Court File No. CV-15-10832-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, C.C-3, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF TARGET CANADA CO., TARGET CANADA HEALTH CO., TARGET CANADA MOBILE GP CO., TARGET CANDA PHARMACY (BC) CORP., TARGET CANADA PHARMACY (ONTARIO) CORP., TARGET CANADA PHARMACY CORP., TARGET CANADA PHARMACY (SK) CORP., and TARGET CANADA PROPERTY LLC

Applicants

BOOK OF AUTHORITIES OF ISSI INC.

Motion by ISSI Inc. to Appoint an *Ad Hoc* Committee of 30 Day Suppliers

May 8, 2015

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A. Farber & Partners Inc.

TO: **THE SERVICE LIST**

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Tab 1

CITATION: Re 4519922 Canada Inc. 2015 ONSC 124
COURT FILE NO.: CV-1410791-00CL
DATE: 20150112

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c.C-36 AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF 4519922 CANADA INC.

BEFORE: Newbould J.

COUNSEL:

Robert I. Thornton, John T. Porter, Lee M. Nicholson and Asim Iqbal, for the Applicant

Harry M. Fogul, for 22 former CLCA partners

Orestes Pasparakis and Evan Cobb, for the Insurers

Avram Fishman and Mark Meland, for the German and Canadian Bank Groups, the Widdrington Estate and the Trustee of Castor Holdings Limited

James H. Grout, for 22 former CLCA partners

Chris Reed, for 8 former CLCA partners

Andrew Kent, for 5 former CLCA partners

Richard B. Jones, for one former CLCA partner

John MacDonald, for Pricewaterhouse Coopers LLP

James A. Woods, Sylvain Vauclair, Bogdan Catanu and Neil Peden, for Chrysler Canada Inc. and CIBC Mellon Trust Company

Jay A. Swartz, for the proposed Monitor Ernst & Young Inc.

HEARD: December 8, 2014 and January 6, 2015

ENDORSEMENT

[1] On December 8, 2014 the applicant 4519922 Canada Inc. ("451"), applied for an Initial Order granting it protection under the *Companies' Creditors Arrangement Act* ("CCAA"), extending the protection of the Initial Order to the partnership Coopers & Lybrand Chartered Accounts ("CLCA"), of which it is a partner and to CLCA's insurers, and to stay the outstanding litigation in the Quebec Superior Court relating to Castor Holdings Limited ("Castor") during the pendency of these proceedings. The relief was supported by the Canadian and German bank groups who are plaintiffs in the Quebec litigation, by the Widdrington Estate that has a final judgment against CLCA, by the insurers of CLCA and by 22 former CLCA partners who appeared on the application.

[2] The material in the application included a term sheet which the applicant wishes to use as a basis of a plan and which provides for an injection of approximately $220 million in return for a release from any further litigation. The term sheet was supported by all parties who appeared.

[3] I granted the order with a stay to January 7, 2015 for reasons to follow, but in light of the fact that Chrysler Canada Inc., with a very large claim against CLCA in the litigation, had not

been given notice of the application, ordered that Chrysler be given notice to make any submissions regarding the Initial Order if it wished to do so.

[4] Chrysler has now moved to set aside the Initial Order, or in the alternative to vary it to delete the appointment of a creditors' committee and the provision for payment of the committee's legal fees and expenses. On the return of Chrysler's motion, a number of other former CLCA partners and PricewaterhouseCoopers appeared in support of the granting of the Initial Order.

Structure of Coopers & Lybrand Chartered Accounts

[5] The applicant 451 is a corporation continued pursuant to the provisions of the *Canada Business Corporations Act,* and its registered head office is in Toronto, Ontario. It and 4519931 Canada Inc. ("4519931") are the only partners of CLCA.

[6] CLCA is a partnership governed by the *Partnerships Act (Ontario)* with its registered head office located in Toronto, Ontario. It was originally established in 1980 under the name of "Coopers & Lybrand" and was engaged in the accountancy profession. On September 2, 1985, the name "Coopers & Lybrand" was changed to "Coopers & Lybrand Chartered Accountants" and the partnership continued in the accountancy profession operating under the new name. Until 1998, CLCA was a national firm of chartered accountants that provided audit and accounting services from offices located across Canada and was a member of a global network of professional firms.

[7] In order to comply with the requirements of the various provincial Institutes of Chartered Accountants across Canada, many of which restricted chartered accountants providing audit services from being partners with persons who were not chartered accountants, Coopers & Lybrand Consulting Group ("CLCG") was established under the *Partnerships Act (Ontario)* in September 1985 to provide management consulting services. Concurrent with the formation of CLCG, Coopers & Lybrand ("OpCo") was established as a partnership of CLCA, CLCG and two other parties to develop and manage the CLCA audit and CLCG management consulting practices that had to remain separate. Until 1998, OpCo owned most of the operating assets of

CLCA and CLCG. OpCo is governed by the Partnerships Act (Ontario) and its registered head office is in Toronto.

[8] In 1998, the member firms of the global networks of each of Coopers & Lybrand and Price Waterhouse agreed upon a business combination of the two franchises. To effect the transaction in Canada, substantially all of CLCA's and CLCG's business assets were sold to PricewaterhouseCoopers LLP ("PwC"), which entity combined the operations of the Coopers & Lybrand entities and Price Waterhouse entities, and the partners of CLCA and CLCG at that time became partners of PwC. Subsequent to the closing of the PwC transaction, CLCA continued for the purpose of winding up its obligations and CLCA and CLCG retained their partnership interests in OpCo. By 2006, all individual CLCA partners had resigned and been replaced by two corporate partners to ensure CLCA's continued existence to deal with the continuing claims and obligations.

[9] Since 1998, OpCo has administered the wind up of CLCA and CLCG's affairs, in addition to its own affairs, including satisfying outstanding legacy obligations, liquidating assets and administering CLCA's defence in the Castor litigation. In conjunction with OpCo, 451 and 4519931 have overseen the continued wind up of CLCA's affairs. The sole shareholders of 451 and 4519931 are two former CLCA partners. 451 and 4519931 have no assets or interests aside from their partnership interests in CLCA.

Castor Holdings litigation

[10] Commencing in 1993, 96 plaintiffs commenced negligence actions against CLCA and 311 of its individual partners claiming approximately $1 billion in damages. The claims arose from financial statements prepared by Castor and audited by CLCA, as well as certain share valuation letters and certificates for "legal for life" opinions. The claims are for losses relating to investments in or loans made to Castor in the period 1988 to 1991. A critical issue in the Castor litigation was whether CLCA was negligent in doing its work during the period 1988-1991.

[11] Fifty-six claims have either been settled or discontinued. Currently, with interest, the plaintiffs in the Castor litigation collectively claim in excess of $1.5 billion.

[12] Due to the commonality of the negligence issues raised in the actions, it was decided that a single case, brought by Peter Widdrington claiming damages in the amount of $2,672,960, would proceed to trial and all other actions in the Castor litigation would be suspended pending the outcome of the Widdrington trial. All plaintiffs in the Castor litigation were given status in the Widdrington trial on the issues common to the various claims and the determination regarding common issues, including the issues of negligence and applicable law, was to be binding in all other cases.

[13] The first trial in the Widdrington action commenced in September 1998, but ultimately was aborted in 2006 due to the presiding judge's illness and subsequent retirement. The new trial commenced in January 2008 before Madam Justice St. Pierre. A decision was rendered in April 2011 in which she held that Castor's audited consolidated financial statements for the period of 1988-1990 were materially misstated and misleading and that CLCA was negligent in performing its services as auditor to Castor during that period. She noted that that the overwhelming majority of CLCA's partners did not have any involvement with Castor or the auditing of the financial statements prepared by Castor.

[14] The decision in the Widdrington action was appealed to the Quebec Court of Appeal which on the common issues largely upheld the lower court's judgment. The only common issue that was overturned was the nature of the defendant partners' liability. The Quebec Court of Appeal held that under Quebec law, the defendant partners were severally liable. As such, each individual defendant partner is potentially and contingently responsible for his or her several share of the damages suffered by each plaintiff in each action in the Castor litigation for the period that he or she was a partner in the years of the negligence.

[15] On January 9, 2014, the defendants' application for leave to appeal the Widdrington decision to the Supreme Court of Canada was dismissed.

[16] The Widdrington action has resulted in a judgment in the amount of $4,978,897.51, inclusive of interest, a cost award in the amount of $15,896,297.26 plus interest, a special fee cost award in the amount of $2.5 million plus interest, and a determination of the common issue

that CLCA was negligent in performing its services as auditor to Castor during the relevant period.

[17] There remain 26 separate actions representing 40 claims that have not yet been tried. Including interest, the remaining plaintiffs now claim more than $1.5 billion in damages. Issues of causation, reliance, contributory negligence and damages are involved in them.

[18] The Castor Litigation has given rise to additional related litigation:

(a) Castor's trustee in bankruptcy has challenged the transfer in 1998 of substantially all of the assets used in CLCA's business to PwC under the provisions of Quebec's bulk sales legislation. As part of the PwC transaction, CLCA, OpCo and CLCG agreed to indemnify PwC from any losses that it may suffer arising from any failure on the part of CLCA, OpCo or CLCG to comply with the requirements of any bulk sales legislation applicable to the PwC transaction. In the event that PwC suffers any loss arising from the bulk sales action, it has the right to assert an indemnity claim against CLCA, OpCo and CLCG.

(b) Certain of the plaintiffs have brought an action against 51 insurers of CLCA. They seek a declaration that the policies issued by the insurers are subject to Quebec law. The action would determine whether the insurance coverage is costs-inclusive (i.e. defence costs and other expenses are counted towards the total insurance coverage) or costs-in-addition (i.e. amounts paid for the defence of claims do not erode the policy limits). The insurers assert that any insurance coverage is costs-inclusive and has been exhausted. If the insurers succeed, there will be no more insurance to cover claims. If the insurers do not succeed and the insurance policies are deemed to be costs-in-addition, the insurers may assert claims against CLCA for further premiums resulting from the more extensive coverage.

(c) The claim against the insurers was set to proceed to trial in mid-January 2015 for approximately six months. CLCA is participating in the litigation as a mis-en-cause and it has all the rights of a defendant to contest the action and is bound by the result. As a result of the stay in the Initial Order, the trial has been put off.

(d) There have been eight actions brought in the Quebec Superior Court challenging transactions undertaken by certain partners and parties related to them (typically a spouse) (the "Paulian Actions").

(e) There is a pending appeal to the Quebec Court of Appeal involving an order authorizing the examination after judgment in the Widdrington action of Mr. David W. Smith.

[19] The next trial to proceed against CLCA and the individual partners will be in respect of claims made by three German banks. It is not expected to start until at the least the fall of 2015 and a final determination is unlikely until 2017 at the earliest, with any appeals taking longer. It is anticipated that the next trial after the three German banks trial will be in respect of Chrysler's claim. Mr. Woods, who acts for Chrysler, anticipates that it will not start until 2017 with a trial decision perhaps being given in 2019 or 2020, with any appeals taking longer. The remaining claims will not proceed until after the Chrysler trial.

[20] The fees incurred by OpCo and CLCA in the defence of the Widdrington action are already in excess of $70 million. The total spent by all parties already amounts to at least $150 million. There is evidence before me of various judges in Quebec being critical of the way in which the defence of the Widdrington action has been conducted in a "scorched earth" manner.

Individual partner defendants

[21] Of the original 311 defendant partners, twenty-seven are now deceased. Over one hundred and fifty are over sixty-five years of age, and sixty-five more will reach sixty-five years of age within five years. There is a dispute about the number of defendant partners who were partners of CLCA at the material time. CLCA believes that twenty-six were wrongly named in the Castor litigation (and most have now been removed), a further three were named in actions that were subsequently discontinued, some were partners for only a portion of the 1988-1991

period and some were named in certain actions but not others. Six of the defendant partners have already made assignments in bankruptcy.

Analysis

(i) Applicability of the CCAA

[22] Section 3(1) of the CCAA provides that it applies to a debtor company where the total claims against the debtor company exceed $5 million. By virtue of section 2(1)(a), a debtor company includes a company that is insolvent. Chrysler contends that the applicant has not established that it is insolvent.

[23] The insolvency of a debtor is assessed at the time of the filing of the CCAA application. While the CCAA does not define "insolvent", the definition of "insolvent person" under the *Bankruptcy and Insolvency Act* is commonly referred to for guidance although the BIA definition is given an expanded meaning under the CCAA. See Holden, Morawetz & Sarra, *the 2013-2014 Annotated Bankruptcy and Insolvency Act* (Carswell) at N§12 and *Re Stelco Inc.* (2004), 48 C.B.R. (4^{th}) 299 (per Farley J.) ; leave to appeal to the C of A refused 2004 CarswellOnt 2936 (C.A.).

[24] The BIA defines "insolvent person" as follows:

> "insolvent person" means a person who is not bankrupt and who resides, carries on business or has property in Canada, whose liabilities to creditors provable as claims under this Act amount to one thousand dollars, and
>
> (a) who is for any reason unable to meet his obligations as they generally become due,
>
> (b) who has ceased paying his current obligations in the ordinary course of business as they generally become due, or
>
> (c) the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due;

[25] The applicant submits that it is insolvent under all of these tests.

[26] The applicant 451 is a debtor company. It is a partner of CLCA and is liable as a principal for the partnership's debts incurred while it is a partner.

[27] At present, CLCA's outstanding obligations for which the applicant 451 is liable include: (i) various post-retirement obligations owed to former CLCA partners, the present value of which is approximately $6.25 million (the "Pre-71 Entitlements"); (ii) $16,026,189 payable to OpCo on account of a loan advanced by OpCo on October 17, 2011 to allow CLCA to pay certain defence costs relating to the Castor litigation; (iii) the Widdrington costs award in the amount of $18,783,761.66, inclusive of interest as at December 1, 2014, which became due and payable to the plaintiff's counsel on November 27, 2014; (iv) the special fee in the amount of $2,675,000, inclusive of interest as at December 1, 2014, awarded to the plaintiff's counsel in the Widdrington action; and (v) contingent liabilities relating to or arising from the Castor litigation, the claims of which with interest that have not yet been decided being approximately $1.5 billion.

[28] The only asset of the applicant 451 on its balance sheet is its investment of $100 in CLCA. The applicant is a partner in CLCA which in turn is a partner in OpCo. At the time of the granting of the Initial Order, Ernst & Young Inc., the proposed Monitor, stated in its report that the applicant was insolvent based on its review of the financial affairs of the applicant, CLCA and OpCo.

[29] Mr. Peden in argument on behalf of Chrysler analyzed the balance sheets of CLCA and OpCo and concluded that there were some $39 million in realizable assets against liabilities of some $21 million, leaving some $18 million in what he said were liquid assets. Therefore he concluded that these assets of $18 million are available to take care of the liabilities of 451.

[30] I cannot accept this analysis. It was unsupported by any expert accounting evidence and involved assumptions regarding netting out amounts, one of some $6.5 million owing to pre-1971 retired partners, and one of some $16 million owing by CLCA to OpCo for defence costs funded by OpCo. He did not consider the contingent claims against the $6.5 million under the indemnity provided to PWC, nor did he consider that the $16 million was unlikely to be collectible by OpCo as explained in the notes to the financial statements of 451.

[31] This analysis also ignored the contingent $1.5 billion liabilities of CLCA in the remaining Castor litigation and the effect that would have on the defence costs and for which the applicant 451 will have liability and a contingent liability for cost awards rendered in that litigation against CLCA. These contingent liabilities must be taken into account in an insolvency analysis under the subsection (c) definition of an insolvent person in the BIA which refers to obligations due and accruing due. In *Re Stelco, supra*, Farley J. stated that all liabilities, contingent or unliquidated, have to be taken into account. See also *Re Muscletech Research & Development Inc.* (2006), 19 C.B.R. (5th) 54 (per Farley J.).

[32] It is obvious in this case that if the litigation continues, the defence costs for which the applicant 451 will have liability alone will continue and will more than eat up whatever cash OpCo may have. As well, the contingent liabilities of CLCA in the remaining $1.5 billion in claims cannot be ignored just because CLCA has entered defences in all of them. The negligence of CLCA has been established for all of these remaining cases in the Widdrington test case. The term sheet provides that the claims of the German and Canadian banks, approximately $720 million in total, and the claim of the Trustee of CLCA of approximately $108 million, will be accepted for voting and distribution purposes in a plan of arrangement. While there is no evidence before me at this stage what has led to the decision of CLCA and its former partners to now accept these claims, I can only conclude that in the circumstances it was considered by these defendants that there was exceptional risk in the actions succeeding. I hesitate to say a great deal about this as the agreement in the term sheet to accept these claims for voting and distribution purposes will no doubt be the subject of further debate in these proceedings at the appropriate time.

[33] As stated, the balance sheet of the applicant 451 lists as its sole asset its investment of $100 in CLCA. The notes to the financial statements state that CLCA was indebted to OpCo at the time, being June 30, 2014, for approximately $16 million and that its only asset available to satisfy that liability was its investment in OpCo on which it was highly likely that there would be no recovery. As a result 451 would not have assets to support its liabilities to OpCo.

[34] For this reason, as well as the contingent risks of liability of CLCA in the remaining claims of $1.5 billion, it is highly likely that the $100 investment of the applicant 451 in CLCA

is worthless and unable to fund the current and future obligations of the applicant caused by the CLCA litigation.

[35] I accept the conclusion of Ernst & Young Inc. that the applicant 451 is insolvent. I find that the applicant has established its insolvency at the time of the commencement of this CCAA proceeding.

(ii) Should an Initial Order be made and if so should it extend to CLCA?

[36] The applicant moved for a stay in its favour and moved as well to extend the stay to CLCA and all of the outstanding Castor litigation. I granted that relief in the Initial Order. Chrysler contends that there should be no stay of any kind. It has not expressly argued that if a stay is granted against the applicant it should not be extended to CLCA, but the tenor of its arguments would encompass that.

[37] I am satisfied that if the stay against the applicant contained in the Initial Order is maintained, it should extend to CLCA and the outstanding Castor litigation. A CCAA court may exercise its jurisdiction to extend protection by way of the stay of proceedings to a partnership related to an applicant where it is just and reasonable or just and convenient to do so. The courts have held that this relief is appropriate where the operations of a debtor company are so intertwined with those of a partner or limited partnership in question that not extending the stay would significantly impair the effectiveness of a stay in respect of the debtor company. See *Re Prizm Income Fund* (2011), 75 C.B.R. (5th) 213 per Morawetz J. The stay is not granted under section 11 of the CCAA but rather under the court's inherent jurisdiction. It has its genesis in *Re Lehndorff General Partner Ltd.* (1993), 17 C.B.R. (3d) 24 and has been followed in several cases, including *Canwest Publishing Inc.* (2010) 63 C.B.R. (5th) 115 per Pepall J. (as she then was) and *Re Calpine Energy Canada Ltd.* (2006), 19 C.B.R. (5th) 187 per Romaine J.

[38] The applicant 451's sole asset is its partnership interest in the CLCA partnership and its liabilities are derived solely from that interest. The affairs of the applicant and CLCA are clearly intertwined. Not extending the stay to CLCA and the Castor litigation would significantly impair the effectiveness of the stay in respect of 451. It would in fact denude it of any force at all as the

litigation costs would mount and it would in all likelihood destroy any ability to achieve a global settlement of the litigation. CLCA is a necessary party to achieve a resolution of the outstanding litigation, and significant contributions from its interest in OpCo and from its former partners are anticipated under the term sheet in exchange for releases to be provided to them.

[39] Chrysler relies on the principle that if the technical requirements for a CCAA application are met, there is discretion in a court to deny the application, and contends that for several reasons the equities in this case require the application to be met. It says that there is no business being carried on by the applicant or by CLCA and that there is no need for a CCAA proceeding to effect a sale of any assets as a going concern. It says there will be no restructuring of a business.

[40] Cases under the CCAA have progressed since the earlier cases such as *Hongkong Bank v. Chef Ready Foods* (1990), 4 C.B.R. (3d) 311 which expressed the purpose of the CCAA to be to permit insolvent companies to emerge and continue in business. The CCAA is not restricted to companies that are to be kept in business. See *First Leaside Wealth Management Inc., Re*, 2012 ONSC 1299 at para. 33 (per Brown J. as he then was). There are numerous cases in which CCAA proceedings were permitted without any business being conducted.

[41] To cite a few, in *Muscletech Research and Development Inc. (Re)* (2006), 19 C.B.R. (5th) 54 the applicants sought relief under the CCAA principally as a means of achieving a global resolution of a large number of product liability and other lawsuits. The applicants had sold all of its operating assets prior to the CCAA application and had no remaining operating business. In *Montreal, Maine & Atlantic Canada Co. (Re)*, 2013 QCCS 3777 arising out of the Lac-Mégant train disaster, it was acknowledged that the debtor would be sold or dismantled in the course of the CCAA proceedings. The CCAA proceedings were brought to deal with litigation claims against it and others. In *Crystallex International Corp. (Re)* 2011 ONSC 7701 (Comm. List) the CCAA is currently being utilized by a company with no operating business, the only asset of which is an arbitration claim.

[42] Chrysler contends, as stated in its factum, that the pith and substance of this case is not about the rescue of a business; it is to shield the former partners of CLCA from their liabilities in

a manner that should not be approved by this court. Chrysler refers to several statements by judges beginning in 2006 in the Castor litigation who have been critical of the way in which the Widdrington test case has been defended, using such phrases as "a procedural war of attrition" and "scorched earth" strategies. Chrysler contends that now that the insurance proceeds have run out and the former partners face the prospect of bearing the cost of litigation which that plaintiffs have had to bear throughout the 22-year war of attrition, the former partners have convinced the German and Canadian banks to agree to the compromise set out in the term sheet. To grant them relief now would, it is contended, reward their improper conduct.

[43] Chrysler refers to a recent decision in Alberta, *Alexis Paragon Limited Partnership (Re)*, 2014 ABQB 65 in which a CCAA application was denied and a receiver appointed at the request of its first secured creditor. In that case Justice Thomas referred to a statement of Justice Romaine in *Alberta Treasury Branches v. Tallgrass Energy Corp.*, 2013 ABQB 432 in which she stated that an applicant had to establish that it has acted and is acting in good faith and with due diligence. Justice Thomas referred to past failures of the applicant to act with due diligence in resolving its financial issues and on that ground denied the CCAA application. Chrysler likens that to the manner in which the Widdrington test case was defended by CLCA.

[44] I am not entirely sure what Justice Romaine precisely had in mind in referring to the need for an applicant to establish that "it has acted and is acting with good faith and with due diligence" but I would think it surprising that a CCAA application should be defeated on the failure of an applicant to have dealt with its affairs in a diligent manner in the past. That could probably said to have been the situation in a majority of cases, or at least arguably so, and in my view the purpose of CCAA protection is to attempt to make the best of a bad situation without great debate whether the business in the past was properly carried out. Did the MM&A railway in Lac-Mégantic act with due diligence in its safety practices? It may well not have, but that could not have been a factor considered in the decision to give it CCAA protection.

[45] I do understand that need for an applicant to act in the CCAA process with due diligence and good faith, but I would be reluctant to lay down any fixed rule as to how an applicant's actions prior to the CCAA application should be considered. I agree with the statement of Farley

J. in *Muscletech Research and Development Inc. (Re)* (2006), 19 C.B.R. (5th) 57 that it is the good faith of an applicant in the CCAA proceedings that is the issue:

> Allegations ... of bad faith as to past activities have been made against the CCAA applicants and the Gardiner interests. However, the question of good faith is with respect to how these parties are conducting themselves in these CCAA proceedings.

[46] There is no issue as to the good faith of the applicant in this CCAA proceeding. I would not set aside the Initial Order and dismiss the application on the basis of the defence tactics in the Widdrington test case.

[47] The Castor litigation has embroiled CLCA and the individual partners for over 20 years. If the litigation is not settled, it will take many more years. Chrysler concedes that it likely will take at least until 2020 for the trial process on its claim to play out and then several more years for the appellate process to take its course. Other claims will follow the Chrysler claim. The costs have been enormous and will continue to escalate.

[48] OpCo has dedicated all of its resources to the defence of the Castor litigation and it will continue to do so. OpCo has ceased distributions to its partners, including CLCA, in order to preserve funds for the purpose of funding the defence of the litigation. If the Castor litigation continues, further legal and other costs will be incurred by OpCo and judgments may be rendered against CLCA and its partners. If so, those costs and judgments will have to be paid by OpCo through advances from OpCo to CLCA. Since CLCA has no sources of revenue or cash inflow other than OpCo, the liabilities of CLCA, and therefore the applicant, will only increase.

[49] If the litigation is not settled, CLCA's only option will be to continue in its defence of the various actions until either it has completely depleted its current assets (thereby exposing the defendant partners to future capital calls), or a satisfactory settlement or judicial determination has been reached. If no such settlement or final determination is achieved, the cost of the defence of the actions could fall to the defendant partners in their personal capacities. If a resolution cannot be reached, the amount that will be available for settlement will continue to decrease due to ongoing legal costs and other factors while at the same time, the damages

claimed by the plaintiffs will continue to increase due to accruing interest. With the commencement of further trials, the rate of decrease of assets by funding legal costs will accelerate.

[50] After a final determination had been reached on the merits in the Widdrington action, CLCA's board of directors created a committee comprised of certain of its members to consider the next steps in dealing with CLCA's affairs given that, with the passage of time, the defendant partners may ultimately be liable in respect of negligence arising from the Castor audits without a settlement.

[51] Over the course of several months, the committee and the defendant partners evaluated many possible settlement structures and alternatives and after conferring with counsel for various plaintiffs in the Castor litigation, the parties agreed to participate in a further mediation. Multiple attempts had earlier been made to mediate a settlement. Most recently, over the course of four weeks in September and October 2014, the parties attended mediation sessions, both plenary and individually. Chrysler participated in the mediation.

