Date of Release: November 21, 1994 **No. A883676**

Vancouver Registry

IN THE SUPREME COURT OF BRITISH COLUMBIA

BETWEEN:

BANK OF MONTREAL

PLAINTIFF

REASONS FOR JUDGMENT

AND:

OF THE HONOURABLE

ON-STREAM NATURAL GAS LIMITED PARTNERSHIP and ON-STREAM NATURAL GAS MANAGEMENT INC.

DEFENDANTS

MR. JUSTICE CLANCY

Counsel for B.D.O. Dunwoody Ward Mallette Inc.: L.C. Donaldson

Counsel for the Bank of Montreal: R.A. Millar

Counsel for Accrued Holdings Limited Partnership: W.A. Ferguson

Counsel for 71 Limited Partners of On-Stream Natural Gas Limited Partnership

F.G. Potts

Appearing as a Limited Partner of On-Stream Natural Gas Limited Partnership

and on behalf of P. Cornish

On-Stream Natural Gas Management Inc.: Appeared in Person

Place and dates of hearing: Vancouver, B.C.

October 27 and 28, 1994

B.D.O. Dunwoody Ward Mallette Inc. (Dunwoody) is the Receiver/Manager of both defendants having been appointed by orders of this Court on February 11, 1988. Those orders empower Dunwoody to sell and liquidate the assets of the defendants at such prices as Dunwoody may consider fair and reasonable. They provide as well that Dunwoody may apply to the Court for directions and guidance in the discharge of its duties.

On August 22, 1989, Dunwoody was also appointed by the plaintiff Bank of Montreal as Receiver/Manager of the assets, property and undertaking of the defendants pursuant to the terms of a debenture held by it and as the agent of the Bank of Montreal to realize on the security of certain promissory notes and to dispose of the Bank's legal interest in the notes.

The history of the promissory notes and the debenture under which the Bank purported to act in obtaining the orders for a Receiver/Manager in 1988 and the appointment of Dunwoody as Receiver/Manager and agent on August 22, 1989 is somewhat obscure. Some facts which I am obliged to accept are found in the judgment of Shaw J. in King v. On-Stream (10 June, 1993), Vancouver C894711 (S.C.), an action commenced by individual investors in the defendant, On-Stream Natural Gas Limited Partnership ("On-Stream Partnership"). Following a trial, Shaw J. made,*inter alia*, the following findings of fact:

To become a limited partner an investor had to purchase at least one "unit" in the Limited Partnership for $25,000, payable by three installments. The first two installments, each of $7,500, were payable on December 15, 1984 and December 15, 1985. The third installment, of $10,000, was by way of a promissory note payable to the order of the Limited Partnership ten years later, on December 15, 1994.

(at p. 2)

....

In transactions that took place on December 13, 1985 and March 13, 1986 the Limited Partnership purchased oil and gas assets and processing facilities from the defendant Argus Resources Ltd. As part of the purchase price the General Partner paid $935,000 which was comprised of $615,000 in funds invested by the limited partners and $320,000 which was part of the $350,000 repaid Mr. Cornish (the remaining $30,000 paid legal fees). The balance of the purchase price was looked after by borrowing money from the Bank and granting a "take back" mortgage to Argus which Argus in turn assigned to the Bank. The Limited Partnership thus became indebted to the Bank for $1,810,000.

(at p. 5)

All the assets which the Limited Partnership purchased from Argus were assigned to the Bank as security for the Bank loan and to provide a source of revenue to devote to the repayment of the loan. In addition, the 1994 promissory notes of the limited partners were endorsed to the Bank as collateral security.

The $935,000 ($615,000 plus $320,000) that was paid to Argus as part of the purchase price was re-directed by Argus to the Bank. Argus was already indebted to the Bank and the $935,000 helped reduce the amount of its debt. Also, as noted above, Argus assigned to the Bank the take back mortgage it was granted by the Limited Partnership.

(at p. 6)

The limited partnership to which Shaw J. referred is On-Stream Partnership, the general partner is the defendant, On-Stream Natural Gas Management Inc. ("On-Stream Management") and Mr. Cornish is Patrick Cornish, its principal.

