Court File No.: CV-20-00649326-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

B E T W E E N:

HALEX CAPITAL INC.

Applicant

- and -

NATURAL ENERGY SYSTEMS INC.

Respondent

APPLICATION UNDER SECTION 243(1) OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, c. B-3, AS AMENDED, AND SECTION 101 OF THE *COURTS OF JUSTICE ACT*, R.S.O. 1990, c. C.43, AS AMENDED

REPLY FACTUM OF THE APPLICANT HALEX CAPITAL INC.
(Returnable December 3, 2020)

November 30, 2020

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PART I - INTRODUCTION

1. Halex Capital Inc. ("**Halex**" or the "**Applicant**") submits this factum in response to certain of the issues raised in the factum of Douglas J. Hallett ("**DJH**"), served on November 27, 2020 (the "**DJH Factum**") seeking a stay of the Applicant's application (the "**Application**") for the appointment of Baigel Corp. as the Receiver of Natural Energy Systems Inc. ("**NES**") pursuant to subsection 243(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended (the "**BIA**") and section 101 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43, as amended, in favour of arbitration between NES and DJH (the "**Arbitration**").

2. Halex makes three submissions in this respect:

(a) In seeking to stay the Application, DJH relies on an arbitration clause contained at Article 10.1 of the Shareholders' Agreement (the "**Arbitration Clause**") and the issues raised in the Arbitration. On their face, the Arbitration and the Arbitration Clause are inapplicable. This is not a shareholders' dispute. Halex is not a party to the Arbitration and no relief is sought in respect of the Halex GSA therein. Rather, Halex is exercising rights under the Halex GSA as a creditor of NES. The Halex GSA expressly provides that this Court is the appropriate forum for the Application.

(b) The Halex GSA has no obvious deficiencies that would undermine its enforcement.

(c) The purpose of the Receivership Proceedings has and continues to be, to preserve the Property, maximize stakeholder value and provide NES' creditors with the opportunity to recover amounts that may be owing to them from an insolvent debtor. The Receiver's appointment is just and convenient in the circumstances and the Applicant's conduct does not preclude the remedy.

3. To the extent that the Applicant does not respond to statements in the DJH Factum, it does not indicate acquiescence. Capitalized terms not otherwise defined herein have the meaning ascribed to them in the Applicant's Factum dated November 2, 2020 and the Reply Affidavit of Dr. Dragan Matovic sworn November 23, 2020 (the "**Reply Affidavit**").

PART II - REPLY

A. THE ARBITRATION CLAUSE AND ARBITRATION ARE, ON THEIR FACE, INAPPLICABLE

4. The Arbitration Clause is inapplicable to the Application commenced pursuant to the Halex GSA, which is also not subject to the Arbitration. However, should this Court find that the Application is subject to the Arbitration Clause or Arbitration, it should refuse to stay the proceeding pursuant to section 7(2) of the *Arbitration Act 1991*, S.O. 1991, c. 17, as amended (the "**Arbitration Act**") or its inherent jurisdiction under the BIA.

1. Neither the Arbitration nor the Arbitration Clause Apply

5. Section 7(1) of the Arbitration Act provides that "[i]f a party to an arbitration agreement commences a proceeding in respect of a matter to be submitted to arbitration under the agreement, the court in which the proceeding is commenced shall, on the motion of another party to the arbitration agreement, stay the proceeding."[1] As the Supreme Court of Canada has made clear, this general rule is not absolute.[2]

6. While the "competence-competence" principle generally favours resolution of a dispute about an arbitrator's jurisdiction by the arbitrator, it admits of exception where, as here, the

[1] *Arbitration Act 1991*, SO 1991, c. 17 s 7(1) [Arbitration Act].
[2] *TELUS Communications Inc v Wellman*, 2019 SCC 19 at para 64.

challenge to the arbitrator's jurisdiction is based solely on a question of law, or one of mixed fact and law that requires for its disposition only "superficial consideration of the documentary evidence in the record".[3]

7. The following analytical framework applies when considering to apply a stay under section 7(1) of the Arbitration Act:

(a) is there an arbitration agreement;

(b) what is the subject matter of the dispute;

(c) what is the scope of the arbitration agreement;

(d) does the dispute arguably fall within the scope of the arbitration agreement; and

(e) are there grounds on which the court should refuse to stay the action.[4]

8. Applied here, these considerations militate toward declining DJH's request for a stay.

9. As the DJH factum notes, the Arbitration Clause provides, in relevant part, that "all disputes and questions whatsoever which shall arise between any of the parties in connection with this Agreement […] or as to any other matter in any way relating to this Agreement".[5] Although not referred to in the DJH Factum, the Shareholders' Agreement elsewhere provides that "[a]ll of the parties to this Agreement irrevocably submit to the exclusive jurisdiction of the courts of the Province of Ontario."[6] The effect, of these competing forum selection provisions, if any, need not

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[3] *Haas v Gunasekaram*, 2016 ONCA 744 at para 14 citing *Seidel v Telus Communications Inc*, 2011 SCC 15 at para 4.
[4] *Ibid* at para 17.
[5] Affidavit of Dr. Dragan Matovic sworn October 5, 2020, Exhibit "I" "Shareholders' Agreement" at Article 10.1 [First Matovic Affidavit], Applicant's Application Record Tab 2 [Application Record].
[6] *Ibid*, Exhibit "I" "Shareholders' Agreement" at Article 11.7.

be resolved on the Application as the subject matter of the dispute is wholly outside of the scope of the Arbitration Clause.