[52] Although a settlement could not be reached, the applicant and others supporting the applicant believe that significant progress was achieved in the mediation. In light of this momentum, the applicant and CLCA continued settlement discussions with certain plaintiffs willing to engage in negotiations. These discussions culminated with the execution of a term sheet outlining a plan of arrangement under the CCAA that could achieve a global resolution to the outstanding litigation.

[53] A CCAA proceeding will permit the applicant and its stakeholders a means of attempting to arrive at a global settlement of all claims. If there is no settlement, the future looks bleak for everyone but the lawyers fighting the litigation.

[54] The CCAA is intended to facilitate compromises and arrangements between companies and their creditors as an alternative to bankruptcy and, as such, is remedial legislation entitled to a liberal interpretation. It is also intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both. It has been

held that the intention of the CCAA is to prevent any manoeuvres for positioning among the creditors during the period required to develop a plan and obtain approval of creditors. Without a stay, such manoeuvres could give an aggressive creditor an advantage to the prejudice of others who are less aggressive and would undermine the company's financial position making it even less likely that the plan would succeed. See *Re Lehndorff General Partner Ltd.* (1993), 17 C.B.R. (3d) 24 per Farley J.

[55] In this case it would be unfair to one plaintiff who is far down the line on a trial list to have to watch another plaintiff with an earlier trial date win and collect on a judgment from persons who may not have the funds to pay a later judgment. That would be chaos that should be avoided. A recent example of a stay being made to avoid such a possibility is the case of *Re Montreal, Maine & Atlantique Canada Co.* which stayed litigation arising out of the Lac-Mégant train disaster. See also *Muscletech Research & Development Inc., Re.*

[56] In this case, the term sheet that the applicant anticipates will form the basis of a proposed Plan includes, among other elements:

(a) the monetization of all assets of CLCA and its partnership OpCo to maximize the net proceeds available to fund the plan, including all applicable insurance entitlements that are payable or may become payable, which proceeds will be available to satisfy the determined or agreed claims of valid creditors;

(b) contributions from a significant majority of the defendant partners;

(c) contributions from non-defendant partners of CLCA and CLCG exposed under the PwC indemnity;

(d) contributions from CLCA's insurers and other defendants in the outstanding litigation;

(e) the appointment of Ernst & Young Inc. as Monitor to oversee the implementation of the plan, including to assist with the realization and monetization of assets and to oversee (i) the capital calls to be made upon the defendant partners, (ii) a claims process, and (iii) the distribution of the aggregate proceeds in accordance with the plan; and

(f) provision to all parties who contribute amounts under the plan, of a court-approved full and final release from and bar order against any and all claims, both present and future, of any kind or nature arising from or in any way related to Castor.

[57] This term sheet is supported by the overwhelming number of creditors, including 13 German banks, 8 Canadian banks, over 100 creditors of Castor represented by the Trustee in bankruptcy of Castor and the Widdrington estate. It is also supported by the insurers. The plaintiffs other than Chrysler, representing approximately 71.2% of the face value of contingent claims asserted in the outstanding litigation against CLCA, either support, do not oppose or take no position in respect of the granting of the Initial Order. Chrysler represents approximately 28.8% of the face value of the claims.

[58] Counsel for the German and Canadian banks points out that it has been counsel to them in the Castor claims and was counsel for the Widdrington estate in its successful action. The German and Canadian banks in their factum agree that during the course of the outstanding litigation over the past 20 years, they have been subjected to a "scorched earth", "war of attrition" litigation strategy adopted by CLCA and its former legal counsel. Where they seriously part company with Chrysler is that they vigorously disagree that such historical misconduct should prevent the CLCA group from using the CCAA to try to achieve the proposed global settlement with their creditors in order to finally put an end to this war of attrition and to enable all valid creditors to finally receive some measure of recovery for their losses.

[59] It is argued by the banks and others that if Chrysler is successful in defeating the CCAA proceedings, the consequence would be to punish all remaining Castor plaintiffs and to deprive them of the opportunity of arriving at a global settlement, thus exacerbating the prejudice which they have already suffered. Chrysler, as only one creditor of the CLCA group, is seeking to impose its will on all other creditors by attempting to prevent them from voting on the proposed Plan; essentially, the tyranny of the minority over the majority. I think the banks have a point. The court's primary concern under the CCAA must be for the debtor and all of its creditors.

While it is understandable that an individual creditor may seek to obtain as much leverage as possible to enhance its negotiating position, the objectives and purposes of a CCAA should not be frustrated by the self-interest of a single creditor. See *Calpine Canada Energy Ltd., Re,* 2007 ABCA 266, at para 38, per O'Brien J.A.

[60] The German and Canadian banks deny that their resolve has finally been broken by the CLCA in its defence of the Castor litigation. On the contrary, they state a belief that due to litigation successes achieved to date, the time is now ripe to seek to resolve the outstanding litigation and to prevent any further dissipation of the assets of those stakeholders funding the global settlement. Their counsel expressed their believe that if the litigation continues as suggested by Chrysler, the former partners will likely end up bankrupt and unable to put in to the plan what is now proposed by them. They see a change in the attitude of CLCA by the appointment of a new committee of partners to oversee this application and the appointment of new CCAA counsel in whom they perceive an attitude to come to a resolution. They see CLCA as now acting in good faith.

[61] Whether the banks are correct in their judgments and whether they will succeed in this attempt remains to be seen, but they should not be prevented from trying. I see no prejudice to Chrysler. Chrysler's contingent claim is not scheduled to be tried until 2017 at the earliest, and it will likely still proceed to trial as scheduled if a global resolution cannot be achieved in the course of this CCAA proceeding. Further, since Chrysler has not obtained a judgment or settlement in respect of its contingent claim, the Initial Order has not stayed any immediate right available to Chrysler. The parties next scheduled to proceed to trial in the outstanding litigation who have appeared, the insurers and then the three German banks, which are arguably the most affected by the issuance of a stay of proceedings, have indicated their support for this CCAA proceeding and Initial Order, including the stay of proceedings.

[62] What exactly Chrysler seeks in preventing this CCAA application from proceeding is not clear. It is hard to think that it wants another 10 years of hard fought litigation before its claim is finally dealt with. During argument, Mr. Vauclair did say that Chrysler participated in the unsuccessful mediation and that it has been willing to negotiate. That remains to be seen, but this CCAA process will give it that opportunity.

[63] Chrysler raises issues with the term sheet, including the provision that the claims of the German and Canadian banks and the Trustee of Castor will be accepted but that the Chrysler claim will be determined in a claims process. Chrysler raises issues regarding the proposed claims process and whether the individual CLCA former partners should be required to disclose all of their assets. These issues are premature and can be dealt with later in the proceedings as required.

[64] Mr. Kent, who represents a number of former CLCA partners, said in argument that the situation cries out for settlement and that there are many victims other than the creditors, namely the vast majority of the former CLCA partners throughout Canada who had nothing to do with the actions of the few who were engaged in the Castor audit. The trial judge noted that the main CLCA partner who was complicit in the Castor Ponzi scheme hid from his partners his relationships with the perpetrators of the scheme.

[65] Mr. Kent's statement that the situation cries out for settlement has support in the language of the trial judge in the Widdrington test case. Madame Justice St. Pierre said in her opening paragraph on her lengthy decision:

> **1** Time has come to put an end to the longest running judicial saga in the legal history of Quebec and Canada.

[66] At the conclusion of her decision, she stated:

> **3637** Defendants say litigation is far from being finished since debates will continue on individual issues (reliance and damages), on a case by case basis, in the other files. They might be right. They might be wrong. They have to remember that litigating all the other files is only one of multiple options. Now that the litigants have on hand answers to all common issues, resolving the remaining conflicts otherwise is clearly an option (for example, resorting to alternative modes of conflict resolution).

[67] In my view the CCAA is well able to provide the parties with a structure to attempt to resolve the outstanding Castor litigation. The Chrysler motion to set aside the Initial Order and to dismiss the CCAA application is dismissed.

(iii) Should the stay be extended to the insurers?

[68] The applicant 451 moves as well to extend the stay to the insurers of CLCA. This is supported by the insurers. The trial against the insurers was scheduled to commence on January 12, 2015 but after the Initial Order was made, it was adjourned pending the outcome of the motion by Chrysler to set aside the Initial Order. Chrysler has made no argument that if the Initial Order is permitted to stand that it should be amended to remove the stay of the action against the insurers.

[69] Under the term sheet intended to form the basis of a plan to be proposed by the applicant, the insurers have agreed to contribute a substantial amount towards a global settlement. It could not be expected that they would be prepared to do so if the litigation were permitted to proceed against them with all of the costs and risks associated with that litigation. Moreover, it could well have an effect on the other stakeholders who are prepared to contribute towards a settlement.

[70] A stay is in the inherent jurisdiction of a court if it is in the interests of justice to do so. While many third party stays have been in favour of partners to applicant corporations, the principle is not limited to that situation. It could not be as the interests of justice will vary depending on the particulars of any case.

[71] In *Re Montreal, Maine & Atlantique Canada Co.*, Castonguay, J.C.S. stayed litigation against the insurers of the railway. In doing so, he referred to the exceptional circumstances and the multiplicity of proceedings already instituted and concluded it was in the interests of sound administration of justice to stay the proceedings, stating:

> En raison des circonstances exceptionnelles de la présente affaire et devant la multiplicité des recours déjà intentés et de ceux qui le seront sous peu, il est dans l'intérêt d'une saine administration de la justice d'accorder cette demande de MMA et d'étendre la suspension des recours à XL.

[72] In my view, it is in the interests of justice that the stay of proceedings extend to the action against the insurers.

(iv) Should a creditors' committee be ordered and its fees paid by CLCA?

[73] The Initial Order provides for a creditors' committee comprised of one representative of the German bank group, one representative of the Canadian bank group, and the Trustee in bankruptcy of Castor. It also provides that CLCA shall be entitled to pay the reasonable fees and disbursements of legal counsel to the creditors' committee. Chrysler opposes these provisions.

[74] The essential argument of Chrysler is that a creditors' committee is not necessary as the same law firm represents all of the banks and the Trustee of Castor. Counsel for the banks and the Trustee state that the German bank group consists of 13 distinct financial institutions and the Canadian bank group consists of 8 distinct financial institutions and that there is no evidence in the record to the effect that their interests do not diverge on material issues. As for the Castor Trustee, it represents the interests of more than 100 creditors of Castor, including Chrysler, the German and Canadian bank groups, and various other creditors. They says that a creditors' committee brings order and allows for effective communication with all creditors.

[75] CCAA courts routinely recognize and accept *ad hoc* creditors' committees. It is common for critical groups of critical creditors to form an *ad hoc* creditors' committee and confer with the debtor prior to a CCAA filing as part of out-of-court restructuring efforts and to continue to function as an *ad hoc* committee during the CCAA proceedings. See Robert J. Chadwick & Derek R. Bulas, *"Ad Hoc Creditors' Committees in CCAA Proceedings: The Result of a Changing and Expanding Restructuring World"*, in Janis P. Sarra, ed, Annual Review of Insolvency Law 2011 (Toronto:Thomson Carswell) 119 at pp 120-121.

[76] Chrysler refers to the fact that it is not to be a member of the creditors' committee. It does not ask to be one. Mr. Meland, counsel for the two bank groups and for the Trustee of Castor said during argument that they have no objection if Chrysler wants to join the committee. If Chrysler wished to join the committee, however, it would need to be considered as to whether antagonism, if any, with other members would rob the committee of any benefit.

[77] Chrysler also takes exception to what it says is a faulty claims process proposed in the term sheet involving the creditors' committee. Whether Chrysler is right or not in its concern,

that would not be a reason to deny the existence of the committee but rather would be a matter for discussion when a proposed claims process came before the court for approval.

[78] The creditors' committee in this case is the result of an intensely negotiated term sheet that forms the foundation of a plan. The creditors' committee was involved in negotiating the term sheet. Altering the terms of the term sheet by removing the creditors' committee could frustrate the applicant's ability to develop a viable plan and could jeopardize the existing support from the majority of claimants. I would not accede to Chrysler's request to remove the Creditors' committee.

[79] So far as the costs of the committee are concerned, I see this as mainly a final cri de couer from Chrysler. The costs in relation to the amounts at stake will no doubt be relatively minimal. Chrysler says it is galling to see it having to pay 28% (the size of its claim relative to the other claims) to a committee that it thinks will work against its interests. Whether the committee will work against its interests is unknown. I would note that it is not yet Chrysler's money, but CLCA's. If there is no successful outcome to the CCAA process, the costs of the committee will have been borne by CLCA. If the plan is successful on its present terms, there will be $220 million available to pay claims, none of which will have come from Chrysler. I would not change the Initial Order an deny the right of CLCA to pay the costs of the creditors' committee.

[80] Finally, Chrysler asks that if the costs are permitted to be paid by CLCA, a special detailed budget should be made and provided to Chrysler along with the amounts actually paid. I see no need for any particular order. The budget for these fees is and will be continued to be contained in the cash flow forecast provided by the Monitor and comparisons of actual to budget will be provided by the Monitor in the future in the normal course.

Conclusion

[81] The motion of Chrysler is dismissed. The terms of the Initial Order are continued.

Newbould J.

Date: January 12, 2015

Tab 2

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5 — Ad Hoc Creditors' Committees in CCAA Proceedings: The Result of a Changing and Expanding Restructuring World

5 — Ad Hoc Creditors' Committees in CCAA Proceedings: The Result of a Changing and Expanding Restructuring World

Robert J. Chadwick and Derek R. Bulas [*]

I. — Introduction

With the expanded forms of credit available in today's credit markets, it is now common to see debtors with multiple credit structures, including first lien creditor groups, second lien creditor groups and unsecured noteholder or bondholder groups. Creditors within a credit agreement or note indenture can be broad and diverse, and include different parties with multiple views and priorities. *Ad hoc* creditors' committees provide a mechanism for creditor groups with similar claims and interests to work together to advance their common interests regarding a financially troubled company prior to and during formal insolvency proceedings.

There is no requirement or statutory framework under the *Companies' Creditors Arrangement Act* [2] (*CCAA*) or the *Bankruptcy and Insolvency Act* [3] (*BIA*) for the appointment or formation of creditors' committees in Canadian insolvency proceedings. Notwithstanding the lack of a statutory framework in Canadian insolvency legislation, debtors, key stakeholders and Canadian courts routinely recognize and accept *ad hoc* creditors' committees, particularly in respect of unsecured noteholder or bondholder groups in *CCAA* proceedings. As *ad hoc* creditors' committees appear most frequency in restructuring proceedings, and not liquidation or reorganization proceedings under the *BIA*, this paper focuses on such committees in *CCAA* proceedings.

While *ad hoc* creditors' committees can play a critical role in advancing a restructuring, the roles and functions of such committees can raise various legal and practical issues. This paper discusses some of the key legal and practical issues relating to *ad hoc* creditors' committees in *CCAA* proceedings and whether such committees add value to the Canadian restructuring process. In considering these matters, we examine and discuss the following subjects: (a) the formation, roles and development of *ad hoc* creditors' committees in Canadian insolvency proceedings; (b) recent amendments to the *CCAA*; (c) the key differences between *ad hoc* creditors' committees in *CCAA* proceedings and official committees in Chapter 11 proceedings under the US *Bankruptcy Code*; [4] (d) the benefits and challenges of *ad hoc* creditors' committees in *CCAA* proceedings; and (e) our conclusions.

II. — Creditors' Committees in Canadian Insolvency Proceedings

A. — Lack of Statutory Framework

There is no requirement or statutory framework under the *CCAA* or the *BIA* for the appointment or formation of creditors' committees in Canadian insolvency proceedings. While the *BIA* contemplates a form of creditors' committee through the appointment of inspectors, who generally act in committees in *BIA* liquidations and proposals, the role and duties of inspectors is primarily to act as the supervisors of the trustee on behalf of the creditors, and it is their function to instruct the trustee to take whatever steps they consider appropriate in order to protect the estate and the creditors. [5] Moreover, in *BIA* proposals, creditors are entitled to elect inspectors, but these powers can be restricted by the debtor in the terms of its *BIA* proposal. [6]

Notwithstanding the lack of a statutory framework under the *CCAA* for the appointment or formation of creditors' committees, debtors, key stakeholders and Canadian courts have been willing to routinely recognize and accept *ad hoc* or informal creditors' committees in *CCAA* cases. In several *CCAA* proceedings, the practice has developed for the formation of *ad hoc* creditors' committees, particularly in respect of unsecured noteholder or bondholder groups. These types of *ad hoc* creditors' committees may be self-funding, but, in many cases, they have received court-approved funding from the debtor for their professional advisors, as they can play a key role in the development of a plan of compromise or arrangement and the restructuring of the debtor. [7] Similarly, Canadian courts have been willing to exercise their general authority under the *CCAA* to appoint representative counsel to represent the interests of vulnerable creditors, such as retirees or employees, where the formal representation of such creditors was considered necessary or important to the restructuring, and to require the debtor to fund the costs of such representative counsel. [8]

B. — Formation of Ad Hoc Creditors' Committees

Ad hoc creditors' committees in *CCAA* proceedings are generally formed by two or more creditors that hold similar types of claims against the debtor and that engage counsel to advance their common goals and interests. These creditors can include groups of bondholders or noteholders, trade creditors, secured loan syndicates, holders of tort claims, landlords and other groups of investors or financial institutions. *Ad hoc* creditors' committees can be formed through the collaboration of similar creditors or through the actions and encouragement of the debtor, who is usually interested in trying to reach an agreement with a critical mass of creditors and/or solicit the support of critical creditors to their restructuring plan. It is common for groups of critical creditors to form an *ad hoc* creditors' committee and confer with the debtor prior to a *CCAA* filing as part of out-of-court restructuring efforts and to continue to function as an *ad hoc* committee during the *CCAA* proceedings. Moreover, if a *CCAA* case is particularly complex and involves multiple classes of debt with different priorities and creditor structures, a number of different *ad hoc* creditors' committees may be formed to advance the common goals of such creditors.

C. — Why Form an Ad Hoc Creditors' Committee?

There are several reasons why similarly situated creditors of a debtor may decide to join together to form an *ad hoc* creditors' committee, which can be grouped into the following general categories: (a) collective influence and action; (b) access and control of information; and (c) minimizing fees and expenses.

(a) *Collective Influence and Action* — One of the basic theories behind creditors' committees is that multiple creditors singing together in chorus is better than a cacophony of individual creditors each singing its own tune. [9] Accordingly, *ad hoc* creditors' committees speaking with one voice and through collective action in a *CCAA* proceeding can generally have more influence on the debtor, the Canadian court and ultimately the outcome of a *CCAA* restructuring than individual creditors acting alone. Moreover, "size really does matter" when it comes to *ad hoc* creditors' committees as debtors are far more willing to negotiate and work with a group of creditors holding substantial claims and voting power in the aggregate than with a series of individual creditors. In that regard, *ad hoc* creditors' committees can be particularly effective and instrumental as part of a consensual plan approval process where such committees hold substantial claims and voting power and are able to assist and support the debtor in meeting the statutory majority test under the *CCAA* for approval of a plan of compromise or arrangement. [10] If more than one-third of the amount of claims in a class are held by members of an *ad hoc* creditors' committee, they could effectively hold a "blocking position" in respect of the approval of the debtor's plan of compromise or arrangement under the *CCAA*. Further, *ad hoc* creditors' committees can assist the restructuring process in a variety of ways by, among other things, advancing credit, providing alternative financing or backstopping a rights offering as part of developing restructuring alternatives. [11]

Restructuring structures and alternatives are not unilateral decisions by any company. *Ad hoc* creditors' committees provide significant input to the restructured capital structure, the business plan and the restructuring direction of a company. The Canadian restructuring regime, similar to many other countries, requires a balancing approach to reach the end result of a restructuring. Such balancing approach can come in different forms, but the result of different stakeholder groups merging or coming together to find one restructuring solution is a key ingredient to any restructuring. *Ad hoc* creditors' committees are an important factor in reaching a proper and effective restructuring solution. *Ad hoc* creditors' committees need to be properly managed as many times they can be comprised of different views and interests and the lowest common denominator can advance restructuring solutions, which may not be the correct path. The debtor, its advisors and the advisors to an *ad hoc* creditors' committee can also play an important role in managing a successful restructuring for all stakeholders.

(b) *Access and Control of Information* — Members of an *ad hoc* creditors' committee generally receive detailed information regarding the debtor and its ongoing restructuring efforts. This information and related legal and financial advice may also be provided through the legal and financial advisors of an *ad hoc* creditors' committee. Moreover, members of an *ad hoc* creditors' committee can generally control their ability to remain unrestricted by deciding whether they would like to receive material non-public information ("MNPI") regarding the debtor so that they may continue to trade in the debtor's securities.

(c) *Minimizing Fees and Expenses* — Acting in an *ad hoc* creditors' committee and co-ordinating with other members of such a committee can significantly reduce the fees and expenses of creditors, particularly professional fees and expenses. Many times, an *ad hoc* creditors' committee is also used to communicate and discuss restructuring alternatives with a broader or different group of creditors, which may save on time and costs that would otherwise be incurred by the debtor or its professional advisors.

D. — Roles and Functions of Ad Hoc Creditors' Committees

The roles and functions of *ad hoc* creditors' committees in *CCAA* proceedings can be both active and passive. These functions can include the following: (a) negotiating the terms of a plan of compromise or arrangement or other restructuring or recapitalization plan with the debtor; (b) reviewing financial information and other disclosures on the debtor's operations and capital structure; (c) acting as a sounding board for the monitor; (d) assessing the governance of the debtor; or (e) assisting in monitoring a going-concern sale. [12] *Ad hoc* creditors' committees in *CCAA* proceedings do not typically have the authority to represent secured or unsecured creditors generally or to take any actions that are legally binding on parties. However, *ad hoc* creditors' committees that have been recognized and accepted by debtors, key stakeholders and Canadian courts in *CCAA* proceedings generally play a key role in advancing the interests of a restructuring or recapitalization and in structuring, negotiating and implementing a successful restructuring solution with the debtor that maximizes value for stakeholders.

The debtor and Canadian courts have the ability to recognize and work with creditor groups. To the extent that the debtor believes that the formation of an *ad hoc* creditors' committee is intended for litigation purposes only and in order to defeat the restructuring alternative proposed by the debtor and its key stakeholders, they can make the decision not to fund and work with them. [13] However, in many of such circumstances, the *ad hoc* creditors' committee will form and work together against the debtor notwithstanding that they are not being supported by the debtor. Below is a limited summary of recent *CCAA* restructurings that have included the active involvement of *ad hoc* creditors' committees.

CCAA Matter	Date of Filing and Court	Type of Ad hoc Creditors' Committee	Restructuring Solution
Opti	July 13, 2011, Alberta Court of Queen's Bench	*Ad hoc* Secured Noteholder Committee	Ongoing
Angiotech	January 28, 2011, British Columbia Supreme Court	*Ad hoc* Unsecured Noteholder Committee	Plan
Canwest	October 6, 2009, Ontario Superior Court of Justice	*Ad hoc* Unsecured Noteholder Committee	Plan

AbitibiBowater	April 17, 2009, Quebec Superior Court of Justice	Multiple *Ad hoc* Secured and Unsecured Noteholder Committees	Plan (including new equity in the restructured debtor)
Nortel	January 14, 2009, Ontario Superior Court of Justice	Multiple *Ad hoc* Creditors' Committees	Ongoing
Adanac	December 19, 2008, British Columbia Supreme Court	*Ad Hoc* Secured Noteholder Committee	Plan (including new equity in the restructured debtor)
Asset Backed Commercial Paper	March 17, 2008, Ontario Superior Court of Justice	Multiple *Ad hoc* Creditors' Committees	Plan
Quebecor	January 21, 2008, Quebec Superior Court of Justice	*Ad hoc* Unsecured Noteholder Committee	Plan
Calpine Canada	December 20, 2005, Alberta Court of Queen's Bench	Multiple *Ad hoc* Creditors' Committees	General settlement agreement and plan
Stelco	January 29, 2004, Ontario Superior Court of Justice	Multiple *Ad hoc* Creditors' Committees	Plan (including new equity in the restructured debtor)
Air Canada	April 1, 2003, Ontario Superior Court of Justice	*Ad hoc* Unsecured creditors' committee comprised of note holders, banks, lessors and rade creditors	Equity investment

III. — Recent Amendments to the CCAA

In the most recent amendments to the *CCAA*, Parliament codified the existing practice of allowing Canadian courts in *CCAA* proceedings to recognize *ad hoc* creditors' committees and, in appropriate circumstances, to secure payment of the professional fees and expenses of such committees. [14] Section 11.52(1)(c) of the *CCAA* permits the court, on notice to the secured creditors who are likely to be affected by the security or charge, to make an order declaring that all or part of the property of a debtor company is subject to a security or charge in an amount that the court considers appropriate in respect of the fees and expenses of any financial, legal or other experts engaged by any interested person if the court is satisfied that the security or charge is necessary for their effective participation in proceedings under the *CCAA*. [15] *Canwest* and *Angiotech* are recent *CCAA* restructurings where Canadian Courts were satisfied that certain *ad hoc* unsecured noteholder committees constituted "interested persons" under section 11.52(1)(c) of the *CCAA*, such that the professional fees and expenses of these committees were entitled to the benefit of the administration charge in the applicable initial order. [16]

The *CCAA* does not contain any specific criteria for a court to consider section 11.52(1)(c) of the *CCAA*, whether the proposed amounts are appropriate and whether the charges should extend to the proposed beneficiaries as "interested persons". Some factors that might be considered by a Canadian court in respect of these matters under section 11.52(1)(c) of the *CCAA* include the size and complexity of the businesses being restructured; the proposed role of the beneficiaries of the charge; whether there is an unwarranted duplication of roles; whether the quantum of the proposed charge appears to be fair and reasonable; the position of the secured creditors likely to be affected by the charge; and the position of the monitor. [17]

IV. — Official Committees in Chapter 11 Proceedings

Unlike the *CCAA*, the US *Bankruptcy Code* expressly permits the appointment of as many official committees by the Office of the United States Trustee ("US trustee") as is necessary to ensure adequate representation of creditors and equity holders in Chapter 11 proceedings. [18] The US trustee usually appoints an official unsecured creditors' committee ("UCC") in most large-scale Chapter 11 proceedings to represent and advance the interests of unsecured creditors where there are substantial assets at issue and a sufficient number of unsecured creditors express an interest in serving on the UCC.

