Federal Court of Appeal  Cour d'appel fédérale

Date: 20150216

Docket: A-439-13

Citation: 2015 FCA 46

CORAM: **NADON J.A.**
DAWSON J.A.
TRUDEL J.A.

BETWEEN:

OFFSHORE INTERIORS INC.

Appellant

and

HARRY SARGEANT III and COMERICA BANK

Respondents

Heard at Ottawa, Ontario, on June 9, 2014.

Judgment delivered at Ottawa, Ontario, on February 16, 2015.

REASONS FOR JUDGMENT BY: NADON J.A.

CONCURRED IN BY: DAWSON J.A.
TRUDEL J.A.

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REASONS FOR JUDGMENT

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NADON J.A.

[1] This is an appeal by Offshore Interiors Inc. ("Offshore") from an order of Madam Justice Strickland of the Federal Court (the "Judge") dated December 19, 2013, 2013 FC 1266 (the "Federal Court Judgment") pursuant to which she held that a builder's mortgage in favour of Harry Sargeant III ("Sargeant") against the vessel "QEO14226C010" (the "Vessel") secured advances made by him to Worldspan Marine Inc. ("Worldspan") for the construction of the Vessel. Hence she found that Worldspan was under an obligation to repay the advances to Sargeant.

[2] In concluding as she did, the Judge allowed the appeal of Sargeant and Comerica Bank ("Comerica") from the order of Prothonotary Lafrenière (the "Prothonotary"), dated March 5, 2013 (the "Prothonotary's Judgment"), in which he held that Sargeant's builder's mortgage (the "Builder's Mortgage") only secured the delivery of the Vessel to Sargeant and hence that Worldspan was under no obligation to repay the advances made to it by Sargeant.

[3] For the reasons that follow I would dismiss the appeal. I come to this conclusion because of my view that the Judge did not err in law nor did she make a palpable and overriding error. More particularly, I am of the opinion that in concluding that the Builder's Mortgage secured the advances made by Sargeant to Worldspan, the Judge properly interpreted the Builder's Mortgage in light of the factual context which included a vessel construction agreement (the "VCA") entered into between Sargeant and the builder, Worldspan.

I. FACTUAL AND PROCEDURAL BACKGROUND

[4] The relevant facts of this case are fairly straightforward and undisputed. Therefore a brief summary will be sufficient for the purposes of this appeal.

[5] On February 29, 2008, Sargeant signed the VCA with Worldspan pursuant to which Worldspan agreed to design, construct, outfit, launch, complete, sell and deliver a 142-foot custom-built luxury yacht to Sargeant.

[6] In March, 2008, construction of the Vessel began and on May 14, 2008, the Builder's Mortgage was filed against the Vessel and in favour of Sargeant in the Vancouver Ship Registry.

[7] By August, 2009, payments made by or on behalf of Sargeant to Worldspan totalled USD $11,064,525.38. On August 14, 2009, Sargeant entered into a Construction Loan Agreement with Comerica for a further USD $9,400,000 in order to finance the completion of the Vessel. By way of an Assignment of Security Agreement and Mortgage (also dated August 14, 2009), Sargeant assigned his interest in the VCA, the Vessel and the Builder's Mortgage to Comerica in exchange for the advanced funds.

[8] From August, 2009 to March, 2010, Comerica paid Worldspan USD $9,387,398.67, on Sargeant's behalf, on account of invoices issued by Worldspan pursuant to the terms of the VCA.

[9] Around April or May, 2010, a dispute arose between Sargeant and Worldspan regarding project costs and construction. By that time, a total of USD $20,651,924.05 had been paid to

Worldspan by Sargeant, or by Comerica on his behalf, in connection with the construction of the Vessel.

[10] On July 20, 2010, Offshore commenced the underlying action against Worldspan, Crescent Custom Yachts Inc., Sargeant and Comerica and all others interested in the Vessel and the Vessel itself for unpaid invoices for services and materials rendered in connection with the Vessel.

[11] On July 28, 2010, Offshore arrested the Vessel. It remained under arrest until June 30, 2014 when it was sold by the Federal Court, free and clear of any and all claims, liens and encumbrances, for the sum of US$5,000,000.

[12] On May 27, 2011, Worldspan, and its related entities, filed a Petition under the *Companies Creditors' Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCCA*") in the Supreme Court of British Columbia ("BC Supreme Court"). The petition resulted in a claims process order which required all creditors to deliver proof of their claims against Worldspan to the BC Supreme Court on or before September 9, 2011 failing which the creditor would be forever barred from making or enforcing a claim against Worldspan. The order also provided that any creditor asserting an *in rem* claim against the Vessel could pursue its claim outside the *CCCA* process in the Federal Court.

[13] On August 29, 2011, the Prothonotary issued a claims process order for all creditors asserting an *in rem* claim against the Vessel. This claims process order gave notice to all

creditors of the requirement to file an affidavit in support of their claim against the Vessel. The order specified that affidavits should describe the nature of their claim and provide any supporting particulars thereby allowing the Federal Court to determine if the claim constituted an *in rem* claim against the Vessel and, if so, its priority.

[14] On October 14, 2011, Sargeant filed an affidavit in support of his claim against the Vessel. According to this affidavit, his claim derived from payments, in excess of USD $21 million, made by him, or on his behalf, to Worldspan for the construction of the Vessel, and from the security interest in the Vessel granted to him by Worldspan to secure those payments.

A. *Relevant terms of the VCA, Builder's Mortgage and the Assignment of Insurance*

[15] For ease of reference, selected provisions of the VCA are copied below. For the purpose of clarity, any reference to "Builder" in the VCA refers to Worldspan while references to "Owner" refer to Sargeant. Sections 1 and 2 of the VCA set out Worldspan's basic obligations.

> **SECTION 1 – SCOPE**
>
> 1.1 Builder undertakes to design, construct, outfit, launch, complete and sell and deliver to Owner […] one […] fibreglass composite motor yacht.
>
> […]
>
> **SECTION 2 – COMPLETION AND DELIVERY**
>
> […]
>
> 2.3 Upon Delivery, the Vessel […] shall be free and clear of all liens, mortgages and encumbrances (except liens and encumbrances approved by Owner in favour of Owner's construction finance lender, if any) […] which arise or attach prior to the delivery of the Vessel to Owner, against the Vessel or against the materials, labour, supplies, or equipment furnished by Builder in performance of this Agreement.

[16] Section 4 of the VCA sets out that payments made on account of Worldspan by Sargeant during construction would be in the nature of advances and would not be considered earned until final delivery and acceptance of the Vessel by Sargeant.

> **SECTION 4 – COST AND PAYMENT**
>
> 4.1 The cost of the Vessel and the final purchase price payable by Owner (the "Final Purchase Price" will be finally determined on a time-and-materials basis subject to reasonable verification/audit […] During the course of construction of the Vessel, Owner will make payments on account of the Final Purchase Price as hereinafter provided but these payments will be in the nature of advances to Builder and the Final Purchase Price will not be earned by Builder until delivery and acceptance of the Vessel in accordance with this Agreement.
>
> [Emphasis added]

[17] The VCA stated that the estimated price of the Vessel was $15 million and established a method by which changes to this estimated price could be made as between the parties (section 4.2). In order to maintain positive cash flow during construction, Sargeant was to forward monthly payments in arrears in order to cover Worldspan's costs for the previous month (section 4.3(a)). As part of this system, Worldspan was to submit to Sargeant a monthly "Claim Certificate" detailing that month's costs (section 4.3(c)).

[18] With respect to risks and insurance, the VCA stated that Worldspan was to retain all risk of loss and damage to the Vessel up until the point of delivery and acceptance by Sargeant. At that point, all risk of loss would immediately transfer to Sargeant (section 5.1).

[19] Furthermore, Worldspan was obligated to obtain and maintain policies of insurance including Hull, Protection and Indemnity and other marine coverage, comprehensive general

liability insurance against bodily injury, death and property damage and standard builder's risk insurance (section 5.2). All policies of insurance were to be taken out in the name of both Worldspan and Sargeant. Additionally, section 5.3 of the VCA stipulated that:

> In the event Builder is unable or otherwise fails to deliver the Vessel to Owner as required hereunder due to total loss of the Vessel during construction, Owner shall be entitled to recover all amounts paid to Builder hereunder, whether by insurance or otherwise (the "Refund"). The Refund shall be without prejudice to any other rights of Owner under law, this Agreement or otherwise.
>
> [Emphasis added]

[20] Sargeant's rights to assign his rights under the VCA were dealt with in section 8.1:

> Owner may freely assign the benefit of this Agreement to any corporation […] Owner may also freely assign the benefit of this Agreement by way of security to any bank or financial institution providing finance in connection with the construction of the Vessel and in that event Builder will cooperate as necessary in the assignment and provide such acknowledgements and assurances consistent with the terms of this Agreement as the bank or financial institution may require.

