

*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 **TARGET CANADA CO., TARGET  
CANADA HEALTH CO., TARGET CANADA MOBILE GP  
CO., TARGET CANADA PHARMACY (BC) CORP.,  
TARGET CANADA PHARMACY (ONTARIO) CORP.,  
TARGET CANADA PHARMACY CORP., TARGET  
CANADA PHARMACY (SK) CORP., and TARGET  
CANADA PROPERTY LLC**

APPLICANTS

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**BOOK OF AUTHORITIES OF THE APPLICANTS**

**(Motion to Accept Filing of the Amended Plan  
and Authorize Creditors' Meeting)**

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April 8, 2016

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14. *Sovereign Life Assurance Co. v. Dodd* (1891), [1892] 2 Q.B. 573 (Eng. C.A.)

### Secondary Source

15. L.W. Houlden, G.B. Morawetz and Janis Sarra, *Bankruptcy and Insolvency Law of Canada*, 4<sup>th</sup> ed. (Toronto: Carswell, 2009)

# **TAB 1**

1990 CarswellOnt 139  
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Nova Metal Products Inc. v. Comiskey (Trustee of)

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**ELAN CORPORATION et al. v. COMISKEY (TRUSTEE OF) et al.**

Finlayson, Krever and Doherty JJ.A.

Heard: October 30 and 31, 1990

Judgment: November 2, 1990

Docket: Doc. Nos. CA 684/90 and CA 685/90

Counsel: *F.J.C. Newbould, Q.C.*, and *G.B. Morawetz*, for appellant The Bank of Nova Scotia.

*John Little*, for respondents Elan Corporation and Nova Metal Products Inc.

*Michael B. Rotsztain*, for RoyNat Inc.

*Kim Twohig* and *Mel Olanow*, for Ontario Development Corp.

*K.P. McElcheran*, for monitor Ernst & Young.

Subject: Corporate and Commercial; Insolvency

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**Cases considered:**

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*Sovereign Life Assurance Co. v. Dodd*, [1892] 2 Q.B. 573, [1891-4] All E.R. 246 (C.A.) — *applied*

*Wellington Building Corp., Re*, [1934] O.R. 653, 16 C.B.R. 48, [1934] 4 D.L.R. 626, [1934] O.W.N. 562 (S.C.) — *applied*

*Per Doherty J.A. (dissenting in part)*

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*Icor Oil & Gas Co. v. Canadian Imperial Bank of Commerce* (1989), 102 A.R. 161 (Q.B.) — *referred to*

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

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*Reference re Residential Tenancies Act (Ontario)*, [1981] 1 S.C.R. 714, 123 D.L.R. (3d) 554, 37 N.R. 158 — *referred to*

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APPEAL from order of Hoolihan J. dated September 11, 1990, allowing application under *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36.

**FINLAYSON J.A. (KREVER J.A. concurring) (orally):**

1 This is an appeal by the Bank of Nova Scotia (the "bank") from orders made by Mr. Justice Hoolihan [(11 September 1990), Doc. Nos. Toronto RE 1993/90 and RE 1994/90 (Ont. Gen. Div.)] as hereinafter described. The Bank of Nova Scotia was the lender to two related companies, namely, Elan Corporation ("Elan") and Nova Metal Products Inc. ("Nova"), which commenced proceedings under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "CCAA"), for the purposes of having a plan of arrangement put to a meeting of secured creditors of those companies.

2 The orders appealed from are:

(i) An order of September 11, 1990, which directed a meeting of the secured creditors of Elan and Nova to consider the plan of arrangement filed, or other suitable plan. The order further provided that for 3 days until September 14, 1990, the bank be prevented from acting on any of its security or paying down any of its loans from accounts receivable collected by Elan and Nova, and that Elan and Nova could spend the accounts receivable assigned to the bank that would be received.

(ii) An order dated September 14, 1990, extending the terms of the order of September 11, 1990, to remain in effect until the plan of arrangement was presented to the Court no later than October 24, 1990. This order continued the stay against the bank and the power of Elan and Nova to spend the accounts receivable assigned to the bank. Further orders dated September 27, 1990, and October 18, 1990, have extended the stay, and the power of Elan and Nova to spend the accounts receivable that have been assigned to the bank. The date of the meetings of creditors has been extended to November 9, 1990. The application to sanction the plan of arrangement must be heard by November 14, 1990.

(iii) An order dated October 18, 1990, directing that there be two classes of secured creditors for the purposes of voting at the meeting of secured creditors. The first class is to be comprised of the bank, RoyNat Inc. ("RoyNat"), the Ontario Development Corporation ("O.D.C."), the city of Chatham and the village of Glencoe. The second class is to be comprised of persons related to Elan and Nova that acquired debentures to enable the companies to apply under the CCAA.

3 There is very little dispute about the facts in this matter, but the chronology of events is important and I am setting it out in some detail.

4 The bank has been the banker to Elan and Nova. At the time of the application in August 1990, it was owed approximately \$1,900,000. With interest and costs, including receivers' fees, it is now owed in excess of \$2,300,000. It has a first registered charge on the accounts receivable and inventory of Elan and Nova, and a second registered charge on the land, buildings and equipment. It also has security under s. 178 of the *Bank Act*, R.S.C. 1985, c. B-1, as am. R.S.C. 1985 (3rd Supp.), c. 25, s.



26. The terms of credit between the bank and Elan as set out in a commitment agreement provide that Elan and Nova may not encumber their assets without the consent of the bank.

5 RoyNat is also a secured creditor of Elan and Nova, and it is owed approximately \$12 million. It holds a second registered charge on the accounts receivable and inventory of Elan and Nova, and a first registered charge on the land, buildings and equipment. The bank and RoyNat entered into a priority agreement to define with certainty the priority which each holds over the assets of Elan and Nova.

6 The O.D.C. guaranteed payment of \$500,000 to RoyNat for that amount lent by RoyNat to Elan. The O.D.C. holds debenture security from Elan and secure the guarantee which it gave to RoyNat. That security ranks third to the bank and RoyNat. The O.D.C. has not been called upon by RoyNat to pay under its guarantee. O.D.C. has not lent any money directly to Elan or Nova.

7 Elan owes approximately \$77,000 to the City of Chatham for unpaid municipal taxes. Nova owes approximately \$18,000 to the Village of Glencoe for unpaid municipal taxes. Both municipalities have a lien on the real property of the respective companies in priority to every claim except the Crown under s. 369 of the *Municipal Act*, R.S.O. 1980, c. 302.

8 On May 8, 1990, the bank demanded payment of all outstanding loans owing by Elan and Nova to be made by June 1, 1990. Extensions of time were granted and negotiations directed to the settlement of the debt took place thereafter. On August 27, 1990, the bank appointed Coopers & Lybrand Limited as receiver and manager of the assets of Elan and Nova, and as agent under the bank's security to realize upon the security. Elan and Nova refused to allow the receiver and manager to have access to their premises, on the basis that insufficient notice had been provided by the bank before demanding payment.

9 Later on August 27, 1990, the bank brought a motion in an action against Elan and Nova (Court File No. 54033/90) for an order granting possession of the premises of Elan and Nova to Coopers & Lybrand. On the evening of August 27, 1990, at approximately 9 p.m., Mr. Justice Saunders made an order adjourning the motion on certain conditions. The order authorized Coopers & Lybrand access to the premises to monitor Elan's business, and permitted Elan to remain in possession and carry on its business in the ordinary course. The bank was restrained in the order, until the motion could be heard, from selling inventory, land, equipment or buildings or from notifying account debtors to collect receivables, but was not restrained from applying accounts receivable that were collected against outstanding bank loans.

10 On Wednesday, August 29, 1990, Elan and Nova each issued a debenture for \$10,000 to a friend of the principals of the companies, Joseph Comiskey, through his brother Michael Comiskey as trustee, pursuant to a trust deed executed the same day. The terms were not commercial and it does not appear that repayment was expected. It is conceded by counsel for Elan that the sole purpose of issuing the debentures was to qualify as a "debtor company" within the meaning of s. 3 of the CCAA. Section 3 reads as follows:

3. This Act does not apply in respect of a debtor company unless

(a) the debtor company has outstanding an issue of secured or unsecured bonds of the debtor company or of a predecessor in title of the debtor company issued under a trust deed or other instrument running in favour of a trustee; and

(b) the compromise or arrangement that is proposed under section 4 or 5 in respect of the debtor company includes a compromise or an arrangement between the debtor company and the holders of an issue referred to in paragraph (a).

11 The debentures conveyed the personal property of Elan and Nova as security to Michael Comiskey as trustee. No consent was obtained from the bank as required by the loan agreements, nor was any consent obtained from the receiver. Cheques for \$10,000 each, representing the loans secured in the debentures, were given to Elan and Nova on Wednesday, August 29, 1990, but not deposited until 6 days later on September 4, 1990, after an interim order had been made by Mr. Justice Farley in favour of Elan and Nova staying the bank from taking proceedings.

12 On August 30, 1990 Elan and Nova applied under s. 5 of the CCAA for an order directing a meeting of secured creditors to vote on a plan of arrangement. Section 5 provides:

5. Where a compromise or an arrangement is proposed between a debtor company and its secured creditors or any class of them, the court may, on the application in a summary way of the company or of any such creditor or of the trustee in bankruptcy or liquidator of the company, order a meeting of the creditors or class of creditors, and, if the court so determines, of the shareholders of the company, to be summoned in such manner as the court directs.

13 The application was heard by Farley J. on Friday, August 31, 1990, at 8 a.m. Farley J. dismissed the application on the grounds that the CCAA required that there be more than one debenture issued by each company. Later on the same day, August 31, 1990, Elan and Nova each issued two debentures for \$500 to the wife of the principal of Elan through her sister as trustee. The debentures provided for payment of interest to commence on August 31, 1992. Cheques for \$500 were delivered that day to the companies but not deposited in the bank account until September 4, 1990. These debentures conveyed the personal property in the assets of Elan and Nova to the trustee as security. Once again it is conceded that the debentures were issued for the sole purpose of meeting the requirements of s. 3 of the CCAA. No consent was obtained from the bank as required by the loan terms, nor was any consent obtained from the receiver.

14 On August 31, 1990, following the creation of the trust deeds and the issuance of the debentures, Elan and Nova commenced new applications under the CCAA which were heard late in the day by Farley J. He adjourned the applications to September 10, 1990, on certain terms, including a stay preventing the bank from acting on its security and allowing Elan to spend up to \$321,000 from accounts receivable collected by it.

15 The plan of arrangement filed with the application provided that Elan and Nova would carry on business for 3 months, that secured creditors would not be paid and could take no action on their security for 3 months, and that the accounts receivable of Elan and Nova assigned to the bank could be utilized by Elan and Nova for purposes of its day-to-day operations. No compromise of any sort was proposed.

16 On September 11, 1990, Hoolihan J. ordered that a meeting of the secured creditors of Elan and Nova be held no later than October 22, 1990, to consider the plan of arrangement that had been filed, or other suitable plan. He ordered that the plan of arrangement be presented to the secured creditors no later than September 27, 1990. He made further orders effective for 3 days until September 14, 1990, including orders:

- (i) that the companies could spend the accounts receivable assigned to the bank that would be collected in accordance with a cash flow forecast filed with the Court providing for \$1,387,000 to be spent by September 30, 1990; and
- (ii) a stay of proceedings against the bank acting on any of its security or paying down any of its loans from accounts receivable collected by Elan and Nova.

17 On September 14, 1990, Hoolihan J. extended the terms of his order of September 11, 1990, to remain in effect until the plan of arrangement was presented to the Court no later than October 24, 1990 for final approval. This order continued the power of Elan and Nova to spend up to \$1,387,000 of the accounts receivable assigned to the bank in accordance with the projected cash flow to September 30, 1990, and to spend a further amount to October 24, 1990, in accordance with a cash flow to be approved by Hoolihan J. prior to October 1, 1990. Further orders dated September 27 and October 18 have extended the power to spend the accounts receivable to November 14, 1990.

18 On September 14, 1990, the bank requested Hoolihan J. to restrict his order so that Elan and Nova could use the accounts receivable assigned to the bank only so long as they continued to operate within the borrowing guidelines contained in the terms of the loan agreements with the bank. These guidelines require a certain ratio to exist between bank loans and the book value of the accounts receivable and inventory assigned to the bank, and are designed in normal circumstances to ensure that there is sufficient value in the security assigned to the bank. Hoolihan J. refused to make the order.

19 On October 18, 1990, Hoolihan J. ordered that the composition of the classes of secured creditors for the purposes of voting at the meeting of secured creditors shall be as follows:

(a) The bank, RoyNat, O.D.C., the City of Chatham and the Village of Glencoe shall comprise one class.

(b) The parties related to the principal of Elan that acquired their debentures to enable the companies to apply under the CCAA shall comprise a second class.

20 On October 18, 1990, at the request of counsel for Elan and Nova, Hoolihan J. further ordered that the date for the meeting of creditors of Elan and Nova be extended to November 9, 1990, in order to allow a new plan of arrangement to be sent to all creditors, including unsecured creditors of those companies. Elan and Nova now plan to offer a plan of compromise or arrangement to the unsecured creditors of Elan and Nova as well as to the secured creditors.

21 There are five issues in this appeal.

(1) Are the debentures issued by Elan and Nova for the purpose of permitting the companies to qualify as applicants under the CCAA debentures within the meaning of s. 3 of the CCAA?

(2) Did the issue of the debentures contravene the provisions of the loan agreements between Elan and Nova and the bank? If so, what are the consequences for CCAA purposes?

(3) Did Elan and Nova have the power to issue the debentures and make application under the CCAA after the bank had appointed a receiver and after the order of Saunders J.?

(4) Did Hoolihan J. have the power under s. 11 of the CCAA to make the interim orders that he made with respect to the accounts receivable?

(5) Was Hoolihan J. correct in ordering that the bank vote on the proposed plan of arrangement in a class with RoyNat and the other secured creditors?

22 It is well established that the CCAA is intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both. Such a resolution can have significant benefits for the company, its shareholders and employees. For this reason the debtor companies, Elan and Nova, are entitled to a broad and liberal interpretation of the jurisdiction of the Court under the CCAA. Having said that, it does not follow that in exercising its discretion to order a meeting of creditors under s. 5 of the CCAA that the Court should not consider the equities in this case as they relate to these companies and to one of its principal secured creditors, the bank.

23 The issues before Hoolihan J. and this Court were argued on a technical basis. Hoolihan J. did not give effect to the argument that the debentures described above were a "sham" and could not be used for the purposes of asserting jurisdiction. Unfortunately, he did not address any of the other arguments presented to him on the threshold issue of the availability of the CCAA. He appears to have acted on the premise that if the CCAA can be made available, it should be utilized.

24 If Hoolihan J. did exercise any discretion overall, it is not reflected in his reasons. I believe, therefore, that we are in a position to look at the uncontested chronology of these proceedings and exercise our own discretion. To me, the significant date is August 27, 1990 when the bank appointed Coopers & Lybrand Limited as receiver and manager of the undertaking, property and assets mortgaged and charged under the demand debenture and of the collateral under the general security agreement, both dated June 20, 1979. On the same date, it appointed the same company as receiver and manager for Nova under a general security agreement dated December 5, 1988. The effect of this appointment is to divest the companies and their boards of directors of their power to deal with the property comprised in the appointment: Raymond Walton, *Kerr on the Law and Practice as to Receivers*, 16th ed. (London: Sweet & Maxwell, 1983), p. 292. Neither Elan nor Nova had the power to create further indebtedness, and thus to interfere with the ability of the receiver to manage the two companies: *Alberta Treasury Branches v. Hat Development Ltd.* (1988), 71 C.B.R. (N.S.) 264, 64 Alta. L.R. (2d) 17 (Q.B.), aff'd (1989), 65 Alta. L.R. (2d) 374 (C.A.).

25 Counsel for the debtor companies submitted that the management powers of the receiver were stripped from the receiver by Saunders J. in his interim order, when he allowed the receiver access to the companies' properties but would not permit it

to realize on the security of the bank until further order. He pointed out that the order also provided that the companies were entitled to remain in possession and "to carry on business in the ordinary course" until further order.

26 I do not agree with counsel's submission covering the effect of the order. It certainly restricted what the receiver could do on an interim basis, but it imposed restrictions on the companies as well. The issue of these disputed debentures in support of an application for relief as insolvent companies under the CCAA does not comply with the order of Saunders J. This is not carrying on business in the ordinary course. The residual power to take all of these initiatives for relief under the CCAA remained with the receiver, and if trust deeds were to be issued, an order of the Court in Action 54033/90 was required permitting their issuance and registration.

27 There is another feature which, in my opinion, affects the exercise of discretion, and that is the probability of the meeting achieving some measure of success. Hoolihan J. considered the calling of the meeting at one hearing, as he was asked to do, and determined the respective classes of creditors at another. This latter classification is necessary because of the provisions of s. 6(a) of the CCAA, which reads as follows:

6. Where a majority in number representing three-fourths in value of the creditors, or class of creditors, as the case may be, present and voting either in person or by proxy at the meeting or meetings thereof respectively held pursuant to sections 4 and 5, or either of those sections, agree to any compromise or arrangement either as proposed or as altered or modified at the meeting or meetings, the compromise or arrangement may be sanctioned by the court, and if so sanctioned is binding

(a) on all the creditors or the class of creditors, as the case may be, and on any trustee for any such class of creditors, whether secured or unsecured, as the case may be, and on the company.

28 If both matters had been considered at the same time, as in my view they should have been, and if what I regard as a proper classification of the creditors had taken place, I think it is obvious that the meeting would not be a productive one. It was improper, in my opinion, to create one class of creditors made up of all the secured creditors save the so-called "sham" creditors. There is no true community of interest among them, and the motivation of Elan and Nova in striving to create a single class is clearly designed to avoid the classification of the bank as a separate class.

29 It is apparent that the only secured creditors with a significant interest in the proceeding under the CCAA are the bank and RoyNat. The two municipalities have total claims for arrears of taxes of less than \$100,000. They have first priority in the lands of the companies. They are in no jeopardy whatsoever. The O.D.C. has a potential liability in that it can be called upon by RoyNat under its guarantee to a maximum of \$500,000, and this will trigger default under its debentures with the companies, but its interests lie with RoyNat.

30 As to RoyNat, it is the largest creditor with a debt of some \$12 million. It will dominate any class it is in because, under s. 6 of the CCAA, the majority in a class must represent three-quarters in value of that class. It will always have a veto by reason of the size of its claim, but requires at least one creditor to vote for it to give it a majority in number (I am ignoring the municipalities). It needs the O.D.C.

31 I do not base my opinion solely on commercial self-interest, but also on the differences in legal interest. The bank has first priority on the receivables referred to as the "quick assets", and RoyNat ranks second in priority. RoyNat has first priority on the buildings and realty, the "fixed assets", and the bank has second priority.

32 It is in the commercial interests of the bank, with its smaller claim and more readily realizable assets, to collect and retain the accounts receivable. It is in the commercial interests of RoyNat to preserve the cash flow of the business and sell the enterprise as a going concern. It can only do that by overriding the prior claim of the bank to these receivables. If it can vote with the O.D.C. in the same class as the bank, it can achieve that goal and extinguish the prior claim of the bank to realize on the receivables. This it can do, despite having acknowledged its legal relationship to the bank in the priority agreement signed by the two. I can think of no reason why the legal interest of the bank as the holder of the first security on the receivables should be overridden by RoyNat as holder of the second security.

33 The classic statement on classes of creditors is that of Lord Esher M.R. in *Sovereign Life Assurance Co. v. Dodd*, [1892] 2 Q.B. 573, [1891-4] All E.R. 246 (C.A.), at pp. 579-580 [Q.B.]:

The Act [*Joint Stock Companies Arrangement Act, 1870*] says that the persons to be summoned to the meeting (all of whom, be it said in passing, are creditors) are persons who can be divided into different classes — classes which the Act of Parliament recognises, though it does not define them. This, therefore, must be done: they must be divided into different classes. What is the reason for such a course? It is because the creditors composing the different classes have different interests; and, therefore, if we find a different state of facts existing among different creditors which may differently affect their minds and their judgment, they must be divided into different classes.

34 The *Sovereign Life* case was quoted with approval by Kingstone J. in *Re Wellington Building Corp.*, [1934] O.R. 653, 16 C.B.R. 48, [1934] 4 D.L.R. 626, [1934] O.W.N. 562 (S.C.), at p. 659 [O.R.]. He also quoted another English authority at p. 658:

In *In re Alabama, New Orleans, Texas and Pacific Junction Ry. Co.*, [1891] 1 Ch. 213, a scheme and arrangement under the Joint Stock Companies Arrangement Act (1870), was submitted to the Court for approval. Lord Justice Bowen, at p. 243, says:

Now, I have no doubt at all that it would be improper for the Court to allow an arrangement to be forced on any class of creditors, if the arrangement cannot reasonably be supposed by sensible business people to be for the benefit of that class as such, otherwise the sanction of the Court would be a sanction to what would be a scheme of confiscation. The object of this section is not confiscation ... Its object is to enable compromises to be made which are for the common benefit of the creditors as creditors, or for the common benefit of some class of creditors as such.

35 Kingstone J. set aside a meeting where three classes of creditors were permitted to vote together. He said at p. 660:

It is clear that Parliament intended to give the three-fourths majority of any class power to bind that class, but I do not think the Statute should be construed so as to permit holders of subsequent mortgages power to vote and thereby destroy the priority rights and security of a first mortgagee.

36 We have been referred to more modern cases, including two decisions of Trainor J. of the British Columbia Supreme Court, both entitled *Re Northland Properties Ltd.* One case is reported in (1988), 73 C.B.R. (N.S.) 166, 31 B.C.L.R. (2d) 35, and the other in the same volume at p. 175 [C.B.R.]. Trainor J. was upheld on appeal on both judgments. The first judgment of the British Columbia Court of Appeal is unreported (16 September, 1988) [Doc. No. Vancouver CA009772, Taggart, Lambert and Locke J.J.A.]. The judgment in the second appeal is reported at 73 C.B.R. (N.S.) 195, [1989] 3 W.W.R. 363, 34 B.C.L.R. (2d) 122.

37 In the first *Northland* case, Trainor J. held that the difference in the terms of parties to and priority of different bonds meant that they should be placed in separate classes. He relied upon *Re Wellington Building Corp.*, supra. In the second *Northland* case, he dealt with 15 mortgagees who were equal in priority but held different parcels of land as security. Trainor J. held that their relative security positions were the same, notwithstanding that the mortgages were for the most part secured by charges against separate properties. The nature of the debt was the same, the nature of the security was the same, the remedies for default were the same, and in all cases they were corporate loans by sophisticated lenders. In specifically accepting the reasoning of Trainor J., the Court of Appeal held that the concern of the various mortgagees as to the quality of their individual securities was "a variable cause arising not by any difference in legal interests, but rather as a consequence of bad lending, or market values, or both" (p. 203).

38 In *Re NsC Diesel Power Inc.* (1990), 79 C.B.R. (N.S.) 1, 97 N.S.R. (2d) 295, 258 A.P.R. 295 (T.D.), the Court stressed that a class should be made up of persons "whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest" (p. 8 [of C.B.R.]).

39 My assessment of these secured creditors is that the bank should be in its own class. This being so, it is obvious that no plan of arrangement can succeed without its approval. There is no useful purpose to be served in putting a plan of arrangement

to a meeting of creditors if it is known in advance that it cannot succeed. This is another cogent reason for the Court declining to exercise its discretion in favour of the debtor companies.

40 For all the reasons given above, the application under the CCAA should have been dismissed. I do not think that I have to give definitive answers to the individual issues numbered (1) and (2). They can be addressed in a later case, where the answers could be dispositive of an application under the CCAA. The answer to (3) is that the combined effect of the receivership and the order of Saunders J. disentitled the companies to issue the debentures and bring the application under the CCAA. It is not necessary to answer issue (4), and the answer to (5) is no.