The roles and functions of official committees, such as a UCC, in Chapter 11 proceedings can be very different from the roles and functions of *ad hoc* creditors' committees in *CCAA* proceedings. Some of the key differences relate to the following matters: (a) formation; (b) fiduciary duties; (c) governance; (d) access to MNPI and trading restrictions; (e) statutory rights and powers; and (f) payment of professional fees and expenses.

(a) *Formation* — Official committees are appointed by the US trustee, who determines both the size and composition of the committee, subject to potential intervention by the US bankruptcy court and the maxim that a creditors' committee should ordinarily be made up of the persons, willing to serve, that hold the seven largest claims against the debtor of the kinds represented on such committee. [19] Additional appointments or removals from official committees remain at the discretion of the US trustee, subject to review by the US bankruptcy court. [20] By contrast, *ad hoc* creditors' committees are generally not appointed or supervised by any type of governing body and members are usually free to join and withdraw from such committees at will.

(b) *Fiduciary Duties* — Official committees represent and advance the interests of unsecured creditors or equity holders as a whole. Accordingly, official committees have fiduciary duties to all members of the applicable class that they represent and are obligated to protect their collective interests. [21] By contrast, *ad hoc* creditors' committees do not generally have fiduciary duties to similarly situated creditors or creditors in the same class. [22] Moreover, members of *ad hoc* creditors' committees are generally not restricted from acting in their own self-interest and may take positions contrary to those taken by the other members of the committee. [23] In certain Canadian cross-border restructurings, there have been *ad hoc* creditors' committees and also a UCC formed under the Chapter 11 proceedings. [24]

(c) *Governance* — Official committees often function pursuant to official by-laws or processes that may govern, among other things, voting, privilege and confidentiality matters. [25] By contrast, *ad hoc* creditors' committees generally function without the use of formal by-laws. Moreover, there is no "one size fits all" strategy for the governance of *ad hoc* creditors' committees and the degree of formality under which they operate is often driven by the members and is addressed on a case by case basis. [26]

(d) *Access to MNPI and Trading Restrictions* — In fulfilling their fiduciary duties, members of official committees generally have access to and receive MNPI regarding the debtor and, therefore, these members cannot trade in the debtor's securities while in possession of such confidential information pursuant to securities law. [27] However, in an effort to permit institutions sitting on official committees to trade in the debtor's securities, US bankruptcy courts routinely approve trading walls and other procedures that are designed to ensure that MNPI obtained by official committee members is not shared with such member's securities trading personnel. [28] By contrast, members of *ad hoc* creditors' committees do not generally receive MNPI regarding the debtor nor are they subject to trading restrictions unless they specifically choose to receive MNPI regarding the debtor and become restricted.

(e) *Statutory Rights and Powers* — Official committees appointed under section 1102 of the US *Bankruptcy Code* are specifically empowered to: (a) consult with the trustee or debtor concerning the administration of the case; (b) investigate the acts, conduct, assets, liabilities, financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business and any other matter relevant to the case or to the formulation of a plan; (c) participate in the formulation of a plan, advise those represented by the committee of such committee's determinations as to any plan formulated, and collect and file with the court acceptances or rejections of a plan; (d) request the appointment of a trustee or examiner; and (e) perform such other services as are in the interest of those represented. [29] By contrast, *ad hoc* creditors' committees do not have any specific statutory rights and powers under the *CCAA* and nothing under the *CCAA* specifically requires the debtor to disclose information or to work with such committees in trying to develop a restructuring plan. Accordingly, in some *CCAA* cases, *ad hoc* creditors' committees may find their access to information limited and may find it difficult to compel an uninterested debtor to constructively work with them in advancing restructuring efforts.

(f) *Payment of Professional Fees* — The professional fees and expenses of official committees are entitled to be compensated from the debtor's estate. [30] By contrast, the professional fees and expenses of *ad hoc* creditors' committees are not entitled to payment from the debtor unless they can demonstrate that they are an "interested person" and fall under section 11.52(1)(c) of the *CCAA* or enter into alternative arrangements with the debtor.

V. — Benefits and Challenges of Ad Hoc Creditors' Committees

A. — Benefits of Ad Hoc Creditors' Committees

There are several benefits that *ad hoc* creditors' committees bring to the restructuring process in *CCAA* proceedings, which can be grouped into the following general categories: (a) increasing the efficiencies of the restructuring process; (b) protecting and advancing creditor interests; and (c) structuring and implementing a restructuring plan with the debtor.

(a) *Increasing Efficiencies of Restructuring Process* — *Ad hoc* creditors' committees can significantly increase the efficiency of the restructuring process in *CCAA* proceedings in a number of ways. First, such committees avoid duplicative filings with Canadian courts and permit the parties to co-ordinate motions and court attendances on a streamlined basis. Second, such committees can exchange ideas, structure and work together to develop restructuring alternatives and solutions. Third, acting in a committee, particularly a committee that holds substantial claims and voting power in the aggregate and that is able to negotiate a mutually agreeable restructuring plan with the debtor, can provide substantial comfort to the debtor that a critical mass of creditors is willing to support a proposed restructuring solution before commencing the formal plan approval process under the *CCAA*.

(b) *Protecting and Advancing Creditor Interests* — *Ad hoc* creditors' committees in *CCAA* proceedings can function as a "check and balance" to the debtor's activities and, in some cases, can also be used to "police the debtor". Functionally, this is similar to the role of the monitor in *CCAA* proceedings. However, the monitor, as a court-appointed officer, is required to be neutral and reasonable and is not a negotiator for creditors, while *ad hoc* creditors' committees can advance matters or positions in order to try and generate value to creditors.[31] Moreover, *ad hoc* creditors' committees have a direct economic interest in the debtor and their views or positions reflect real and direct input. Accordingly, *ad hoc* creditors' committees are in a better position than the monitor to constructively advance the interests of creditors, which enables them to be valuable participants in *CCAA* proceedings and to add value to the restructuring process.

(c) *Structuring and Implementing a Restructuring Plan* — *Ad hoc* creditors' committees in *CCAA* proceedings can play a key role in adding value to the restructuring process by structuring, negotiating, and implementing a restructuring plan or other restructuring solution with the debtor that maximizes value for all stakeholders. This role is especially true where an *ad hoc* creditors' committee represents a critical constituency of creditors that hold substantial claims and voting power in the aggregate and their support is critical to a successful restructuring.

B. — Challenges of Ad Hoc Creditors' Committees

The benefits of *ad hoc* creditors' committees need to be balanced against the challenges of such committees, which can be grouped into the following general categories: (a) governance; (b) information control matters; and (c) lack of fiduciary duties.

(a) *Governance* — The governance and management of *ad hoc* creditors' committees in *CCAA* proceedings is, as the name suggests, *ad hoc* or informal, and may cause certain legal and practical challenges. While some *ad hoc* creditors' committees may establish formal by-laws or other processes to govern decision-making, voting, privilege and confidentiality matters, most *ad hoc* creditors' committees generally conduct business on an informal basis and make collective decisions through inter-committee discussions and then direct their counsel to take the specified action. Decision-making within *ad hoc* creditors' committees can also be influenced by vocal members and/or those members with the largest claims. Moreover, since membership in *ad hoc* creditors' committees is generally at will, the roster of members may change over the course of a *CCAA* proceeding. Changes in membership can impact the functioning of an *ad hoc* creditors' committee both internally, by changing the dynamic between members, and externally, if new members push the committee's goals in different directions, which could also run the risk of compromising the committee's credibility in the restructuring process.[32]

(b) *Information Control Matters* — A challenge that members of *ad hoc* creditors' committees usually face at some point in a *CCAA* proceeding is whether they want to receive MNPI regarding the debtor. The free flow of information is critical to allow members of an *ad hoc* creditors' committee to make informed decisions that best advance their interests, and access to confidential information is important to receive a full understanding of the debtor's business and its restructuring options. [33] Receiving MNPI and becoming restricted may also benefit the restructuring process as it permits the debtor and the applicable restricted committee members to have fully informed discussions regarding restructuring matters. However, once a member receives MNPI regarding the debtor, it becomes restricted from trading its interests in the debtor's securities pursuant to securities law until such MNPI is no longer considered to be MNPI and/or such member has been "cleansed". These matters and the related cleansing mechanisms are usually addressed in confidentiality or non-disclosure agreements that may be entered into by the debtor and the applicable committee member before any confidential information is provided.

The decision on whether to become restricted is for each committee member to make. Each member must consider whether it wants to make an informed decision regarding the debtor by receiving MNPI and become restricted or if it wants to maintain its rights to freely trade its interests in the debtor's securities. Members of *ad hoc* creditors' committees that are large institutions may be able to establish a trading wall between individuals in the institution that receive MNPI and individuals who are involved in trading the debtor's securities. [34] However, trading walls may be impractical for smaller financial institutions or hedge funds that become members of *ad hoc* creditors' committees as generally only one individual or a small group of individuals are responsible for such member's investments, which makes it difficult to effectively create and maintain trading walls. [35] A further challenge in respect of MNPI may arise if some, but not all, members of an *ad hoc* creditors' committee decide to receive MNPI regarding the debtor and become restricted. In such circumstances, the *ad hoc* creditors' committee may become fractured and face additional governance challenges, including how key decisions are made and how meetings are conducted among restricted and unrestricted members.

(c) *Lack of Fiduciary Duties* — Members of *ad hoc* creditors' committees in *CCAA* proceedings do not generally have fiduciary duties to similarly situated creditors or other creditors in the same class nor are they subject to oversight by any type of governing body. As a result, *ad hoc* creditors' committees in *CCAA* proceedings are generally free to advance their own self-interests without any requirement to consider the interests of non-members. [36] Moreover, the lack of fiduciary duties imposed on *ad hoc* creditors' committees in *CCAA* proceedings could mean that they have less incentive (and no obligation) to be constructive participants in the proceedings, and could cause them to be detrimental to the restructuring process if they are acting selfishly or in a manner that is destructive or hinders the restructuring process. [37]

VI. — Conclusion

The roles and functions of *ad hoc* creditors' committees in *CCAA* proceedings raise a number of legal and practical issues, which are not easily determinable and need to be addressed on a case by case basis. That being said, *ad hoc* creditors' committees have taken part in a number of recent *CCAA* proceedings, where, on balance, they have demonstrated that they can play a key role in advancing a restructuring to maximize value for stakeholders. The restructuring of debtors with multiple creditor structures under the *CCAA* can involve multiple creditor groups with numerous holders and diverse interests. *Ad hoc* creditors' committees provide a mechanism for these creditor groups, particularly those with direct economic interests, to constructively take part in the restructuring process. In the right circumstances, *ad hoc* creditors' committees work with the debtor in canvassing and developing restructuring solutions and alternatives, which, in many cases, is necessary to achieve and complete a successful restructuring under the *CCAA*.

Footnotes

* Robert J. Chadwick and Derek R. Bulas, Goodmans LLP. The authors would like to thank Cody Cornale, student-at-law, for his assistance with research for this paper.

2 *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 [*CCAA*].

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

4 USC title 11 §§ 101-1532 [US *Bankruptcy Code*].

5 *Re Fishman* (1985), 56 CBR (NS) 316 (Ont SC); *Re Global Plastic Packaging Ltd* (2004), 2 CBR (5th) 217 (Ont Sup Ct).

6 Section 56 of the *BIA* provides that the creditors may appoint one or more, but not exceeding five, inspectors of the estate of the debtor, who shall have the powers of an inspector under the *BIA*, subject to any extension or restriction of those powers by the terms of the proposal.

7 See for example *Re Canwest Global Communications Corp*, CV-09-8396-00CL (Ont Sup Ct) and *Re Angiotech Pharmaceuticals Ltd*, S-110587 (BCSC).

8 See for example *Re Nortel Networks Corp* (2009), 53 CBR (5th) 196; additional reasons at (2009), 55 CBR (5th) 114 (Ont Sup Ct) and *Re Fraser Papers Inc*, CV-09-8241-OOCL, 2009 CarswellOnt 6169 (Ont Sup Ct).

9 Robert J Rosenberg, Martin J Bienenstock, Hon Robert D Drain, Ramona D Elliott & Jeffrey L Jonas, "Ad Hoc Committees and Other (Unofficial) Creditor Groups: Management, Disclosure and Ethical Issues" (2008) 7 American Bankruptcy Institute Reorganization Committee Newsletter 261 at 263.

10 In order for a class of creditors to accept a plan of compromise or arrangement under the *CCAA*, holders of a majority in number and representing at least two-thirds in value of the class of creditors must cast votes in favour of the plan. Accordingly, if more than one-third of the claims of a particular class is held by members of an *ad hoc* creditors' committee, such committee's support becomes essential to a consensual plan approval process.

11 See for example *Re AbitibiBowater Inc*, 500-11-036133-094 (Qc SC), where members of the *ad hoc* unsecured noteholder committee backstopped the debtor's rights offering; *Re Canwest Global Communications Corp*, CV-09-8396-00CL (Ont Sup Ct), where members of the *ad hoc* unsecured noteholder committee replaced the existing lender in conjunction with a new lender, and *Re Opti Canada Inc*, 1101-09476 (Alta QB), where members of the *ad hoc* unsecured noteholder committee backstopped the debtor's rights offering.

12 Janis P Sarra, *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations* (Toronto: University of Toronto Press, 2003) at 82.

13 See for example *Re Smurfit-Stone Container Canada Inc*, CV-09-7966-00CL (Ont Sup Ct).

14 *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts, SC 2005, c 47; An Act to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act, the Wage Earner Protection Program Act and chapter 47 of the Statutes of Canada, 2005*, SC 2007, c 36.

15 *CCAA*, s 11.52(1)(c). *BIA*, s 64.2(1)(c) contains similar language as *CCAA*, s 11.52(1)(c).

16 See *Re Canwest Global Communications Corp* (2009), 59 CBR (5th) 72 (Ont Sup Ct) and related initial order of the Honourable Madam Justice Pepall dated October 6, 2009 in *Re Canwest Global Communications Corp*, File No CV-09-8396-00CL (Ont Sup Ct) and initial order of the Honourable Mr. Justice Walker dated January 28, 2011 in *Re Angiotech Pharmaceuticals Ltd*, File No S-110587 (BCSC).

17 *Re Canwest Publishing Inc/Publications Canwest Inc* (2010), 63 CBR (5th) 115, ¶54 (Ont Sup Ct).

18 US *Bankruptcy Code*, *supra* note 3, § 1102.

19 Rosenberg et al, *supra* note 8 at 265; US *Bankruptcy Code*, *supra* note 3, § 1102(b)(1).

20 Rosenberg et al, *supra* note 8 at 265.

21 *Ibid.*

22 Rosenberg et al, *supra* note 8 at 264, 266; Evan D Flaschen & Kurt A Mayr, "Bankruptcy Rule 2019 and the Unwarranted Attack on Hedge Funds" (2007) 26:7 Am Bank Inst J 16.

23 *Ibid.* However, some US cases appear to suggest that *ad hoc* committees may owe fiduciary duties to non-committee members in certain circumstances. For example, in *Official Comm of Equity Security Holders v The Wilson Law Firm PC (In re Mirant Corp)*, 334 BR 787 (Bankr ND Tex 2005), the US Bankruptcy Court found that an *ad hoc* equity committee owed a fiduciary duty to equity holders as a whole and could not solicit rejection of a plan of reorganization with misleading information. Similarly, in the September 13, 2011 Opinion of the Honourable Madam Justice Walrath *In re Washington Mutual Inc et al*, Case No 08-12229, the US Bankruptcy Court found, in *obiter*, that members of an *ad hoc* noteholders' committee can be considered to owe fiduciary duties to other noteholders in the same class on the basis that: (1) since the members of the *ad hoc* noteholders' committee received material non-public information from the debtor, they became "temporary insiders" of the debtor and owed similar fiduciary duties as directors and officers of the debtor; and (2) the members of the *ad hoc* noteholders' committee held themselves out as representing the entire class of noteholders and assumed fiduciary duties to act in the best interests of the entire class of noteholders.

24 See for example *Re AbitibiBowater Inc*, Court File No 500-11-036133-094 (Qc SC).

25 Michael S Stamer, Scott L Alberino & Joanna F Newdeck, "Ad Hoc Committees in Chapter 11" (Paper delivered at the Thirty-Third Annual Southeastern Bankruptcy Law Institute, Atlanta, Georgia, 12-14 April 2007) at 4.

26 *Ibid.*

27 Rosenberg et al, *supra* note 8 at 266.

28 *Ibid.*

29 *Ibid* at 266-267; Stamer et al, *supra* note 24 at 11; US *Bankruptcy Code*, *supra* note 3 § 1103.

30 Stamer et al, *supra* note 24 at 11; US *Bankruptcy Code*, *supra* note 3 § 330.

31 Aubrey Kauffman & Stuart Brotman, "*CCAA* Versus Chapter 11 — An Examination of the Role of the Monitor" (2010) 22 BNA's Bankruptcy Law Reporter 1245 at 3.

32 Rosenberg et al, *supra* note 8 at 265.

33 See Eric B Fischer & Andrew L Buck, "Hedge Funds and the Changing Face of Corporate Bankruptcy Practice" (2007) 25:10 Am Bank Inst J 24; Rosenberg et al, *supra* note 8 at 268.

34 *Ibid.*

35 Fischer & Buck, *supra* note 32.

36 Rosenberg et al, *supra* note 8 at 264, 266; Flaschen & Mayr, *supra* note 21. However, see US cases, *supra* note 22 that appear to suggest that *ad hoc* committees may owe fiduciary duties to non-committee members in certain circumstances.

37 Rosenberg et al, *supra* note 8 at 271.

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Tab 3

Date of Release: January 21, 1993

No. A924791
Vancouver Registry

IN THE SUPREME COURT OF BRITISH COLUMBIA

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36

- AND -

IN THE MATTER OF THE COMPANY ACT, R.S.B.C. 1979, c. 59

IN THE MATTER OF WOODWARD'S LIMITED, WOODWARD STORES LIMITED AND ABERCROMBIE & FITCH CO. (CANADA) LTD.	REASONS FOR JUDGMENT OF THE HONOURABLE MR. JUSTICE TYSOE (IN CHAMBERS)

Counsel for Woodward's Limited, Woodward Stores Limited and Abercrombie & Fitch Co. (Canada) Ltd.:	R.A. Millar
Counsel for Transcontinental West, a division of Trans-Continental Printing Inc.:	C.M. Trower
Counsel for Accord Business Credit Inc. and others:	D.B. Hyndman
Counsel for Dale's Industries Ltd. and others:	N.E. Kornfeld
Counsel for Cosmair Canada Inc. and others:	A.L. Edgson
Counsel for Cambridge Shopping Centres Limited:	D.I. Knowles and C.W. Caverly
Date and place of hearing:	January 15, 1993 Vancouver, B.C.

In my Reasons for Judgment dated January 14, 1993 I invited counsel to make further submissions with respect to the preservation of the potential rights of suppliers under s. 81.1 of the ***Bankruptcy and Insolvency Act*** (the "***B & I Act***"). The issue that I posed in brief terms was whether the Court in these proceedings under the ***Companies' Creditors Arrangement Act*** (the "***CCAA***") should produce a result that is the same as the result that would have been created had Woodward's filed a notice of intention to file a proposal under the ***B & I Act***.

As I pointed out in my January 14 Reasons for Judgment, a supplier's right of repossession under s. 81.1 of the ***B & I Act*** does not arise until the purchaser of the goods is in bankruptcy or receivership. The stay of proceedings contained in my interim Order dated December 11, 1992 prevents any proceedings being taken that would result in Woodward's going into bankruptcy or receivership. In particular, the stay prevents any of the suppliers from petitioning Woodward's into bankruptcy and thereby crystallizing their potential rights under s. 81.1. The bankruptcy of Woodward's would obviously be inconsistent with its effort to reorganize its business and financial affairs. On the day of the hearing of this issue I pronounced a continuing stay Order and it also prevents the suppliers and any other person from petitioning Woodward's into bankruptcy.

The Court often exercises its discretion in connection with the stay under the ***CCAA*** so that the rights of parties are not prejudiced by the effluxion of time during the continuance of a ***CCAA*** stay which prevents them from taking steps to preserve their rights. One example arises from the requirement of the B.C. ***Builders Lien Act*** that an action for the enforcement of the lien must be commenced within one year of the lien being filed at the Land Title Office. The Court has granted leave for a builders lien claimant to commence the action against a company having the protection of a ***CCAA*** stay so that the lien right was not extinguished by the effluxion of time during the course of the ***CCAA*** stay.

Another example which is more analogous to the present situation relates to s. 95 of the ***B & I Act***, a provision dealing with fraudulent preferences. Subsection (2) of s. 95 creates a rebuttable presumption that a transaction is fraudulent if it occurs within the three month period preceding the date of bankruptcy and if it has the effect of giving a preference to one creditor over other creditors. Section 71 of the ***B & I Act*** provides that in the case of an involuntary bankruptcy where the bankrupt has been petitioned into bankruptcy, the date of bankruptcy is deemed to be the date on which the petition is filed. The Court in ***CCAA*** proceedings has granted leave for a creditor to file a bankruptcy petition in order to preserve the three month presumption period under s. 95 in the event that the reorganization is not successful. In fact, I have granted such leave in these proceedings and one of the creditors has filed a bankruptcy petition against Woodward's (subject to the re-imposition of the stay preventing the bankruptcy petition from being heard). The filing of the bankruptcy petition preserves the status quo in the sense that while the ability of the creditors to pursue a bankruptcy is restrained during the period of attempted reorganization, the effluxion of time during the ***CCAA*** stay does not prejudice their rights. If the reorganization attempt is not successful and the company goes into bankruptcy, the bankruptcy will date back to the filing of the petition and the three month presumption period will not have expired during the period of attempted reorganization.

Unfortunately, the filing of a bankruptcy petition does not preserve the potential rights of suppliers under s. 81.1 of the ***B & I Act***. The usual "retroactive effect" or "dating back" of a bankruptcy to the date on which a petition or a proposal is filed does not apply to the potential rights under s. 81.1. Subsection (3) of s. 81.1 effectively states that the date of bankruptcy in the case of an unsuccessful attempt to reorganize is the date on which the proposal is not approved by the creditors or the Court. Thus, even though a bankruptcy petition may have been filed, the date of bankruptcy for the purposes of s. 81.1 is the day on which the reorganization attempt fails and it is not retroactive to the day on which the petition was filed. The reason for this result is obvious - suppliers cannot make the demand of repossession until a bankruptcy occurs and it is known that the insolvent company will not be continuing. This result is consistent with the conclusion I reached in my January 14 Reasons for Judgment in the sense that, until it is known that the reorganization attempt is not successful, the suppliers have no rights under s. 81.1.

In granting a stay under the ***CCAA*** to prevent the insolvent company from being petitioned into bankruptcy, the Court is taking a necessary step to allow the company an opportunity to reorganize itself. A stay under the ***CCAA*** will almost always prejudice rights of some or all of the creditors. However, the Court should avoid or lessen the prejudice if it can do so without disadvantaging the insolvent company or other creditors. In the two above examples dealing with builders liens and fraudulent preferences, the Courts have imposed the ***CCAA*** stay in a manner that avoided or lessened the prejudice to the creditors because the steps permitted by the Court did not have an adverse effect on the company or its reorganization effort (although there may be circumstances where the filing of a bankruptcy petition will have a material adverse effect). In this case, I am preventing the suppliers from petitioning Woodward's into bankruptcy but it is my view that I should endeavour to minimize the prejudice caused to the suppliers as a result of the stay.

Parliament considered the issue of suppliers' potential repossession rights during a reorganization under the ***B & I Act*** and it decided to implement s. 81.1(4) of the ***B & I Act*** . That subsection essentially provides that the period of attempted reorganization will not count as part of the 30 day period following delivery of the goods in which the supplier is required to give its demand for repossession (that cannot be given until the purchaser of the goods has gone into bankruptcy or receivership).

It is my view that the potential rights of the suppliers under a ***CCAA*** reorganization should be preserved in the same fashion as Parliament decided to preserve them under s. 81.1(4) of the ***B & I Act.*** If the potential rights are not preserved in this fashion, it would probably lead to abuses of the insolvency legislation. Insolvent companies would attempt to defeat the potential rights of suppliers by utilizing the ***CCAA*** and the protection given to suppliers by s. 81.1 would become illusory. A theoretical answer to the potential abuse of the insolvency legislation is that the Court should refuse to exercise its discretion to grant a stay of proceedings under the ***CCAA*** if it believes that the insolvent company has chosen the ***CCAA*** over the ***B & I Act*** in order to defeat the potential rights of suppliers. However, there are other advantages of the ***CCAA*** over the ***B & I Act*** and it would be very difficult for suppliers to prove that there is an abuse. In my opinion, the Courts should avoid the possible abuse by treating suppliers in ***CCAA*** proceedings in the same way that they are treated under the ***B & I Act.***

It is my view that I should lessen the prejudice to the suppliers by making an Order that deems the date on which the goods are considered to be delivered to the insolvent company with the result that the running of the 30 day period under s. 81.1 is suspended during the period of attempted reorganization. In exercising its jurisdiction the Court often makes Orders that deem events to occur in order to produce an appropriate result. In granting the stay of proceedings under s. 11 of the ***CCAA*** and thereby preventing the suppliers from putting Woodward's into bankruptcy, I may impose a condition that serves to preserve the positions of the parties. In doing so, I am not creating rights and I am simply imposing the ***CCAA*** stay in a qualified manner that preserves potential rights of the suppliers against goods that are not sold during the period of reorganization.

