SEP 22 1997

T-2915-93

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BETWEEN: ROYAL BANK OF CANADA,

Plaintiff,

AND: HER MAJESTY THE QUEEN IN RIGHT OF CANADA
-and-
MINISTER OF NATIONAL REVENUE (Revenue Canada),

Defendants,

AND: GROUPE LMB EXPERTS CONSEILS (1992) INC.
-and-
REMILLARD MOQUIN NADEAU INC.,

Mis-en-cause

REASONS FOR JUDGMENT

DENAULT J.:

In June 1992, Groupe LMB Experts Conseils Inc. (Groupe LMB) owed Revenue Canada an amount of $394,527.90 that was still unpaid. On September 29, 1992, requirements to pay issued under subsection 224(1.2) of the *Income Tax Act* were sent to two of Groupe LMB's debtors: the Hôtel-Dieu de Roberval and the town of Mascouche. Shortly afterwards, these institutions paid the Receiver General of Canada the amounts they owed Groupe LMB: $44,009.98 and $50,503.03, respectively.

The plaintiff Royal Bank of Canada (the Bank) submits that Revenue Canada unlawfully collected these amounts, which belong to it as of right, and seeks repayment thereof plus interest and costs

The point in issue, which is very narrow, can be summarized as follows. the plaintiff argues that the amounts collected by the defendants from the Hôtel-Dieu de Roberval and the town of Mascouche belong to it as of right pursuant to an agreement dated June 6, 1992 under which 176840 Canada Inc sold, assigned and transferred its accounts receivable to Groupe LMB experts conseils (1992) Inc (LMB (1992)), and more specifically pursuant to an agreement dated June 9, 1992 between Caron, Bélanger, Ernst & Young Inc., the trustee in the bankruptcy of 176840 Canada Inc,[1] and LMB (1992), which was duly authorized by the Registrar in Bankruptcy on June 8, 1992 and, subsequently, by a decision of the Superior Court dated August 3, 1992.

In short, the plaintiff submits that at the time of the Department of National Revenue's requirements to pay dated September 29, 1992 to the Hôtel-Dieu de Roberval and the town of Mascouche, these accounts receivable had already been sold in due form by the trustee, as approved by the Registrar in Bankruptcy, pursuant to an unambiguous contract. It adds that Revenue Canada was entitled to seize only what belonged to the tax debtor and that since the Hôtel-Dieu de Roberval and the town of Mascouche were no longer debtors of the tax debtor but of LMB (1992), Revenue Canada was too late and had in effect seized what was the property of another. The plaintiff accordingly submits that the seizure was unlawful and seeks repayment of the amounts so collected by the Department of National Revenue

The defendants counter that the agreement dated June 9, 1992 between the trustee and LMB (1992) giving effect to the agreement for the sale of accounts receivable dated June 6, 1992 in which the Bank had intervened was not a sale but at the very most constituted an agreement to manage the accounts receivable In the alternative, the defendants submit that even should the Court find that the agreement in the case at bar was a contract for the sale of accounts receivable, it was proper for the Department of National Revenue to collect these amounts under subsection 224(1.2) of the *Income Tax Act* as it was entitled to it anyway, since it was the Bank that would, as a secured creditor, have received the moneys "otherwise payable to the tax debtor".[2] Finally, they submit that should the Court find that the agreement is a

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1 As will be explained later in the reasons, 176840 Canada Inc made an assignment of its property on June 8, 1992

2 224 (1 2) Notwithstanding any other provision of this Act, the *Bankruptcy and Insolvency Act*, any other enactment of Canada, any enactment of a province or any law, but subject to subsections 69(1) and 69 1(1) of the *Bankruptcy and Insolvency Act*, where the Minister has knowledge or suspects that a particular person is, or will become within one year, liable to make a payment

(*a*) to another person (in this subsection referred to as the "tax debtor") who is liable to pay an amount assessed under subsection 227(10 1) or a similar provision, or

(*b*) to a secured creditor who has a right to receive the payment that, but for a security interest in favour of the secured creditor, would be payable to the tax debtor,

contract for the sale of debts, this act of sale cannot be raised against the defendants because it was not served on them (signification) as required by article 1571[3] of the *Civil Code*

The first issue to be resolved in the case at bar is whether, as the plaintiff submits, the accounts receivable actually left the patrimony of the tax debtor Groupe LMB or whether the agreement to sell its accounts receivable dated June 6, 1992 between 176840 Canada Inc and LMB (1992), to which the trustee, duly authorized by the Registrar in Bankruptcy, gave effect on June 9, 1992, instead constituted an agreement to manage the accounts receivable to which the trustee consented.

