CITATION: Re: LWP Capital Inc., 2016 ONSC 3091
COURT FILE NO.: CV-16-11242-00CL
DATE: 20160511

SUPERIOR COURT OF JUSTICE – ONTARIO
COMMERCIAL LIST

IN THE MATTER OF THE LIQUIDATION OF LWP CAPITAL INC. PURSANT TO SECTION 211 OF THE *CANADA BUSINESS CORPORATIONS ACT*, R.S.C. 1985, c. C-44, AS AMENDED

And

KSV ADVISORY INC. IN ITS CAPACITY AS LIQUIDATOR OF LWP CAPITAL INC.

BEFORE: Newbould J.

COUNSEL: *James D.G. Douglas and Caitlin R. Sainsbury*, for the applicant KSV Advisory Inc. in its capacity of liquidator of LWP Capital Inc.

Peter F.C. Howard and David Spence, for The Scoular Company

HEARD: April 29, 2016

ENDORSEMENT

[1] The Liquidator of LWP Capital Inc. moves for declaratory relief in connection with a dispute over a working capital adjustment to be made following a sale of the special crops division of Legumex Walker Inc. ("LWP") to The Scoular Company ("Scoular"). There is a provision in the Asset Purchase Agreement that requires disputes for the matters in issue to be decided by a Mr. Brian Clancey, agreed to be an expert in his field. Scoular says that the matter in dispute should be dealt with by Mr. Clancey. The Liquidator says that the objection of Scoular under the APA was invalid and asks for a declaration of rights regarding the dispute.

[2] For the reasons that follow, the motion of the Liquidator is dismissed.

Relevant factual background

[3] LWP was a public company that entered into voluntary liquidation proceedings by order of this Court dated January 11, 2016. LWP had two primary business operations. The business operation material to this motion was the special crops division. The other division was an indirect 84% share in a canola and oilseed processing plant in Washington State.

[4] The special crops division processed and sold crops known in the agribusiness as "special crops", which include pulses (lentils, peas, beans and chickpeas), sunflower seeds, and flaxseed. LWP did not grow any of the crops it processed and merchandised. It was a dealer that purchased commodities from growers in the Canadian Prairies, American Midwest and China. After processing the commodities, LWP marketed them around the world.

[5] Scoular is, except for the assets it acquired from LWP, primarily an American merchandiser of bulk grain. It also has a small corn processing facility and, prior to its acquisition of LWP's assets, it traded special crops. However, except for the assets acquired from LWP, Scoular did not, and does not, process or market any special crops.

[6] On September 14, 2015, Scoular entered into an asset purchase agreement (APA) with LWP pursuant to which Scoular agreed to acquire substantially all of the assets of LWP's special crops division for CAD $94 million, plus an amount to be paid for Working Capital as defined in the APA.

[7] The APA has its complexities. However, in simple terms, it provided for a purchase price of $94 million plus the amount of the Closing Working Capital less other amounts not relevant to this motion. There was to be a good faith best estimate of a Preliminary Closing Working Capital to be paid on the closing. Within 45 days after the closing the vendor was to deliver a Closing Statement that included a Closing Working Capital calculation and the purchaser could deliver an Objection Notice within the same time. The parties were then obliged to negotiate in good faith and if any dispute was not settled within 15 days the purchaser was to appoint Mr. Clancey

to resolve the dispute. The parties agree that Mr. Clancey is to act as an expert and is not an arbitrator.

[8] Scoular agreed to a figure for the Preliminary Closing Working Capital. It did not agree to the Closing Working Capital figure in the Closing Statement. The Liquidator says that Scoular is now impermissibly going back on the agreed Preliminary Closing Working Capital calculation and claiming that it was too high and that any objection Scoular has to the Closing Working Capital is limited to the discrepancies in inventory quantity and/or quality as between the Preliminary Closing Working Capital agreed to by Scoular and the Closing Working Capital.