41 Accordingly, I would allow the appeal, set aside the three orders of Hoolihan J., and, in their place, issue an order dismissing the application under the CCAA. The bank should receive its costs of this appeal, the applications for leave to appeal, and the proceedings before Farley and Hoolihan JJ., to be paid by Elan, Nova and RoyNat.

42 Ernst & Young were appointed monitor in the order of Hoolihan J. dated September 14, 1990, to monitor the operations of Elan and Nova and give effect to and supervise the terms and conditions of the stay of proceedings in accordance with Appendix "C" appended to the order. The monitor should be entitled to be paid for all services performed to date, including whatever is necessary to complete its reports for past work, as called for in Appendix "C".

***DOHERTY J.A. (dissenting in part):***

**I Background**

43 On November 2, 1990, this Court allowed the appeal brought by the Bank of Nova Scotia (the "bank") and vacated several orders made by Hoolihan J. Finlayson J.A. delivered oral reasons on behalf of the majority. At the same time, I delivered brief oral reasons dissenting in part from the conclusion reached by the majority and undertook to provide further written reasons. These are those reasons.

44 The events relevant to the disposition of this appeal are set out in some detail in the oral reasons of Finlayson J.A. I will not repeat that chronology, but will refer to certain additional background facts before turning to the legal issues.

45 Elan Corporation ("Elan") owns the shares of Nova Metal Products Inc. ("Nova Inc."). Both companies have been actively involved in the manufacture of automobile parts for a number of years. As of March 1990, the companies had total annual sales of about \$30 million, and employed some 220 people in plants located in Chatham and Glencoe, Ontario. The operation of these companies no doubt plays a significant role in the economy of these two small communities.

46 In the 4 years prior to 1989, the companies had operated at a profit ranging from \$287,000 (1987) to \$1,500,000 (1986). In 1989, several factors, including large capital expenditures and a downturn in the market, combined to produce an operational loss of about \$1,333,000. It is anticipated that the loss for the year ending June 30, 1990, will be about \$2.3 million. As of August 1, 1990, the companies continued in full operation, and those in control anticipated that the financial picture would improve significantly later in 1990, when the companies would be busy filling several contracts which had been obtained earlier in 1990.

47 The bank has provided credit to the companies for several years. In January 1989, the bank extended an operating line of credit to the companies. The line of credit was by way of a demand loan that was secured in the manner described by Finlayson J.A. Beginning in May 1989, and from time to time after that, the companies were in default under the terms of the loan advanced by the bank. On each occasion, the bank and the companies managed to work out some agreement so that the bank continued as lender and the companies continued to operate their plants.

48 Late in 1989, the companies arranged for a \$500,000 operating loan from RoyNat Inc. It was hoped that this loan, combined with the operating line of \$2.5 million from the bank, would permit the company to weather its fiscal storm. In March 1990, the bank took the position that the companies were in breach of certain requirements under their loan agreements, and warned that if the difficulties were not rectified the bank would not continue as the company's lender. Mr. Patrick Johnson, the president of both companies, attempted to respond to these concerns in a detailed letter to the bank dated March 15, 1990.

The response did not placate the bank. In May 1990, the bank called its loan and made a demand for immediate payment. Mr. Spencer, for the bank, wrote: "We consider your financial condition continues to be critical and we are not prepared to delay further making formal demand." He went on to indicate that, subject to further deterioration in the companies' fiscal position, the bank was prepared to delay acting on its security until June 1, 1990.

49 As of May 1990, Mr. Johnson, to the bank's knowledge, was actively seeking alternative funding to replace the bank. At the same time, he was trying to convince the union which represented the workers employed at both plants to assist in a co-operative effort to keep the plants operational during the hard times. The union had agreed to discuss amendment of the collective bargaining agreement to facilitate the continued operation of the companies.

50 The June 1, 1990 deadline set by the bank passed without incident. Mr. Johnson continued to search for new financing. A potential lender was introduced to Mr. Spencer of the bank on August 13, 1990, and it appeared that the bank, through Mr. Spencer, was favourably impressed with this potential lender. However, on August 27, 1990, the bank decided to take action to protect its position. Coopers & Lybrand was appointed by the bank as receiver-manager under the terms of the security agreements with the companies. The companies denied the receiver access to their plants. The bank then moved before the Honourable Mr. Justice E. Saunders for an order giving the receiver possession of the premises occupied by the companies. On August 27, 1990, after hearing argument from counsel for the bank and the companies, Mr. Justice Saunders refused to install the receivers and made the following interim order:

1. THIS COURT ORDERS that the receiver be allowed access to the property to monitor the operations of the defendants but shall not take steps to realize on the security of The Bank of Nova Scotia until further Order of the Court.
2. THIS COURT ORDERS that the defendants shall be entitled to remain in possession and to carry on business in the ordinary course until further Order of this Court.
3. THIS COURT ORDERS that until further order the Bank of Nova Scotia shall not take steps to notify account debtors of the defendants for the purpose of collecting outstanding accounts receivable. This Order does not restrict The Bank of Nova Scotia from dealing with accounts receivable of the defendants received by it.
4. THIS COURT ORDERS that the motion is otherwise adjourned to a date to be fixed.

51 The notice of motion placed before Saunders J. by the bank referred to "an intended action" by the bank. It does not appear that the bank took any further steps in connection with this "intended action."

52 Having resisted the bank's efforts to assume control of the affairs of the companies on August 27, 1990, and realizing that their operations could cease within a matter of days, the companies turned to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "Act"), in an effort to hold the bank at bay while attempting to reorganize their finances. Finlayson J.A. has described the companies' efforts to qualify under that Act, the two appearances before the Honourable Mr. Justice Farley on August 31, 1990, and the appearances before the Honourable Mr. Justice Hoolihan in September and October 1990, which resulted in the orders challenged on this appeal.

## II The Issues

53 The dispute between the bank and the companies when this application came before Hoolihan J. was a straightforward one. The bank had determined that its best interests would be served by the immediate execution of the rights it had under its various agreements with the companies. The bank's best interest was not met by the continued operation of the companies as going concerns. The companies and their other two substantial secured creditors considered that their interests required that the companies continue to operate, at least for a period which would enable the companies to place a plan of reorganization before its creditors.

54 All parties were pursuing what they perceived to be their commercial interests. To the bank, these interests entailed the "death" of the companies as operating entities. To the companies, these interests required "life support" for the companies through the provisions of the Act to permit a "last ditch" effort to save the companies and keep them in operation.

55 The issues raised on this appeal can be summarized as follows:

(i) Did Hoolihan J. err in holding that the companies were entitled to invoke the Act?

(ii) Did Hoolihan J. err in exercising his discretion in directing that a meeting of creditors should be held under the Act?

(iii) Did Hoolihan J. err in directing that the bank and RoyNat Inc. should be placed in the same class of creditors for the purposes of the Act?

(iv) Did Hoolihan J. err in the terms of the interim orders he made pending the meeting of creditors and the submission to the court of a plan of reorganization?

### III The Purpose and Scheme of the Act

56 Before turning to these issues, it is necessary to understand the purpose of the Act, and the scheme established by the Act for achieving that purpose. The Act first appeared in the midst of the Great Depression (S.C. 1932-33, c. 36). The Act was intended to provide a means whereby insolvent companies could avoid bankruptcy and continue as ongoing concerns through a reorganization of their financial obligations. The reorganization contemplated required the cooperation of the debtor companies' creditors and shareholders: *Re Avery Construction Co.*, 24 C.B.R. 17, [1942] 4 D.L.R. 558 (Ont. S.C.); Stanley E. Edwards, "Reorganizations under the Companies' Creditors Arrangement Act" (1947) 25 Can. Bar Rev. 587, at pp. 592-593; David H. Goldman, "Reorganizations Under the Companies' Creditors Arrangement Act (Canada)" (1985) 55 C.B.R. (N.S.) 36, at pp. 37-39.

57 The legislation is remedial in the purest sense in that it provides a means whereby the devastating social and economic effects of bankruptcy- or creditor-initiated termination of ongoing business operations can be avoided while a court-supervised attempt to reorganize the financial affairs of the debtor company is made.

58 The purpose of the Act was artfully put by Gibbs J.A., speaking for the British Columbia Court of Appeal, in *Hongkong Bank of Canada v. Chef Ready Foods Ltd.*, an unreported judgment released October 29, 1990 [Doc. No. Vancouver CA12944, Carrothers, Cumming and Gibbs J.J.A., now reported [1991] 2 W.W.R. 136, 51 B.C.L.R. (2d) 84], at pp. 11 and 6 [unreported, pp. 91 and 88 B.C.L.R.]. In referring to the purpose for which the Act was initially proclaimed, he said:

Almost inevitably liquidation destroyed the shareholders' investment, yielded little by way of recovery to the creditors, and exacerbated the social evil of devastating levels of unemployment. The government of the day sought, through the C.C.A.A. [the Act], to create a regime whereby the principals of the company and the creditors could be brought together under the supervision of the court to attempt a reorganization or compromise or arrangement under which the company could continue in business.

59 In an earlier passage, His Lordship had said:

The purpose of the C.C.A.A. is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors to the end that the company is able to continue in business.

60 Gibbs J.A. also observed (at p. 13) that the Act was designed to serve a "broad constituency of investors, creditors and employees." Because of that "broad constituency", the Court must, when considering applications brought under the Act, have regard not only to the individuals and organizations directly affected by the application, but also to the wider public interest. That interest is generally, but not always, served by permitting an attempt at reorganization: see S.E. Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act," at p. 593.



61 The Act must be given a wide and liberal construction so as to enable it to effectively serve this remedial purpose: *Interpretation Act*, R.S.C. 1985, c. I-21, s. 12; *Hongkong Bank of Canada v. Chef Ready Foods Ltd.*, supra, at p. 14 [unreported, p. 92 B.C.L.R.].

62 The Act is available to all insolvent companies, provided the requirements of s. 3 of the Act are met. That section provides:

3. This Act does not apply in respect of a debtor company unless

(a) the debtor company has outstanding an issue of secured or unsecured bonds of the debtor company or of a predecessor in title of the debtor company issued under a trust deed or other instrument running in favour of a trustee; and

(b) the compromise or arrangement that is proposed under section 4 or 5 in respect of the debtor company includes a compromise or an arrangement between the debtor company and the holders of an issue referred to in paragraph (a).

63 A debtor company, or a creditor of that company, invokes the Act by way of summary application to the Court under s. 4 or s. 5 of the Act. For present purposes, s. 5 is the relevant section:

5. Where a compromise or an arrangement is proposed between a debtor company and its secured creditors or any class of them, the court may, on the application in a summary way of the company or of any such creditor or of the trustee in bankruptcy or liquidator of the company, order a meeting of the creditors or class of creditors, and, if the court so determines, of the shareholders of the company, to be summoned in such manner as the court directs.

64 Section 5 does not require that the Court direct a meeting of creditors to consider a proposed plan. The Court's power to do so is discretionary. There will no doubt be cases where no order will be made, even though the debtor company qualifies under s. 3 of the Act.

65 If the Court determines that a meeting should be called, the creditors must be placed into classes for the purpose of that meeting. The significance of this classification process is made apparent by s. 6 of the Act:

6. Where a majority in number representing three-fourths in value of the creditors, or class of creditors, as the case may be, present and voting either in person or by proxy at the meeting or meetings thereof respectively held pursuant to sections 4 and 5, or either of those sections, agree to any compromise or arrangement either as proposed or as altered or modified at the meeting or meetings, the compromise or arrangement may be sanctioned by the court, and if so sanctioned is binding

(a) on all the creditors or the class of creditors, as the case may be, and on any trustee for any such class of creditors, whether secured or unsecured, as the case may be, and on the company; and

(b) in the case of a company that has made an authorized assignment or against which a receiving order has been made under the *Bankruptcy Act* or is in the course of being wound up under the *Winding-up Act*, on the trustee in bankruptcy or liquidator and contributories of the company.

66 If the plan of reorganization is approved by the creditors as required by s. 6, it must then be presented to the Court. Once again, the Court must exercise a discretion, and determine whether it will approve the plan of reorganization. In exercising that discretion, the Court is concerned not only with whether the appropriate majority has approved the plan at a meeting held in accordance with the Act and the order of the Court, but also with whether the plan is a fair and reasonable one: *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 175 at 182-185 (S.C.), aff'd 73 C.B.R. (N.S.) 195, [1989] 3 W.W.R. 363, 34 B.C.L.R. (2d) 122 (C.A.).

67 If the Court chooses to exercise its discretion in favour of calling a meeting of creditors for the purpose of considering a plan of reorganization, the Act provides that the rights and remedies available to creditors, the debtor company, and others during the period between the making of the initial order and the consideration of the proposed plan may be suspended or otherwise controlled by the Court.

68 Section 11 gives a court wide powers to make any interim orders:

11. Notwithstanding anything in the *Bankruptcy Act* or the *Winding-up Act*, whenever an application has been made under this Act in respect of any company, the court, on the application of any person interested in the matter, may, on notice to any other person or without notice as it may see fit,

(a) make an order staying, until such time as the court may prescribe or until any further order, all proceedings taken or that might be taken in respect of the company under the *Bankruptcy Act* and the *Winding-up Act* or either of them;

(b) restrain further proceedings in any action, suit or proceeding against the company on such terms as the court sees fit; and

(c) make an order that no suit, action or other proceeding shall be proceeded with or commenced against the company except with the leave of the court and subject to such terms as the court imposes.

69 Viewed in its totality, the Act gives the Court control over the initial decision to put the reorganization plan before the creditors, the classification of creditors for the purpose of considering the plan, conduct affecting the debtor company pending consideration of that plan, and the ultimate acceptability of any plan agreed upon by the creditors. The Act envisions that the rights and remedies of individual creditors, the debtor company and others may be sacrificed, at least temporarily, in an effort to serve the greater good by arriving at some acceptable reorganization which allows the debtor company to continue in operation: *Icor Oil & Gas Co. v. Canadian Imperial Bank of Commerce* (1989), 102 A.R. 161 at p. 165 (Q.B.).

#### IV Did Hoolihan J. Err in Holding that the Debtor Companies were Entitled to Invoke the Act?

70 The appellant advances three arguments in support of its contention that Elan and Nova Inc. were not entitled to seek relief under the Act. It argues first that the debentures issued by the companies after August 27, 1990, were "shams" and did not fulfil the requirements of s. 3 of the Act. The appellant next contends that the issuing of the debentures by the companies contravened their agreements with the bank, in which they undertook not to further encumber the assets of the companies without the consent of the bank. Lastly, the appellant maintains that once the bank had appointed a receiver-manager over the affairs of the companies on August 27, 1990, the companies had no power to create further indebtedness by way of debentures or to bring an application on behalf of the companies under the Act.

##### (i) Section 3 and "Instant" Trust Deeds

71 The debentures issued in August 1990, after the bank had moved to install a receiver-manager, were issued solely and expressly for the purpose of meeting the requirements of s. 3 of the Act. Indeed, it took the companies two attempts to meet those requirements. The debentures had no commercial purpose. The transactions did, however, involve true loans in the sense that moneys were advanced and debt was created. Appropriate and valid trust deeds were also issued.

72 In my view, it is inappropriate to refer to these transactions as "shams." They are neither false nor counterfeit, but rather are exactly what they appear to be, transactions made to meet jurisdictional requirements of the Act so as to permit an application for reorganization under the Act. Such transactions are apparently well known to the commercial Bar: B. O'Leary, "A Review of the Companies' Creditors Arrangement Act" (1987) 4 Nat. Insolvency Rev. 38, at p. 39; C. Ham, " 'Instant' Trust Deeds Under the C.C.A.A." (1988) 2 Commercial Insolvency Reporter 25; G.B. Morawetz, "Emerging Trends in the Use of the Companies' Creditors Arrangement Act" (1990) Proceedings, First Annual General Meeting and Conference of the Insolvency Institute of Canada.

73 Mr. Ham writes, at pp. 25 and 30:

Consequently, some companies have recently sought to bring themselves within the ambit of the C.C.A.A. by creating 'in stan't' trust deeds, i.e., trust deeds which are created solely for the purpose of enabling them to take advantage of the C.C.A.A.

74 Applications under the Act involving the use of "instant" trust deeds have been before the Courts on a number of occasions. In no case has any court held that a company cannot gain access to the Act by creating a debt which meets the requirements of s. 3 for the express purpose of qualifying under the Act. In most cases, the use of these "instant" trust deeds has been acknowledged without comment.

75 The decision of Chief Justice Richard in *Re United Maritime Fishermen Co-op.* (1988), 67 C.B.R. (N.S.) 44, 84 N.B.R. (2d) 415, 214 A.P.R. 415 (Q.B.), varied on reconsideration (1988), 68 C.B.R. (N.S.) 170, 87 N.B.R. (2d) 333, 221 A.P.R. 333 (Q.B.), at 55-56 [67 C.B.R.], speaks directly to the use of "instant" trust deeds. The Chief Justice refused to read any words into s. 3 of the Act which would limit the availability of the Act depending on the point at which, or the purpose for which, the debenture or bond and accompanying trust deed were created. He accepted [at p. 56 C.B.R.] the debtor company's argument that the Act:

does not impose any time restraints on the creation of the conditions as set out in s. 3 of the Act, nor does it contain any prohibition against the creation of the conditions set out in s. 3 for the purpose of obtaining jurisdiction.

76 It should, however, be noted that in *Re United Maritime Fishermen Co-op.*, supra, the debt itself was not created for the purpose of qualifying under the Act. The bond and the trust deed, however, were created for that purpose. The case is therefore factually distinguishable from the case at Bar.

77 The Court of Appeal reversed the ruling of the Chief Justice ((1988), 69 C.B.R. (N.S.) 161, 51 D.L.R. (4th) 618, 88 N.B.R. (2d) 253, 224 A.P.R. 253) on the basis that the bonds required by s. 3 of the Act had not been issued when the application was made, so that on a precise reading of the words of s. 3 the company did not qualify. The Court did not go on to consider whether, had the bonds been properly issued, the company would have been entitled to invoke the Act. Hoyt J.A., for the majority, did, however, observe without comment that the trust deeds had been created specifically for the purpose of bringing an application under the Act.

78 The judgment of MacKinnon J. in *Re Stephanie's Fashions Ltd.*, unreported, Doc. No. Vancouver A893427, released January 24, 1990 (B.C. S.C.) [now reported 1 C.B.R. (3d) 248], is factually on all fours with the present case. In that case, as in this one, it was acknowledged that the sole purpose for creating the debt was to effect compliance with s. 3 of the Act. After considering the judgment of Chief Justice Richard in *Re United Maritime Fishermen Co-op.*, supra, MacKinnon J. held, at p. 251:

The reason for creating the trust deed is not for the usual purposes of securing a debt but, when one reads it, on its face, it does that. I find that it is a genuine trust deed and not a fraud, and that the petitioners have complied with s. 3 of the statute.

79 *Re Metals & Alloys Co.* (16 February 1990) is a recent example of a case in this jurisdiction in which "instant" trust deeds were successfully used to bring a company within the Act. The company issued debentures for the purpose of permitting the company to qualify under the Act, so as to provide it with an opportunity to prepare and submit a reorganization plan. The company then applied for an order, seeking, inter alia, a declaration that the debtor company was a corporation within the meaning of the Act. Houlden J.A., hearing the matter at first instance, granted the declaration request in an order dated February 16, 1990. No reasons were given. It does not appear that the company's qualifications were challenged before Houlden J.A.; however, the nature of the debentures issued and the purpose for their issue was fully disclosed in the material before him. The requirements of s. 3 of the Act are jurisdictional in nature, and the consent of the parties cannot vest a court with jurisdiction it does not have. One must conclude that Houlden J.A. was satisfied that "instant" trust deeds suffice for the purposes of s. 3 of the Act.

80 A similar conclusion is implicit in the reasons of the British Columbia Court of Appeal in *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* In that case, a debt of \$50, with an accompanying debenture and trust deed, was created specifically to enable the company to make application under the Act. The Court noted that the debt was created solely for that purpose in an effort to forestall an attempt by the bank to liquidate the assets of the debtor company. The Court went on to deal with the merits, and to dismiss an appeal from an order granting a stay pending a reorganization meeting. The Court could not have reached the merits without first concluding that the \$50 debt created by the company met the requirements of s. 3 of the Act.

81 The weight of authority is against the appellant. Counsel for the appellant attempts to counter that authority by reference to the remarks of the Minister of Justice when s. 3 was introduced as an amendment to the Act in the 1952-53 sittings of Parliament (House of Commons Debates, 1-2 Eliz. II (1952-53), vol. II, pp. 1268-1269). The interpretation of words found in a statute, by reference to speeches made in Parliament at the time legislation is introduced, has never found favour in our Courts: *Reference Re Residential Tenancies Act (Ontario)*, [1981] 1 S.C.R. 714, 123 D.L.R. (3d) 554, 37 N.R. 138, at 721 [S.C.R.], 561 [D.L.R.]. Nor, with respect to Mr. Newbould's able argument, do I find the words of the Minister of Justice at the time the present s. 3 was introduced to be particularly illuminating. He indicated that the amendment to the Act left companies with complex financial structures free to resort to the Act, but that it excluded companies which had only unsecured mercantile creditors. The Minister does not comment on the intended effect of the amendment on the myriad situations between those two extremes. This case is one such situation. These debtor companies had complex secured debt structures, but those debts were not, prior to the issuing of the debentures in August 1990, in the form contemplated by s. 3 of the Act. Like Richard C.J.Q.B. in *Re United Maritime Fishermen Co-op.*, supra, at pp. 52-53, I am not persuaded that the comments of the Minister of Justice assist in interpreting s. 3 of the Act in this situation.

82 The words of s. 3 are straightforward. They require that the debtor company have, at the time an application is made, an outstanding debenture or bond issued under a trust deed. No more is needed. Attempts to qualify those words are not only contrary to the wide reading the Act deserves, but can raise intractable problems as to what qualifications or modifications should be read into the Act. Where there is a legitimate debt which fits the criteria set out in s. 3, I see no purpose in denying a debtor company resort to the Act because the debt and the accompanying documentation was created for the specific purpose of bringing the application. It must be remembered that qualification under s. 3 entitles the debtor company to nothing more than consideration under the Act. Qualification under s. 3 does not mean that relief under the Act will be granted. The circumstances surrounding the creation of the debt needed to meet the s. 3 requirement may well have a bearing on how a court exercises its discretion at various stages of the application, but they do not alone interdict resort to the Act.

83 In holding that "instant" trust deeds can satisfy the requirements of s. 3 of the Act, I should not be taken as concluding that debentures or bonds which are truly shams, in that they do not reflect a transaction which actually occurred and do not create a real debt owed by the company, will suffice. Clearly, they will not. I do not, however, equate the two. One is a tactical device used to gain the potential advantages of the Act. The other is a fraud.

84 Nor does my conclusion that "instant" trust deeds can bring a debtor company within the Act exclude considerations of the good faith of the debtor company in seeking the protection of the Act. 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: see Lawrence J. Crozier, "Good Faith and the Companies' Creditors Arrangement Act" (1989) 15 Can. Bus. L.J. 89.

**(ii) Section 3 and the Prior Agreement with the Bank Limiting Creation of New Debt**

85 The appellant also argues that the debentures did not meet the requirements of s. 3 of the Act because they were issued in contravention of a security agreement made between the companies and the bank. Assuming that the debentures were issued in contravention of that agreement, I do not understand how that contravention affects the status of the debentures for the purposes of s. 3 of the Act. The bank may well have an action against the debtor company for issuing the debentures, and it may have remedies against the holders of the debentures if they attempted to collect on their debt or enforce their security. Neither possibility, however, negates the existence of the debentures and the related trust deeds. Section 3 does not contemplate an inquiry into the effectiveness or enforceability of the s. 3 debentures, as against other creditors, as a condition precedent to qualification under the Act. Such inquiries may play a role in a judge's determination as to what orders, if any, should be made under the Act.

