*Case Name:*

# Maddocks Manufacturing Ltd. (Re)

**IN THE MATTER OF the Bankruptcy of Maddocks Manufacturing Limited, Moving Party**

[2011] O.J. No. 6571

2011 ONSC 3036

Bankruptcy Court File No. 35-1047438

Ontario Superior Court of Justice

**S.K. Campbell J.**

Heard: May 13, 2011.
Judgment: July 4, 2011.

(47 paras.)

**Counsel:**

Enio Zeppieri and Gregory Gryguc, for the Moving Party.

Francesco Peluso, for the Moving Party.

Demetrios Yiokaris, for the Responding Parties, Maddocks Engineering Ltd. and Gerald Edward Maddocks.

---

## REASONS ON MOTION

S.K CAMPBELL J.:--

Prologue

**1** By Notice of Motion dated February 7, 2011, Francesco ("Frank") Peluso ("moving party") moved before the Registrar in Bankruptcy a London, Ontario. The relief claimed was an order pursuant to section 38 of the Bankruptcy and Insolvency Act, R.S.C. 1985, c.B-3 (the "NA") to allow the moving party to continue an action initiated by Maddocks Manufacturing Limited ("Manufacturing") against Maddocks Engineering Limited and Gerald Edward Maddocks. The motion itself claimed nine specific forms of relief. All were directly related to the moving party's request to continue the action.

**2** The action by Manufacturing was commenced by a Statement of Claim issued December 12, 2008, in Superior Court at Toronto. The court file number for the action is CV-08-368502.

**3** Initially, the proposed method of hearing the motion was in writing and before a Registrar in Bankruptcy. Maddocks Engineering Limited and Gerald Edward Maddocks (who for the sake of convenience the court will refer to as the "responding parties") objected to the proposed method of hearing. Ultimately, the parties agreed that the motion ought to be heard orally and before a single justice of the Superior Court of Justice.

Background

**4** There was no dispute as to the facts in this matter and I will attempt to state them briefly.

**5** Manufacturing carries on the business of the manufacturing and sales of filters. Engineering carried on a similar business. Maddocks was the principal of Engineering.

**6** In 2005, Maddocks had discussions with representatives of Manufacturing about his ceasing to be involved in the business of manufacturing. Those discussions resulted in Manufacturing, Engineering and Maddocks entering into an Asset Purchase Agreement, dated November 30, 2005. The agreement closed January 31, 2006. By that agreement Manufacturing purchased certain assets from Engineering and assumed certain liabilities.

**7** On March 11, 2008, Manufacturing began bankruptcy and receivership proceedings. MSI Spergel Inc. was appointed trustee and receiver and continues in that capacity today.

**8** The above mentioned Statement of Claim was issued by Manufacturing against Engineering and Maddocks. The Statement of Claim alleges the Asset Purchase Agreement was breached and as a result of that breach Manufacturing suffered damages. Indeed, the allegation is that the breach resulted in Manufacturing's bankruptcy.

**9** The Moving Party is an officer and director of the manufacturing. He is also a creditor of Manufacturing. He is not a party to the Asset Purchase Agreement.

**10** On or about February 19, 2009, the responding parties filed a Statement of Defence and counterclaim in that action. That document included a claim that the action be declared a nullity and

dismissed. The basis of that assertion was that Manufacturing was an undischarged bankrupt and no order under section 38 of the MA had been obtained. It was therefore claimed that Manufacturing had no lawful authority to issue the Statement of Claim.

**11** On March 18, 2009, counsel for Manufacturing who was also counsel for the moving party, advised counsel for the responding parties by letter that he was "making an inquiry" to the plaintiffs trustee in bankruptcy, MSI Spergel Inc., with respect to the action continuing. In that letter, counsel sought an indulgence to file a Statement of Defence to the counterclaim until April 30, 2009. On or about May 1, 2009, Manufacturing served a Statement of Defence to the counterclaim.

