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For the past four years, inflation-adjusted investment in new machinery and equipment has seen average growth of over 9% per year. This is even higher than during the pre-2000 boom associated with the fears of Y2K.

Second, Canadian companies are diversifying into fast-growing emerging markets. Exports to emerging markets were up 18% in 2006, and 9% growth is forecast for 2007. These same markets also represent some of the best places to build global supply networks. Canadian direct investment abroad totalled \$48 billion in 2006.

Third, the use of trade as a tool of production is on the rise. Goods at an intermediate stage of production now constitute 46% of Canada's imports, and 43% of exports. Manufacturers now do \$2.75 in trade for every dollar of new value they create in Canada – up 50 cents from 15 years ago. And, a recent study from the Conference Board of Canada shows that the increase in Canada's intermediate goods trade over that period has been with the large emerging markets.

The bottom line? The new trade paradigm poses implementation challenges for established and new companies alike. But the wider scope of opportunities it presents, especially for smaller companies, is worth looking forward to.

*The views expressed here are those of the author, and not necessarily of Export Development Canada.*

*Stephen S. Poloz is Senior Vice-President, Corporate Affairs and Chief Economist at Export Development Canada. Stephen can be reached at [spoloz@edc.ca](mailto:spoloz@edc.ca).*

## CIRCULAR PRIORITY ISSUES UNDER THE PPSA

By Jennifer Dezell, FMC Vancouver

### BEWARE OF CIRCULAR PRIORITIES

Parties taking a security interest in a debtor's personal property as collateral should always ensure that their interest is properly registered or otherwise perfected under the *Personal Property Security Act* ("PPSA"). However, proper registration or perfection is not always a complete answer. Secured parties may need to take further precautions to fully protect their interests against competing secured parties.



Situations can arise in which a subordinate secured party obtains priority over one but not all of the parties holding prior interests. This is referred to as a "circular priority" and can give rise to confusion and uncertainty. By entering into a subordination

agreement, a secured party can foresee potential circularity issues and take steps to ensure that their impact is eliminated or minimized.

### SUBORDINATION AGREEMENTS

The Newfoundland Court of Appeal, in *Royal Bank of Canada v. General Motors Acceptance Corporation of Canada Limited* ("Royal Bank"), recently considered certain circular priorities arising in the context of the Newfoundland *Personal Property Security Act*. In this case, a secured party in third position (RBC) obtained a subordination agreement (the "CIBC Subordination") from the secured party in first position (CIBC). The debtor was declared bankrupt, and some of its assets were sold. RBC claimed priority and entitlement to the proceeds of sale by virtue of the CIBC Subordination. At trial, the Court granted the second-position secured party (GMAC) priority over RBC with respect to the proceeds of sale. The Court reasoned that GMAC had not subordinated its interests to RBC, and therefore GMAC maintained its priority over RBC.

The Newfoundland Court of Appeal overturned this decision on the basis that the CIBC Subordination allowed RBC to satisfy its claim out of CIBC's first-place share (the "CIBC Share"). Although there were no excess proceeds in this case, the Court of Appeal suggested that, to the extent that the CIBC Share exceeded what was owed to RBC, CIBC would be entitled to the balance of the CIBC Share. GMAC would take its share next and, to the extent of any excess proceeds available, CIBC would be entitled to satisfy itself from those. On the other hand, if RBC were owed more than the CIBC Share, RBC would take the entire CIBC Share, and CIBC would not be entitled to any part of the remaining proceeds until both GMAC (in second place) and RBC (in third place) had been satisfied. Presumably, if RBC had also obtained a subordination agreement from GMAC, the result would be the same from CIBC's point of view.

The results can be conceptualized as follows:

Realization	Initial priorities	With CIBC Subordination	With CIBC and GMAC Subordinations in favour of RBC
1. CIBC share	CIBC	RBC (balance, if any, to CIBC)	RBC (balance, if any, to CIBC)
2. GMAC share	GMAC	GMAC	RBC (balance, if any, to GMAC)
3. RBC share	RBC	RBC (balance, if any, to CIBC)	RBC (balance, if any, to CIBC and then GMAC)

The result of this case was equitable as far as GMAC was concerned since GMAC was put in no worse position than it would have been without the CIBC Subordination being in place. However, the result may seem harsh for a secured party in CIBC's position. In effect, CIBC as first place security holder was pushed to the bottom of the list by virtue of subordinating its interest to one of the two subordinate creditors. CIBC had no subordination agreement with GMAC and may have assumed (erroneously, though perhaps logically) that granting the CIBC Subordination would have no effect on its statutory priority over GMAC.

To avoid this problem, CIBC could have sought a subordination agreement from GMAC, in which case the priorities would have been altered as shown in the right-hand column below:

Realization	Initial priorities	With CIBC Subordination in favour of RBC	With CIBC and GMAC Subordinations in favour of RBC	With CIBC Subordination in favour of RBC and GMAC Subordination in favour of CIBC
1. CIBC share	CIBC	RBC (balance, if any, to CIBC)	RBC (balance, if any, to CIBC)	RBC (balance, if any, to CIBC)
2. GMAC share	GMAC	GMAC	RBC (balance, if any, to GMAC)	CIBC (balance, if any, to GMAC)
3. RBC share	RBC	RBC (balance, if any, to CIBC)	RBC (balance, if any, to CIBC and then GMAC)	RBC (balance, if any, to CIBC and then GMAC)

## PROTECT YOUR PRIORITY

It is important for senior secured parties to recognize that granting subordination agreements could affect their priorities as against any intervening subordinate secured parties. Similarly, subordinate secured parties such as GMAC, if asked to grant priority agreements in favour of senior secured parties, should consider the possibility that their position could be further eroded by any present or subsequent subordination agreements entered into by the senior secured party. Had GMAC subordinated its interest to CIBC, it may have opened itself to the risk of being pushed into third place by virtue of CIBC granting the CIBC Subordination. In those circumstances, it would have been prudent for GMAC to obtain, as a condition of granting any subordination, CIBC's agreement not to subordinate its interest to any creditors subordinate to GMAC.

