Federal Court of Appeal | Cour d'appel fédérale

**Date: 20161115**

**Docket: A-453-15**

**Citation: 2016 FCA 283**

**CORAM:** **WEBB J.A.**
**NEAR J.A.**
**RENNIE J.A.**

**BETWEEN:**

**JASON SWIST, and CRUDE SOLUTIONS LTD.**

**Appellants**

**and**

**MEG ENERGY CORP.**

**Respondent**

Heard at Ottawa, Ontario, on June 8, 2016.

Judgment delivered at Ottawa, Ontario, on November 15, 2016.

REASONS FOR JUDGMENT BY: WEBB J.A.

CONCURRED IN BY: NEAR J.A.
RENNIE J.A.

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## REASONS FOR JUDGMENT

**WEBB J.A.**

[1] This is an appeal from an Order of the Federal Court (Docket: T-1069-14) requiring Crude Solutions Ltd. (CSL) to post security for costs in the amount of $195,785.70 before it could take any further steps in its proceeding before the Federal Court.

[2] For the reasons that follow I would allow this appeal.

## I. Background

[3] Jason Swist and CSL commenced an action in the Federal Court for patent infringement against MEG Energy Corp. (MEG). MEG brought a motion for an Order requiring CSL to post security for costs. MEG was not seeking security for costs from Jason Swist.

[4] Rules 416(1) and 417 of the *Federal Courts Rules*, SOR/98-106 (Rules) provide in part that:

| | |
|---|---|
| 416 (1) Where, on the motion of a defendant, it appears to the Court that: | 416 (1) Lorsque, par suite d'une requête du défendeur, il paraît évident à la Cour que l'une des situations visées aux alinéas a) à h) existe, elle peut ordonner au demandeur de fournir le cautionnement pour les dépens qui pourraient être adjugés au défendeur: |
| […] | … |
| (b) the plaintiff is a corporation, an unincorporated association or a nominal plaintiff and there is reason to believe that the plaintiff would have insufficient assets in Canada available to pay the costs of the defendant if ordered to do so, | b) le demandeur est une personne morale ou une association sans personnalité morale ou n'est demandeur que de nom et il y a lieu de croire qu'il ne détient pas au Canada des actifs suffisants pour payer les dépens advenant qu'il lui soit ordonné de le faire; |
| […] | … |
| the Court may order the plaintiff to give security for the defendant's costs | |
| […] | … |
| 417 The Court may refuse to order that security for costs be given under any of paragraphs 416(1)(a) to (g) if a plaintiff demonstrates impecuniosity and the Court is of the opinion that the case has merit | 417 La Cour peut refuser d'ordonner la fourniture d'un cautionnement pour les dépens dans les situations visées aux alinéas 416(1)a) à g) si le demandeur fait la preuve de son indigence et si elle est convaincue du bien-fondé de la cause. |

[5] There are two shareholders of CSL: Jason Swist and his wife, Francisca Swist. In the reasons of the Federal Court Judge the share ownership of CSL is described as follows:

> [8] According to the evidence, Mr. Swist is a 90% shareholder in CSL; the remaining shares are held by his wife. Mr. Swist holds 100% of the voting shares.

[6] However, in his affidavit, Jason Swist stated that:

> 6. CSL is a corporation incorporated, on June 2, 1981, pursuant to the laws of the province of Alberta. It was initially registered as "California Coal & Carbon Corporation Ltd." until September 9, 2005. Effective June 1989, I owned 100% of the voting shares of CSL….
>
> […]
>
> 10. As per the information found in Exhibit "A", I currently hold 90% of the voting shares of CSL. My wife, Francisca Swist holds the remaining 10%.

[7] Therefore, it appears that there is only one class of shares of CSL of which Jason Swist owns 90% of such shares that are issued and outstanding and his wife owns the remaining 10%.