[9] Relevant parts of the APA are as follows:

> **2.5. Purchase Price and Purchase Price Allocation.**
>
> (1) Subject to the terms and conditions of this Agreement, the aggregate purchase price (the "Purchase Price") to be paid by the Purchaser to the Vendors, or as the Vendors may direct, for the Purchased Assets is:
>
> (a) $94,000,000; plus the amount of the Closing Working Capital (which shall be determined in accordance with Sections 2.7 and 2.8);…
>
> **2.6 Payment of Purchase Price.**
>
> (1) Subject to Sections 2.7, 2.8, 2.9 and 2.10 and Section 6.8, the Purchaser shall pay and satisfy the Purchase Price at Closing:
>
> …
>
> (c) by payment to or to the order of the Vendors of $94,000,000 …*plus* the amount of the Preliminary Closing Working Capital, determined immediately prior to Closing pursuant to Section 2.7(1); and
>
> **2.7 Closing Date Adjustments.**
>
> (1) For purposes of determining a good faith best estimate of a detailed calculation of the Working Capital as of the Effective Time [the closing date], not less than five (5) Business Days prior to the Closing Date, the Parent [Vendor or LWP] shall, in consultation with the Purchaser, prepare and deliver to the Purchaser the Parent's reasonable estimate of the

Closing Working Capital (the "Preliminary Closing Working Capital"), which shall be prepared in the same manner as the Closing Statement under Section 2.7(2) below; ... In the event the Purchaser shall object to any of the information set forth in the calculation of the Preliminary Closing Working Capital or the accompanying schedules as presented by the Parent, the Parties shall negotiate in good faith and agree on appropriate adjustments to the end that such Preliminary Closing Working Capital and the accompanying schedules reflect a good faith best estimate of the Closing Working Capital....

(2) As soon as possible, but not later than 45 days, following the Closing Date, the Parent shall prepare and deliver to the Purchaser the following (collectively, the "Closing Statement"):

(a) a detailed calculation of the Working Capital as of the Effective Time (the "Closing Working Capital"); and

(b) a calculation of:

(i) the amount by which the Closing Working Capital exceeds or is less than, as the case may be, the Preliminary Closing Working Capital; and

(ii) the Purchase Price, as adjusted in accordance with Section 2.8.

(3) The Purchaser shall have 45 days from receipt of the Closing Statement within which to review the Closing Statement. For the purposes of this review, the Parent shall permit and shall cause the Vendors and the Acquired Subsidiaries to permit the Purchaser and the Purchaser's authorized Representatives to examine all working papers, schedules, accounting, Books and Records and other documents and information used or prepared by the Parent in connection with the preparation of the Closing Statement and to have reasonable access to appropriate personnel of the Parent for the Purchaser to verify the accuracy and presentation and other matters relating to the preparation of the Closing Statement. The Purchaser may dispute any of the items in the Closing Statement by written notice (an "Objection Notice") to the Parent within the same 45 days. If the Purchaser has not delivered an Objection Notice to the Parent within this 45-day period, the Purchaser shall be deemed to have accepted the Closing Statement. If the Purchaser delivers an Objection Notice, the Parent and the Purchaser shall work expeditiously and in good faith in an attempt to resolve all of the items in dispute within 15 days of receipt of the Objection Notice. ...

> **2.8. Purchase Price Adjustment.** The Purchase Price is to be adjusted by the amount by which the Closing Working Capital is greater than, or is less than, as the case may be, the Preliminary Closing Working Capital. …

[10] Working Capital was defined in the APA in part as follows:

> (186) "**Working Capital**" means, as of the Closing Date… Closing Inventories … which will be calculated in accordance with the calculation guidelines set forth on Schedule G and, except as otherwise expressly contemplated by Schedule G, in accordance with IFRS [International Financial Reporting Standards] applied on a basis consistent with the preparation of the Financial Statements.

[11] Schedule G provided for the Closing Inventory to be divided into Lots differentiated on the basis of commodity, type and class. Inventory that was subject to a sale to close within 30 days was to be valued at cost. The remaining inventory, which is the inventory in dispute, was to be valued at the lower of cost or net realizable value. Schedule G provided, in part:

> The remaining Closing Inventory ("**Open Closing Inventory**") will be valued at the lower of (i) Cost and (ii) net realizable value.
>
>> *Net Realizable Value*: If the Parent and the Purchaser are unable to agree on the net realizable value for any Lot of Closing Open Inventory, then the Parties shall jointly engage Brian Clancey, Senior Market Analyst at STAT Communications Ltd. to determine the net realizable value (as the mid-point between bids and offers for similar product for a similar shipment period) for such Lot, and such determination shall be final and binding on the parties. … The parties acknowledge that they are retaining Brian Clancey as an individual and not the firm STAT Communications Ltd. Should Brian Clancey be unavailable or otherwise unable to provide the requested services, the parties will agree on a mutually acceptable substitute broker.