Security interests are only as valuable as the priority they enjoy. Secured parties and their legal counsel must be alive to any issues, including circular priorities, which may erode the secured party's

priority and ensure that all possible measures have been taken to adequately protect that priority.

*Jennifer is an Associate at FMC Vancouver. She can be reached at 604 443 7146.*

## ELECTRONIC DISCOVERY

*By Ben Ingram, FMC Vancouver*



### DISCOVERY OF ELECTRONIC DOCUMENTS

In our adversarial legal system, parties must make full disclosure of all documents relating to matters in dispute. In the past, document discovery has focused on disclosure of paper documents. However the current trend is for greater emphasis on disclosure of electronic communications, including emails and other forms of electronic data.

### WHAT ARE ELECTRONIC DOCUMENTS?

What exactly is meant by the terms "electronic documents" and "electronic discovery"? These terms refer to the preservation, retrieval, and production of documents from electronic sources in electronic form. Examples of electronic documents include photos, emails, Word, Excel and Powerpoint files, voice messages, Blackberry and text messages, accounting systems, and information contained on removable memory cards and camera phones.

The characteristics of electronic documents are very different than paper documents. For instance:

- A paper document can be simply and permanently destroyed, but electronic documents may continue to be retrievable despite efforts to delete them.
- Electronic documents can be programmed to change automatically over time. For example, certain documents when opened will automatically insert the current date, overwriting the previous date.
- Additional background information called "meta data" is stored behind the viewable contents of an electronic document. This information normally includes the date the document was created, as well as revision details, printout times, and operator identification.

### RECENT DEVELOPMENTS

Electronic discovery rules in the United States have led major corporations to appoint electronic discovery managers. While it is not expected that similar steps will be necessary in B.C. in the

## CONTACT US

John R. Sandrelli  
Managing Partner  
Fraser Milner Casgrain LLP  
The Grosvenor Building, 15<sup>th</sup> Floor  
1040 West Georgia Street  
Vancouver, BC V6E 4H8  
Phone: 604 443 7132 | Fax: 604 683 5214  
Email: [john.sandrelli@fmc-law.com](mailto:john.sandrelli@fmc-law.com)

Aboriginal & Environmental	Wally Braul .....604 443 7148.....	<a href="mailto:wally.braul@fmc-law.com">wally.braul@fmc-law.com</a>
Corporate Commercial	Robert A. Goodrich.....604 443 7108.....	<a href="mailto:robert.goodrich@fmc-law.com">robert.goodrich@fmc-law.com</a>
Employment and Labour	Carman J. Overholt, Q.C. ....604 622 5165.....	<a href="mailto:carman.overholt@fmc-law.com">carman.overholt@fmc-law.com</a>
Energy & Natural Resources	Ron Stuber .....604 443 7129.....	<a href="mailto:ron.stuber@fmc-law.com">ron.stuber@fmc-law.com</a>
Entertainment	Gordon W. Esau .....604 443 7105.....	<a href="mailto:gordon.esau@fmc-law.com">gordon.esau@fmc-law.com</a>
Financial Services	Colin M. Emslie .....604 622 5160.....	<a href="mailto:colin.emslie@fmc-law.com">colin.emslie@fmc-law.com</a>
Forestry	Tim Bezeredi.....604 443 7124.....	<a href="mailto:tim.bezeredi@fmc-law.com">tim.bezeredi@fmc-law.com</a>
Income Trusts	Bruce M. McKay .....604 443 7114.....	<a href="mailto:bruce.mckay@fmc-law.com">bruce.mckay@fmc-law.com</a>
Infrastructure/P3	Colin J. McIver .....604 443 7128.....	<a href="mailto:colin.mciver@fmc-law.com">colin.mciver@fmc-law.com</a>
Insolvency	Douglas I. Knowles, Q.C. ....604 443 7104.....	<a href="mailto:doug.knowles@fmc-law.com">doug.knowles@fmc-law.com</a>
Intellectual Property	Taran Atwal.....604 443 7147.....	<a href="mailto:taran.atwal@fmc-law.com">taran.atwal@fmc-law.com</a>
Litigation	Susan A. Griffin, Q.C.....604 443 7141.....	<a href="mailto:susan.griffin@fmc-law.com">susan.griffin@fmc-law.com</a>
Mining	Brian E. Abraham.....604 443 7134.....	<a href="mailto:brian.abraham@fmc-law.com">brian.abraham@fmc-law.com</a>
Real Estate	John G.R. Third.....604 443 7103.....	<a href="mailto:john.third@fmc-law.com">john.third@fmc-law.com</a>
Securities	Jeffrey A. Read.....604 443 7107.....	<a href="mailto:jeffrey.read@fmc-law.com">jeffrey.read@fmc-law.com</a>
	Gary R. Sollis.....604 443 7130.....	<a href="mailto:gary.sollis@fmc-law.com">gary.sollis@fmc-law.com</a>
Tax	Gordon S. Funt.....604 443 7109.....	<a href="mailto:gordon.funt@fmc-law.com">gordon.funt@fmc-law.com</a>
	Lori A. Mathison.....604 443 7118.....	<a href="mailto:lori.mathison@fmc-law.com">lori.mathison@fmc-law.com</a>
	Joel A. Nitikman .....604 443 7115.....	<a href="mailto:joel.nitikman@fmc-law.com">joel.nitikman@fmc-law.com</a>