*(iii) Section 3 and the Appointment of a Receiver-Manager*

86 The third argument made by the bank relies on its installation of a receiver-manager in both companies prior to the issue of the debentures. I agree with Finlayson J.A. that the placement of a receiver, either by operation of the terms of an agreement or by court order, effectively removes those formerly in control of the company from that position, and vests that control in the receiver-manager: *Alberta Treasury Branches v. Hat Development Ltd.* (1988), 71 C.B.R. (N.S.) 264, 64 Alta. L.R. (2d) 17 (Q.B.), aff'd without deciding this point (1989), 65 Alta. L.R. (2d) 374 (C.A.). I cannot, however, agree with his interpretation of the order of Saunders J. I read that order as effectively turning the receiver into a monitor with rights of access, but with no authority beyond that. The operation of the business is specifically returned to the companies. The situation created by the order of Saunders J. can usefully be compared to that which existed when the application was made in *Hat Development Ltd.* Forsyth J., at p. 268 C.B.R., states:

The receiver-manager in this case and indeed in almost all cases is charged by the court with the responsibility of managing the affairs of a corporation. It is true that it is appointed pursuant, in this case, to the existence of secured indebtedness and at the behest of a secured creditor to realize on its security and retire the indebtedness. Nonetheless, this receiver-manager was court-appointed and not by virtue of an instrument. As a court-appointed receiver it owed the obligation and the duty to the court to account from time to time and to come before the court for the purposes of having some of its decisions ratified or for receiving advice and direction. *It is empowered by the court to manage the affairs of the company and it is completely inconsistent with that function to suggest that some residual power lies in the hands of the directors of the company to create further indebtedness of the company and thus interfere, however slightly, with the receiver-manager's ability to manage.*

[Emphasis added.]

87 After the order of Saunders J., the receiver-manager in this case was not obligated to manage the companies. Indeed, it was forbidden from doing so. The creation of the "instant" trust deeds and the application under the Act did not interfere in any way with any power or authority the receiver-manager had after the order of Saunders J. was made.

88 I also find it somewhat artificial to suggest that the presence of a receiver-manager served to vitiate the orders of Hoolihan J. Unlike many applications under s. 5 of the Act, the proceedings before Hoolihan J. were not ex parte and he was fully aware of the existence of the receiver-manager, the order of Saunders J., and the arguments based on the presence of the receiver-manager. Clearly, Hoolihan J. considered it appropriate to proceed with a plan of reorganization despite the presence of the receiver-manager and the order of Saunders J. Indeed, in his initial order he provided that the order of Saunders J. "remains extant." Hoolihan J. did not, as I do not, see that order as an impediment to the application or the granting of relief under the Act. Had he considered that the receiver-manager was in control of the affairs of the company, he could have varied the order of Saunders J. to permit the applications under the Act to be made by the companies: *Hat Development Ltd.*, at pp. 268-269 C.B.R. It is clear to me that he would have done so had he felt it necessary. If the installation of the receiver-manager is to be viewed as a bar to an application under this Act, and if the orders of Hoolihan J. were otherwise appropriate, I would order that the order of Saunders J. should be varied to permit the creation of the debentures and the trust deeds and the bringing of this application by the companies. I take this power to exist by the combined effect of s. 14(2) of the Act and s. 144(1) of the *Courts of Justice Act*, 1984, S.O. 1984, c. 11.

89 In my opinion, the debentures and "instant" trust deeds created in August 1990 sufficed to bring the company within the requirements of s. 3 of the Act, even if in issuing those debentures the companies breached a prior agreement with the bank. I am also satisfied that, given the terms of the order of Saunders J., the existence of a receiver-manager installed by the bank did not preclude the application under s. 3 of the Act.

**V Did Hoolihan J. Err in Exercising his Discretion in Favour of Directing that a Creditors' Meeting be Held to Consider the Proposed Plan of Reorganization?**

90 As indicated earlier, the Act provides a number of points at which the Court must exercise its discretion. I am concerned with the initial exercise of discretion contemplated by s. 5 of the Act, by which the Court may order a meeting of creditors for purposes of considering a plan of reorganization. Hoolihan J. exercised that discretion in favour of the debtor companies. The factors relevant to the exercise of that discretion are as variable as the fact situations which may give rise to the application. Finlayson J.A. has concentrated on one such factor, the chance that the plan, if put before a properly constituted meeting of the creditors, could gain the required approval. I agree that the feasibility of the plan is a relevant and significant factor to be considered in determining whether to order a meeting of creditors: S.E. Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act," at pp. 594-595. I would not, however, impose a heavy burden on the debtor company to establish the likelihood of ultimate success from the outset. As the Act will often be the last refuge for failing companies, it is to be expected that many of the proposed plans of reorganization will involve variables and contingencies which will make the plan's ultimate acceptability to the creditors and the Court very uncertain at the time the initial application is made.

91 On the facts before Hoolihan J., there were several factors which supported the exercise of his discretion in favour of directing a meeting of the creditors. These included the apparent support of two of the three substantial secured creditors, the companies' continued operation, and the prospect (disputed by the bank) that the companies' fortunes would take a turn for the better in the near future, the companies' ongoing efforts — that eventually met with some success — to find alternate financing, and the number of people depending on the operation of the company for their livelihood. There were also a number of factors pointing in the other direction, the most significant of which was the likelihood that a plan of reorganization acceptable to the bank could not be developed.

92 I see the situation which presented itself to Hoolihan J. as capable of a relatively straightforward risk-benefit analysis. If the s. 5 order had been refused by Hoolihan J., it was virtually certain that the operation of the companies would have ceased immediately. There would have been immediate economic and social damage to those who worked at the plants, and those who depended on those who worked at the plants for their well-being. This kind of damage cannot be ignored, especially when it occurs in small communities like those in which these plants are located. A refusal to grant the application would also have put the investments of the various creditors, with the exception of the bank, at substantial risk. Finally, there would have been obvious financial damage to the owner of the companies. Balanced against these costs inherent in refusing the order would be the benefit to the bank, which would then have been in a position to realize on its security in accordance with its agreements with the companies.

93 The granting of the s. 5 order was not without its costs. It has denied the bank the rights it had bargained for as part of its agreement to lend substantial amounts of money to the companies. Further, according to the bank, the order has put the bank at risk of having its loans become undersecured because of the diminishing value of the accounts receivable and inventory which it holds as security and because of the ever-increasing size of the companies' debt to the bank. These costs must be measured against the potential benefit to all concerned if a successful plan of reorganization could be developed and implemented.

94 As I see it, the key to this analysis rests in the measurement of the risk to the bank inherent in the granting of the s. 5 order. If there was a real risk that the loan made by the bank would become undersecured during the operative period of the s. 5 order, I would be inclined to hold that the bank should not have that risk forced on it by the Court. However, I am unable to see that the bank is in any real jeopardy. The value of the security held by the bank appears to be well in excess of the size of its loan on the initial application. In his affidavit, Mr. Gibbons of Coopers & Lybrand asserted that the companies had overstated their cash flow projections, that the value of the inventory could diminish if customers of the companies looked to alternate sources for their product, and that the value of the accounts receivable could decrease if customers began to claim set-offs against those receivables. On the record before me, these appear to be no more than speculative possibilities. The bank has had access to all of the companies' financial data on an ongoing basis since the order of Hoolihan J. was made almost 2 months ago. Nothing was placed before this Court to suggest that any of the possibilities described above had come to pass.

95 Even allowing for some overestimation by the companies of the value of the security held by the bank, it would appear that the bank holds security valued at approximately \$4 million for a loan that was, as of the hearing of this appeal, about \$2.3 million. The order of Hoolihan J. was to terminate no later than November 14, 1990. I am not satisfied that the bank ran any

real risk of having the amount of the loan exceed the value of the security by that date. It is also worth noting that the order under appeal provided that any party could apply to terminate the order at any point prior to November 14. This provision provided further protection for the bank in the event that it wished to make the case that its loan was at risk because of the deteriorating value of its security.

96 Even though the chances of a successful reorganization were not good, I am satisfied that the benefits flowing from the making of the s. 5 order exceeded the risk inherent in that order. In my view, Hoolihan J. properly exercised his discretion in directing that a meeting of creditors should be held pursuant to s. 5 of the Act.

**VI Did Hoolihan J. Err in Directing that the Bank and RoyNat Inc. Should be Placed in the Same Class for the Purposes of the Act?**

97 I agree with Finlayson J.A. that the bank and RoyNat Inc., the two principal creditors, should not have been placed in the same class of secured creditors for the purposes of ss. 5 and 6 of the Act. Their interests are not only different, they are opposed. The classification scheme created by Hoolihan J. effectively denied the bank any control over any plan of reorganization.

98 To accord with the principles found in the cases cited by Finlayson J.A., the secured creditors should have been grouped as follows:

— Class 1 — The City of Chatham and the Village of Glencoe

— Class 2 — The Bank of Nova Scotia

— Class 3 — RoyNat Inc., Ontario Development Corporation, and those holding debentures issued by the company on August 29 and 31, 1990.

**VII Did Hoolihan J. Err in Making the Interim Orders He Made?**

99 Hoolihan J. made a number of orders designed to control the conduct of all of the parties, pending the creditors' meeting and the placing of a plan of reorganization before the Court. The first order was made on September 11, 1990, and was to expire on or before October 24, 1990. Subsequent orders varied the terms of the initial order somewhat, and extended its effective date until November 14, 1990.

100 These orders imposed the following conditions pending the meeting:

(a) all proceedings with respect to the debtor companies should be stayed, including any action by the bank to realize on its security;

(b) the bank could not reduce its loan by applying incoming receipts to those debts;

(c) the bank was to be the sole banker for the companies;

(d) the companies could carry on business in the normal course, subject to certain very specific restrictions;

(e) a licensed trustee was to be appointed to monitor the business operations of the companies and to report to the creditors on a regular basis; and

(f) any party could apply to terminate the interim orders, and the orders would be terminated automatically if the companies defaulted on any of the obligations imposed on them by the interim orders.

101 The orders placed significant restrictions on the bank for a 2-month period, but balanced those restrictions with provisions limiting the debtor companies' activities, and giving the bank ongoing access to up-to-date financial information concerning the companies. The bank was also at liberty to return to the Court to request any variation in the interim orders which changes in financial circumstances might merit.

102 These orders were made under the wide authority granted to the court by s. 11 of the Act. L.W. Houlden and C.H. Morawetz, in *Bankruptcy Law of Canada*, 3d ed. (Toronto: Carswell, 1989), at pp. 2-102 to 2-103, describe the purpose of the section:

The legislation is 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. This aim is facilitated by s. 11 of the Act, which enables the court to restrain further proceedings in any action, suit or proceeding against the company upon such terms as the court sees fit.

103 A similar sentiment appears in *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* Gibbs J.A., in discussing the scope of s. 11, said at p. 7 [unreported, pp. 88-89 B.C.L.R.]:

When a company has recourse to the C.C.A.A. the court is called upon to play a kind of supervisory role to preserve the status quo and to move the process along to the point where a compromise or arrangement is approved or it is evident that the attempt is doomed to failure. Obviously time is critical. Equally obviously, if the attempt at compromise or arrangement is to have any prospect of success, there must be a means of holding the creditors at bay, hence the powers vested in the court under s. 11.

104 Similar views of the scope of the power to make interim orders covering the period when reorganization is being attempted are found in *Meridian Developments Inc. v. Toronto-Dominion Bank*; *Meridian Developments Inc. v. Nu-West Ltd.*, 52 C.B.R. (N.S.) 109, [1984] 5 W.W.R. 215, 32 Alta. L.R. (2d) 150, 11 D.L.R. (4th) 576, 53 A.R. 39 (Q.B.) at 114-118 [C.B.R.]; *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 1, 63 Alta. L.R. (2d) 361, 92 A.R. 81 (Q.B.) at 12-15 [C.B.R.]; *Quintette Coal Ltd. v. Nippon Steel Corp.*, an unreported judgment of Thackray J., released June 18, 1990 [since reported (1990), 47 B.C.L.R. (2d) 193 (S.C.)], at pp. 5-9 [pp. 196-198 B.C.L.R.]; and B. O'Leary, "A Review of the Companies' Creditors Arrangement Act," at p. 41.

105 The interim orders made by Hoolihan J. are all within the wide authority created by s. 11 of the Act. The orders were crafted to give the company the opportunity to continue in operation, pending its attempt to reorganize, while at the same time providing safeguards to the creditors, including the bank, during that same period. I find no error in the interim relief granted by Hoolihan J.

### VIII Conclusion

106 In the result, I would allow the appeal in part, vacate the order of Hoolihan J. of October 18, 1990, insofar as it purports to settle the class of creditors for the purpose of the Act, and I would substitute an order establishing the three classes referred to in Part VI of these reasons. I would not disturb any of the other orders made by Hoolihan J.

*Appeal allowed.*



# **TAB 2**

1993 CarswellOnt 241  
Ontario Court of Justice (General Division), In Bankruptcy

Armbro Enterprises Inc., Re

1993 CarswellOnt 241, [1993] O.J. No. 4482, 22 C.B.R. (3d) 80

**Re ARMBRO ENTERPRISES INC.**

R.A. Blair J.

Judgment: November 1, 1993

Counsel: *Geoffrey B. Morawetz* and *Craig J. Hill*, for applicants.

*Irving Marks*, for opposing creditor.

*Michael S.F. Watson* and *Lilly A. Wong*, for Royal Bank of Canada.

Subject: Corporate and Commercial; Insolvency

**Table of Authorities**

**Cases considered:**

*Ayer's Ltd., Re* (December 9, 1991), (Nfld. T.D.) [unreported] — referred to

*Dairy Corp. of Canada Ltd., Re*, [1934] O.R. 436, [1934] 3 D.L.R. 347 (S.C.) — referred to

*Grafton-Fraser Inc. v. Canadian Imperial Bank of Commerce* (1992), 11 C.B.R. (3d) 161, 90 D.L.R. (4th) 285 (Ont. Gen. Div.) — considered

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

*Inducon Development Corp., Re* (1992), 8 C.B.R. (3d) 306 (Ont. Gen. Div.) — referred to

*Keddy Motor Inns Ltd., Re* (1992), 13 C.B.R. (3d) 245, 90 D.L.R. (4th) 175, 6 B.L.R. (2d) 116, 110 N.S.R. (2d) 246, 299 A.P.R. 246 (C.A.) — referred to

*Northland Properties Ltd., Re*, (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada*) 73 C.B.R. (N.S.) 195, [1989] 3 W.W.R. 363, 34 B.C.L.R. (2d) 122 (C.A.) — referred to

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

*Quintette Coal Ltd., Re* (1992), 13 C.B.R. (3d) 146, 68 B.C.L.R. (2d) 219 (S.C.) — referred to

*Silcorp Ltd. v. Canadian Imperial Bank of Commerce* (June 26, 1992), Doc. B152/92 (Ont. Gen. Div.) — referred to

*Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 8 C.B.R. (3d) 312, 86 D.L.R. (4th) 621 (Ont. Gen. Div.) — *referred to*

*Woodward's Ltd., Re* (1993), 20 C.B.R. (3d) 74, 84 B.C.L.R. (2d) 206 (S.C.) — *referred to*

**Statutes considered:**

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

s. 6

Motion for order sanctioning and approving plan of compromise and arrangement.

**R.A. Blair J. (Endorsement):**

1 This is a motion by the Applicants for an Order pursuant to s. 6 of the CCAA for sanction and approval of the plan of compromise and arrangement filed by the Applicants on September 24, 1993, as amended. On that date, I made an Order granting the Applicants the protection of a stay of proceedings under the Act, in order to permit them to restructure their operations and develop a plan of compromise or arrangement for presentation to their Creditors.

2 The Plan has now been negotiated and put to meetings of the classes of creditors established under the Sept. 24th Order. With certain amendments it has been voted on and approved by creditors of sufficient numbers and in sufficient value amounts in each class to meet the requirements of s. 6 of the Act. One creditor, a landlord — 803774 Ontario Limited — opposes the sanctioning and approval of the Plan.

3 In considering whether to sanction a Plan of this sort, the Court must have regard to the following criteria, namely:

1) whether there has been complete compliance with all statutory requirements;

2) whether any material filings or procedures have been done or are purported to have been done otherwise than as authorized by the CCAA; and,

3) whether the proposed Plan is fair and reasonable.

See: *Re Dairy Corp. of Canada*, [1934] O.R. 436 (S.C.); *Re Quintette Coal Ltd.* (1992), 13 C.B.R. (3d) 146 (B.C. S.C.).

4 I am satisfied that this Plan meets the foregoing criteria. The position put forward on behalf of the opposing creditor needs to be addressed, however.

5 As I apprehend the Landlord's position, it is essentially twofold, namely

a) that the landlord ought to have been placed in a separate class of creditors, and ought not to have been grouped with the unsecured creditors, generally; and,

b) that the Plan purports to terminate the tenancy, and there is no power in the Court under the CCAA to sanction a Plan which purports to do so.

6 Counsel for the opposing creditor advanced an additional argument under the "fairness" criterion to the effect that the "new common shares" to be issued under the Plan were not evenly allocated amongst the unsecured creditors, and that Royal Bank of Canada ("RBC") — the major creditor, and also a secured creditor for part of its claim — was being favoured. I am not persuaded that there is a sufficient tilt in the allocation of these new common shares in favour of RBC to justify the Court in interfering with the business decision made by the creditor classes in approving the proposed Plan, as they have done. RBC's

co-operation is a *sine qua non* for the Plan, or any Plan, to work, and it is the only creditor continuing to advance funds to the Applicants to finance the proposed re-organization. It does not seem unfair or unreasonable to me that it should receive some additional incentive to support the Plan.

### Classification

7 In the circumstances of this case, it is not, in my view, inappropriate to have classified the landlord in the same class of creditors as the unsecured creditors. The landlord's claim has two bases: it is a judgment creditor for approximately \$1 million as a result of a default judgment obtained against Armbro Inc. for arrears of rent; and it has a contingent claim for unliquidated damages arising out of the termination of the lease. A landlord has a right of distraint under a lease, but I am told that this right is academic for present purposes. Thus, it seems to me that 803774 Ontario Limited is not in a materially different position than other unsecured creditors who have either a claim for liquidated damages or an unliquidated claim for damages which is contingent or which has crystallized.

8 There is, in my view, a sufficient community of interest and rights between the Landlord here objecting and the other unsecured creditors to warrant their inclusion in the same class of creditors and to avoid an unnecessary fragmentation of creditors into an unwieldy patchwork or into a patchwork which may — as it would here — give one creditor an undue advantage and influence over the negotiations. The Landlord's claim is sizeable — between \$3.5 million and \$4.5 million, depending on whose version prevails — but it is nonetheless relatively insignificant in an overall blanket of approximately \$130 million in indebtedness. See: *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 8 C.B.R. (3d) 312 (Ont. Gen. Div.); *Re Northland Properties Ltd.* (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada*) (1989), 73 C.B.R. (N.S.) 195 (B.C. C.A.); *Re Woodward's Ltd.* (1993), 20 C.B.R. (3d) 74 (B.C. S.C.).

9 There is another factor to be considered at this juncture, as well. The Applicants have been assiduous in their efforts to negotiate in good faith and in advance of their Application with all of their creditors — and the opposing creditor falls within this category. The Landlord had notice of the Application which was returnable on Sept. 24 and of the Order which was sought, including the classification of creditors into three groups: Secured, Unsecured, and RBC. It did not attend and oppose or make submissions at that time regarding its classification with the unsecured creditors. It did not avail itself of the "come back" clause within the Sept. 24th Order, to raise the issue before the creditor's meetings. It did not appeal. In my opinion, one of those avenues should have been followed. To await the sanctioning hearing is too late, unless it can be said — which it cannot, in this case — that the classification has given rise to a "substantial injustice": *Re Keddy Motor Inns Ltd.* (1992), 13 C.B.R. (3d) 245 (N.S. C.A.).

### Termination of Leases within CCAA Proceedings

10 This brings me to the second major issue raised on behalf of the objecting creditor, namely that the Court does not have the power under the CCAA to sanction or approve a Plan which terminates leases as part of its arrangement.

11 I do not accept this submission.

12 The CCAA is broad, remedial legislation, designed to facilitate a re-organization of a debtor company's affairs in a way that is in the interests of the company, its creditors and the public. It is to be liberally construed. See: *Nova Metal Products Inc. v. Comiskey (Trustee of)* (sub nom. *Elan Corp. v. Comiskey*) (1990), 1 O.R. (3d) 289 (C.A.); *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 51 B.C.L.R. (2d) 84 (C.A.).

13 It is true that there is no specific provision in the CCAA which states openly that the Court has the power to sanction the termination of leases. This, I think, is what Houlden J.A. must have been contemplating when he noted, in *Grafton-Fraser Inc. v. Canadian Imperial Bank of Commerce* (1992), 90 D.L.R. (4th) 285 (Ont. Gen. Div.) [at p. 287], that "[i]t is difficult to make a plan of compromise for such a company (a chain of retail clothing stores in rented premises) under the C.C.A.A., because there is no way ... to terminate leases and to limit the amount of the claims of landlords." Section 6 of the Act is discretionary, however, and provides that "the compromise or arrangement *may be sanctioned* by the court" — assuming the statutory requirements respecting voting have been met, as they have here. There are a number of examples where the Courts

have granted their approval to arrangements which involve the repudiation, surrender and ultimate termination of leases — including, incidentally, *Re Grafton-Fraser* itself in its ultimate disposition. See also: *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia*, *supra*; *Re Ayer's Ltd.* (unreported, December 9, 1991, Nfld. T.D.); *Re Inducon Development Corp.* (1992), 8 C.B.R. (3d) 306 (Ont. Gen. Div.); *Silcorp Ltd. v. Canadian Imperial Bank of Commerce* (June 26, 1992), Doc. B152/92 (Ont. Gen. Div.) (unreported). I see nothing in principle which precludes a Court from interfering with the rights of a landlord under a lease, in the CCAA context, any more than from interfering with the rights of a secured creditor under a security document. Both may be sanctioned when the exigencies of the particular re-organization justify such balancing of the prejudices.

14 In this case the sanction and approval of the Court is warranted, for the reasons I have articulated, and an Order will issue to that effect in terms of the draft Order filed on which I have placed my fiat.

15 In addition, an Order will go directing the Registrar of Deeds to discharge and vacate the registration of certain Instruments described in a companion draft Order on which I have placed my fiat, and directing the Sheriff to withdraw certain Writs of Seizure and Sale also described therein. This Order is to issue immediately upon the filing of an Affidavit on behalf of the Applicants deposing that the conditions to implementation referred to in Article 5.3 of the Plan have been satisfied and that the Applicants are proceeding to implement the Plan. The Court office shall issue, enter and return this Order to the Applicants on the day on which the Order is presented for signing and entry.

*Motion allowed.*

# TAB 3

2000 CarswellAlta 623  
Alberta Court of Queen's Bench

Canadian Airlines Corp., Re

2000 CarswellAlta 623, [2000] A.W.L.D. 642, [2000] A.J. No. 1693, 19 C.B.R. (4th) 12

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

In the Matter of the Business Corporations Act (Alberta) S.A. 1981, c. B-15, As Amended, Section 185

In the Matter of Canadian Airlines Corporation and Canadian Airlines International Ltd.

Paperny J.

Judgment: May 12, 2000 \*  
Docket: Calgary 0001-05071

Proceedings: refused leave to appeal *Canadian Airlines Corp., Re*, 2000 ABCA 149, 80 Alta. L.R. (3d) 213 (Alta. C.A. [In Chambers])

Counsel: *A.L. Friend, Q.C., H.M. Kay, Q.C., and R.B. Low, Q.C.*, for Canadian Airlines.

*V.P. Lalonde and Ms M. Lalonde*, for AMR Corporation.

*S. Dunphy*, for Air Canada.

*P.T. McCarthy, Q.C.*, for PricewaterhouseCoopers.

*D. Nishimura*, for Resurgence Asset Management LLC.

*E. Halt*, for Claims Officer.

*A.J. McConnell*, for Bank of Nova Scotia Trust Company of New York and Montreal Trust Co. of Canada.