[12] Representatives from Scoular and AltaCorp, a consultant to LWP, negotiated the Preliminary Closing Working Capital value from November 10 to 22, 2015. On November 22, 2015 Scoular sent an email confirming its agreement on the final calculations representing the Preliminary Closing Working Capital of $71,512,688. The transaction closed effective November 23, 2015, and Scoular fully funded the Purchase Price on closing, including the value ascribed to the Preliminary Closing Working Capital of $71,512,688.

[13] After closing, LWP submitted its Closing Working Capital calculation to Scoular on January 7, 2016, which contained a write-down of $110,404 from the Preliminary Closing Working Capital. LWP acknowledges that due to time constraints, an error was made in that calculation and that the total write-down from Preliminary Closing Working Capital should have been $534,091.33.

[14] On December 10, 2015, Scoular provided LWP with a proposed set of NRVs for the crops listed in the Closing Working Capital. Scoular incorporated these values into the calculation that resulted in its Notice of Objection, delivered on February 19, 2016, which claimed the Preliminary Closing Working Capital should be written-down by approximately $20 million for the purposes of the Closing Working Capital.

[15] Under section 2(7) of the APA, the parties were to try to work out any dispute. Apparently Scoular asked to do this but LWP did not respond other than to bring this motion.

Analysis

[16] What is at issue are the rights of the parties under the APA. Winkler C.J.O. articulated the test for construing a commercial contract in *Salah v. Timothy's Coffees of the World Inc.* (2010), 74 B.L.R. (4th) 161 as follows:

> **16** The basic principles of commercial contractual interpretation may be summarized as follows. When interpreting a contract, the court aims to determine the intentions of the parties in accordance with the language used in the written document and presumes that the parties have intended what they have said. The court construes the contract as a whole, in a manner that gives meaning to all of its terms, and avoids an interpretation that would render one or more of its terms ineffective. In interpreting the contract, the court must have regard to the objective evidence of the "factual matrix" or context underlying the negotiation of the contract, but not the subjective evidence of the intention of the parties. The court should interpret the contract so as to accord with sound commercial principles and good business sense, and avoid commercial absurdity. If the court finds that the contract is ambiguous, it may then resort to extrinsic evidence to clear up the ambiguity.

[17] In *Kentucky Fried Chicken v. Scott's Food Services Inc.* (1998), 41 B.L.R. (2d) 42 (Ont. C.A.) Goudge J.A. stated the following regarding the interpretation of a commercial agreement at para. 27

> Where, as here, the document to be construed is a negotiated commercial document, the court should avoid an interpretation that would result in a commercial absurdity. *City of Toronto v. W.H. Hotel Ltd.* (1966), 56 D.L.R. (2d) 539 at 548 (S.C.C.). Rather, the document should be construed in accordance with sound commercial principles and good business sense; *Scanlon v. Castlepoint Development Corporation et al.* (1992), 11 O.R. (3d) 744 at 770 (Ont.C.A.). Care must be taken, however, to do this objectively rather than from the perspective of one contracting party or the other, since what might make good business sense to one party would not necessarily do so for the other.

[18] I take the principles in *Kentucky Fried Chicken* and in *Salah,* the latter adopted by Cronk J.A. in *Downey v. Ecore International Inc.* 2012 ONCA 480 and by Juriansz J.A. in *Ariston Realty Corp. v. Elcarim Inc.* 2014 ONCA 737, as the applicable principles governing this case. See also *Unique Broadband Systems Inc. (Re)* 2014 ONCA 538 at para. 88.[1] They are consistent with the principles enunciated by Rothstein J. in *Sattva Capital Corp. v. Creston Moly Corp.,* 2014 SCC 53.