The principles of interpretation applicable in this case are not in dispute. It is true that whatever the circumstances, the parties are free to contract, and that the agreement is the law as between the parties. It is also true, as the Supreme Court noted in *Elsley v. J.G. Collins Agencies*, [1978] 2 S C R. 916, that the courts are disinclined to restrict the right to contract, particularly when that right is exercised by knowledgeable persons of equal bargaining power As the Supreme Court added, *per* Dickson J .

> It is important, I think, to resist the inclination to lift a restrictive covenant out of an employment agreement and examine it in a disembodied manner, as if it were some strange scientific specimen under microscopic scrutiny The validity, or otherwise, of a restrictive covenant can be determined only upon an overall assessment, of the clause, the agreement within which it is found, <u>and all of the surrounding circumstances</u>
>
> (Emphasis added)

However, cases can arise in which, as in the case at bar, the intention of the parties is unclear and the true nature of the agreement is accordingly in doubt On this subject, Jean-Louis Baudouin stated the following:[4]

> [TRANSLATION] Since Quebec law is not formalistic, the parties are bound by the actual agreement they intended to enter into, not the form they used to give effect to it Where their common intention is in doubt, the judge must therefore attach greater importance to the actual intention of the contracting parties than to their apparent intention, as objectively suggested by the

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the Minister may in writing require the particular person to pay forthwith, where the moneys are immediately payable, and in any other case as and when the moneys become payable, the moneys otherwise payable to the tax debtor or the secured creditor in whole or in part to the Receiver General on account of the tax debtor's liability under subsection 227(10 1) or the similar provision, and on receipt of that requirement by the particular person, the amount of those moneys that is so required to be paid to the Receiver General shall, notwithstanding any security interest in those moneys, become the property of Her Majesty to the extent of that liability as assessed by the Minister and shall be paid to the Receiver General in priority to any such security interest

3 1571 The buyer has no possession available against third persons until signification of the act of sale has been made, and a copy of it delivered to the debtor. He may, however, be put in possession by the acceptance of the transfer by the debtor, subject to the special provisions contained in article 2127

4 <u>Les obligations</u>, 3rd ed (Yvon Blais Inc , 1989), at p 246

formal expression thereof Before doing so, however, there must be a doubt, as the court cannot distort a clear contract on the pretext of determining this intention

In the instant case, since the investigation raised a doubt as to the intention of the contracting parties, this issue can be resolved only by carefully analysing the evidence. Although the parties called no witnesses, there is abundant documentary evidence, filed by consent of the parties, that makes it possible to trace the sequence of events.

In June 1992, an auditor's statement of account showed that Le Groupe LMB Experts Conseils Inc., then known as 176840 Canada Inc ,[5] owed the tax authorities $394,527.90.[6] At that time, the company was doing poorly and accordingly decided to make an assignment of its property for the benefit of its creditors on June 8, 1992.[7] However, it had to cease its engineering, management, purchasing and construction activities then in progress as of June 5, 1992 It also agreed on June 6, 1992, two days before its bankruptcy, to sell its goodwill and all its other intangible assets, under the name of 176840 Canada Inc , to an engineering firm — Le Groupe LMB Experts Conseils (1992) Inc — which intended to pursue the company's professional activities It was pursuant to Exhibit D-4 that LMB (1992) acquired the goodwill and intangible assets of Groupe LMB, and its rights, titles, benefits and interests in the rental contracts, for $3 00.

That same day, the company agreed to a final sale, assignment and transfer of its accounts receivable to LMB (1992) for a monetary consideration equal to their market value (Exhibit D-5) In this agreement, LMB (1992) undertook to collect the accounts in question and pay the net proceeds of collection — after deducting a collection fee of 20% of the collected amounts — to the Royal Bank of Canada up to the amount of the advances previously granted (clause 3.1 of Exhibit D-5). Despite the words used in clause 3.1, namely that the sale, assignment and transfer were "final", it is clear that numerous conditions and reservations were attached to this sale. Some of them are worth mentioning First of all, this sale was contingent on the sale,

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5 In all the agreements at issue here, 176840 Canada Inc is described as [TRANSLATION] "a duly incorporated corporation having its head office and principal place of business at Montréal, province of Quebec, formerly known and designated as Le Groupe LMB Experts Conseils Inc " The evidence does not indicate how the shares of Groupe LMB came to be in the patrimony of 176840 Canada Inc , that is, whether by a change in the company's name, a share transfer or otherwise

