*, 8th ed., Vol. 1. (Toronto: Canada Law Book, 1986) at 434; *Re Victor Varnish Co.; Clare's Claim (1908)*, 16 O.L.R. 338 (H.C.J.) [*Victor Varnish*] at 344-345; *Chesley Furniture Co. Ltd. v. Krug* (1914), 18 D.L.R. 486 (Ont. H.C.) [*Chesley Furniture*] at 487-488.

¹¹ *Victor Varnish*, *ibid.* at 343, 344-345 and 346; *Chesley Furniture*, *ibid.* at 487-488;

¹² I.F.G. Baxter, *The Law of Banking*, 4th ed., (Toronto: Carswell, 1992) at 116-117.

¹³ J.D. Falconbridge, *Banking and Bills of Exchange*, 6th ed. (Toronto: Canada Law Bank Company Limited, 1956) at 242-243.

23. As noted by the Honourable J. J. MacLaren, Justice of the Court of Appeal for Ontario, in the 1928 edition of his text on the law pertaining to banks and banking “If, however, another bank purchased the assets of the bank which held the security, or became otherwise entitled to the security, an assignment to it might be upheld as it would not be against the policy of the Act.”¹⁴
24. The Honourable Justice MacLaren’s observation was adopted by Crawford, who observes in his more recent text that the reasoning in the *Victor Varnish* and *Chesley Furniture* cases “would not appear to preclude a bank from assigning any security to another bank as may occur, e.g., where the debtor changes his banking relations”.¹⁵

Effect of Recent Amendments to the Bank Act

25. It is also important to note certain of the amendments made to the *Bank Act* since the court decided the *Victor Varnish* and *Chesley Furniture* cases and since Parliament enacted s. 428(14), which have a significant impact on the effect of those authorities.
26. S. 428(14) of the *Bank Act* only specifies what a bank “may” or is permitted to do. The *capacity* of a bank is articulated in section 15 of the *Bank Act*, which stipulates that a bank has the capacity of a natural person and, subject to the Act, the rights, powers and privileges of a natural person. This includes the power to assign security.¹⁶
27. The distinction between what a bank “can” do and what a bank “may” do is important in light of ss. 16 and 988 of the *Bank Act*:
- (a) S. 16 of the *Bank Act*, which was included in the 1999 amendments to the *Bank Act*, stipulates that “no act of a bank...including any transfer of property to or by a bank...is invalid by reason only that the act or transfer is contrary to...this Act”.

¹⁴ J. J. MacLaren, *Banks and Banking: The Bank Act, Canada*, 5th ed., (Toronto: The Carswell Company, Limited, 1928) at 333-334.

¹⁵ B. Crawford, *supra* note 10 at 434.

¹⁶ *Bank Act*, s. 15.

- (b) Similarly, s. 988 of the *Bank Act*, which was included in the 2001 amendments to the *Bank Act*, provides that “unless otherwise expressly provided in this Act, the contravention of any provision of this Act or the regulations does not invalidate any contract entered into in contravention of the provision.”¹⁷
28. Therefore, even if BNS was prohibited from assigning its security in the Manderley sod crops to RBC, the fact remains that it had the capacity to do so and that it did so. By operation of sections 16 and 988 of the *Bank Act*, the assignment remains valid and RBC is entitled to rely on it.

PART V – ORDER REQUESTED

29. RBC requests that an order be made substantially in the form appended hereto as Schedule “A”.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 3rd DAY OF JUNE, 2005.



Clifton P. Prophet, of counsel to
Royal Bank of Canada.

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¹⁷ *Bank Act*, ss. 16, 988.