**12** Thereafter, there was a series of correspondence between the parties. I would summarize the correspondence as follows:

a) May 11, 2009: Zeppieri & Associates to Koskie Minsky, update of status to the trustee;
b) June 3, 2009: Koskie Minsky to Zeppieri & Associates, inquiring about progress with the bank's counsel and the trustee. Letter indicated response not received, motion would be brought
c) June 5, 2009: Zeppieri & Associates to Koskie Minsky, acknowledging June 3rd, letter;
d) October 9, 2009: Zeppieri & Associates to Koskie Minsky, indicating that counsel has received consent from the Bank of Montreal to allow the action to continue and inquiring about setting dates for discovery;
e) October 19, 2009: Koskie Minsky to Zeppieri & Associates referring to sections 30 or 38 of the MA. The letter seeks clarification of the creditors consent. The letter further states if clarification was not received in 10 days intent to bring a motion for summary judgment;
f) October 28, 2009: Zeppieri & Associates to Koskie Minsky, response to October 19 letter. It confirms the author's understanding that the trustee in bankruptcy will take the position that Manufacturing's action could proceed with the consent of the bank. The letter inquired whether or not counsel was going to insist upon an order pursuant to sections 30 or 38 of the BIA;
g) October 30, 2009: Koskie Minsky to Zeppieri & Associates, this letter advises that, "the within action is a nullity, was improperly commenced without first obtaining a section 38 order under the MA and was not even brought by the appropriate party." The letter also states they expect to be served with any motion under section 38.

There does not appear to be any communication between Zeppieri & Associates and Koskie Minsky after that date.

**13** Counsel for Manufacturing communicated with counsel for the bank and the trustee during this time as well. As part of the motion record of the moving party there is correspondence dated September 28, 2009; January 10, 2010; February 18, 2010; and January 5, 2011. This correspondence dealt with the section 38 order which Manufacturing was proposing.

**14** The correspondence does not demonstrate that them Was ever an agreement as to the terms of such an order. However, upon return of the motion, counsel indicated to me that there was agreement among all parties including the trustee and the major creditor as to the terms of the order.

**15** On January 17, 2011, the court issued a Status Notice. The within motion record was prepared and apparently served February 22, 2011.

Issues

**16** The parties agree that the issues to be resolved are:

1) Can the moving party continue this action in bis name (i.e. pursuant to section 38 of the BIA?)
2) Should the court grant a section 38 order on a nunc pro tunc basis? and
3) Do Engineering and Maddocks have standing on this motion?

**17** The responding patties raised two additional issues in their factum. One dealt with the form of the order and the other the manner in which the motion was heard. I was advised both issues were resolved and I need not deal with them.

Threshold Issue

**18** Neither counsel argued the third issue as a threshold issue. Neither counsel sought termination of that issue before arguing the matter fully. In my view, a decision on that issue should be made first.

Moving Party's Position on Threshold Issue

**19** The moving party takes the position that the responding parties do not have standing on the section 38 application nor can they cross examine on the material filed. He takes the position that the responding parties were served with the application and materials simply because they are creditors of Manufacturing and may wish an opportunity to join the action. The moving party further argues that standing should not be granted because he has not taken any steps that undermine the integrity of the bankruptcy process nor has he committed fraud.

**20** The responding parties argue generally that:

a) a proposed defendant should have standing to challenge a section 38 order when the order sought goes beyond merely authorizing the proceeding to

be brought
b) the tights of the intended defendant are affected; or
c) the proposed defendants will suffer prejudice.

**21** Specifically, the responding parties argue that standing should be allowed in this matter because:

a) the moving party sought relief in addition to simple authorization;
b) the responding parties are actual defendants in the action not proposed defendants;
c) responding parties are creditors of the bankrupt;
d) the responding parties will suffer prejudice if the order is granted because the action is time-barred and the relief sought will effectively circumvent the Limitations Act;
e) the order sought is an abuse of process and irregular;
f) the responding parties have raised a discreet issue of law; and
g) the moving party sewed the responding parties with the motion material.