## II. Decision of the Federal Court

[8] The Federal Court Judge noted that the key question for Rule 417 was the financial standing of CSL. In paragraph 20 of her reasons, the Federal Court Judge found that the only assets of CSL were two patents and a patent application. In paragraph 21 she then stated that:

> [w]here a corporate party has no assets…

[9] Since CSL did have the two patents and the patent application, it appears that she was referring to liquid assets or assets that could be pledged to raise capital in paragraph 21. In any

event, it is clear that she found that CSL does not have any assets that could be used, directly or indirectly, to post security for costs.

[10] The Federal Court Judge also found that Jason Swist does not have any assets that could be used to assist CSL in posting security for costs.

[11] The Federal Court Judge then determined that she could look to the minority shareholder, Francisca Swist, to determine if she had the financial means to provide funds to CSL to allow CSL to post security for costs. The Federal Court Judge found that Francisca Swist was employed and had some assets. As a result she was "not satisfied that the minority shareholder is unable to provide security for costs." She, therefore, ordered CSL to post security for costs in the amount of $195,785.70.

## III. Issue

[12] The issue in this appeal is whether the Federal Court Judge committed an error by determining that CSL had not established that it was impecunious for the purposes of Rule 417, because there was a minority shareholder who may have the ability to provide funds to CSL to allow it to post an amount as security for costs.

## IV. Standard of Review

[13] In *Hospira Healthcare Corp. v. Kennedy Institute of Rheumatology*, 2016 FCA 215, [2016] F.C.J. No. 943 this Court held, in paragraph 79, that the standards of review as set out in *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235 (*Housen*) are applicable to appeals of

discretionary decisions of Judges (palpable and overriding error for questions of fact and correctness for questions of law).

## V. Analysis

[14] In this case, there is no dispute that the condition as set out in Rule 416(1)(b) is satisfied. CSL does not have sufficient assets in Canada available to pay the costs of MEG if it is ordered to do so.

[15] The issue in this appeal is whether the first condition (impecuniosity) as set out in Rule 417 has been satisfied. It should be noted that Rule 417 is discretionary. Even if a plaintiff demonstrates impecuniosity and the Court is satisfied that a case has merit, the Judge is not obligated to refuse to order security. Rule 417 only provides that a Judge may refuse to order security if these two conditions are satisfied. In this case, the Federal Court Judge determined that the first condition was not satisfied and therefore did not determine whether the discretion granted by Rule 417 should have been exercised.

[16] Rule 417 provides that it is the plaintiff who must demonstrate that it is impecunious. There is no dispute that CSL, on its own, is impecunious and that Jason Swist is not able to provide any financial assistance to CSL. The issue is whether it was appropriate in the circumstances of this case to find that CSL had not demonstrated that it was impecunious, because it had not established that its minority shareholder could not provide the financial assistance to allow it to post security for costs. Shareholders of a corporation (other than an unlimited liability company) have limited liability and, therefore, would not be obligated to provide additional funds to the corporation to allow it to post security for costs. The issue is not,

therefore, whether any particular shareholder is obligated to provide the security for costs but whether, in determining if a corporation is impecunious, it is appropriate to consider that such shareholder could be regarded as a source of financing a payment as security for costs.

[17] The Federal Court Judge, in paragraph 21 of her reasons, stated that:

> [21] Where a corporate party has no assets, the Court can consider the ability of a shareholder to post security; see *Nicholas, supra* at paragraph 24.

[18] In my view, this statement is too broad as it seems to assume that all shareholders of a company should be treated equally when determining whether a company can look to its shareholders for financial assistance. Shareholders will share, indirectly, in the assets and profits of a company in proportion to their shareholdings. Therefore a person who holds 10% of the shares of a company will only, indirectly, share in 10% of the assets and profits of the company. Why should it be assumed that a shareholder who will only share, indirectly, in 10% of any gain that may be realized by a company if it is successful in a lawsuit be expected to fund 100% of a security for costs in relation to that lawsuit?

[19] The case cited by the Federal Court Judge for the proposition that the Court can consider the ability of any shareholder to provide funds to a corporate plaintiff to allow it to post security for costs is *Nicholas v. Environmental Systems (International) Ltd.*, 2009 FC 1160, 377 F.T.R. 1. In that case, Mosley J. stated that:

> [24] In the case of a shell corporation without discoverable assets, the courts can reasonably look to the shareholders to provide the indemnification. In the case of a non-corporate plaintiff, it is appropriate to look at other sources of funds that may be available to the litigant including those held by close family members.

