
CANADA / JUDGMENT

Skagen v. CIBC

2004 BCSC 602

COURT

Supreme Court of British Columbia

DECIDED

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2004 BCSC 602 Skagen v. CIBC

IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation:

Skagen v. CIBC,

2004 BCSC 602

Date: 20040505

Docket: S77677

Registry: New Westminster

Between:

Arthur Wayne Skagen and 522152 B.C. Ltd.

Plaintiffs

And

Canadian Imperial Bank of Commerce

Defendant

Before: The Honourable Mr. Justice Williams

Reasons for Judgment

Counsel for the plaintiffs:

B.F. Schreiber

Counsel for the defendant:

P.C. Lee

Date and Place of Hearing:

May 16, 2003

New Westminster, B.C.

Introduction

[1] In this Rule 18A summary trial, the plaintiffs seek the following relief:

1. An order setting aside the judgment against the plaintiffs in Action No. SO20892, Vancouver Registry (the "Guarantee Action").
2. A declaration that the plaintiffs are released from any obligation as guarantors under any guarantee granted in connection with Moderngroove Entertainment Inc. ("Moderngroove").
3. An order dismissing the Guarantee Action as against the plaintiffs.
4. An order or declaration that any securities or brokerage accounts which are charged, pledged, or otherwise secured in favour of the defendant in connection with the debts of Moderngroove, be released and discharged from any such charge, security or pledge and for cancellation of any such security charge or pledge.
5. Return of \$100,000 which was paid by the plaintiff Skagen to the defendant in two instalments in May and July, 2002, pursuant to a settlement agreement between the plaintiffs and the defendant made in May, 2002 (the "Settlement Agreement").

Background Facts:

[2] The following facts are relevant:

1. The plaintiff Skagen is a solicitor. At all material times, he was the director and sole shareholder of the plaintiff, 522152 B.C. Ltd. ("522152"), a B.C. company.
2. On or about January 17, 2001, the defendant ("CIBC") established an operating line of credit with a credit limit of \$300,000 (the "Credit Agreement") with Moderngroove, a B.C. company. One of the directors of Moderngroove was a Mr. John Stroppa.
3. Pursuant to the Credit Agreement, CIBC required the following security:
 - (a) a General Security Agreement (the "GSA"), covering all present and after acquired personal property of Moderngroove;
 - (b) an unlimited guarantee of the indebtedness of Moderngroove from Mr. John Stroppa (the "Stroppa Guarantee");
 - (c) an unlimited guarantee of the indebtedness of Moderngroove from 522152 supported by certain hypothecated stocks/bonds (the "522152 Guarantee") namely, 3,000,000 shares of eCom Corporation;

4. Between January, 2001 and March, 2001, CIBC advanced monies to Moderngroove up to approximately \$490,000, thereby exceeding the credit limit of \$300,000 under the Credit Agreement (the "Overdraft").
5. The revised and expanded credit arrangement was evidenced by a new credit agreement (the "Second Credit Agreement") between CIBC and Moderngroove. That agreement, dated March 6, 2001, provided for a credit up to the sum of \$490,000. The document is executed on behalf of the Bank by Ron Marbach and on behalf of Moderngroove by John Stroppa.
6. The Second Credit Agreement required the same security as had been provided for the initial Credit Agreement, but it also required that Skagen provide a guarantee "in an amount that is unlimited, secured by hypothecated CIBC deposit balances in the amount of \$190,000" (the "Skagen Guarantee").
7. It was a term of the Skagen Guarantee that upon reduction of the indebtedness of Moderngroove to within the \$300,000 credit limit under the Credit Agreement, the Skagen Guarantee would be discharged and the aforesaid Supporting Security would be released.
8. In compliance with CIBC's requirement for the Skagen Guarantee, on March 5, 2001, Skagen executed a bank form guarantee and a Securities Pledge Agreement. In addition, the evidence discloses a letter from Skagen's investment house, BMO Nesbitt Burns, dated April 27, 2001, wherein it is confirmed that the investment house has received an "Hypothecation and Pledge account in favour of CIBC" for Skagen's account number 550 89568.
9. At the request of CIBC, Skagen advanced monies to CIBC in reduction of the overdraft. In particular, between March, 2001 and about October 15, 2001, Skagen paid CIBC at its request approximately \$180,000 in reduction of the Overdraft and subsequently, paid a further \$20,000 to bring the indebtedness of Moderngroove to CIBC to within the \$300,000 credit limit.
10. In early November, 2001, CIBC called for payment of the loan.
11. On November 14, 2001, Skagen requested that CIBC forbear from taking action for sixty days. By a letter to the Bank's solicitor, dated November 14, 2001, Skagen advised that he was prepared to pay the loan amount on condition that the Bank would grant him a sixty-day extension in which to pay and that the Bank would provide him with the security which it held, unimpaired.

