**COURT FILE NO.: 07-CV-038944**
**DATE: 2008/08/10**



**SUPERIOR COURT OF JUSTICE - ONTARIO**

**RE:** 1493677 Ontario Limited v. Glenn Henry Crain et. al.

**BEFORE:** MASTER MACLEOD

**COUNSEL:** **Kenneth Radnoff Q.C.** for defendants Rivington, Dow & 34511 **(**"Rivington Group"), moving parties

**Barry D. Laushway** for defendants Crain, Quigley & James ("Crain Group"), moving parties

**Jennifer L. Radford** for defendant solicitors ("Howard Group"), moving parties

**Stephen Victor Q.C.** for the plaintiff Responding Party

## E N D O R S E M E N T

[1] This is a motion for security for costs. There are three issues. Firstly, is the threshold requirement of the rule engaged so that security for costs is appropriate? Secondly, would it be unjust to order security for costs in the context of this action? Thirdly, what is the appropriate amount of security and should it be ordered in stages?

[2] For the reasons that follow, I have concluded that Rule 56.01 (1) (d) is engaged. There is good reason to believe that the corporate plaintiff has insufficient assets in Ontario to satisfy a costs award should the matter proceed to trial and the plaintiff be unsuccessful. As required by the rule I have then attempted to craft an order that appears just in all of the circumstances.

[3] The relevant portion of the rule reads as follows:

> **56.01 (1)** The court, on motion by the defendant or respondent in a proceeding, may make such order for security for costs as is just where it appears that, …
>
> (d) the plaintiff or applicant is a corporation or a nominal plaintiff or applicant, and there is good reason to believe that the plaintiff or applicant has insufficient assets in Ontario to pay the costs of the defendant or respondent;
>
> …

**Background & Nature of the Action**

[4] This is a $3.5 million action involving a condominium conversion in Perth, Ontario. The first group of defendants ("the Crain Group") were the owners of the property when it was an apartment building and before it was converted. The second group of defendants ("the Rivington Group") were purchasers and resellers of a number of units. The Howard defendants were the plaintiff's lawyers.

[5] The plaintiff is a corporation established by Kevin Purdy who is an entrepreneur with considerable experience in converting apartment buildings into condominiums. According to the statement of claim, the owners and Mr. Purdy were working together to accomplish the first condominium conversion of its kind in Perth. There appear to have been various arrangements discussed to allow both parties to benefit but ultimately an agreement was struck in which the plaintiff was to acquire all 78 of the units in the building at an average cost of $80,000.00 per unit and resell them at a profit.

[6] Under this agreement the Crain Group would be the original owner, vendor and declarant and the plaintiff would be the first purchaser of all of the units. The plaintiff claims it had been able to market 27 units to individual purchasers and had entered into an agreement with the Rivington Group by which Rivington would acquire 26 units. The average sale price to the individual purchasers and the Rivington Group would have been $100,000.00 per unit. The plaintiff would have made an immediate profit on closing and would then have been left with 25 units for future sale or lease.

[7] The plaintiff claims that the Crain Group and the Rivington Group conspired to deprive the plaintiff of the benefit of this arrangement. Specifically it is alleged that through a combination of misrepresentations and economic duress, the plaintiff was systematically undermined and forced to agree to revisions to the contracts of purchase and sale. According to the claim this resulted in the Rivington Group acquiring 46 of the best units at an average of $82,000.00 per unit. The plaintiff only acquired 26 units and sold 14 to individual purchasers. It is left with 13 units that it continues to hold.

[8] In anticipation of acquiring all of the units, the plaintiff asserts it posted all of the condominium reserve fund in the amount of $225,000.00 and all of the rental pool guarantee fund of $100,000.00. After closing, the plaintiff alleges the Crain group took control of the management of the condominium and diverted rents owed to the plaintiff to service the vendor take back mortgage given by the plaintiff to Crain on closing. The plaintiff also complains that its lawyers, the Howard Group, failed to protect its interests, were professionally negligent and acted in conflict of interest.

[9] Part of the arrangement between the plaintiff and the Crain Group was a vendor take back mortgage on the units acquired by the plaintiff. The 13 units retained by the plaintiff are thus encumbered by a mortgage to Crain for $104,000.00 bearing interest at 10%. Crain asserts that the mortgage is in default and had in fact commenced power of sale proceedings. Crain

had also commenced a mortgage action but in the face of an injunction motion brought by the plaintiff that action resulted in certain consent orders. As a result, the Crain Group is currently collecting the rents on the the plaintiff's units, paying the carrying costs of the units and holding surplus in trust pending the outcome of this proceeding. Also under that order, the plaintiff cannot dispose of its units and the Crain Group cannot access the trust funds until further order or agreement. The plaintiff expects that if it is successful in this action and recovers damages against the Crain Group, it will be able to set off those damages against the liability under the mortgage.