[20] However, the plaintiff in that case was an individual, not a corporation. Therefore, this reference to looking to shareholders of a shell company was simply a general comment made in *obiter*.

[21] MEG referred to *Continental Breweries Inc. v. 707517 Ontario Ltd.*, 1990 CarswellOnt 422, 46 C.P.C. (2d) 151. In that case Master Sandler found that a company was not impecunious and in so finding, stated that:

> 13 In this case, it is clear that the plaintiff company itself has no realizable assets except this claim. If it loses this action, the defendant might well be awarded substantial costs for defending the claim, and the defendant could never collect them from the plaintiff corporation.
>
> 14 So far as the shareholders are concerned, the plaintiff is owned 51 per cent by 29 shareholders, some of whom are, by their very names, people of substance, and 49 per cent by Calford, his wife and Coutou who, it is clear have little assets and could not pay security. So at least some shareholders could fund the action and post security but won't, and others (49 per cent) might want to, but can't. Is this company thus impecunious?
>
> 15 I think not. If those shareholders who can, do not want to advance any more money to see this claim pursued, why should a minority of the company be allowed to pursue the claim without posting security? Why should the defendant be pursued by an insolvent company who is at no risk if it loses, and could never itself pay any costs award. The best that can be said of plaintiff's claims before me is that there is a 50-50 chance they will win. It could well turn out that they will recover nothing because of the defences and counterclaims of the defendants. The plaintiff and its shareholders chose a corporate structure, and must take the consequences of that choice. Its principal, Calford, has incorporated a new corporate entity through which all new business will be directed so he seeks protection behind corporations whenever he can get it.
>
> 16 I conclude that because the plaintiff is not impecunious, as defined in *Kurzela, and Smith Bus Lines v. Bank of Montreal* (1987), 61 O.R. (2d) 688 at 690, 20 C.P.C. (2d) 38 (H.C.), leave to appeal to Ont. Div. Ct. refused (1987), 61 O.R. (2d) 688, 25 C.P.C.

> (2d) 255 (H.C.), and *408466 Ontario Ltd. v. Fidelity Trust Co.* (1986), 10 C.P.C. (2d) 278 at 282 (Ont. H.C.) that the plaintiff cannot avoid security.

[22] Although there is a reference to 51% of the shares being held by 29 people, there is no indication of the number or percentage of shares held by any particular person "of substance." If each of the 29 people owned an equal number of these shares, each person would own less than 2% of the shares. I do not agree that it should be assumed that someone who only owns less than 2% of the shares of a particular company should be expected to provide 100% of the amount that may be required by that company to post security for costs for litigation being pursued by that company. In that case it was also the minority shareholders who wanted to continue the litigation, whereas in this case it is the majority shareholder who wants CSL to continue the litigation.

[23] In *ABI Biotechnology Inc.* v. *Apotex Inc.*, 142 Man.R. (2d) 80, [2000] 3 W.W.R. 217, Philp J.A., writing on behalf of the Manitoba Court of Appeal, stated that:

> [45] What, then, are the principles that should guide the court in applying Rule 56.01(d) to the defendants' applications for security for costs? The general rule at common law and in equity has been, from time immemorial, that poverty is not a bar to a litigant, and that rule remains alive and well in Manitoba. Security for costs will not be ordered against a plaintiff who has no assets if its effect is to stifle a genuine claim. However, as we have seen, the courts have applied the rule less generously when a corporate plaintiff asserts insolvency or impoverishment in response to an application for security for costs. A corporate plaintiff with "insufficient assets" must also establish that it cannot raise the security; that its shareholders are unable to advance funds to allow it to post security. In my view, that is not an attack on the legal persona of a corporation or a lifting of the corporate veil. To me, it reflects the court's recognition of its duty to do what is just in the circumstances. Courts have determined that a corporate plaintiff