[21] Section 12.1 of the VCA dealt with title in the Vessel during construction and explicitly granted Sargeant a first priority security interest in the Vessel to secure the sums advanced to Worldspan under the VCA.

> Builder will retain title to the Vessel until delivery to Owner. Builder grants to Owner a continuing first priority security interest in the Vessel, including all work, materials, machinery, and equipment relating to the Vessel, to secure any sums advanced or paid to Builder under this Agreement; provided, however, that such security interest shall be subordinate to Owner's obligations under the Contract Documents including Builder's right to receive payments pursuant to this Agreement. In support of Owner's security interest in the Vessel Builder agrees to register a Ship's Mortgage in favour of Owner or Owner's construction lender (the form of the mortgage document is to be agreed upon between the parties acting reasonably) if Owner requests that this be done for any purpose.
>
> [Emphasis added]

[22] Termination on the basis of Worldspan's default was dealt with in section 13 of the VCA:

> **Builder's Default**
>
> 13.1 Owner shall have the right and power, without prejudice to any other right or remedy, to terminate this Agreement, in whole or in part, in the event of any of the following events […]:
>
> […]
>
> (c) if Builder suspends payment of its debts or ceases to carry on its business or makes any arrangement or composition with its creditors;
>
> […]
>
> 13.2 Upon termination of this Agreement by Owner, Owner will be freely entitled to take over and complete the Vessel elsewhere in which event Builder will be liable:
>
> (a) to deliver up the Vessel and/or such parts as have been constructed and all materials engines, machinery, outfit and equipment from time to time appropriated to the Vessel and/or pertaining to this Agreement (including Owner's supplies) free and clear of all mortgages, maritime liens and debts and claims whatsoever for removal from Builder's shipyard;
>
> […]
>
> 13.3 As an alternative to its rights under the preceding provisions of this SECTION 13 Owner will be entitled […] to require Builder to cooperate in the prompt sale of the Vessel on such terms and in such manner as Owner may decide and Builder may approve […] and following such sale the provisions of SECTION 24 will apply.

[23] Section 24, in turn, established a formula that would apply in the event of a sale pursuant to section 13.3. In these circumstances, Worldspan would be obliged to pay Sargeant a specified amount if the sale proceeds were less than the cumulative sum of the advances made by Sargeant to Worldspan at the time of sale. Correlatively, if the sale proceeds exceeded the cumulative sum of Sargeant's advances to Worldspan at the time of sale, Sargeant would have to pay a portion of any profit made on the sale of the Vessel to Worldspan.

[24] If Sargeant failed to make payments in accordance with the VCA, section 13.5 gave Worldspan the right to terminate the VCA. In this situation, property in the Vessel would revert to Worldspan and Sargeant was to, "promptly do and execute all acts, matters, things and documents necessary or reasonably required by Builder to perfect Builder's property therein". Following this, Worldspan could sell the Vessel and would be liable to repay Sargeant his advances from the sale proceeds, less Worldspan's out-of-pocket costs for storage and resale. If Worldspan then sold the Vessel for an amount less than the "Capped Purchase Price" (defined to be the lesser of the sum of advances paid by Sargeant at the time of sale or 10% greater than the original $15 million estimated price of the Vessel), it was to refund Sargeant all instalment payments less its direct out-of-pocket costs and expenses and less the difference between the Capped Purchase Price and the actual resale price of the Vessel.

[25] The Builder's Mortgage granted to Sargeant by Worldspan was in statutory form (Form 16), as required by the *Canada Shipping Act, 2001*, S.C. 2001, c.26 (the "*Shipping Act*") and named Sargeant the mortgagee and Worldspan the mortgagor. Form 16 contains a text box with the following instructional text written above:

> **Whereas** (State that there is an account current between mortgagor and mortgagee (describing both), and describe the nature of the transaction so as to show how the amount of principal and interest due at any given time is to be ascertained and the manner and time of payment).

[26] Below these instructions the following text had been inserted on the Builder's Mortgage granted to Sargeant:

> There is an account current pursuant to that certain Vessel Construction Agreement dated February 29, 2008 among mortgagor and mortgagee which Agreement specifies the obligations hereby secured.

[27] Below these excerpts, another part of the Builder's Mortgage contained the following standard text to which the number "64" had been added, as shown below:

> I/We, the mortgagor(s) in consideration of the above now covenant with the mortgagee(s) to pay to the mortgagee(s) the sums for the time being due on this security, whether by way of principal or interest, at the times and in the manner set out. For the purpose of better securing payment to the mortgagee(s), the mortgagor(s) hereby mortgage to the mortgagee(s) ___**64**_____ shares (**number of shares must be indicated**) of which the mortgagor(s) have the power to mortgage the shares and that they are free of encumbrances except as appears in the record of the said vessel. (delete if not applicable)

[28] Lastly, as noted above, on August 14, 2009, Sargeant assigned his rights under the VCA to Comerica in return for additional financing to complete the construction of the Vessel. The following paragraph comes from a document entitled "Assignment of Insurances" that was concluded between Sargeant, Worldspan and Comerica as part of this assignment and is relevant to this appeal:

> By executing this assignment, it is acknowledged by the parties that the rights assigned to Assignee [Comerica] herein shall be no greater than Purchaser's [Sargeant's] rights under the Construction Agreement. The parties expressly acknowledge Builder's [Worldspan's] first lien rights and rights to payment of any insurance proceeds. Builder [Worldspan] has no duties to Purchaser [Sargeant] that are not expressly set forth in the Vessel Construction Agreement and no additional obligations are created by this assignment, as their interests may appear.

II. DECISIONS UNDER REVIEW

A. *March 5, 2013 decision of the Prothonotary*

[29] Offshore sought a declaration from the Prothonotary to the effect that the Builder's Mortgage granted to Sargeant, pursuant to the VCA, did not create a lien or charge in the Vessel other than to secure its delivery. On March 5, 2013, the Prothonotary granted Offshore's motion, with costs.

[30] Preliminarily, the Prothonotary relied upon a portion of Offshore's written submissions and determined that the argument made by Sargeant and Comerica that the Sargeant had an equitable mortgage or a claim based on paragraph 22(2)(*n*) of the *Federal Courts Act*, R.S.C. 1985, c. F-7 (the "*Act*") was "of no moment" (Prothonotary's Judgment, para. 27).

[31] Instead, the Prothonotary indicated that the key question was the correct interpretation of the language used in the contracts in question and, specifically, whether there was an obligation, express or implied, under the Builder's Mortgage or the VCA for Worldspan to repay the funds advanced by Sargeant and Comerica.

[32] The Prothonotary first concluded that while the Builder's Mortgage complied with the form prescribed by the *Shipping Act*, (Form 16), it did not contain the specifics of the transaction required by that form. Namely, neither the VCA nor the Builder's Mortgage included the amount owing and the "time of payment".

[33] Second, the Prothonotary concluded that the VCA did not contain an express or implied repayment term. In support of this conclusion, he found, notwithstanding the language of the Builder's Mortgage, that there was no evidence that an account current had been created and furthermore that the terms of the VCA, "clearly allowed Worldspan to retain all advances made by Sargeant for the purpose of making payments for the labour and materials to construct the Vessel" (Prothonotary's Judgment, para. 39).

[34] Relying upon an arbitral decision (*FC Yachts Ltd. v. P.R. Yacht Builders Ltd. v. New World Expedition Yachts LLC*, Ad Hoc Decision on Priorities, (31 August 2010) (McIntyre, Abr.)) where it was held that obligations to finance construction of a vessel, such as Sargeant and Comerica's advances in this case, did not constitute a loan, the Prothonotary concluded that, "the parties plainly contemplated that all monies provided for construction of the Vessel would be utilized in its construction and would not exist as a fund" (Prothonotary's Judgment, para. 45). Furthermore, the Prothonotary concluded that, in the event of a breach, the parties had contemplated that Worldspan would be unable to repay the substantial advances made to construct the Vessel. Sargeant's remedies in this circumstance were to have the Vessel completed elsewhere or sold.

[35] As a result, the Prothonotary concluded that no express or implied repayment term could be found in the VCA. Worldspan therefore owed no financial obligations to Sargeant under the VCA. Sargeant's remedies for breach of the VCA were in turn limited to possession and ownership of the Vessel and an *in personam* action against Worldspan. In the result, the Prothonotary found that because the advances were not in the nature of a loan, Worldspan had no obligation to repay them and, in turn, Sargeant did not have an *in rem* claim against the Vessel for their repayment.

B. *December 19, 2013 decision of the Federal Court*

[36] On appeal, the Judge reversed the Prothonotary's decision and concluded that the VCA and the Builder's Mortgage created an obligation upon Worldspan, either express or implied, to repay the advances made by Sargeant and Comerica.

[37] She was of the view that three issues had to be dealt with:

(1) What was the appropriate standard of review for a Federal Court judge hearing the appeal of an order made by a Prothonotary?

