CITATION: Bank of Montreal v. ACS Precision Components Partnership, 2011 ONSC 700
COURT FILE NO.: 10-8702-00CL
DATE: 20110222

SUPERIOR COURT OF JUSTICE - ONTARIO

RE: BANK OF MONTREAL, Applicant

AND:

ACS PRECISION COMPONENTS PARTNERSHIP, Respondent

BEFORE: CUMMING J.

COUNSEL: Tony van Klink, for the Receiver, Zeifman Partners Inc.

R. M. Slattery and D. T. Ullmann, for the Unsecured Creditors

W. Brad Hanna and Wael Rostom, for Magna Closures Inc.

Graham Phoenix, for Continental Automotive

John D. Leslie, for Brose

Brian Empey, for ATS Automation Tooling Systems Inc.

Jackie Moher, for Delphi Automotive Systems, LLC

J. H. Grout, for OMEX and Anderson Cook

David Preger, for Vistcon Corporation and Automotive Components Holdings, LLC

HEARD: January 20, 2011

ENDORSEMENT

[1] Zeifman Partners Inc. (the "Receiver"), the Court appointed Receiver of ACS Precision Components Partnership ("ACS"), brings a motion seeking, *inter alia*, approval of the Receiver's Eighth Report.

[2] The Receiver entered into a Settlement Agreement involving secured creditors which was approved at the return of the motion on January 20, 2010. The several items raised by the motion, save one, were approved in an endorsement of that date.

[3] There remains a contested issue arising from the motion in respect of a single item, being the Receiver's request for directions from the Court with respect to the entitlement to net income generated from operations during the receivership.

[4] There are some 230 unsecured creditors of ACS, with claims totalling some $6.7 million.

Background

[5] Prior to going into receivership. ACS carried on a plastic injection moulding and related mould building business in Cambridge, Ontario. The customer base of ACS consisted primarily of tier one parts suppliers to the automotive industry. Thus, ACS was one participant in the vertically integrated 'just-in-time' delivery system for components in the overall process of manufacturing automobiles for sale to the public.

[6] The largest customer of ACS was Magna Closures Inc. ("Magna"), with some 60% of ACS's historical sales.

[7] Following its appointment on May 6, 2010, the Receiver caused ACS to continue operations and produce parts for customers of ACS until September 22, 2010.

[8] In managing ACS's operation, the Receiver entered into so-called "Accommodation Agreements" with each of the ACS customers having more than 4% of sales in the 12 month period preceding the receivership so as to allow for continued production of parts and the building of parts banks for those customers while they were transitioned to new suppliers. The Accommodation Agreements for five of those customers were for a term ending July 2, 2010, being the projected exit date of Magna from the premises.

[9] The Receiver also entered into so-called "Letter Agreements" with seven ACS customers having less than 4% of sales in the 12 month period preceding the receivership and who required a continued supply of parts during the receivership.

[10] The Accommodation Agreements were either substantially in the form of the model Accommodation Agreement which was an Exhibit to the Court-approved "Agreement Regarding Receivership", being Schedule "A" to the Receivership Order, or in the form negotiated with ACS's largest customer, Magna.

[11] The Accommodation Agreements and Letter Agreements provided for a 30% surcharge on the price of parts shipped during the receivership until July 2, 2010. If the Receiver, acting reasonably, believed the surcharge to be insufficient to fully fund all cash losses to be incurred in producing component parts for customers, the Accommodation Agreements permitted the Receiver, on 5 days' notice to the customers, to increase the surcharge. The customers had the option of not placing further orders for parts by treating the notice as an exit event under the Accommodation Agreement.

[12] The Letter Agreements were silent as to any increase in the amount of the surcharge; however, the Receiver was not obligated to supply the Letter Agreement customers with parts in any fixed quantity for any period of time.

[13] The surcharge of 30% determined in the first instance was calculated by the Receiver just prior to the commencement of the receivership with the intention of offsetting the Receiver's forecasted cash losses from continuing the operations of ACS. Some, but not all, of the Accommodation Agreement customers of ACS, such as Magna, received this pre-receivership forecast. The forecast was not provided to any of the smaller customers who entered into Letter Agreements.

[14] The continuance of operations was of benefit to both the customers and to the estate of the receivership. The customers would receive an ongoing supply of parts while they transitioned to new suppliers. The receivership estate would benefit from maximizing the realization of work in process and inventory, and maximizing the realization from the existing accounts receivable by customers providing accommodations with respect to the payment thereof. Customers agreed to expedited payment terms for new shipments of component parts.