During the course of submissions I suggested that there was another possible alternative to preserve some of the suppliers' potential rights. The alternative was to make my earlier Order of December 17, 1992 a permanent Order. That Order was a temporary Order pending full argument with respect to the position of the suppliers and it provided that the proceeds from the sale of any goods after December 17 will stand in the place and stead of such goods. The Order allowed Woodward's to use the sale proceeds for the purpose of carrying on its business and the expenditure of the monies was deemed to be a reduction in the available proceeds of each sale on a pro rata basis.

If the December 17 Order is made permanent, the suppliers will have rights in the event that Woodward's is not successful in its reorganization and goes into bankruptcy or receivership. Subject to the pro rata reduction, the suppliers would have access to the funds in the possession of Woodward's at the time of the bankruptcy or receivership to the extent that they could identify the funds as representing proceeds from the sale of goods supplied by them in the 30 day period preceding December 17.

I have concluded that the December 17 Order should not be made permanent. I think that the Court should be guided by the provisions of s. 81.1 that Parliament decided to enact to deal with the analogous situation under the ***B & I Act***. The potential rights with which we are concerned were created by the ***B & I Act*** and I do not think that it would be appropriate to give added strength to these rights under the auspices of the ***CCAA*** (which could ironically lead insolvent companies to select the ***B & I Act*** over the ***CCAA*** because the rights of suppliers would potentially be weaker in the case of a reorganization under the very statute that created them). It is also noteworthy that Parliament did not give suppliers the right to trace proceeds from the sale of goods that are delivered within the 30 day period preceding the demand for repossession by the supplier and that are resold by the insolvent company prior to the demand being made.

In making my Order it must be borne in mind that time has already elapsed since the interim stay Order was granted. Indeed, more than 30 days have already passed since December 11 when it was granted. I granted the December 17 Order so that the potential rights of the suppliers would be preserved until there could be full submissions. In my January 14 Reasons for Judgment I set aside the December 17 Order effective 4:00 p.m. on January 18. This date was first extended until January 22 (at the conclusion of submissions on this matter) and it has now been extended until January 28 (to give time to one of the suppliers to apply for leave to appeal my January 14 decision). My new Order is replacing the December 17 Order with respect to the preservation of the potential rights of suppliers and the new Order should have the same effect as if it were made on December 17.

Accordingly, I order that, in the event that Woodward's goes into receivership or bankruptcy, each good coming into the possession of Woodward's within the 30 day period preceding December 17, 1992 shall be deemed to be delivered to Woodward's by the supplier of the good on the day that follows the date on which the good came into the possession of Woodward's by the same number of days as there are between December 17, 1992 and the earlier of (a) the date on which Woodward's goes into receivership and (b)(i) the date on which a receiving order is made against Woodward's under the ***B & I Act*** or (ii) the date on which Woodward's makes an assignment for the benefit of its creditors pursuant to the ***B & I Act***, as the case may be.

January 21, 1992 " D. Tysoe, J. "

Vancouver, B.C.

Date of Release: January 14, 1993

No. A924791
Vancouver Registry

IN THE SUPREME COURT OF BRITISH COLUMBIA

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT,
R.S.C. 1985, c. C-36

- AND -

IN THE MATTER OF THE COMPANY ACT, R.S.B.C. 1979, c. 59

IN THE MATTER OF WOODWARD'S LIMITED, WOODWARD STORES LIMITED AND ABERCROMBIE & FITCH CO. (CANADA) LTD.	REASONS FOR JUDGMENT OF THE HONOURABLE MR. JUSTICE TYSOE (IN CHAMBERS)

Counsel for Woodward's Limited, Woodward Stores Limited and Abercrombie & Fitch Co. (Canada) Ltd.:	M.A. Fitch, R.A. Millar and J.K. Irving
Counsel for Transcontinental West, a division of Trans-Continental Printing Inc.:	C.M. Trower
Counsel for Accord Business Credit Inc. and others:	D.B. Hyndman
Counsel for Dale's Industries and others:	N.E. Kornfeld
Counsel for Cosmair Canada Inc. and others:	A.L. Edgson
Counsel for Matsushita Electric of Canada Limited:	A.S. Wilson
Counsel for Restwell Manufacture Ltd.:	S.J. Gaerber
Counsel for Palmer Jarvis Advertising:	G.S. Snarch
Counsel for Cambridge Shopping Centres Limited:	D.I. Knowles and C.W. Caverly

Counsel for Gesco Industries Inc.:	L.H. Koo
Counsel for Ernst & Young Inc., the Monitor herein:	W.D. Riley
Dates and place of hearing:	January 11 and 12, 1993 Vancouver, B.C.

On December 11, 1992 I granted an interim stay Order pursuant to the ***Companies' Creditors Arrangement Act*** (the "***CCAA***") in favour of Woodward's Limited, Woodward Stores Limited and Abercrombie & Fitch Co. (Canada) Ltd. (collectively, "Woodward's"). Shortly thereafter a number of Woodward's suppliers of goods and services made applications for various forms of relief. The item of relief that was pursued at the hearing of the applications was the creation of a trust fund for the benefit of the suppliers.

The interim stay Order was granted on an *ex parte* basis and it was expressed to expire at 6 p.m. on January 8, 1993, the day on which the hearing of the Petition in this matter was intended to take place. The applications of the suppliers first came on for hearing at 4 p.m. on December 17, 1992. The relief requested at that time included (i) the setting aside or varying of the interim stay Order, (ii) the payment of the amounts owing to the suppliers, (iii) the return of the goods provided by the suppliers and (iv) the creation of the trust fund. Time did not permit the hearing of the applications on that day and the earliest they could be heard was one week later. I adjourned the applications for one week but as I did not want the adjournment to prejudice any rights that the suppliers may have, I made an interim Order that the proceeds from the sale of any goods after December 17 would stand in the place and stead of such goods. When the matter came back on for hearing on December 24, the parties agreed that the applications could be adjourned until January 8 and heard concurrently with the hearing of the Petition.

The hearings began on January 8 and when it became clear that these and other applications would take several days to be heard, I extended the interim Orders until further Order of the Court with the intent that they would continue until I made my determinations on the various issues to be decided. There appears to be little doubt that there will be an extension of the stay Order and it is the terms of the continuing stay Order and the related applications that are in dispute. I will approach the present applications on the basis that the ***CCAA*** stay is going to be extended and the issue to be determined is how the suppliers should be treated within this context.

Woodward Stores Limited operates a chain of 59 full line and junior department stores in British Columbia and Alberta. Abercrombie & Fitch Co. (Canada) Ltd. operates two stores in Ontario. Each of these companies is a subsidiary of Woodward's Limited.

Woodward's has been carrying on business for 100 years. Until January 8, 1993 when it terminated 1,200 employees as part of its downsizing strategy, Woodward's had approximately 6,000 employees. Woodward's has been an important part of the economy of Western Canada for a long period of time and every effort should be made to facilitate its financial reorganization, which is the stated purpose of the ***CCAA***.

Woodward's suppliers generally support its reorganization but they do not feel that they have been treated fairly in all of the circumstances. The principal complaints of the suppliers are that Woodward's purchased a substantial amount of inventory in the period preceding the commencement of these ***CCAA*** proceedings and that Woodward's is proceeding with its reorganization under the ***CCAA*** rather than the ***Bankruptcy and Insolvency Act (the "B & I Act")***.

On December 17 I directed that the Monitor appointed by the interim stay Order report to the Court regarding the inventory purchased by Woodward's during the period prior to the commencement of these proceedings. The Monitor has reported that in the 30 day period prior to December 11 Woodward's received goods having an aggregate cost of approximately $30.4 million, of which $27.3 remains unpaid. The Monitor estimates that approximately $4.3 million worth of the goods for which payment has not been made can be identified and were unsold by Woodward's at the time these proceedings were commenced. Identification of goods appears to be a major difficulty because the Monitor believes that less than $8 million of the $30.4 worth of goods received within the 30 day period preceding December 11 can be identified by way of Woodward's inventory control system. The suppliers say that they will be able to assist in identifying the goods that were supplied by them.

The reason for the importance of the 30 day period preceding the commencement of these proceedings is s. 81.1 of the ***B & I Act*** which came into effect on November 30, 1992. Section 81.1 gives rights of repossession to suppliers of goods similar to the revendication rights that suppliers have previously enjoyed by virtue of the ***Civil Code of Lower Canada*** in effect in Quebec. In brief terms, s. 81.1(1) provides that suppliers are entitled to the return of goods supplied by them within 30 days of a written demand for repossession that can be given if the purchaser of the goods has gone into bankruptcy or receivership. Two important qualifications are that the goods have not been resold and that the goods are identifiable.

Section 81.1(4) is also relevant because it deals with a situation analogous to these ***CCAA*** proceedings; namely, a situation where the purchaser of the goods has filed a notice of intention to file a proposal under the ***Bankruptcy & Insolvency Act***. The section provides that the time between the filing of the notice of intention and the date on which the purchaser goes into bankruptcy or receivership is not counted as part of the 30 day period following delivery of the goods within which the supplier must make its demand of repossession. Hence, if the purchaser of the goods files a notice of intention to file a proposal 20 days after the goods are delivered, the supplier can make the written demand for repossession within the first 10 days of a subsequent bankruptcy or receivership even though the reorganization attempt by means of the proposal may have taken several months. The statute is silent with respect to the resale of goods by the purchaser during the period of reorganization and, all other things being equal, the supplier will lose its right of repossession if the goods are sold during this period.

The suppliers submitted that if Woodward's had proceeded under the ***B & I Act*** rather than the ***CCAA***, they could have taken one of two steps to protect their rights. First, they say that an application could have been made for the appointment of an interim receiver under s. 47.1 of the ***B & I Act*** and that upon the appointment of the interim receiver the suppliers could exercise their rights under s. 81.1. Second, they say that an application could be made under s. 81.1(8) which allows the Court to make any order it considers appropriate if a supplier is aggrieved by an act of the purchaser of the goods and that such an order could direct the creation of a trust fund. The suppliers conclude this aspect of their argument by saying that it would be an abuse if the rights under s. 81.1 could be frustrated by allowing the insolvent company to choose the **CCAA** over the ***B & I Act*** and that the suppliers should therefore be given the protection of the trust fund.

In addition to the potential rights under the ***B & I Act***, the suppliers argued that the trust fund should be created to redress an inequity. They say that other creditors such as Woodward's banker had advance warning that Woodward's would be commencing these proceedings and that they took steps to ensure payment of the indebtedness owing to them. Although the evidence does not support an allegation that Woodward's purchased additional inventory with the knowledge that it would be commencing these proceedings, the suppliers say that Woodward's purposely choose the December 11 date to obtain the stay Order because the aggregate of all unpaid amounts for the purchase of inventory would be at its highest on or about that date. An Affidavit was filed to the effect that some of Woodward's directors first consulted the Monitor about the possibility of commencing ***CCAA*** proceedings in October, 1992.

There was not a consensus among the suppliers as to the exact nature to the trust fund that they were requesting be established. All of the suppliers did want the Court to make the determination that they were entitled to the monies in the trust fund if Woodward's is not successful in its reorganization effort. Most of the suppliers suggested that the fund be equal to the total cost of the purchases during the 30 day period preceding December

11. One supplier wrote a letter requesting that the fund be equal to 90 days worth of purchases. One supplier of services was represented during the hearing and had filed its own Notice of Motion. It wanted the fund to provide for services that were purchased by Woodward's as well as the inventory.

The purpose of the stay under s. 11 of the ***CCAA*** was first summarized by Wachowich J. in ***Meridian Developments Inc. v. Toronto Dominion Bank*** [1984] 5 W.W.R. 215 (Alta. Q.B.). At p. 219 Wachowich J. said:

> The legislation in intended to have wide scope and allows a judge to make orders which will effectively maintain the status quo for a period while the insolvent company attempts to gain the approval of its creditors for a proposed arrangement which will enable the company to remain in operation for what is, hopefully, the future benefit of both the company and its creditors.

And at p. 220 he stated:

> This order is in accord with the general aim of the Companies' Creditors Arrangement Act. The intention was to prevent any manoeuvres for positioning among creditors during the interim period which would give the aggressive creditor an advantage to the prejudice of others who were less aggressive and would further undermine the financial position of the company making it less likely that the eventual arrangement would succeed.

In ***Quintette Coal Limited v. Nippon Steel Corporation*** (1990), 80 C.B.R. 98 (B.C.S.C.) the stay Order authorized Quintette to pay its trade creditors who were owed less than $200,000 on the basis that these creditors were mostly small local businesses which would face insolvency themselves if they were not paid. Trade creditors which were owed in excess of $200,000 complained that the

Order did not maintain the status quo and they applied to be paid the first $200,000 of the debt owed to them by Quintette. In dismissing the application Thackray J. said the following about the status quo at p. 109:

> While it is a compelling argument to suggest that the status quo should be maintained between *classes* of creditors, I do not believe that I should be blinkered by such a narrow view. The overall design of the C.C.A.A. is to preserve the debtor as a viable operation and to reorganize its affairs to the benefit of not only the debtor but also its creditors. With that design in mind, I do not believe that Wachowich J. was suggesting that every detail of the status quo would be maintained. Indeed he went on to note that [p.220] "The intention was to prevent any manoeuvres for positioning among creditors during the interim period".
>
> What is meant by maintaining the status quo is that the debtor will be able to stay in business, and that they will have breathing space in which to develop a proposal during which time there will be a stay under any bankruptcy or winding-up legislation, a restraint of all actions against the company, and no realization of guarantees or other rights against the company. In this case the order also restrained creditors from exercising any right of set-off.

An unusual case relating to the maintenance of the status quo is ***Re Alberta-Pacific Terminals Ltd.*** (1991), 8 C.B.R. (3d) 99 (B.C.S.C.). In that case the owner of the facilities at which the insolvent company carried on business made application for an Order compelling the insolvent company to make the ongoing monthly payments under the operating agreement between the parties. The payments were the equivalent of rental payments under a lease. The insolvent company did not have sufficient funds to make the payments, in part because it was making the interest payments on the pre-stay debt of one of its lenders. The company had agreed to make the interest payments in exchange for the agreement of the lender to continue providing an operating credit facility. Huddart J. dismissed the application and she said the following about the status quo at p. 105:

> The status quo is not always easy to find. It is difficult to freeze any ongoing business at a moment in time long enough to make an accurate picture of its financial condition. Such a picture is at best an artist's view, more so if the real value of the business, including goodwill, is to be taken into account. Nor is the status quo easy to define. The preservation of the status quo cannot mean merely the preservation of the relative pre-stay debt status of each creditor. Other interests are served by the CCAA. Those of investors, employees, and landlords among them, and in the case of the Fraser Surrey terminal, the public too, not only of British Columbia, but also of the prairie provinces. The status quo is to be preserved in the sense that manoeuvres by creditors that would impair the financial position of the company while it attempts to reorganize are to be prevented, not in the sense that all creditors are to be treated equally or to be maintained at the same relative level. It is the company and all the interests its demise would affect that must be considered.

This case is unusual because one would normally expect during a reorganization period that ongoing rental payments would be made and that interest on pre-stay debt would not be paid. However, the particular circumstances of the case meant that the preservation of the status quo produced a different result. The payment of the interest was considered to be a preservation of the status quo because the company required the continuation of the operating credit facility in order to survive and attempt to reorganize. The non-payment of the monthly amounts under the operating agreement was considered to be a preservation of the status quo because the company did not have sufficient funds and could not have continued if it had been required to make the payments.

It is my view that the maintenance of the status quo is intended to attempt to accomplish the following three objectives:

1. To suspend or freeze the rights of all creditors as they existed as at the date of the stay Order (which, in British Columbia, is normally the day on which the ***CCAA*** proceedings are commenced). This objective is intended to allow the insolvent company an opportunity to reorganize itself without any creditor having an advantage over the company or any other creditor.
2. To postpone litigation in which the insolvent company is involved so that the human and monetary resources of the company can be devoted to the reorganization process. The litigation may be resolved by way of the reorganization.
3. To permit the insolvent company to take certain action that is beneficial to its continuation during the period of reorganization or its attempt to reorganize or, conversely, to restrain a non-creditor or a creditor with rights arising after the stay from exercising rights that are detrimental to the continuation of the company during the period of reorganization or its attempt

> to reorganize. This is the objective recognized by ***Quintette*** and ***Alberta-Pacific Terminals.*** The first case to recognize that the maintenance of the status quo could affect the rights of non-creditors was ***Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.*** [1989] 2 W.W.R. 566, 72 C.B.R. (N.S.) 20 (Alta. Q.B.). This is the objective that takes into account the broad constituency of interests served by the ***CCAA***. As the overriding intent of the ***CCAA*** is to facilitate reorganizations, this is the overriding objective of maintaining the status quo and it may produce results that are not entirely consistent with the other objectives. The most common example of an inconsistency is a situation where the giving of effect to this objective results in an unequal treatment of creditors.

There are exceptions to the maintenance of the status quo but they are not relevant to this case.

Apart from consideration of s. 81.1 of the ***B & I Act***, there is no justification for the creation of the trust fund. It would not serve to maintain the status quo. To the contrary, it would give the suppliers an advantage over other creditors of Woodward's. It would not be beneficial to the continuation of Woodward's business during the reorganization period or Woodward's attempt to reorganize. Indeed, it was the position of Woodward's on these application that the creation of a trust fund in the amount of $30 million would make any reorganization impossible.

I am not prepared to order the creation of the trust fund on the basis of the allegations of events that took place prior to the commencement of these proceedings or on the basis of the timing of the commencement of these proceedings. There is no evidence in this case of fraud that could justify the preservation of assets by way of the creation of a trust fund. If the allegations were proven, it could possibly be argued that there has been an abuse of process or that Woodward's has not come to Court with clean hands. But these would not justify the creation of a trust fund for the benefit of the suppliers. The likely result would be that the Court would decline to exercise its discretion to afford Woodward's the protection it requires to reorganize and no one is suggesting that Woodward's should not be given an opportunity to attempt to reorganize its business and financial affairs.

That brings me to s. 81.1 of the ***B & I Act***. In order to decide whether the creation of a trust fund will preserve rights of the suppliers, I must consider the rights that exist as a result of s. 81.1. I am reluctant to make definitive comments regarding s. 81.1 because I am not required to make a decision under that section and I do not wish to constrain another judge who is required in the future to make such a decision. I am particularly sensitive because s. 81.1 has only been in force for 1½ months and I am not aware of any cases that have considered it. However, I must make some comments about the likelihood of the Courts making certain Orders in relation to s. 81.1 because I must determine what rights are to be preserved.

I begin by making the observation that on December 11 when these proceedings were commenced, the suppliers had no rights under s. 81.1 that could have been acted upon because Woodward's was not in bankruptcy or receivership. In ***Re Westar Mining Ltd.*** (unreported, June 16, 1992, B.C. Supreme Court Action No. A921164, Vancouver Registry) Macdonald J. was faced with an argument by the Crown that he should not have created a charge against Westar's assets to secure credit being extended during the reorganization period by Westar's suppliers because it would alter the priorities that would prevail in a bankruptcy of Westar. Macdonald J. rejected this argument in the following manner at p. 9:

> But, the Company was not in bankruptcy on June 10 when the charge was created. The Crown claims which are not afforded the protection of a statutory lien are not yet preferred. The June 10 order creating the charge does not purport to alter the priorities which will apply between the claims of the Crown and the unsecured trade creditors as at May 14.

The suppliers argue that the rights that I must preserve are the right to crystallize their position under s. 81.1 by way of the appointment of an interim receiver and the right to have the Court make an Order for the creation of a trust fund pursuant to s.

81.1(8). I must therefore consider the likelihood of the Court appointing an interim receiver or making an Order for the creation of a trust fund in the event that Woodward's had filed a notice of intention to file a proposal under the ***B & I Act***.

I agree with the submission of Mr. Fitch that s. 81.1 was intended to give suppliers the right to repossess goods that they had sold to the insolvent company if the company is to be liquidated by way of a bankruptcy or a receivership. Parliament directed its mind to the possibility that an insolvent company may first attempt to reorganize its affairs and it enacted subsection (4) of s. 81.1. Parliament decided that the period of the attempted reorganization should not be counted as part of the 30 day period under subsection (1) of s. 81.1. Parliament was silent as to the potential appointment of an interim receiver so that the suppliers could exercise their repossession rights during the reorganization period. Parliament was also silent as to the creation of a trust fund to be held for the benefit of the suppliers in the event that the reorganization is not successful. It must therefore be inferred in my view that Parliament intended that the insolvent company could continue to sell its goods in the ordinary course of business and utilize the sale proceeds to continue carrying on business pending its reorganization attempt.

It is my view that the likelihood of a Court appointing an interim receiver for the purpose of enabling suppliers to repossess the goods they supplied during the preceding 30 day period is low. The repossession of such goods would be counter-productive to the company's reorganization effort because it would deprive the company of assets it requires to continue carrying on business and to make a viable reorganization proposal. I can envisage a case where the Court may be willing to take such a step if it is concerned that the reorganization attempt may not be bona fide and the Court wishes to have an interim receiver to oversee the collection and disbursement of funds and to preserve the rights of suppliers if it is proven that the reorganization attempt was not bona fide. In this case there is no suggestion that Woodward's attempt to reorganize is not bona fide. In addition, I have reservations about whether an interim receiver is a receiver within the meaning of s. 243(2) of the ***B & I Act***. An interim receiver is very different from a (permanent) receiver.

Similarly, I believe that the likelihood of a Court making an Order under s. 81.1(8) for the creation of a trust fund is low. This would again be counter-productive to the attempt of the company to reorganize. I also doubt that it was intended by Parliament that the filing of a notice of intention to file a proposal would be considered to be an act aggrieving a supplier within the meaning of s. 81.1(8) unless, possibly, the filing was not bona fide.

I was referred to two Quebec decisions dealing with the ***CCAA*** and the revendication rights of suppliers in Quebec. The first case was ***Century Industries Inc. v. Enterprises Union Électrique Ltée.*** (unreported, April 29, 1992, Que. S.C. Action No. 500-05-005804-925). I have been provided with a translation of the decision. Archambault J. ordered that the proceeds from the sale of any merchandise delivered in the 30 days prior to the service of the application before him be deposited in a trust account and that the monies in the trust account not be disbursed without further Court Order. The paragraph containing the reasoning of Archambault J. reads as follows (at p. 9):

> Le tribunal doit s'assurer que le statu quo est maintenu. Si une ordonnance n'était pas rendue, la requérante pourrait, si les marchandises étaient vendues dans l'intervalle par Union Électrique, perdre ses droits quant a la revendication des marchandises qui furent vendues et livrées a Union Électrique dans les derniers 30 jours. De plus, il serait fondamentalement injuste de permettre a Union Électrique de continuer de vendre ces marchandises qui ne lui appartiennent peut-être pas, au détriment des personnes qui en sont véritablement les propriétaires.

The translation for this paragraph with which I have been provided reads as follows:

> The Court must ensure that the statue quo is maintained. If no order were given, the Applicant might, if the merchandise was sold by Union Électrique in the interim, lose its rights of revendication of the goods which were sold and delivered to Union Électrique within the last 30 days. Moreover, it would be fundamentally unjust to permit Union Électrique to continue to sell merchandise which perhaps does not belong to it, to the detriment of those who are the true owners.

I do not believe that the last sentence of the above paragraph relates to the right of revendication. In addition to merchandise that had been delivered within the previous 30 days, the applicant had sold goods to Union Électrique by way of conditional sale and title to these goods had not passed to Union Électrique.

I am not familiar with the details of a supplier's right of revendication in Quebec but I think that there is an important distinction between it and the right afforded by s. 81.1 of the ***B & I Act***. The distinction is that the right of revendication is not dependent upon the bankruptcy or receivership of the purchaser of the goods. Thus, the applicant in the***Union Électrique*** case had an existing right to repossess the goods supplied by it at the time the ***CCAA*** were commenced. Archambault J. was preserving that right when he made the Order that he did. In the present case, the suppliers did not have a right to repossess the goods supplied by them at the time these proceedings were instituted.

The second Quebec case took a different approach. In ***Steinberg Inc. v. Colgate-Palmolive Canada Inc.*** (1992) 13 C.B.R. (3d) 139 a supplier made application for leave under s. 11 of the ***CCAA*** to exercise its right of revendication with respect to goods delivered to the insolvent company within the previous 30 days. The Quebec Superior Court dismissed the application. The headnote, which is consistent with the translation of the decision provided to me, reads as follows:

> The power conferred on the judge under the Act applies to all proceedings likely to affect the survival of a company. The individual interest of any creditor must be weighed against the objects of the Act and must yield to the collective interests of all creditors. Granting the application would impose on the court an obligation to do the same for all 30-day suppliers. Therefore, an arrangement proposal submitted to the judge at the time of the order might fail before it was presented to all creditors, and might cause the debtor to go bankrupt. It followed that the goods in question should not be allowed to be seized prior to judgment.

This reasoning is similar to my reasoning in concluding that it is unlikely that a Court would appoint an interim receiver or order the creation of a trust fund when an insolvent company is attempting to reorganize pursuant to the ***B & I Act***.