(2) Did the Prothonotary err when he concluded that the Builder's Mortgage did not create a lien or charge in the Vessel other than to secure its delivery?

(3) Did the Prothonotary err when he did not consider Sargeant and Comerica's alternate claim under the *Act*, paragraph 22(2)(*n*)?

[38] Having laid out the issues as the Judge saw them, I will summarize her findings on each of these points.

(1) The Judge's determination of the appropriate standard of review for a Federal Court judge hearing the appeal of an order made by a Prothonotary

[39] With respect to the first issue, the Judge determined that the Prothonotary's Judgment did not involve the exercise of discretion but rather, "concerned the task of gleaning the parties' intentions by interpreting the relevant facts and contract provisions" (Federal Court Judgment, para. 21). She therefore concluded that this was a question of mixed fact and law, reviewable against the "palpable and overriding error" standard of review established in *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235 ("*Housen*").

[40] However, with respect to Sargeant and Comerica's assertion that the claim fell under paragraph 22(2)(*n*) of the *Act*, the Judge concluded that the issue determined by the Prothonotary constituted a question of law reviewable on a correctness standard.

(2) The Judge's determination of whether the Prothonotary erred when he concluded that the Builder's Mortgage did not create a lien or charge in the Vessel other than to secure its delivery

[41] Turning to the second issue, the Judge determined that the Prothonotary had correctly recognized that the aim of contract interpretation was to determine the intent of the parties, having regard to the language used in the contract documents and the context in which the contract was executed. In this regard, she determined that the Prothonotary had erred in that he had failed to take the entirety of the factual matrix, including the VCA and the Builder's Mortgage, into account in determining the true intent of the parties.

[42] The Judge determined that section 12.1 was the starting point for an analysis of the VCA. According to this clause, title to the Vessel would remain with Worldspan during construction while the Builder's Mortgage would be granted to Sargeant as security for the sums he advanced to Worldspan.

[43] The key question to be determined was the scope of the security interest held by Sargeant under the Builder's Mortgage. Considering sections 12.1 and 4.1 of the VCA, the Judge concluded that the purpose of the Builder's Mortgage was to provide Sargeant with a continuing first priority security interest in the Vessel to secure the unearned advances. The Judge opined as follows (Federal Court Judgment, para. 52):

> It [the security interest] was intended to be effective against third parties and was not limited in effect as between Worldspan and Sargeant. In short, it served to manage the risk to Sargeant which arose by making the advances while not holding title to the Vessel […]. In my view, the scope of the Builder's Mortgage security was not limited to securing the delivery of the Vessel, rather, it was intended that the Vessel itself was to stand as security for Sargeant's pre-delivery instalments.

(a) *Obligation to repay*

[44] With respect to an obligation to repay the advances, the Judge found that the factual arrangement among the parties was such that Sargeant was to provide the working capital needed by Worldspan to construct the Vessel, Worldspan was to remain the owner until delivery and Sargeant's advances were to be secured by the Builder's Mortgage.

[45] The Judge acknowledged that the VCA and the Builder's Mortgage did not constitute a "loan" in the traditional sense. Furthermore, she noted that there was an absence of explicit language to this effect in the VCA or other regular indicia of a loan arrangement such as a promissory note or schedule of principal and interest payments.

[46] Nevertheless, she found that the language of section 4.1 of the VCA, namely that the advances would be "on account" of the purchase price and that the advances were not considered "earned" until delivery and acceptance of the Vessel, implied the existence of an extended credit, and resultant potential debt, until the advances were considered earned (Federal Court Judgment, para. 53). Therefore, on a plain reading of the VCA, she concluded that Worldspan was, "not entitled to retain and not disgorge the advances if the Vessel was not delivered" (Federal Court Judgment, para. 56).

[47] The Judge found further support for an obligation to repay Sargeant's advances in section 5.3 of the VCA which dealt with the issue of total loss of the Vessel. She concluded that this provision entitled Sargeant to recover all amounts paid to Worldspan pursuant to the VCA whether by insurance or otherwise. Although this provision clearly envisions any refund being

paid by Worldspan to Sargeant from insurance proceeds, she found that it was not limited to such payments and would allow for recovery directly from Worldspan in the event of a denial of insurance coverage by Worldspan's insurer (Federal Court Judgment, para. 58).

[48] The Judge also found support for an obligation to repay in the VCA provisions dealing with the sale of the Vessel in the event of Worldspan's default under the VCA. She determined that the primary purpose of these provisions was to enable Sargeant to recover the sums contributed to the costs of construction. She further observed that the Final Purchase Price, a term defined in section 4.1 of the VCA, is an element of the formula set out in section 24 to determine the liabilities as between the parties in the event of a default and resultant sale of the Vessel. Section 4.1, in turn, states that Sargeant was to make payments on account of the Final Purchase Price in the nature of advances to Worldspan and that the Final Purchase Price was not to be considered earned by Worldspan until delivery and acceptance. She, therefore, concluded that, "it cannot be reasonably argued that the proceeds from the sale of the Vessel payable to Sargeant are anything other than repayment of the advances under this provision" (Federal Court Judgment, para. 60).

[49] With respect to the VCA's term regarding a breach by Sargeant (section 13.5), the Judge found that this term meant that in such an event, the Builder's Mortgage would have to be discharged so as to allow Worldspan to sell the Vessel with clear title. However, she determined that this would not impact upon Worldspan's obligation to repay Sargeant's advances prior to the sale of the Vessel.

[50] The Judge agreed with the Prothonotary that the parties to the VCA contemplated that, in the event of a breach of the VCA or the total loss of the Vessel, the Vessel would be sold to repay the advances made by Sargeant. However, she determined that as the Vessel had been arrested and made subject to claims by third parties, the VCA's provisions pertaining to the Vessel's sale were not directly applicable. Nevertheless, she concluded that these terms were relevant to the intent of the parties and the correct interpretation of the VCA as a whole in the context of the factual matrix. Specifically, she determined that the VCA contained an implied obligation on Worldspan's part to repay Sargeant's advances.

[51] The Judge thus concluded (at paras 72 and 74 of the Federal Court Judgment):

> 72. […] [I]nterpreting the transaction as a whole to determine the intent of the parties and within the relevant factual matrix, the Builder's Mortgage and VCA implied an obligation to repay the unearned advances which created a potential debt that would, in effect, crystallize upon failure to deliver the Vessel in these circumstances. Although there was no actual "loan" there was a potential debt created by the provisions of the VCA and Sargeant secured the satisfaction of the potential debt by way of the Builder's Mortgage.
>
> […]
>
> 74. Here, the potential debt was created by the advances that would not be earned until delivery. The satisfaction of that debt would have occurred by delivery of the Vessel. As that did not occur, and the VCA contractual terms that would have otherwise governed the parties upon default have no application in these circumstances, the debt crystallized and satisfaction would be achieved by repaying the advances, accounts of which were kept by both parties.

(b) *Advances as a fund*

[52] The Judge found that the Prothonotary had erred in finding that the advances were not a loan as they were to be utilized in the construction of the Vessel and therefore would not exist as a "fund". She stated that a commercial absurdity would arise if, "advanced funds could not be

used for the intended purpose of the construction of a ship, and instead had to be set aside to repay the advances" (Federal Court Judgment, para. 81).

(c) *Evidence of account current*

[53] The Judge found that the Prothonotary had erred when he concluded that there was no evidence of an account current having been created pursuant to the VCA.

[54] She concluded that the VCA's terms contemplated that the monthly payments claimed by Worldspan would be subject to verification and audits. Indeed, she noted that Worldspan was required to keep appropriate records in this regard and to submit a Claim Certificate, which set out and supported its claimed monthly expenditures to Sargeant for verification and approval. This process verified what had been spent by Worldspan each month, and therefore, what Sargeant owed. This process allowed the parties to determine, each month, the total cost of the construction to date (Federal Court Judgment, para. 84).

[55] Therefore, she concluded that the intention was that the sums advanced would comprise the account current secured by the Builder's Mortgage, regardless of the fact that the VCA does not explicitly reference an account current (Federal Court Judgment, para. 89).

(d) *Lack of particulars of the Builder's Mortgage*

[56] The Judge found that the Prothonotary had erred when he focused on the parties' failure to include certain formalities in the Builder's Mortgage, namely the amount owing and the "time of payment". She determined that the Prothonotary should have focused on determining the

parties' intentions with respect to the substance of their agreement and should not have adopted an overly formalistic and literal approach to the interpretation of the Builder's Mortgage. Looking at the Builder's Mortgage, she concluded that the amount owing and time of payment were not required to be specified as these sums could be ascertained by reference to the VCA, specifically its verification and audit procedures.