[10] Whatever the truth of the plaintiff's allegations, this is an action that is objectively difficult. This is because besides bearing the onus of factual proof, the plaintiff must persuade the court to set aside the legal effect of the renegotiated agreements with the Crain Group and the Rivington Group including releases. The plaintiff must also ask for equitable relief from the terms of the Crain mortgage. Moreover, the plaintiff is asking the court to enforce the previous agreements which were themselves renegotiated from an earlier set of agreements. In addition, there are three sets of defendants who each stand in a different relationship with the plaintiff. Without analyzing the merits of the plaintiff's claim in depth it is apparent that even if the plaintiff is successful, the measure of damages and the appropriate remedies will be a matter of court discretion. On the other hand, if the plaintiff fails on any of a number of crucial aspects of its case it may well be liable for three sets of costs. The defendants estimate their recoverable costs after trial at $100,000.00 for each set of defendants. Given the complexity of the issues, I do not regard this as improbable

**Assets of the Plaintiff**

[11] The plaintiff asserts that it has assets in Ontario sufficient to meet a costs obligation. These assets consist of the 13 condominium units, an interest in the reserve fund and rental pool fund (which the plaintiff says it has overpaid) and the accumulating trust fund held by the Crain Group. The defendants' evidence was largely directed towards the sufficiency of these assets.

[12] The reserve fund and the rental pool fund may well have been posted in their entirety by the plaintiff but neither fund is owned or controlled by the plaintiff. At best the plaintiff has a claim to be repaid out of these funds. For the purposes of this motion that is not an exigible asset belonging to the plaintiff.

[13] The trust fund under the control of the Crain Group consists of the surplus of the rents collected on the 13 units over the taxes, condominium fees and other operating and carrying costs of the units and is accumulating at roughly $7600.00 per month. It is however largely offset by the accumulating liability for interest under the Crain mortgage. The outstanding amount claimed for interest is currently in excess of $40,000.00 and it exceeds the amount held in trust. Since escape from the terms of the mortgage requires complete success in the litigation, it is highly unlikely there will be sufficient funds in the trust account to satisfy an order for costs. What this fund will do however is provide security for the interest owing under the mortgage ($104,000 per year) and to the extent that the fund accumulates, it will

have the effect of preserving the plaintiff's equity in the condominium units.

[14] Those 13 units are the only real asset owned by the plaintiff. The parties have differing appraisal reports but it appears these units collectively are worth between $1.3 and $1.6 million if they could be sold for their full market value. The units are of course encumbered by the Crain mortgage. Allowing for accumulated interest and other costs due under the mortgage, to the extent not covered by the trust fund, there is notionally at least $200,000.00 in net equity in these units.

[15] The plaintiff also has liabilities. According to its own evidence, it is overdrawn at the bank by an amount in excess of $30,000.00. It also has contingent liabilities in the form of other litigation detailed in the defendants' evidence. One of those actions relates to a construction lien for $9,592.00 which is registered against the units. As pointed out by the defendants, should the interest in the condominium units have to be realized, there would be legal costs and other costs of disposition that would reduce the net recoverable amount. As well a forced sale of 13 units might well result in some reduction in the price that might be expected if they were marketed individually and at leisure.

[16] I am satisfied on the evidence that while there remains value in the units, there is good reason to believe that it would be insufficient to meet potential costs awards to all three defendants.

**Analysis**

[17] Based on the evidence before me, the threshold requirement under Rule 56.01 (1) (d) is met. The question then is what order would be just in the circumstances of this case?

[18] The plaintiff attempts to blur the distinction between being potentially judgment proof and being impecunious. In its factum the plaintiff argues that it is not impecunious because it has assets but if the court finds it is impecunious then it would be unfair to order security. This is not how the rule has been interpreted. The finding I have made is that there is good reason to believe that the assets held by the corporation are insufficient to meet a potential judgment for costs. This is not a finding that the corporation is unable to raise funds or access a means of posting security. As the case law establishes, once the rule is engaged, the onus shifts to the plaintiff to show that an order for security would be unjust.

[19] The plaintiff is not able to rely on "impecuniosity" within the meaning of *Smith Bus Lines* and cases following it because it did not put forward substantial evidence about the ability of its shareholders or others with an interest in the litigation to post security.[1] This is a fundamental requirement for the court to find that the plaintiff is unable to post security if ordered to do so. There is an often cited decision of this court which holds that the

[1] *Smith Bus Lines Ltd. v. Bank of Montreal* (1987) 61 O.R. (2d) 688 (H.C.J.) followed and interpreted by numerous authorities. See in particular *Kurzela et. al. v. 526442 Ontario Ltd. et. al.* (1988) 66 O.R. (2d) 446 (Div. Ct.); *713484 Ontario Ltd. v. McMillan Binch* [2003] O.J. No. 403 (S.C.J.) cited by the defendants in their factums.

requirement should be met with "robust particularity".[2] In the case at bar, the evidence is at best a bare assertion that no funds are available.