The result in the ***Steinberg*** case is also consistent with the decision of the B.C. Court of Appeal in ***Chef Ready Foods Ltd. v. Hongkong Bank of Canada*** (1990), 51 B.C.L.R. (2d) 84 where the issue involved security under s. 178 of the ***Bank Act***. Section 178 security creates a security interest in inventory and the bank has the right to seize and sell the inventory. The right of the bank is therefore similar to the right of revendication enjoyed by a Quebec supplier. If the goods covered by s. 178 security are sold during the period of reorganization, the bank will be prejudiced in the same fashion as a supplier whose 30 day goods are sold during the period of reorganization (except to the extent that proceeds from the sale of inventory are utilized to purchase new inventory which would become covered by the bank's s. 178 security). In ***Chef Ready Foods*** the B.C. Court of Appeal held that the enforcement of s. 178 security can be stayed by an Order under s. 11 of the ***CCAA***. Gibbs J.A. said the following at p. 92:

> It is apparent from these excerpts and from the wording of the statute that, in contrast with ss. 178 and 179 of the Bank Act which are preoccupied with the competing rights and duties of the borrower and the lender, the C.C.A.A. serves the interests of a broad constituency of investors, creditors and employees. If a bank's rights in respect of s. 178 security are accorded a unique status which renders those rights immune from the provisions of the C.C.A.A., protection afforded that constituency for any company which has granted s. 178 security will be largely illusory. It will be illusory because almost inevitably the realization by the bank on its security will destroy the company as a going concern. Here, for example, if the bank signifies and collects the accounts receivable, Chef Ready will be deprived of working capital. Collapse and liquidation must necessarily follow. The lesson will be that where s. 178 security is present a single creditor can frustrate the public policy objectives of the C.C.A.A. There will be two classes of debtor companies: those for whom there are prospects for recovery under the C.C.A.A.; and those for whom the C.C.A.A. may be irrelevant dependent upon the whim of the s. 178 security holder. Given the economic circumstances which prevailed when the C.C.A.A. was enacted, it is difficult to imagine that the legislators of the day intended that result to follow.

The above passage contains persuasive reasoning why the Court is unlikely to appoint an interim receiver or to create a trust fund under the ***B & I Act*** if an insolvent company files a notice of intention to file a proposal. The ability to reorganize would be illusory for companies which deal with goods provided on credit by suppliers.

Subject to the point on which I will subsequently invite further submissions, I have concluded that there is likely to be no difference in the approach of the Court when dealing with a proposal under the ***B & I Act*** from the approach of the Court when dealing with a reorganization under the ***CCAA*** as they relate to the rights of suppliers. Therefore, there is no special right of suppliers that needs to be preserved by the creation of a trust fund and there is no abuse in Woodward's choosing the ***CCAA*** over the ***B & I Act***. In addition, I repeat that the suppliers did not have any right to repossess the goods supplied by them at the time of the commencement of these proceedings. Accordingly, I dismiss the application of the suppliers for an Order creating a trust fund for their benefit.

Subsection 81.1(4) of the ***B & I Act*** does attempt to preserve the potential rights of suppliers by providing that the period of reorganization does not count in the computation of the 30 day period under s. 81.1(1). This is consistent with the status quo objective of suspending the rights of creditors during the period of reorganization. No submissions were made to me by the parties as to whether I can make an Order in these proceedings that has the same effect as s. 81.1(4). It may be possible that I could order that the period during which Woodward's is attempting to reorganize will not be counted as part of the 30 day period under s. 81.1(1) with the result that if Woodward's reorganization attempt is not successful and it goes into bankruptcy or receivership, the suppliers would still have the right to repossess goods supplied by them within the 30 day period preceding the commencement of these proceedings that have not been sold by Woodward's in the meantime. I invite counsel to make submissions in this regard.

As I have concluded that there are no rights of the suppliers that should be preserved other than a potential postponement of the running of the 30 day period under s. 81.1 of the ***B & I Act***, my interim Order of December 17 should be set aside as it relates to the proceeds from the sale of goods after December 17. Counsel for several of the suppliers has requested that he have the opportunity to seek instructions regarding an appeal before the Order is set aside. Counsel for Woodward's does not object. I therefore set aside my December 17 Order as it relates to the sale proceeds effective 4:00 p.m. on January 18, 1993 or such later time as I may order.

January 14, 1993 " D. Tysoe, J. "

Vancouver, B.C.

Tab 4

Ontario Supreme Court
Bruce Agra Foods Inc. v. Proposal of Everfresh Beverages Inc. (Receiver of)
Date: 1996-12-29

Bruce Agra Foods Inc., Cargill Citro-America Inc., Citradex Limited, Lawson Mardon Packaging Inc. and Package Development Corporation, Moving Parties

and

Ernst & Young Inc. as Interim Receiver and Trustee under the Proposal of Everfresh Beverages, Inc., Respondent

Ontario Court of Justice (General Division) Farley J.

Heard–December 11, 1996.

Judgment–December 29, 1996.

Kevin J. Zych, for moving parties.

E. Bruce Leonard and John R. Sandrelli, for respondent.

(Doc. 32-077978)

[1] December 29, 1996. FARLEY J.:–The central issue in this matter is whether Ernst & Young Inc. was a receiver within the meaning of section 243(2) of the *Bankruptcy and Insolvency Act,* R.S.C. 1985, c. B-3 as amended ("BIA") in relation to Everfresh (which was a purchaser of goods from the moving parties who are claiming section 81.1 rights of repossession). The wording of the relevant sections in the BIA is somewhat awkward and convoluted.

> S. 243 (1)In paragraph (2)(b) and 250(2)(a) and (b), "court" means(a)any court other than a court as defined in section 2; and(b)a court as defined in section 2 when not exercising jurisdiction in
>
> bankruptcy.(2)Subject to subsection (3), in this Part, "receiver" means a person who has been appointed to take, or has taken, possession or control, pursuant to(a)an agreement under which property becomes subject to a security (in this Part referred to as a "security agreement"), or(b)an order of a court made under any law that provides for or authorizes the appointment of a receiver or receiver-manager, of all or substantially all of(c)the inventory,(d)the accounts receivable, or(e)the other property of an insolvent person or a bankrupt that was acquired for or is used in relation to a business carried on by the insolvent person or bankrupt.
>
> S. 2. "Court", except in paragraph 178(1)(a) and sections 204.1 to 204.3 and subject to subsection 243(1), means the court having jurisdiction in bankruptcy or a judge thereof,

and includes a registrar when exercising the powers of the court conferred on a registrar under this Act;

S. 183(1) The following named courts are invested with such jurisdiction at law and in equity as will enable them to exercise original, auxiliary and ancillary jurisdiction in bankruptcy and in other proceedings authorized by this Act during their respective terms, as they are now, or may hereafter, held, and in vacation and in chambers:(a)in the Province of Ontario, the Ontario Court (General Division);...

S. 81.1 (1) Subject to this section, where a person (in this section referred to as the "supplier") has sold and delivered goods to another person (in this section referred to as the "purchaser") for use in relation to the purchaser's business, and the purchaser has not fully paid for the goods, the supplier may have access to and repossess the goods at the supplier's own expense, and the purchaser, trustee or receiver shall release the goods, if(a)the supplier presents a written demand for repossession to the purchaser, trustee or receiver, in prescribed form and containing the details of the transaction, within a period of thirty days after the delivery of the goods to the purchaser;(b)at the time when the demand referred to in paragraph (a) is presented,(i)the purchaser is bankrupt, or(ii)there is a receiver, within the meaning of subsection 243(2), in relation to the purchaser;

[2] If Parliament had intended that unpaid suppliers have direct *immediate* rights in a reorganization scenario as envisaged by a Notice of Intention to File a Proposal, then it would seem to me that it would have provided for same to take place in s. 81.1(b) but rather Parliament addressed the Notice of Intention situation by having a suspension during the relevant time period: see s. 81.1(4). Unfortunately for those affected, in order to promote reorganizations (which is an underlying fundamental of the BIA including the 1992 amendments which puts some teeth or perhaps "life blood" into that part of the BIA), there will be some prejudice to creditors (who may be unpaid sellers). If the rights of unpaid suppliers were to override, then there would have to be an amendment to section 69.1 (a) to that effect.

[3] On November 17, 1995, I gave an order pursuant to section 47.1 appointing Ernst & Young Inc. as Interim Receiver of the property, business and assets of Everfresh within Canada. While the preamble to the order recited that the motion was made by the CIT Group, this would appear to be an inadvertence as the motion was made by Everfresh which had filed a Notice of Intention to File a Proposal that same day. The motion recited that Everfresh had filed as well on November 17, 1995 a voluntary petition under Chapter 11 (the reorganization chapter) of the U.S. Bankruptcy Code. It was indicated to be "essential that an Interim Receiver of the assets, property and undertaking of the debtor situate in Canada be appointed for the protection of such assets, property and undertaking of the debtor and for the protection of the interests of CIT and the other creditors of the debtor."

S. 47.1 (1) Where a notice of intention has been filed under section 50.4 or a proposal has been filed under subsection 62(1), the court may at any time thereafter, subject to subsection (3), appoint as interim receiver of all of or any part of the debtor's property, for such term as the court may determine,(a)the trustee under the notice of intention or proposal;(b)another trustee; or(c)the trustee under the notice of intention or proposal and another trustee jointly.

(2) The court may direct an interim receiver appointed under subsection (1) to do any or all of the following:(a)carry out the duties set out in subsection 50(10) or 50.4(7), in substitution for the trustee referred to in that subsection or jointly with that trustee;(b)take possession of all or part of the debtor's property mentioned in the order of the court;(c)exercise such control over that property, and over the debtor's business as the court considers advisable; and(d)take such other action as the court considers advisable.

[4] It would not appear to me that a "receiver" as contemplated under Part XI of the BIA which deals with secured creditors and receivers includes an "interim receiver" appointed under Part II. I note that Chaput, J.C.S. at p. 32 of *Re People's Department Stores Ltd. (1992) Inc.*, 37 C.B.R. (3d) 28, [1994] I.C.R. 195 (Que. S.C.) did not find that a "séquestre intérimaire" was the equivalent of a "séquestre" in the sense of section 243(2). While section 243(2) (Part XI) defines a receiver under (b) as taking possession, it would appear that Part II encompasses the reorganization sections found in Part IV which fundamentally import the absence of physical possession by anyone other than the debtor. I note that in the interim receivership order, I authorized and empowered the Interim Receiver to do certain things, but I did not obligate it to do so. The thrust of the power was to review and approve particular activities of Everfresh although there are instances of controlling or collecting receipts and the ambivalent aspect of "to sell or concur in the sale by [Everfresh] of assets of [Everfresh] comprised in the property." (Paragraph 3 (i)). I note the advertisement in *The Globe and Mail* called for letters of intent to be submitted to Everfresh, not to the Interim Receiver (although the submissions were to be to Everfresh care of the Interim Receiver). The sale approval motion was made by Everfresh on January 4, 1996–and not by the Interim Receiver.

[5] The 30 days rights of section 81.1 are not triggered unless the purchaser (Everfresh here) is a bankrupt or there is a section 243(2)(b) receiver. While section 12 of the *Interpretation Act,* R.S.C. 1985, Chapter 1-21 provides that "every enactment is deemed remedial and shall be given such fair, large and liberal construction and interpretation as best ensures the attainment of its objects," this does not provide that proper regard not be paid to the cannons of statutory interpretation and where the legislature confers a right or benefit on persons which they would not have had at common law, the conditions which the legislature

prescribes for the acquisition of that right or benefit are mandatory: see *Thomson Consumer Electronics Canada Inc. v. Consumers Distributing Inc. (Receiver of),* [1996] I.C.R. 166, [1996] O.J. No. 3918 at para. 6 (Gen. Div.) [reported at (1996), 43 C.B.R. (3d) 77] (citing *Barrette v. Crabtree Estate,* [1933] 1 S.C.R. 1027; *Langille v. Toronto-Dominion Bank* (1981), 37 C.B.R. (N.S.) 35 (N.S. C.A.), affirmed 131 D.L.R. (3d) 571 (S.C.C.); *John Goodison Thresher Co. v. MacNab* (1909), 19 O.L.R. 188 (C.A.) at p. 204, affirmed (1910), 44 S.C.R. 694; *Czerwonka v. Paslawski* (1989), 8 R.P.R. (2d) 73 (Sask. C.A.); Bennion, F.A.R. *Statutory Interpretation* 2nd ed. (London: Butterworths, 1992) at p. 32.

[6] It would seem to me that unpaid supplier rights are truly intended to protect against the unfair consequences in liquidation as seen by Parliament and are not intended to affect or disrupt reorganizations proposed pursuant to Part IV of the BIA. See *Re Henry Birks & Sons Ltd.* (1993), 22 C.B.R. (3d) 235 at pp. 237-8, [1993] I.C.R. 168 (Que. S.C.); *Détaillants Shirmax Ltée/Shirmax Retail Ltd. c. 170974 Canada Inc.* (1994), 28 C.B.R. (3d) 177, [1994] I.C.R. 196 (C.S. Qué.) and *Textiles Tri-Star Ltée c. Dominion Novelty Inc.,* 22 C.B.R. (3d) 213, [1993] I.C.R. 169 (C.S. Qué.).

[7] In conclusion it appears to me that Ernst and Young Inc. operating as interim receiver with the powers given to it and operating in the way that it did in the circumstances was not a receiver within the meaning of section 243(2)(b). Therefore, the claims of unpaid suppliers are dismissed.

[8] I will go on although it is not necessary to advise as to my views regarding Cargill Citro-America Inc. ("Cargill"). It is indeed unfortunate that an employee of the interim receiver used the word "identify" or "identified" when advising as to the Cargill goods. I would think that, when dealing with persons who may advance section 81.1 claims, people should be more careful in their terminology. However, it appears to me that in the circumstances what was described was a "book count"–and not an actual physical identification of the specific goods. It would have had to have been a most unique set of circumstances that the Cargill FCOJ (frozen concentrated orange juice) which is shipped in liquid form would have been pumped into an empty vat since Everfresh apparently used a Solera method of dumping in new goods into a *continuing* vat. Apparently only at certain periods of the year would the vat have been completely emptied and cleaned. Thus it was certainly more likely on the probabilities that the new shipment was pumped into a *continuing* mixture - thus destroying

the identifiability of this most fungible good (as opposed to having been pumped into an empty vat). I would therefore rule against Cargill–but without prejudice to its renewing its claim (if it were to get around my general dismissal of the claims, *supra*) on the presentation of new evidence to support the empty vat situation (e.g., records of vat cleaning, recollections of workmen or delivery men, etc.).

[9] As for costs, the moving parties are to pay $7,500 forthwith.

Motion dismissed.

Tab 5

Citation:	In the Matter of the Companies' Creditors Arrangement Act 2000 BCSC 837	Date:	20000530
		Docket:	L001146
		Registry:	Vancouver

IN THE SUPREME COURT OF BRITISH COLUMBIA

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*
R.S.C. 1985, c. C-36

AND

IN THE MATTER OF THE *COMPANY ACT*
R.S.B.C. 1996, C62

AND

IN THE MATTER OF AGRO PACIFIC INDUSTRIES LTD.

PETITIONER

REASONS FOR JUDGMENT

OF THE

HONOURABLE THE JUSTICE THACKRAY

Counsel for Agro Pacific Industries Ltd. and KPMG Inc.:	D.I. Knowles
Counsel for Archer Daniels Midland Company, Interag, Calhoun Agri Services Ltd., Market Laboratory Inc., United Agri Products, United Grain Growers Limited and Van Waters & Rogers Ltd.:	G.E.H. Cadman, Q.C. S.R. McGladery
Counsel for the Monitor, KPMG Inc.:	R.J. Kearns
Counsel for the National Bank of Canada:	M.A. Fitch, Q.C.

Counsel for the Bank of Montreal:	J.I. McLean
Counsel for Barenbrug USA Export, Inc., Cargill Limited, International Raw Materials, J.R. Simplot Company, Hydro Agri North America, Inc., IMC Kalium Canada Limited:	S.C. Fitzpatrick
Counsel for Agrium Inc. and Pioneer Hi Bred:	J.Lynch
Counsel for B.C. Transportation Financing Authority:	T.J. Potter
Counsel for Parrish & Heimbecker Ltd.:	J.P. Mancuso
Date and Place of Hearing:	May 19, 2000 Vancouver, BC

[1] This is a ***Companies' Creditors Arrangement Act*** (CCAA) proceeding. The petitioner, Agro Pacific Industries Ltd. (Agro), obtained an interim stay order from this Court on April 27, 2000. A significant number of suppliers of inventory have applied to set aside that order and to obtain the return of goods supplied to Agro within 30 days of the order.

[2] Alternatively, they ask to vary the stay order whereby the goods supplied would be traced and identified and the proceeds of the sale of such goods placed in a trust fund. The funds could not be used by Agro to pay either the Bank of

Montreal or the National Bank of Canada, who are secured creditors, nor be deposited to an operating account.

[3] The applicants on this motion are as follows: Van Waters & Rogers Ltd., Market Laboratory Inc., Interag, a division of Aventis CropScience Canada Co., Archer Daniels Midland Company, United Agri Products, United Grain Growers Limited and Calhoun Agri Services, counsel for whom is Mr. George E.H. Cadman, Q.C. The other applicants are represented by Ms. S.C. Fitzpatrick and are as follows: Cargill Limited, International Raw Materials, J.R. Simplot Company, Hydro Agri North America, Inc., IMC Kalium Canada Limited and Barenbrug USA Export, Inc.

A Brief History

[4] Pursuant to an amalgamation agreement dated October 14, 1997, subsidiaries of the East Chilliwack Agricultural Co-operative were acquired by Agro. Those subsidiaries were Pro Form Feeds Inc., Coast Agri Ltd. and Richardson Seed company Limited. Initially, members of the Co-op exchanged their ownership interest for common shares of Agro. Subsequently, Agro commenced trading on the Toronto Stock Exchange.

[5] In 1998 the Saskatchewan Wheat Pool, through its wholly owned subsidiary Cangro Processors Ltd., acquired a 39%

interest in Agro. It is, today, not only one of Agro's suppliers but one of its largest non-secured creditors.

[6] Agro is a major animal feed and crop products supplier to the farming industry, particularly in the Fraser Valley. The feed division, under the brand name "Pro Form Feeds" operates manufacturing facilities in Chilliwack. It produces feed for livestock, poultry, aquaculture and pets.

[7] The crop division, based in Abbotsford, distributes fertilizer, seed and crop protection services under the brand name "Coast Agri".

[8] The application for the stay was heard *ex parte* and was supported by the affidavit of Mr. Glen Vanderhaeghe, the then president and chief executive officer of Agro. Mr. Vanderhaeghe's employment was terminated on April 28, 2000, pursuant to a decision made by the Board of Directors held concurrently with the hearing of the application on April 27. The affidavit and the outline in the petition reviewed the financial structure and plight of Agro.

[9] The National Bank of Canada extended a line of credit to Agro for which it holds an assignment of accounts receivable, security pursuant to s. 427 of the ***Bank Act*** and a general security agreement comprising a charge over all the assets of

Agro secured by a promissory note for $20 million. Of this, $4 million was reserved for fish feed and, since the stay, the credit line has been reduced by $4 million leaving $12 million available to Agro. The indebtedness as of February 29, 2000 stood at $11.4 million but this has been reduced by some $2.6 million.

[10] The Bank of Montreal holds security by way of a fixed and floating charge over all of the assets and real property of Agro and as well a s. 427 charge. This is subject to priority agreements in favour of the National Bank and "Cathedral" to the extent of $2.961 million with respect to certain equipment. As of February 29, 2000 the indebtedness to the Bank of Montreal stood at $7.93 million.

[11] The petition shows the indebtedness to unsecured creditors as of February 29, 2000, as $10.869 million. I have been informed that the unsecured indebtedness is now $13.1 million. Annexed to the petition was a summary of the financial statements for Agro for the years ended October 31, 1998 and 1999. They show roughly comparable sales for the two years, net cash flow losses for both years, accounts payable and accounts receivable both rising in 1999 and share losses in both years although less in 1999.

[12] Mr. Vanderhaeghe deposed that as of the last week of April, 2000, Agro had exhausted its available operating line with the National Bank, had cheques printed but not released of $4.5 million, had a projected cheque run for the last week of April of $2.5 million and had collections of accounts receivable of $4 million in April as opposed to a projected $9 million. The Saskatchewan Wheat Pool stopped supplying inventory in that its $800,000 line of credit had been exceeded by some $100,000.

[13] Mr. Vanderhaeghe said that unpaid suppliers were exerting increased pressure for payment of their accounts and that some of them had refused to supply inventory other than on a COD basis. He concluded that Agro is "unable to meet its obligations generally as they become due and is therefore insolvent." Mr. Vanderhaeghe outlined the anticipated results should Agro be unable to obtain a stay of proceedings. He said that Agro would have to cease operations and that secured creditors would take steps to enforce their security that could include the appointment of a receiver and/or bankruptcy. The result would be "nothing available for unsecured creditors and shareholders" and that Agro would be "put out of business, probably permanently."

[14] The result of the petition was an interim order in terms not unfamiliar in CCAA proceedings. It stayed all proceedings and demands and suspended all obligations incurred prior to the filing date. The petitioner could pay amounts up to $1,000 to creditors whose claims did not exceed that amount or to pay that amount if it was agreed by the claimant that this extinguished the indebtedness.

[15] The usual "continuation of supply" clauses were included. The order provided that Agro may apply funds to finance these proceedings, to pay the Monitor and Chief Restructuring Officer, pay ongoing wages, taxes, rents and inventory supplied after the date of filing.

[16] The Court appointed KPMG Inc. as Monitor and Mr. Colin Rogers as Chief Restructuring Officer and set out the responsibilities and jurisdiction of each.

[17] The date for the hearing of the petition ("come-back hearing") is set for May 31, 2000. The order provides for a four day notice to the petitioners for any application to vary the initial order. It is pursuant to this provision that this hearing took place.

Affidavit Evidence

[18] The suppliers filed affidavits deposing to the type of the goods that were shipped to Agro, the value of those goods, the dates on which they were supplied and alleging that much of it is identifiable. Some of the deponents said that the loss of revenue will be devastating to them both in their corporate and personal capacities. None of this evidence was challenged.

[19] Deponents also identified goods and the value thereof delivered within thirty days of the filing of the petitioner's application. On behalf of Interag it was said that $18,744.21 worth of animal nutrition products were shipped after March 28, 2000. Mr. M. Ward deposed that as well $115,609 worth of crop protection products such as herbicides were sold to Agro after March 17, 2000.

[20] Mr. Leonard Calhoun, president of Calhoun Agri Services Ltd., deposed that silage wrap delivered to Agro is in identifiable rolls. The amount owing is $72,058.08 which, if lost, "will be devastating to Calhoun and will put the whole business in jeopardy."

[21] Mr. Richard P. Spycher said that since March 17, 2000, Archer Daniels Midland Company has shipped to Agro soybean meal with a value of $276,230.23(U.S.). Of that, some

$216,000 worth was supplied within 30 days of the CCAA application.

[22] On behalf of Van Waters & Rogers Ltd., Mr. F. Hermesmann deposed that $1.4 million worth of chemicals was supplied to Agro. He said the products are identifiable and that approximately $1.05 million worth was provided since March 28.

[23] Mr. Michael Olson of Market Laboratory Inc. deposed that after March 19, 2000, Agro placed orders for liquid iron DTPA in the amount of $53,864.66. Market's gross annual sales approximate $300,000 and it "risks insolvency" if Agro defaults.

[24] On behalf of United Agri Products, Mr. C. McLean stated that since February 8, 2000, it has shipped $900,000 worth of product to Agro, of which $318,000 is since March 27. United Grain Growers Limited, through Mr. S. Olson, deposed that nearly $300,000 worth of forage and barley seed were supplied since March 28, 2000.

[25] Mr. Cadman said that the aggregate amount of goods supplied by his clients within 30 days of the interim order is approximately $1.785 million. Ms. Fitzpatrick informed the Court that the value of her clients' goods so supplied is in the vicinity of $1.7 million. Her clients deposed as follows.

[26] Mr. B. Stevens said that Cargill Limited had been supplying fertilizer products to Agro and its predecessor company since 1994. In January 2000, Cargill entered into an agreement with Argo to become a major supplier. In February Mr. Stevens met with representatives of Agro, including Mr. Vanderhaeghe, and discussed what security Agro would give to Cargill. A decision was deferred until Agro received year-end financial statements.

[27] On March 26, 2000, an assistant to Mr. Stevens spoke with a representative of Agro with respect to the financial statements. He was informed that in that Agro was a public company this information could be obtained on the internet. In the meantime significant volumes of fertilizer were shipped to Agro with credit terms being that payment was due by the end of the month that followed the month of the shipment.

[28] As of April 26, 2000, Agro owed Cargill $1.4 million. A cheque was delivered dated April 10 for $522,877.17. However a "stop payment" was applied against this cheque. An additional amount of $115,329.26 U.S. is owed to Cargill for oilseed.

[29] An affidavit from K. Reiswig of J.R. Simplot states that in April, 2000, a dry granular fertilizer with a value $22,091.63 was supplied to Agro. On behalf of Agri North

America, Inc., Mr. D. Birkelund said that Agro owes $95,813.80 for chemicals. Most of these were shipped in April, 2000 and is identifiable.

[30] Mr. A.I. Stannard of International Raw Materials Ltd. said that his company entered into business with Agro about March 20, 2000. This was for the supply of super sulphate fertilizer. As of May 9, 2000, the amount owing was $85,768.06. On behalf of Barenbrug USA Export, Inc., Mr. R. Kapsenberg deposed that grass and clover seed with a value of $62,268.50 was supplied to Agro after February, 2000.

[31] Mr. J. Procyshen stated that Agro owes $310,381.76 to IMC Kalium Canada Limited as of May 11, 2000. He could not say if the potash and other crop nutrients are still on the premises of Agro or identifiable.

Applicants' Submissions

[32] Counsel for the suppliers suggested that Agro knew of its impending position but nevertheless entered into contracts with the suppliers and "bulked up" its inventory.
Ms. Fitzpatrick submitted that "in the circumstances under which the suppliers supplied inventory to Agro Pacific in the time leading up to the Initial Order, Agro Pacific clearly was not acting in good faith."

[33] The contention of the suppliers is that the financial circumstances of Agro, as set out in Mr. Vanderhaeghe's affidavit, "were known to Mr. Vanderhaeghe, to KPMG Inc. and to Mr. Rogers well in advance of the last week of April and, most certainly, within the 30 days preceding the date of issuance of the petition and the grant of the initial order."

[34] The "good faith" argument arises from s. 11 of the CCAA. It provides that a court shall not make an initial order unless "the applicant satisfies the court that circumstances exist that make such an order appropriate"; and, other than on the initial application, unless the court is satisfied "that the applicant has acted, and is acting, in good faith and with due diligence."

