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LAVERY, DE BILLY
BARRISTERS AND SOLICITORS

THE SUPREME COURT HAS RULED: A LIQUIDATOR APPOINTED UNDER THE WINDING-UP ACT, R.S.C., 1985, C-W-11 MUST RESPECT PRIOR CONTRACTS

From the perspective of the legal winding-up scheme, the liquidator is a court-appointed official whose function is to close up the company's business and distribute its assets to its creditors. The liquidator is not a third party in relation to the insolvent company, but is the person designated by the court to act in the place of the directors of the company being wound up. He must, therefore, respect contracts previously entered into by the insolvent, in the light of the circumstances and the purpose of the legislation, which is to ensure that the losses suffered by and the burdens imposed upon creditors are minimized and distributed as fairly as possible.

This judgment specifically deals with the validity of default clauses and the possibility for a contracting party to seek a mandatory sale in the event of default. It may have applicability to other types of contracts and, in certain aspects, to bankruptcy matters.

By unanimous judgment rendered April 25, 1996, the Supreme Court decided on these issues in the matter of *Dubois* v. *Raymond, Chabot, Fafard, Gagnon Inc.* (No. 23993), which firm acted as liquidator in the liquidation of Coopérants, Mutual Life Insurance Society. The appellant *Dubois* was represented by Mtres. Richard Wagner and Odette Jobin-Laberge of our firm.

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1 Place Ville Marie
Suite 4000
Montréal (Québec)
H3B 4M4
Tel. : (514) 871-1522
Fax : (514) 871-8977

925 Chemin St-Louis
Suite 500
Québec (Québec)
G1S 1C1
Tel. : 1-800-463-4002
Tel. : (418) 688-5000
Fax : (418) 688-3458

45 O'Connor Street
20th Floor
World Exchange Plaza
Ottawa (Ontario)
Tel. : (613) 594-4936
Fax : (613) 594-8783

Associated Firm:
Blake, Cassels & Graydon
Toronto, Ottawa, Calgary
Vancouver, Londres

THE FACTS

Dubois and Coopérants had been, for several years, the undivided co-owners of two immovables located in Laval. The ownership titles, which were registered, set forth the respective shares of the undivided co-owners. The parties had also entered into unregistered indivision agreements governing their respective rights as to each immovable. These agreements provided for a 35-year term and a mandatory sale to one party in the event of default of the other. The liquidation or bankruptcy of either party was specified as an immediate event of default.

Under the terms of these agreements, the non-defaulting party could offer to purchase the defaulting party's share and, if the defaulting party refused this offer within the prescribed delay, the purchase price was then set at 75% of the fair market value of the undivided interest, which was to be established by appraisers appointed by the parties, without considering the fact that the immovable was held in undivided co-ownership.

In January 1992, Coopérants, alleging its insolvency, applied for the judicial appointment of a liquidator. On January 10, 1992, Dubois initiated the notice procedure leading to a mandatory sale. He submitted, for each immovable, a firm offer which was refused by the liquidator. The liquidator contended that the indivision agreements were void due to the 35-year term provided for therein. It also claimed that the agreements could not be set up against it because a liquidator was a third party in relation to the debtor and that it must act in the sole interest of the creditors. Lastly, the liquidator alleged that the clause providing for the purchase of the Coopérants' share at 75% of its market value was invalid because it would give an unjust preference to Dubois. Since 1992, the liquidator had also refused to pay its share of the disbursements and expenses related to the immovables, contrary to the requirements of the indivision agreement.

LOWER COURT PRONOUNCEMENTS

In June 1992, the liquidator brought a motion for a declaratory judgment seeking a confirmation of its position by the Superior Court, but the latter reached a different conclusion. It held that the liquidator was not a third party in relation to the debtor in that the contract was valid and had to be complied with by the liquidator.

In December 1993, the Court of Appeal accepted the liquidator's argument to the effect that the clause providing for the purchase of the Coopérants' undivided interest at 75% of its market value created an unjust preference, as only securities authorized by law could have precedence over the rights of unsecured creditors. The Court of Appeal also held that the liquidator was acting in a position similar to that of a trustee and had a duty to act in the best interest of creditors and that the agreements could not be set up against it.

THE SUPREME COURT DECISION

- **The validity of the indivision agreements**

The parties in voluntary undivided co-ownership are free to provide as they wish for the exercise of their undivided rights and the terms and conditions upon which the indivision agreement may be terminated. The waiver of the right to demand partition for a period of 35 years is justified in the circumstances and the agreements are valid.

- **Their enforceability against the liquidator**

The corporate state and all of the powers of the corporation continue after a winding-up order is made and the liquidator, acting in the place of the directors of the insolvent company, is empowered to exercise its rights and honour its obligations. The liquidator is not a third party and there was neither a legal nor a contractual requirement that the indivision agreement be registered in order to be set up against the liquidator.

The Court acknowledged that the imposition of a winding-up scheme might affect the future performance of the contract, but held that the principle that must guide the liquidator, and the Court if the latter exercises its controlling powers, is that of respect for contracts signed in good faith prior to the winding-up, unless the obligations contained therein are prejudicial to the other creditors in light of all the circumstances.

One of the factors to be considered is the nature of the obligation which the liquidator must respect. The *pari passu* rule among unsecured creditors can be fully applied only for an obligation to do, in this case the obligation to sell the immovable, and the Court gave as an example, the obligation of a lessor to provide the enjoyment of the premises.

Moreover, it was clear that, at least for the same price, there was no advantage for the debtor in selling to a purchaser other than Dubois. On the contrary, a refusal to sell to Dubois may cause him harm related to the nature and object of his rights as an undivided owner, harm that is completely gratuitous since it does not benefit the other creditors in any way.

- **The 75% clause**

The appraisal at 75% of the market value to be determined without regard to the fact that the immovable is held in undivided co-ownership is not, on its face, liable to harm the other creditors, since a state of indivision entails restrictions to which the ownership of an undivided portion is subject. Such restrictions should normally be reflected in the price.

Given that the liquidator has adduced no evidence as to the market value of the immovable, it cannot establish that the price offered is not fair. The offer is therefore valid, subject to the right of the liquidator to apply to the court to clarify the terms for the implementation of the sale, if need be.

POINTS TO BE NOTED

- The liquidator is not a third party in relation to the debtor and it may not repudiate contracts entered into in good faith prior to the insolvency.

- The liquidator must respect prior contracts, taking into account all the circumstances, especially the nature of the obligation to be fulfilled. The *pari passu* rule among creditors can be fully applied only for monetary obligations.

- An appraisal at 75% of the value is not, per se, an indication of undue preference.

- Where the liquidator believes that the contract creates an undue preference, it must furnish evidence to that effect and apply to the Court for instructions.

- The Court, in the exercise of its discretion, must take into account all the circumstances and the purpose of the legislation, which is to minimize the losses and harm imposed on unsecured creditors and to distribute same as fairly as possible.

This decision is of key importance for the assessment of the rights of any creditor of a non-monetary obligation and as to the validity of any mandatory sale clause which provides for a calculation of the price to be paid. Several types of contracts contain clauses of this nature, such as shareholder agreements. Although this decision was rendered in the context of a winding-up, certain of the principles set forth therein could have repercussions in bankruptcy matters.

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