10. The Application is brought pursuant to Halex's contractual rights as a secured creditor of NES under Section 6.1 of the Halex GSA in respect of amounts that continue to be due and owing under the Promissory Notes (as defined below). Neither the Halex GSA nor the Promissory Notes rely on or make reference to the Shareholders' Agreement, including the Arbitration Clause.[7] Further, neither the Halex GSA nor the Promissory Notes contain an arbitration clause. Rather, Section 7.11 of the Halex GSA provides that NES and Halex agree that:

> [t]he courts of the Province of Ontario shall have non-exclusive jurisdiction to entertain any action or other legal proceedings based on any provision of this Agreement. The undersigned hereby attorn to the jurisdiction of the courts of the Province of Ontario.[8]

11. Given the inclusion of the following entire agreement clause at Section 7.1 of the Halex GSA, the Shareholders' Agreement is also not, by implication, incorporated in the Halex GSA:

> [t]here are no understandings and agreements between the parties concerning the subject matter of this Agreement except as set forth in this Agreement [and the other Security Documents]. There are no representations, warranties, terms, conditions, undertakings or collateral agreements, express, implied or statutory, between the Secured Party and the Debtor concerning the subject matter hereof except as expressly set forth in this Agreement [or in the other Security Documents].[9]

12. Similarly, Section 7.1 of the Halex GSA precludes the assertion in the DJH Factum that any reference to the Shareholders' Agreement in NES' resolution approving the Halex GSA invariably makes the Halex GSA subject to the Arbitration.[10] This assertion conflates *NES'* acknowledgement that a grant of security is not contrary to its constating documents with an

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[7] Reply Affidavit of Dr. Dragan Matovic sworn November 23, 2020 at para 20 [Second Matovic Affidavit].
[8] First Matovic Affidavit, *supra* note 5, Exhibit "C" "Halex GSA" at Section 7.11, Application Record Tab 2.
[9] *Ibid*, Exhibit "C" "Halex GSA" at Section 7.1, Application Record Tab 2.
[10] Factum of Douglas J. Hallett dated November 27, 2020 at paras 32-33 [DJH Factum].

agreement by *Halex* that any such grant is subject, in all respects, to the Shareholders' Agreement. Such an interpretation ignores the plain terms of the Halex GSA, including Section 7.1 thereof.

13. While DJH has refused to answer whether NES and Halex were entitled to agree to submit to the jurisdiction of the courts of the Province of Ontario, it is clear that there is nothing precluding such an arrangement.[11]

14. In light of the foregoing, the Ontario Superior Court of Justice's decision in *805882 Ontario Inc. v Moffat* ("***Moffat***") is instructive. In *Moffat*, a tenant and shareholder, party to a shareholders' agreement containing a mandatory arbitration clause, sought leave to appeal from a decision refusing to stay a landlord's action to recover for unpaid operating costs under a lease.[12] The shareholders' agreement, to which the landlord was also a party, contemplated that the company owning the leased premises may lease same to shareholders of the company or non-shareholders.

15. Paul Kane J., in *Moffat*, declined to grant leave to appeal on the basis that the action was not a "matter to be submitted to arbitration" as contemplated by section 7(1) of the Arbitration Act.[13] In doing so, Paul Jane J. noted that:

> The lease;
>
> (a) Contains no arbitration provision regarding disputes between the landlord and tenant;
>
> (b) Does not refer to a written shareholder agreement between the parties nor the shares owned by the tenant in the landlord corporation;
>
> (c) Does not incorporate by reference, any term of the shareholder agreement and in particular, the arbitration clause in the shareholder agreement.

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[11] Cross-Examination of Douglas J. Hallett taken November 25, 2020, at 20-21, Q. 61 [DJH Cross-Examination].

[12] *805882 Ontario Inc v Moffat*, 183 ACWS (3d) 895 at paras 1-3. The arbitration clause at issue provided that "The parties agree to arbitrate any and all claims, controversies or disputes arising out of or relating to this agreement. All such claims, controversies or disputes shall be submitted to a sole arbitrator, and failing agreement by the parties, then the arbitrator shall be nominated by the president of the Arbitrators' Institute of Canada."

[13] *Ibid* at para 16.

> […]
>
> this lease upon which this claim is founded, does not rely upon, arise out of nor is it intertwined with the tenant's ownership of shares or the shareholders agreement. The obligation to pay rent and the enforcement of that obligation arises solely under the lease. That obligation and default issue is not intertwined with the rights or obligations of a shareholder at law or pursuant to the terms of this shareholder agreement.[14]

16. Here, similar to *Moffat*:

(a) The Halex GSA and the Promissory Notes do not contain an arbitration provision.

(b) The Halex GSA and the Promissory Notes do not refer to the Shareholders' Agreement or incorporate same by reference, including the Arbitration Clause.

(c) The Halex GSA and the Promissory Notes on which NES' debt obligations are founded, do not rely upon or arise out of Halex's ownership of shares of NES or the Shareholders' Agreement.

(d) NES' obligation to pay and the enforcement by Halex of that obligation arises solely under the Halex GSA and the Promissory Notes.

(e) NES' default under the Halex GSA and the Promissory Notes are not intertwined with the rights or obligations of a shareholder at law or pursuant to the terms of the Shareholders' Agreement. In fact, the Shareholders' Agreement is silent on the enforcement rights of any party that advances funds to NES.