Analysis

**22** Cronk J.A. in Shaw (Trustee of) v. Nicol Island Development Inc., [2009] O.J. No. 1333 (ONCA) at paragraph 44 states that the general rule is that neither a bankrupt or a proposed defendant has standing to be heard on a section 38 motion. However, Croak J.A. further stated that this is a general rule so long as the section 38 order merely authorizes the proceeding to brought, the rights of the intended defendant will not be affected and no prejudice will be suffered.

**23** The responding parties argue that the order sought is significantly more than my order authorizing a creditor to take a proceeding which the estate trustee bas either refused or neglected to take. The order sought would allow the moving party to take over an existing action. Additionally, if the order is made on a nunc pro tunc basis it will have the effect of depriving the responding parties of a defence that would be available to them. It was accepted or at least unchallenged by both parties that a new action would be barred by the provisions of the Limitations Act, 2002, S.O. 2002, c. 24, Sch. B. To deprive the responding parties of a legitimate defence which would otherwise be available to them is certainly prejudicial.

**24** Counsel for the moving party referred me to Nest Energy Marketing Canada Inc., Re (1998), 8 C.B.R. (4th) 476 (A.B.Q.B.). The court in that case concluded that the proposed defendant in the application bad no standing in part because it was not affected by the order sought (see paragraph 18).

**25** It cannot be said that the order sought here does not affect the rights of the responding parties/defendants. Clearly, to allow the action to be continued by the moving party would effectively deny the limitation defence to the responding parties/defendants. In my view that

significantly affects their rights.

**26** The responding parties referred me to a decision of Bielby J. of the Alberta Court of Queen's Bench, Tirecraft Group Inc. (Re), [2009] A.J. No. 505. Bielby J. reviews situations in which courts have allowed proposed defendants standing. An example given, where a proposed defendant was granted standing, is where that defendant was able to raise a discreet issue of law which is a complete answer to the proposed litigation.

**27** In my view, that is the situation here. The responding parties seek to raise a limitation defence which would be a complete answer to the new proceeding. That is, it would be a defence if any order under section 38 is not made nunc pro tunc.

**28** The other arguments raised by the responding parties are meritorious. However I find arguments d) and f) are an answer to the moving party's objection. I conclude that the responding parties do have standing in this motion.

Position of the Parties on the Remaining Issues

**29** The moving party argues that an order pursuant to section 38 of the BIA should follow as a matter of course. The only consideration is that the trustee has refused or neglected to take the proceeding which the creditor is of the opinion would be for the benefit of the estate of the bankrupt. The moving party refers the court to correspondence between his counsel and counsel for the trustee and major secured creditor to support that position.

**30** The moving party submits that the order should be made nunc pro tune because it is in the best interest of the creditors to do so and making the order in that fashion is consistent with the interest of justice. The moving party argues that the facts support the notion that the moving party immediately took the proper steps to obtain the position of the trustee and the largest creditor.

**31** The responding parties argue that while the cause of action is an asset which in normal circumstances can be assigned, here the cause of action no longer exists because of the provisions of the Limitations Act. That is, the limitation period has tolled and there is no longer an asset.

**32** The responding parties acknowledge that making a section 38 order nunc pro tune would be an answer to that argument. However, they argue the order should not be made on a nunc pro tunc basis because:

a) Manufacturing is named as the plaintiff in the action not Peluso;
b) the two-year limitation period expired by March 12, 2010;
c) that the action was a nullity was specifically pleaded in the Statement of Defence and counterclaim;
d) there is no reason provided in the material for the delay in bringing the section 38 motion;

e) the moving party failed to submit evidence established that Manufacturing's claim has merit;
f) there is no reason provided for the court to exercise its discretion to grant the order on a nunc pro tune basis.

Can Frank Peluso continue the action in his own name?

**33** Section 38 of the BIA provides:

> 38.(1) Where a creditor requests the trustee to take any proceeding that in his opinion would be for the benefit of the estate of a bankrupt and the trustee refuses or neglects to take the proceeding, the Creditor may obtain from the court an order authorizing him to take the proceeding in his own name and at his own expense and risk, on notice being given the other creditors of the contemplated proceeding, and on such other terms and conditions as the court may direct.