[19] The Liquidator makes the following arguments as to why the dispute should not be dealt with by Mr. Clancey as provided for in schedule G to the APA:

(a) LWP closed the transaction on November 23, 2015 based on Scoular's agreement to the Preliminary Closing Working Capital, including the NRVs on which it was based, and

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[1] I prefer this test to that articulated in *Ventas, Inc. v. Sunrise Senior Living Real Estate Investment Trust* (2007), 85 O.R. (3d) 254 (C.A.), in which it was said that interpreting a contract that accords with sound commercial principles is limited to situations in which there is some ambiguity. I do not think that is correct and it is not what other cases of appellate authority have stated. See my comments in *Thomas Cook Canada Inc. v. Skyservice Airlines Inc.* (2011), 83 C.B.R. (5th) 106 at para. 13 and *Oncap L.P. v. Computershare Trust Co. of Canada* (2011), 94 B.L.R. (4th) 314 at paras. 21 to 24. See also Geoff R. Hall, *Canadian Contractual Interpretation Law*, 2nd ed. (Markham Ont.:LexisNexis 2012 at p. 46 fn. 191. See also *Nortel Networks Corporation (Re)*, (2015), 27 C.B.R. (6th) 175 at paras. 52-54, leave to appeal refused 2016 ONCA 332.

Scoular is estopped from claiming the NRVs are significantly different for the purposes of calculating the Closing Working Capital;

(b) the proposed inventory values on which Scoular's Notice of Objection is based do not conform with IFRS, and so the Notice of Objection does not raise a valid dispute that engages the dispute resolution mechanism in Schedules G to the APA; and

(c) the parties must agree on NRV for the purpose of Preliminary Closing Working Capital in order for that to be a best estimate of Closing Working Capital, so the dispute resolution mechanism in Schedule G with relation to NRV only applies to disputes in post-closing fluctuations in NRV.

[20] I will first deal with the estoppel argument.

[21] The Liquidator relies on a statement by Bastarache J. in *Ryan v. Moore*, [2005] 2 S.C.R. 53 describing estoppel by convention:

> **59** This Court is not bound by any of the above analytical frameworks. After having reviewed the jurisprudence in the United Kingdom and Canada as well as academic comments on the subject, I am of the view that the following criteria form the basis of the doctrine of estoppel by convention:
>
> 1) The parties' dealings must have been based on a shared assumption of fact or law: estoppel requires manifest representation by statement or conduct creating a mutual assumption. Nevertheless, estoppel can arise out of silence (impliedly).
>
> 2) A party must have conducted itself, i.e. acted, in reliance on such shared assumption, its actions resulting in a change of its legal position.
>
> 3) It must also be unjust or unfair to allow one of the parties to resile or depart from the common assumption. The party seeking to establish estoppel therefore has to prove that detriment will be suffered if the other party is allowed to resile from the assumption since there has been a change from the presumed position.

[22] I was referred to evidence by counsel for the Liquidator to the effect that Scoular was aware of things that it did not raise during the negotiations leading to the agreed amount for the Preliminary Closing Working Capital that Scoular later raised in its Notice of Objection to the Closing Working Capital amount proposed by LWP. It was argued that this was a breach by

Scoular of its obligation under the APA to negotiate the estimated Preliminary Closing Working Capital in good faith. I was referred to evidence by counsel for Scoular which indicated that there was some discussion during the negotiations leading to the Preliminary Closing Working Capital that indicated the parties agreed there could be adjustments later in accordance with the APA. In rebuttal, counsel for the Liquidator says what was discussed was not the major issue that has now arisen.

[23] On the state of the record, I would not be in a position to decide exactly what was said during the negotiations leading to the Preliminary Closing Working Capital without a trial of the issue. However, I do not think that necessary.

[24] Assuming without deciding that there was a shared assumption at the time of the closing as contended by the Liquidator, it would be necessary, to use the language of Bastarache J., for the Liquidator to establish that LWP acted in reliance on such shared assumption and that its actions resulting in a change of its legal position. I do not see what LWP did to change its legal position. It negotiated under the APA in accordance with the terms that called for the negotiation. I do not see any cogent evidence that LWP changed anything or that its position was irreversibly altered as of the closing.

[25] I also have difficulty with the notion that LWP suffered any detriment. The Liquidator says that it would have had an opportunity to continue negotiations until the parties agreed on some other basis. But there is no evidence that if the parties had continued negotiations the end result would have been what the Liquidator now contends should be the result. It is speculation. What LWP received was a payment based on the agreed Preliminary Closing Working Capital. The Closing Working Capital was subject to being increased or decreased after the closing. That LWP might have to pay back something received on the closing was specifically contemplated in the APA. LWP agrees that it was overpaid on the closing. The issue is how much overpayment it received.