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[14] *Ibid* at paras 2, 15.

17. In addition to not being within the scope of the Arbitration Clause, the subject matter of the Application, including the Halex GSA, are not issues within the Arbitration as the DJH Factum suggests.[15]

18. The issues raised by DJH in the Arbitration are confined to the Amended Statement of Defence and Counterclaim dated March 6, 2020 (the "**Arbitration Pleadings**").[16] Notably, Halex is not a named party in the Arbitration Pleadings and no relief is sought in respect of the Halex GSA by counterclaim or otherwise, including an order cancelling security interests granted pursuant to the Halex GSA and declaring same void.[17] Rather, the Arbitration Pleadings accept the validity of the Halex GSA, albeit while impugning NES' conduct in granting it, to buttress an argument that the value of DJH's common and preferred shares has been diminished by NES:

> (v) the plaintiff has accumulated significant debts, including to Mr. Matovic and his company Halex Capital Inc., owing in part to its litigation against the defendant, which is being funded primarily through this debt.
>
> (vi) the plaintiff has granted security over its inventory, equipment, motor vehicle and other assets to Halex Capital Inc., without the defendant's consent, contrary to the provisions of the USA.
>
> […]
>
> 158.(b) In the result, the Fair Market Value of the defendant's significant investment and common shares in the plaintiff corporation has been reduced.[18]

19. The Arbitration Pleadings do not refute that Halex advanced funds to NES or that such funds are due and owing, take issue with Halex's PPSA registration or contest that NES granted security to Halex. Rather, the Arbitration Pleadings accept as a premise that NES "has accumulated

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[15] DJH Factum, *supra* note 10 at para 35.
[16] Second Matovic Affidavit, *supra* note 7 at para 18; DJH Factum, *ibid*.
[17] Second Matovic Affidavit, *ibid*; DJH Cross-Examination, *supra* note 11 at 28, Q. 82-83.
[18] Second Matovic Affidavit, *ibid*.

significant debts to […] Halex" and that NES "granted security over its inventory, equipment, motor vehicle and other assets to Halex", to argue for a favourable evaluation of DJH's shares.

2. Alternatively, the BIA Vests this Court with Inherent Jurisdiction to Render the Arbitration Clause Inoperative

20. The BIA confers jurisdiction on courts to disrupt private contractual rights, including forum selection clauses in appropriate circumstances.[19] This authority stems from section 183(1) of the BIA, which vests this Court "with such jurisdiction at law and in equity as will enable [it] to exercise original, auxiliary and ancillary jurisdiction in bankruptcy and in other proceedings authorized by this Act".[20]

21. The Applicant submits that this Court's inherent jurisdiction under the BIA to refuse to stay the Application may operate in two ways. First, by rendering "the arbitration clause 'incapable of being performed' or 'inoperative'" such that it is "invalid"[21] within the meaning of section 7(2) of the Arbitration Act. Second, to the extent that section 7(2) of the Arbitration Act "does not admit of that interpretation" there is a conflict between provincial and federal laws, which pursuant to doctrine of paramountcy, requires the federal law to prevail.[22]

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[19] *Pope & Talbot Ltd, Re*, 2009 BCSC 1014 at para 150; *Industrial Alliance Insurance Financial Services Inc v Wedgemount Power Limited Partnership*, 2018 BCSC 970 at paras 48-49; *Petrowest Corporation v Peace River Hydro Partners*, 2019 BCSC 2221 at paras 40-41 [*Petrowest*].

[20] *Bankruptcy and Insolvency Act*, RSC 1985, c. B-3 s 183(1); *Petrowest*, *ibid* at paras 41, 43.

[21] See *Canada (Attorney General) v Reliance Industrial Co* (2007), OJ No. 3830 at paras 31-32 where Pepall J. affirmed that "[i]f a party is bankrupt or insolvent and under court protection then the arbitration agreement, as any other commercial contract, is affected. It becomes inoperative. […] The expression 'inoperative' has no accepted meaning in English law, but it would seem apt to describe an agreement which, although not void ab initio, has for some reason ceased to have effect for the future". While Pepall J.'s decision more squarely addresses the conflict between the *International Commercial Arbitration Act*, RSO 1990, c. I.9 and the *Winding-up and Restructuring Act*, RSC 1985, c. W-11, the Applicant submits that it is nonetheless instructive here. See also *Petrowest*, *ibid* at para 42.

[22] *Petrowest*, *ibid.*

22. In *Petrowest Corporation v Peace River Hydro Partners*, the British Columbia Supreme Court considered the application of the court's inherent jurisdiction under the BIA to refuse a stay in favour of arbitration in the context of an ongoing receivership. Specifically, Iyer J. held that a court may exercise its inherent jurisdiction to refuse a stay "where the benefit of granting the remedy to the insolvency process as a whole outweighs the prejudice to affected parties."[23] This assessment may be informed by the:

(a) stage of the proceedings and the effect of such an order on them;

(b) need to maintain the integrity of the insolvency process;

(c) realistic alternatives in the circumstances;

(d) impact on claimants and other creditors of the debtor; and

(e) anticipated time and costs involved.[24]

23. Applied to the instant case, these factors support the exercise of this Court's inherent jurisdiction to refuse to stay the Application, given that:

(a) The only realistic alternative to the Application is NES' bankruptcy. The uncontroverted evidence is that NES is insolvent. NES has no more than $1,634.71, no operations, no employees, and no funds to pay its obligations generally as they become due.[25] Recognizing the dire liquidity crisis facing NES and the urgent need to preserve NES' most valuable asset, its intellectual property, the Honourable

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[23] *Ibid* at para 49.
[24] *Ibid* at para 50.
[25] Second Matovic Affidavit, *supra* note 7 at paras 10, 12; DJH Cross-Examination, *supra* note 11 at 23-24, Qs. 69-72.