[57] The Judge specifically rejected Offshore's submission that the Builder's Mortgage was strictly intended to secure delivery of the Vessel. Pointing to the plain language used in the VCA, she noted that a first priority security interest in the Vessel, as supported by the Builder's Mortgage, was granted to Sargeant in order to "secure the sums advanced or paid to the Builder under this Agreement," and that neither the VCA nor the Builder's Mortgage made reference to its simply securing the delivery of the Vessel. She found that delivery was instead secured by other terms in the VCA, particularly those pertaining to default and total loss. She concluded that (Federal Court Judgment, para. 99):

> 99. […][T]he Builder's Mortgage was intended to secure Sargeant's first priority rights in the Vessel as against third parties in circumstances, such as these, where the terms of the VCA do not govern the disposition of the Vessel as between Worldspan and Sargeant as it has been arrested by third parties and will be sold by the Court.

[58] After laying out the above analysis, the Judge concluded that the Prothonotary had not interpreted the VCA and the Builder's Mortgage so as to ascertain the true intent of the parties. Specifically, she found that the Prothonotary had failed to take account of the whole transaction in its relevant factual matrix and had also failed to interpret the VCA and the Builder's Mortgage in order to avoid a commercial absurdity. She concluded that this was a palpable and overriding

error which led to the erroneous conclusion that the Builder's Mortgage did not create a lien or charge against the Vessel other than to secure its delivery.

(3) The Judge's determination of whether the Prothonotary erred when he did not consider Sargeant and Comerica's alternate claim under the *Act*, paragraph 22(2)(*n*)

[59] Regarding the third issue, the Judge began by reproducing the excerpt of the portion of Offshore's written submissions which the Prothonotary adopted in his decision. She noted that this excerpt did not address Sargeant and Comerica's arguments with respect to paragraph 22(2)(*n*) of the *Act*. Instead, the submissions solely focused on the question of whether Sargeant or Comerica had a claim to an equitable mortgage. The Judge noted, aside from this adopted excerpt, the Prothonotary had failed to provide any explanation as to why paragraph 22(2)(*n*) of the *Act* did not apply or explained why such reasons would be unnecessary in the circumstances (Federal Court Judgment, paras. 102-103). In light of this failure, the Judge determined that she should properly address this submission.

[60] The Judge determined that a claim for the "delivery, possession or ownership" of the ship is not required to support a claim made under paragraph 22(2)(*n*) of the *Act*. Instead, this provision allows for any claim arising out of a contract relating to the construction of a ship. She found that the case before her involved a claim based on the recovery of advances made for the construction of the Vessel pursuant to the VCA, a ship construction contract. She therefore concluded that this was a sufficient basis upon which to found an *in rem* claim pursuant to paragraph 22(2)(*n*) of the *Act*.

[61] The Judge therefore determined that the Prothonotary had erred in law when he failed to consider Sargeant and Comerica's alternative submission. She found that this alternative claim had merit and ought to be considered at the priorities hearing.

III. ISSUES

[62] The parties differ as to the characterization of the issues before this Court. Offshore takes the view that the Judge implied a repayment obligation into the VCA and frames its submissions based on the case-law regarding the implication of contractual terms. Sargeant and Comerica (collectively the "Respondents") both argue that the Judge, first, interpreted the VCA and surrounding factual matrix such that she found a repayment obligation in its terms, and second, concluded that even if she had not interpreted the VCA in that way, she would have implied a repayment obligation into the VCA in the circumstances.

[63] I favour the Respondents' characterization of the issues. The Judge relied upon authorities pertaining to the interpretation of contracts and their factual matrix in reaching her conclusions. Her analytical approach is most clearly revealed at paragraphs 71-72 of the Federal Court Judgment where she stated:

> 71. […] That wording in the VCA can be interpreted to characterize the advances as being in the nature of a loan. And, as I have addressed below, the mere fact that the Builder's Mortgage itself does not state the particulars of the account current is not fatal.
>
> 72. Even if I had not found this I would have concluded that, interpreting the transaction as a whole to determine the intent of the parties and within the relevant factual matrix, the Builder's Mortgage and VCA implied an obligation to repay the unearned advances which created a potential debt that would, in effect, crystallize upon failure to deliver the Vessel in these circumstances.
>
> [Emphasis added]

[64] Offshore puts forward ten grounds for appeal. However, given my conclusion above as to the analytical framework that the Judge applied, I have regrouped these grounds under either alleged errors of interpretation or alleged errors with respect to the implication of a term into the VCA.

[65] In my view, four issues need to be determined in this appeal:

A. First, what is the correct standard of review for this Court when it reviews a decision of a Federal Court judge who has overturned a decision of a Prothonotary?

B. Second, was the Judge "plainly wrong" in her interpretation of the VCA, Builder's Mortgage and their surrounding factual matrix such that Worldspan must repay the advances to Sargeant?

C. Third, was the Judge "plainly wrong" when she concluded that a repayment obligation on the part of Worldspan could be implied into the VCA?

D. Fourth, did the Judge err in law in her consideration of the Respondents' claim under paragraph 22(2)(*n)* of the *Act*?

IV. ANALYSIS

A. *What is the correct standard of review*?

[66] Offshore submits that the Judge's decision should be reviewed on the basis of palpable and overriding errors for questions of mixed fact and law. However, it also argues that the standard of correctness should apply to two questions of law: first, whether the claim gives rise to *in rem* rights under paragraph 22(2)(*n*) of the *Act*; and second, whether the Judge erred in law by determining that mortgages require a monetary debt in order to be effective.

[67] The Respondents submit that the standard of review enunciated by this Court in *Bristol-Myers Squibb Co. v. Apotex Inc.*, 2011 FCA 34, [2011] F.C.J. No. 147 ("*Bristol Myers*") at para.

7, applies to all issues before the Court. In that case, this Court determined that the standard of review applicable to the review of a Federal Court decision overturning the decision of a Prothonotary is whether the Federal Court, "had no grounds to interfere with the Prothonotary's decision or, in the event such grounds existed, if the Judge's decision was arrived at on a wrong basis or was plainly wrong" (see also *Kniss v. Telecommunications Workers Union*, 2013 FCA 293, [2013] F.C.J. No. 1409 at para. 14 citing *Z.I. Pompey Industrie v. ECU-Line N.V.*, 2003 SCC 27, [2003] 1 S.C.R. 450 at para. 18).

[68] In my opinion, the standard set out in *Bristol-Myers* applies to the determination of the second and third issues, i.e. whether the Judge was "plainly wrong" in her interpretation of the contractual documents or her alternative conclusion that a repayment obligation could be implied into the VCA. However, the correctness standard will apply to the Judge's conclusion with respect to the application of paragraph 22(2)(*n*) of the *Act* to the present case.

[69] The Judge conducted her review of the Prothonotary's decision on the basis that it was non-discretionary and, as such, attracted *Housen* review. Although it was argued in *Bristol Myers* that non-discretionary decisions of prothonotaries should be subject to *Housen* review, we did not in that case determine that point because it was not necessary to do so (*Bristol Myers*, paras. 8 and 9). I am also of the view that we need not decide that issue in the present matter because the parties are not truly at odds regarding the standard of review applied by the Judge and second, regardless of which standard applies, I am satisfied that the Judge had grounds to interfere with the Prothonotary's Judgment.

B. *Was the Judge "plainly wrong" in her interpretation of the VCA, Builder's Mortgage and their surrounding factual matrix such that Worldspan must repay the advances to Sargeant?*

(1) Offshore's Submissions

[70] I begin by setting out the arguments put forward by Offshore as to why we should interfere with the Judge's decision.

[71] Offshore argues that the Judge made two errors in her interpretation of the Builder's Mortgage specifically. First, it argues that she erred in law when she implicitly concluded that mortgages, in order to be effective, require a monetary debt. It argues that mortgages can clearly secure a non-financial obligation such as the delivery of a vessel. Offshore submits that this error of law became a "distorted lens" through which the Judge viewed the factual matrix in the present case. Second, and building upon this alleged error of law, Offshore argues that the Judge failed to appreciate that mortgages do not secure things, but obligations. In this case, Offshore argues that the only obligation expressly placed upon Worldspan in the contractual arrangement was that of the delivery of the Vessel.

[72] Offshore also makes a number of arguments against the Judge's interpretation of the VCA's provisions and surrounding factual matrix.

[73] First, Offshore submits that the Judge erred when she found a broader repayment obligation based on the presence of several specific repayment obligations in the VCA. Offshore says that such specific obligations do not indicate that the parties intended a broader repayment obligation. It argues that if the parties had intended such a broad repayment obligation, it would

have been a very simple thing to express in the VCA. In the absence of such an express repayment obligation, the Judge should have deferred to the written agreement as evidence of the parties' intentions.

[74] Second, Offshore submits that the Judge erred in concluding that a failure of delivery had occurred which crystallized the potential debt owing to Sargeant. On a factual basis, Offshore claims that delivery did not occur because Sargeant failed to pay Worldspan in accordance with his obligations under the VCA. Therefore, Sargeant was not entitled to delivery of the Vessel. Further, Offshore argues that the VCA contained provisions that accounted for the intervention of third-party creditors and that the Judge erred when she concluded that the VCA's terms did not account for such interventions. Offshore points to section 13.1(*c*) of the VCA as evidence that such an occurrence is treated as an act of default although it is quick to say that whether this act can be relied upon by Sargeant depends on whether it was caused by his failure to pay.