After noting that in or about 1987 On-Stream Partnership failed, Shaw J. went on to find:

The Bank called the loans and obtained a court order appointing Dunwoody Limited the Receiver-Manager of the General Partner. The Receiver-Manager sold off the assets of the Limited Partnership. The proceeds were devoted to reducing the amount owing to the Bank.

(at p. 6)

I am advised, as noted above, that the Bank obtained separate orders appointing Dunwoody as Receiver/Manager of both On-Stream Partnership and On-Stream Management.

On August 25, 1989 Dunwoody entered into an agreement with Accrued Holdings Limited Partnership ("Accrued") for the sale of the promissory notes. The sale was never completed, primarily because the limited partners of On-Stream Partnership commenced the action heard by Shaw J. Among the defendants named were the general partner On-Stream Management, the Bank and Dunwoody.

A condition provided for in the agreement with Accrued for the purchase of the notes was approval of the sale by this Court. Approval was to be obtained before the purchaser could be called upon to fulfil its obligations. The agreement stipulated that the condition was for the exclusive benefit of Accrued.

In late 1993, the litigation commenced by the limited partners was concluded. On December 1, 1993 counsel for Accrued wrote to counsel for Dunwoody advising that Accrued wished to proceed with the closing of the agreement for its purchase of the promissory notes.

During the long delay awaiting the outcome of the litigation, counsel who had been acting for both the Bank and Dunwoody reached the conclusion that the contract had been frustrated and was unenforceable. He referred Dunwoody to independent counsel who now bring this motion before me.

The nature of the relief sought is important. Directions are sought pursuant to Rule 43(5) of the **Rules of Court** as follows:

1. Whether the agreement dated as of August 25, 1989 (the "Agreement") between the Receiver and Accrued Holdings Limited Partnership ("Accrued") regarding the sale of certain promissory notes described therein has been frustrated or is otherwise unenforceable against the Receiver; and

2. In the alternative, if the Agreement has not been frustrated, for directions as to whether the Court approves the sale of the Notes to Accrued under the terms of the Agreement.

Counsel for Accrued by way of preliminary objection raised three issues for resolution:

1. Does Rule 43(5) authorize the making of an order for directions in circumstances such as these? He submits that it does not. But interestingly, he asks the Court to rule on the question of frustration since that would be of benefit to his client.

2. If the Court is able to give directions, does the wording of paragraph two in the notice of motion allow the Court to deal with the questions of approval of the sale of the notes to Accrued and the making of a vesting order?

3. If the wording of paragraph two, which purports to seek directions, does not permit consideration of the issues of approval and the vesting of title, can Dunwoody amend the notice of motion to ask directly for that relief? If amendment is required, counsel has proposed the following wording by way of amendment to paragraph two of the notice of motion:

"If the agreement has not been frustrated, for approval of the sale of the notes to Accrued under the terms of the agreement."

If the application for approval is to be heard on its merits, an included issue is whether in bringing the application, Dunwoody is bound to seek approval or is it free to recommend against completion of the sale.

The relevant provisions of Rule 43 are:

SALES BY THE COURT

Court may order sale

(1) Where in a proceeding it appears necessary or expedient that property be sold, the court may order the sale and may order a person in possession of the property or in receipt of the rents, profits or income from it to join in the sale and transfer of the property and deliver up the possession or receipt to the purchaser or person designated by the court.

. . . .

Application for directions

(5) A person having conduct of a sale may apply to the court for further directions.

Counsel for Dunwoody brings the application for directions on behalf of Dunwoody in its capacity as Receiver/Manager appointed by the Court.

Accrued concedes that Dunwoody had the power to sell the assets of the defendants in its capacity as court-appointed Receiver/Manager but submits that it did not do so. Counsel for Accrued submits that, when examined carefully, it is apparent that the sale agreement was completed by Dunwoody pursuant to its powers as agent or Receiver/Manager appointed by the Bank and not under the powers granted by the Court.