[35] The words "good faith" appear in the CCAA only in that section and it is directed to "other than an initial application." The applicants submit that the initial order would not have been granted at all, or not in its present form, if certain information had been revealed to the Court. This information includes the fact that KPMG, which is also the auditor of Agro, "was on the premises [of Agro] for three months as a consultant prior to the protection application."

[36] Ms. Fitzpatrick said that it is "clear from the affidavit of Colin Rogers, sworn May 15, 2000, that Agro Pacific was in

financial difficulty as early as February 2000, when he was engaged as a consultant." The suppliers point out that the petitioner failed to inform the Court that the National Bank issued a "demand" to Agro before March 30, 2000.

Discussion and Conclusions

[37] The "good faith" submission and the contention for a thirty day clause and trust fund are bound together by a common thread. That thread is the feeling of the suppliers that they have been treated unfairly. They point out that the spring is the prime retail season for Agro and consequently it requires increased inventory in the early months of the year. It therefore did what the suppliers call "bulking up" its inventory. This bulking up, while not unusual for Agro, was done this year while the company, in the opinion of the suppliers, knew that its existence was threatened by its financial condition.

[38] Even more galling to the suppliers is their belief that the secure creditors also knew that Agro was teetering. This, they say, is demonstrated by the demand made upon Agro before March 30, 2000 by the National Bank. However, the suppliers were not aware of the nature of the demand and the Court has been informed that the demand was for a report.

[39] The suppliers feel that they were duped by Agro and that the result is that the value of their supplies is now being used to pay down the secured creditors. Particularly the National Bank who's operating loan has been reduced by some $2.6 million since the initiation of these proceedings.

[40] The chagrin of the suppliers is understandable. However, unless they can demonstrate a lack of good faith and, in my opinion, such is required even in the obtaining of the initial order, they cannot succeed simply because they are the losers as between themselves and the secured creditors. The relationships between the secured creditors and the company and between the unsecured creditors and the company were established in a competitive commercial setting.

[41] The secured creditors, who make the financial means available so that companies such as Agro can operate, do not, and would not, make such sizeable advances without security. On the other hand, the inventory suppliers, who generally are involved for lesser amounts, must take certain risks. They can lessen those risks by having agreements as to the amount of supplies on credit or limit the time within which payments are to be made. However, they do not generally, and did not in this case, have liens comparable to those obtained by the secured creditors.

[42] Consequently, they take risks in order to do business. If the gamble fails they cannot look to the secured creditors for relief nor, short of some lack of good faith, fairly criticise the secured creditors. In the case at bar there is no evidence that the secured creditors were culpable of any moral, business or civil law transgression.

[43] There is no doubt but that Agro knew that it was having financial difficulties, particularly with its cash flow position. However, that does not mean that bankruptcy, or the necessity for CCAA protection, was inevitable. The fact that there is a risk of financial failure does not require the company at risk to reveal this to suppliers. To do so would, in itself, jeopardize its business prospects.

[44] In short, on the material before the Court, I am not satisfied that there was any lack of good faith on the part of Agro or its secured creditors. It follows that it cannot be said that there was any collusion between them to disadvantage the unsecured creditors.

[45] The application for an order that the supplies that came into the possession of Agro within thirty days of the initial order be traced and the proceeds put into trust is an attempt to introduce into CCAA proceedings a requirement similar to that contained in s. 81.1 of the ***Bankruptcy and Insolvency***

Act, R.S.C. 1985, c. B-3. That section provides that where a person has delivered goods to a purchaser and the purchaser has not fully paid for the goods, the supplier may repossess them.

[46] The suppliers submit that "it is clear" that insolvent companies will not be permitted to elect CCAA proceedings over bankruptcy proceedings simply to gain a benefit that would not have been available in bankruptcy proceedings. For this proposition they refer to ***Re Woodward's Ltd.*** (1993), 77 B.C.L.R. (2d) 346 (S.C.). At page 349 Mr. Justice Tysoe said as follows:

> A theoretical answer to the potential abuse of insolvency legislation is that the Court should refuse to exercise its discretion to grant a stay of proceedings under the CCAA if it believes that the insolvent company has chosen the CCAA over the B & I Act in order to defeat the potential rights of suppliers.

[47] On the evidence before me I cannot come to a conclusion that Agro chose the CCAA proceedings for such a purpose. It might well be that in choosing CCAA proceedings Agro recognized that it would garner some benefits not available under the B & I Act. However, there is nothing morally or legally culpable about that. The CCAA, while a somewhat unique legislative creation, is nevertheless a vehicle

designed for use by qualified companies with financial problems.

[48] Both Mr. Justice Tysoe in ***Re Woodward's*** and Mr. Justice Farley in ***T. Eaton Co. (Re),*** [1999] O.J. No 3277 (Ont. Sup. Ct. of Justice) ordered that the running of the thirty day period under s. 81.1 of the B & I Act was suspended during the period of attempted reorganization. Tysoe J. reflected that "it would be very difficult for suppliers to prove that there is an abuse" in choosing the CCAA over the B & I Act. He said "the Courts should avoid the possible abuse by treating suppliers in CCAA proceedings in the same way that they are treated under the B & I Act."

[49] Mr. Justice Tysoe commenced by saying that he was theorizing. Then he agonized over the difficulty that suppliers have in proving an abuse by a petitioner company. He then reflected that suppliers should be treated in the same way regardless of the form of the proceedings. However, this must be read to embody the concept that the treatment must be equal as far as possible within the relevant legislation. In the case at bar the suppliers do not want to settle for the provisions given in ***Re Woodward's*** or ***T. Eaton Co. (Re).*** They say:

> In ***Re: Woodward's,*** the order ultimately made by the Honourable Mr. Justice Tysoe extending the time for the thirty (30) day suppliers recovering their goods was workable in that situation because the goods were, presumably, not consumable. In the case at bar, the products are supplied at the beginning of the season with payment terms that allow the goods to be sold by July of each year. They are not intended to remain on the premises for a long period of time. As such, an order similar to that made in re Woodward's without a trust provision may well be hollow. Consequently, the status quo would not be maintained."

[50] In rejecting the petitioner's offer to consent to such an order the suppliers contend that it would give protection that is no more than "illusory". They say that by the time the suppliers could get to the inventory under the B & I Act "it would be gone." Mr. Fitch, on behalf of the National Bank, said that the suppliers are correct in categorizing the benefit of a Woodward's order as illusory but adds that this is a legislative problem.

[51] Further in reply to the suppliers' submission that ***Re Woodward's*** supports the proposition that insolvent companies will not be permitted to use the CCAA simply to gain a benefit not available under the B & I Act, the petitioner says that there are no rights of the creditors being transgressed by using the CCAA. It says that there are no rights inherent in the suppliers until such time as a receiver or trustee is in place pursuant to the B & I Act. This reflects what was said

by Tysoe J. in ***Re Woodward's***. He said that "until it is known that the reorganization attempt is not successful, the suppliers have no rights under s. 81.1."

[52] An order establishing a trust fund in favour of the applicant suppliers would create a class of secured creditors after the fact. It would turn the Court into the author of a new class of creditor. Classes of creditors should be created by the parties on a contractual basis when entering into their business relationships.

[53] The issue of a trust fund was similarly raised in ***Re Woodward's***. The judge concluded that apart from s. 81.1 of the B & I Act, "there is no justification for the creation of the trust fund. It would not serve to maintain the status quo. To the contrary, it would give the suppliers an advantage over other creditors of Woodward's." In the case at bar it would disadvantage not only the secured creditors but also the unsecured creditors who are not within the assembled group of applicants. It must be remembered that the applicants represent only some $3 million of the total of $13 million owed to unsecured creditors.

[54] I have made many references to the Woodward's case. This is because it is about as close to the case at bar as cases can get. Mr. Kearns, on behalf of the Monitor, said that it

is "right on point." Mr. Knowles, counsel for Agro, said that the cases are "almost identical." Furthermore, no counsel suggested that there was any error in the reasoning or conclusions of the presiding judge in ***Re Woodward's***.

[55] Mr. Justice Tysoe in ***Re Woodward's*** also alluded to the potential that the Court cannot lose sight of legislative intention. He pointed out that the CCAA is "silent as to the creation of a trust fund to be held for the benefit of the suppliers in the event that the reorganization is not successful." Many of the challenges by the suppliers in the case at bar are legislative.

[56] The CCAA must be accepted as Parliament's approval of the continued business activities of an insolvent company, to be carried out in as normal a manner as possible while reorganizing. The Court is not allowed to suggest that the legislative intent is one designed, *per se*, to disadvantage the suppliers. It must, rather, be taken as giving hope that reorganization, rather than bankruptcy, will eventually benefit <u>all</u> interested parties.

[57] Mr. McLean, on behalf of the Bank of Montreal, said that "all that is happening" is that the suppliers are not being paid. He asserted that there is no inconsistency in this in

that "none of the unsecured creditors are being paid. That is exactly what the CCAA envisages."

[58] The applications of the suppliers are dismissed. However, the petitioner has consented to a ***Woodward's*** type of order in the form mentioned earlier in these reasons and to the suppliers filing a petition under the B & I Act if they agree not to proceed with it until the conclusion of the CCAA proceedings or without leave of the Court. It is acceptable to the Court that these provisions form part of the Court order if that is agreed to by the applicants, the petitioner and the secured creditors.

"A.D. Thackray, J."
The Honourable Mr. Justice A.D. Thackray

Tab 6

2005 ABQB 91
Alberta Court of Queen's Bench

San Francisco Gifts Ltd., Re

2005 CarswellAlta 174, 2005 ABQB 91, [2005] A.W.L.D. 1426, [2005] A.J. No. 131, 10 C.B.R. (5th) 275, 137 A.C.W.S. (3d) 242, 378 A.R. 361, 42 Alta. L.R. (4th) 377

In the Matter of the Companies' Creditors Arrangement Act, R.S.A. 1985, c. C-36, As Amended

And In the Matter of a Plan of Compromise or Arrangement of San Francisco Gifts Ltd., San Francisco Retail Gifts Incorporated (Previously Called San Francisco Gifts Incorporated), San Francisco Gift Stores Limited, San Francisco Gifts (Atlantic) Limited, San Francisco Stores Ltd., San Francisco Gifts & Novelties Inc., San Francisco Gifts & Novelty Merchandising Corporation (Previously Called San Francisco Gifts and Novelty Corporation), San Francisco (The Rock) Ltd. (Previously Called San Francisco Newfoundland Ltd.) And San Francisco Retail Gifts & Novelties Limited (Previously Called San Francisco Gifts & Novelties Limited)

Topolniski J.

Heard: January 17, 2005
Judgment: February 9, 2005
Docket: Edmonton 0403-00170

Counsel: Richard T.G. Reeson, Q.C., John Bridgadear, Howard J. Sniderman for Companies
Michael McCabe, Q.C. for Monitor, Browning Crocker Inc.
Jeremy H. Hockin for Oxford Properties Group Inc., Ivanhoe Cambridge 1 Inc.; 20 Vic Management Ltd.; Morguard Investments Ltd.; Morguard Real Estate Investments Trust; Millwoods Town Centre, Edmonton; Park Place, Lethbridge; Metro Town, Burnaby, B.C.; Northgate Mall, Edmonton; Brandon Shopping Mall, MB; Herongate Mall, Ottawa; Westmount Shopping Centre, London; Village Mall, St. John's NFLD; Kingsway Garden Mall; Westbrook Mall; Bonnie Doon Shopping Centre; Red Deer Centre; Marlborough Mall; Circile Park Mall; Kildonan Place Mall; Cambridge Centre; Oshawa Centre; Tecumseh Mall; Downtown Chatham Centre; Simcoe Town Centre; Niagara Square; Halifax Shopping Centre; RioCan Property Services; 1113443 Ontario Inc.; Shoppers World, Brampton, ON; Tillicum Mall, Victoria, BC; Confederation Mall, Saskatoon, SK; Parkland Mall, Yorkton, SK; Cambrian Mall, Sault Ste. Marie, ON; Northumberland Mall, Cobourg, ON; Orangeville Mall, Orangeville, ON; Renfrew Mall, Renfrew, ON; Orillia Square Mall, Orillia, ON; Elgin Mall, St. Thomas, ON; Lawrence Square, North York, ON; Trinity Conception Square, Carbonear, NFLD; Charlottetown Mall, Charlottetown PEI; Timiskaming Square
Kent Rowan for Locher Evers International, Neuvo Rags, Quality Press
Tim Shelley (Agent Employee) for Lauer Transportation Services

Subject: Insolvency; Civil Practice and Procedure

Related Abridgment Classifications
For all relevant Canadian Abridgment Classifications refer to highest level of case via History

Headnote

Bankruptcy and insolvency --- Proposal — Companies' Creditors Arrangement Act — Arrangements — Effect of arrangement — Stay of proceedings

Debtor operated national chain of novelty goods stores with some 400 employees — Debtor obtained Companies' Creditors Arrangement Act (CCAA) protection on January 7, 2000 — Stay of proceedings under CCAA was extended three times with expectation that entire CCAA process would be completed by February 7th, 2005 — On December 30, 2004, debtor pleaded guilty to nine counts of wilful copyright infringement and paid $150,000 fine — Debtor had sold lamps with counterfeit safety certification labels and was found to have other counterfeit goods in its possession — Debtor brought application for further extension of time — Application granted — Stay was extended to July 19, 2005 — This was not case where debtor's business practices were so offensive as to warrant refusal of extension on public policy grounds — Debtor's conduct was illegal and offensive, but debtor had already been condemned for its illegal conduct in appropriate forum — Denying extension would be additional form of punishment — Of greater concern was effect on unsecured creditors who would be denied right to vote on plan and any chance for small financial recovery — Debtor met prerequisites of acting with due diligence and in good faith in working towards presenting plan of arrangement to its creditors — Delay was primarily attributable to time required for debtor to seek leave to appeal from prior classification decision — Monitor was satisfied that debtor was financially viable despite payment of fine — Potential adverse effect of debtor's misconduct on business relationships was sheer speculation at this point.

Table of Authorities

Cases considered by *Topolniski J.*:

Agro Pacific Industries Ltd., Re (2000), 2000 BCSC 837, 2000 CarswellBC 1143, 76 B.C.L.R. (3d) 364, 5 B.L.R. (3d) 203 (B.C. S.C.) — considered

Associated Investors of Canada Ltd., Re (1987), 56 Alta. L.R. (2d) 259, [1988] 2 W.W.R. 211, 38 B.L.R. 148, 67 C.B.R. (N.S.) 237, (sub nom. *First Investors Corp., Re)* 46 D.L.R. (4th) 669, 1987 CarswellAlta 330 (Alta. Q.B.) — considered

Associated Investors of Canada Ltd., Re (1988), 60 Alta. L.R. (2d) 242, 89 A.R. 344, 71 C.B.R. (N.S.) 71, 1988 CarswellAlta 310 (Alta. C.A.) — considered

Avery Construction Co., Re (1942), [1942] 4 D.L.R. 558, 24 C.B.R. 17, 1942 CarswellOnt 86 (Ont. S.C.) — referred to

Canadian Cottons Ltd., Re (1951), 33 C.B.R. 38, [1952] Que. S.C. 276, 1951 CarswellQue 27 (C.S. Que.) — referred to

Fracmaster Ltd., Re (1999), 1999 CarswellAlta 461, 245 A.R. 102, 11 C.B.R. (4th) 204 (Alta. Q.B.) — referred to

Hongkong Bank of Canada v. Chef Ready Foods Ltd. (1990), 51 B.C.L.R. (2d) 84, 4 C.B.R. (3d) 311, (sub nom. *Chef Ready Foods Ltd. v. Hongkong Bank of Canada)* [1991] 2 W.W.R. 136, 1990 CarswellBC 394 (B.C. C.A.) — referred to

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Juniper Lumber Co., Re (2001), 2001 NBCA 30, 2001 CarswellNB 114 (N.B. C.A.) — referred to

Meridian Development Inc. v. Toronto Dominion Bank (1984), [1984] 5 W.W.R. 215, 52 C.B.R. (N.S.) 109, 32 Alta. L.R. (2d) 150, 53 A.R. 39, 11 D.L.R. (4th) 576, 1984 CarswellAlta 259 (Alta. Q.B.) — referred to

Nova Metal Products Inc. v. Comiskey (Trustee of) (1990), 1 C.B.R. (3d) 101, (sub nom. *Elan Corp. v. Comiskey)* 1 O.R. (3d) 289, (sub nom. *Elan Corp. v. Comiskey)* 41 O.A.C. 282, 1990 CarswellOnt 139 (Ont. C.A.) — referred to

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Sairex GmbH v. Prudential Steel Ltd. (1991), 8 C.B.R. (3d) 62, 1991 CarswellOnt 215 (Ont. Gen. Div.) — considered

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Generally — referred to

Companies Act, 1929 (19 & 20 Geo. 5), c. 23
s. 153 — referred to

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
Generally — considered

s. 11(6) — referred to

Copyright Act, R.S.C. 1985, c. C-42
Generally — referred to

s. 42 — referred to

APPLICATION by debtor for further extension of stay of proceedings under *Companies' Creditors Arrangement Act.*

***Topolniski J.*:**

Introduction

1 The San Francisco group of companies (San Francisco) obtained *Companies' Creditors Arrangement Act* [1] (*CCAA*) protection on January 7, 2000 (Initial Order). Key to that protection was the requisite stay of proceedings that gives a debtor company breathing room to formulate a plan of arrangement. The stay was extended three times thereafter with the expectation that the entire *CCAA* process would be completed by February 7th, 2005. That date was not met. Accordingly, San Francisco now applies to have the stay extended to June 30, 2005.

2 A small group of landlords opposes the motion on the basis of San Francisco's recent guilty plea to *Copyright Act* offenses and the sentencing judge's description of San Francisco's conduct as: "...a despicable fraud on the public. Not only

not insignificant but bordering on a massive scale..." The landlords suggest that this precludes any possibility of the company having acted in "good faith" and therefore having met the statutory prerequisite to an extension. Further, they contend that extending the stay would bring the administration of justice into disrepute.

3 San Francisco acknowledges that its conduct was stupid, offensive and dangerous. That said, it contends that it already has been sanctioned and that it has "paid its debt to society." It argues that subjecting it to another consequence in this proceeding would be akin to double jeopardy. Apart from the obvious consequential harm to the company itself, San Francisco expresses concern that its creditors might be disadvantaged if it is forced into bankruptcy.

4 While there has been some delay in moving this matter forward towards the creditor vote, this delay is primarily attributable to the time it took San Francisco to deal with leave to appeal my classification decision of September 28, 2004. Despite the opposing landlords' mild protestations to the contrary, it is evident that the company has acted with due diligence. The real focus of this application is on the meaning and scope of the term "good faith" as that term is used in s. 11(6) of the *CCAA*, and on whether San Francisco's conduct renders it unworthy of the protective umbrella of the Act in its restructuring efforts. It also raises questions about the role of a supervising court in *CCAA* proceedings.

Background

5 San Francisco operates a national chain of novelty goods stores from its head office in Edmonton, Alberta. It currently has 62 locations and approximately 400 employees.

6 The group of companies is comprised of the operating company, San Francisco Gifts Ltd., and a number of hollow nominee companies. The operating company holds all of the group's assets. It is 100 percent owned by Laurier Investments Corp., which in turn is 100 percent owned by Barry Slawsky (Slawsky), the driving force behind the companies.

7 Apart from typical priority challenges in insolvency matters, this proceeding has been punctuated by a series of challenges to the process and its continuation, led primarily by a group of landlords that includes the opposing landlords.

8 On December 30, 2004, San Francisco pleaded guilty to nine charges under s. 42 of the *Copyright Act*, [2] which creates offences for a variety of conduct constituting wilful copyright infringement. The evidence in that proceeding established that:

(a) An investigation by the St. John's, Newfoundland, Fire Marshall, arising from a complaint about a faulty lamp sold by San Francisco, led to the discovery that the lamp bore a counterfeit safety certification label commonly called a "UL" label. [3] The R.C.M.P. conducted searches of San Francisco stores across the country, its head office, and a warehouse, which turned up other counterfeit electrical UL labels as well as counterfeit products bearing the symbols of trademark holders of Playboy, Marvel Comics and others.

(b) Counterfeit UL labels were found in the offices of Slawsky and San Francisco's Head of Sales. There was also a fax from "a Chinese location" found in Slawsky's office that threatened that a report to Canadian authorities about the counterfeit safety labels would be made if payment was not forthcoming.

(c) *Copyright Act* charges against Slawsky were withdrawn when San Francisco entered a plea of guilty to the charges;

(d) The sentencing judge accepted counsels' joint submission that a $150,000.00 fine would be appropriate. In passing sentence, he condemned the company's conduct, particularly as it related to the counterfeit labels, expressing grave concern for the safety of unknowing consumers. [4]

(e) San Francisco was co-operative during the R.C.M.P. investigation and the Crown's prosecution of the case.

(f) San Francisco had been convicted of similar offences in 1998.

9 Judge Stevens-Guille's condemnation of San Francisco's conduct was the subject of local and national newspaper coverage.

10 The company paid the $150,000.00 fine from last year's profits.

Analysis

Fundamentals

11 The well established remedial purpose of the *CCAA* is to facilitate the making of a compromise or arrangement by an insolvent company with its creditors to the end that the company is able to stay in business. The premise is that this will result in a benefit to the company, its creditors and employees. [5] The Act is to be given a large and liberal interpretation. [6]

12 The court's jurisdiction under s. 11(6) to extend a stay of proceedings (beyond the initial 30 days of a *CCAA* order) is preconditioned on the applicant satisfying it that:

(a) circumstances exist that make such an order appropriate; and

(b) the applicant has acted, and is acting, in good faith and with due diligence.

13 Whether it is "appropriate" to make the order is not dependant on finding "due diligence" and "good faith." Indeed, refusal on that basis can be the result of an independent or interconnected finding. Stays of proceedings have been refused where the company is hopelessly insolvent; has acted in bad faith; [7] or where the plan of arrangement is unworkable, impractical or essentially doomed to failure. [8]

Meaning of "Good Faith"

14 The term "good faith" is not defined in the *CCAA* and there is a paucity of judicial consideration about its meaning in the context of stay extension applications. The opposing landlords on this application rely on the following definition of "good faith" found in *Black's Law Dictionary* to support the proposition that good faith encompasses general commercial fairness and honesty:

> A state of mind consisting of: (1) honesty in belief or purpose, (2) faithfulness to one's duty or obligation, (3) <u>observance of reasonable commercial standards of fair dealings</u> in a given trade or business, or (4) <u>absence of intent to defraud</u> or seek unconscionable advantage. [9] [Emphasis added]

15 "Good faith" is defined as "honesty of intention" in the *Concise Oxford Dictionary*. [10]

16 Regardless of which definition is used, honesty is at the core. Honesty is what the opposing landlords urge is desperately wanting now and, as evidenced by San Francisco's earlier conviction for *Copyright Act* offences, was wanting in the past.

17 Accepting that the duty of "good faith" requires honesty, the question is whether that duty is owed to the court and the stakeholders directly affected by the process, including investors, creditors and employees, or does the *CCAA* cast a broader net by requiring good faith in terms of the company's dealings with the public at large? As will be seen from the following review of the jurisprudence, it usually means the former.

18 *Rio Nevada Energy Inc., Re* [11] and *Skeena Cellulose Inc.. Re* [12] both involved opposed stay extension applications. In *Skeena Cellulose Inc.*, one of the company's two major secured creditors argued that the company's failure to carry out certain layoffs in the time recommended by the monitor showed a lack of good faith and due diligence. Brenner C.J.S.C. found that the delay in carrying out the layoffs was not a matter of bad faith. Given the severe consequences of terminating the stay, he granted the extension.

19 Romaine J. rejected a suggestion of lack of good faith arising from a creditor dispute and allegations of debtor dishonesty in *Rio Nevada Energy Inc.*, finding that: "Rio Nevada has acted and is acting in good faith *with respect to these proceedings*." [13] [Emphasis added]

20 *Sairex GmbH v. Prudential Steel Ltd.* [14] involved an application by a creditor to proceed against a company under *CCAA* protection. Farley J. declined the application despite his sympathy for the creditor's position and his view that the creditor could make out a fairly strong case. He said: "... I would think that public policy also dictates that a company under *CCAA* protection or about to apply for it should not be allowed to engage in very offensive business practices against another and thumb its nose at the world from the safety of the *CCAA*." [15] In the end, he concluded that the dominant purpose behind the company's actions was not to harm the creditor.

21 Inventory suppliers in *Agro Pacific Industries Ltd., Re* [16] sought to set aside a *CCAA* stay on the ground that the company had not been acting in good faith in entering into contracts. The suppliers' contention that the company knew it was in shaky financial circumstances when it ordered goods and that it did so to pay down the secured creditors was rejected by Thackeray J. He was not satisfied that there was any lack of good faith or collusion between the company and its secured creditors to disadvantage the unsecured creditors.

22 *Juniper Lumber Co., Re* [17] addressed a creditor's allegations of bad faith in the context of an application to set aside the *ex parte* Initial Order. Turnbull J. held that, while fraud may not always preclude *CCAA* relief, it was of such a magnitude in that case as to warrant setting aside the order. He commented that: "basic honesty has to be present" in the course of conduct between a bank and its customer. [18] However, his decision was overturned by the Court of Appeal because the necessary evidentiary foundation was wanting. [19]

23 *Nova Metal Products Inc. v. Comiskey (Trustee of)*, [20] although addressing instant trust deeds, which are no longer of concern under the present *CCAA*, offers a useful discussion of "good faith." Doherty J.A., dissenting in part, commented:

> ...A debtor company should not be allowed to use the Act for any purpose other than to attempt a legitimate reorganization. If the purpose of the application is to advantage one creditor over another, to defeat the legitimate interests of creditors, to delay the inevitable failure of the debtor company, or for some other improper purpose, the court has the means available to it, apart entirely from s. 3 of the Act, to prevent misuse of the Act. In cases where the debtor company acts in bad faith, the court may refuse to order a meeting of creditors, it may deny interim protection, it may vary interim protection initially given when the bad faith is shown, or it may refuse to sanction any plan which emanates from the meeting of the creditors. [21]

24 Doherty J.A. referred to an article by L. Crozier, "*Good Faith and the Companies' Creditors Arrangement Act*," [22] in which the author contends that the possibility of abuse and manipulation by debtors should be checked by implying a requirement of good faith, as American bankruptcy courts routinely do by invoking good faith to dismiss applications under Chapter 11 of the *Bankruptcy Code* where the debtor's conduct in filing for reorganization is found to constitute bad faith. [23] He also suggests that, as a result of the injunctive nature of the stay, the court's power to take into account the debtor's conduct is inherent in its equitable jurisdiction.

