

SUPREME COURT OF BRITISH COLUMBIA

Citation: ***Natco International, Inc. v. Photo
Violation Technologies Corp.,***
2008 BCSC 1527

Date: 20081107
Docket: S078417
Registry: Vancouver

Between:

Natco International, Inc.

Plaintiffs

And

**Photo Violation Technologies Corp.,
Fred Mitschele aka Fred Marlatt**

Defendants

AND

Docket: S081159
Registry: Vancouver

Between:

Natco International, Inc.

Plaintiffs

And

**Michael Wallace Minor, aka Mike Minor,
Jason Michael Joseph Mitschele, and Malisa Phoiliang**

Defendants

Before: The Honourable Madam Justice Griffin

Reasons for Judgment - Security for Costs

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Jason Mitschele, and Malisa Phoiliang:

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Date and Place of Hearing:

October 17-17,
2008
Vancouver, B.C.

INTRODUCTION

[1] The personal defendants in two lawsuits commenced by Natco International, Inc. ("Natco") have applied for an order that Natco post security for costs of these personal defendants or that Natco's claims be otherwise stayed or dismissed failing the posting of the security for costs.

NATURE AND STATUS OF ACTIONS

[2] Natco's lawsuits arise out of a failed corporate transaction between Natco and Photo Violation Technologies Corp ("PVT"). Natco is a publicly traded company on the Over the Counter Bulletin Board ("OTCBB") in the United States. PVT is a company which claims to have rights to automated parking meter technology.

[3] The two lawsuits, Action No. S078417 and S081159, Vancouver Registry, were ordered consolidated into Action No. S078417: see **Natco International, Inc. v. Photo Violation Technologies Corp.**, 2008 BCSC 1325. At the time of the applications for security for costs, Natco had not yet filed a Consolidated Statement of Claim. It promised the court that it would do so by October 24, 2008. As at close of the registry on November 6, 2008, it still had not done so, although by letter dated November 4, 2008 it delivered an unfiled Consolidated Statement of Claim to the defendants, who then provided it to the court.

[4] In summary, Natco claims it was induced by negligent and "intentional" misrepresentations of representatives of PVT, the personal defendants, to enter into contracts with PVT and advance it \$1.485 million (USD). Natco further claims that

PVT breached its contracts with Natco; that the personal defendants owed duties to Natco which they negligently breached; and the personal defendants have personally profited from the misrepresentations and breaches of duties by receiving the benefit of the monies advanced by Natco to PVT. In the latest Consolidated Statement of Claim, Natco alleges that the personal defendants conspired to divert the monies paid by Natco to PVT to their own personal use; and that the defendant Fred Mitschele "interfered" in the economic and business relations between Natco and PVT.

[5] The defendants denied Natco's allegations in their earlier Statements of Defence and it is clear they intend to vigorously defend these claims.

[6] PVT has counterclaimed against Natco for breach of contract. PVT also advances a counterclaim against three personal directors of Natco. None of the personal defendants advance counterclaims or at present intend to do so.

[7] Not much has happened in the substantive prosecution of these claims and cross-claims due to preliminary motions that were brought soon after the Natco Actions were commenced.

[8] The personal defendants filed these applications for security for costs early on in these proceedings.

[9] Some months ago, Natco filed an application for summary trial, seeking judgment against PVT.

[10] All of the defendants also brought applications to strike out all or part of Natco's pleadings. This was the first of the parties' various applications to be heard, and it resulted in the Order of this court striking Natco's claims and ordering the filing of a consolidated Statement of Claim, as referred to above: 2008 BCSC 1325.

[11] Natco sought to have its summary trial application heard at the same time as the personal defendants' applications for security for costs, but due to availability of counsel and the court, this could not be scheduled until January 2009.

[12] There have been no examinations for discovery yet.