It is noteworthy that in his letter, Skagen stated his understanding that the Bank held as security, inter alia, the personal guarantee of Arthur Skagen.

12. There followed a meeting with Skagen, a representative of CIBC and the Bank's solicitor on November 22, 2001. Following that meeting, a letter was sent to Skagen by the Bank's solicitor confirming acceptance of the arrangements set out in Skagen's letter of November 14, 2001.

13. Sixty days passed without any payment on the Moderngroove debt.
14. On February 13, 2002, CIBC commenced Action No. SO20892 in the Vancouver Registry against Moderngroove, Stroppa, Skagen and 52215, claiming a debt in the sum of \$304,482.40, pursuant to a loan agreement, and pursuant to certain guarantees (the "Guarantee Action").
15. On March 19, 2002, all the defendants filed a statement of defence, denying all liability to CIBC; Skagen specifically denied liability on the basis that his guarantee was released because the loans were reduced to within the limit of \$300,000.
16. On April 9, 2002, a receiving order was pronounced in Vancouver Registry Bankruptcy Division Action No. 225054VA02 adjudging Moderngroove bankrupt. As of the date of the receiving order, Moderngroove was indebted to CIBC in the sum of \$304,482.40, plus interest and costs. BDO Dunwoody Limited was appointed trustee in bankruptcy of Moderngroove (the "trustee").
17. On May 7, 2002, CIBC filed a notice of hearing for summary judgment application against Skagen, to be heard May 14, 2002.
18. On May 10, 2002, Skagen, through his counsel, made an offer to settle the CIBC's claim against him; he also requested that the hearing be adjourned to May 16 or 17, 2002.
19. On May 14, 2002, Skagen's offer was rejected by CIBC and the hearing was adjourned by consent to May 16, 2002.
20. On May 16, 2002, while counsel were waiting to be heard in the summary judgment application of CIBC, they negotiated an agreement in settlement of CIBC's claim against Skagen and 522152 (the "Settlement Agreement").
21. The terms of the Settlement Agreement were:
 - (a) the hearing of the summary judgment application would be adjourned;
 - (b) Skagen would pay CIBC the sum of \$50,000 on or before May 30, 2002 and the further sum of \$50,000 on or before July 31, 2002 and the balance of the debt owing by Moderngroove pursuant to the Credit Agreement on or before October 31, 2002;
 - (c) Skagen was to provide CIBC with a recent Nesbitt Burns account statement for an account of Skagen's disclosing securities held in that account having a liquidation value of at least \$300,000;
 - (d) by May 17, 2002, CIBC was to provide Skagen with a Securities Pledge Agreement in the Bank's standard form creating a first security interest covering the securities in the Nesbitt Burns account as security for Skagen's performance of the arrangements;
 - (e) the executed original of the Securities Pledge Agreement was to be in the hands of the Bank no later than 9:00 a.m. on May 21, 2002;

- (f) as further security for the monies payable by Skagen pursuant to the Settlement Agreement, Skagen was to instruct his counsel to endorse a consent to judgment against Skagen and 522152 in the Guarantee Action for \$305,326.08, plus costs (the "Consent to Judgment");
 - (g) the Consent to Judgment was to be held in trust by the solicitor for CIBC, unentered, on the trust condition that it should not be submitted for entry at the court registry except in the event of default by Skagen in the performance of the Settlement Agreement;
 - (h) Upon payment in full by Skagen of the Moderngroove debt, CIBC would assign and transfer to Skagen all security it held from Moderngroove, and all of CIBC's rights under the Stroppa Guarantee and in the Guarantee Action (collectively the "Co-guarantor Security").
22. Pursuant to the Settlement Agreement, Skagen executed and delivered a securities pledge agreement dated May 21, 2002, whereby he pledged securities in three accounts at Nesbitt Burns, namely, account numbers 55089567, 55189888 and 55189887 (the "three pledged accounts").
 23. On or about May 30, 2002, CIBC obtained default judgment against Stroppa in the Guarantee Action in the amount of \$304,482.40, plus interest in the sum of \$6,182 and costs in the sum of \$961.50 (the "Default Judgment").
 24. On May 31, 2002, Skagen paid CIBC the sum of \$50,000 and on July 31, 2002, Skagen paid CIBC the further sum of \$50,000, pursuant to the Settlement Agreement.
 25. At all material times up to the date of the Settlement Agreement, Moderngroove owned a valuable asset, namely the right to apply to Canada Customs and Revenue Agency ("CCRA") for a scientific research and experimental development grant (the "SR&ED Grant"). As of about May 2002, the value of the SR&ED Grant was estimated to be in the range of \$250,000-\$750,000.
 26. By reason of the GSA granted by Moderngroove to CIBC pursuant to the Credit Agreement dated January, 2001, CIBC had a security interest in the proceeds of the SR&ED Grant in priority to the interests of all other parties or creditors of Moderngroove.
 27. On June 11, 2002 the first meeting of creditors of Moderngroove took place. The trustee learned of the possibility of the SR&ED Grant with a deadline of July 2, 2002 for the application to be filed.
 28. Between June 11, 2002 and July 2, 2002, the trustee made a number of arrangements with Stroppa and personnel formerly employed by Moderngroove, as well as other parties, all in aid of completing and filing the SR&ED application.