[15] Paragraph 5 of the Receivership Order authorizes the Receiver to do all the things contemplated by the "Agreement Regarding Receivership" (Schedule A to the Receiving Order) entered into between the Receiver, ACS and the prime secured lender of ACS, the Bank of Montreal. Paragraph 3, in particular, of this "Agreement Regarding Receivership" affords considerable protection to the receivership estate in the course of continuing the operations of ACS. (A prime objective of that provision was to protect the secured interest of the Bank of Montreal, through ensuring that the value of the receivership estate was not eroded through continuing operations.)

[16] The Bank of Montreal was a party to the "Agreement Regarding Receivership", which (paragraph 3) placed restrictions upon the Receiver in using any of the cash proceeds of ACS's accounts receivable and inventory to produce parts for any customer unless the customer agreed to purchase the parts on the terms set forth in the Accommodation Agreements. Thus, in entering into a supply contract, a customer was obliged to do so on terms that afforded considerable protection from loss to the receivership estate (and the Bank). Notwithstanding this protection, there was some residual risk of a loss to the receivership estate in having continuing operations. The purpose of the surcharge(s) was to further minimize the risk of a net loss to the receivership estate.

[17] The Receiver sought an increase in the surcharge to 40% effective for shipments after July 2, 2010, on the basis that an increase was necessary to offset the forecasted cash losses from continuing operations beyond July 2, 2010. There is no suggestion that the Receiver did not act reasonably in making this forecast. The Receiver gave a copy of the ACS production budget for July/August to all customers (*i.e.*, both those who were parties to Accommodation Agreements and those who were parties to Letter agreements), with a notice (Schedules "H" and "I" to the Eighth Report) to each customer which stated in part:

> The Budget indicates that a 40% Surcharge is necessary to fund your pro-rata share of all cash losses anticipated during the months of July and August 2010. As a result, the Receiver requests that [name of customer] agrees in writing to a 40% Surcharge...for all product manufactured after July 2, 2010.

[18] Thus, a 40% surcharge was levied on all parts shipped from July 2, 2010 to September 2, 2010 pursuant to the Accommodation Agreements and by agreement between the Receiver and customers with Letter Agreements. A single customer, Delphi Automotive Systems LLC ("Delphi") was given continued production after September 2, 2010, to September 22, 2010 when ACS ceased production entirely.

[19] The Receiver was very successful in its management of ACS, such that a significant profit was generated from the operations of ACS during the receivership. The "Operating Results" prepared by the Receiver indicate that a total of $377,590 profit was generated from the 30% surcharge, and a profit of $423,661 resulted from the 40% surcharge.

Analysis

[20] Neither the Accommodation Agreements nor the Letter Agreements provide for any reimbursement to customers of all or any part of the surcharge under any circumstances, including if there were to be positive operating income, *i.e.*, a profit, generated thereby. The Agreements are silent on the issue of a surplus accruing from the utilization of the surcharges. The Accommodation Agreements also contain an 'entire agreement' clause.

[21] The customers who are parties to the Accommodation Agreements and Letter Agreements have made submissions as to why they should receive the operating profits generated during the 30% surcharge period and the 40% surcharge period. Magna was the main force in making these submissions. Magna's submissions are adopted by the other customers.

[22] The responding affiant for Magna, Mr. Al Kresovic, states that, in entering the Accommodation Agreement, Magna understood the surcharge "represented the amount required by the Receiver to allow ACS to supply parts to Magna on a break even basis, rather than at a loss". The Receiver states in its Eighth Report that its "intention [was] that the operation of the ACS business during the receivership would run on a break even basis".

[23] The Receiver states that it was not its intention under the Accommodation Agreements or Letter Agreements to make a profit from continuing to operate the ACS business. The purpose was to avoid a loss. However, realistically, given that the surcharges were based upon forecasts, it seems that there would inevitably be some profit or some loss. That is, it was extremely improbable there would be a precise 'break even' resulting from operations.

[24] Mr. Kresovic goes on to state: "significantly, Magna never expected that the [s]urcharge that it paid ...would exceed what the Receiver actually required to operate ACS on a break even basis".

[25] Magna submits in its factum that "the amount of the surcharge was designed only to offset losses which would otherwise arise from continuing parts production during the receivership". It is a reasonable inference that was the purpose of the surcharge. However, that was not the nature of the exchanged promises set forth in the Accommodation Agreements and Letter Agreements.

[26] An 'entire agreement' clause does not prevent a court from interpreting terms that are already part of a written agreement in the context of the agreement as a whole in its commercial

setting. *Paddon-Hughes Development Co. v. Pancontinental Oil Ltd.* 1998 CarswellAlta 940 at para.46 (Alta. C.A.), leave to appeal to S.C.C. refused, [1993] 1 S.C.R. 12. Even if an agreement is unambiguous, evidence of surrounding circumstances as to its commercial purpose and the context of the market in which the parties operate are relevant considerations with respect to the interpretation of the agreement. *Hi-Tech Group Inc v. Sears Canada Inc.* 2001 CarswellOnt 9 (Ont. C.A.) at paras. 18, 23 and 24.