ISSUES ON SECURITY FOR COSTS APPLICATION

[13] The court has jurisdiction to order Natco to post security for costs pursuant to s. 236 of the *Business Corporations Act*, S.B.C. 2002, c. 57, which provides:

236. If a corporation is the plaintiff in a legal proceeding brought before the court, and if it appears that the corporation will be unable to pay the costs of the defendant if the defendant is successful in the defence, the court may require security to be given by the corporation for those costs, and may stay all legal proceedings until the security is given.

[14] As well, the court has inherent jurisdiction to order a party to post security for costs.

[15] The issues on this application for security for costs, as established by the authorities, are

1. Have the personal defendants shown that it appears that Natco will be unable to pay the defendants' costs if the action fails? If so,
2. Has Natco shown that it has exigible assets that could satisfy an award of costs? Or,
3. Has Natco shown that there is no arguable defence to its claims? Or,
4. Has Natco shown that Natco's claim will be stifled if it is required to post security for costs?
5. If security for costs is to be ordered, what quantum of security should be ordered and what should be the terms of any stay of proceedings pending the posting of security?

See *Citizens for Foreign Aid Reform Inc. v. Canadian Jewish Congress* (1999), 36 C.P.C. (4th) 266 (B.C.S.C.) at ¶¶13-14; *Kropp v. Swanest Bay Golf Course Ltd.* (1997), 29 B.C.L.R. (3d) 252 (C.A.), 90 B.C.A.C. at 260-61; and *Fat Mel's Restaurant Ltd. v. Canadian Northern Shield Insurance Co.* (1993), 76 B.C.L.R. (2d) 231 (C.A.), 25 B.C.A.C. 95, at ¶¶16.

Have the personal defendants shown that it appears that Natco will be unable to pay the defendants' costs if the action fails?

[16] Natco is a company incorporated pursuant to the laws of Delaware, United States of America. It is currently registered as an extra-provincial company in British Columbia, although its registration lapsed for a time.

[17] Delaware is a non-reciprocating jurisdiction pursuant to the *Court Order Enforcement Act*, R.S.B.C. 1996, c. 78, s. 37. This means a judgment obtained in

British Columbia cannot be simply registered and automatically enforced in Delaware. This is a factor that can be taken into account as weighing in favour of an order for security for costs.

[18] Natco is a self-described "shell" company. Natco is required to file financial reports as a publicly traded company. Natco's publicly filed report for the quarter ended June 30, 2008, filed August 19, 2008, revealed that Natco has virtually no real assets other than its contingent claim against PVT. It has no active business. Its financial statements show only \$2,856 worth of assets, apart from its claim against PVT, and current liabilities of over \$1.4 million.

[19] The CEO and President of Natco, Mr. Gurm, filed an Affidavit in which he described Natco's value as a publicly trading company on the OTCBB as approximately \$800,000. However, at best, this is the value of Natco's shares, something held by Natco's shareholders and not by Natco itself.

[20] Mr. Gurm also briefly described in his Affidavit #1 a business deal between Natco and another company, Lassen Energy, Inc. However, the evidence falls short of establishing that this business deal has become binding, or that Natco has reaped or will reap any financial gains from it that would allow it to pay the defendants' costs in the future.

[21] I conclude that the personal defendants have shown that Natco will be unable to pay their costs if Natco's action fails.

Has Natco shown that it has exigible assets that could satisfy an award of costs?

[22] The focus of Natco's argument in opposing the applications for security for costs is that Natco has a very strong claim in debt against PVT for \$1.485 million (USD) plus interest. Natco argued that if security for costs is desirable, the security should be ordered by giving the personal defendants' costs first priority against the judgment that Natco is sure to recover against the corporate defendant, PVT.

[23] I do not accept Natco's argument. Natco's claim against PVT is not an exigible asset. Even if I was to find that Natco's claim against PVT is a strong claim, it is being actively defended by PVT which is advancing a counterclaim. PVT is not a respondent to the present application. Until Natco recovers judgment against PVT, its claim against PVT is not an asset which can satisfy a costs award in favour of the personal defendants.

[24] Simply put, Natco's position would shift the risk of Natco's claim against PVT to the personal defendants. The personal defendants will be out-of-pocket their costs in defending the claims against them if Natco does not succeed in its claim against PVT. In my view, this does not satisfy the burden on Natco to demonstrate that it could satisfy an award of costs in favour of the personal defendants.