[26] I cannot find that Scoular is estopped from taking the position that it has.

[27] I will deal with the last two arguments of the Liquidator together. Both have to do with the divergent interpretations of the APA asserted on this motion.

[28] The Liquidator says that because a precondition to resort to the dispute resolution provisions in Schedule G to the APA is that the parties have a disagreement over NRV, there must be a legitimate dispute over NRV. It says that the Preliminary Closing Working Capital and the Closing Working Capital had to be calculated in accordance with IFRS [International Financial Reporting Standards] and that while LWP did that, Scoular has provided no evidence that the values it proposed in its December 10, 2015 email, on which most of the values in its Notice of Objection are based, are in any way related to the values for each commodity that LWP could obtain in the ordinary course of business, and thus are not calculated in accordance with IFRS. It says that in order for the parties to trigger the dispute resolution provisions in Schedule G with respect to NRV, the parties must have presented differing NRVs, but both of which were based on IFRS. As Scoular's objections were not based on IFRS, it has no right to resort to the dispute resolution mechanism.

[29] The Liquidator also says that to the extent Scoular is able to engage the dispute resolution mechanism in Schedule G, it cannot adjust the NRV of all commodities in the Closing Inventory, but rather can only adjust for any fluctuations in NRV post-closing. It says this is the result of the method of calculating the Preliminary Closing Working Capital and the Closing Working Capital being different than the method to be used by Mr. Clancey in the dispute resolution process. More particularly, the Liquidator says that the Preliminary Closing Working Capital is to be prepared in the same manner as the Closing Working Capital and that both are required to be calculated on the basis of IFRS as Schedule G does not provide any other method of calculation prior to the parties having a disagreement over the NRVs. It says that Schedule G, when its dispute resolution process is engaged, contemplates a somewhat different method of determining price (which is one of a number of factors used to arrive at NRV) than that prescribed by IFRS, namely "the mid-point between bids and offers for similar product for a similar shipment period".

[30] I do not agree that the APA provides for a method of determining the NRV in the dispute resolution process that is any different from the method to be used to determine NRV in the

Preliminary Closing Working Capital or Closing Working Capital calculations. The APA does not state that IFRS principles different from what is contained in Schedule G are to be used. To the contrary, it states that Schedule G applies if it is different than IFRS:

> **"Closing Inventories"** means the value of all raw materials, works-in-progress and finished good commodities that are Inventories as of the Effective Time, **as calculated in accordance with the calculation guidelines set forth on Schedule G and, except as otherwise expressly contemplated by Schedule G, in accordance with IFRS applied on a basis consistent with the preparation of the Financial Statements**, but excluding any Excluded Assets. [Emphasis Added]

[31] Schedule G deals with a number of valuation issues involved in calculating the Closing Working Capital other than closing inventories, including accounts receivable and payable, accrued liabilities, prepaid expenses and currency adjustments. Schedule G states at the outset:

> Closing Working Capital means, as of the Effective Time, (1) the sum of (a) Closing Accounts Receivable, (b) Closing Inventories and (c) Closing Prepaid Expenses; minus (2) the sum of (x) Closing Accounts Payable and (y) Closing Accrued Liabilities; plus or minus (3) Closing Currency Adjustment. **Except as expressly set forth below in this Schedule G, the calculation of Closing Working Capital shall be prepared in accordance with IFRS applied on a basis consistent with the preparation of the Financial Statements.** [Emphasis added]

[32] Thus it is clear that Closing Inventories are to be prepared in accordance with IFRS except as expressly set forth in Schedule G. So far as the NRV of the inventory in dispute (Open Closing Inventory) is concerned, the method of calculating Closing Working Capital is expressly stated in Schedule G:

> Any Lot of Closing Inventory that is finished and conforms to the specifications of a Trade Sale with delivery to occur within thirty (30) days following the Closing Date (**"Sold Closing Inventory"**) will be valued at Cost for purposes of calculating Closing Working Capital. The remaining Closing Inventory (**"Open Closing Inventory"**) will be valued at the lower of (i) Cost and (ii) net realizable value.
>
> *Net Realizable Value*: If the Parent and the Purchaser are unable to agree on the net realizable value for any Lot of Closing Open Inventory, then the Parties shall jointly engage Brian Clancey, Senior Market Analyst at STAT

> Communications Ltd. to determine the net realizable value (as the mid-point between bids and offers for similar product for a similar shipment period) for such Lot, and such determination shall be final and binding on the parties….