[27] The Accommodation Agreements and Letter Agreements are contracts. Contracts involve the exchange of promises which create bundles of reasonable expectations to each party. Essentially, the contracts at hand involved the promise by the Receiver to supply parts. This created the expectation interest on the part of the customers to receive the delivery of the ordered parts in exchange for a fixed price (including the surcharge).

[28] There was no promise on the part of the customer to pay a higher price than the contract (including surcharge) price if the fixed price was insufficient to cover the expenses of the continued operations. Conversely, there was no promise by the Receiver to reimburse the customers for such part of the fixed contract price that was ultimately unnecessary to cover the cost of operations.

[29] The reasonable expectations at play in a contract are that the exchanged promises will be fulfilled. An objective test is employed in determining the content of a contractual promise; that is, what would a reasonable person have expected the contractual promise to include? For example, in a contract for the sale of goods, the seller's obligation is to deliver the goods promised and the enforceable reasonable expectation of the buyer in exchange for payment of the purchase price is to receive delivery or money damages equal to the amount necessary to purchase like goods in the open market. There may well be other, subjectively-held, non-enforceable expectations as to benefits ultimately resulting from the fulfillment of a contractual promise.

[30] Commercial contracts are entered into as 'win-win' exchanges of executory promises, with the assurance that the law will enforce those promises. The law seeks to give realization (through a remedy of specific performance or, more commonly, damages) to the reasonable expectation interest of the promisee(s) created by the contractual promise received.

[31] The customers in the situation at hand could have negotiated an express provision whereby any residual profit resulting from the surcharges would be refunded. Alternatively, the contractual arrangement could have been for the customers to reimburse the Receiver for actual losses.

[32] An example is seen with the contract entered into between the Receiver and Delphi for the period following September 3, 2010. Parts production ceased for all customers other than Delphi by about September 3, 2010. Production continued on a limited basis for Delphi until September 22, 2010 when ACS ceased production completely.

[33] During the Delphi production period, a net operating loss of $121,649 resulted. Delphi had contracted in advance to cover any operating losses incurred during the Delphi operating period and for that purpose had deposited $200,000 with the Receiver.

[34] Magna points to the language in paragraph 5 of the Accommodation Agreement:

> If the Receiver, acting reasonably, believes that the Surcharge is insufficient to fully fund Customer's pro-rata share of all cash losses incurred or to be incurred in producing Component Parts for Customer...the Receiver shall provide...the Surcharge Increase Notice....

[35] The Accommodation Agreements and Letter Agreements were bargained at arm's length by sophisticated parties familiar with commercial contracts. Indeed, Magna, negotiated changes to the model Accommodation Agreement. For example, Magna obtained a change to the contractual provision limiting setoff rights whereby Magna would be able to take into account "material setoffs" in respect of so-called "hostage payments" demanded from Magna by a critical supplier of ACS (on account of pre-filing amounts owed by ACS) as a prerequisite to the timely release and supply of materials by that critical supplier.

[36] It is useful to first isolate the 30% surcharge period and deal with the operating profit over this period.

[37] Magna argues that it was the intention of both Magna and the Receiver that the surcharge was to be paid to cover actual losses arising from the continued operation of ACS during the receivership. In my view it is fair to say that such was the underlying purpose of the Accommodation Agreements and Letter Agreements. However, the promises exchanged by the Accommodation Agreements and Letter agreements over the currency of the 30% surcharge period were to pay a fixed price for goods manufactured.

[38] Magna argues that ACS's unsecured creditors extended credit to ACS before the start of the receivership. Hence, Magna submits they had no reasonable expectation of ACS generating net income during the receivership as a result of customers paying a surcharge. However, it is not the unsecured creditors who are contracting with the customers of ACS. It is the estate of the receivership, represented by the Receiver. If the estate of the receivership has a profit it will accrue to the benefit of the unsecured creditors but that does not change the contractual relationship. (If the estate of the receivership had incurred an overall net loss, that loss would ultimately fall upon the unsecured creditors and they would not have any contractual recourse against the customers.)

[39] Moreover, the operations of ACS during the receivership were conducted in part with the benefit of goods and services supplied to ACS prior to the receivership, in respect of which payment was not made.

[40] Magna argues that any distribution of net income generated by ACS as a result of the surcharges would be a windfall to the unsecured creditors and constitute unjust enrichment and hence, it is "fair and equitable" that such net income be returned to the customers.

[41] Unjust enrichment has three elements: (1) an enrichment to the defendant; (2) a corresponding deprivation of the plaintiff; and (3) an absence of juristic reason for the enrichment. *Garland v. Consumers' Gas Co.* (2004), CanLII 25 (S.C.C.) at para. 30.