[75] Therefore, the result of the intervention of a third party creditor is that either Sargeant or Worldspan was in breach of the VCA. If Sargeant breached the VCA, he cannot found a new remedy upon that breach. If Worldspan breached the VCA, Sargeant's failure to exercise his rights to delivery or sale under the VCA does not create a new right to the repayment of his advances. In short, the failure of delivery was caused by either Sargeant's failure to pay or Sargeant or Comerica's failure to claim for delivery of the Vessel prior to such claims being barred by the claims process order issued by the Prothonotary on August 29, 2011.

[76] Further to the argument that the VCA accounts for the intervention of third party creditors, Offshore disagrees with the Judge's conclusion that a commercial absurdity would result from the failure to find a repayment obligation in the VCA. Offshore argues that the Judge has in fact created a powerful alternate remedy for Sargeant, allowing him to "play the market". In other words, if the market for yachts rose dramatically and completed yachts had values substantially higher than their construction costs, Sargeant could claim for delivery. If the market went down and completed yachts were worth less than their construction costs, Sargeant could ask for repayment of his advances.

[77] Third, Offshore argues that the Judge erred when she concluded that the advances were repayable because they were considered unearned until delivery. Offshore argues that the advances were considered unearned until delivery in order to avoid the payment of taxes. Offshore claims that supporting proof by way of affidavit is not required for this point on the basis that parties to a contract, "are presumed to know and structure their affairs in such a way as to avoid the unnecessary implication of taxes". Offshore does not cite any legal authority for this supposed contractual presumption.

[78] Fourth, Offshore claims that the Judge misinterpreted the breach and remedy provisions of the VCA. It argues that she wrongly implied a repayment obligation into sections 13.5 and 24, which deal with the sale of the Vessel. Offshore argues that these sections provide for an accounting for sale proceeds, which is not the same thing as a repayment obligation. As Offshore states in its factum, "in no instance under section 24 would the Builder have to repay the Owner

all or any funds advanced to build the Vessel. The Buyer [Sargeant] is only entitled to the Vessel or its sale proceeds, net of any amounts due the Builder".

[79] In Offshore's view, the Judge's interpretation of the VCA's breach and remedy provisions would require Worldspan to repay the full amount of the advances regardless of the sale price. This finding negates the express provisions of the VCA which, Offshore submits, "contemplate a final determination of the obligations as between the Builder and Owner based on the sale price of the Vessel but without any residual obligation should the sale price not exceed the amounts advanced".

[80] Offshore further observes that the Judge omitted wording from and mis-cited a portion of section 13.5, which deals with termination of the VCA on account of a breach of its terms by Sargeant. The omitted wording from this section indicates that the amount of instalments to be refunded to Sargeant would depend on the sale price of the Vessel. Offshore submits that, "it is difficult to know if and to what extent [these omissions and mis-quotations] may have influenced [the Judge's] conclusion[s]," with respect to the breach and remedy provisions of the VCA.

[81] Lastly, concerning the misinterpretation of the VCA, Offshore argues that the Judge's finding that the Builder's Mortgage would remain in place pending the sale of the Vessel by Worldspan pursuant to section 13.5 ignores the express wording of that section that, in the event of a breach of the VCA by Sargeant and a termination of the VCA by Worldspan, "property in the Vessel will revert or pass to" Worldspan and that Sargeant was to take any requisite action to

perfect Worldspan's interest therein. Such a finding essentially means that property in the Vessel would never revert or pass to Worldspan.

[82] Fifth, Offshore argues that the Judge erred in her interpretation of the Prothonotary's findings with respect to the existence of the advances as a "fund". In Offshore's opinion, the Prothonotary found that the advances were to be utilized in the construction of the Vessel and that, in the event of a breach, the parties envisioned that Worldspan would not be able to repay the money forwarded to it. In this circumstance, Sargeant's remedy would be to complete the Vessel elsewhere or sell it. Offshore submits that these findings by the Prothonotary were misconstrued by the Judge such that she took him to be saying that the fact that the advances were not set aside as a fund meant that they could not qualify as a loan. She found this to be a commercial absurdity in that money forwarded for the construction of a ship could not be used for that purpose but would have to be set aside in order to repay the advances. In this situation, the Builder's Mortgage granted to Sargeant would be a nullity.

[83] Offshore submits that the Prothonotary's comments had nothing to do with whether the money was a loan or whether the Builder's Mortgage was a nullity. In its words, "the point being made by the Prothonotary was simply that the Vessel was the asset to which Sargeant or any assignee would be looking to should the need arise". Therefore, a repayment obligation was purposefully left out of the VCA as it would never be a useful remedy.

[84] Sixth, Offshore argues that the Judge's interpretation of the insurance provisions of the VCA contravenes the principles established in *Imperial Oil Ltd. v. Commonwealth Construction*

Co., [1978] 1 S.C.R. 317, [1976] S.C.J. No. 115 ("*Commonwealth Construction*"). In Offshore's submission, the VCA's insurance provisions set up a covenant to insure whereby both Sargeant and Worldspan are to be named as insureds under any insurance policy. Therefore, in reliance on *Commonwealth Construction*, Sargeant and Worldspan are co-assureds with a true joint interest, without the possibility of subrogation. By interpreting section 5.3 of the VCA as creating an obligation to repay, whether from insurance or otherwise, the Judge has, in effect, given the underwriter the right of subrogation. Without the presence of an express "notwithstanding" clause in the VCA, such an interpretation contravenes the principle of *Commonwealth Construction*. Offshore argues that section 5.3 of the VCA must be interpreted to mean that Sargeant had the right to recover any money advanced either by insurance or "otherwise", i.e. through the pursuit of third parties other than Worldspan.

(2) Analysis

(a) *Principles of contractual interpretation*

[85] It will be useful at this stage to say a few words concerning contractual interpretation. Most recently in *Sattva Corp. v. Creston Moly Corp.*, 2014 SCC 53, [2014] S.C.J. No. 53 ("*Sattva*"), a unanimous Supreme Court reiterated the principles which should guide us in interpreting contractual documents. In determining whether contractual interpretation, i.e. the determination of rights and obligations under a written agreement, was a question of law or mixed fact and law (the Court answered that it was the latter), Rothstein J. wrote as follows at paragraph 46 to 48 of his reasons:

> 46. The shift away from the historical approach in Canada [i.e. that determining rights of obligations under a written contract was a question of law] appears to be based on two developments. The first is the adoption of an approach to contractual interpretation which directs courts to have regard for the

> surrounding circumstances of the contract -- often referred to as the factual matrix -- when interpreting a written contract […].
>
> 47. Regarding the first development, the interpretation of contracts has evolved towards a practical, common-sense approach not dominated by technical rules of construction. The overriding concern is to determine "the intent of the parties and the scope of their understanding" […]. To do so, a decision-maker must read the contract as a whole, giving the words used their ordinary and grammatical meaning, consistent with the surrounding circumstances known to the parties at the time of formation of the contract. Consideration of the surrounding circumstances recognizes that ascertaining contractual intention can be difficult when looking at words on their own, because words alone do not have an immutable or absolute meaning:
>
> > No contracts are made in a vacuum: there is always a setting in which they have to be placed... . In a commercial contract it is certainly right that the court should know the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating.
> >
> > (*Reardon Smith Line*, at p. 574, *per* Lord Wilberforce)
>
> 48. The meaning of words is often derived from a number of contextual factors, including the purpose of the agreement and the nature of the relationship created by the agreement […]. As stated by Lord Hoffmann in *Investors Compensation Scheme Ltd. v. West Bromwich Building Society*, [1998] 1 All E.R. 98 (H.L.):
>
> > The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. [p. 115].
>
> [Emphasis added]

[86] At paragraphs 56 to 58 of his reasons, Rothstein J. indicated that it was proper to consider surrounding circumstances in interpreting the terms of a contract, but that the circumstances, "must never be allowed to overwhelm the words of that agreement," adding that the purpose of considering surrounding circumstances was to help the decision maker to obtain a better

understanding of the mutual and objective intentions of the parties as these were expressed in the words of their contract. Further, "[t]he interpretation of a written contractual provision must always be grounded in the text and read in light of the entire contract" (*Sattva*, para. 57). Lastly, Rothstein J. made it clear that "surrounding circumstances" could only consist of, "objective evidence of the background and facts at the time of the execution of the contract" (*Sattva*, para. 58).