Over this same period, there were a number of discussions, meetings and exchanges between the trustee and Skagen regarding the grant application process.

29. On June 25, 2002, CIBC entered into an agreement with Stroppa and BDO Dunwoody Limited in its capacity as trustee in bankruptcy of Moderngroove (the "trustee") and certain other parties, with respect to the realization of the SR&ED Grant and other assets of Moderngroove (the "June 25, 2002 Agreement").
30. The June 25, 2002 Agreement provided, inter alia, as follows:
 - (a) CIBC would release its security interest in Moderngroove which it owned pursuant to the GSA, and in particular, with respect to the realization of the SR&ED Grant, CIBC would subordinate its security interest in the assets of Moderngroove pursuant to the GSA to the interests of the other parties to the June 25, 2002, Agreement;
 - (b) the trustee was to proceed with a claim to CCRA to realize the SR&ED Grant on behalf of Moderngroove;
 - (c) the trustee was to pay the unsecured creditors of the estate of Moderngroove (the "estate") 16% of the proceeds of the SR&ED Grant and the balance of the proceeds of the SR&ED Grant was to be divided among the other parties to the June 25, 2002 Agreement;
 - (d) CIBC would consent to an order setting aside the default judgment against Stroppa;
 - (e) within a further 12 months after the June 25, 2002 Agreement, CIBC would consent to an order dismissing any claim in the Guarantee Action against Stroppa;
 - (f) CIBC would release Stroppa from any claim it had relating to Moderngroove including the aforesaid Stroppa Guarantee.
31. On October 31, 2002, the deadline for the payment of the balance of the debt by Skagen passed without payment being made.
32. On or about November 5, 2002, CIBC entered the Consent Judgment against both plaintiffs in the amount of \$305,326.08 which it held in trust pursuant to the Settlement Agreement.
33. On or about November 6, 2002, CIBC issued a notice of disposition of collateral pursuant to the provisions of the Personal Property Security Act, R.S.B.C. 1996, c. 359, under which CIBC purported to seize the securities in the three pledged accounts and in addition, the four accounts which Skagen says were never pledged, delivered or charged by Skagen in favour of the CIBC under the Settlement Agreement or under the Securities Pledge Agreement dated May 21, 2002 or otherwise.
34. As a consequence of CIBC's release of Stroppa from the Stroppa Guarantee, the default judgment, the Guarantee Action and any other claim in connection with Moderngroove, Skagen has no recourse or right of recovery whatsoever against Stroppa as a co-guarantor of the debts of Moderngroove or as a judgment creditor under the default judgment as assignee of the CIBC default judgment.

Present Circumstances; Positions of the Parties:

- [3] At the time of hearing, CIBC had entered the Consent Judgment against Skagen and 522152 B.C. Ltd. As well, seven brokerage accounts that the Bank says Skagen gave as security are effectively frozen, pending disposition of this application.
- [4] CCRA made a payment pursuant to the grant application; I have subsequently been advised that the amount paid was \$416,000; presumably that amount was allocated in accordance with the agreement that was made and, assuming that to be so, the sum of \$99,840 would have been paid against Moderngroove's obligation to the Bank, that is, 24% of the total recovery.
- [5] In accordance with the agreement that was made with Stroppa, the Bank has consented to a dismissal of its claim against him.
- [6] The plaintiffs say the Bank has breached its agreement and that the Consent Judgment which was entered against both Skagen and the numbered company should be set aside. The plaintiffs also seek an order that the Guarantee Action be dismissed, a declaration that the plaintiffs are released from any guarantee in connection with Moderngroove obligations, that the brokerage accounts be released and that the Bank return the \$100,000 paid by Skagen pursuant to the agreement.
- [7] I do not understand the plaintiffs to say that the Bank's decision to apply for nor the actual application for the grant were breaches of the contract, but the plaintiffs do challenge the arrangements that were made, specifically, the arrangement that Stroppa would be released from his obligations under the Guarantee.
- [8] The Bank says that there has been no breach of the contract for three reasons. The Bank says Skagen should be taken to have known of the terms of the agreement that were made respecting the grant, that its actions to pursue the grant claim were necessary and reasonable in the circumstances, and that Skagen's complaint that he has been deprived of the benefit of the Agreement is simply wrong because Stroppa was without any means whatsoever when the Bank agreed to release him.
- [9] In all the circumstances, the Bank says that the agreement should be enforced: the Consent Judgment should be affirmed and execution should be permitted to proceed against all seven accounts.