Subject: Corporate and Commercial; Insolvency

**Table of Authorities**

**Cases considered by Paperny J.:**

*Fairview Industries Ltd., Re* (1991), 11 C.B.R. (3d) 71, (sub nom. *Fairview Industries Ltd., Re (No. 3)*) 109 N.S.R. (2d) 32, (sub nom. *Fairview Industries Ltd., Re (No. 3)*) 297 A.P.R. 32 (N.S. T.D.) — considered

*Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 64 Alta. L.R. (2d) 139, [1989] 2 W.W.R. 566, 72 C.B.R. (N.S.) 20, 72 C.R. (N.S.) 20 (Alta. Q.B.) — considered

*Northland Properties Ltd., Re* (1988), 31 B.C.L.R. (2d) 35, 73 C.B.R. (N.S.) 166 (B.C. S.C.) — considered

*Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada*, 34 B.C.L.R. (2d) 122, 73 C.B.R. (N.S.) 195, [1989] 3 W.W.R. 363 (B.C. C.A.) — considered

*NsC Diesel Power Inc., Re* (1990), 79 C.B.R. (N.S.) 1, 97 N.S.R. (2d) 295, 258 A.P.R. 295 (N.S. T.D.) — considered

*Savage v. Amoco Acquisition Co.* (1988), 59 Alta. L.R. (2d) 260, 68 C.B.R. (N.S.) 154, 40 B.L.R. 188, (sub nom. *Amoco Acquisition Co. v. Savage*) 87 A.R. 321 (Alta. C.A.) — considered

*Sklar-Pepler Furniture Corp. v. Bank of Nova Scotia* (1991), 8 C.B.R. (3d) 312, 86 D.L.R. (4th) 621 (Ont. Gen. Div.) — considered

*Sovereign Life Assurance Co. v. Dodd* (1891), [1891-4] All E.R. Rep. 246, [1892] 2 Q.B. 573 (Eng. C.A.) — applied

*Wellington Building Corp., Re*, 16 C.B.R. 48, [1934] O.R. 653, [1934] 4 D.L.R. 626 (Ont. S.C.) — distinguished

*Woodward's Ltd., Re* (1993), 20 C.B.R. (3d) 74, 84 B.C.L.R. (2d) 206 (B.C. S.C.) — considered

**Statutes considered:**

*Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3

Generally — referred to

*Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36

Generally — considered

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

s. 5.1(3) [en. 1997, c. 12, s. 122] — considered

APPLICATION by unsecured creditors of corporation for order that unsecured claims held by Air Canada should be placed in separate class from other unsecured creditors, and for order striking portion of reorganization plan.

**Paperny J. (orally):**

1 Resurgence Asset Management LLC "Resurgence" appeared on behalf of holders of approximately 60 percent of the unsecured notes issued by Canadian Airlines Corporation in the total amount of \$100 million U.S. These unsecured note holders are proposed to be classified as unsecured creditors in the plan that is the subject of these proceedings.

2 Resurgence applied for the following relief:

1. An order lifting the stay of proceedings against Canadian Airlines Corporation and Canadian Airlines International Ltd. (respectively "CAC" and "CAIL" and collectively called "Canadian") to permit Resurgence to commence and proceed with an oppression action against Canadian, Air Canada and others.

2. Further, and in the alternative, Resurgence sought the same relief described in item one above in the context of the C.C.A.A. proceedings.

3. An order that any and all unsecured claims held or controlled, directly or indirectly by Air Canada shall be placed in a separate class and either not allowed to be voted at all, or, alternatively, allowed to be voted in separate class from all other affected unsecured claims.

4. An order that there be a separation in class between creditors of CAC and CAIL

5. An order striking Section 6.2(2)(ii) of the plan on the basis that it is contrary to the C.C.A.A.

3 Resurgence abandoned the application described in item 1 above, and the application in item 2 was addressed in my ruling given May 8, 2000, in these proceedings.

**Standing**



4 Prior to dealing with the remaining issues of classification, voting and Section 6.2(2)(ii) of the plan, the issue of standing needs to be addressed. This was a matter of some debate, largely in the context of the first two applications. Canadian argued that Resurgence was only a fund manager and did not hold the unsecured notes, beneficially or otherwise, and, accordingly, did not have standing to make any of the applications. The evidence establishes that Resurgence is not the legal owner and the evidence of beneficial ownership is equivocal.

5 Canadian has not raised this issue on any of the previous occasions on which Resurgence has been before the court in these proceedings. There has been a consent order involving Resurgence and Canadian.

6 In my view, it is not appropriate now for Canadian to suggest that Resurgence does not represent the interests of the holders of 60 percent of the unsecured notes and essentially seek a declaration that Resurgence is a stranger to these proceedings.

7 I am not prepared to dismiss the applications of Resurgence on classification, voting and amending the plan out of hand on the basis of standing.

8 Resurgence was also supported in these applications by the senior secured note holders. For the purposes of these applications, I accept that Resurgence is representing the interests of 60 percent of the unsecured note holders.

#### **Classification of Air Canada's Unsecured Claim**

9 By my April 14, 2000 order in these proceedings, I approved transactions involving CAIL, a large number of aircraft lessors and Air Canada, which achieved approximately \$200 million worth of concessions for CAIL. In exchange for granting the concession, each creditor received a guarantee from Air Canada and the assurance that the creditor would immediately cease to be affected by the C.C.A.A. proceedings.

10 These concessions or deficiency claims were quantified and reflected in promissory notes which were assigned to Air Canada in exchange for its guarantee of the aircraft leases. The monitor approved the method of quantifying these claims and recognized the value of the concessions to Canadian. In that order I reserved the issue of classification and voting to be determined at some later date. The plan provides for two classes of creditors, secured and unsecured.

11 The unsecured class is composed of a number of types of unsecured claims, including aircraft financings, executory contracts, unsecured notes, litigation claims, real estate leases and the deficiencies, if any, of the senior secured note holders.

12 In one portion of the application, Resurgence seeks to have Air Canada vote the promissory notes in separate class and relied on several factors to distinguish the claims of other Affected, Unsecured Creditors from Air Canada's unsecured claim, including the following:

1. The Air Canada appointed board caused Canadian to enter into these C.C.A.A. proceedings under which Air Canada stands to gain substantial benefits in its own operations and in the merged operations and ownership contemplated after the compromise of debts under the plan.
2. Air Canada is providing the fund of money to be distributed to the Affected Unsecured Creditors and will, therefore, end up paying itself a portion of that money if it is included in the Affected Unsecured Creditors' class and permitted to vote.
3. Air Canada gave no real consideration in acquiring the deficiency claims and manufactured them only to secure a 'yes' vote.

13 Air Canada and Canadian argue that the legal right associated with Air Canada's unsecured promissory notes and with the other Affected, Unsecured Claims, are the same and that the matters raised by Resurgence, as relating to classification, are really matters of fairness, more appropriately dealt with at the fairness hearing. Air Canada and Canadian emphasized that classification must be determined according to the rights of the creditors, not their personalities.

14 The starting point in determining classification is the statute under which the parties are operating and from which the court obtains its jurisdiction. The primary purpose of the C.C.A.A. is to facilitate the re-organization of insolvent companies, and this goal must be given proper consideration at every stage of the C.C.A.A. process, including classification of claims; see, for example, *Norcen Energy Resources Ltd. v. Oakwood Petroleum Ltd.* (1988), 72 C.B.R. (N.S.) 20 (Alta. Q.B.)

15 Beyond identifying secured and unsecured classes, the C.C.A.A. does not offer any guidance to the classification of claims. The process, instead, has developed in the case law.

16 A frequently cited description of the method of classification of creditors for the purposes of voting on a plan, under the C.C.A.A., is *Sovereign Life Assurance Co. v. Dodd* (1891), [1892] 2 Q.B. 573 (Eng. C.A.).

17 At page 583 (Q.B.), Bowen, L.J. stated:

The word 'class' is vague and to find out what is meant by it, we must look at the scope of the section which is a section enabling the court to order a meeting of a class of creditors to be called. It seems plain that we must give such a meaning to the term 'class' as will prevent the section being so worked as to result in confiscation and injustice, and that it must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with the view to their common interest.

This test has been described as the "commonality of interest" test. All counsel agree that this is the test to apply in classification of claims under the C.C.A.A. However, there is a dispute on the types of interests that are to be considered in determining commonality.

18 Generally, the cases hold that classification is a fact-driven determination unique to the circumstances of every case, upon which the court should be loathe to impose rules for universal application, particularly in light of the flexible and remedial jurisdiction involved; see, for example, *Re Fairview Industries Ltd.* (1991), 11 C.B.R. (3d) 71 (N.S. T.D.)

19 The majority of the cases presented to me, held that commonality of the interest is to be determined by the rights the creditor has vis-a-vis the debtor. Courts have also found it helpful to consider the context of the proposed plan and treatment of creditors under a liquidation scenario. In the absence of bad faith, motivation for supporting or rejecting a plan is not a classification issue in the authorities.

20 In considering what interests are included in the commonality of interest test, Forsyth J., in *Norcen Energy Resources Ltd.* (Supra) had to determine whether all the secured creditors of the company ought to be included in one class. The creditors all had first-charge security and the same method of valuation was applied to each secured claim in order to determine security value under the plan. The distinguishing features were submitted to be based on the difference in the security held, including ease of marketability and realization potential. In holding that a separate class was not necessary, Forsyth J., said at page 29:

Different security positioning and changing security values are a fact of life in the world of secured financing. To accept this argument would again result in a different class of creditor for each secured lender.

In doing so, Forsyth J. rejected the "identity of the interest" approach in which creditors in a class must have identical interests.

21 It was also submitted in *Norcen Energy Resources Ltd.* that since the purchaser under the plan had made financing arrangements with the Royal Bank, the bank had an interest not shared by the other secured creditors. Forsyth J., held that in the absence of any allegation that the Royal Bank was not acting bona fide in considering the benefit of the plan, the secured creditors could not be heard to criticize the presence of the Royal Bank in their class.

22 Forsyth J., also emphasized in *Norcen Energy Resources Ltd.* that the commonality test cannot be considered without also considering the underlying purpose of the C.C.A.A., which is to facilitate reorganizations of insolvent companies. To that end, the court should not approve a classification scheme which would make a reorganization difficult, if not impossible, to

achieve. At the same time, while the C.C.A.A. grants the court the authority to alter the legal rights of parties other than the debtor company without their consent, the court will not permit a confiscation of rights or an injustice to occur.

23 The *Norcen Energy Resources Ltd.* approach was specifically adopted in British Columbia in *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada* (1989), 73 C.B.R. (N.S.) 195 (B.C. C.A.), where it was held that various mortgagees with different mortgages against different properties were included in the same class.

24 In *Savage v. Amoco Acquisition Co.* (1988), 68 C.B.R. (N.S.) 154 (Alta. C.A.) the Alberta Court of Appeal rejected the argument that shareholders who have private arrangements with the applicant or who are brokers or officers or otherwise in a special position vis-a-vis the debtor company, should be put in a special category.

25 At page 158 the court stated in regard to the test applied to classification:

We do not think that this rule justifies the division of shareholders into separate classes on the basis of their presumed prior commitment to a point of view. The state of facts, common to all, is that they are all offered this proposal, face as an alternative the break-up of this apparently insolvent company and hold shares that appear to be worthless on break-up. In any event, any attempt to divide them on the basis suggested, would be futile. One would have as many groups as there are shareholders.

The commonality of interest test was addressed by the British Columbia Supreme Court in *Re Woodward's Ltd.* (1993), 84 B.C.L.R. (2d) 206 (B.C. S.C.). Tysoe J. rejected the identity of interest approach and held that it was permissible to include creditors with different legal rights in the same class, so long as their legal rights were not so dissimilar that it was still possible for them to vote with a common interest.

26 Tysoe J. went on to find that legal interests should be considered in the context of the proposed plan and that it was also necessary to examine the legal rights of creditors in the context of the possible failure of the plan.

27 In other words, "interest" for the purpose of classification does not include the personality or identity of the creditor, and the interests it may have in the broader commercial sphere that might influence its decision or predispose it to vote in a particular way; rather, "interest" involves the entitlement of the debt holder viewed within the context of the provisions of the proposed plan. In that regard, see *Woodward's Ltd.* at page 212.

28 In *Fairview Industries Ltd.*, the court held that in classification there need not be a commonality of interest of debts involved, so long as the legal interests were the same. Justice Glube (as she then was) stated that it did not automatically follow that those with different commercial interests, for example, those with security on "quick" assets, are necessarily in conflict with those with security on "fixed" assets. She stated that just saying there is a conflict is insufficient to warrant separation.

29 In *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 86 D.L.R. (4th) 621 (Ont. Gen. Div.) at 626 like *Norcen Energy Resources Ltd.*, the "identity of interests" approach was rejected. The court preserved a class of creditors which included debenture holders, terminated employees, realty lessors and equipment lessors.

30 Borins J. held that not every difference in the nature of the debt warrants a separate class and that in placing a broad and purposive interpretation on the C.C.A.A., the court should "take care to resist approaches which would potentially jeopardize a potentially viable plan." He observed that "excessive fragmentation is counterproductive to the legislative intent to facilitate corporate reorganization" and that it would be "improper to create a special class simply for the benefit of an opposing creditor which would give that creditor the potential to exercise an unwarranted degree of power." (p. 627).

31 In summary, the cases establish the following principles applicable to assessing commonality of interest:

1. Commonality of interest should be viewed on the basis of the non-fragmentation test, not on an identity of interest test;
2. The interests to be considered are the legal interests the creditor holds qua creditor in relationship to the debtor company, prior to and under the plan as well as on liquidation;

3. The commonality of these interests are to be viewed purposively, bearing in mind the object of the C.C.A.A., namely to facilitate reorganizations if at all possible;
4. In placing a broad and purposive interpretation on the C.C.A.A., the court should be careful to resist classification approaches which would potentially jeopardize potentially viable plans.
5. Absent bad faith, the motivations of the creditors to approve or disapprove are irrelevant.
6. The requirement of creditors being able to consult together means being able to assess their legal entitlement *as creditors* before or after the plan in a similar manner.

32 With this background, I will make several observations relating to the reasons asserted by Resurgence that distinguish Air Canada from the rest of the Affected Unsecured Creditors.

33 The first two reasons given relate to interests of Air Canada extraneous to its legal rights as a unsecured creditor. The third reason relates largely to the further assertion that Air Canada should not be allowed to vote at all. The matter of voting is addressed more specifically later in these reasons.

34 The factors described by Resurgence distinguish between Air Canada and other unsecured creditors relate largely to the fact that Air Canada is the assignee of the unsecured debt. In my view, that approach is to be discouraged at the classification stage. To require the court to consider who holds the claim, as distinct from what they hold, at that point would be untenable. I note that Mr. Edwards recognizes in 1947 in his article, "*Reorganizations under the Companies Creditors Arrangement Act*", (1947), 25 Cdn. Bar Rev. 587, and observe this concern is heightened in the current commercial reality of debt trading.

35 Resurgence also asserted that a court should avoid placing creditors with a potential conflict of interest in the same class and relies on *Re NsC Diesel Power Inc.* (1990), 79 C.B.R. (N.S.) 1 (N.S. T.D.), a case in which the court considered a potential conflict of interest between subcontractors and direct contractors. To the extent this case can be seen as decided on the basis of the distinct legal rights of the creditors, I agree with the result. To the extent that the case determined that a class could be separated based on a conflict of interest not based on legal right, I disagree. In my view, this would be the sort of issue the court should consider at the fairness hearing.

36 Resurgence also relied on the decisions of the British Columbia Supreme Court in *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 166 (B.C. S.C.), a case decided prior to *Norcen Energy Resources Ltd.* In that case the court held that a subsidiary wholly owned by Northland Bank was incorporated to purchase certain bonds from Northland in exchange for preferred shares and was not entitled to vote. The court found that would be tantamount to Northland Bank voting in its own reorganization and relied on *Re Wellington Building Corp.*, [1934] O.R. 653, 16 C.B.R. 48 (Ont. S.C.) In this regard, I would note that the passage relied upon at page 5 in that case, in *Wellington Building Corp* (Supra) dealt with whether the scheme, as proposed, was unfair.

37 All creditors proposed to be included in the class of Affected, Unsecured Creditors, are all unsecured and are treated the same under the plan. All would be treated similarly under the BIA. The plan provides that they will receive 12 cents on the dollar. The Monitor opined that in liquidation unsecured creditors would realize a maximum of 3 cents on the dollar. Their legal interests are essentially the same. Issue is taken with the presence of Air Canada, supporter and funder of the plan, also having taken an assignment of a substantial, unsecured claim. However, absent bad faith, who creditors are is not relevant. Air Canada's mere presence in the class does not in and of itself constitute bad faith.

38 Further, all of these methods of distinguishing Air Canada's unsecured claim at their core are fundamentally issues of fairness which will be addressed by the Court at the fairness hearing on June 5, 2000. I am prepared to give serious consideration to these matters at that time and direct that there be a separate tabulation of the votes cast by Air Canada arising from any assignments of promissory notes they have taken, so that there is an evidentiary record to assist me in assessing the fairness of the vote when and if I am called upon to sanction the plan. This approach was taken by Justice Forsyth in *Norcen Energy*

*Resources Ltd.*, and in my view is consistent with the underlying purpose of the C.C.A.A. I wish to emphasize that the concerns raised by Resurgence will form part of the assessment of the overall fairness of the plan.

39 Permitting the classification to remain intact for voting purposes will not result in a confiscation of rights of or injustice to the unsecured note holders. Their treatment does not at this point depart from any other Affected Unsecured Creditors and recognizes the similarity of legal rights. Although based on different legal instruments, the legal rights of the unsecured note holders and Air Canada are essentially the same. Neither has security, nor specific entitlement to assets. Further, the ability of all of the Affected Unsecured Creditors to realize their claims against the debtor companies, depend in significant part, on the company's ability to continue as a going concern.

40 The separate tabulation of votes will allow the "voice" of unsecured creditors to be heard, while at the same time, permit rather than rule out the possibility that a plan might proceed.

41 It is important to preserve this possibility in the interests of facilitating the aim of the C.C.A.A. and protecting interests of all constituents. To fracture the class prior to the vote, may have the effect of denying the court jurisdiction to consider sanctioning a plan which may pass the fairness test but which has been rejected by one creditor. This would be contrary to the purpose of the C.C.A.A.

#### **Separating the Claims Against CAC and CAIL**

42 Resurgence briefly argued that since Air Canada's debt is owed by CAIL only, it could only look to CAIL's assets in a bankruptcy and would not be able to look to any CAC assets. In contrast, Resurgence suggested that the unsecured note holders are creditors of both CAIL under a guarantee, and CAC under the notes. Resurgence submitted that the resulting difference in legal rights destroys the commonality of interests.

43 There is insufficient evidence to suggest that the unsecured note holders are also creditors of CAIL. Counsel referred only to a statement made by Mr. Carty on cross-examination that there was an "unsecured guarantee". However, no documents have been brought to my attention that would support this statement and, in of itself, the statement is not determinative. In any case, I do not have sufficient evidence before me to conclude that there would be a meaningful difference in recoveries for unsecured creditors of CAC and CAIL in the event of bankruptcy. I, therefore, cannot conclude on this basis that rights are being confiscated, unlike Tysoe J.'s ability to do so in *Re Woodward's Ltd.* Simply looking to different assets or pools of assets will not alone fracture a class; some unique additional legal right of value in liquidation going unrecognized in a plan and not balanced by others losing rights as well is needed on the analysis of Tysoe J.

44 I recognize the struggle between the unsecured note holders, represented by Resurgence on one side, and Air Canada and Canadian on the other. Resurgence fears the inclusion of Air Canada and the Affected Unsecured Creditors' class will swamp the vote. Air Canada and Canadian fear that exclusion of Air Canada will result in the voting down of a plan which, in their view, otherwise stands a realistic chance of approval. As unsecured creditors, they do share similar legal rights. As supporters or opponents of the plan, they may well have distinctly different financial or strategic interests. I believe that in the circumstances of this case, these other interests and their impact on the plan, are best addressed as matters of fairness at the June 5, 2000 hearing, and in this way, the concerns will be heard by the court without necessarily putting an end to the entire process.

#### **Voting**

45 Although my decision on classification makes it clear that I will permit Air Canada to vote on the plan, I wish to comment further on this issue. Air Canada submitted that it should be entitled to vote the face value of the promissory notes which represent deficiency claims assigned to it from aircraft lessors in the same fashion as any other creditor who has acquired the claims by assignment. All parties accept that deficiency claims such as these would normally be included and voted upon in an unsecured claims class. The request by Resurgence to deny them a vote would have the effect of varying rights associated with those notes.

46 The concessions achieved in the re-negotiation of the aircraft leases, represent value to CAIL. The methodology of calculation of the claims and their valuation was reviewed by the Monitor and this is not being challenged. Rather, it is because it is Air Canada that now holds them, that it is objectionable to Resurgence. Resurgence asserts that Air Canada manufactured the assignment so it could preserve a 'yes' vote. This, in my view, is a matter going to fairness. Is it fair for Air Canada to vote to share in the pool of cash funded by it for the benefit of unsecured creditors? That matter is best resolved at the fairness hearing.

47 Resurgence relied on *Northland Properties Ltd.* in which a wholly owned subsidiary of the debtor company was not allowed to vote because to do so would amount to the debtor company voting in its own reorganization. The corporate relationship between Air Canada and CAIL can be distinguished from the parent and wholly owned subsidiary in *Northland Properties Ltd.* Air Canada is not CAIL's parent and owns 10 percent of a numbered company which owns 82 percent of CAIL. Further, as noted above, the court in *Northland Properties Ltd.* apparently relied on the passage from *Wellington Building Corp* which indicated in that case the court was being asked to approve a plan as fair. Again, the basis on which Resurgence seeks to deprive Air Canada of its vote is really an issue of fairness.

#### Section 6(2)(2) of the Plan

48 Resurgence wishes me to strike out Section 6(2)(2) of the plan, which essentially purports to provide a release by affected creditors of all claims based in whole or in part on any act, omission transaction, event or occurrence that took place prior to the effective date in any way relating to the debtor companies and subsidiaries, the C.C.A.A. proceeding or the plan against:

1. The debtor companies and its subsidiaries;
2. The directors, officers and employees;
3. The former directors, officers and employees of the debtor companies and its subsidiaries; or
4. The respective current and former professionals of the entities, including the Monitor, its counsel and its current officers and directors, et cetera. Resurgence submits that this provision constitutes a wholesale release of directors and others which is beyond that permitted by Section 5.1 of the C.C.A.A. CAIL and CAC submit that the proposed release was not intended to preclude rights expressly preserved by the statute and are prepared to amend the plan to state this.

49 Section 5.1(3) of the C.C.A.A. provides that the court may declare that a claim against directors shall not be compromised if it is satisfied that the compromise would not be fair and reasonable in the circumstances.

50 In this application of Resurgence, the court must deal with two issues: One, what releases are permitted under the statute; and, two, what releases ought to be permitted, if any, under the plan.

51 In my view, I will be in a better position to assess the fairness of the proposed compromise of claims which is drafted in extremely broad terms, when I consider the other issues of fairness raised by Resurgence. Accordingly, I leave that matter to the fairness hearing as well.

52 In summary, the application contained in paragraph (d) of the Resurgence Notice of Motion is dismissed. The application in paragraph (e) is adjourned to June 5, 2000.

*Application dismissed.*

#### Footnotes

- \* Leave to appeal refused 2000 ABCA 149, 80 Alta L.R. (3d) 213, 19 C.B.R. (4th) 33 (Alta C.A. [In Chambers]).

**End of Document**

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# TAB 4



2010 ONSC 4209  
Ontario Superior Court of Justice [Commercial List]

Canwest Global Communications Corp., Re

2010 CarswellOnt 5510, 2010 ONSC 4209, 191 A.C.W.S. (3d) 378, 70 C.B.R. (5th) 1

**IN THE MATTER OF SECTION 11 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 CANWEST GLOBAL COMMUNICATIONS AND THE OTHER APPLICANTS

Pepall J.