[87] While there has been some debate in the jurisprudence over what constitutes a "factual matrix," at a bare minimum it encompasses the contract's genesis, its purpose and its commercial context (*Primo Poloniato Grandchildren's Trust (Trustee of) v. Browne*, 2012 ONCA 862, [2012] O.J. No. 5772 at para. 69, leave to appeal to S.C.C. refused, [2013] S.C.C.A. No. 68). As Chief Justice Winkler of the Ontario Court of Appeal held in *Salah v. Timothy's Coffees of the World Inc.*, 2010 ONCA 673, [2010] O.J. No. 4336 at para. 16:

> 16. The basic principles of commercial contractual interpretation may be summarized as follows. When interpreting a contract, the court aims to determine the intentions of the parties in accordance with the language used in the written document and presumes that the parties have intended what they have said. The court construes the contract as a whole, in a manner that gives meaning to all of its terms, and avoids an interpretation that would render one or more of its terms ineffective. In interpreting the contract, the court must have regard to the objective evidence of the "factual matrix" or context underlying the negotiation of the contract, but not the subjective evidence of the intention of the parties. The court should interpret the contract so as to accord with sound commercial principles and good business sense, and avoid commercial absurdity. If the court finds that the contract is ambiguous, it may then resort to extrinsic evidence to clear up the ambiguity. Where a transaction involves the execution of several documents that form parts of a larger composite whole -- like a complex commercial transaction -- and each agreement is entered into on the faith of the others being executed, then assistance in the interpretation of one agreement may be drawn from the related agreements […].
>
> [Emphasis added]

(b) *The nature of builder's mortgages*

[88] In the case before us, the factual matrix takes place within the contours of the Builder's Mortgage, which, itself, is part of a larger series of agreements relating to the construction, financing, delivery and sale of the Vessel. As such, to understand the context of this case, it is worth reviewing the general features of a builder's mortgage.

[89] Like all mortgages, a builder's mortgage provides a creditor with security for the repayment of a loan or the performance of some obligation by the acquisition of a security interest in a vessel or a share thereof (Edgar Gold, Aldo Chircop & Hugh Kindred, *Essentials of Canadian Law: Maritime Law* (Toronto: Irwin Law, 2003) at 241-242 ("Gold")). A builder's mortgage, in particular, is used during the construction of a vessel, where the incomplete vessel is held as security for loans made to the vessel's owner (Gold at 160).

[90] Pursuant to the *Shipping Act*, builder's mortgages are in a standard, statutory form (Form 16). Since the statutory form does not contain as much information as one usually finds in a mortgage agreement, other documents, such as a VCA, are often used to supplement its terms (Gold at 160-61; *Shipping Act* at subsection 65(1)).

[91] Importantly, the statutory forms allows for two kinds of mortgages: a mortgage that secures a principal sum and a fixed interest rate, or a mortgage that secures an account current (Gold at 246). This case pertains to an account current mortgage.

[92] Although there seems to be a dearth of case law on the subject, Prothonotary Hargrave in *Governor and Company of the Bank of Scotland v. "Nel" (The)*, [2001] 1 F.C. 408, [2000] F.C.J. No. 1305 (F.C.T.D.) at para. 20, described an account current as an "all encompassing security" which, in that case, secured a broad range of running accounts, including advances made to or on behalf of the owner. Likewise, as Gold writes (at 246):

> […] an account current […] is a continuing security for a balance that may fluctuate and an interest rate that may change. An account current mortgage is the more flexible of the two kinds of mortgage because it allows for future advances, perhaps to cover operations or repairs to the ship after the initial loan for its purchase, and it can be used to accommodate financing by a revolving line of credit.

[93] Typically, the mortgagee (Sargeant) has the right to proceed against a vessel *in rem* and have the vessel arrested pending a declaration of default (J. D. Buchan, *Mortgages of Ships: Maritime Security in Canada* (Toronto and Vancouver: Butterworths, 1986) at 82 ("Buchan")). Generally, the rights of the mortgagee with respect to the security in the vessel are governed by the rights and remedies set out in the collateral loan agreement (in this case the VCA) (Buchan at 69).

[94] Likewise, provided the mortgage has not been foreclosed or the vessel has not been sold through the mortgagee's power of sale, the mortgagor (Worldspan) should have a right to redeem its property upon the payment of the debt (Buchan at 63); however, even if the mortgagee has exercised its right of sale over the vessel, he has an obligation to hold the excess proceeds (i.e. those above the amount required to extinguish the mortgage debt, plus accumulated interest and the cost of storage/sale) in trust for the mortgagor and other claimants in the vessel (Buchan at 66-67).

(c) *The Builder's Mortgage was intended to secure Sargeant's advances*

[95] With these principles in mind, I now turn to the question of whether the Judge erred in finding that the Builder's Mortgage secured Sargeant's advances to Worldspan. I am of the opinion that the Judge's conclusion that the Builder's Mortgage secures repayment of the advances was not "plainly wrong" or to use *Housen* terminology, I am satisfied that the Judge made no palpable and overriding error.

[96] I come to this conclusion for the following reasons. First, there can be no doubt that the Judge was aware of the relevant principles of contractual interpretation which she applied in construing the documents at issue in the light of the surrounding circumstances or factual matrix.

[97] Second, she held, after proper consideration of the Builder's Mortgage and the VCA, that the intent of the parties in executing the Builder's Mortgage was to secure the advances made by Sargeant to Worldspan, advances which were in the nature of a loan.

[98] Third, I am of the view that the Judge, in concluding as she did, cannot be considered to have implied a term of repayment into the VCA. Rather, she found, after a proper contractual analysis, and in particular after a careful review of sections 4.1, 5.3 and 12.1 of the VCA, that the advances were in the nature of a loan and thus repayable. Therefore, Offshore's submission that the Judge erred when she did not refer to the caselaw regarding the implication of contractual terms is incorrect.

[99] Fourth, my own view of the matter is that when the VCA and the Builder's Mortgage are properly construed, this can only lead to the conclusion that the advances must necessarily be considered as a loan to Worldspan and thus repayable.

[100] In the following paragraphs I will expand the brief reasons which I have just set out above as to why I am of the view that there is no basis for us to intervene in this appeal. Following this, I will address the specific submissions put forward by Offshore in support of its appeal.

[101] The Prothonotary found that, notwithstanding the wording of the Builder's Mortgage, there was no evidence that any "account current" was created pursuant to the VCA. In support of this position, he relied on a decision of an arbitrator which held that advances were insufficient to constitute an account current. The Prothonotary also relied particularly on the fact that the advances in this case were clearly not intended to be kept in a fund, but were to be used in the construction of the Vessel. As such, the Prothonotary was of the opinion that Worldspan had no obligation under the VCA to repay the advances to Sargeant and that the Builder's Mortgage only secured delivery of the Vessel. I am in total agreement with the Judge that this interpretation does not withstand scrutiny.

[102] For one, the Prothonotary's interpretation essentially casts aside the explicit wording in the Builder's Mortgage which refers to the existence of an "account current" and provides no other explanation for what those words could have meant. In my opinion, this alone justified the Judge to interfere with the Prothonotary's order.

[103] It is a cardinal rule of contractual interpretation that, "an interpretation that renders one or more of the contract's provisions ineffective will be rejected" (*Athwal v. Black Top Cabs Ltd.*, 2012 BCCA 107, [2012] B.C.J. No. 420 at para. 42). Whether or not a mortgage can secure non-financial obligations, the statutory forms for ship mortgages only refer to two types of consideration: an account current or a principal sum. In turn, one of those two obligations must be present for the mortgage to be effective; otherwise, there would be no consideration as between the parties. In that light, I subscribe to the Judge's view that adopting the Prothonotary's interpretation would render the Builder's Mortgage of no force or effect to secure delivery, since there would have been no consideration to support the agreement.

[104] Moreover, the Prothonotary's interpretation ignores the essential promise of a builder's mortgage (as stated in the statutory Form 16), which is that the mortgagor (Worldspan) must pay the mortgagee (Sargeant), in consideration of an account current, "the sums for the time being due on this security, whether by way of principal or interest, at the times and in the manner set out". Indeed, again using the language of Form 16, the Vessel was only given as security, "for the purpose of better securing payment to the mortgagee". Consequently, like the Judge, while the VCA and the Builder's Mortgage are somewhat unclear with respect to when and how the advances are to be repaid to Sargeant, I do not consider this as fatal to Sargeant's claim.

[105] As pointed out by the Judge, the advances are, pursuant to section 4.1 of the VCA, paid on account of the Final Purchase Price, but not earned by Worldspan until delivery and acceptance of the Vessel by Sargeant. While I agree with the Judge that the fact that the advances are "unearned" strongly suggests that they were made in the nature of a loan, in my view the fact

that the advances are paid on account of the Final Purchase Price provides stronger evidence that the advances were secured by the Builder's Mortgage.

[106] Since the advances are paid "on account of the Final Purchase Price," Sargeant will, presumably, have the Final Purchase Price reduced by those amounts upon final purchase of the Vessel. Indeed, sections 4.1 and 24.2 of the VCA show that such amounts will be taken into account when calculating the Final Purchase Price. In turn, once the Vessel is delivered, the advances will, effectively, be returned to Sargeant with their value represented in the Vessel by the reduced purchase price. In this light, the "time being due on the security" can be seen to refer to delivery of the Vessel to Sargeant. If the Vessel is destroyed or Worldspan is no longer capable of delivering it, however, the advances would no longer be able to be returned through a reduced purchase price and, as such, would have to be returned in liquid form, i.e. hence the obligation to repay.