Discussion:

- [10] In order to adjudicate the issue thrown up by these facts, it is first necessary to properly understand and determine what is the true nature of the plaintiffs' obligation to pay and the precise terms of the agreement.
- [11] There is considerable confusion in the evidence and submissions, particularly with respect to Skagen's role as a guarantor. In fact, I find that there were two separate and distinct credit agreements between CIBC and Moderngroove. First was the agreement dated January 17, 2001, providing for an operating line of credit, not to exceed \$300,000. The security required

was a GSA of Moderngroove, the unlimited personal guarantee of Stroppa and a guarantee from 522152 B.C. Ltd. in an unlimited amount, supported by hypothecated stocks/bonds having a minimum market value at all times of not less than \$600,000.

- [12] Skagen appears to have believed that he was required to provide a personal guarantee, limited to \$300,000 plus interest, in respect of this credit agreement. In his submissions, he states that to be the case; as well, in discussions with a Bank representative and the Bank's solicitor on November 22, 2001, he evidently told them that he believed that to be the case. The Bank's solicitor followed up with a letter to Skagen, dated November 23, 2001, wherein he adverts to the discussion concerning the guarantee but I do not find that to be particularly determinative in terms of establishing an enforceable obligation.
- [13] As well, there is in evidence a guarantee, bearing the date "January /01", that is, without a precise date of execution, on the Bank's standard guarantee form, whereby Skagen has ostensibly provided his guarantee for the Moderngroove debt. This guarantee indicates that it is limited to \$300,000. I note that all other personal (that is, non-corporate) guarantees in evidence are witnessed by an officer of the Bank. The Skagen guarantee with the January date which I have just discussed does not have any such witness execution.
- [14] When the Bank commenced Action No. SO20892, Skagen was named as a defendant; in the pleadings, the Bank alleges that Skagen was a guarantor by virtue of having provided a guarantee, limited to a principal amount of \$300,000, on some unspecified date in January, 2001. On April 19, 2001, Skagen swore an affidavit in that action, wherein he deposed that it was not a condition of the credit extended by the Bank to Moderngroove on January 17, 2001 that he (Skagen) provide a personal guarantee.
- [15] In spite of all the confusion, on a careful examination of the material, I am satisfied that the Bank did not hold an enforceable guarantee against Skagen with respect to the January loan and guarantee documents.
- [16] On March 6, 2001, new arrangements were made and documented. There is in evidence a new credit agreement, bearing that date and executed by Stroppa as an officer of the company, namely "CEO/President". That agreement provides for a revolving demand credit with a limit of \$490,000 and a condition that it will be reduced to \$300,000 on April 5, 2001, and operate within that limit thereafter.
- [17] The March 6, 2001 agreement stipulates the following security requirements:
- (a) a general security agreement over all personal property of the business and all personal property to be acquired in the future;
 - (b) an unlimited personal guarantee of John Stroppa;
 - (c) a guarantee from 522152 B.C. Ltd. in an amount that is unlimited, secured by hypothecated stocks/bonds having a minimum market value at all times of not less than \$600,000; and

- (d) a personal guarantee from Arthur W. Skagen in an amount that is unlimited, secured by hypothecated CIBC deposit balances in the amount of \$190,000.

The agreement goes on to provide a specific condition relating to Skagen's guarantee:

Upon reduction of loans to within the \$300,000 limit on April 5, 2001, the guarantee of Arthur W. Skagen and the supporting security will be released.

- [18] The guarantee document executed by Skagen is in evidence; his execution of it is witnessed by Mr. Marbach, an officer of the Bank.
- [19] I conclude that there were two separate and distinct credit agreements. The first of these was the agreement of January 6, 2001 in the amount of \$300,000. Skagen was not, in his personal capacity, a guarantor of that agreement.
- [20] Although it has been referred to in the submissions of the plaintiffs as a supplemental agreement, I find that the credit agreement of March 6, 2001 was a new agreement, replacing the January agreement. By that agreement, Skagen was, in a personal capacity, for the first time a guarantor of the debts of Moderngroove, but his obligation as a guarantor was limited. That is, he was entitled to release at the point in time the debt had been paid down to \$300,000.
- [21] As indicated in the summary of events set out earlier, Skagen, in fact, made payments and brought the obligation of Moderngroove within the \$300,000 limit. Accordingly, I find that at that point, his obligation as a guarantor was satisfied and came to an end. The guarantees of Stroppa and 522152 continued. Skagen would have had a continuing interest in the situation being resolved, if for no other reason than that his corporation, 522152, was liable under its continuing guarantee.
- [22] In early November, 2001, the Bank demanded payment of the loan. Skagen directed a letter to the Bank on November 14 and there followed an exchange of correspondence. I find that Skagen entered into an agreement with the Bank in November, 2001. The terms of that agreement are to be found in his letter of November 14 (his offer) and the acceptance letter of the Bank's solicitor, dated November 23, 2001. In his letter of November 14, Skagen offered to pay the loan, then approximately \$298,000; in consideration, he required the Bank to give him a reasonable period of time to do so, a 60-day extension, and required that the Bank provide him with the security it held, unimpaired.
- [23] The Bank accepted his offer and agreed with its terms, that is, the requested forbearance and the provision of the security.