[42] Magna submits that there is an unjust enrichment because of a mistake of fact and that a constructive trust is properly to be imposed to prevent the unjust enrichment. See *Harper v. Royal Bank of Canada* (1994), CanLII 8765 (Ont. Div. Ct.) at paras. 12-13.

[43] In my view, the enrichment of the receivership estate in the situation at hand was due to a juristic reason, namely, the contracts entered into between the Receiver and the customers. In my view, the issue at hand is properly to be determined by contract law.

[44] Magna says that it paid the surcharge "on the mistaken belief, based on information provided and representations made by the Receiver, that the [s]urcharge would only cover ACS's operating losses". However, there was not any mistake as to existing fact upon which the contractual exchange of promises was made. In my view, the Receiver made a representation only that it reasonably believed the surcharge would be necessary to avoid losses.

[45] There was a reasonably based opinion by the Receiver as to the necessity of a surcharge in a given amount. The 30% surcharge was based upon a forecast of revenues and expenses determined by the information available at the time the forecast was prepared. Forecasts are by definition simply forward looking estimates.

[46] The promise of the customer in the Accommodation Agreements in the first instance (paragraph 3) was straightforward and unqualified, that is, it was "to pay a surcharge ...of thirty percent....".

[47] It is noted that ACS incurred a loss of $62,443 for the period May 6 to 31, 2010 notwithstanding the 30% premium and it was only because of a profit of $440,033 for the balance of the 30% surcharge period that an eventual profit of $377,590 was realized for the overall 30% surcharge period.

[48] It is only with the benefit of hindsight that it was determined that the projected amount of the 30% surcharge was seen, in fact, to be more than was necessary to avoid a loss for the 30% surcharge period. This result does not mean that there was any operative 'mistake' whereby the contractual promises and obligations are to be modified.

[49] The customers received the goods and services for which they bargained, at the agreed-upon contractual price, during the 30% surcharge period.

[50] I turn now to the 40% surcharge period.

[51] The existing contract through the Accommodation Agreements/Letter Agreements afforded flexibility to the Receiver to increase the surcharge: "if the Receiver, acting reasonably, believes the Surcharge is insufficient to fully fund Customer's pro-rata share of all cash losses incurred or to be incurred....". In the event of a notice of a surcharge increase pursuant to that belief of the Receiver, the customer could treat such surcharge increase notice as an exit event. That is, the notice of a surcharge increase is an offer by the Receiver to enter into a new contract with the customer. Thus, there were new contracts entered into for the 40% surcharge period with somewhat new language to be taken into account.

[52] The notice (*i.e.*, offer to contract) by the Receiver as to the surcharge increase states:

> The Receiver of ACS believes that the 30% Surcharge...in excess of the applicable Purchase Order price will no longer be sufficient to fully fund [named customer's] pro-rata share of all cash losses incurred or to be incurred....". The Budget indicates a 40% Surcharge is necessary to fund your pro-rata share of all cash losses anticipated....

[53] This offer of the Receiver is intended as a promise to continue to supply component parts if the customer pays a given price. The Receiver's notice is simply stating as to how the Receiver calculated the fixed price for the future supply of goods. That is, the Receiver was stating that the fixed price (inclusive of the 40% surcharge) was based upon the Receiver's reasoned judgment as to the determination of an amount equal to cover the customer's share of all anticipated losses from operations. The Receiver's Budget "indicates that a 40% Surcharge is necessary to fund your pro-rata share of all [future] cash losses....".

[54] The question is whether this language in the notice changes the promises/obligations of the contracts as found above in respect of the contracts operative during the 30% surcharge period. In my view, the same reasoning applicable in the analysis of the contracts during the 30% surcharge period applies to the contracts in the 40% surcharge period.

[55] Again, there was a reasonably based opinion by the Receiver as to the necessity of a surcharge in a given amount. The 40% surcharge was based upon a forecast of revenues and expenses determined by the information available at the time the forecast was prepared. Forecasts are by definition simply forward looking estimates. The customers were given a copy of the forecast before deciding whether to contract for further components from ACS.

[56] The promise of the customer in the contract was straightforward and unqualified, that is, it was to pay a fixed price (inclusive of a 40% surcharge) for the manufacture and supply of components by ACS. There was no promise, express or implied, by the Receiver to give a refund if the surcharge resulted in a profit: conversely, there was no promise, express or implied, by the customer to pay an add-on amount in the event that the surcharge was inadequate to avoid a loss. The customers received the goods and services for which they bargained, at the agreed-upon contractual price, during the 40% surcharge period.

Disposition

[57] For the reasons given, this Court finds that the customers of ACS during the receivership are not entitled to receive the net income generated from operations during the receivership.

[58] An Order shall issue in accordance with these reasons.

Peter A. Cumming J.

CUMMING J.

Date: February 22, 2011