[107] This interpretation is supported by section 12.1 of the VCA which explicitly states that Worldspan grants Sargeant a security interest in the Vessel to secure any sums advanced or paid to the Builder under the VCA and that, "in support of Owner's security interest in the Vessel [the] Builder agrees to register a Ship's Mortgage in favour of Owner […] if Owner requests that this be done for any purpose". From this, the main concern of the Builder's Mortgage appears to be securing the sums advanced by Sargeant, not the delivery of the Vessel.

[108] I also agree with the Judge that the remedy provisions of the VCA support the view that Worldspan was required to return the advances to Sargeant, in particular through showing that

Sargeant's rights in the Vessel, until payment of the Final Purchase Price, were defined by the amounts advanced.

[109] Under section 13.5 of the VCA, if Sargeant were to default on his obligations under the VCA, Worldspan would have the right to terminate the VCA and sell the Vessel. However, as noted by the Judge, in the event of sale by Worldspan, Worldspan is still liable to return all "instalment payments" (i.e. advances) made by Sargeant if the sale price is higher than the Capped Purchase Price. Even if the sale price is lower than the Capped Purchase Price, Worldspan would still have to return the advances, less the difference between the Capped Purchase Price and the actual purchase price. This, in turn, suggests that Sargeant has a surviving interest in the Vessel equal to the amount of the advances paid.

[110] Likewise, under section 24 of the VCA, in the event that Sargeant sells the Vessel within three years of the delivery date (whether complete or not), four different formulas are used to determine the amount of money owing between Sargeant and Worldspan. As noted by the Judge, whenever the sale results in a profit, Sargeant is liable to pay a portion of that profit to Worldspan. However, whenever the sale results in a loss, Worldspan is liable to indemnify Sargeant for a portion of that loss. Moreover, under section 24.8, when making a payment under any of the section 24 formulas, each party is entitled to deduct from the amount due the other any amount owing to them under the VCA. In light of these formulas, I entirely agree with the Judge that the proceeds from the sale of the Vessel that are payable to Sargeant are, in effect, a repayment of the advances.

[111] To that end, because these formulas require Sargeant to split the profits of a sale with Worldspan, the "commercial absurdity" referenced by Offshore, whereby Sargeant would be allowed to "play the market" and seek delivery of the Vessel to secure a higher return instead of claiming a repayment of the advances does not realistically arise since both parties would benefit equally from selling the Vessel at an increased cost. And while Offshore suggests that it would be unfair if Worldspan's obligations to Sargeant could be satisfied "simply by repaying the advances," even if the Vessel was sold at a drastically inflated price, in my opinion such a result is not unfair if one views Sargeant's rights in the Vessel as confined to the advances already paid, which again supports the view that the parties intended the Builder's Mortgage to secure those rights.

[112] Finally, I also share the Judge's view that section 5.3 of the VCA supports the proposition that the parties intended to secure the repayment of the advances (whether as a fund or through delivery of the Vessel). According to that provision, in the event that the Vessel is lost during construction, Sargeant is entitled to recover all amounts paid to Worldspan under the VCA. Offshore submits that this provision only entitles Sargeant to claim amounts that have been paid to Worldspan by insurance or a third-party claim; not amounts that he has previously paid to Worldspan. However, a grammatically-correct reading of section 5.3 shows that because of the placement of a comma between "hereunder" and "whether", the amounts recoverable by Sargeant are indeed those which Sargeant has paid to Worldspan. The reference to "insurance or otherwise" is simply an indication of the ways in which Worldspan might repay this amount.

[113] Ultimately, Offshore, in my respectful view, confuses the means with the end when it asserts that the Mortgage was intended to secure delivery of the Vessel. Because the advances are paid "on account of" the Final Purchase Price, which as per section 24.2 takes into account all amounts paid, delivery of the Vessel will satisfy a return of the advances. However, nothing in the Builder's Mortgage or the VCA rebuts the general principle that, until foreclosure or sale, the mortgagor has the right to redeem the mortgaged vessel upon repayment of the debt, or that upon sale, the mortgagee has an obligation to return the excess to the mortgagor. Indeed, this principle is supported by the remedy provisions of the VCA and the sale formulas. In that light, I agree with Comerica and Sargeant that, on a full consideration of the factual matrix, section 12.1 of the VCA and the general terms of the Builder's Mortgage explicitly secure repayment of the advances as the "account current".

(d) *Responses to Offshore's specific arguments against the Judge's interpretation of the Builder's Mortgage and the VCA*

[114] I now turn to various specific submissions Offshore makes as to why the Judge erred in her interpretation of both the Builder's Mortgage and the VCA.

[115] First, Offshore said that the Judge erred in finding at paragraph 97 of the Federal Court Judgment that the Builder's Mortgage would be of no force or effect if all it secured was the delivery of the Vessel. In its view, it is clear on the authorities that a mortgage can secure a debt or the discharge of any other non-financial obligation. In my view, I need not arrive at any definite conclusion on this point because the Judge found, on her interpretation of the contractual documents, that the Builder's Mortgage was not intended to secure only the delivery of the Vessel. Rather, she found that the Builder's Mortgage was clearly intended to secure Sargeant's

advances to Worldspan, failing which it would not provide Sargeant with any effective remedy. Consequently, we need not decide whether or not a mortgage can only secure non-financial obligations, such as the delivery of a vessel.

[116] Second, Offshore says that the Judge erred, at paragraph 74 of the Federal Court Judgment, when she held that the debt was created by reason of the advances not being earned until delivery of the Vessel and by reason of Worldspan's failure to deliver the Vessel. In the circumstances of the case, the Judge held that the VCA's provisions concerning default did not apply. Thus, in the Judge's view, the debt had crystallized and satisfaction thereof would be met by Worldspan repaying the advances to Sargeant.

[117] More particularly, Offshore says that delivery did not occur because either Sargeant failed to pay amounts due to Worldspan under Section 12 of the VCA or Sargeant or Comerica failed to claim delivery of the Vessel prior to their claims becoming time-barred under the Prothonotary's claims process order of August 29, 2011. In making this point, Offshore reiterates its assertion that the Builder's Mortgage existed to secure delivery of the Vessel. Offshore also says that the Judge was wrong to hold, at paragraph 64 of the Federal Court Judgment, that the arrest of the Vessel by a third-party creditor of Worldspan was a circumstance unforeseen by the VCA. In such a scenario, Offshore says that two outcomes were possible: first, if Sargeant was in breach of the VCA, he could not obtain repayment of his advances; or second, if Worldspan was in breach, Sargeant would have the right to ask for delivery and sale of the Vessel pursuant to the VCA's terms.

[118] Consequently, Offshore says that there is no basis for implying a term of repayment of the advances because these are secured by the express obligation of Worldspan to deliver the Vessel. Thus, no commercial absurdity results from the non-existence of a repayment provision.

[119] I cannot subscribe to Offshore's point of view. The Vessel was arrested by Offshore because Worldspan failed to pay it. This failure led to a judgment against Worldspan in favour of Offshore. In those circumstances, Worldspan was unable to obtain the release of the Vessel which, in due course, was sold by the Federal Court free and clear of all claims, liens and encumbrances.

[120] Offshore's argument regarding delivery is premised on its assertion that Sargeant is indebted to Worldspan due to his failure to pay his advances. Consequently, following Offshore's reasoning, Worldspan had no obligation to deliver the Vessel. However, this assertion is disputed by Sargeant. He argues that he was over-billed by Worldspan. In any event, the issue of whether Sargeant or Worldspan or both of them were in breach of the VCA is one that has yet to be determined by a court. It is clear, however, that the VCA does not address the situation where the Vessel has been arrested by a third-party creditor before either Sargeant or Comerica could ask for delivery and subsequently has been sold by the Court. While it is true that the VCA imposes upon Worldspan the obligation to deliver the Vessel, such an obligation is not mentioned in the Builder's Mortgage nor in that part of the VCA which provides that Worldspan, upon demand of Sargeant, will execute a mortgage in his favour. Therefore, it can hardly be said that the Builder's Mortgage was intended solely to secure delivery of the Vessel.

[121] If Offshore's position is to be accepted, Sargeant would effectively have had to conduct ongoing monitoring of Worldspan's accounts with third party creditors (such as Offshore) in order to ensure that it did not enter into any arrangements or default on any of its financial obligations. In turn, if Worldspan did enter into an arrangement or default on its obligations to any third party, Sargeant would have had to immediately sue for delivery of the Vessel before the third party arrested the Vessel. Failing that, he would have been left without an effective remedy. Such an interpretation of the effect of the VCA and the Builder's Mortgage is clearly a commercial absurdity.