[24] Skagen did not satisfy his obligation under that agreement, and so the Bank commenced its proceeding, Action No. S020892. It was in the face of that action and at a point that the Bank had set the matter down for summary judgment application that Skagen made an offer to settle. This initial offer was not accepted; a subsequent discussion between Skagen's counsel and the Bank's lawyer on May 16, 2001 resulted in an agreement. It is that agreement that is before this Court for adjudication. The terms are set out above.

[25] In summary, Skagen agreed to pay the debt, paying \$50,000 by May 30, 2002, \$50,000 by July 31, 2002, and the balance on or before October 31, 2002. The agreement also required him to provide security (hypothecated securities) and to provide a consent judgment, for both himself and his numbered company, to be entered by the Bank in the event of default. In exchange, upon payment of the loan as scheduled, the Bank agreed

[T]o assign, as may be directed by Mr. Skagen, the security held by the Bank and given it to by Moderngroove and by its guarantors, as well as the benefit of Vancouver Registry Action No. SO20892, so that Mr. Skagen or his nominee can therefore pursue them in his name or his nominee's name.

This is taken from the email of the Bank's solicitor, sent May 16, 2002, to Skagen's counsel.

[26] There were problems with the arrangement whereby Skagen was to post security. The Bank proceeded on the basis that Skagen would execute a standard form securities pledge document, creating a first security interest covering securities in a Nesbitt Burns account of Mr. Skagen, having a liquidation value of at least \$300,000, as security for Skagen's performance of the agreement. The agreement required Skagen to provide the Bank with a recent Nesbitt Burns account statement for the account which would constitute the security. In fact, Skagen delivered to the Bank account statements for a total of seven accounts; he also provided the Bank with the requested "Securities Pledge Agreement" and specified three account numbers as being secured.

[27] It is difficult to fully understand what occurred with respect to the security component of the agreement. Skagen says that he only intended the agreement to extend to three accounts which were described on the pledge document; the Bank says Skagen delivered up and represented that there were seven accounts. The discrepancy became apparent quite readily and the respective positions of the parties were documented by counsel in correspondence, although the dispute was never resolved.

[28] As it turns out, the problems with respect to the security were even more serious in that certain of the accounts were trust accounts (that is, R.R.S.P. accounts, and thus trustee) and some may not have been in Skagen's name. The trustee of the accounts indicated to the Bank that the pledge was disputed. In the final analysis, Skagen did not provide security in a form that satisfied the requirements of the agreement.

- [29] I find that the Bank became aware of the problem with respect to the security within a fairly short time of the making of the agreement, probably by early June. The matter remained under discussion between the parties.
- [30] Significantly, the Bank did not contend nor communicate to the plaintiffs that the failure to perfect the security requirement constituted a breach. To the contrary, the Bank accepted the \$50,000 payment that was tendered on May 31, 2002 and also accepted the \$50,000 payment which was tendered on July 31, 2002. I find that the Bank elected not to treat the deficiency of the security arrangement as a breach such as to terminate the agreement.
- [31] At some point, it was recognized by the trustee in bankruptcy and CIBC that Moderngroove had an asset of value, the right to make application for the SR&ED Grant. By reason of holding the GSA over the assets of Moderngroove, the Bank was entitled to the benefit of that asset. However, actually realizing its value was not straightforward because the application was complicated, technical and required certain expertise and the co-operation of persons with a knowledge of Moderngroove's business dealings. As well, there was a deadline fast approaching (July 2, 2002), after which the claim would be of no value. Finally, certain other parties were interested in the grant and the proceeds, including the trustee in bankruptcy and the Director of Employment Standards, who had a large claim for unpaid wages. In the result, a complicated agreement was reached and finalized, whereby the trustee in bankruptcy and the Director of Employment Standards agreed to support the efforts necessary to prepare and submit the application prior to the deadline. The actual preparation required the assistance of a number of parties, including a technological consultant whose expertise was necessary, as well as certain former employees of Moderngroove, including Stroppa. The agreement that was reached provided for the proceeds of the grant to be shared by a number of parties, including the consultant, the unsecured creditors, the essential former employees and the Director of Employment Standards who sought to obtain some payment for the benefit of former employees of the company.
- [32] Stroppa agreed to assist in making the application, but he apparently negotiated an agreement which, in exchange for his assistance, released him, after a certain passage of time, from his guarantee or any other responsibility for the debts of Moderngroove. This condition was agreed to by CIBC, and as a result, he has now been released from any claim arising from the Moderngroove financing, including his personal guarantee. I understand that a consent dismissal order has been entered.
- [33] Accordingly, there can be no proceeding taken against him in the matter and the default judgment which had been earlier obtained by CIBC is of no value.
- [34] This development is central to the plaintiff's claim in the present application. It is the plaintiffs' contention that a significant component of the consideration to which the agreement entitled them (and for which they bargained) was the right to pursue the creditors' security, which included Stroppa's personal guarantee and the default judgment