Justice Koehnen granted the Interim Order, which, among other things, directed the Receiver to take certain steps to preserve NES' intellectual property and authorized the Receiver to borrow monies up to the principal amount of $75,000. To this end, the Receiver has borrowed approximately $46,263.80 from Halex, the sole party willing to advance funds to NES to preserve its intellectual property. Such borrowings are unassailable and benefit from a super-priority charge on the Property. NES has no funds to pay its counsel or continue to protect its rights in the Arbitration. When asked "who's going to pay for the arbitration" DJH's response was "I don't care. Somebody should."[26]

(b) In the circumstances, the Receivership Proceedings are the only efficient, expedient and practical means of establishing the validity and priority of the claims of all of NES' creditors and preserving and monetizing the Property, each with a view to maximizing the interests of NES' stakeholders. Pursuant to the terms of the Receivership Order, which empowers the Receiver to continue any proceedings to which NES is a party, the Receiver will determine whether any continuation of the Arbitration is in the interests of NES' stakeholders, including whether it is practically possible due to NES' financial circumstances. Disputes as to the ability of the Receiver to resolve issues that touch on the Arbitration through the course of the Receivership Proceedings will be addressed by the Receiver and will be subject to this Court's approval.

[26] DJH Cross-Examination, *ibid* at 30, Qs. 87-88.

B. THE HALEX GSA IS NOT DEFICIENT

24. The DJH Factum relies on sections 11(2), 45(4) and 46 of the PPSA to assert that the Halex GSA is not a valid security instrument. On the contrary, these provisions, properly interpreted, support the validity of the Halex GSA.

1. The Halex GSA Complies with Section 11(2) of the PPSA

25. As the DJH Factum notes, section 11(2) of the PPSA provides, in relevant part, that:

> a security interest […] attaches to collateral only when value is given, the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party and,
>
> (a) the debtor has signed a security agreement that contains,
>
> (i) a description of the collateral sufficient to enable it to be identified […].[27]

26. Notably, "value" is defined under section 1(1) of the PPSA to mean "any consideration sufficient to support a simple contract and includes an antecedent debt or liability."[28] Additionally, section 1(1) of the PPSA defines "security agreement" to mean "an agreement that creates or provides for a security interest and includes a document evidencing a security interest".[29]

27. NES as borrower, and Halex as lender, executed five promissory notes in 2019, dated February 6, 2019, April 24, 2019, June 21, 2019, July 27, 2019, and August 16, 2019 in the aggregate principal amount of $108,000 (the "**2019 Promissory Notes**"). The 2019 Promissory Notes contemplated NES' granting a security interest in favour of Halex pursuant to a general security agreement to be negotiated – each stating that "Natural Energy Systems Inc. grants the registration of a General Security Agreement to Halex Capital Inc. on terms to be negotiated for

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[27] *Personal Property Security Act*, RSO 1990, c. P. 10 s 11(2) [PPSA]; *ACAT Global LLC v Bondyra*, 2016 ONSC 106 at para 27 [ACAT].
[28] PPSA, *ibid*, s 1(1) "value".
[29] *Ibid*, s 1(1) "security agreement".

the funds borrowed."[30] As the DJH factum notes, between February 6, 2019 August 19, 2019 $108,000 was advanced by Halex to or on behalf of NES.[31]

28. In 2020, NES as borrower, and Halex as lender, executed a further five promissory notes dated January 31, 2020, March 24, 2020, April 28, 2020, May 25, 2020 and June 26, 2020 (collectively, the "**2020 Promissory Notes**", and together with the 2019 Promissory Notes, the "**Promissory Notes**").[32] The first of the 2020 Promissory Notes provides that:

> [t]he amount of CDN$175,000 represents the total of all loans provided to the Borrower by the Lender between February 6, 2019 through to the date hereof. All previous promissory notes granted by the Borrower to and in favour of the Lender are hereby replaced with this consolidated Promissory Note. All such previous, promissory notes, each dated between February 6, 2019 through to August 16, 2019 are now null and void.[33]

29. As contemplated by the Promissory Notes, Halex and NES entered into the Halex GSA, which is effective January 31, 2020. As Dr. Matovic had recused himself,[34] the Halex GSA was executed by an independent director of NES, Paul Greenwood. There is no evidence to suggest that Mr. Greenwood did not have authority to bind NES.[35]

30. The Halex GSA provides, among other things, that:

> the Secured Party has made certain loans and may make further loans to the Debtor as evidenced by promissory notes granted by the Debtor to and in favour of the Secured Party from time to time (the "**Promissory Notes**").
>
> […]
>
> the Debtor has agreed to grant the Secured Party a security interest in and an assignment of the Collateral (as defined in Section 2.1) to secure all amounts owing from time to time

[30] Brief of Transcripts dated November 30, 2020 at Tab 5.
[31] DJH Factum, *supra* note 10 at para 43.
[32] First Matovic Affidavit, *supra* note 5 at para 8, Application Record Tab 2.
[33] *Ibid*, Exhibit "B" "Promissory Notes", Application Record Tab 2.
[34] *Ibid* at para 10, Application Record Tab 2.
[35] DJH Cross-Examination, *supra* note 11 at 19, Qs. 58-59.