Judgment: July 28, 2010  
Docket: CV-09-8396-00CL

Counsel: Lyndon Barnes, Jeremy Dacks, Shawn Irving for CMI Entities  
David Byers, Marie Konyukhova for Monitor  
Robin B. Schwill, Vince Mercier for Shaw Communications Inc.  
Derek Bell for Canwest Shareholders Group (the "Existing Shareholders")  
Mario Forte for Special Committee of the Board of Directors  
Robert Chadwick, Logan Willis for Ad Hoc Committee of Noteholders  
Amanda Darrach for Canwest Retirees  
Peter Osborne for Management Directors  
Steven Weisz for CIBC Asset-Based Lending Inc.

Subject: Insolvency; Corporate and Commercial

**Table of Authorities**

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*A&M Cookie Co. Canada, Re* (2009), 2009 CarswellOnt 3473 (Ont. S.C.J. [Commercial List]) — referred to

*Armbro Enterprises Inc., Re* (1993), 1993 CarswellOnt 241, 22 C.B.R. (3d) 80 (Ont. Bkcty.) — considered

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*Cadillac Fairview Inc., Re* (1995), 1995 CarswellOnt 3702 (Ont. Gen. Div. [Commercial List]) — referred to

*Calpine Canada Energy Ltd., Re* (2007), 2007 CarswellAlta 1050, 2007 ABQB 504, 35 C.B.R. (5th) 1, 415 A.R. 196, 33 B.L.R. (4th) 68 (Alta. Q.B.) — referred to

*Canadian Airlines Corp., Re* (2000), [2000] 10 W.W.R. 269, 20 C.B.R. (4th) 1, 84 Alta. L.R. (3d) 9, 9 B.L.R. (3d) 41, 2000 CarswellAlta 662, 2000 ABQB 442, 265 A.R. 201 (Alta. Q.B.) — considered

*Canadian Airlines Corp., Re* (2000), 2000 CarswellAlta 919, [2000] 10 W.W.R. 314, 20 C.B.R. (4th) 46, 84 Alta. L.R. (3d) 52, 9 B.L.R. (3d) 86, 2000 ABCA 238, 266 A.R. 131, 228 W.A.C. 131 (Alta. C.A. [In Chambers]) — referred to

*Canadian Airlines Corp., Re* (2000), 88 Alta. L.R. (3d) 8, 2001 ABCA 9, 2000 CarswellAlta 1556, [2001] 4 W.W.R. 1, 277 A.R. 179, 242 W.A.C. 179 (Alta. C.A.) — referred to

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s. 173(1)(e) — considered

s. 173(1)(h) — considered

s. 191 — considered

s. 191(1) "reorganization" (c) — considered

s. 191(2) — referred to

*Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36

Generally — referred to

s. 2(1) "debtor company" — referred to

s. 6 — considered

s. 6(1) — considered

s. 6(2) — considered

s. 6(3) — considered

s. 6(5) — considered

s. 6(6) — considered

s. 6(8) — referred to

s. 36 — considered

APPLICATION by debtors for order sanctioning plan of compromise, arrangement, and reorganization and for related relief.

***Pepall J.:***

1 This is the culmination of the *Companies' Creditors Arrangement Act*<sup>1</sup> restructuring of the CMI Entities. The proceeding started in court on October 6, 2009, experienced numerous peaks and valleys, and now has resulted in a request for an order sanctioning a plan of compromise, arrangement and reorganization (the "Plan"). It has been a short road in relative terms but not without its challenges and idiosyncrasies. To complicate matters, this restructuring was hot on the heels of the amendments to the CCAA that were introduced on September 18, 2009. Nonetheless, the CMI Entities have now successfully concluded a Plan for which they seek a sanction order. They also request an order approving the Plan Emergence Agreement, and other related relief. Lastly, they seek a post-filing claims procedure order.

2 The details of this restructuring have been outlined in numerous previous decisions rendered by me and I do not propose to repeat all of them.

**The Plan and its Implementation**

3 The basis for the Plan is the amended Shaw transaction. It will see a wholly owned subsidiary of Shaw Communications Inc. ("Shaw") acquire all of the interests in the free-to-air television stations and subscription-based specialty television channels currently owned by Canwest Television Limited Partnership ("CTLP") and its subsidiaries and all of the interests in the specialty television stations currently owned by CW Investments and its subsidiaries, as well as certain other assets of the CMI Entities. Shaw will pay to CMI US \$440 million in cash to be used by CMI to satisfy the claims of the 8% Senior Subordinated Noteholders (the "Noteholders") against the CMI Entities. In the event that the implementation of the Plan occurs after September 30, 2010, an additional cash amount of US \$2.9 million per month will be paid to CMI by Shaw and allocated by CMI to the Noteholders. An additional \$38 million will be paid by Shaw to the Monitor at the direction of CMI to be used to satisfy the claims of the Affected Creditors (as that term is defined in the Plan) other than the Noteholders, subject to a pro rata increase in that cash amount for certain restructuring period claims in certain circumstances.

4 In accordance with the Meeting Order, the Plan separates Affected Creditors into two classes for voting purposes:

(a) the Noteholders; and

(b) the Ordinary Creditors. Convenience Class Creditors are deemed to be in, and to vote as, members of the Ordinary Creditors' Class.

5 The Plan divides the Ordinary Creditors' pool into two sub-pools, namely the Ordinary CTLP Creditors' Sub-pool and the Ordinary CMI Creditors' Sub-pool. The former comprises two-thirds of the value and is for claims against the CTLP Plan Entities and the latter reflects one-third of the value and is used to satisfy claims against Plan Entities other than the CTLP Plan Entities. In its 16<sup>th</sup> Report, the Monitor performed an analysis of the relative value of the assets of the CMI Plan Entities and the CTLP Plan Entities and the possible recoveries on a going concern liquidation and based on that analysis, concluded that it was fair and reasonable that Affected Creditors of the CTLP Plan Entities share pro rata in two-thirds of the Ordinary Creditors' pool and Affected Creditors of the Plan Entities other than the CTLP Plan Entities share pro rata in one-third of the Ordinary Creditors' pool.

6 It is contemplated that the Plan will be implemented by no later than September 30, 2010.

7 The Existing Shareholders will not be entitled to any distributions under the Plan or other compensation from the CMI Entities on account of their equity interests in Canwest Global. All equity compensation plans of Canwest Global will be extinguished and any outstanding options, restricted share units and other equity-based awards outstanding thereunder will be terminated and cancelled and the participants therein shall not be entitled to any distributions under the Plan.

8 On a distribution date to be determined by the Monitor following the Plan implementation date, all Affected Creditors with proven distribution claims against the Plan Entities will receive distributions from cash received by CMI (or the Monitor at CMI's direction) from Shaw, the Plan Sponsor, in accordance with the Plan. The directors and officers of the remaining CMI Entities and other subsidiaries of Canwest Global will resign on or about the Plan implementation date.

9 Following the implementation of the Plan, CTLP and CW Investments will be indirect, wholly-owned subsidiaries of Shaw, and the multiple voting shares, subordinate voting shares and non-voting shares of Canwest Global will be delisted from the TSX Venture Exchange. It is anticipated that the remaining CMI Entities and certain other subsidiaries of Canwest Global will be liquidated, wound-up, dissolved, placed into bankruptcy or otherwise abandoned.

10 In furtherance of the Minutes of Settlement that were entered into with the Existing Shareholders, the articles of Canwest Global will be amended under section 191 of the CBCA to facilitate the settlement. In particular, Canwest Global will reorganize the authorized capital of Canwest Global into (a) an unlimited number of new multiple voting shares, new subordinated voting shares and new non-voting shares; and (b) an unlimited number of new non-voting preferred shares. The terms of the new non-voting preferred shares will provide for the mandatory transfer of the new preferred shares held by the Existing Shareholders to a designated entity affiliated with Shaw for an aggregate amount of \$11 million to be paid upon delivery by Canwest Global of the transfer notice to the transfer agent. Following delivery of the transfer notice, the Shaw designated entity will donate and surrender the new preferred shares acquired by it to Canwest Global for cancellation.

11 Canwest Global, CMI, CTLP, New Canwest, Shaw, 7316712 and the Monitor entered into the Plan Emergence Agreement dated June 25, 2010 detailing certain steps that will be taken before, upon and after the implementation of the plan. These steps primarily relate to the funding of various costs that are payable by the CMI Entities on emergence from the CCAA proceeding. This includes payments that will be made or may be made by the Monitor to satisfy post-filing amounts owing by the CMI Entities. The schedule of costs has not yet been finalized.

#### **Creditor Meetings**

12 Creditor meetings were held on July 19, 2010 in Toronto, Ontario. Support for the Plan was overwhelming. 100% in number representing 100% in value of the beneficial owners of the 8% senior subordinated notes who provided instructions for voting at the Noteholder meeting approved the resolution. Beneficial Noteholders holding approximately 95% of the principal amount of the outstanding notes validly voted at the Noteholder meeting.

13 The Ordinary Creditors with proven voting claims who submitted voting instructions in person or by proxy represented approximately 83% of their number and 92% of the value of such claims. In excess of 99% in number representing in excess of 99% in value of the Ordinary Creditors holding proven voting claims that were present in person or by proxy at the meeting voted or were deemed to vote in favour of the resolution.

#### **Sanction Test**

14 Section 6(1) of the CCAA provides that the court has discretion to sanction a plan of compromise or arrangement if it has achieved the requisite double majority vote. The criteria that a debtor company must satisfy in seeking the court's approval are:

- (a) there must be strict compliance with all statutory requirements;

(b) all material filed and procedures carried out must be examined to determine if anything has been done or purported to be done which is not authorized by the CCAA; and

(c) the Plan must be fair and reasonable.

See *Canadian Airlines Corp.*, Re<sup>2</sup>

**(a) Statutory Requirements**

15 I am satisfied that all statutory requirements have been met. I already determined that the Applicants qualified as debtor companies under section 2 of the CCAA and that they had total claims against them exceeding \$5 million. The notice of meeting was sent in accordance with the Meeting Order. Similarly, the classification of Affected Creditors for voting purposes was addressed in the Meeting Order which was unopposed and not appealed. The meetings were both properly constituted and voting in each was properly carried out. Clearly the Plan was approved by the requisite majorities.

16 Section 6(3), 6(5) and 6(6) of the CCAA provide that the court may not sanction a plan unless the plan contains certain specified provisions concerning crown claims, employee claims and pension claims. Section 4.6 of Plan provides that the claims listed in paragraph (l) of the definition of "Unaffected Claims" shall be paid in full from a fund known as the Plan Implementation Fund within six months of the sanction order. The Fund consists of cash, certain other assets and further contributions from Shaw. Paragraph (l) of the definition of "Unaffected Claims" includes any Claims in respect of any payments referred to in section 6(3), 6(5) and 6(6) of the CCAA. I am satisfied that these provisions of section 6 of the CCAA have been satisfied.

**(b) Unauthorized Steps**

17 In considering whether any unauthorized steps have been taken by a debtor company, it has been held that in making such a determination, the court should rely on the parties and their stakeholders and the reports of the Monitor: *Canadian Airlines Corp.*, Re<sup>3</sup>.

18 The CMI Entities have regularly filed affidavits addressing key developments in this restructuring. In addition, the Monitor has provided regular reports (17 at last count) and has opined that the CMI Entities have acted and continue to act in good faith and with due diligence and have not breached any requirements under the CCAA or any order of this court. If it was not obvious from the hearing on June 23, 2010, it should be stressed that there is no payment of any equity claim pursuant to section 6(8) of the CCAA. As noted by the Monitor in its 16<sup>th</sup> Report, settlement with the Existing Shareholders did not and does not in any way impact the anticipated recovery to the Affected Creditors of the CMI Entities. Indeed I referenced the inapplicability of section 6(8) of the CCAA in my Reasons of June 23, 2010. The second criterion relating to unauthorized steps has been met.

**(c) Fair and Reasonable**

19 The third criterion to consider is the requirement to demonstrate that a plan is fair and reasonable. As Paperny J. (as she then was) stated in *Canadian Airlines Corp.*, Re:

The court's role on a sanction hearing is to consider whether the plan fairly balances the interests of all stakeholders. Faced with an insolvent organization, its role is to look forward and ask: does this plan represent a fair and reasonable compromise that will permit a viable commercial entity to emerge? It is also an exercise in assessing current reality by comparing available commercial alternatives to what is offered in the proposed plan.<sup>4</sup>

20 My discretion should be informed by the objectives of the CCAA, namely to facilitate the reorganization of a debtor company for the benefit of the company, its creditors, shareholders, employees and in many instances, a much broader constituency of affected persons.

21 In assessing whether a proposed plan is fair and reasonable, considerations include the following:

- (a) whether the claims were properly classified and whether the requisite majority of creditors approved the plan;
- (b) what creditors would have received on bankruptcy or liquidation as compared to the plan;
- (c) alternatives available to the plan and bankruptcy;
- (d) oppression of the rights of creditors;
- (e) unfairness to shareholders; and
- (f) the public interest.

22 I have already addressed the issue of classification and the vote. Obviously there is an unequal distribution amongst the creditors of the CMI Entities. Distribution to the Noteholders is expected to result in recovery of principal, pre-filing interest and a portion of post-filing accrued and default interest. The range of recoveries for Ordinary Creditors is much less. The recovery of the Noteholders is substantially more attractive than that of Ordinary Creditors. This is not unheard of. In *Armbro Enterprises Inc.*, *Re*<sup>5</sup> Blair J. (as he then was) approved a plan which included an uneven allocation in favour of a single major creditor, the Royal Bank, over the objection of other creditors. Blair J. wrote:

"I am not persuaded that there is a sufficient tilt in the allocation of these new common shares in favour of RBC to justify the court in interfering with the business decision made by the creditor class in approving the proposed Plan, as they have done. RBC's cooperation is a sine qua non for the Plan, or any Plan, to work and it is the only creditor continuing to advance funds to the applicants to finance the proposed re-organization."<sup>6</sup>

23 Similarly, in *Uniforêt inc.*, *Re*<sup>7</sup> a plan provided for payment in full to an unsecured creditor. This treatment was much more generous than that received by other creditors. There, the Québec Superior Court sanctioned the plan and noted that a plan can be more generous to some creditors and still fair to all creditors. The creditor in question had stepped into the breach on several occasions to keep the company afloat in the four years preceding the filing of the plan and the court was of the view that the conduct merited special treatment. See also Romaine J.'s orders dated October 26, 2009 in *SemCanada Crude Company et al.*

24 I am prepared to accept that the recovery for the Noteholders is fair and reasonable in the circumstances. The size of the Noteholder debt was substantial. CMI's obligations under the notes were guaranteed by several of the CMI Entities. No issue has been taken with the guarantees. As stated before and as observed by the Monitor, the Noteholders held a blocking position in any restructuring. Furthermore, the liquidity and continued support provided by the Ad Hoc Committee both prior to and during these proceedings gave the CMI Entities the opportunity to pursue a going concern restructuring of their businesses. A description of the role of the Noteholders is found in Mr. Strike's affidavit sworn July 20, 2010, filed on this motion.

25 Turning to alternatives, the CMI Entities have been exploring strategic alternatives since February, 2009. Between November, 2009 and February, 2010, RBC Capital Markets conducted the equity investment solicitation process of which I have already commented. While there is always a theoretical possibility that a more advantageous plan could be developed than the Plan proposed, the Monitor has concluded that there is no reason to believe that restarting the equity investment solicitation process or marketing 100% of the CMI Entities assets would result in a better or equally desirable outcome. Furthermore, restarting the process could lead to operational difficulties including issues relating to the CMI Entities' large studio suppliers and advertisers. The Monitor has also confirmed that it is unlikely that the recovery for a going concern liquidation sale of the assets of the CMI Entities would result in greater recovery to the creditors of the CMI Entities. I am not satisfied that there is any other alternative transaction that would provide greater recovery than the recoveries contemplated in the Plan. Additionally, I am not persuaded that there is any oppression of creditor rights or unfairness to shareholders.

26 The last consideration I wish to address is the public interest. If the Plan is implemented, the CMI Entities will have achieved a going concern outcome for the business of the CTLP Plan Entities that fully and finally deals with the Goldman Sachs Parties, the Shareholders Agreement and the defaulted 8% senior subordinated notes. It will ensure the continuation of

employment for substantially all of the employees of the Plan Entities and will provide stability for the CMI Entities, pensioners, suppliers, customers and other stakeholders. In addition, the Plan will maintain for the general public broad access to and choice of news, public and other information and entertainment programming. Broadcasting of news, public and entertainment programming is an important public service, and the bankruptcy and liquidation of the CMI Entities would have a negative impact on the Canadian public.

27 I should also mention section 36 of the CCAA which was added by the recent amendments to the Act which came into force on September 18, 2009. This section provides that a debtor company may not sell or otherwise dispose of assets outside the ordinary course of business unless authorized to do so by a court. The section goes on to address factors a court is to consider. In my view, section 36 does not apply to transfers contemplated by a Plan. These transfers are merely steps that are required to implement the Plan and to facilitate the restructuring of the Plan Entities' businesses. Furthermore, as the CMI Entities are seeking approval of the Plan itself, there is no risk of any abuse. There is a further safeguard in that the Plan including the asset transfers contemplated therein has been voted on and approved by Affected Creditors.

28 The Plan does include broad releases including some third party releases. In *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*<sup>8</sup>, the Ontario Court of Appeal held that the CCAA court has jurisdiction to approve a plan of compromise or arrangement that includes third party releases. The *Metcalfe* case was extraordinary and exceptional in nature. It responded to dire circumstances and had a plan that included releases that were fundamental to the restructuring. The Court held that the releases in question had to be justified as part of the compromise or arrangement between the debtor and its creditors. There must be a reasonable connection between the third party claim being compromised in the plan and the restructuring achieved by the plan to warrant inclusion of the third party release in the plan.

29 In the *Metcalfe* decision, Blair J.A. discussed in detail the issue of releases of third parties. I do not propose to revisit this issue, save and except to stress that in my view, third party releases should be the exception and should not be requested or granted as a matter of course.

30 In this case, the releases are broad and extend to include the Noteholders, the Ad Hoc Committee and others. Fraud, wilful misconduct and gross negligence are excluded. I have already addressed, on numerous occasions, the role of the Noteholders and the Ad Hoc Committee. I am satisfied that the CMI Entities would not have been able to restructure without materially addressing the notes and developing a plan satisfactory to the Ad Hoc Committee and the Noteholders. The release of claims is rationally connected to the overall purpose of the Plan and full disclosure of the releases was made in the Plan, the information circular, the motion material served in connection with the Meeting Order and on this motion. No one has appeared to oppose the sanction of the Plan that contains these releases and they are considered by the Monitor to be fair and reasonable. Under the circumstances, I am prepared to sanction the Plan containing these releases.

31 Lastly, the Monitor is of the view that the Plan is advantageous to Affected Creditors, is fair and reasonable and recommends its sanction. The board, the senior management of the CMI Entities, the Ad Hoc Committee, and the CMI CRA all support sanction of the Plan as do all those appearing today.

32 In my view, the Plan is fair and reasonable and I am granting the sanction order requested.<sup>9</sup>

33 The Applicants also seek approval of the Plan Emergence Agreement. The Plan Emergence Agreement outlines steps that will be taken prior to, upon, or following implementation of the Plan and is a necessary corollary of the Plan. It does not confiscate the rights of any creditors and is necessarily incidental to the Plan. I have the jurisdiction to approve such an agreement: *Air Canada, Re*<sup>10</sup> and *Calpine Canada Energy Ltd., Re*<sup>11</sup> I am satisfied that the agreement is fair and reasonable and should be approved.

34 It is proposed that on the Plan implementation date the articles of Canwest Global will be amended to facilitate the settlement reached with the Existing Shareholders. Section 191 of the CBCA permits the court to order necessary amendments to the articles of a corporation without shareholder approval or a dissent right. In particular, section 191(1)(c) provides that reorganization means a court order made under any other Act of Parliament that affects the rights among the corporation, its

shareholders and creditors. The CCAA is such an Act: *Beatrice Foods Inc., Re*<sup>12</sup> and *Laidlaw, Re*<sup>13</sup>. Pursuant to section 191(2), if a corporation is subject to a subsection (1) order, its articles may be amended to effect any change that might lawfully be made by an amendment under section 173. Section 173(1)(e) and (h) of the CBCA provides that:

(1) Subject to sections 176 and 177, the articles of a corporation may by special resolution be amended to

(e) create new classes of shares;

(h) change the shares of any class or series, whether issued or unissued, into a different number of shares of the same class or series or into the same or a different number of shares of other classes or series.

35 Section 6(2) of the CCAA provides that if a court sanctions a compromise or arrangement, it may order that the debtor's constating instrument be amended in accordance with the compromise or arrangement to reflect any change that may lawfully be made under federal or provincial law.

36 In exercising its discretion to approve a reorganization under section 191 of the CBCA, the court must be satisfied that: (a) there has been compliance with all statutory requirements; (b) the debtor company is acting in good faith; and (c) the capital restructuring is fair and reasonable: *A&M Cookie Co. Canada, Re*<sup>14</sup> and *MEI Computer Technology Group Inc., Re*<sup>15</sup>

37 I am satisfied that the statutory requirements have been met as the contemplated reorganization falls within the conditions provided for in sections 191 and 173 of the CBCA. I am also satisfied that Canwest Global and the other CMI Entities were acting in good faith in attempting to resolve the Existing Shareholder dispute. Furthermore, the reorganization is a necessary step in the implementation of the Plan in that it facilitates agreement reached on June 23, 2010 with the Existing Shareholders. In my view, the reorganization is fair and reasonable and was a vital step in addressing a significant impediment to a satisfactory resolution of outstanding issues.

38 A post-filing claims procedure order is also sought. The procedure is designed to solicit, identify and quantify post-filing claims. The Monitor who participated in the negotiation of the proposed order is satisfied that its terms are fair and reasonable as am I.

39 In closing, I would like to say that generally speaking, the quality of oral argument and the materials filed in this CCAA proceeding has been very high throughout. I would like to express my appreciation to all counsel and the Monitor in that regard. The sanction order and the post-filing claims procedure order are granted.

*Application granted.*

#### Footnotes

1 R.S.C. 1985, c. C-36 as amended.

2 2000 ABQB 442 (Alta. Q.B.) at para. 60, leave to appeal denied 2000 ABCA 238 (Alta. C.A. [In Chambers]), aff'd 2001 ABCA 9 (Alta. C.A.), leave to appeal to S.C.C. refused July 12, 2001 [2001 CarswellAlta 888 (S.C.C.)].

3 Ibid, at para. 64 citing *Olympia & York Developments Ltd. v. Royal Trust Co.*, [1993] O.J. No. 545 (Ont. Gen. Div.) and *Cadillac Fairview Inc., Re*, [1995] O.J. No. 274 (Ont. Gen. Div. [Commercial List]).

4 Ibid, at para. 3.

5 (1993), 22 C.B.R. (3d) 80 (Ont. Bkcty.).

6 Ibid, at para. 6.

7 (2003), 43 C.B.R. (4th) 254 (C.S. Que.).



8 (2008), 92 O.R. (3d) 513 (Ont. C.A.).

9 The Sanction Order is extraordinarily long and in large measure repeats the Plan provisions. In future, counsel should attempt to simplify and shorten these sorts of orders.

10 (2004), 47 C.B.R. (4th) 169 (Ont. S.C.J. [Commercial List]).

11 (2007), 35 C.B.R. (5th) 1 (Alta. Q.B.).

12 (1996), 43 C.B.R. (4th) 10 (Ont. Gen. Div. [Commercial List]).

13 (2003), 39 C.B.R. (4th) 239 (Ont. S.C.J.).

14 [2009] O.J. No. 2427 (Ont. S.C.J. [Commercial List]) at para. 8/

15 [2005] Q.J. No. 22993 (C.S. Que.) at para. 9.

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# TAB 5

2011 ONSC 2750  
Ontario Superior Court of Justice

Nelson Financial Group Ltd., Re

2011 CarswellOnt 3100, 2011 ONSC 2750, 202 A.C.W.S. (3d) 444, 79 C.B.R. (5th) 307

**In the Matter of the Companies' Creditors  
Arrangement Act, R.S.C. 1985, Cc. C-36, as Amended**

And In the Matter of a Proposed Plan of Compromise or Arrangement of Nelson Financial Group Ltd. (Applicant)

Morawetz J.