against him. The plaintiffs say that CIBC, by releasing the security, breached its agreement with the plaintiffs and the plaintiffs are therefore absolved of any obligation to perform their contractual commitment, and as well, are entitled to have refunded the money that was paid pursuant to the agreement.

[35] The Bank disputes the plaintiff's claim on two bases:

- (a) the Bank says that Skagen was in frequent contact with the trustee in bankruptcy and was quite aware of the situation concerning the grant application. Accordingly, the Bank contends that he cannot now credibly claim that he did not know of and concur in the application. Reference is made to the affidavit of Mr. Murphy, the trustee in bankruptcy, who says:
 - 4. I thereafter had discussion, exchanges and meetings with Arthur Wayne Skagen during which we discussed the eneral form of the arrangement which the Trustee would have to make in order to obtain the cooperation of necessary third parties, the selection of the consultant to be used to prepare and submit the actual grant application and related matters. Those discussions, exchanges and meetings took place on June 11, 13, 14, 18, 20 and 21, 2002.
 - 5. By June 25, 2002, the agreement amongst the interested parties had been finalized, in the form annexed hereto as Exhibit "A", and was executed for the Trustee and CIBC on June 28, 2002, after another discussion between myself and Mr. Skagen on June 27, 2002.
 - ...
 - 7. Following the making of the agreement I had further discussions with Mr. Skagen concerning the grant application on July 31 and October 21, 2002, as well as discussions with him on other subjects on August 15 and 16, 2002.
 - 8. Throughout the entire period from June 11, 2002 to July 2, 2002, it was clear that Mr. Skagen keenly wished the Trustee to make whatever practical arrangements had to be made to ensure that a grant application was filed timeously.
 - ...
 - 10. At no time did I withhold from Mr. Skagen any information concerning the terms of the arrangements (as they were developing) which I knew or which I detected from my discussion with him might be controversial from his perspective.
 - 11. At no time did he ask to receive a copy of any draft of the agreement in its final form or in a preliminary form.

It is the position of the Bank that, in light of this evidence, there is a positive onus on Skagen to establish that he did not concur in the making of the grant application.

In respect of this issue, there is before the Court the affidavit of Skagen, wherein he deposes:

2. In answer to paragraphs 4 and 5 of the Affidavit of Lloyd Murphy sworn January 7, 2003 in the herein action, and to clarify paragraph 11 of my Affidavit sworn herein on December 24, 2002, I did not know until about late October, 2002, that under the Agreement dated June 25, 2002, Mr. John Stroppa obtained a release and discharge from the Default Judgment and from his guarantee obligations in connection with Moderngroove in the Guarantee Action. I did not know that Mr. Stroppa was negotiating for such a release and I never consented to such a release. I did not know the details of the June 25, 2002, Agreement for payment or disbursement of the SR&ED grant proceeds.
3. I did not realize from reading Mr. Murphy's Affidavit when I first received it some months ago, that it might later possibly be suggested or inferred that I knew before October, 2002, that Mr. John Stroppa would be released or was released and discharged under the June 25, 2002, Agreement, from the Default Judgment and from his guarantee obligations in connection with Moderngroove in the Guarantee Action.
- (b) The Bank says the fact that the plaintiffs no longer have the right to pursue Stroppa is of no significance because Stroppa was without means and therefore there is no prospect of any recovery. For that reason, it is the position of the CIBC that the release of Stroppa does not constitute a breach of its contractual obligation to the plaintiffs. As noted above, there is a statutory declaration of Stroppa in evidence, wherein he deposes:
 1. My current assets, liabilities, income and expenses are as follows
 - a. Assets:
 - i. Cash: \$750,000;
 - ii Equities: approximately 26,000,000 shares of Moderngroove Entertainment International Inc. (the US parent company); made up of approximately 25,000,000 restricted shares and 1,000,000 free trading shares; the free trading shares are currently quoted on the NASDOTCBB at \$0.016 US each; however, there is no daily trading in these shares and with no market for these shares their value, if any, is unknown;
 - iii Receivables: \$277,500.00 unpaid wages owing by Moderngroove Entertainment, Inc. (the Canadian subsidiary company) which is currently in bankruptcy;
 - iv. Personal effects including: bed, old skiis [sic], boots poles, television, laptop computer, portable stereo, minidisk player, camping gear, mobile phone, stereo, record players, mixer, mobile phone, clothing, cds, records and miscellaneous personal items: total estimated value \$2,500.00;
 - b. Liabilities:
 - i approximately \$20,000.00 in credit card debts;
 - ii \$374,683.91 owing pursuant to October 1, 2001 Determination by the Director of Employment Standards;