> by the Debtor to the Secured Party, including without limitation, pursuant to the Promissory Notes.[36]

31. The securing of "all amounts owing from time to time", including future amounts under a single general security agreement, is expressly permitted by section 13 of the PPSA.[37] Between February 3, 2020 and July 13, 2020, the uncontroverted evidence is that Halex advanced a further $152,026.37 to or on behalf of NES.

32. Based on the foregoing, the requirements of section 11(2) of the PPSA are satisfied and thus attachment occurred upon execution of the Halex GSA:[38]

(a) the antecedent debt of NES pursuant to the 2019 Promissory Notes, in and of itself, constitutes value sufficient to support the Halex GSA;

(b) the Halex GSA was executed by NES effective January 31, 2020; and

(c) no party has taken issue with the clear description of the collateral provided in the Halex GSA.

2. Halex's Financing Statement Complies with Sections 45(4) and 46 of the PPSA

33. The DJH Factum asserts that the Halex GSA is contrary to section 45(4) and 46 of the PPSA as it "purports to secure security interests advanced to NES from February 2019 until August 2019".[39] For this proposition, the DJH Factum relies on *Adelaide Capital Corp. v Integrated Transportation Finance Inc.*'s ("***Adelaide***"), which holds that section 45(4) of the PPSA "was not intended […] to permit a financing statement to perfect a security interest created or provided for

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[36] First Matovic Affidavit, *supra* note 5, Exhibit "C" "Halex GSA", Application Record Tab 2.
[37] See PPSA, *supra* note 27 s 13, which provides that "[a] security agreement may secure future advances".
[38] *ACAT*, *supra* note 27 at para 29.
[39] DJH Factum, *supra* note 10 at para 74.

in an earlier security agreement between the parties."[40] As set out immediately below, this argument is premised on a misapplication of section 45(4) of the PPSA.

34. Section 45(4) of the PPSA provides that:

> Except where the collateral is consumer goods, one financing statement may perfect one or more security interests created or provided for in one or more security agreements between the parties, whether or not,
>
> (a) the security interests or security agreements are part of the same transaction or related transactions; or
>
> (b) the security agreements are signed by the debtor before the financing statement is registered.

35. In *Adelaide*, Blair J. (as he then was) made clear that a secured party cannot rely on section 45(4) of the PPSA to perfect a security interest created by an earlier security agreement. In the present case, *Adelaide* is wholly inapplicable. That is, *Adelaide* can only apply if:

(a) Halex had entered a separate security agreement prior to January 31, 2020 in respect of advances under the 2019 Promissory Notes but, failed to register a financing statement under the PPSA at that time; and

(b) Halex later sought to rely on its existing PPSA registration made on January 23, 2020[41] in connection with the Halex GSA to argue that its previous security interest that attached under the above previous hypothetical general security agreement was perfected prior to January 23, 2020.

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[40] *Adelaide Capital Corp v Integrated Transportation Finance Inc*, [1994] OJ No. 103 at para 78.

[41] First Matovic Affidavit, *supra* note 5, Exhibit "H", "PPSA Search Results Dated August 27, 2020", Application Record Tab 2.

36. The above is strictly hypothetical as no such argument has been made. In the instant case:

(a) there is a single "security agreement" relied on to establish attachment in accordance with the PPSA – the Halex GSA effective January 31, 2020;

(b) the Halex GSA secures antecedent debt and all other amounts owing from time to time as permitted by the PPSA;

(c) there is a single financing statement in connection with the Halex GSA relied on to establish perfection of Halex's security interest registered on January 23, 2020;

(d) Halex has never asserted that all pre-requisites of attachment or perfection of its security interest were satisfied prior to January 31, 2020; and

(e) Halex has never taken the position that for the purpose of determining priority, its security interest was perfected prior to January 31, 2020.

37. For the foregoing reasons, there is no obvious deficiency in the Halex GSA.

C. THE RECEIVERSHIP IS JUST AND CONVENIENT & HALEX'S CONDUCT SUPPORTS THE REMEDY

38. The Receivership Proceedings were commenced to preserve the Property, maximize stakeholder value and provide NES' creditors with the opportunity to recover amounts that may be owing to them. The Receivership Proceedings are just and convenient in the circumstances. Contrary to the assertions in the DJH Factum, the Receivership Proceedings are not intended to circumvent the Arbitration and Halex's conduct does not preclude the granting of the Receivership Order.

39. The Applicant and DJH agree that the appointment of a receiver is an equitable remedy and as such, is subject to the principles that govern the grant of equitable orders, including the maxim that one who comes to equity must do so with "clean hands".[42] However, the Applicant disagrees with DJH on whether Halex comes with "clean hands" such that its conduct justifies this Court's refusal to grant the Receivership Order.