Heard: April 20, 2011

Judgment: April 21, 2011

Written reasons: May 6, 2011

Docket: 10-8630-00CL

Counsel: Richard B. Jones, Douglas Turner, Q.C. for Interim Operating Officer and Noteholders

James H. Grout, Seema Aggarwal for Monitor, A. John Page & Associates Inc.

Jane Waechter, Swapna Chandra for Ontario Securities Commission

Subject: Insolvency

**Table of Authorities**

**Cases considered by Morawetz J.:**

*Sammi Atlas Inc., Re* (1998), 1998 CarswellOnt 1145, 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]) — followed

**Statutes considered:**

*Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36

Generally — referred to

MOTION by debtor company to sanction plan of arrangement .

**Morawetz J.:**

1 The motion to sanction the Plan of Arrangement of Nelson Financial Group Ltd. ("Nelson") was heard on April 20, 2011.

2 On April 21, 2011, following consideration of the supplementary affidavit of Richard B. Jones, sworn April 20, 2011, the record was endorsed as follows:

Motion granted. The Plan is sanctioned. An order has been signed in the form presented, as amended, which includes sealing provision relating to Exhibit B to the Thirteenth Report of the Monitor. Reasons will follow.

3 These are the reasons.

4 At the outset, I note that this *Companies' Creditors Arrangement Act* ("CCAA") application proceeded in a somewhat unconventional manner. These reasons reflect the very specific facts of the application.

5 Nelson filed its application under the CCAA on March 22, 2010. Nelson had sold to members of the public some \$80 million of term promissory notes and preferred shares. As of the date of filing, over \$37 million of the promissory notes were outstanding. The sole director, voting shareholder and president of Nelson was Mr. Marc Boutet.

6 Under the Initial Order of March 23, 2010, A. John Page & Associates Inc. was appointed as Monitor of the Applicant (the "Monitor").

7 By order of Pepall J., made on consent of the Applicant and the Monitor on June 15, 2010, Douglas Turner, Q.C. was appointed as Representative Counsel for the holders of the notes issued by Nelson and Richard B. Jones was appointed as his Special Counsel.

8 The restructuring was commenced as an application made by Nelson under the direction and control of incumbent management and ownership.

9 Commencing in September 2010, Representative Counsel sought the replacement of management, as issues had been raised questioning the competency and *bona fides* of management.

10 In October 2010, the Representative Counsel's Noteholder Advisory Committee canvassed noteholders and obtained confirmation from more than two-thirds in claim amount that they would not support any plan of arrangement that continued the incumbency of Mr. Boutet.

11 On November 11, 2010, Mr. Boutet resigned all of his positions with Nelson, surrendered his shares for cancellation and released all claims against Nelson held by him or any of his associated corporations. In exchange, he was provided with a limited release. The arrangements in respect of his departure were approved by order of Pepall J. made November 22, 2010. In that same decision, Pepall J. appointed a substantial shareholder, Ms. Sherri Townsend, as the Interim Operating Officer ("IOO"). Under the terms of her appointment, the IOO was granted full powers as the Chief Executive Officer and was given particular authority to review the circumstances of the debtor company and its assets and, if practicable, to develop a plan for its restructuring.

12 Under the direction of the IOO, a business plan was developed and a Plan of Compromise and Arrangement was devised.

13 Counsel for the IOO takes the position that since the business of Nelson came under the authority and direction of the IOO, Nelson has conducted itself in full compliance with the requirements of the CCAA and of the court orders made in these proceedings. Specifically, counsel submits that the IOO has performed all of the duties and responsibilities placed upon her by the order of November 22, 2010 and by subsequent orders of the court.

14 Under the Plan, creditors have the following options:

- (a) creditors with claims for \$1,000 or less will receive a cash payment for the full amount of their claims (the "Convenience Class");
- (b) creditors may elect to receive a cash payment of 25% of their claims in full satisfaction of their claims and all of their rights against the Applicant or any other person in respect of their claims (the "Cash Exit Option"); and
- (c) creditors who are not in the Convenience Class and who do not elect the Cash Exit Option will receive:
  - (i) capital recovery debentures for 25% of their claim;
  - (ii) new special shares with a redemption price of 25% of their claim; and
  - (iii) one common share of the Applicant for each \$100 of their claims (the "General Plan Option").

15 The Plan was substantially finalized on February 11, 2011.

16 The Plan Filing and Meeting Order was granted on March 4, 2011.

17 From and after the appointment of the IOO, the relationship as between the Monitor, the IOO and their respective counsel became strained, if not dysfunctional. Further details in respect of this relationship are set out in the materials served by the parties in the period leading up to the granting of the Plan Filing and Meeting Order on March 4, 2011.

18 Subsequent to the granting of the Plan Filing and Meeting Order, issues were raised by Ms. Brenda Bissell, in her capacity as power of attorney for Gloria Bissell, who holds promissory notes of Nelson in her own name and also in her capacity as the owner of Globis Administrators Inc. The concerns of Ms. Bissell are set out in her affidavit of April 12, 2011.

19 Ms. Bissell, through counsel, attended before Mesbur J. on April 13, 2011 in respect of a request for scheduling of a motion seeking to adjourn the meeting of creditors scheduled by the Plan Filing and Meeting Order for April 16, 2011.

20 The endorsement of Mesbur J. reads as follows:

Brenda Bissell P.A. [Power of Attorney] for a noteholder wishes to move urgently to postpone the vote on the proposed Plan of Arrangement, etc. scheduled for Saturday, April 16, 2011. Essentially, she wishes the opportunity to communicate her position and information to the other Noteholders. A solution has emerged at this 9:30 that will avoid both an urgent motion and any necessity to delay the vote.

On consent:

1. Special Counsel, Mr. Jones, will forthwith (i.e. today, as soon as possible) email all the Noteholders directing them to Ms. Bissell's motion materials posted on the Monitor's website, and suggesting they review the material before the meeting.
2. Mr. Page will provide Mr. Yellin today with a copy of the unredacted claims procedure memorandum: (done)
3. Mr. Yellin will provide Mr. Jones with an electronic copy of the communication his client wishes to send to the Noteholders and Mr. Jones will immediately email it to all the Noteholders, subject to the communication not containing defamatory, libellous or illegal statements.
4. If the plan is approved, Ms. Bissell's motion materials may be filed for the purposes of the sanction hearing and considered as a dissenting creditor's responding materials on the sanction hearing.

"Mesbur J."

21 Counsel to the IOO stated that all required steps, directed by the court in the Plan Filing and Meeting Order, have been taken by the IOO and the Monitor.

22 About 93% of the creditor claims were voted and the Plan of Compromise and Arrangement including its technical amendments to April 12, 2011, was approved by over 96% of the creditors voting representing 94.9% of the claim value voted.

23 For a plan to be sanctioned, the application must meet the following three tests:

- (i) there has been strict compliance with all statutory requirements and adherence to previous orders of the court;
- (ii) nothing has been done or purported to be done that is not authorized by the CCAA; and
- (iii) the plan is fair and reasonable.

*Sammi Atlas Inc., Re* (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]).

24 Counsel to the IOO submits that the circumstances of this case are atypical. Until late 2010, the Applicant was under the direction of Mr. Boutet who, counsel submits, appears to have committed a number of wrongful and fraudulent acts. The IOO, in her First Report dated February 18, 2011, set out some of those acts that had come to her attention. Counsel advised that there can be no assurance provided by the IOO or the Monitor that there was strict compliance with the court orders or the CCAA by the Applicant prior to the appointment of the IOO. Counsel submitted that in a case where the control of the debtor company is changed in the course of the CCAA proceedings, the tests of compliance must be applied with reference to the conduct of the persons who are directing the debtor company and the persons who will benefit from the exercise of the court's discretion at the time of the application for sanctioning.

25 In the circumstances of this case, I accept this submission and consider it appropriate to apply the test as set out in *Sammi Atlas*, in respect of compliance with statutory requirements and orders of the court, for the period subsequent to the appointment of the IOO.

26 Based on what was disclosed in the Motion Record filed April 19, 2011, the test as set out in *Sammi Atlas* would appear to have been satisfied.

27 However, it is also necessary to consider the Motion Record submitted by counsel on behalf of Ms. Bissell. In the hearing, I inquired as to whether counsel had any comment in respect of the materials filed by Ms. Bissell, as it was apparent that neither Ms. Bissell nor her counsel were in attendance.

28 In response to my inquiries, counsel advised that there had been the aforementioned attendance before Mesbur J. on April 13, 2011.

29 I find it surprising that the directions ordered by Mesbur J. were not placed in the materials put before the court. In submissions, Mr. Jones advised that there had been full compliance with respect to the directions issued by Mesbur J. He subsequently filed, in response to my request, his affidavit setting forth complete details of the steps taken to comply with the directions of Mesbur J.

30 Having had the opportunity to review the affidavit of Mr. Jones, I am satisfied that, in the period following the application of the IOO, there has been compliance with all statutory requirements and adherence to all previous orders of the court. Further, I am satisfied that it appears that there has been nothing done or purported to be done that has not been authorized by the CCAA.

31 With respect to the third part of the test, namely, whether the plan is fair and reasonable, the Plan does extinguish the equity interests of shareholders. Counsel to the IOO submits that this is just and equitable as the liquidation analysis of the Monitor, as set out in the Thirteenth Report as of April 6, 2011, confirms that there is no reasonable basis on which there is any economic value or interest in any shareholding of the Applicant at this time.

32 Further, the Monitor, in its Thirteenth Report, finds that the Plan is "fair and reasonable".

33 In addition, counsel to the IOO points out that the IOO and Representative Counsel provided an information circular to the creditors including specific information as to the business plan, financial projections and management of Nelson if the plan should be approved. Further, the circular was reviewed by the Ontario Securities Commission and was found to be unobjectionable.

34 Counsel also submits that the Plan proposed and approved by the creditors is fair and reasonable on its face and the only persons who receive any benefit under the Plan are the creditors and those benefits are strictly proportionate to the proven claim interests of each creditor.

35 In its Report, the Monitor makes a recommendation to the creditors and the court. The Monitor clearly states that the creditors of Nelson are faced with a choice. They could choose to approve the Plan which has both upsides and downsides. The upside is that if the new board of directors and new management can successfully carry on the business, then, in time, the creditors may recover the full amount of their claim and perhaps make a profit. However, the downside is that, if not successful,

then the corporation may end up being wound up and creditors may recover less than the approximately 42% recovery over five years that is estimated by the Monitor in a bankruptcy or other form of liquidation at this time.

36 In this case, creditors had the benefit of the information circular and the supplementary materials posted on the website and voted overwhelmingly in favour of the Plan.

37 In determining whether a plan is fair and reasonable, the following are relevant considerations:

1. The claims must have been properly classified; there must be no secret arrangements to give an advantage to a creditor or creditors; the approval of the plan by the requisite majority of creditors is most important.
2. It is helpful if the monitor or some other disinterested person has prepared an analysis of anticipated receipts and liquidation or bankruptcy.
3. If other options or alternatives have been explored and rejected as workable, this will be significant.
4. Consideration of the oppression of rights of certain creditors.
5. Unfairness to shareholders.
6. The court will consider the public interest.

(See N§45, The 2011 Annotated Bankruptcy and Insolvency Act (Houlden, Morawetz and Sarra))

38 I am satisfied that the foregoing considerations have been taken into account and, I am satisfied that, in these circumstances, the Plan can be considered fair and reasonable.

39 Accordingly, the motion is granted. An order has been signed approving and sanctioning the Plan and the Articles of Reorganization and providing for its implementation.

*Motion granted.*

# TAB 6



1988 CarswellAlta 319  
Alberta Court of Queen's Bench

Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.

1988 CarswellAlta 319, [1989] 2 W.W.R. 566, [1989] A.W.L.D.  
231, [1989] C.L.D. 336, 64 Alta. L.R. (2d) 139, 72 C.B.R. (N.S.) 20

**NORCEN ENERGY RESOURCES LIMITED and PRAIRIE OIL  
ROYALTIES COMPANY LTD. v. OAKWOOD PETROLEUMS LTD.**

Forsyth J.

Judgment: December 22, 1988

Docket: No. 8801-14453

Counsel: *J.J. Marshall, Q.C.*, and *J.A. Legge*, for Norcen Energy Resources Limited and Prairie Oil Royalties Company, Ltd.  
*E.D. Tavender, Q.C.*, *D. Lloyd*, *R. Wigham* and *R.C. Dixon*, for Oakwood Petroleums Ltd.

*B. Tait* and *B.D. Newton*, for Bank of Montreal.

*B. O'Leary, M.R. Russo, A. Pettie* and *A.Z. Breitman*, for Sceptre Resources Limited.

*L. Robinson*, for Royal Bank of Canada.

*P.T. McCarthy* and *T. Warner*, for HongKong Bank of Canada.

*R. Gregory* and *P. Jull*, for Bank America, Canada.

*R.C. Pittman* and *B.J. Roth*, for Esso Resources.

*W. Corbett*, for Canadian Co-operative Society and Saskatchewan Co-operative Society.

*T.L. Czechowskyj*, for National Bank.

*J.G. Hanley* and *H.J.R. Clarke*, for A.B.C. noteholders.

*V.P. Lalonde* and *L.R. Duncan*, for Innovex Equities Corporation.

*I. Kerr*, for Alberta Securities.

*G.K. Randall, Q.C.*, for Director C.B.C.A.

Subject: Corporate and Commercial; Insolvency; Criminal

**Table of Authorities**

**Cases considered:**

*Alabama, New Orleans, Texas & Pac. Junction Ry. Co., Re*, [1891] 1 Ch. 213 (C.A.) — *distinguished*

*Amoco Can. Petroleum Co. v. Dome Petroleum Ltd.*, Calgary No. 8701-20108 (not yet reported) — *distinguished*

*Companies' Creditors Arrangement Act, Re; A.G. Can. v. A.G. Que.*, [1934] S.C.R. 659, 16 C.B.R. 1, [1934] 4 D.L.R. 75 — *referred to*

*Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 71 C.B.R. (N.S.) 1, 63 Alta. L.R. (2d) 361 (Q.B.) — *considered*

*Palisades-on-the-Desplaines, Re; Seidel v. Palisades-on-the-Desplaines*, 89 F. 2d 214 (1937, Ill.) — *referred to*

*Savage v. Amoco Acquisition Co.* (1988), 59 Alta. L.R. (2d) 260, 68 C.B.R. (N.S.) 154, 87 A.R. 321 (C.A.) [leave to appeal to S.C.C. refused 60 Alta. L.R. (2d) 1v, 89 A.R. 80] — *applied*

*Sovereign Life Assur. Co. v. Dodd*, [1892] 2 Q.B. 573 (C.A.) — *referred to*

**Statutes considered:**

Business Corporations Act, S.A. 1981, c. B-15

s. 186 [am. 1988, c. 7, s. 3]

Canada Business Corporations Act, S.C. 1974-75-76, c. 33 [now R.S.C. 1985, c. C-44]

s. 185 [now s. 191]

s. 185.1 [en. 1978-79, c. 9, s. 61; now s. 192]

Companies' Creditors Arrangement Act, R.S.C. 1970, c. C-25 [now R.S.C. 1985, c. C-36]

s. 4

s. 5

s. 6

**Authorities considered:**

Edwards, "Reorganization under the Companies' Creditors Arrangement Act" (1947), 25 Can. Bar Rev. 587, p. 603.

Robertson, "Legal Problems on Reorganization of Major Financial and Commercial Debtors", Canadian Bar Association — Ontario Continuing Legal Education, 5th April 1983, pp. 15, 16, 19-21.

Application to approve classification of creditors for purpose of voting on plan of arrangement.

**Forsyth J.:**

1 On 12th December 1988 Oakwood Petroleums Limited ("Oakwood") filed with the court a plan of arrangement ("the plan") made pursuant to the Companies' Creditors Arrangement Act (Canada), R.S.C. 1970, c. C-25 [now R.S.C. 1985, c. C-36] ("C.C.A.A."), as amended, ss. 185 and 185.1 [now ss. 191 and 192] of the Canada Business Corporations Act, S.C. 1974-75-76 [now R.S.C. 1985, c. C-44] as amended, and s. 186 of the Business Corporations Act (Alberta), S.A. 1981, c. B-15, as amended.

2 On 16th December 1988 Oakwood brought an application before me for an order which would, inter alia, approve the classification of creditors and shareholders proposed in the plan. I would note that the classifications requested are made pursuant to ss. 4, 5 and 6 of the C.C.A.A. for the purpose of holding a vote within each class to approve the plan.

3 Since my concern primarily is with the secured creditors of Oakwood, I shall set out, in part, the sections of the C.C.A.A. relevant to the court's authority with respect to compromises with secured creditors:

4 5. Where a compromise or arrangement is proposed between a debtor company and its secured creditors or any class of them, the court may ... order a meeting of such creditors or class of creditors ...

5     6. Where a majority in numbers representing three-fourths in value of the creditors, or class of creditors, as the case  
may be, present and voting either in person or by proxy at the meeting or meetings ... held pursuant to sections 4 and  
5 ... agree to any compromise or arrangement ... [it] may be sanctioned by the court, and if so sanctioned is binding on  
all the creditors ...

6     The plan filed with the court envisions five separate classes of creditors and shareholders. They are as follows:

7     (i) The secured creditors;

8     (ii) The unsecured creditors;

9     (iii) The preferred shareholders of Oakwood;

10    (iv) The common shareholders and holders of class A non-voting shares of Oakwood;

11    (v) The shareholders of New York Oils Ltd.

12    With the exception of the proposed class comprising the secured creditors of Oakwood, there has been for the moment no  
objection to the proposed groupings. I add here that shareholders of course have not yet had notice of the proposal with respect  
to voting percentages and classes with respect to their particular interests. With that caveat, and leaving aside the proposed  
single class of secured creditors, I am satisfied that the other classes suggested are appropriate and they are approved.

13    I turn now to the proposed one class of secured creditors. The membership of and proposed scheme of voting within  
the secured creditors class is dependent upon the value of each creditor's security as determined by Sceptre Resources Ltd.  
("Sceptre"), the purchaser under the plan.

14    As a result of those valuations, the membership of that class was determined to include: the Bank of Montreal, the A.B.C.  
noteholders, the Royal Bank of Canada, the National Bank of Canada and the HongKong Bank of Canada and the Bank of  
America Canada. Within the class, each secured creditor will receive one vote for each dollar of "security value". The valuations  
made by Sceptre represent what it considers to be a fair value for the securities.

15    Any dispute over the amount of money each creditor is to receive for its security will be determined at a subsequent  
fairness hearing where approval of the plan will be sought. Further, it should be noted that all counsel have agreed that, on the  
facts of this case, any errors made in the valuations would not result in any significant shift of voting power within the proposed  
class so as to alter the outcome of any vote. Therefore, the valuations made by Sceptre do not appear to be a major issue before  
me at this time insofar as voting is concerned.

16    The issue with which I am concerned arises from the objection raised by two of Oakwood's secured creditors, namely,  
HongKong Bank and Bank of America Canada, that they are grouped together with the other secured creditors. They have  
brought applications before me seeking leave to realize upon their security or, in the alternative, to be constituted a separate  
and exclusive class of creditors and to be entitled to vote as such at any meeting convened pursuant to the plan.

17    The very narrow issue which I must address concerns the propriety of classifying all the secured creditors of the  
company into one group. Counsel for Oakwood and Sceptre have attempted to justify their classifications by reference to the  
"commonality of interests test" described in *Sovereign Life Assur. Co. v. Dodd*, [1892] 2 Q.B. 573 (C.A.). That test received the  
approval of the Alberta Court of Appeal in *Savage v. Amoco Acquisition Co.* (1988), 59 Alta. L.R. (2d) 260, 68 C.B.R. (N.S.)  
154, 87 A.R. 321, where Kerans J.A., on behalf of the court, stated [pp. 264-65]:

18    We agree that the basic rule for the creation of groups for the consideration of fundamental corporate changes was  
expressed by Lord Esher in *Sovereign Life Assur. Co. v. Dodd*, [supra] when he said, speaking about creditors:

- 19 ... if we find a different state of facts existing among different creditors which may differently affect their minds and their judgments, they must be divided into different classes.
- 20 In the case of *Sovereign Life Assur. Co.*, Bowen L.J. went on to state at p. 583 that the class:
- 21 ... must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.
- 22 Counsel also made reference to two other "tests" which they argued must be complied with — the "minority veto test" and the "bona fide lack of oppression test". The former, it is argued, holds that the classes must not be so numerous as to give a veto power to an otherwise insignificant minority. In support of this test, they cite my judgment in *Amoco Can. Petroleum Co. v. Dome Petroleum Ltd.*, Calgary No. 8701-20108, 28th January 1988 (not yet reported).
- 23 I would restrict my comments on the applicability of this test to the fact that, in the *Amoco* case, I was dealing with "a very small minority group of [shareholders] near the bottom of the chain of priorities". Such is not the case here.
- 24 In support of the "bona fide lack of oppression test", counsel cite *Re Alabama, New Orleans, Texas & Pac. Junction Ry. Co.*, [1891] 1 Ch. 213 (C.A.), where Lindley L.J. stated at p. 239:
- 25 The Court must look at the scheme, and see whether the Act has been complied with, whether the majority are acting *bona fide*, and whether they are coercing the minority in order to promote interests adverse to those of the class whom they purport to represent ...
- 26 Whether this test is properly considered at this stage, that is, whether the issue is the constitution of a membership of a class, is not necessary for me to decide as there have been no allegations by the HongKong Bank or Bank of America as to a lack of bona fides.
- 27 What I am left with, then, is the application to the facts of this case of the "commonality of interests test" while keeping in mind that the proposed plan of arrangement arises under the C.C.A.A.
- 28 Sceptre and Oakwood have argued that the secured creditors' interests are sufficiently common that they can be grouped together as one class. That class is comprised of six institutional lenders (I would note that the A.B.C. noteholders are actually a group of ten lenders) who have each taken first charges as security on assets upon which they have the right to realize in order to recover their claims. The same method of valuation was applied to each secured claim in order to determine the security value under the plan.
- 29 On the other hand, HongKong Bank and Bank of America have argued that their interests are distinguishable from the secured creditors class as a whole and from other secured creditors on an individual basis. While they have identified a number of individually distinguishing features of their interests vis-à-vis those of other secured parties (which I will address later), they have put forth the proposition that since each creditor has taken separate security on different assets, the necessary commonality of interests is not present. The rationale offered is that the different assets may give rise to a different state of facts which could alter the creditors' view as to the propriety of participating in the plan. For example, it was suggested that the relative ease of marketability of a distinct asset as opposed to the other assets granted as security could lead that secured creditor to choose to disapprove of the proposed plan. Similarly, the realization potential of assets may also lead to distinctions in the interests of the secured creditors and consequently bear upon their desire to participate in the plan.
- 30 In support of this proposition, the HongKong Bank and Bank of America draw from comments made by Ronald N. Robertson, Q.C., in a publication entitled "Legal Problems on Reorganization of Major Financial and Commercial Debtors", Canadian Bar Association — Ontario Continuing Legal Education, 5th April 1983, at p. 15, and by Stanley E. Edwards in an earlier article, "Reorganizations under the Companies'; Creditors Arrangement Act" (1947), 25 Can. Bar Rev. 587, at p. 603. Both authors gave credence to this "identity of interest" proposition that secured creditors should not be members of the same class "unless their security is on the same or substantially the same property and in equal priority". They also made reference to

a case decided under c. 11 of the Bankruptcy Code of the United States of America which, while not applying that proposition in that given set of facts, accepted it as a "general rule". That authority is *Re Palisades-on-the-Desplaines; Seidel v. Palisades-on-the-Desplaines*, 89 F. 2d. 214 at 217-18 (1937, Ill.).