[25] A similar but not identical argument was advanced by a plaintiff and rejected in ***Vetshopaustralia Ppty. Ltd. v. Pivotal Partners Inc.***, 2007 BCSC 1519 (**"*Vetshopaustralia*"**). The court noted in ***Vetshopaustralia*** that the plaintiff's argument "misses the point" because "the focus of an application of this kind is on

the protection of a defendant where the plaintiff's action is unsuccessful". These comments apply equally to Natco's argument.

[26] I conclude that Natco has not shown that it has exigible assets that could satisfy an award of costs in favour of the personal defendants.

Has Natco shown that there is no arguable defence to its claims?

[27] Once the defendants, as here, have established that it appears that the plaintiff may not be able to pay costs if the defence prevails, the plaintiff must show either that it will be able to pay costs, or that the defendants have no arguable case, or that an order for security for costs will stifle the plaintiffs action: ***Citizens for Foreign Aid Reform*** at ¶23; ***Fat Mel's Restaurant Ltd.*** at ¶16.

[28] Natco failed to establish that there is no arguable defence to its claims against the personal defendants. The focus of Natco's argument and evidence was directed to the question that there is no arguable defence to its claim against PVT, but that is not the correct issue.

[29] I am mindful that on a security for costs application, the court is not to embark on a detailed examination of the merits of the claim or defences: see ***Dong v. Au***, 2007 BCCA 37 at ¶10, approving ***Kropp*** at ¶17. Natco argues that the personal defendants have not filed affidavits denying many of the facts alleged in the plaintiff's affidavits. The personal defendants make the point that this is because the evidence in Natco's affidavits is confused, inadmissible, and falls short of establishing causes of action against them. I find that Natco's evidence against the personal defendants

is not clear and compelling, and I am unable to conclude that the personal defendants do not have arguable defences.

Has Natco shown that Natco's claim will be stifled if it is required to post security for costs?

[30] The ordering of security for costs is discretionary. The court must consider, in the exercise of its discretion, whether the ordering of security for costs would work an undue hardship on the plaintiff. A plaintiff must do more than show it has no assets if arguing that an order for security for costs would stifle the action: *Kropp* at ¶21.

[31] In *Vetshopaustralia* the plaintiff argued that if it had an inability to pay security for costs this was due entirely to the defendant's wrongful actions in withholding funds that were the subject of the lawsuit. Natco makes a similar claim here, although it focuses on its claim against PVT and not the personal defendants. The court in *Vetshopaustralia* noted that for this argument to have weight, the plaintiff would need to show that an order to post security for costs would stifle the action. This was not shown in *Vetshopaustralia*, nor has Natco shown this here.

[32] Natco has not filed any evidence that it would be unable to raise funds and proceed if ordered to post security for costs of the personal defendants. It appears from the evidence that Natco raised the funds it provided to PVT from third party investors. It also appears from Natco's public filings that personal investors are funding the legal costs of the litigation against PVT. As such, it appears that persons backing Natco may have a stake in the outcome of this litigation. There is

no basis for concluding that these persons would not assist Natco in posting security for costs if it was to be ordered. If other persons are supporting Natco in advancing litigation against the personal defendants, knowing that the personal defendants will only have recourse against Natco for costs, it would seem fair that Natco be required to post security for costs: see **Fat Mel's Restaurant Ltd.** at ¶¶27-30.

If security for costs is to be ordered, what quantum of security should be ordered and what should be the terms of any stay of proceedings pending the posting of security?

[33] I conclude that security for costs of the personal defendants should be ordered. The defendants have shown that it appears that Natco has no assets to satisfy an order for costs. Natco has been unable to show that it does have exigible assets, or that the personal defendants have no arguable defence, or that an order for security for costs would stifle its claim.

[34] The next issue is what should be the terms of an order for security for costs.