**34** In most instances, a section 38 order would be made as a matter of course by the Registrar in Bankruptcy. Property has a broad definition under section 2 of the BIA and includes "things in action." This definition is sufficiently broad to include the action commenced by Manufacturing.

**35** The expiration of the limitation period takes this situation out of the ordinary course. It is clear that an action commenced without capacity is a nullity and will not toll a limitation period (see Solomon v. Education Fund Services Inc. (2006), 26 C.B.R. (5th) 266 (OSCJ). The action is a nullity and therefore void ab initio.

**36** Lederman J. in Solomon v. Education Fund Services Inc., supra, accepted the above proposition and concluded at paragraph 28 of his decision:

> For these reasons, I must conclude that if the claims indeed vested in the trustee, this action. would be a nullity and void ab initio. Moreover, the limitation period has passed for these causes of action and any transfer of the claims by the trustee to the plaintiff would not revive the action.

**37** The moving party did not challenge the assertion that the action that was commenced is a nullity. That is why they are seeking the order to be made nunc pro tune. Although counsel for the moving party argued a position contrary to Solomon he did not provide the court with any authority for his position.

**38** I conclude that the action is a natty and therefore there is nothing to assign. The action contemplated is barred by virtue of the Limitations Act. Therefore, the moving party should not receive the benefit of a section 38 order in these circumstances.

Should the Court Grant a section 38 Order on a nunc pro tune basis?

**39** The moving party argues that the difficulty created for it, should the court come to the conclusion it has, can be cured by making the order nunc pro tune. He refers me to a decision of Sproat J. in Rowland v. Middlebrook 2009 CarswellOnt 7576, where an order was made nunc pro tunc.

**40** However in Rowland v. Middlebrook supra, there was no limitation issue. The learned motions judge referred specifically to that fact in his decision (paragraph 8).

**41** The Ontario Court of Appeal in Degroote v. Canadian Imperial Bank of Commerce, [1998] O.J. No. 395 (ONCA) appears to accept the view of the Alberta Court of Appeal in Toyota Canada Inc. v. Imperial Richmond Holdings Ltd (1994), 27 C.B.R. (3d) 1. That is, the commencement of an action without a section 38 order is an irregularity only. Therefore it may be cured through the mechanism of an order nunc pro tuna However, in Toyota Canada Inc. v. Imperial Richmond Holdings Ltd, supra, the court concluded that not every case will lend itself to the wanting of section 38 order nunc pro tunc. Specifically, the court stated:

> Circumstances alter cases: the facts presented in many cases may not engage the discretion of the court to make such an order, whereas the facts presented in others may invite the exercise of that discretion.

**42** In Degroote v. Canadian Imperial Bank of Commerce, supra, the court agreed that the exercise of the motions judge's discretion was appropriate. The trustee had been a party to the proceeding from inception. The action proceeded for more than four years without objection and much time and money had been expended by all parties.

**43** Counsel for the moving party argued that immediate steps were taken to secure a section 38 order. I do not agree. As I have noted above there was lengthy correspondence. However, the moving party could easily have brought the motion without the consent of the trustee. Any issues about the form of the order could have been dealt with in the course of the conduct of that motion.

**44** To make the section 38 order nunc pro tune would significantly interfere with real rights of the responding parties. That is the right to plead the Limitations Act. In my view, this is not an appropriate case in which the court should exercise its discretion. The defendants' position that the action was a nullity was placed squarely in issue by the pleadings. The moving party was reminded in correspondence of the responding parties' position but took no action.

Conclusion

**45** Therefore I have concluded:

a) The responding parties do have standing to participate in this motion;
b) An order pursuant to section 38 should not be made granting the moving party the right to continue the proceeding in his own name;

c) An order under section 38 should not be made nunc pro tunc.

**46** Therefore the motion is dismissed.

**47** The parties can make written submissions to me with respect to the issue of costs. The responding parties shall provide the court and the moving party with their written submissions within 20 days of the release of these The moving party shall respond within 15 days of its receipt of those submissions.

S.K. CAMPBELL J.

cp/s/qlrxg/qlrdp/qljac