iii \$304,482.40 owing to CIBC pursuant to May 30, 2002 Default Judgment in SCBC Action #SO20892, Vancouver Registry;

iv approximately \$15,000.00 loans from parents and friends;

c. Income:

i \$0.00 per month - unemployed;

d. Expenses:

i \$80.00/month mobile phone

ii no other monthly expenses at this time because currently living with and being supported by parents while I try to get back on my feet and recover from the Moderngroove Entertainment, Inc. experience

[36] In my view, on the evidence before the Court, it is reasonable to find that Skagen was generally aware that the grant application was being prepared for submission and there is no reason to find that he objected to that being done. Indeed, it was in the plaintiffs' interest, because any recovery would go to the reduction of the Moderngroove indebtedness to the Bank, and would reduce the amount of repayment that would have to be made by the plaintiffs. I observe as well that the asset was a very perishable commodity; it had to be claimed prior to July 2, 2002, long before the plaintiff's right to the assets of Moderngroove would crystallize, namely on the date of the last payment, scheduled for October 31, 2002. The plaintiffs had no right to the grant proceeds when the application was made, and I do not understand the plaintiffs to argue that the application and realization of the grant was a breach. What the plaintiffs do say is that the release of security was a breach. Furthermore, the plaintiffs do not deny that Skagen was generally aware of the grant application being made. However, Skagen states specifically that he did not know until sometime later, that is, in October, 2002, that the Bank had made its arrangement to release Stroppa. Skagen says that specific information was never provided to him in the course of any dealings he had with the trustee in bankruptcy. As noted, that is evidence that is before this Court in Skagen's affidavit.

[37] Upon consideration of the matter, I have concluded that the evidence establishes that Skagen did not know until well after the fact, most likely in October, 2002, of the feature of the agreement that released Stroppa. This conclusion is based upon the following factors:

1. The affidavit evidence of the trustee, wherein it is stated that there was discussion with Skagen with respect to "the general form of the arrangement". He does not specifically say that Skagen was advised that Stroppa had been released.
2. Skagen's affidavit specifically addresses the point and states that he was not told and did not know. That affidavit is not contradicted.

3. While the arrangements to release Stroppa are set out in detail in the agreement among the parties to the grant completion, neither Skagen nor his numbered company are parties to that agreement. There is no basis whatsoever to find that Skagen was apprised of the details as they are set out in the agreement.
 4. There is no logical reason that Skagen would expect that a release of Stroppa would be a part of the grant application agreement; there is no basis to say that he ought to have known or that he was put on notice and ought to have made enquiries.
 5. The fact that the plaintiffs made the second payment on July 31 is quite telling. If Skagen had known that a main component of the consideration for which he had bargained was no longer available, it is not logical that he would have made that payment.
- [38] An argument was made on behalf of the defendant Bank which found itself, in the latter part of May, 2002, in a position by which it would be criticized no matter what course of action it took. On one hand, the Bank says that it would have been unreasonable and commercially irresponsible to elect not to pursue the grant application, the proceeds of which might well repay the entire debt. That makes good sense. To have refused to accede to the proposal to pursue the grant would have been unreasonable, and I doubt anyone would argue with that proposition.
- [39] In order to prepare the application, fairly significant accommodations had to be made with a number of parties. Evidence adduced on behalf of the defendant Bank indicates that it was necessary to make the rather drastic arrangement with Stroppa, and there is no basis in the evidence to reject that. As well, it is recognized that the time pressure was very much a factor in the making of the application; the necessary steps had to be taken quickly.
- [40] Nevertheless, the fact remains that there was a positive obligation on the Bank to preserve the security which it had bargained to deliver to Skagen upon his satisfaction of his obligations. On the evidence, it is apparent that the Bank did not apprise Skagen of the steps that were being taken that would materially impact upon the status and value of the security and instead took measures that effectively rendered that security worthless.