[35] The court has discretion, when ordering security for costs, to order such amount as appears just in the circumstances of the case: **Fat Mel's Restaurant Ltd.** at ¶¶34-35. The court should order more than a nominal amount but does not need to order the maximum amount of security for costs: **Kropp** at ¶17.

[36] There were two sample bills of costs put forward by the personal defendants, one totalling approximately \$56,000 on behalf of the defendant Mike Minor; and the other totalling approximately \$195,274 on behalf of the other three personal defendants. The latter bill of costs claimed the maximum tariff for many items, plus

large disbursements. The former bill of costs claimed a reasonable middle ground for most tariff items.

[37] One of the circumstances to consider is the early stage of the proceedings and the fact that there may be opportunities to settle or dismiss or discontinue the claims prior to trial once the discovery process takes place and each side learns the strengths and weaknesses of the other's case. The first stage of discovery will be document discovery. This may reveal sufficient facts to give rise to negotiations for discontinuance or settlement of some of the claims. Examinations for discovery will be the next stage for the plaintiff and defendants to learn the strengths and weaknesses of their opponent's case, following which it may or may not be possible for them to reach agreement on resolution of the claims.

[38] Another circumstance to consider is the very complicated nature of the allegations in the case at bar. Furthermore, the allegations suggest dishonesty on the part of the personal defendants. As such, it is an exceptional case and it is likely that the personal defendants will be required to spend considerable time and effort defending the claims against them.

[39] Counsel for the personal defendants Fred Mitschele, Jason Mitschele and Malisa Phoiliang submitted that payment of security for costs in stages would be appropriate. I agree. Instalment payments for security for costs were ordered in ***Gold River Chinook Project Society v. Bowater Pulp and Paper Canada Inc.***, 2002 BCSC 166, and in ***Scopeset Technology Inc. v. Astaro Corp.***, 2004 BCSC 830.

[40] In this case I consider it appropriate to order security for costs to be posted in three stages. I order that the plaintiff's action against a personal defendant be stayed unless the plaintiff posts the following as security for costs for each personal defendant against whom it advances claims:

Stage 1. \$10,000 for each personal defendant forthwith;

Stage 2. An additional \$15,000 for each personal defendant within 150 days of this order and at least 60 days prior to examination for discovery of that defendant, whichever is earlier;

Stage 3. An additional \$20,000 for each personal defendant no later than at least 120 days prior to the earliest assigned trial date for the trial of the action against the personal defendants, or before any summary judgment or summary trial application brought by the plaintiff against the personal defendants.

[41] These amounts are cumulative. The security can be posted with the court, or, subject to agreement of the parties, in the trust account of one of the counsel for the parties.

[42] The order for security for costs does not relieve the plaintiff from paying any other costs which may be come ordered or due under the Rules, such as reasonable costs for photocopying of the defendants' documents or for conduct money to bring the personal defendants to examination for discovery, or costs ordered by the Court to be payable forthwith.

[43] I consider it inappropriate to make a "guillotine order" that the action be dismissed failing the posting of security: see ***Global Banking Systems Inc.v.***

Datawest Solutions Inc., 2006 BCCA 577, 38 C.P.C. (6th) 353 at 1119-23. However, should the plaintiff's action against a personal defendant be stayed due to the failure to post the cumulative security for costs required as of 120 days before trial or before any summary judgment or summary trial application against that personal defendant, that personal defendant shall have liberty to apply to strike the claims against him or her.

[44] There will be certain exceptions to the stay of proceeding. The stay of the proceeding does not prevent the plaintiff from filing its Consolidated Statement of Claim or from proceeding with any leave to appeal application or appeal in connection with this court's earlier ruling on the plaintiff's pleadings. The stay also does not prevent the defendants from proceeding with their current outstanding applications for costs against the plaintiff in relation to the court's earlier ruling on the plaintiff's pleadings.

[45] As well, the personal defendants and the plaintiff shall have liberty to apply for a full or partial lift of the stay if necessary to respond to any other active steps in the proceeding between the remaining parties.

"S. Griffin"

The Honourable Madam Justice S. Griffin