31 Basically, in putting forth that proposition, the HongKong Bank and Bank of America are asserting that they have made advances to Oakwood on the strength of certain security which they identified as sufficient and desirable security and which they alone have the right to realize upon. Of course, the logical extension of that argument is that in the facts of this case each secured creditor must itself comprise a class of creditors. While counsel for the HongKong Bank and Bank of America suggested it was not necessary to do so in this case, as they are the only secured creditors opposed to the classification put forth, in principle such would have to be the case if I were to accept their proposition.

32 To put the issue in another light, what I must decide is whether the holding of distinct security by each creditor necessitates a separate class of creditor for each, or whether notwithstanding this factor that they each share, nevertheless this factor does not override the grouping into one class of creditors. In my opinion, this decision cannot be made without considering the underlying purpose of the C.C.A.A.

33 In *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.*, Calgary No. 8801-14453, 17th November 1988 [now reported ante, p. 1, 63 Alta. L.R. (2d) 361], after canvassing the few authorities on point, I concluded that the purpose of the C.C.A.A. is to allow debtor companies to continue to carry on their business and that necessarily incidental to that purpose is the power to interfere with contractual relations. In referring to the case authority *Re Companies' Creditors Arrangement Act; A.G. Can. v. A.G. Que.*, [1934] S.C.R. 659, 16 C.B.R. 1, [1934] 4 D.L.R. 75, I stated at pp. 24 and 25 [p. 15]:

34 It was held in that case that the Act was valid as relating to bankruptcy and insolvency rather than property and civil rights. At p. 664, Cannon J. held:

35 Therefore, if the proceedings under this new Act of 1933 are not, strictly speaking, 'bankruptcy' proceedings, because they had not for object the sale and division of the assets of the debtor, they may, however, be considered as 'insolvency proceedings' *with the object of preventing a declaration of bankruptcy and the sale of these assets*. If the creditors directly interested for the time being reach the conclusion that an opportune arrangement to avoid such sale would better protect their interest, as a whole or in part, provisions for the settlement of the liabilities of the insolvent are an essential element of any insolvency legislation ...

36 I went on to note:

37 *The C.C.A.A. is an Act designed to continue, rather than liquidate companies ...* The critical part of the decision is that federal legislation pertaining to assisting in the continuing operation of companies is constitutionally valid. In effect the Supreme Court of Canada has given the term "insolvency" a broad meaning in the constitutional sense by bringing within that term *an Act designed to promote the continuation of an insolvent company*. [emphasis added]

38 In this regard, I would make extensive reference to the article by Mr. Robertson, Q.C., where, in discussing the classification of creditors under the C.C.A.A. and after stating the proposition referred to by counsel for the HongKong Bank and Bank of America, he states at p. 16 in his article:

39 An initial, almost instinctive, response that differences in claims and property subject to security automatically means segregation into different classes does not necessarily make economic or legal sense in the context of an act such as the C.C.A.A.

40 And later at pp. 19 and 20, in commenting on the article by Mr. Edwards, he states:

41 However, if the trend of Edwards' suggestions that secured creditors can only be classed together when they held security of the same priority, that perhaps classes should be sub-divided into further groups according to whether or not a member of the class also holds some other security or form of interest in the debtor company, *the multiplicity of discrete*

*classes or subclasses classes might be so compounded as to defeat the object of the act.* As Edwards himself says, the subdivision of voting groups and the counting of angels on the heads of pins must top somewhere and some forms of differences must surely be disregarded.

42 In summarizing his discussion, he states on pp. 20-21:

43 From the foregoing one can perceive at least two potentially conflicting approaches to the issue of classification. On the one hand there is the concept that members of a class ought to have the same "interest" in the company, ought to be only creditors entitled to look to the same "source" or "fund" for payment, and ought to encompass all of the creditors who do have such an identity of legal rights. *On the other hand, there is recognition that the legislative intent is to facilitate reorganization, that excessive fragmentation of classes may be counter-productive and that some degree of difference between claims should not preclude creditors being put in the same class.*

44 *It is fundamental to any imposed plan or reorganization that strict legal rights are going to be altered and that such alteration may be imposed against the will of at least some creditors.* When one considers the complexity and magnitude of contemporary large business organizations, and the potential consequences of their failure it may be that the courts will be compelled to focus less on whether there is any identity of legal rights and rather focus on whether or not those constituting the class are persons, to use Lord Esher's phrase, "whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest" ...

45 If the plan of reorganization is such that the creditors' particular priorities and securities are preserved, especially in the event of ultimate failure, *it may be that the courts will, for example in an apt case decide that creditors who have basically made the same kinds of loans against the same kind of security, even though on different terms and against different particular secured assets, do have a sufficient similarity of interest to warrant being put into one class and being made subject to the will of the required majority of that class.* [emphasis added]

46 These comments may be reduced to two cogent points. First, it is clear that the C.C.A.A. grants a court the authority to alter the legal rights of parties other than the debtor company without their consent. Second, the primary purpose of the Act is to facilitate reorganizations and this factor must be given due consideration at every stage of the process, including the classification of creditors made under a proposed plan. To accept the "identity of interest" proposition as a starting point in the classification of creditors necessarily results in a "multiplicity of discrete classes" which would make any reorganization difficult, if not impossible, to achieve.

47 In the result, given that this planned reorganization arises under the C.C.A.A., I must reject the arguments put forth by the HongKong Bank and the Bank of America, that since they hold separate security over different assets, they must therefore be classified as a separate class of creditors.

48 I turn now to the other factors which the HongKong Bank and Bank of America submit distinguishes them on individual bases from other creditors of Oakwood. The HongKong Bank and Bank of America argue that the values used by Sceptre are significantly understated. With respect to the Bank of Montreal, it is alleged that that bank actually holds security valued close to, if not in excess of, the outstanding amount of its loans when compared to the HongKong Bank and Bank of America whose security, those banks allege, is approximately equal to the amount of its loans. It is submitted that a plan which understates the value of assets results in the oversecured party being more inclined to support a plan under which they will receive, without the difficulties of realization, close to full payments of their loans.

49 The problem with this argument is that it is a throwback to the "identity of interest" proposition. Differing security positions and changing security values are a fact of life in the world of secured financing. To accept this argument would again result in a different class of creditor for each secured lender, with the possible exception of the A.B.C. noteholders who could be lumped with the HongKong Bank or Bank of America, as their percentage realization under the proposed plan is approximately equal to that of the HongKong Bank and Bank of America.

50 Further, the HongKong Bank and Bank of America also submit that since the Royal Bank and National Bank of Canada are so much more undersecured on their loans, they too have a distinct interest in participating in the plan which is not shared by themselves. The sum total of their submissions would seem to be that, since oversecured and undersecured lenders have a greater incentive to participate, it is only those lenders, such as themselves with just the right amount of security, that do not share that common interest. Frankly, it appears to me that these arguments are drawn from the fact that they are the only secured creditors of Oakwood who would prefer to retain their right to realize upon their security, as opposed to participating in the plan. I do not wish to suggest that they should be chided for taking such a position, but surely expressed approval or disapproval of the plan is not a valid reason to create different classes of creditors. Further, as I have already clearly stated, the C.C.A.A. can validly be used to alter or remove the rights of creditors.

51 Finally, I wish to address the argument that, since Sceptre has made arrangements with the Royal Bank of Canada relating to the purchase of Oakwood, it has an interest not shared by the other secured creditors. The Royal Bank's position as a principal lender in the reorganization is separate from its status as a secured creditor of Oakwood and arises from a separate business decision. In the absence of any allegation that the Royal Bank will not act bona fide in considering the benefit of the plan of the secured creditors as a class, the HongKong Bank and Bank of America cannot be heard to criticize the Royal Bank's presence in the same class.

52 In light of my conclusions, the result is that I approve the proposed classification of secured creditors into one class.

53 There is one further comment I wish to make with respect to the valuations made by Sceptre for the purposes of the vote calculations. I assume that Sceptre will be relying on those valuations at any fairness hearing, assuming this matter proceeds. I would simply observe that the onus is of course on Sceptre to establish that the valuations relied on and set forth in their plan in fact represent fair value under all the circumstances.

54 It has been obvious during the course of the hearing of this phase of the application that at least two of the secured creditors, to whom reference has been made, are not satisfied that that is the case, and in the event evidence is led by them in an effort to establish that the values proposed do not represent the fair value, the onus will be on Sceptre and Oakwood to establish the contrary. Underlying my comments above are of course the court's concern of ensuring that approval of any plan proposed does not result in unfair confiscation of the property of any secured creditors. In that regard, the underlying value of the assets of each individual secured creditor on the facts of this case would appear to be of prime importance.

*Application granted.*

**TAB 7**



2004 ABQB 705  
Alberta Court of Queen's Bench

San Francisco Gifts Ltd., Re

2004 CarswellAlta 1241, 2004 ABQB 705, [2004] A.W.L.D. 579, [2004] A.J. No.  
1062, 134 A.C.W.S. (3d) 239, 359 A.R. 71, 42 Alta. L.R. (4th) 352, 5 C.B.R. (5th) 92

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF SAN FRANCISCO GIFTS LTD. ("SAN FRANCISCO"), 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) (COLLECTIVELY "THE COMPANIES")

Topolniski J.

Heard: September 1, 2004

Judgment: September 28, 2004 \*

Docket: Edmonton 0403-00170

Counsel: Richard T.G. Reeson, Q.C., Howard J. Sniderman for Companies

Jeremy H. Hockin for Oxford Properties Group Inc., Ivanhoe Cambridge 1 Inc., 20 Vic Management Ltd., Morguard Investments Ltd. Morguard Investments Ltd, Morguard Real Estate Investments Trust, RioCan Property Services, 1113443 Ontario Inc. (the "Objecting Landlords")

Michael J. McCabe, Q.C. for Monitor

Subject: Insolvency; Property

**Table of Authorities**

**Cases considered by Topolniski J.:**

*Alternative Fuel Systems Inc., Re* (2004), 2004 ABCA 31, 2004 CarswellAlta 64, (sub nom. *Remington Development Corp. v. Alternative Fuel Systems Inc.*) 346 A.R. 28, (sub nom. *Remington Development Corp. v. Alternative Fuel Systems Inc.*) 320 W.A.C. 28, 24 Alta. L.R. (4th) 1, [2004] 5 W.W.R. 475, 47 C.B.R. (4th) 1, 236 D.L.R. (4th) 155 (Alta. C.A.) — considered

*Armbro Enterprises Inc., Re* (1993), 22 C.B.R. (3d) 80, 1993 CarswellOnt 241 (Ont. Bkcty.) — considered

*Buyer's Furniture Ltd. v. Barney's Sales & Transport Ltd.* (1982), 37 Nfld. & P.E.I.R. 259, 104 A.P.R. 259, 137 D.L.R. (3d) 320, 1982 CarswellNfld 90 (Nfld. T.D.) — referred to

*Buyer's Furniture Ltd. v. Barney's Sales & Transport Ltd.* (1983), 43 Nfld. & P.E.I.R. 158, 127 A.P.R. 158, 3 D.L.R. (4th) 704, 1983 CarswellNfld 68 (Nfld. C.A.) — referred to

*Canadian Airlines Corp., Re* (2000), 2000 CarswellAlta 623, 19 C.B.R. (4th) 12 (Alta. Q.B.) — distinguished

*Canadian Airlines Corp., Re* (2000), 2000 ABCA 149, 2000 CarswellAlta 503, 80 Alta. L.R. (3d) 213, 19 C.B.R. (4th) 33, 261 A.R. 120, 225 W.A.C. 120 (Alta. C.A. [In Chambers]) — referred to

*Dairy Corp. of Canada, Re* (1934), [1934] O.R. 436, [1934] 3 D.L.R. 347, 1934 CarswellOnt 33 (Ont. C.A.) — referred to

*Fairview Industries Ltd., Re* (1991), 11 C.B.R. (3d) 71, (sub nom. *Fairview Industries Ltd., Re (No. 3)*) 109 N.S.R. (2d) 32, (sub nom. *Fairview Industries Ltd., Re (No. 3)*) 297 A.P.R. 32, 1991 CarswellNS 36 (N.S. T.D.) — referred to

*Grafton-Fraser Inc. v. Canadian Imperial Bank of Commerce* (1992), 11 C.B.R. (3d) 161, 90 D.L.R. (4th) 285, 1992 CarswellOnt 164 (Ont. Gen. Div.) — not followed

*Highway Properties Ltd. v. Kelly, Douglas & Co.* (1971), [1971] S.C.R. 562, [1972] 2 W.W.R. 28, 17 D.L.R. (3d) 710, 1971 CarswellBC 239, 1971 CarswellBC 274 (S.C.C.) — referred to

*Jackpine Forest Products Ltd., Re* (2004), 2004 BCSC 20, 2004 CarswellBC 87, 27 B.C.L.R. (4th) 332, 47 C.P.C. (5th) 313, 49 C.B.R. (4th) 110 (B.C. S.C.) — referred to

*Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 64 Alta. L.R. (2d) 139, [1989] 2 W.W.R. 566, 72 C.B.R. (N.S.) 20, 1988 CarswellAlta 319 (Alta. Q.B.) — considered

*Northland Properties Ltd., Re* (1988), 31 B.C.L.R. (2d) 35, 73 C.B.R. (N.S.) 166, 1988 CarswellBC 556 (B.C. S.C.) — considered

*Olympia & York Developments Ltd., Re* (March 14, 1994), Doc. B125/92 (Ont. Gen. Div. [Commercial List]) — referred to

*Playdium Entertainment Corp., Re* (2001), 2001 CarswellOnt 4109, 31 C.B.R. (4th) 309 (Ont. S.C.J. [Commercial List]) — considered

*Sammi Atlas Inc., Re* (1998), 1998 CarswellOnt 1145, 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]) — referred to

*Sklar-Pepppler Furniture Corp. v. Bank of Nova Scotia* (1991), 8 C.B.R. (3d) 312, 86 D.L.R. (4th) 621, 1991 CarswellOnt 220 (Ont. Gen. Div.) — considered

*Smoky River Coal Ltd., Re* (1999), 1999 CarswellAlta 491, 175 D.L.R. (4th) 703, 237 A.R. 326, 197 W.A.C. 326, 71 Alta. L.R. (3d) 1, [1999] 11 W.W.R. 734, 12 C.B.R. (4th) 94, 1999 ABCA 179 (Alta. C.A.) — referred to

*Sovereign Life Assurance Co. v. Dodd* (1892), [1891-94] All E.R. Rep. 246, [1892] 2 Q.B. 573 (Eng. C.A.) — considered

*Wellington Building Corp., Re* (1934), 16 C.B.R. 48, [1934] O.R. 653, [1934] 4 D.L.R. 626, 1934 CarswellOnt 103 (Ont. S.C.) — referred to

*Woodward's Ltd., Re* (1993), 20 C.B.R. (3d) 74, 84 B.C.L.R. (2d) 206, 1993 CarswellBC 555 (B.C. S.C.) — considered

**Statutes considered:**

*Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3

Generally — referred to

s. 4 — referred to

s. 4(3)(c) — referred to

s. 54(3) — referred to

*Commercial Tenancies Act*, R.S.O. 1990, c. L.7

Generally — referred to

ss. 48-50 — referred to

*Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36

Generally — referred to

s. 2 — referred to

s. 6 — referred to

*Distress for Rent Act*, 1737 (11 Geo. 2), c. 19

Generally — referred to

s. 1 — referred to

*Landlord and Tenant Act*, R.S.N.B. 1973, c. L-1

Generally — referred to

s. 27 — referred to

s. 29 — referred to

*Tenancies and Distress for Rent Act*, R.S.N.S. 1989, c. 464

Generally — referred to

s. 13 — referred to

s. 14 — referred to

**Rules considered:**

*Alberta Rules of Court*, Alta. Reg. 390/68

Generally — referred to

**Tariffs considered:**

*Alberta Rules of Court*, Alta. Reg. 390/68

Sched. C, Tariff of Costs, column 1 — referred to

APPLICATION by landlords for order reclassifying creditors for purposes of voting on plan of arrangement under *Companies' Creditors Arrangement Act*.

**Topolniski J.:**

**Introduction**

1 The San Francisco group of companies (San Francisco) obtained *Companies' Creditors Arrangement Act*<sup>1</sup> (CCAA) protection on January 7, 2004 under a consolidated Initial Order. The Initial Order has been extended and the companies continue in business. They now propose a compromise of their debt that is spelled out in a plan of arrangement ("Plan") that has been circulated to their creditors. Like all CCAA plans of arrangement, this Plan proposes classes of creditors for voting purposes. Two-thirds in value and a majority in number of the creditors in each class must cast a positive vote for the Plan in order for it to pass muster. If approved, the Plan will then be presented to the Court for sanctioning at what is commonly referred to as a "fairness hearing".<sup>2</sup> These steps have been delayed by the present application.

2 The six applicants are landlords (the "objecting landlords") of retail premises in Ontario, New Brunswick, Nova Scotia and Newfoundland that were leased to San Francisco. The leases were either abandoned by San Francisco before the CCAA proceedings began or were later terminated with court approval. The objecting landlords seek to reclassify the creditors of San Francisco for purposes of voting on the Plan. They rely on three grounds for their application. First, they argue that they should be placed in a separate class because they have distinct legal rights, their claims are difficult to value and they are preferred over other creditors in the class. Second, they believe that their reclassification is warranted as a result of inequitable treatment of certain creditors under the Plan. Third, they seek to ban closely related creditors, or "related persons", as that phrase is defined in s. 4 of the *Bankruptcy and Insolvency Act*<sup>3</sup> (BIA), from voting on the Plan at all. They submit that, at the very least, related persons should be placed in a separate class to prevent them from controlling the creditor vote.

**Background**

3 San Francisco operates a national chain of novelty goods stores. It currently has 450 employees working from 84 locations. The head office is in Edmonton, Alberta.

4 The group of companies is comprised of the operating company San Francisco Gifts Ltd., and a number of nominee companies. The operating company, which is 100 percent owned by Laurier Investments Corp. ("Laurier"), holds all of the group's assets. In turn, Laurier is 100 percent owned by Barry Slawsky ("Slawsky"), the driving force behind the companies. He is the president and sole director of virtually all of the companies, and is one of the companies' two secured creditors, the other being Laurier. The nominee companies are hollow shells incorporated for the sole purpose of leasing premises.

5 The Monitor reports that the reviews by its counsel of Slawsky and Laurier's security documents "do not indicate any deficiencies in the security position" and that the combined book value of their loans to the companies is \$9,767,000.00. San Francisco's debt at the date of the Initial Order was \$5,300,000.00, not including any unsecured deficiency claims by the secured creditors. There are 1183 creditors in total.

6 Like many consolidated CCAA plans of arrangement, this Plan contemplates the compromise of all of the participant companies' debts from one pool of assets. The Plan places all non-governmental unsecured creditors into one class and proposes

a compromise payment of roughly \$.10 on the dollar by dividing \$500,000 between all unsecured creditors in this class on a *pro rata* basis, after payment of the first \$200.00 of each proven claim. The Plan also provides that Slawsky and Laurier's claims will survive the reorganization. They are defined in the Plan as "unaffected creditors" who will not share in the payment to creditors. They may, however, value their security and vote as unsecured creditors for their deficiency claims.

7 There is little common ground between the parties on this application, except for their ready recognition that a separate landlords' class will secure its members the power to veto the creditor vote.

## Analysis

### *Classification of Creditors Generally*

8 The CCAA does not direct how creditors should be classified for voting purposes. It does nothing more than define what a secured versus an unsecured creditor is<sup>4</sup> and specify that a plan of arrangement must be approved by the various classes of creditors affected by it.<sup>5</sup> However, a "commonality of interest" test and well-defined guidelines for classification have been set out in the case law.

9 In *Sovereign Life Assurance Co. v. Dodd*,<sup>6</sup> Lord Esher M.R. articulated the rationale for the commonality of interest test:

...It seems plain that we must give such a meaning to the term "class" that will prevent the section being so worked as to prevent a confiscation and injustice, and that it must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.

10 The objecting landlords focus their argument on the two themes in this passage: the need for meaningful consultation between class members, something the objecting landlords say will not occur because their rights are different from other creditors in the proposed class; and avoidance of injustice by "confiscation of rights", something the objecting landlords say is preordained if there is no reclassification.

11 The commonality of interest test has evolved over time and now involves application of the following guidelines that were neatly summarized by Paperny J. (as she then was) in *Canadian Airlines Corp., Re* ("Canadian Airlines")<sup>7</sup>:

1. Commonality of interest should be viewed based on the non-fragmentation test,<sup>8</sup> not on an identity of interest test.
2. The interests to be considered are the legal interests that a creditor holds *qua* creditor in relationship to the debtor prior to and under the Plan as well as on liquidation.
3. The commonality of interests should be viewed purposively, bearing in mind that the object of the CCAA, namely to facilitate reorganizations if possible.
4. In placing a broad and purposive interpretation on the CCAA, the Court should be careful to resist classification approaches that would potentially jeopardize viable Plans.
5. Absent bad faith, the motivations of creditors to approve or disapprove [of the Plan] are irrelevant.
6. The requirement of creditors being able to consult together means being able to assess their legal entitlement as creditors before or after the Plan in a similar manner.

12 To this pithy list, I would add the following considerations:

- (i) Since the CCAA is to be given a liberal and flexible interpretation, classification hearings should be dealt with on a fact specific basis and the court should avoid rigid rules of general application.<sup>9</sup>

(ii) In determining commonality of interests, the court should also consider factors like the plan's treatment of creditors, the business situation of the creditors, and the practical effect on them of a failure of the plan.<sup>10</sup>

### *Landlord Classifications Generally*

13 The objecting landlords rely on the affidavit of Walter R. Stevenson, a Toronto lawyer who acts for them. I find it odd that counsel for a party would swear an affidavit in support of his client's motion. It is a risky proposition that is strongly discouraged in this Court. In any event, Mr. Stevenson deposes that he has thirteen years of experience representing clients in insolvency matters. He says that he has been involved in nine cases where national tenants abandoned leased premises and their landlords were placed in a separate class. Presumably, all of this information was intended to persuade me that a separate landlord class is now or should be the norm. It does not.

14 Mr. Stevenson's list is not, nor does it purport to be, an exhaustive review of classifications in multi-location CCAA restructurings across Canada. Further, he provides no insight as to whether it was the debtor company or the court which decided that a separate class was appropriate in each of the cases to which he referred. Nor does not provide any information as to why a particular classification decision was made in the first place. There may be valid reasons for a debtor to segregate landlords. For example, in *Grafton-Fraser Inc. v. Canadian Imperial Bank of Commerce*,<sup>11</sup> the court refused to disturb a separate class proposed by the debtor company for 130 landlords. A landlord in that case was funding the Plan.

15 *Grafton-Fraser Inc.* is cited as authority for the general proposition that landlords should be entitled to a separate class. In his brief reasons, Houlden J. indicated that he was allowing the separate class to remain on the basis that, as compared to other creditors, landlords would have difficulty valuing their claims and would be enjoined from exercising the contractual and statutory claims that they would ordinarily enjoy on a tenant's insolvency. *Grafton-Fraser Inc.*, like all CCAA cases, was doubtless decided on its facts. It was considered, but not applied, in *Woodward's Ltd., Re*, a case that brought widespread attention to the non-fragmentation and contextual approach in classification.<sup>12</sup>

16 Landlords are not entitled to a separate class simply because of who they are. There must be sufficient evidence that their claims are materially different from the claims of other creditors in the class to warrant that. To find otherwise would require that I ignore the contextual and non-fragmentation approach (which I observe does not appear to have firmly take hold until after *Grafton-Fraser Inc.* was decided), and give excessive power to one creditor group in relation to a plan of arrangement designed for the benefit of all of the creditors. This concern was expressed by Borins J. in *Sklar-Peppeler Furniture Corp. v. Bank of Nova Scotia*<sup>13</sup> in dismissing a landlord's plea for a separate class so that it's intended negative vote would not be fruitless. A similar caution was voiced by Blair J. in *Armbrö Enterprises Inc., Re*<sup>14</sup>. He too found that a separate class for landlords was unwarranted in that case.