40. The clean hands maxim requires a party seeking "equitable relief to show that his past record *in the transaction* is clean".[43] Courts have previously cautioned that the "maxim must not be taken too widely" and that the impugned conduct "must have 'an immediate and necessary relation' to the equity sued for" and "must have secured a person an advantage in the very contract sought to be enforced."[44]

41. Here, the alleged impugned conduct asserted in the DJH Factum is that:

(a) Halex has restructured the 2019 Promissory Notes to be a comprehensive promissory note subject to the Halex GSA with knowledge that NES would almost certainly default; and

(b) Dr. Matovic failed to disclose that he was in a conflict of interest with respect to the Halex GSA.[45]

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[42] *Royal Bank of Canada v Boussoulas*, 2010 ONSC 4650 at para 21; *Sherwood Dash Inc v Woodview Products Inc* (2005), OJ No. 5298 at para 51.
[43] *Toronto (City) v Polai*, [1970] 1 OR 483 at para 46.
[44] *2324702 Ontario v 1305 Dundas*, 2019 ONSC 1885 at para 20; *BMO Nesbitt Burns Inc v Wellington West Capital Inc* (2005), 77 OR (3d) 161 at para 28 citing *SBS Sealants Inc v Robroy Industries Ltd* (2002), 59 OR (3d) 257.
[45] DJH Factum, *supra* note 10 at paras 78-80.

42. Each assertion is clearly contradicted by the record. Namely:

(a) DJH has conceded that there is no evidence, beyond his unsupported personal belief and suspicion, that (i) the Promissory Notes were made with the intention of precipitating NES' insolvency and the Receivership Proceedings and (ii) Dr. Matovic, Mr. Greenwood and NES' former director, Bob Naiman, discussed enforcing Halex's security and removing NES' intellectual property. Moreover, as discussed above, the 2019 Promissory Notes always contemplated that they would be secured by a general security agreement and there is nothing untoward about such a general security agreement securing antecedent debt – it is expressly permitted by the PPSA.[46] Equally, there is nothing perverse about a creditor advancing funds to a debtor to protect its investment and subsequently enforcing its contractual rights when it determines it has no hope of being repaid.[47]

(b) The fact that Dr. Matovic declared a conflict and recused himself in respect of the Halex GSA and the Promissory Notes and proof of same were disclosed within the Affidavit of Dr. Dragan Matovic sworn October 5, 2020 and affirmed in the Reply Affidavit.[48] Moreover, at the request of DJH, the Applicant has since produced each of Dr. Matovic's declarations of conflicts of interest with respect to the 2019 Promissory Notes.

(c) The Receivership Proceedings have not halted the Arbitration – NES' insolvency has. Halex is the single largest investor in NES and has been its primary source of

[46] DJH Cross-Examination, *supra* note 11 at 25-27, Qs. 73-78.
[47] Second Matovic Affidavit, *supra* note 7 at para 9.
[48] First Matovic Affidavit, *supra* note 5 at para 10, Application Record Tab 2; Second Matovic Affidavit, *ibid* at para 14.

financing recently, including approximately $90,475 to the maintenance of NES' most valuable asset – its intellectual property – between February 4, 2019 and June 8, 2020. Absent the funds advanced under the Promissory Notes, the Property could not have been preserved and NES would have been forced to make an assignment in bankruptcy. Such an assignment would have been detrimental to all of NES' stakeholders, including any interest held by DJH and Halex's $500,000 equity investment in NES.

(d) The counterparty to the Halex GSA – 'the very contract sought to be enforced' – does not dispute the Promissory Notes or the Halex GSA and has confirmed that Dr. Matovic properly recused himself in respect of each.[49] Further, the Applicant is not aware of any complaint by NES regarding Halex's conduct in enforcing its contractual rights under the Halex GSA qua creditor.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 30th day of November, 2020

BENNETT JONES LLP

[49] First Matovic Affidavit, *ibid* at paras 14-15, Application Record Tab 2.

SCHEDULE "A"

LIST OF AUTHORITIES

Cases Cited

1. *ACAT Global LLC v Bondyra*, 2016 ONSC 106
2. *Adelaide Capital Corp v Integrated Transportation Finance Inc*, [1994] OJ No. 103
3. *BMO Nesbitt Burns Inc v Wellington West Capital Inc* (2005), 77 OR (3d) 161
4. *Canada (Attorney General) v Reliance Industrial Co* (2007), OJ No. 3830
5. *Haas v Gunasekaram*, 2016 ONCA 744
6. *Industrial Alliance Insurance Financial Services Inc v Wedgemount Power Limited Partnership*, 2018 BCSC 970
7. *Petrowest Corporation v Peace River Hydro Partners*, 2019 BCSC 2221
8. *Pope & Talbot Ltd, Re*, 2009 BCSC 1014
9. *Royal Bank of Canada v Boussoulas*, 2010 ONSC 4650
10. *Sherwood Dash Inc v Woodview Products Inc* (2005), OJ No. 5298
11. *Toronto (City) v Polai*, [1970] 1 OR 483
12. *2324702 Ontario v 1305 Dundas*, 2019 ONSC 1885
13. *805882 Ontario Inc v Moffat*, 183 ACWS (3d) 895

SCHEDULE "B"

RELEVANT STATUTES

***Arbitration Act, 1991*, SO 1991, c. 17**

Section 7

Stay
7 (1) If a party to an arbitration agreement commences a proceeding in respect of a matter to be submitted to arbitration under the agreement, the court in which the proceeding is commenced shall, on the motion of another party to the arbitration agreement, stay the proceeding.

Exceptions
(2) However, the court may refuse to stay the proceeding in any of the following cases:

1. A party entered into the arbitration agreement while under a legal incapacity.

2. The arbitration agreement is invalid.

3. The subject-matter of the dispute is not capable of being the subject of arbitration under Ontario law.

4. The motion was brought with undue delay.

5. The matter is a proper one for default or summary judgment.

Arbitration may continue
(3) An arbitration of the dispute may be commenced and continued while the motion is before the court.