6 D-13

7 D-7

assignment and transfer of all contracts in progress,[8] it was recognized that the accounts receivable generated by the work in progress had been assigned to the plaintiff[9] and that the plaintiff was intervening in the agreement to consent to it "without prejudice to its security interests".[10] In addition, even though LMB (1992) agreed to make every reasonable effort in good faith to collect the accounts receivable, it was the bank that assumed the judicial and extra-judicial costs relating to any legal proceedings brought against a defaulting debtor (clause 3 5) Furthermore, clause 3 3 provided that once the total of the amounts paid by LMB (1992) to the Royal Bank of Canada had reached the amount of the advances granted by the Bank, LMB (1992) agreed to pay the net proceeds of collection to 176840 Canada Inc. subject to the same conditions as those provided for in favour of the Royal Bank of Canada. Finally, in clause 3.8, LMB (1992) agreed that six months after the transaction, on December 2, 1992, it would assign and transfer all the accounts receivable uncollected as of that date to the Royal Bank of Canada or to Groupe LMB, as the case may be, for $1.00 and other good and valuable consideration.

In another agreement (D-6) dated June 6, 1992 between the Royal Bank of Canada and LMB (1992), the Bank granted LMB (1992) certain rights and privileges. Thus, the Bank authorized LMB (1992) to decide on its own, if necessary, to pay a subcontractor for services rendered before June 6, 1992 if the amount due to it were less than $10,000, although it reserved the right to consent to any amount greater than that The Bank also authorized LMB (1992) to resolve any cases of defective work or over-billing by subtracting the amount from the account receivable in question

The Court concludes from its analysis of these documents that, contrary to what the contracting parties wanted to have others believe, 176840 Canada Inc 's sale or assignment of its accounts receivable was not final, as the transfer was subject to a number of conditions that changed the nature of the transaction. On the basis in

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8 [TRANSLATION] WHEREAS LMB (1992) intends to act on and give effect to the provisions set out hereinabove only after all of Groupe's contracts in progress have been assigned and transferred to it pursuant to a contract to be entered into on this day and to the conditions incorporated therein Should the sale, assignment and transfer of Groupe's contracts in progress by Groupe to LMB (1992) fail to take place or should the contract giving effect to the said sale, assignment and transfer of work in progress be cancelled for any reason whatsoever, this agreement shall *ipso facto* be null and void as of the date of forfeiture or cancellation of the contract of sale of Groupe's work in progress.

9 [TRANSLATION] WHEREAS the sole purpose of this agreement is to set out the terms and conditions of the sale, assignment and transfer to LMB (1992) of Groupe's accounts receivable as of June 5, 1992 and of the accounts receivable generated by work in progress as of that date, it being established that Groupe's accounts receivable were assigned to the Royal Bank of Canada by way of a general assignment of debts granted by Groupe to the Royal Bank of Canada on . . 1992 as security for advances made from time to time by the Royal Bank of Canada to Groupe, and that the said general assignment of debts, a copy of which is attached to this agreement and constitutes an integral part hereof as if reproduced in full, is still in effect and continues to have full force and effect,

10 [TRANSLATION] WHEREAS the Royal Bank of Canada, by intervening in this agreement, consents, subject to the conditions set out hereinbelow, to the final sale, assignment and transfer of the accounts receivable to LMB (1992), without prejudice to its security interests;

particular of the 20% collection fee the Bank agreed to pay LMB (1992), of the fact that it assumed the costs relating to any legal proceedings against a defaulting debtor, of the fact that the "sale" was limited to a term of 6 months, and above all of the special agreement (D-6) between these parties dated the same day, it is the Court's view that the agreement of June 6, 1992 (D-5) is more like a contract to manage accounts receivable granted by the Royal Bank of Canada for the purpose of realizing upon its secured debt.