During submissions I indicated to counsel that I would consider the question of the capacity in which the Receiver/Manager acted when selling the promissory notes to Accrued. I have concluded that I should not do so. The point was not fully argued and, given the view I take of the application for directions, consideration of that issue is premature. Included in the consideration of the issue of capacity is the question of whether Dunwoody, if it acted pursuant to its court appointments, had the power to sell the promissory notes given the finding of Shaw J. that the Bank of Montreal was a holder in due course of those notes, limited to the remaining debt of On Stream Partnership to the bank. That issue should also await full argument.

As to the applications for directions, Rule 43(5) must be read with Rule 43(4). That Rule provides:

(4) The court may give directions it thinks just for the purpose of effecting a sale, including directions

(a) appointing the person who is to have conduct of the sale,

(b) fixing the manner of sale, whether by contract conditional on the approval of the court, private negotiation, public auction, sheriff's sale, tender or some other manner,

(c) fixing a reserve or minimum price,

(d) defining the rights of a person to bid, make offers or meet bids,

(e) requiring payment of the purchase price into court or to trustees or to other persons,

(f) settling the particulars or conditions of sale,

(g) obtaining evidence of the value of the property,

(h) fixing the remuneration to be paid to the person having conduct of the sale and any commission, costs or the expenses resulting from the sale,

(i) that any conveyance or other document necessary to complete the sale be executed on behalf of any person by a person designated by the court, and

(j) authorizing a person to enter upon any land or building.

(my emphasis)

It would appear that the directions authorized by Rule 43(4) are limited to those assisting the effecting of a sale. Rule 43(5) refers to further directions, which I take to mean directions given in the same context.

Both directions sought by Dunwoody relate not to the procedure of effecting a sale but to substantive issues involving frustration of the contract and approval of the sale by the Court. An application for directions on those issues is inappropriate. Those questions are more properly considered on an application to the Court for approval. I am satisfied that the directions requested in the notice of motion should not be given. Questions one and two raised by counsel for Accrued are answered in the negative. Rule 43(5) does not authorize the making of an order for direction in circumstances such as these. The Court should not deal with the question of approval of the sale of the promissory notes to Accrued on an application for directions.

I conclude as well that I should not on this motion consider the question of frustration of the contract as a separate issue.

I am satisfied, however, that nothing prevents Dunwoody in its capacity as court-appointed Receiver/Manager from bringing an application for court approval of the sale of the promissory notes. The application to amend the notice of motion to bring that application is allowed or, alternatively, counsel may bring a new motion if they choose to do so.

I do not purport to decide whether the Court can give approval of the sale. I do not wish to impose my view on the Judge who will hear the motion, but it seems to me that on a motion for approval of the sale the following issues should be considered:

1. The capacity in which the Receiver/Manager made the contract for the sale of the notes.

2. Whether, if Dunwoody in entering into the contract acted in its capacity as Receiver/Manager appointed by the Court, it had any power to sell the promissory notes in that capacity.

3. If Dunwoody sold the notes as court-appointed Receiver/Manager, whether the contract has been frustrated.

4. If Dunwoody had no power to sell the promissory notes in its capacity as court-appointed Receiver/Manager, whether the parties can confer jurisdiction on the Court by contract or whether the Court has inherent jurisdiction to approve the sale.

5. Whether the Court has inherent jurisdiction to consider the question of frustration of the contract absent a lis between the parties.

Finally, in the absence of any authority to the contrary, I see no reason why Dunwoody, on an application for approval of the sale of the notes, cannot recommend against completion of the sale. It seems to me that a Receiver/Manager has a duty to bring to the attention of the Court any reason it perceives might lead the Court to conclude that the sale should not be approved. Dunwoody is contractually bound to bring the contract to the Court for approval. That does not mean it must recommend approval.

Costs of this application are left to the discretion of the Judge hearing the motion seeking approval of the sale. I am not seized of that motion.

"D.L. Clancy J."

D.L. CLANCY J.

November 21, 1994

Vancouver, B.C.