Effect of refusal to stay
(4) If the court refuses to stay the proceeding,

(a) no arbitration of the dispute shall be commenced; and

(b) an arbitration that has been commenced shall not be continued, and anything done in connection with the arbitration before the court made its decision is without effect.

Agreement covering part of dispute
(5) The court may stay the proceeding with respect to the matters dealt with in the arbitration agreement and allow it to continue with respect to other matters if it finds that,

(a) the agreement deals with only some of the matters in respect of which the proceeding was commenced; and

(b) it is reasonable to separate the matters dealt with in the agreement from the other matters.

No appeal
(6) There is no appeal from the court's decision.

***Bankruptcy and Insolvency Act*, RSC 1985, c. B-3**

Section 183

Courts vested with jurisdiction

(1) The following courts are invested with such jurisdiction at law and in equity as will enable them to exercise original, auxiliary and ancillary jurisdiction in bankruptcy and in other proceedings authorized by this Act during their respective terms, as they are now, or may be hereafter, held, and in vacation and in chambers:

(a) in the Province of Ontario, the Superior Court of Justice;

(b) [Repealed, 2001, c. 4, s. 33]

(c) in the Provinces of Nova Scotia and British Columbia, the Supreme Court;

(d) in the Provinces of New Brunswick and Alberta, the Court of Queen's Bench;

(e) in the Province of Prince Edward Island, the Supreme Court of the Province;

(f) in the Provinces of Manitoba and Saskatchewan, the Court of Queen's Bench;

(g) in the Province of Newfoundland and Labrador, the Trial Division of the Supreme Court; and

(h) in Yukon, the Supreme Court of Yukon, in the Northwest Territories, the Supreme Court of the Northwest Territories, and in Nunavut, the Nunavut Court of Justice.

Superior Court jurisdiction in the Province of Quebec

(1.1) In the Province of Quebec, the Superior Court is invested with the jurisdiction that will enable it to exercise original, auxiliary and ancillary jurisdiction in bankruptcy and in other proceedings authorized by this Act during its term, as it is now, or may be hereafter, held, and in vacation and in chambers.

Courts of appeal — common law provinces

(2) Subject to subsection (2.1), the courts of appeal throughout Canada, within their respective jurisdictions, are invested with power and jurisdiction at law and in equity, according to their ordinary procedures, except as varied by this Act or the General Rules, to hear and determine

appeals from the courts vested with original jurisdiction under this Act.

Court of Appeal of the Province of Quebec

(2.1) In the Province of Quebec, the Court of Appeal, within its jurisdiction, is invested with power and jurisdiction, according to its ordinary procedures, except as varied by this Act or the General Rules, to hear and determine appeals from the Superior Court.

Supreme Court of Canada

(3) The Supreme Court of Canada has jurisdiction to hear and to decide according to its ordinary procedure any appeal so permitted and to award costs.

Section 243

Court may appoint receiver
(1) Subject to subsection (1.1), on application by a secured creditor, a court may appoint a receiver to do any or all of the following if it considers it to be just or convenient to do so:

> (a) take possession of all or substantially all of the inventory, accounts receivable or other property of an insolvent person or bankrupt that was acquired for or used in relation to a business carried on by the insolvent person or bankrupt;
>
> (b) exercise any control that the court considers advisable over that property and over the insolvent person's or bankrupt's business; or
>
> (c) take any other action that the court considers advisable.

Restriction on appointment of receiver
(1.1) In the case of an insolvent person in respect of whose property a notice is to be sent under subsection 244(1), the court may not appoint a receiver under subsection (1) before the expiry of 10 days after the day on which the secured creditor sends the notice unless

> (a) the insolvent person consents to an earlier enforcement under subsection 244(2); or
>
> (b) the court considers it appropriate to appoint a receiver before then.

Definition of receiver
(2) Subject to subsections (3) and (4), in this Part, receiver means a person who

> (a) is appointed under subsection (1); or
>
> (b) is appointed to take or takes possession or control — of all or substantially all of the inventory, accounts receivable or other property of an insolvent person or bankrupt that was acquired for or used in relation to a business carried on by the insolvent person or bankrupt — under

(i) an agreement under which property becomes subject to a security (in this Part referred to as a "security agreement"), or

(ii) a court order made under another Act of Parliament, or an Act of a legislature of a province, that provides for or authorizes the appointment of a receiver or receiver-manager.

Definition of receiver — subsection 248(2)
(3) For the purposes of subsection 248(2), the definition receiver in subsection (2) is to be read without reference to paragraph (a) or subparagraph (b)(ii).

Trustee to be appointed
(4) Only a trustee may be appointed under subsection (1) or under an agreement or order referred to in paragraph (2)(b).

Place of filing
(5) The application is to be filed in a court having jurisdiction in the judicial district of the locality of the debtor.

Orders respecting fees and disbursements
(6) If a receiver is appointed under subsection (1), the court may make any order respecting the payment of fees and disbursements of the receiver that it considers proper, including one that gives the receiver a charge, ranking ahead of any or all of the secured creditors, over all or part of the property of the insolvent person or bankrupt in respect of the receiver's claim for fees or disbursements, but the court may not make the order unless it is satisfied that the secured creditors who would be materially affected by the order were given reasonable notice and an opportunity to make representations.

Meaning of disbursements
(7) In subsection (6), disbursements does not include payments made in the operation of a business of the insolvent person or bankrupt.