Furthermore, this is how one of the parties to the agreement has interpreted it, as have the intervenors in the case. First of all, in his affidavit in support of the trustee's request for permission to sell assets prior to the first meeting (D-9), Jean Roquet, the president of 176840 Canada Inc., asserted that the purpose of the agreement was to ensure [TRANSLATION] ". . . that it will be possible to collect a surplus on the accounts receivable after the advances have been repaid to the Royal Bank of Canada, which holds a security interest in the accounts receivable", and that LMB (1992) had been formed [TRANSLATION] "to manage the accounts receivable of 176840 Canada Inc , as can be seen from the . contract to manage the accounts receivable. . ."[11] Claude Gilbert, the representative of the trustee making this request, interpreted this agreement in the same way in his affidavit. In granting this request on June 8, 1992, the Registrar in Bankruptcy also interpreted Exhibit D-5, then R-2, as [TRANSLATION] "an agreement to manage accounts receivable".[12] It should be added that this document served as a basis for the agreement of June 9, 1992[13] between the trustee Caron, Bélanger, Ernst & Young Inc. and LMB (1992), of which it forms an integral part Finally, even Mr. Justice Banford of the Superior Court of Quebec found, at page 29 of his judgment (D-28), that the agreement was a [TRANSLATION] "contract to manage accounts receivable that yielded from 20 to 25% in fees. . ."[14]

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11 Paragraphs 28 and 30 of the request that he supported with his affidavit

12 D-10

13 D-11 I wish to point out inaccuracies in two paragraphs of the preamble to this agreement They are not insignificant considering that the preamble forms an integral part of the agreement The second paragraph, on page 2, reads as follows. [TRANSLATION] "Whereas, in a judgment rendered by the Superior Court the Court granted the motion on the basis of its conclusions . ." This statement is false, as the copy of the judgment reproduced in Schedule C contains conclusions that differ from those in the motion The fourth paragraph refers to [TRANSLATION] " the agreement for the <u>sale</u> of accounts receivable", whereas the judgment characterizes this document as an [TRANSLATION] "agreement to manage accounts receivable"

14 The Superior Court was considering a motion by a creditor of the bankruptcy who was appealing the Registrar's decision to permit the sale of assets of 176840 Canada Inc and authorize LMB (1992) to carry out the assignments and transfers necessary to the continuation of the contracts. The judge held that for the purposes of the case before him, these transactions had been conducted in the best interests of the mass and that they did not need to be revised The Superior Court did not of course rule on the nature of the transaction and on whether or not it was valid as against third parties, such as Revenue Canada Nevertheless, the judge did characterize the agreement as a [TRANSLATION] "contract to manage accounts receivable"

In short, it can be seen from an analysis of the agreement "for the sale of accounts receivable" (D-5) dated June 6, 1992, which was the basis for the agreement between the trustee and LMB (1992) (D-11) afteı being approved by the Registrar in Bankruptcy, and from the way it was characterized, or in other words from the circumstances surrounding the agreement, that it did not concern a final sale of accounts receivable, but was a contract to manage accounts receivable. Thus, there was no dispossession of the patrimony of Groupe LMB, which continued to be a tax debtor within the meaning of the Act

Even had the Court found that there had indeed been a sale of accounts receivable in this case, since it has not been proven that the act of sale was served on Revenue Canada — a third person — the sale could not be raised against Revenue Canada as a result of article 1571 of the *Civil Code*. Nor could the Bank, which consented to this sale, but only without prejudice to its security interests, raise a prior right to payment of these debts against the defendants In a recent judgment, *Alberta (Treasury Branches) v. M.N.R.*, [1996] 1 S C.R 963, the Supreme Court held that the definition of "security interest" is broad enough to include a general assignment of book debts and that the wording of subsection 224(1 2) is sufficiently clear and non-equivocal to allow a transfer of property in garnished funds to the Department of National Revenue and to grant it a priority in circumstances where the balance of the section applies Furthermore, counsel for the parties did not pursue this argument.

For these reasons, the plaintiff's action is dismissed with costs.

OTTAWA, June 16, 1997

PIERRE DENAULT

J.F.C.C.

Certified true translation

Stephen Balogh

FEDERAL COURT OF CANADA
TRIAL DIVISION

NAMES OF COUNSEL AND SOLICITORS OF RECORD

COURT NO.:	T-2915-93
STYLE OF CAUSE:	Royal Bank of Canada v. Her Majesty the Queen in right of Canada and Minister of National Revenue *et al.*
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DATED:	June 16, 1997

APPEARANCES:

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THE FEDERAL COURT OF CANADA

LA COUR FÉDÉRALE DU CANADA

Court No.: T-2915-93

No. de la cause:

Let the attached certified translation of the following document in this cause be utilized to comply with Section 20 of the **Official Languages Act.**

Je requiers que la traduction ci-annexée du document suivant telle que certifiée par le traducteur soit utilisée pour satisfaire aux exigences de l'article 20 de la **Loi sur les langues officielles.**

Reasons for Judgment

8 sept. 1997

DATE

Pierre Denault

J.F.C.C. J.C.F.C.

Form T-4F

Formule T-4F

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