[122] I can therefore detect no error on the Judge's part when she found that failure on the part of Worldspan to deliver the Vessel to Sargeant gave rise to an obligation to repay the advances.

[123] Offshore's third submission is that had the parties intended to impose upon Worldspan a broad repayment obligation, they would have done so explicitly in the VCA. Consequently, in the absence of an express provision, the Judge should not have found such an obligation on the basis of the various specific repayment obligations found in the VCA. In support of its proposition, Offshore says that the VCA must have been drafted by knowledgeable attorneys and, in that respect, points to the fact that, according to the VCA, a copy of any notice to Sargeant was to be sent to law firm in the United Kingdom. Consequently, in Offshore's view, this gives greater weight to its arguments that the omission to insert a general repayment clause was not accidental but, to the contrary, is reflective of the parties' intentions.

[124] First of all, there is no evidence on the record that the VCA was, in fact, drafted by solicitors. In any event, even if that were the case, I cannot set how that can impact on the manner in which the Judge ought to have interpreted the contractual documents.

[125] The Judge found that there was an obligation to repay the advances to Sargeant on the basis of her reading of both the VCA and the Builder's Mortgage. In other words, she interpreted the contractual documents and determined that it was the parties' intention that should delivery of the Vessel not take place, Sargeant would be entitled to be repaid the advances which had not yet been earned. In so interpreting the contractual documents, the Judge considered, correctly in my view, other provisions in the VCA which obliged Worldspan, in specific circumstances, to repay the advances to Sargeant. I can find no error on the part of the Judge in regard to this finding.

[126] Offshore's fourth submission is that the Judge was in error in concluding that Sargeant's advances were repayable by Worldspan because they were considered unearned until delivery of the Vessel. Offshore submits that the reason why the advances were unearned until delivery was to avoid the payment of taxes. They argue that no evidence was required to make this point because parties to a contract, "are presumed to know and structure their affairs in such a way as to avoid the unnecessary implication of taxes". More particularly, in support of that assertion, Offshore notes that the VCA states that delivery of the Vessel was to be made in international waters. Thus, in its view, the fact that the Vessel was to be exported was an essential element of the sale (Offshore's Memorandum of Fact and Law, para. 56).

[127] In my view, there is no merit to this submission. First, Offshore does not cite any legal authority for the asserted contractual presumption regarding the minimization of unnecessary taxes. Second, there is no evidence on the record to support Offshore's argument. One would have expected that some form of affidavit evidence would be required to support such an argument.

[128] Offshore's fifth submission is that while certain provisions of the VCA, namely sections 13.5 and 5.3, specifically address the repayment of the advances in defined circumstances, these provisions did not justify the Judge to imply a general repayment obligation. The Judge, however, did not see it that way. In her view, those provisions were relevant in determining the intent of the parties and the interpretation of the VCA in the context of the factual matrix. Again, I see no basis to interfere with the Judge's findings.

[129] Offshore makes a further argument in its Memorandum of Fact and Law, under the subtitle, "Misinterpretation of 'the Fund'". Offshore argues that the Judge misinterpreted the Prothonontary's findings with regard to the existence or non-existence of the advances as a "fund". In Offshore's view, the parties contemplated that the advances made to Worldspan by Sargeant would be used for the construction of the Vessel and would not exist as a fund and that the parties were well aware that should there be a breach of the VCA, Worldspan would be unable to repay the substantial advances made to it. Consequently, the only remedy left for Sargeant would be to take delivery of the Vessel from the construction yard and then either complete the construction or sell the Vessel.

[130] Offshore argues that the point made in the Prothonotary's Judgment was simply that Sargeant and Comerica would be looking at the Vessel as their asset should the need arise and not to the repayment of the advances, an obligation which was intentionally left out of the VCA, except for the specific circumstances addressed in sections 13.5 and 5.3 of the VCA.

[131] I see no reason to disagree with the Judge who found that although the parties expected that Worldspan would use the advances to construct the Vessel and therefore, the advances would not exist as a "fund" *per se*, this did not prevent the advances from constituting a loan, albeit in an unconventional one.

[132] Offshore also submits that the Judge erred by misinterpreting the insurance provisions of the VCA, found at section 5.3 thereof, in finding that they supported an obligation to repay the advances. In its view, interpreting section 5.3 to create a repayment obligation independent of the parties' status as joint-assureds cannot have been contemplated and would have required express "notwithstanding" language. For the reasons that I have already given at paragraph 112 of these reasons, I cannot agree with Offshore. Section 5.3 of the VCA cannot be restricted in the way it suggests. Further, I am satisfied that Offshore's reliance on *Commonwealth Construction* is misplaced since that case deals with an insurer's right to subrogate against a co-assured under the policy. The factual matrix of this case is entirely distinguishable from that of *Commonwealth Construction*. Consequently, I see no error on the part of the Judge.

[133] Offshore makes a further submission. It says that the Judge, at paragraphs 59 and following of her reasons, also misinterpreted the various breach and remedy provisions of the

VCA, found at sections 13.1, 13.5 and 24.8 thereof, by interpreting them to support the view that Worldspan was obliged to repay the advances upon default.

[134] In my view, the Judge made no reviewable error. I am satisfied that she considered these provisions in her interpretation of the VCA and the Builder's Mortgage and determined that they also, effectively, served to secure Sargeant's advances. I cannot detect any palpable and overriding error in the conclusion that she reached in regard to these provisions.

C. *Was the Judge "plainly wrong" when she concluded that a repayment obligation on the part of Worldspan could be implied into the VCA?*

[135] In view of the conclusion that I have reached in regard to the second question, I need not address the third issue. However, I note that there can be no doubt, in view of paragraph 72 of the Federal Court Judgment, that the Judge did not base her decision on an implied term. At that paragraph, she wrote as follows:

> 72. Even if I had not found this I would have concluded that, interpreting the transaction as a whole to determine the intent of the parties and within the relevant factual matrix, the Builder's Mortgage and VCA implied an obligation to repay the unearned advances which created a potential debt that would, in effect, crystallize upon failure to deliver the Vessel in these circumstances. Although there was no actual "loan" there was a potential debt created by the provisions of the VCA and Sargeant secured the satisfaction of the potential debt by way of the Builder's Mortgage.
>
> [Emphasis added]

[136] The phrase "even if I had not found this" in the above paragraph refers to the Judge's conclusion (at paragraph 71 of the Federal Court Judgment) that the VCA's wording can be interpreted to characterize Sargeant's advances as being in the nature of loan. Therefore, the above passage makes clear that the Judge's implied term conclusion was only put forward as an

alternative route by which she would have arrived at the same result. Given my finding that she did not err in her contractual interpretation, I need not comment further upon this issue.

D. *Did the Judge err in law in her consideration of the Respondents' claim under paragraph 22(2)(n) of the Act?*

[137] There can be no doubt that the Judge was correct in finding that Sargeant's claim was one that fell within the ambit of paragraph 22(2)(*n*) of the *Act*, which provides that the Federal Court has jurisdiction over, "any claim arising out of a contract relating to the construction, repair or equipping of a ship," and that further, by reason of subsection 43(2) of the *Act*, Sargeant's claim could be exercised *in rem*.

[138] I see no basis to disturb the Judge's determination. In any event, Offshore does not really challenge that part of her decision. It simply says that this determination is, in reality, of no relevance.

[139] Offshore says that although paragraph 22(2)(*n*) provides jurisdiction to deal with Sargeant's claim, it does not found a cause of action which, in the present instance, results from obligations created by the VCA and a resultant possible claim for damages for breach of contract.

[140] I agree with Offshore that a paragraph 22(2)(*n*) claim cannot do more than the Builder's Mortgage if that document does no more than secure advances through the obligation of delivery.

[141] Be that as it may, the Judge's finding with regard to paragraph 22(2)(*n*) will remain but, in my respectful view, nothing in the end will turn on this in view of my conclusion that the Builder's Mortgage secured more than simply the delivery of the Vessel and in fact, secured Sargeant's advances.

V. CONCLUSION

[142] For these reasons, I would dismiss the appeal with costs.

"M. Nadon"

J.A.

"I agree.
Eleanor R. Dawson J.A."

"I agree.
Johanne Trudel J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-439-13

(APPEAL FROM AN ORDER OF THE HONOURABLE MADAM JUSTICE STRICKLAND OF THE FEDERAL COURT DATED DECEMBER 19, 2013, DOCKET NUMBER T-1226-10)

STYLE OF CAUSE:	OFFSHORE INTERIORS INC. v. HARRY SARGEANT III and COMERICA BANK
PLACE OF HEARING:	OTTAWA, ONTARIO
DATE OF HEARING:	JUNE 9, 2014
REASONS FOR JUDGMENT BY:	NADON J.A.
CONCURRED IN BY:	DAWSON, TRUDEL JJ.A.
DATED:	FEBRUARY 16, 2015

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