[20] This is not the end of the inquiry. "Impecuniousity" is not a word that appears in the rule and it is merely one of the circumstances that might render an order for security unjust. There may be other circumstances in which it would be unjust to erect a barrier to the plaintiff pursuing its action.[3] The general principle is that it would be unjust to make an order having the effect of barring an apparently meritorious claim. There may be cases in which the plaintiff's claim appears so strong that the risk to the defendant of having an unpaid costs award is virtually non-existent due to the improbability of the defendant recovering costs. Perhaps in those cases, consideration of the merits should persuade the court not to order security even in the absence of a finding of impecuniousity. The extent to which the merits may play a role on a motion for security for costs was thoroughly reviewed by Nordheimer J. in *Aviaco v. Boeing.*[4] It is abundantly clear that the court ought not to engage in weighing the evidence or making predictions about credibility.

[21] It is also abundantly clear that this is not one of those cases in which the merits may be assessed as overwhelming. I have already observed that objectively the plaintiff has a difficult case because it has both evidentiary and legal hurdles to contend with and because it seeks discretionary remedies. Since there are also three sets of defendants who stand in different legal relationships to the plaintiff and three opposing counsel, the risk of costs is real and apparent.

[22] Mr. Victor's most forceful argument is the argument that the plaintiff's financial circumstances are the result of the very wrong which is at the centre of the litigation. This may be a factor in deciding what is just. It would seem particularly unfair to permit a defendant to wrongfully choke off a plaintiff's cash flow and then to insist on security for costs as a condition of seeking a remedy. There are two problems with that submission however. Firstly, it leads back to the question of the merits and to whether the order will actually be a barrier to the plaintiff. Secondly, as discussed in *Aviaco, supra* insolvency as a result of the impugned actions of the defendants is not determinative.

[23] Where, as here, a corporation has been incorporated as the vehicle for a project or investment, its only asset is the subject matter of the dispute and its source of funds has always been the investor or investors behind the corporation, it is not appropriate to refuse an order for security without compelling evidence that injustice would result. A closely held special purpose corporation is intended to insulate the investors from liability should the project fail for any reason. This is the legitimate purpose of limited liability but it is also the reason that Rule 56.01 (1) (d) exists. The policy behind the rule is to protect defendants from suits by shell corporations and where appropriate to require the ultimate beneficiaries of the

[2] *Morton et. al. v. Canada (Attorney General)* (2005) 75 O.R. (3d) 63 (S.C.J.). Leave to appeal was granted at (2005) 76 O.R. (3d) 748 (S.C.J.) but it does not appear that the appeal proceeded nor that leave was granted on the question of the evidentiary burden.
[3] See *Pitkeathly v. 1059288 Ontario Inc.* [2004] O.J. No. 2145 (Master)
[4] *Aviaco International Leasing Inc. v. Boeing Canada Inc.* [2000] O.J. No. 3284 (S.C.J.)

litigation to post security.

[24] Although I am not persuaded an order for security for costs would be unjust, I do accept the alternative submission that security should be ordered in stages.[5] Taking into account the early stage of the litigation and the fact that there is some value in the plaintiff's assets, it is reasonable to order security posted at three stages. It is also not necessary for the security to be paid into court in the form of cash. An appropriate bond or letter of credit will provide the same security in case it is required.

**Order for Security for Costs**

[25] The plaintiff is ordered to post security for costs to the credit of this action in such form as may be agreed or approved by the court. The amounts and times for posting of the security will be as follows:

1. Within 30 days $75,000.00.
2. If the action is set down for trial or at least 60 days prior to any scheduled Settlement Conference, $75,000.00
3. 90 days prior to trial $100,000.00

[26] In the event an order for costs is made in favour of one or more of the defendants, subject to any contrary order of the court making the costs order, should the order remain unsatisfied after 30 days, the defendant or defendants may draw on the security and if the security does not cover the costs, they may share pro-rata. Pursuant to Rule 56.07 any party may move on proper evidence to increase or decrease the amounts of the security hereby ordered.

[27] The parties may make costs submission in writing. The moving party shall make any such submissions within 15 days and the responding party within 15 days thereafter. There shall be no reply without leave. The submissions should be supported by the costs outlines and bill of costs or docket entries as may be necessary to allow me to fix costs should I determine costs ought to be awarded. If no timely submissions are received, there will be no order as to costs.

_____

Master Calum U.C. MacLeod

**DATE:** August 10, 2008

[5] See *Hawaiian Airlines Inc v. Chartermasters* (1985) 50 O.R. (2d) 575 (Master)