25 An obligation of good faith in the context of an application to sanction a plan of arrangement was implied in *Associated Investors of Canada Ltd., Re* [24] While *First Investors* was an atypical *CCAA* proceeding, it is worth discussion. Allegations that fraud had been committed on creditors and consumers/investors led to the additional appointment of both a receiver and an inspector under the Alberta *Business Corporations Act*. The inspector had a broad mandate to investigate the company's affairs and business practices that included inquiring into whether the company had intended to defraud anyone.

26 Berger J. (as he then was) noted that the *CCAA* is derived from s. 153 of the English *Companies Act*, 1929 (19 and 20 Geo. 5) c. 23. Having sought assistance from other legislation with wording similar to the *CCAA* and with a genesis in the British statute, [25] he concluded that the court should not sanction an illegal, improper or unfair plan of arrangement. [26] He emphasized that: "If evidence of fraud, negligence, wrongdoing or illegality emerges, the Court may be called upon by interested parties to draw certain conclusions in fact and in law that bear directly upon the Plans of Arrangement." [27] He also determined that, while it might be expedient to approve the plans, the court was bound to proceed with caution, "so as to ensure that wrongful acts, if any, do not receive judicial sanction." [28]

27 In the end, Berger J. adjourned the application pending receipt of a report by the inspector. His decision was reversed on appeal [29] on the basis that there was nothing in the plans that sanctioned wrongful acts or omissions. The Court of Appeal remitted the matter back for reconsideration on the merits, stating that while the discretion to be exercised must relate to the merits or propriety of the plans, the court could consider whether approving the plans would sanction possible wrongdoing or otherwise hinder later litigation.

Supervising Court's Role

28 The court's role during the stay period has been described as a supervisory one, meant to: "...preserve the *status quo* and to move the process along to the point where an arrangement or compromise is approved or it is evident that the attempt is doomed to failure." [30] That is not to say that the supervising judge is limited to a myopic view of balance sheets, scheduling of creditors' meetings and the like. On the contrary, this role requires attention to changing circumstances and vigilance in ensuring that a delicate balance of interests is maintained.

29 Although the supervising judge's main concern centres on actions affecting stakeholders in the proceeding, she is also responsible for protecting the institutional integrity of the *CCAA* courts, preserving their public esteem, and doing equity. [31] She cannot turn a blind eye to corporate conduct that could affect the public's confidence in the *CCAA* process but must be alive to concerns of offensive business practices that are of such gravity that the interests of stakeholders in the proceeding must yield to those of the public at large.

Conclusions

30 While "good faith" in the context of stay applications is generally focused on the debtor's dealings with stakeholders, concern for the broader public interest mandates that a stay not be granted if the result will be to condone wrongdoing. [32]

31 Although there is a possibility that a debtor company's business practices will be so offensive as to warrant refusal of a stay extension on public policy grounds, this is not such a case. Clearly, San Francisco's sale of knockoff goods was illegal and offensive. Most troubling was its sale to an unwitting public of goods bearing counterfeit safety labels. Allowing the stay to continue in this case is not to minimize the repugnant nature of San Francisco's conduct. However, the company has been condemned for its illegal conduct in the appropriate forum and punishment levied. Denying the stay extension application would be an additional form of punishment. Of greater concern is the effect that it would have on San Francisco's creditors, particularly the unsecured creditors, who would be denied their right to vote on the plan and whatever chance they might have for a small financial recovery, one which they, for the most part, patiently await.

32 San Francisco has met the prerequisites that it has acted and is acting with due diligence and in good faith in working towards presenting a plan of arrangement to its creditors. Appreciating that the *CCAA* is to be given a broad and liberal interpretation to give effect to its remedial purpose, I am satisfied that, in the circumstances, extending the stay of proceedings is appropriate. The stay is extended to July 19, 2005. The revised time frame for next steps in the proceedings is set out on the attached Schedule.

33 Although San Francisco has paid the $150,000.00 fine, the Monitor is satisfied that the company's current cash flow statements indicate that it is financially viable. Whether San Francisco can weather any loss of public confidence arising from its actions and resulting conviction is yet to be seen. Its creditors may look more critically at the plan of arrangement, and its customers and business associates may reconsider the value of their continued relationship with the company. However, that is sheer speculation.

Schedule

Time Frames

1. February 14, 2005 Date Monitor posts Notice to Creditors on website
2. February 14, 2005 Date Monitor publishes the advertisement for one day in Globe & Mail or National Post
3. April 1, 2005 Date for receipt of claims from creditors
4. May 13, 2005 Date by which Monitor must send Notice of Revision or Disallowance.
5. June 13, 2005 Last date for bringing application to challenge a Notice of Revision or Disallowance.
6. June 27, 2005 Date for creditors meeting to vote on the Plan.
7. July 11, 2005 Date for court application to approve Plan (if required).
8. August 18, 2005 Date for Distribution to Prove Unsecured Claims

Stay Extended to July 19, 2005

Application granted.

Footnotes

1 R.S.A. 1985, c. C-36, as am.

2 R.S.C. 1985, c. C-42.

3 Underwriters' Laboratories (UL) operates facilities globally for the testing, certification and quality assessment of products, systems and services. Products are tested to Canadian standards and, if the product complies with those standards, UL issues an identification or listing mark confirming certification (Transcript of the proceedings held December 30, 2004 at pp.4-5)

4 Judge Stevens-Guille said: "Quite frankly, this is and should be described as nothing else than a despicable fraud on the public. Not only not insignificant but bordering on a massive scale company, stores, all of these places that we have been told they had stores...We are talking about electrical appliances that cause fires bought by someone who whether they relied on the UL certificate or not it had a certificate on it and to go to the exercise of getting cheap stuff somewhere and dressing it up with false labels and false safety certificates causes me great pause, such pause that if it were an individual who pled guilty before me today my starting point would be a term of imprisonment in a federal penitentiary, without a doubt." (Transcript of the proceedings held December 30, 2004 at pp. 18/15-18 and 19/2-11).

5 See for example *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 4 C.B.R. (3d) 311 (B.C. C.A.) and *Meridian Development Inc. v. Toronto Dominion Bank* (1984). 52 C.B.R. (N.S.) 109 (Alta. Q.B.).

6 *Nova Metal Products Inc. v. Comiskey (Trustee of)* (1990), 1 C.B.R. (3d) 101 (Ont. C.A.).

7 *Avery Construction Co., Re*, [1942] 4 D.L.R. 558 (Ont. S.C.), at 559.

8 *Fracmaster Ltd., Re* (1999), 11 C.B.R. (4th) 204 (Alta. Q.B.); aff'd (1999), 11 C.B.R. (4th) 230 (Alta. C.A.).

9 *Black's Law Dictionary*, 7th ed. (St. Paul, Minnesota: West Group, 1999), p.701.

10 *The Concise Oxford Dictionary of Current English*, 6th ed., (Oxford, Eng.: Clarendon Press, 1976), p.373.

11 (2000), 283 A.R. 146 (Alta. Q.B.).

12 2001 BCSC 1423, 29 C.B.R. (4th) 157 (B.C. S.C.).

13 *Rio Nevada Energy Inc.*, at para. 31.

14 (1991), 8 C.B.R. (3d) 62 (Ont. Gen. Div.).

15 *Sairex GmbH*, at p. 73.

16 2000 BCSC 837, 76 B.C.L.R. (3d) 364 (B.C. S.C.).

17 *Juniper Lumber Co., Re* (N.B. Q.B.).

18 *Juniper Lumber Co.. Re*, at para. 13.

19 2001 NBCA 30 (N.B. C.A.).

20 (1990), 1 O.R. (3d) 289 (Ont. C.A.).

21 *Elan Corp.*, at p. 313.

22 (1989), 15 Can. Bus. L.J. 89.

23 Crozier cites *Victory Construction Co. Inc.. Re*, 9 B.R. 549 as an example of this. The court in that case found that the debtor company's purpose in filing under c. 11 was to isolate assets from its creditors rather than to reorganize the business. At p. 558, the court commented that good faith was "an implicit prerequisite to the filing or continuation of a proceeding under Chapter 11 of the *Code*."

24 (1987), 46 D.L.R. (4th) 669 (Alta. Q.B.), at 673-674, (1987), 67 C.B.R. (N.S.) 237 (Alta. Q.B.); See also *Agro Pacific Industries Ltd., Re*, footnote 16, at para. 40 where Thackray J. held that there was an implied duty of good faith on initial applications.

25 *First Investors*, at p. 676.

26 *First Investors*, at p. 677.

27 *First Investors*, at p. 678.

28 *First Investors*, at p. 678.

29 (1988), 89 A.R. 344, 71 C.B.R. (N.S.) 71 (Alta. C.A.).

30 McFarlane J.A. in *Pacific National Lease Holding Corp., Re* (1992), 15 C.B.R. (3d) 265 (B.C. C.A. [In Chambers]), at 270, quoting with approval Brenner J. in the court below at (B.C. S.C.) at para. 26.

31 L. J. Crozier, footnote 22 at p. 95, quotes Edith H. Jones, in "The Good Faith Requirement in Bankruptcy," Proceedings of the 61st Annual Meeting of the National Conference of Bankruptcy Judges, 1987, as statingd that: "... the bankruptcy judge usually at the instance of counsel, upon the filing of appropriate motions, is principally responsible to protect the institutional integrity of the bankruptcy courts, preserve their public esteem, and do equity in specific cases."

32 *Associated Investors of Canada Ltd., Re* (1988), 89 A.R. 344 (Alta. C.A.) at para. 16; *Canadian Cottons Ltd.. Re* (1951), 33 C.B.R. 38 (C.S. Que.).

End of Document

Tab 7

2012 ONSC 234
Ontario Superior Court of Justice [Commercial List]

Kitchener Frame Ltd., Re

2012 CarswellOnt 1347, 2012 ONSC 234, 212 A.C.W.S. (3d) 631, 86 C.B.R. (5th) 274

In the Matter of the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, as Amended

In the Matter of the Consolidated Proposal of Kitchener Frame Limited and Thyssenkrupp Budd Canada, Inc. (Applicants)

Morawetz J.

Judgment: February 3, 2012
Docket: CV-11-9298-00CL

Counsel: Edward A. Sellers, Jeremy E. Dacks for Applicants
Hugh O'Reilly — Non-Union Representative Counsel
L.N. Gottheil — Union Representative Counsel
John Porter for Proposal Trustee, Ernst & Young Inc.
Michael McGraw for CIBC Mellon Trust Company
Deborah McPhail for Financial Services Commission of Ontario

Subject: Insolvency

Table of Authorities

Cases considered by *Morawetz J.*:

A. & F. Baillargeon Express Inc., Re (1993), 27 C.B.R. (3d) 36, 1993 CarswellQue 49 (C.S. Que.) — referred to

Air Canada, Re (2004), 2004 CarswellOnt 1842, 2 C.B.R. (5th) 4 (Ont. S.C.J. [Commercial List]) — referred to

Allen-Vanguard Corp., Re (2011), 2011 CarswellOnt 1279, 2011 ONSC 733 (Ont. S.C.J.) — referred to

Angiotech Pharmaceuticals Inc., Re (2011), 2011 BCSC 450, 2011 CarswellBC 841, 76 C.B.R. (5th) 210 (B.C. S.C. [In Chambers]) — referred to

Ashley v. Marlow Group Private Portfolio Management Inc. (2006), 2006 CarswellOnt 3449, 22 C.B.R. (5th) 126, 270 D.L.R. (4th) 744 (Ont. S.C.J. [Commercial List]) — referred to

ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp. (2008), 2008 ONCA 587, 2008 CarswellOnt 4811, (sub nom. *Metcalfe & Mansfield Alternative Investments II Corp., Re)* 240 O.A.C. 245, (sub nom. *Metcalfe & Mansfield Alternative Investments II Corp., Re)* 296 D.L.R. (4th) 135, (sub nom. *Metcalfe & Mansfield Alternative Investments II Corp., Re)* 92 O.R. (3d) 513, 45 C.B.R. (5th) 163, 47 B.L.R. (4th) 123 (Ont. C.A.) — followed

C.F.G. Construction inc., Re (2010), [2010] R.J.Q. 2360, 2010 CarswellQue 10226, 2010 QCCS 4643 (C.S. Que.) — considered

Canwest Global Communications Corp., Re (2010), 70 C.B.R. (5th) 1, 2010 ONSC 4209, 2010 CarswellOnt 5510 (Ont. S.C.J. [Commercial List]) — referred to

Cosmic Adventures Halifax Inc., Re (1999), 13 C.B.R. (4th) 22, 1999 CarswellNS 320 (N.S. S.C.) — considered

Employers' Liability Assurance Corp. v. Ideal Petroleum (1959) Ltd. (1976), 1976 CarswellQue 32, [1978] 1 S.C.R. 230, 26 C.B.R. (N.S.) 84, 75 D.L.R. (3d) 63, (sub nom. *Employers' Liability Assurance Corp. v. Ideal Petroleum (1969) Ltd.)* 14 N.R. 503, 1976 CarswellQue 25 (S.C.C.) — referred to

Farrell, Re (2003), 2003 CarswellOnt 1015, 40 C.B.R. (4th) 53 (Ont. S.C.J. [Commercial List]) — referred to

Kern Agencies Ltd., (No. 2), Re (1931), 1931 CarswellSask 3, [1931] 2 W.W.R. 633, 13 C.B.R. 11 (Sask. C.A.) — considered

Lofchik, Re (1998), 1998 CarswellOnt 194, 1 C.B.R. (4th) 245 (Ont. Bktcy.) — referred to

Magnus One Energy Corp., Re (2009), 2009 CarswellAlta 488, 2009 ABQB 200, 53 C.B.R. (5th) 243 (Alta. Q.B.) — referred to

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N.T.W. Management Group Ltd., Re (1994), 29 C.B.R. (3d) 139, 1994 CarswellOnt 325 (Ont. Bktcy.) — referred to

NAV Canada c. Wilmington Trust Co. (2006), 2006 CarswellQue 4890, 2006 CarswellQue 4891, 2006 SCC 24, (sub nom. *Greater Toronto Airports Authority v. International Lease Finance Corp.)* 80 O.R. (3d) 558 (note), (sub nom. *Canada 3000 Inc., (Bankrupt), Re)* 349 N.R. 1, (sub nom. *Canada 3000 Inc., Re)* [2006] 1 S.C.R. 865, 10 P.P.S.A.C. (3d) 66, 20 C.B.R. (5th) 1, (sub nom. *Canada 3000 Inc. (Bankrupt), Re)* 212 O.A.C. 338, (sub nom. *Canada 3000 Inc., Re)* 269 D.L.R. (4th) 79 (S.C.C.) — referred to

Olympia & York Developments Ltd., Re (1995), 34 C.B.R. (3d) 93, 1995 CarswellOnt 340 (Ont. Gen. Div. [Commercial List]) — referred to

Olympia & York Developments Ltd., Re (1997), 45 C.B.R. (3d) 85, 143 D.L.R. (4th) 536, 1997 CarswellOnt 657 (Ont. Bktcy.) — referred to

Society of Composers, Authors & Music Publishers of Canada v. Armitage (2000), 2000 CarswellOnt 4120, 20 C.B.R. (4th) 160, 50 O.R. (3d) 688, 137 O.A.C. 74 (Ont. C.A.) — referred to

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Statutes considered:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3
Generally — referred to

Pt. III — referred to

s. 50(14) — considered

s. 54(2)(d) — considered

s. 59(2) — considered

s. 62(3) — considered

s. 136(1) — referred to

s. 178(2) — referred to

s. 179 — considered

s. 183 — referred to

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
Generally — referred to

s. 5.1 [en. 1997, c. 12, s. 122] — referred to

Excise Tax Act, R.S.C. 1985, c. E-15
Generally — referred to

MOTION by applicants for court sanction of proposal under Bankruptcy and Insolvency Act which contained third-party release.

***Morawetz J.*:**

1 At the conclusion of this unopposed motion, the requested relief was granted. Counsel indicated that it would be helpful if the court could provide reasons in due course, specifically on the issue of a third-party release in the context of a proposal under Part III of the *Bankruptcy and Insolvency Act* ("*BIA*").

2 Kitchener Frame Limited ("KFL") and Thyssenkrupp Budd Canada Inc. ("Budd Canada"), and together with KFL, (the "Applicants"), brought this motion for an order (the "Sanction Order") to sanction the amended consolidated proposal involving the Applicants dated August 31, 2011 (the "Consolidated Proposal") pursuant to the provisions of the *BIA*. Relief was also sought authorizing the Applicants and Ernst & Young Inc., in its capacity as proposal trustee of each of the Applicants (the "Proposal Trustee") to take all steps necessary to implement the Consolidated Proposal in accordance with its terms.

3 The Applicants submit that the requested relief is reasonable, that it benefits the general body of the Applicants' creditors and meets all other statutory requirements. Further, the Applicants submit that the court should also consider that the voting

affected creditors (the "Affected Creditors") unanimously supported the Consolidated Proposal. As such, the Applicants submit that they have met the test as set out in s. 59(2) of the *BIA* with respect to approval of the Consolidated Proposal.

4 The motion of the Applicants was supported by the Proposal Trustee. The Proposal Trustee filed its report recommending approval of the Consolidated Proposal and indicated that the Consolidated Proposal was in the best interests of the Affected Creditors.

5 KFL and Budd Canada are inactive entities with no operating assets and no material liquid assets (other than the Escrow Funds). They do have significant and mounting obligations including pension and other non-pension post-employment benefit ("OPEB") obligations to the Applicants' former employees and certain former employees of Budcan Holdings Inc. or the surviving spouses of such former employees or others who may be entitled to claim through such persons in the *BIA* proceedings, including the OPEB creditors.

6 The background facts with respect to this motion are fully set out in the affidavit of Mr. William E. Aziz, sworn on September 13, 2011.

7 Affiliates of Budd Canada have provided up to date funding to Budd Canada to enable Budd Canada to fund, on behalf of KFL, such pension and OPEB obligations. However, given that KFL and Budd Canada have no active operations, the *status quo* is unsustainable.

8 The Applicants have acknowledged that they are insolvent and, in connection with the *BIA* proposal, proceedings were commenced on July 4, 2011.

9 On July 7, 2011, Wilton-Siegel J. granted Procedural Consolidation Orders in respect of KFL and Budd Canada which authorized the procedural consolidation of the Applicants and permitted them to file a single consolidated proposal to their creditors.

10 The Orders of Wilton-Siegel J. also appointed separate representative counsel to represent the interests of the Union and Non-Union OPEB creditors and further authorized the Applicants to continue making payments to Blue Cross in respect of the OPEB Claims during the *BIA* proposal proceedings.

11 On August 2, 2011, an order was granted extending the time to file a proposal to August 19, 2011.

12 The parties proceeded to negotiate the terms of the Consolidated Proposal, which meetings involved the Applicants, the Proposal Trustee, senior members of the CAW, Union Representative Counsel and Non-Union Representative Counsel.

13 An agreement in principle was reached which essentially provided for the monetization and compromise of the OPEB claims of the OPEB creditors resulting in a one-time, lump-sum payment to each OPEB creditor term upon implementation of the Consolidated Proposal. The Consolidated Proposal also provides that the Applicants and their affiliates will forego any recoveries on account of their secured and unsecured inter-company claims, which total approximately $120 million. A condition precedent was the payment of sufficient funds to the Pension Fund Trustee such that when such funds are combined with the value of the assets held in the Pension Plans, the Pension Fund Trustee will be able to fully annuitize the Applicants' pension obligations and pay the commuted values to those creditors with pension claims who so elected so as to provide for the satisfaction of the Applicants' pension obligations in full.

14 On August 19, 2011, the Applicants filed the Consolidated Proposal. Subsequent amendments were made on August 31, 2011 in advance of the creditors' meeting to reflect certain amendments to the proposal.

15 The creditors' meeting was held on September 1, 2011 and, at the meeting, the Consolidated Proposal, as amended, was accepted by the required majority of creditors. Over 99.9% in number and over 99.8% in dollar value of the Affected Creditors' Class voted to accept the Consolidated Proposal. The Proposal Trustee noted that all creditors voted in favour of the Consolidated Proposal, with the exception of one creditor, Canada Revenue Agency (with 0.1% of the number of votes representing 0.2% of the value of the vote) who attended the meeting but abstained from voting. Therefore, the Consolidated

Proposal was unanimously approved by the Affected Creditors. The Applicants thus satisfied the required "double majority" voting threshold required by the *BIA*.

16 The issue on the motion was whether the court should sanction the Consolidated Proposal, including the substantive consolidation and releases contained therein.

17 Pursuant to s. 54(2)(d) of the *BIA*, a proposal is deemed to be accepted by the creditors if it has achieved the requisite "double majority" voting threshold at a duly constituted meeting of creditors.

18 The *BIA* requires the proposal trustee to apply to court to sanction the proposal. At such hearing, s. 59(2) of the *BIA* requires that the court refuse to approve the proposal where its terms are not reasonable or not calculated to benefit the general body of creditors.

19 In order to satisfy s. 59(2) test, the courts have held that the following three-pronged test must be satisfied:

(a) the proposal is reasonable;

(b) the proposal is calculated to benefit the general body of creditors; and

(c) the proposal is made in good faith.

See *Mayer, Re* (1994), 25 C.B.R. (3d) 113 (Ont. Bktcy.); *Steeves, Re* (2001), 25 C.B.R. (4th) 317 (Sask. Q.B.); *Magnus One Energy Corp., Re* (2009), 53 C.B.R. (5th) 243 (Alta. Q.B.).

20 The first two factors are set out in s. 59(2) of the *BIA* while the last factor has been implied by the court as an exercise of its equitable jurisdiction. The courts have generally taken into account the interests of the debtor, the interests of the creditors and the interests of the public at large in the integrity of the bankruptcy system. See *Farrell, Re* (2003), 40 C.B.R. (4th) 53 (Ont. S.C.J. [Commercial List]).

21 The courts have also accorded substantial deference to the majority vote of creditors at a meeting of creditors; see *Lofchik, Re*, [1998] O.J. No. 332 (Ont. Bktcy.). Similarly, the courts have also accorded deference to the recommendation of the proposal trustee. See *Magnus One*, *supra.*

22 With respect to the first branch of the test for sanctioning a proposal, the debtor must satisfy the court that the proposal is reasonable. The court is authorized to only approve proposals which are reasonable and calculated to benefit the general body of creditors. The court should also consider the payment terms of the proposal and whether the distributions provided for are adequate to meet the requirements of commercial morality and maintaining the integrity of the bankruptcy system. For a discussion on this point, see *Lofchik*, *supra*, and *Farrell* , *supra.*

23 In this case, the Applicants submit that, if the Consolidated Proposal is sanctioned, they would be in a position to satisfy all other conditions precedent to closing on or prior to the date of the proposal ("Proposal Implementation Date").

24 With respect to the treatment of the Collective Bargaining Agreements, the Applicants and the CAW brought a joint application before the Ontario Labour Relations Board ("OLRB") on an expedited basis seeking the OLRB's consent to an early termination of the Collective Bargaining Agreements. Further, the CAW has agreed to abandon its collective bargaining rights in connection with the Collective Bargaining Agreements.

25 With respect to the terms and conditions of a Senior Secured Loan Agreement between Budd Canada and TK Finance dated as of December 22, 2010, TK Finance provided a secured creditor facility to the Applicants to fund certain working capital requirements before and during the *BIA* proposal proceedings. As a result of the approval of the Consolidated Proposal at the meeting of creditors, TK Finance agreed to provide additional credit facilities to Budd Canada such that the Applicants would be in a position to pay all amounts required to be paid by or on behalf of the Applicants in connection with the Consolidated Proposal.

26 On the issue as to whether creditors will receive greater recovery under the Consolidated Proposal than they would receive in the bankruptcy, it is noted that creditors with Pension Claims are unaffected by the Consolidated Proposal. The Consolidated Proposal provides for the satisfaction of Pension Claims in full as a condition precedent to implementation.

27 With respect to Affected Creditors, the Applicants submit that they will receive far greater recovery from distributions under the Consolidated Proposal than the Affected Creditors would receive in the event of the bankruptcies of the Applicants. (See Sanction Affidavit of Mr. Aziz at para. 61.)

28 The Proposal Trustee has stated that the Consolidated Proposal is advantageous to creditors for the reasons outlined in its Report and, in particular:

(a) the recoveries to creditors with claims in respect of OPEBs are considerably greater under the Amended Proposal than in a bankruptcy;

(b) payments under the Amended Proposal are expected in a timely manner shortly after the implementation of the Amended Proposal;

(c) the timing and quantum of distributions pursuant to the Amended Proposal are certain while distributions under a bankruptcy are dependent on the results of litigation, which cannot be predicted with certainty; and

(d) the Pension Plans (as described in the Proposal Trustee's Report) will be fully funded with funds from the Pension Escrow (as described in the Proposal Trustee's Report) and, if necessary, additional funding from an affiliate of the Companies if the funds in the Pension Escrow are not sufficient. In a bankruptcy, the Pension Plans may not be fully funded.

29 The Applicants take the position that the Consolidated Proposal meets the requirements of commercial morality and maintains the integrity of the bankruptcy system, in light of the superior coverage to be afforded to the Applicants' creditors under the Consolidated Proposal than in the event of bankruptcy.