Analysis:

- [41] The dispute at bar is properly analyzed by application of the principles of contract law. The contract in question is the Settlement Agreement of May, 2002.
- [42] When the Bank released Stroppa, it rendered itself unable to perform an important obligation of the contract, that is, upon payment in full by Skagen of the Moderngroove debt, to assign and transfer to Skagen all security it held from Moderngroove, and all of its rights under the Stroppa Guarantee and in the Guarantee Action. It is necessary to consider whether that particular obligation is such that it can be properly characterized as a term of fundamental importance. Counsel for CIBC suggests that the answer is no, because on the strength of the Stroppa statutory declaration, the prospects of any meaningful recovery by

the plaintiffs from him were unlikely. In my view, that position is not persuasive for the following reasons:

- (a) while his financial circumstances at the time of the preparation of the statutory declaration are poor, the greatest part of his debt relates to the Moderngroove business. Without these financial obligations, it cannot be said that his situation is hopeless.
 - (b) The right to pursue Stroppa was a significant part of the benefit which the plaintiffs bargained to gain. On the face of the evidence, it was not a minor or insignificant consideration. Accordingly, the Court should be loathe to arbitrarily attribute a minimal or meaningless value to it.
- [43] The Bank, by its actions, dealt with the security that it held in such a way that it would be unable to honour its obligation, which would arise upon payment in full by Skagen. When that became known to the plaintiffs, they were entitled to treat that as a repudiation of the contract and to accept that repudiation. Accordingly, the plaintiffs were relieved of their obligation to perform any further duties under the contract; that is in fact what occurred. On this analysis, the plaintiffs had no obligation to make the final payment.
- [44] In the circumstances of this contract, the plaintiffs had agreed to make two "advance payments", that is, they had agreed to pay \$50,000 at the time the agreement was originally made and to pay a further \$50,000 in July. I characterize these as advance payments because they were to be made in advance of receiving the intended principal benefit of the contract, that is, the right to the Bank's security.
- [45] Where there has been a repudiation, and where an innocent party has made such "advance payments", and has not received the benefit of the contract, that party has the right to recover those payments.
- [46] In the present case, apart from the benefit to be realized by the plaintiffs upon final payment being made, there was arguably a benefit that was received at the outset and continued through the term of the Agreement, that is, the Bank's agreement to forbear from making its application for summary judgment. That was in addition to the substantial benefit to be realized at the conclusion of the contract, the right to pursue and realize upon the security held by the Bank, and which turned out not to be available to the plaintiffs.
- [47] Accordingly, I find it cannot be said that the plaintiffs received no benefit for these two \$50,000 payments, and thus there cannot be found here a "total failure of consideration" in respect of these two payments, such that the plaintiffs are entitled to recover those two instalments.
- [48] With respect to the consent judgment that was provided to the Bank, it constitutes valuable consideration provided by the plaintiffs on the understanding that it would be entered in the event that the plaintiffs defaulted on their contractual obligations. When the October payment was not received, the Bank entered the judgment. In my view, that must be set aside, as the pre-condition for its entry, default by the plaintiffs of their obligations under

the Agreement, did not occur. When the consent judgment was entered, the repudiation had been accepted and there was no further obligation owing by the plaintiffs, hence there could be no default. The decision of Koenigsberg J. in *Harbelah Enterprises Ltd. v. O'Neil* (1994), 94 B.C.L.R. (2d), 26 C.P.C. (3d) 315, [1994] 9 W.W.R. 162 (paras. 22-25) establishes that a consent order can be set aside in circumstances such as these.

- [49] There is the further matter of the security accounts against which the Bank seeks to execute. These were required as a condition of the Agreement but then confusion and complications arose with respect to whether they actually satisfied the requirement of the Agreement. It is my determination that the accounts must be released by the Bank; it has no right of enforcement because, upon repudiation, there was no continuing right to enforce the contract.
- [50] The obligation of the numbered company as a guarantor is not extinguished by the events described above. I am not aware of any explicit term of the Settlement Agreement that would have the effect of terminating the guarantee, although there may well be defences to that liability arising independently from the release of Stroppa. That issue was not argued in this Court.
- [51] Finally, there is the matter of the plaintiffs' liability to the defendant as it arises from the Agreement struck between Skagen and the Bank in November, 2001. On the face of the matter, that liability (whatever it may be) remains extant, in that the agreement which purported to resolve the issue has now been held to be unenforceable.

Summary:

[52] The plaintiff is entitled to the following:

1. an order setting aside the judgment against the plaintiffs in Action No. S020892, the Guarantee Action;
2. an order that the securities or brokerage accounts which are charged, pledged or otherwise secured in favour of the defendant in connection with the debts of Moderngroove be released and discharged from any such charge, security or pledge and for cancellation of any such security, charge or pledge.

[53] The following relief sought by the plaintiffs is denied:

1. a declaration that the plaintiffs are released from any obligation as guarantors under any guarantee granted in connection with Moderngroove;
2. an order dismissing the Guarantee Action as against the plaintiffs; and
3. the application to return \$100,000 paid by the plaintiff Skagen to the defendant in May and July, 2002.

[54] Given the mixed success of the parties in this trial, there will be an order that each shall bear its own costs.

"J.W. Williams, J."

The Honourable Mr. Justice J.W. Williams

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