> without assets, manipulated by shareholders with assets, ought not to be able to say to the defendant, "Heads I win, tails you lose."
>
> [46] Underlying the decisions reviewed above is the realization that the making of an order for security for costs against a corporate plaintiff without assets will not have the effect of stifling the action if its shareholders, or some of them, have the ability to provide the necessary funds. Whether or not the action proceeds when security has been ordered remains the decision of the shareholders who are manipulating the plaintiff and funding the litigation. In that sense, it is a decision not unlike the one any plaintiff or prospective litigant must face: Do the chances of success justify the expense and exposure to costs?
>
> [Emphasis added and footnote references have not been included]

[24] In deciding whether a corporation is impecunious, it seems appropriate to distinguish between those shareholders who are "manipulating the corporation" and those who are not. If a corporation is controlled by one person or by a group of persons, then it is appropriate to consider the financial resources of the person who controls the corporation or who is part of the group of persons who control the corporation in determining whether that corporation is impecunious.

[25] However, if the person is a minority shareholder and is not part of a group of shareholders controlling the corporation, then, in my view, the circumstances related to that shareholder should be examined to determine if it is appropriate to consider the financial resources of that person when determining if the corporation is impecunious. One important factor will be the percentage of shares held by that person. The smaller the percentage of shares held by that person the less likely it is that the financial resources of such person should be considered in determining whether the corporation is impecunious. Since Rule 417 provides that

the plaintiff must demonstrate impecuniosity, the onus would remain on any corporate plaintiff to establish:

(a) that any particular minority shareholder is not part of the group of shareholders who control the corporation; and

(b) the circumstances related to such shareholder that would justify not looking to such shareholder to provide financial assistance to the corporation to fund a payment as security for costs.

[26] In this case, Francisca Swist only owns 10% of the shares of CSL. The only evidence submitted in relation to Francisca Swist's acquisition of the shares and participation in the affairs of the corporation is that she received the shares from Jason Swist for no consideration and that she has never been involved in the business of CSL. Jason Swist also stated that he was informed by Francisca Swist that she is unwilling to post any security for costs. It is not surprising that she would refuse to provide the necessary funds to allow CSL to post security for costs as she did not pay anything for her shares and, therefore, has nothing to lose if the action is not continued.

[27] In my view, it was an error in law, in determining whether CSL was impecunious, to consider whether Francisca Swist, in the circumstances of this case, could be the sole source of the amount that CSL would be required to post as security for costs. In my view, CSL had demonstrated that it was impecunious for the purposes of Rule 417.

[28] Since the Federal Court Judge found that CSL had not established that it was impecunious, she did not consider the second part of Rule 417 which is whether the case has merit.

[29] As a result, I would allow the appeal with costs in the cause, set aside the Order of the Federal Court requiring CSL to post security for costs and refer the matter back to the Federal Court to determine whether the case has merit for the purposes of Rule 417, and if so, whether the discretion provided in Rule 417 should be exercised. I would also set aside the award of costs made by the Federal Court in favour of MEG and provide that the costs in the Federal Court would also be in the cause.

"Wyman W. Webb"
J.A.

"I agree
D.G. Near J.A."

"I agree
Donald J. Rennie J.A."

**FEDERAL COURT OF APPEAL**

**NAMES OF COUNSEL AND SOLICITORS OF RECORD**

**APPEAL FROM A CONFIDENTIAL ORDER OF FEDERAL COURT DATED OCTOBER 9, 2015, NO. T-1069-14**

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|---|---|
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| **STYLE OF CAUSE:** | JASON SWIST, and CRUDE SOLUTIONS LTD. v. MEG ENERGY CORP. |
| **PLACE OF HEARING:** | OTTAWA, ONTARIO |
| **DATE OF HEARING:** | JUNE 8, 2016 |
| **REASONS FOR JUDGMENT BY:** | WEBB J.A. |
| **CONCURRED IN BY:** | NEAR J.A.<br>RENNIE J.A. |
| **DATED:** | NOVEMBER 15, 2016 |

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| | |
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