***Courts of Justice Act* RSO 1990, c. 43**

Section 101

Injunctions and receivers
(1) In the Superior Court of Justice, an interlocutory injunction or mandatory order may be granted or a receiver or receiver and manager may be appointed by an interlocutory order, where it appears to a judge of the court to be just or convenient to do so.

Terms
(2) An order under subsection (1) may include such terms as are considered just.

***Personal Property Security Act*, RSO 1990, c. P. 10**

Section 1

"security agreement"

means an agreement that creates or provides for a security interest and includes a document evidencing a security interest.

"value"

means any consideration sufficient to support a simple contract and includes an antecedent debt or liability.

Section 11

Attachment required to enforce security interest
(1) A security interest is not enforceable against a third party unless it has attached.

When security interest attaches to collateral
(2) Subject to section 11.1, a security interest, including a security interest in the nature of a floating charge, attaches to collateral only when value is given, the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party and,

(a) the debtor has signed a security agreement that contains,

(i) a description of the collateral sufficient to enable it to be identified, or

(ii) a description of collateral that is a security entitlement, securities account or futures account, if it describes the collateral by any of those terms or as investment property or if it describes the underlying financial asset or futures contract;

(b) the collateral is not a certificated security and is in the possession of the secured party or a person on behalf of the secured party other than the debtor or the debtor's agent pursuant to the debtor's security agreement;

(c) the collateral is a certificated security in registered form and the security certificate has been delivered to the secured party under section 68 of the Securities Transfer Act, 2006 pursuant to the debtor's security agreement;

(d) the collateral is investment property and the secured party has control of it under subsection 1 (2) pursuant to the debtor's security agreement; or

(e) the collateral is electronic chattel paper and the secured party has control of it under subsection 1 (3).

Same
(3) If the parties have agreed to postpone the time for attachment, the security interest attaches at the agreed time instead of at the time determined under subsection (2).

Attachment in securities account
(4) The attachment of a security interest in a securities account is also attachment of a security interest in the security entitlements carried in the securities account.

Attachment in futures account
(5) The attachment of a security interest in a futures account is also attachment of a security interest in the futures contracts carried in the futures account.

Section 13

Future advances
A security agreement may secure future advances.

Section 45

Registration of financing statement
45 (1) In order to perfect a security interest by registration under this Act, a financing statement shall be registered.

Consumer goods
(2) Where the collateral is consumer goods, the financing statement referred to in subsection (1) shall not be registered before the security agreement is signed by the debtor and, where a financing statement is registered in contravention of this subsection, the registration of the financing statement does not constitute registration or perfection under this Act.

Collateral other than consumer goods
(3) Where the collateral is not consumer goods, the financing statement referred to in subsection (1) may be registered before or after the security agreement is signed by the debtor.

Subsequent security agreements
(4) Except where the collateral is consumer goods, one financing statement may perfect one or more security interests created or provided for in one or more security agreements between the parties, whether or not,

> (a) the security interests or security agreements are part of the same transaction or related transactions; or
>
> (b) the security agreements are signed by the debtor before the financing statement is registered.

Section 46

Registration requirements
(1) A financing statement or financing change statement that is to be registered shall contain the required information presented in a required format. 2006, c. 34, Sched. E, s. 15 (1).

Electronic transmission
(2) A financing statement or financing change statement in a required format may be tendered for registration by direct electronic transmission to the registration system's database. 2006, c. 34, Sched. E, s. 15 (1).

Classification of collateral
(2.1) Except with respect to rights to proceeds, where a financing statement or financing change statement sets out a classification of collateral and also contains words that appear to limit the scope of the classification, then, unless otherwise indicated in the financing statement or financing change statement, the secured party may claim a security interest perfected by registration only in the class as limited.

Authorized person
(3) A financing statement or financing change statement in a required format may be tendered for registration by direct electronic transmission only by a person who is, or is a member of a class of persons that is, authorized by the registrar to do so.

Errors, etc.
(4) A financing statement or financing change statement is not invalidated nor is its effect impaired by reason only of an error or omission therein or in its execution or registration unless a reasonable person is likely to be misled materially by the error or omission.

Effect of registration
(5) Registration of a financing statement or financing change statement,

(a) does not constitute constructive notice or knowledge to or by third parties of the existence of the financing statement or financing change statement or of the contents thereof; and

(b) does not create a presumption that this Act applies to the transaction to which the registration relates.

Copy to debtor
(6) Within 30 days after the date of registration of a financing statement or financing change statement, the secured party shall deliver a copy of a verification statement to the debtor.

Copy not required
(6.1) A copy of a verification statement is not required if the debtor has waived in writing the right to receive a copy.

Same

(6.2) Subsection (6.1) applies where the financing statement or financing change statement to which the verification statement relates is registered on or after the day subsection 7 (2) of Schedule 12 to the Burden Reduction Act, 2017 comes into force.

Penalty
(7) Where the secured party without reasonable excuse fails to deliver a copy required under subsection (6), the secured party shall pay $500 to the debtor which sum is recoverable in the Small Claims Court.

IN THE MATTER OF AN APPLICATION UNDER SECTION 243(1) OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, C. B-3, AS AMENDED; AND SECTION 101 OF THE *COURTS OF JUSTICE ACT*

HALEX CAPITAL INC.	and	**NATURAL ENERGY SYSTEMS INC.**	
Applicant		Respondent	Court File No.: CV-20-00649326-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceedings commenced in Toronto

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