30 The Applicants also submit that substantive consolidation inherent in the proposal will not prejudice any of the Affected Creditors and is appropriate in the circumstances. Although not expressly contemplated under the *BIA*, the Applicants submit that the court may look to its incidental, ancillary and auxiliary jurisdiction under s. 183 of the *BIA* and its equitable jurisdiction to grant an order for substantive consolidation. See *Ashley v. Marlow Group Private Portfolio Management Inc.* (2006), 22 C.B.R. (5th) 126 (Ont. S.C.J. [Commercial List]). In deciding whether to grant substantive consolidation, courts have held that it should not be done at the expense of, or possible prejudice of, any particular creditor. See *Ashley* , *supra*. However, counsel submits that this court should take into account practical business considerations in applying the *BIA*. See *A. & F. Baillargeon Express Inc., Re* (1993), 27 C.B.R. (3d) 36 (C.S. Que.).

31 In this case, the Applicants submit that substantive consolidation inherent in the Consolidated Proposal is appropriate in the circumstances due to, among other things, the intertwined nature of the Applicants' assets and liabilities. Each Applicant had substantially the same creditor base and known liabilities (other than certain Excluded Claims). In addition, KFL had no cash or cash equivalents and the Applicants are each dependant on the Escrow Funds and borrowings under the Restated Senior Secured Loan Agreement to fund the same underlying pension and OPEB obligations and costs relating to the Proposal Proceedings.

32 The Applicants submit that creditors in neither estate will be materially prejudiced by substantive consolidation and based on the fact that no creditor objected to the substantial consolidation, counsel submits the Consolidated Proposal ought to be approved.

33 With respect to whether the Consolidated Proposal is calculated to benefit the general body of creditors, TK Finance would be entitled to priority distributions out of the estate in a bankruptcy scenario. However, the Applicants and their affiliates have agreed to forego recoveries under the Consolidated Proposal on account of their secured and unsecured intercompany claims in

the amount of approximately $120 million, thus enhancing the level of recovery for the Affected Creditors, virtually all of whom are OPEB creditors. It is also noted that TK Finance will be contributing over $35 million to fund the Consolidated Proposal.

34 On this basis, the Applicants submit that the Consolidated Proposal is calculated to benefit the general body of creditors.

35 With respect to the requirement of the proposal being made in good faith, the debtor must satisfy the court that it has provided full disclosure to its creditors of its assets and encumbrances against such assets.

36 In this case, the Applicants and the Proposal Trustee have involved the creditors pursuant to the Representative Counsel Order, and through negotiations with the Union Representative Counsel and Non-Union Representative Counsel.

37 There is also evidence that the Applicants have widely disseminated information regarding their *BIA* proposal proceedings through the media and through postings on the Proposal Trustee's website. Information packages have also prepared by the Proposal Trustee for the creditors.

38 Finally, the Proposal Trustee has noted that the Applicants' conduct, both prior to and subsequent to the commencement of the *BIA* proposal proceedings, is not subject to censure in any respect and that the Applicants' have acted in good faith.

39 There is also evidence that the Consolidated Proposal continues requisite statutory terms. The Consolidated Proposal provides for the payment of preferred claims under s. 136(1) of the *BIA*.

40 Section 7.1 of the Consolidated Proposal contains a broad release in favour of the Applicants and in favour of certain third parties (the "Release"). In particular, the Release benefits the Proposal Trustee, Martinrea, the CAW, Union Representative Counsel, Non-Union Representative Counsel, Blue Cross, the Escrow Agent, the present and former shareholders and affiliates of the Applicants (including Thyssenkrupp USA, Inc. ("TK USA"), TK Finance, Thyssenkrupp Canada Inc. ("TK Canada") and Thyssenkrupp Budd Company), as well as their subsidiaries, directors, officers, members, partners, employees, auditors, financial advisors, legal counsel and agents of any of these parties and any person liable jointly or derivatively through any or all of the beneficiaries of the of the release (referred to individually as a "Released Party").

41 The Release covers all Affected Claims, Pension Claims and Escrow Fund Claims existing on or prior to the later of the Proposal Implementation Date and the date on which actions are taken to implement the Consolidated Proposal.

42 The Release provides that all such claims are released and waived (other than the right to enforce the Applicants' or Proposal Trustee's obligations under the Consolidated Proposal) to the full extent permitted by applicable law. However, nothing in the Consolidated Proposal releases or discharges any Released Party for any criminal or other wilful misconduct or any present or former directors of the Applicants with respect to any matters set out in s. 50(14) of the *BIA*. Unaffected Claims are specifically carved out of the Release.

43 The Applicants submit that the Release is both permissible under the *BIA* and appropriately granted in the context of the *BIA* proposal proceedings. Further, counsel submits, to the extent that the Release benefits third parties other than the Applicants, the Release is not prohibited by the *BIA* and it satisfies the criteria that has been established in granting third-party releases under the *Companies' Creditors Arrangement Act* ("*CCAA*"). Moreover, counsel submits that the scope of the Release is no broader than necessary to give effect to the purpose of the Consolidated Proposal and the contributions made by the third parties to the success of the Consolidated Proposal.

44 No creditors or stakeholders objected to the scope of the Release which was fully disclosed in the negotiations, including the fact that the inclusion of the third-party releases was required to be part of the Consolidated Proposal. Counsel advises that the scope of the Release was referred to in the materials sent by the Proposal Trustee to the Affected Creditors prior to the meeting, specifically discussed at the meeting and adopted by the unanimous vote of the voting Affected Creditors.

45 Counsel also submits that there is no provision in the *BIA* that clearly and expressly precludes the Applicants from including the Release in the Consolidated Proposal as long as the court is satisfied that the Consolidated Proposal is reasonable and for the general benefit of creditors.

46 In this respect, it seems to me, that the governing statutes should not be technically or stringently interpreted in the insolvency context but, rather, should be interpreted in a manner that is flexible rather than technical and literal, in order to deal with the numerous situations and variations which arise from time to time. Further, taking a technical approach to the interpretation of the *BIA* would defeat the purpose of the legislation. See *N.T.W. Management Group Ltd., Re* (1994), 29 C.B.R. (3d) 139 (Ont. Bktcy.); *Olympia & York Developments Ltd., Re* (1995), 34 C.B.R. (3d) 93 (Ont. Gen. Div. [Commercial List]); *Olympia & York Developments Ltd., Re* (1997), 45 C.B.R. (3d) 85 (Ont. Bktcy.).

47 Moreover, the statutes which deal with the same subject matter are to be interpreted with the presumption of harmony, coherence and consistency. See *NAV Canada c. Wilmington Trust Co.*, 2006 SCC 24 (S.C.C.). This principle militates in favour of adopting an interpretation of the *BIA* that is harmonious, to the greatest extent possible, with the interpretation that has been given to the *CCAA*.

48 Counsel points out that historically, some case law has taken the position that s. 62(3) of the *BIA* precludes a proposal from containing a release that benefits third parties. Counsel submits that this result is not supported by a plain meaning of s. 62(3) and its interaction with other key sections in the *BIA*.

49 Subsection 62(3) of the *BIA* reads as follows:

> (3) The acceptance of a proposal by a creditor does not release any person who would not be released under this Act by the discharge of the debtor.

50 Counsel submits that there are two possible interpretations of this subsection:

> (a) It prohibits third party releases — in other words, the phrase "does not release any person" is interpreted to mean "cannot release any person"; or
>
> (b) It simply states that acceptance of a proposal does not automatically release any party other than the debtor — in other words, the phrase "does not release any person" is interpreted to mean "does not release any person without more"; it is protective not prohibitive.

51 I agree with counsel's submission that the latter interpretation of s. 62(3) of the *BIA* conforms with the grammatical and ordinary sense of the words used. If Parliament had intended that only the debtor could be released, s. 62(3) would have been drafted more simply to say exactly that.

52 Counsel further submits that the narrow interpretation would be a stringent and inflexible interpretation of the *BIA*, contrary to accepted wisdom that the *BIA* should be interpreted in a flexible, purposive manner.

53 The *BIA* proposal provisions are designed to offer debtors an opportunity to carry out a going concern or value maximizing restructuring in order to avoid a bankruptcy and related liquidation and that these purposes justify taking a broad, flexible and purposive approach to the interpretation of the relevant provisions. This interpretation is supported by *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60 (S.C.C.).

54 Further, I agree with counsel's submissions that a more flexible purposive interpretation is in keeping with modern statutory principles and the need to give purposive interpretation to insolvency legislation must start from the proposition that there is no express prohibition in the *BIA* against including third-party releases in a proposal. At most, there are certain limited constraints on the scope of such releases, such as in s. 179 of the *BIA*, and the provision dealing specifically with the release of directors.

55 In the absence of an express prohibition against including third-party releases in a proposal, counsel submits that it must be presumed that such releases are permitted (subject to compliance with any limited express restrictions, such as in the case of a release of directors). By extension, counsel submits that the court is entitled to approve a proposal containing a third-party release if the court is able to satisfy itself that the proposal (including the third-party release) is reasonable and for the general

benefit for creditors such that all creditors (including the minority who did not vote in favour of the proposal) can be required to forego their claims against parties other than the debtors.

56 The Applicants also submit that s. 62(3) of the *BIA* can only be properly understood when read together with other key sections of the *BIA*, particularly s. 179 which concerns the effect of an order of discharge:

> 179. An order of discharge does not release a person who at the time of the bankruptcy was a partner or co-trustee with the bankrupt or was jointly bound or had made a joint contract with the bankrupt, or a person who was surety or in the nature of a surety for the bankrupt.

57 The order of discharge of a bankrupt has the effect of releasing the bankrupt from all claims provable in bankruptcy (section 178(2) *BIA*). In the absence of s. 179, this release could result in the automatic release at law of certain types of claims that are identified in s. 179. For example, under guarantee law, the discharge of the principal debt results in the automatic discharge of a guarantor. Similarly, counsel points out the settlement or satisfaction of a debt by one joint obligor generally results in the automatic release of both joint obligors. Section 179 therefore serves the limited purpose of altering the result that would incur at law, indicating that the rule that the *BIA* generally is that there is no automatic release of third-party guarantors of co-obligors when a bankrupt is discharged.

58 Counsel submits that s. 62(3), which confirms that s. 179 applies to a proposal, was clearly intended to fulfil a very limited role — namely, to confirm that there is no automatic release of the specific types of co-obligors identified in s. 179 when a proposal is approved by the creditors and by the court. Counsel submits that it does not go further and preclude the creditors and the court from approving a proposal which contains the third-party release of the types of co-obligors set out in s. 179. I am in agreement with these submissions.

59 Specific considerations also apply when releasing directors of a debtor company. The *BIA* contains specific limitations on the permissible scope of such releases as set out in s. 50(14). For this reason, there is a specific section in the *BIA* proposal provisions outlining the principles governing such a release. However, counsel argues, the presence of the provisions outlining the circumstances in which a proposal can contain a release of claims against the debtor's directors does not give rise to an inference that the directors are the only third parties that can be released in a proposal. Rather, the inference is that there are considerations applicable to a release or compromise of claims against directors that do not apply generally to other third parties. Hence, it is necessary to deal with this particular type of compromise and release expressly.

60 I am also in agreement with the alternative submissions made by counsel in this area to the effect that if s. 62(3) of the *BIA* operates as a prohibition it refers only to those limitations that are expressly identified in the *BIA*, such as in s. 179 of the *BIA* and the specific limitations on the scope of releases that can benefit directors of the debtor.

61 Counsel submits that the Applicants' position regarding the proper interpretation of s. 62(3) of the *BIA* and its place in the scheme of the *BIA* is consistent with the generally accepted principle that a proposal under the *BIA* is a contract. See *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*, 2008 ONCA 587 (Ont. C.A.); *Employers' Liability Assurance Corp. v. Ideal Petroleum (1959) Ltd.* (1976), [1978] 1 S.C.R. 230 (S.C.C.); and *Society of Composers, Authors & Music Publishers of Canada v. Armitage* (2000), 20 C.B.R. (4th) 160 (Ont. C.A.). Consequently, counsel submits that parties are entitled to put anything into a proposal that could lawfully be incorporated into any contract (see *Air Canada, Re* (2004), 2 C.B.R. (5th) 4 (Ont. S.C.J. [Commercial List])) and that given that the prescribed majority creditors have the statutory right under the *BIA* to bind a minority, however, this principle is subject to any limitations that are contained in the express wording of the *BIA*.

62 On this point, it seems to me, that any provision of the *BIA* which purports to limit the ability of the debtor to contract with its creditors should be clear and explicit. To hold otherwise would result in severely limiting the debtor's ability to contract with its creditors, thereby the decreasing the likelihood that a viable proposal could be reached. This would manifestly defeat the purpose of the proposal provisions of the *BIA*.

63 The Applicants further submit that creditors' interests — including the interests of the minority creditors who do not vote in favour of a proposal containing a third-party release — are sufficiently protected by the overriding ability of a court to refuse to approve a proposal with an overly broad third-party release, or where the release results in the proposal failing to demonstrate that it is for the benefit of the general body of creditors. The Applicants submit that the application of the *Metcalfe* criteria to the release is a mechanism whereby this court can assure itself that these preconditions to approve the Consolidated Proposal contained in the Release have been satisfied.

64 The Applicants acknowledge that there are several cases in which courts have held that a *BIA* proposal that includes a third-party release cannot be approved by the court but submits that these cases are based on a mistaken premise, are readily distinguishable and do not reflect the modern approach to Canadian insolvency law. Further, they submit that none of these cases are binding on this court and should not be followed.

65 In *Kern Agencies Ltd., (No. 2), Re* (1931), 13 C.B.R. 11 (Sask. C.A.), the court refused to approve a proposal that contained a release of the debtor's directors, officers and employees. Counsel points out that the court's refusal was based on a provision of the predecessor to the *BIA* which specifically provided that a proposal could only be binding on creditors (as far as relates to any debts due to them from the debtor). The current *BIA* does not contain equivalent general language. This case is clearly distinguishable.

66 In *Mister C's Ltd., Re* (1995), 32 C.B.R. (3d) 242 (Ont. Bktcy.), the court refused to approve a proposal that had received creditor approval. The court cited numerous bases for its conclusion that the proposal was not reasonable or calculated to benefit the general body of creditors, one of which was the release of the principals of the debtor company. The scope of the release was only one of the issues with the proposal, which had additional significant issues (procedural irregularities, favourable terms for insiders, and inequitable treatment of creditors generally). I agree with counsel to the Applicants that this case can be distinguished.

67 *Cosmic Adventures Halifax Inc., Re* (1999), 13 C.B.R. (4th) 22 (N.S. S.C.) relies on *Kern* and furthermore the Applicants submit that the discussion of third-party releases is technically *obiter* because the proposal was amended on consent.

68 The fourth case is *C.F.G. Construction inc., Re*, 2010 CarswellQue 10226 (C.S. Que.) where the Quebec Superior Court refused to approve a proposal containing a release of two sureties of the debtor. The case was decided on alternate grounds — either that the *BIA* did not permit a release of sureties, or in any event, the release could not be justified on the facts. I agree with the Applicants that this case is distinguishable. The case deals with the release of sureties and does not stand for any broader proposition.

69 In general, the Applicants' submission on this issue is that the court should apply the decision of the Court of Appeal for Ontario in *Metcalfe*, together with the binding principle set out by the Supreme Court in *Ted Leroy Trucking*, dictating a more liberal approach to the permissibility of third-party releases in *BIA* proposals than is taken by the Quebec court in *C.F.G. Construction Inc*. I agree.

70 The object of proposals under the *BIA* is to permit the debtor to restructure its business and, where possible, avoid the social and economic costs of liquidating its assets, which is precisely the same purpose as the *CCAA*. Although there are some differences between the two regimes and the *BIA* can generally be characterized as more "rules based", the thrust of the case law and the legislative reform has been towards harmonizing aspects of insolvency law common to the two statutory schemes to the extent possible, encouraging reorganization over liquidation. See *Ted Leroy Trucking*.

71 Recent case law has indicated that, in appropriate circumstances, third-party releases can be included in a plan of compromise and arrangement that is approved under the *CCAA*. See *Metcalfe*. The *CCAA* does not contain any express provisions permitting such third-party releases apart from certain limitations that apply to the compromise of claims against directors of the debtor company. See *CCAA* s. 5.1 and *Allen-Vanguard Corp., Re*, 2011 ONSC 733 (Ont. S.C.J.).

72 Counsel submits that although the mechanisms for dealing with the release of sureties and similar claimants are somewhat different in the *BIA* and *CCAA*, the differences are not of such significance that the presence of s. 62(3) of the *BIA* should be viewed as dictating a different approach to third-party releases generally from the approach that applies under the *CCAA*. I agree with this submission.

73 I also accept that if s. 62(3) of the *BIA* is interpreted as a prohibition against including the third-party release in the *BIA* proposal, the *BIA* and the *CCAA* would be in clear disharmony on this point. An interpretation of the *BIA* which leads to a result that is different from the *CCAA* should only be adopted pursuant to clear statutory language which, in my view, is not present in the *BIA*.

74 The most recent and persuasive example of the application of such a harmonious approach to the interpretation of the *BIA* and the *CCAA* can be found in *Ted Leroy Trucking*.

75 At issue in *Ted Leroy Trucking* was how to resolve an apparent conflict between the deemed trust provisions of the *Excise Tax Act* and the provisions of the *CCAA*. The language of the *Excise Tax Act* created a deemed trust over GST amounts collected by the debtor that was stated to apply "despite any other Act of Parliament". The *CCAA* stated that the deemed trust for GST did not apply under the *CCAA*, unless the funds otherwise specified the criteria for a "true" trust. The court was required to determine which federal provision should prevail.

76 By contrast, the same issue did not arise under the *BIA*, due to the language in the *Excise Tax Act* specifically indicating that the continued existence of the deemed trust depended on the terms of the *BIA*. The *BIA* contained a similar provision to the *CCAA* indicating that the deemed trust for GST amounts would no longer apply in a *BIA* proceeding.

77 Deschamps J., on behalf of six other members of the court, with Fish J. concurring and Abella J. dissenting, held that the proper interpretation of the statutes was that the *CCAA* provision should prevail, the deemed trust under the *Excise Tax Act* would cease to exist in a *CCAA* proceeding. In resolving the conflict between the *Excise Tax Act* and the *CCAA*, Deschamps J. noted the strange asymmetry which would arise if the *BIA* and *CCAA* were not in harmony on this issue:

> Moreover, a strange asymmetry would arise if the interpretation giving the *ETA* priority over the *CCAA* urged by the Crown is adopted here: the Crown would retain priority over GST claims during *CCAA* proceedings but not in bankruptcy. As courts have reflected, this can only encourage statute shopping by secured creditors in cases such as this one where the debtor's assets cannot satisfy both the secured creditors' and the Crown's claims (*Gauntlet*, at para. 21). If creditors' claims were better protected by liquidation under the *BIA*, creditors' incentives would lie overwhelmingly with avoiding proceedings under the *CCAA* and not risking a failed reorganization. Giving a key player in any insolvency such skewed incentives against reorganizing under the *CCAA* can only undermine that statute's remedial objectives and risk inviting the very social ills that it was enacted to avert.

78 It seems to me that these principles indicate that the court should generally strive, where the language of both statutes can support it, to give both statutes a harmonious interpretation to avoid the ills that can arise from "statute-shopping". These considerations, counsel submits, militate against adopting a strained reading of s. 62(3) of the *BIA* as a prohibition against third-party releases in a *BIA* proposal. I agree. In my opinion, there is no principled basis on which the analysis and treatment of a third-party release in a *BIA* proposal proceeding should differ from a CCAA proceeding.

79 The Applicants submit that it logically follows that the court is entitled to approve the Consolidated Proposal, including the Release, on the basis that it is reasonable and calculated to benefit the general body of creditors. Further, in keeping with the principles of harmonious interpretation of the *BIA* and the *CCAA*, the court should satisfy itself that the *Metcalfe* criteria, which apply to the approval of a third-party release under the CCAA, has been satisfied in relation to the Release.

80 In *Metcalfe*, the Court of Appeal for Ontario held that the requirements that must be satisfied to justify a third-party release are:

(a) the parties to be released are necessary and essential to the restructuring of the debtor;

(b) the claims to be released are rationally related to the purpose of the Plan (Proposal) and necessary for it;

(c) the Plan (Proposal) cannot succeed without the releases;

(d) the parties who are to have claims against them released are contributing in a tangible and realistic way to the Plan (Proposal); and

(e) the Plan (Proposal) will benefit not only the debtor companies but creditors generally.

81 These requirements have also been referenced in *Canwest Global Communications Corp., Re* (2010), 70 C.B.R. (5th) 1 (Ont. S.C.J. [Commercial List]) and *Angiotech Pharmaceuticals Inc., Re* (2011), 76 C.B.R. (5th) 210 (B.C. S.C. [In Chambers]).

82 No single requirement listed above is determinative and the analysis must take into account the facts particular to each claim.

83 The Applicants submit that the Release satisfies each of the *Metcalfe* criteria. Firstly, counsel submits that following the closing of the Asset Purchase Agreement in 2006, Budd Canada had no operating assets or income and relied on inter-company advances to fund the pension and OPEB requirements to be made by Budd Canada on behalf of KFL pursuant to the Asset Purchase Agreement. Such funded amounts total approximately $112.7 million in pension payments and $24.6 million in OPEB payments between the closing of the Asset Purchase Agreement and the Filing Date. In addition, TK Finance has been providing Budd Canada and KFL with the necessary funding to pay the professional and other costs associated with the *BIA* Proposal Proceedings and will continue to fund such amounts through the Proposal Implementation Date. Moreover, TK Canada and TK Finance have agreed to forego recoveries under the Consolidated Proposal on account of their existing secured and unsecured intercompany loans in the amount of approximately $120 million.

84 Counsel submits that the releases provided in respect of the Applicants' affiliates are the *quid pro quo* for the sacrifices made by such affiliates to significantly enlarge recoveries for the unsecured creditors of the Applicants, particularly the OPEB creditors and reflects that the affiliates have provided over $135 million over the last five years in respect of the pension and OPEB amounts and additional availability of approximately $49 million to allow the Applicants to discharge their obligations to their former employees and retirees. Without the Releases, counsel submits, the Applicants' affiliates would have little or no incentive to contribute funds to the Consolidated Proposal and to waive their own rights against the Applicants.

85 The Release in favour of Martinrea is fully discussed at paragraphs 121-127 of the factum. The Applicants submit that the third-party releases set out in the Consolidated Proposal are clearly rationally related, necessary and essential to the Consolidated Proposal and are not overly broad.

86 Having reviewed the submissions in detail, I am in agreement that the Released Parties are contributing in a tangible and realistic way to the Consolidated Proposal.

87 I am also satisfied that without the Applicants' commitment to include the Release in the Consolidated Proposal to protect the Released Parties, it is unlikely that certain of such parties would have been prepared to support the Consolidated Proposal. The releases provided in respect of the Applicants' affiliates are particularly significant in this regard, since the sacrifices and monetary contributions of such affiliates are the primary reason that the Applicants have been able to make the Consolidated Proposal. Further, I am also satisfied that without the Release, the Applicants would be unable to satisfy the borrowing conditions under the Amended and Restated Senior Secured Loan Agreement with respect to the Applicants having only certain permitted liabilities after the Proposal Implementation Date. The alternative for the Applicants is bankruptcy, a scenario in which their affiliates' claims aggregating approximately $120 million would significantly erode recoveries for the unsecured creditors of the Applicants.

88 I am also satisfied that the Releases benefit the Applicants and creditors generally. The primary non-affiliated Creditors of the Applicants are the OPEB Creditors and Creditors with Pension Claims, together with the CRA. The Consolidated Proposal, in my view, clearly benefits these Creditors by generating higher recoveries than could be obtained from the bankruptcies of the Applicants. Moreover, the timing of any such bankruptcy recoveries is uncertain. As noted by the Proposal Trustee, the amount that the Affected Creditors would receive in the event of the bankruptcies of the Applicants is uncertain both in terms of quantum and timing, with the Applicants' funding of OPEB Claims terminating on bankruptcy, but distributions to the OPEB Creditors and other Creditors delayed for at least a year or two but perhaps much longer.

89 The Applicants and their affiliates also benefit from the Release as an affiliate of the Applicants may become enabled to use the net operating losses (NOL) following a series of transactions that are expected to occur immediately following the Proposal Implementation Date.

90 I am also satisfied that the Applicants have provided full and adequate disclosure of the Releases and their effect. Full disclosure was made in the proposal term sheet circulated to both Representative Counsel in early August 2011. The Release was negotiated as part of the Consolidated Proposal and the scope of the Release was disclosed by the Proposal Trustee in its Report to the creditors on the terms of the Consolidated Proposal, which Report was circulated by the Proposal Trustee to the Applicants' known creditors in advance of the creditors' meeting.

91 I am satisfied that the Applicants, with the assistance of the Proposal Trustee, took appropriate steps to ensure that the Affected Creditors were aware of the existence of the release provisions prior to the creditors' meeting.

92 For the foregoing reasons, I have concluded that the Release contained in the Consolidated Proposal meets the *Metcalfe* criteria and should be approved.

93 In the result, I am satisfied that the section 59(2) *BIA* test has been met and that it is appropriate to grant the Sanction Order in the form of the draft order attached to the Motion Record. An order has been signed to give effect to the foregoing.

Motion granted.

End of Document

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, C.C-3, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF TARGET CANADA CO., TARGET CANADA HEALTH CO., TARGET CANADA MOBILE GP CO., TARGET CANDA PHARMACY (BC) CORP., TARGET CANADA PHARMACY (ONTARIO) CORP., TARGET CANADA PHARMACY CORP., TARGET CANADA PHARMACY (SK) CORP., and TARGET CANADA PROPERTY LLC

Applicants

Court File No. CV-15-10832-00CL

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RCP-E 4C (July 1, 2007)