[33] This valuation method, being the mid-point between bids and offers for similar product for a similar shipment period for any Lot, is not different from the method of calculating Closing Working Capital but rather is expressly stated to be the method for that calculation. By virtue of clause 2.7(1), the Preliminary Closing Working Capital was to be prepared in the same manner as the Closing Statement, including the Closing Working Capital figure. Thus under the APA, the Preliminary Closing Working Capital and Closing Working Capital figures were to be calculated in accordance with Schedule G.

[34] The Liquidator has filed an affidavit of Mr. Bryan Buss, the corporate comptroller of LWP, who stated that LWP was required to prepare its quarterly and annual financial statements in accordance with International Financial Reporting Standards purposes and that the value of the inventory is calculated as the lower of the cost or the NRV in the ordinary course of business, in the context of the particular business. In this case, Mr. Buss stated that such an NRV would contemplate the prices a dealer, like LWP, would sell a commodity for and not the prices another market participant, for example a grower. Mr. Buss acknowledged on cross-examination that he had not done the NRV analysis for the APA and that it was not his area of expertise. His information came from a Mr. Ivan Sabourin, who is a large shareholder of LWP and an inspector of the estate. No affidavit of Mr. Sabourin was filed.

[35] However, assuming Mr. Buss is right in what he said about IFRS, it would mean that Schedule G has provided an exception to the requirement that the calculation of Closing Working Capital shall be prepared in accordance with IFRS applied on a basis consistent with the preparation of the Financial Statements.

[36] The APA and Schedule G do not require any particular kind of dispute regarding the net realizable value of the inventory in order for the dispute resolution process to be applicable. The only precondition to Mr. Clancey being engaged is that the parties are unable to agree on the net realizable value of any Lot. That has occurred. It is up to Mr. Clancey to determine what the net realizable value is.

[37] Nor does the APA and Schedule G permit only post-closing changes to the Closing Inventory or, as requested in the Liquidator's notice of motion, limit relief to the discrepancies in inventory quantity or quality as between the Preliminary Closing Working Capital and the Closing Working Capital and not permit a challenge to the methodology employed in relation to the valuation of Closing Inventory for the purpose of calculating the Preliminary Closing Working Capital as agreed to by the parties. The fact that section 2.7 provided that the Preliminary Closing Working Capital was to be an estimate of the Working Capital as of the date of closing is an indication it was not to be a final figure that could not be changed.

Conclusion

[38] I see no reason why Mr. Clancey should not now be engaged to determine the net realizable value of the Open Closing Inventory. The motion of the Liquidator is dismissed. The Liquidator should cause LWP to agree to the appointment of Mr. Clancey to determine the net realizable value of the Open Closing Inventory in accordance with Schedule G of the APA.

[39] Scoular is entitled to its costs. It claims costs on a substantial indemnity basis on the grounds that allegations of bad faith were made against it. I realize that it was alleged that Scoular acted in bad faith in negotiating the Preliminary Closing Working Capital and providing a different basis for the calculation of the Closing Working Capital. I made no finding however of what was said during the negotiations and I do not think that the allegations, even if disproven, would amount to a sufficiently serious claim of wrongdoing of the kind to merit the higher scale of costs.

[40] Scoular claims total fees, including HST, of approximately $101,500. This is to be contrasted with the cost outline of the Liquidator in which total fees, including HST, are claimed in the amount of approximately $63,000. In reviewing the Scoular fee claim, there may have been overwork done, although this is very difficult to determine. Taking into account the factors in rule 57.1, including what the Liquidator could reasonably expect to pay, I fix the legal fees,

including HST, at $80,000 and disbursements as claimed at $6,666.09 for a total of $86,666.09 to be paid within 30 days.

Newbould J.

Date: May 11, 2016