### *Distinct Legal Rights and Valuation Issues*

17 Depending on their particular circumstances, the objecting landlords assert that they have one or more of three distinct legal rights that will be eroded or confiscated if they are unsuccessful in their application: (1) the right to follow and seize assets removed from abandoned premises; (2) the right to claim damages against any person who aided the tenant in clandestinely removing goods from their reach; and (3) the right to terminate a lease for default under what is commonly called an "insolvency clause" in their leases. At the risk of stating the obvious, objecting landlords who had leases terminated with court approval after the Initial Order cannot advance these arguments.

#### *1. Rights Arising from Clandestine Removal of Goods*

18 Before applying for CCAA protection, San Francisco removed assets and abandoned 14 of the 16 premises leased from the objecting landlords.

19 Ontario and New Brunswick's legislation allows a landlord the right to follow and seize goods that were fraudulently and clandestinely removed to prevent the landlord from distraining for rental arrears. There is a thirty day time limit on this right to seize. The landlord is also granted a right of action against any person who knowingly aided in the removal or concealment of the goods.<sup>15</sup> These remedies are akin to those provided in the 1737 *Distress for Rent Act* of England,<sup>16</sup> commonly called *The Statute of George*, 11 Geo. II, c. 19. Nova Scotia's legislation differs from that in Ontario and New Brunswick in that it does not provide for the third party right of action and the time period for following the goods and seizing is twenty-one rather than thirty days.<sup>17</sup> Newfoundland lacks any specific legislation granting these remedies, and it is questionable if *The Statute of George*, although incorporated into the laws of Newfoundland before December 31, 1831, remains in effect there.<sup>18</sup>

20 To succeed in an action under these statutory schemes (and perhaps under the common law in Newfoundland), there must be sufficient evidence to establish that: (1) rent payments are in arrears; (2) goods owned by the tenant were removed from the premises; (3) this conduct was clandestine or fraudulent; and (4) the goods were removed for the purpose of preventing the landlord from seizing them for arrears of rent.

21 The issue arises whether the objecting landlords must prove their claims for classification purposes or simply show that they have an arguable case. Clearly, the court is not interested in ruling on hypothetical matters, but it would be unreasonable at this stage to require an applicant in a reclassification hearing to actually prove their claim. Proof will be required at a later date to establish entitlement to membership in a new class, if one is ordered. What must be presented at this point is sufficient evidence to show that there is an arguable case that would justify a separate class.

22 The objecting landlords rely on two leases, which they say are typical of the leases entered into between them and San Francisco (or its nominee corporations), to demonstrate that there were arrears owing at the date of abandonment. The alleged arrears are comprised of accelerated rent which, under the terms of the leases, became due on termination and are contractually deemed arrears. Without deciding on the correctness of the objecting landlords' assertion, I find that there is sufficient evidence to establish at least an arguable case that there are arrears of rent.

23 Insofar as evidence of clandestine removal is concerned, two landlords depose that, without their knowledge and without notice to them, San Francisco vacated and removed all of its assets from their premises. Although it would have been preferable to have more detail of the circumstances of the alleged removal of assets, this evidence again is sufficient to establish an arguable case. The merits of the objecting landlords' position will be fully aired and determined in quantifying their claims.

24 I have concluded that the objecting landlords have an arguable case. Their rights to pursue distraint and sue a person for aiding in clandestine removal of goods are unique ones. However, the uniqueness of a right is, in and of itself, insufficient to warrant a separate class. The right must be adjudged worthy of a separate class after considering the various factors outlined above. In essence, it must preclude consultation between the creditors.

25 The Initial Order specifically preserved all creditors' rights to take or continue an action against San Francisco if their claims were subject to statutory time limitations.<sup>19</sup> The objecting landlords elected not to pursue their statutorily time limited remedy of following and seizing goods within the time permitted. As a result, it is unreasonable to allow them to now assert that entitlement as the justification for a separate class. Moreover, in the context of a bankruptcy, the remedy is generally academic since there are no goods available for distraint. For these reasons, the inability to follow and seize goods cannot support the ordering of a separate class.

26 The Plan requires that all creditors give up claims against the company, its officers, employees, agents, affiliates, associates and directors. This requirement is subject to the qualification that an action based on allegations of misrepresentations made by a director to creditors or of *wrongful or oppressive conduct by a director* is preserved (emphasis added).<sup>20</sup> While candidly acknowledging that their best chance of financial recovery on a successful action would be against Slawsky, the objecting landlords contend that preserving their right of action only against him would be insufficient protection given that they do not know at the moment whether he alone was the person who orchestrated or aided in the removal of San Francisco's goods. In

view of Slawsky's apparent level of control over the companies, it might be reasonable to conclude that he was involved in the decision to abandon the premises. However, that is speculative at this point and others may well have been involved.

27 Although the Initial Order did not stay actions against San Francisco's employees or agents, the landlords' failure as yet to pursue the employees or agents does not end the matter. This aspect of a removal action is quite different from the statutorily time limited ability of a landlord to follow and seize their tenant's goods, which the objecting landlords chose not to exercise. Only general limitations legislation and the practical effects of the Releases contained in the Plan affect this aspect of the claim.

28 I find that the Plan does not adequately address the objecting landlords' unique legal entitlement to claim damages against persons who aided their tenant in clandestinely removing goods from the premises. In making this finding, I considered the following to be significant factors:

1. Unlike the ability to follow and seize goods, which has been rendered academic, this right of action is potentially meaningful.
2. The Plan does not offer compensation for deprivation of this right of action, resulting in a "confiscation" of the objecting landlords' right as described in *Sovereign Life*.
3. Unlike claims that would be extinguished on a bankruptcy of the companies, this right of action would survive since it is against third parties.

29 The CCAA is designed to be fluid and flexible, and the Court is given wide discretion to facilitate that flexibility. Alternatives to establishing a separate voting class should be explored. I can envision at least three other options: (1) direct an amendment to the Plan to compensate the objecting landlords for the loss of their potential rights of action against persons other than Slawsky; (2) direct an amendment to the Plan to expand the survival of actions provision (clause 6.1 (b)) to include potential defendants other than Slawsky; or (3) deal with the matter at the fairness hearing.

30 Ordering a separate class would clearly recognize and protect the objecting landlords' potential causes of action against third parties other than Slawsky. Further, it would overcome potential hurdles in consultation among the unsecured creditors. However, a separate class would give the objecting landlords a veto power over the Plan. This flags the principle that courts should be careful to resist classification approaches that might jeopardize viable plans of arrangement.

31 Directing that the Plan be amended to compensate the objecting landlords for the loss of their potential rights of action is not a viable option. It would require that the Court blindly enter into San Francisco's strategic arena. Such a direction would interfere with the right of the companies to make their own Plan and would purport to cloak the Court with knowledge of the companies' resources, strategies and plans, knowledge which it simply does not possess. Interference of this sort should be avoided.

32 Directing an amendment to the Plan to expand the survival of actions provision to include potential defendants other than Slawsky certainly would be less intrusive than compensating the objecting landlords for the loss of their potential right of action. It would preserve their right to pursue the removal action against persons other than Slawsky and would enhance consultation with other creditors in the class. On the other hand, it would impose an obligation on the companies that they may not have contemplated or may have been unwilling to voluntarily assume.

33 As to dealing with the matter at a fairness hearing, I note that the CCAA does not require that debtors present a 'guaranteed winner' of a plan to their creditors. Debtors can make any proposal to their creditors and take whatever chances they might consider appropriate. However, to succeed, they must act in good faith and present a plan of arrangement at the end of the day which is fair and reasonable. If they fail to do so, the process is a waste of time and valuable resources. It accomplishes nothing but an erosion of assets that otherwise would be available to creditors on liquidation. This is precisely what Tysoe J. sought to avoid when he ordered a separate class for guarantee holders in *Woodward's Ltd., Re*, on being convinced that the plan in that case was unfair to them.<sup>21</sup>



34 The opposite result occurred in *Canadian Airlines*, where Madam Justice Paperny deferred the classification issue to the fairness hearing. *Canadian Airlines* presented quite a different scenario to that in *Woodward's Ltd., Re* or the one before me. The concern in *Canadian Airlines* was with Air Canada voting in the same class as other unsecured creditors when it had appointed the board which directed the CCAA proceedings, was funding the Plan, and fears existed about its acquisition of deficiency claims to secure a positive vote. The court was not concerned about a confiscation of legal rights but was attempting to safeguard against "ballot stuffing".<sup>22</sup>

35 In the particular circumstances of the present case, I find it preferable to protect the objecting landlords' remedy by directing that there be an amendment to the Plan to preserve any cause of action they might have against any party who aided San Francisco in clandestinely removing its assets from their premises. This measure balances the need to avoid giving unwarranted power to one creditor group and the need to protect a unique legal entitlement. It avoids the potential of valuable resources being expended on creditors' meetings when the potential exists that at the end of the day I would find the Plan to be unfair on the basis of this aspect of the objecting landlords' argument. Finally, it avoids significant interference with the debtor's financial strategy in formulating its Plan.

## *2. Loss of Default/Insolvency Clause Remedy*

36 Some, if not all, of the leases allow the landlord to terminate the lease in the event of the tenant's insolvency. The objecting landlords argue that this is another unique right which is not compensated for in the Plan.

37 The Initial Order enjoined all of San Francisco's landlords from enforcing contractual insolvency clauses. This is a common prohibition designed, at least in part, to avoid a creditor frustrating the restructuring by relying on a contractual breach occasioned by the very insolvency that gave rise to the proceedings in the first place.<sup>23</sup> The objecting landlords complain that their rights are permanently lost because of the Release contained in the Plan. They do not acknowledge that the stay is essential to the longer-term feasibility of the CCAA restructuring and something which courts have granted with increasing regularity to give effect to the remedial nature of the CCAA.<sup>24</sup> Even ignoring this pragmatic consideration, the objecting landlords' argument fails. The contractual right that is affected is neither unique, nor of any practical use. Thirteen other creditors, mainly equipment lessors and utility providers, have similar contractual default provisions. Further, all of the leases have already been terminated.

## *3. Difficulty in Valuing Claim*

38 The objecting landlords rely on *Grafton-Fraser Inc.* for the proposition that landlords' claims are difficult to value and therefore a separate class is warranted. Unfortunately, the brief reasons given by Houlden J. do not provide any insight as to how the company in that case proposed to value the landlords' claims. No doubt, Houlden J. had the specific facts before him clearly in focus as he made his decision. I reject the contention that *Grafton-Fraser Inc.* is a decision of sweeping application, being mindful that rigid rules of general application are to be avoided in CCAA matters.

39 The Claims Procedure Order, issued on June 22, 2004 in this matter, establishes a mechanism for valuing landlords' abandoned premises claims that reflects the methodology established by the Supreme Court of Canada in *Highway Properties Ltd. v. Kelly, Douglas & Co.*<sup>25</sup> The valuation mechanism, set out in para. 12 of the Order,<sup>26</sup> is straightforward. A claimant simply follows the formula. There is a clear cut-off date for mitigation efforts and a readily calculable present value. The landlords' claims will not be difficult to value.

## *Inequitable Treatment of Creditors*

### *1. Preferential Treatment of Some Landlords*

40 The objecting landlords make the curious complaint that the Plan prefers them to other unsecured creditors in that it contemplates the duty to mitigate, for valuation purposes, ending at the claims bar date.

41 Presumably, the objecting landlords could re-let the premises the following day and still base their claim on the value of unpaid rent for the unexpired portion of the term of their lease. While they might receive a benefit, it is trite that there must always be a cut-off date for mitigation when future losses are the subject of a *CCAA* creditor claim. San Francisco chose the claims bar date for ease of analyzing claims for voting purposes. Its choice makes practical sense and is not facially offensive. As noted in *Alternative Fuel Systems Inc., Re*,<sup>27</sup> courts have approved a variety of solutions to quantifying landlords' claims. That approach is in keeping with the distinct purpose of the *CCAA*. Further, the treatment of landlords' claims under a plan of arrangement is an issue for negotiation and, ultimately, court approval.

42 The objecting landlords also say that they are preferred in that the Plan is a consolidated one that proposes a compromise regardless of whether a landlord's claim against a hollow nominee company would have been worthless outside of the *CCAA*. This issue will be of interest to other creditors as they consider their vote and position on the fairness hearing. However, it does not warrant creation of a separate class. If anything, it might warrant San Francisco revisiting the Plan, which some of the beneficiaries appear to think is too generous in the circumstances.

## *2. Preferential Treatment of Slawsky and Laurier*

43 The objecting landlords take issue with Slawsky and Laurier being classified as "unaffected creditors" whose claims survive the reorganization despite their ability to value their security for voting purposes and to vote as unsecured creditors for their deficiency claims. Slawsky and Laurier's view is that the Plan does not prefer them because they do not share in the payment available to the general pool of unsecured creditors under the Plan and they are, by deferring payment of their secured claims, effectively funding the Plan.

44 The Plan's treatment of Slawsky and Laurier does not serve as a reason to segregate the landlords. Whether it is a reason to place Slawsky and Laurier into a separate class is discussed under the next heading.

## *Related Parties*

45 The objecting landlords take umbrage with Slawsky, his son Aaron, Laurier, and other corporate entities in which Slawsky has an interest, voting on the Plan. They want to import into the *CCAA* proceedings the *BIA* prohibition against "related persons" voting in favour of a proposal, urging that the same policy considerations apply against allowing an insider to control the vote.<sup>28</sup>

46 The Alberta Court of Appeal in *Alternative Fuel Systems Inc., Re* declined to import *BIA* landlord claim calculations into a *CCAA* proceeding. The court found that the section of the *CCAA* at issue did not mandate importation of *BIA* provisions and, more significantly, the court found that to do so would not pay sufficient attention to the distinct objectives of the *CCAA* (remedial) and *BIA* (largely liquidation). In conducting its contextual analysis, the court acknowledged the need to maintain flexibility in *CCAA* matters, discouraging importation of any statutory provision that might impede creative use of the *CCAA* without a demonstrated need or statutory direction. There is no such direction or need in this case.

47 The objecting landlords find support for their position in *Northland Properties Ltd., Re*<sup>29</sup> Trainor J. in that case refused to allow a subsidiary to vote on its parent's *CCAA* plan. While care should be exercised to avoid a corporation "stuffing the ballot boxes in its own favour",<sup>30</sup> a blanket ban on insider voting is not always necessary or desirable. Safeguards against potential abuses can be built into a plan and the voting mechanism. For example, the Monitor could procure sworn declarations from insiders as to their direct and indirect shareholdings in order to help track voting. That information, together with proofs of claim, proxies, and ballots, which relate to the insiders' claims could then be presented at the fairness hearing. This type of safeguard was taken in *Canadian Airlines*. Paperny J. observed in that case that "absent bad faith, who creditors are is irrelevant".<sup>31</sup>

48 Safeguards such as this are applicable only if the court is satisfied that there is sufficient commonality of interest between the insiders and the other creditors to place them in the same class. That was the case in *Canadian Airlines*. There, all of the creditors in the class were unsecured creditors. They were treated in the same way under the plan, and would have been treated

the same way on a bankruptcy. The plan called for the insider, Air Canada, to compromise its claim, just like all of the other creditors.

49 Here, there is no compromise by Slawsky or Laurier. Further, they would, but for a security position shortfall, be unaffected by a bankruptcy of the companies, whereas all of the other creditors in the class would receive nothing. Slawsky has created a Plan which gives him voting rights that he doubtless wants to employ if he senses the need to sway the vote. In return, he gives up nothing. It stretches the imagination to think that other creditors in the class could have meaningful consultations about the Plan with Slawsky and, through him, with Laurier. For that reason, Slawsky and Laurier must be placed in a separate class.

## Conclusions

50 The right of the objecting landlords to pursue distraint is unique as is their right to sue a person for aiding in clandestine removal of goods from the leased premises. For the reasons stated, loss of the objecting landlords' right to follow and seize goods cannot support the ordering of a separate class. However, I find that the Plan does not adequately address their right to claim damages against persons who aided a tenant in clandestinely removing goods from the premises. Rather than create a separate voting class for the objecting landlords, I direct that the Plan be amended to preserve any cause of action the objecting landlords and others in their position might have against any party who aided San Francisco in clandestinely removing its assets from their premises.

51 The right or ability of the objecting landlords to terminate the leases in question in the event of their tenants' insolvency is neither unique nor of any practical effect at this point. It is not a sufficient ground for creation of a separate voting class. Nor have I accepted the argument of the objecting landlords that a separate class should be established because their claims will be difficult to value. The Claims Procedure Order provides a mechanism for valuing their claims.

52 I have determined that, to the extent there is preferential treatment of the landlords or of Slawsky and Laurier under the Plan, such preferential treatment does not justify segregating the objecting landlords. However, as Slawsky and Laurier do not share a commonality of interest with other unsecured creditors, they must constitute a separate class for voting purposes.

53 Although success on this application has been somewhat divided, the objecting landlords have enjoyed greater success. There are no provisions in the *CCAA* dealing with costs, however, the Court has the discretion to award costs under the *Rules of Court* and its inherent jurisdiction.<sup>32</sup> The nature of the relief granted to the objecting landlords is akin to declaratory relief and accordingly, costs under Column 1 of Schedule C to the *Rules of Court* are appropriate. The costs are payable forthwith.

*Order accordingly.*

## Footnotes

\* Leave to appeal refused *San Francisco Gifts Ltd., Re* (2004), 5 C.B.R. (5th) 300, 42 Alta. L.R. (4th) 371, 361 A.R. 220, 339 W.A.C. 220, 2004 ABCA 386, 2004 CarswellAlta 1607 (Alta. C.A.).

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

2 The considerations at this hearing are typically whether there has been strict compliance with statutory requirements, whether any unauthorized acts have occurred, and whether the plan is fair and reasonable: see *Sammi Atlas Inc., Re* (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]).

3 R.S.C. 1985, c. B-3, as am.

4 *CCAA*, s. 2.

5 *CCAA*, s. 6.

6 *Sovereign Life Assurance Co. v. Dodd*, [1892] 2 Q.B. 573 (Eng. C.A.), at 583.

- 7 *Canadian Airlines Corp., Re* (2000), 19 C.B.R. (4th) 12 (Alta. Q.B.), leave to appeal denied (2000), 19 C.B.R. (4th) 33 (Alta. C.A. [In Chambers]), cited in the Court of Appeal's subsequent decision in *Canadian Airlines Corp., Re* (2000), 261 A.R. 120, 2000 ABCA 149 (Alta. C.A. [In Chambers]) at para. 27: see also *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 86 D.L.R. (4th) 621, 8 C.B.R. (3d) 312 (Ont. Gen. Div.).
- 8 "Non-fragmentation" means that a multiplicity of classes should be avoided if possible. The notion was first expressed in the Canadian context in *Norcen Energy Resources Ltd. v. Oakwood Petroleum Ltd.* (1988), 72 C.B.R. (N.S.) 20 (Alta. Q.B.), but does not appear to have gained wide acceptance until 1993 when *Woodward's Ltd., Re* (1993), 20 C.B.R. (3d) 74 (B.C. S.C.), at 81 was decided. There were five creditor groups in *Woodward's Ltd., Re*, including one group of landlords of abandoned premises and another of creditors holding cross-corporate guarantees or joint covenants, which sought separate classes. The court ruled that, given there was sufficient commonality of interest among the general body of creditors and the applicant landlords, a separate class was unwarranted. Tysoe J. rejected the landlords' proposition that their legal interests differed from that of the other creditors in that repudiation of an anchor tenant's lease would cause the landlord to be in breach of other tenant obligations. He did, however, order a separate class for the holders of cross-corporate guarantees, observing that their unique rights were "confiscated without compensation" under the plan. Interestingly, Tysoe J. rejected the suggestion that the issue be dealt with at the fairness hearing because he was convinced that the scheme was so unfair that he would refuse to sanction a successful outcome, rendering the creditors' vote pointless.
- 9 *Fairview Industries Ltd., Re* (1991), 109 N.S.R. (2d) 32, 11 C.B.R. (3d) 71 (N.S. T.D.).
- 10 *Woodward's Ltd., Re* at p. 81.
- 11 *Grafton-Fraser Inc. v. Canadian Imperial Bank of Commerce* (1992), 90 D.L.R. (4th) 285, 11 C.B.R. (3d) 161 (Ont. Gen. Div.).
- 12 Peter B. Birkness, "Re Woodward's Limited — The Contextual Commonality of Interest Approach to Classification of Creditors" (1993), 20 C.B.R. (3d) 91 at 92.
- 13 *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 86 D.L.R. (4th) 621, 8 C.B.R. (3d) 312 (Ont. Gen. Div.).
- 14 *Armbro Enterprises Inc., Re* (1993), 22 C.B.R. (3d) 80 (Ont. Bkcy.).
- 15 *Commercial Tenancies Act*, R.S.O.1990, c. L-7, ss. 48-50 and *Landlord and Tenant Act*, R.S.N.B. 1973, c. L-1, ss. 27, 29.
- 16 *Distress for Rent Act 1737*, 11 Geo. 2, c. 19, s. 1, which provides: "In case of any tenant or tenants, lessee or lessees ... upon the demise or withholding whereof, any rent is or shall be reserved due or payable, shall fraudulently or clandestinely, convey away, or carry off or from such premises, his or her or their goods or chattels, to prevent the landlord or lessor ... from distraining the same for arrears of rent, it shall or may be lawful for every landlord or lessee ... to take or seize such goods and chattels wherever the same shall be found as distress for the said arrears of rent. "
- 17 *An Act Respecting Tenancies and Distress for Rent*, R.S.N.S. 1989, c. 464, ss. 13 and 14.
- 18 *Buyer's Furniture Ltd. v. Barney's Sales & Transport Ltd.* (1982), 137 D.L.R. (3d) 320 (Nfld. T.D.), affirmed (1983), 3 D.L.R. (4th) 704 (Nfld. C.A.).
- 19 The amendment on January 12, 2004 does not affect the issues at bar.
- 20 Article 6.1 of the Plan provides as follows: "On the Effective Date, and except as provided below, each of the Companies, the Monitor, and the past and present directors, officers, employees, agents, affiliates and associates of each of the foregoing parties (the "Released Parties") shall be released and discharged by all Creditors, including holders of Unsecured Creditor Claims, and Goods and Services Tax Claims from any and all demands, claims, including claims of any past and present officers, directors or employees for contribution and indemnity, actions, causes of action, counterclaims, suits, debts, sums of money, accounts, covenants, damages, judgments, expenses, executions, charges and other recoveries on account of any liability, obligation, demand or cause of action of whatever nature which any person may be entitled to assert, including, without limitation, any and all claims in respect of any environmental condition or damage affecting any of the property or assets of the Companies, whether known or unknown, matured or unmatured, foreseen or unforeseen, existing or hereafter arising, based in whole or in part on any act or omission, transaction, dealing or other occurrence existing or taking place on or prior to the Effective Date relating to, arising out of or in connection with

any Claims, the business and affairs of the Companies, whenever and however conducted, this Plan and the CCAA Proceedings, and any Claim that has been barred or extinguished by the Claims Procedure Order shall be irrevocably released and discharged, provided that this release shall not affect the rights of any Person to pursue any recoveries for a Claim against a director or the Companies that: (a) relates to contractual rights of one or more creditors against a director; or (b) are based on allegations of misrepresentations made by a director to creditors or of wrongful or oppressive conduct by a director."

- 21 At para. 11.
- 22 *Olympia & York Developments Ltd., Re*, [1994] O.J. No. 1335 (Ont. Gen. Div. [Commercial List]) at para. 24.
- 23 See for example: *Norcen Energy Resources Ltd.*, where one of the debtor's joint venture partners was enjoined from relying on an insolvency clause to replace the operator under a petroleum operating agreement.
- 24 As noted by Spence J. in *Playdium Entertainment Corp., Re* (2001), 31 C.B.R. (4th) 309 (Ont. S.C.J. [Commercial List]) at para. 32: "If no permanent order could be made under s. 11(4) it would not be possible to order, for example, that the insolvency defaults which occasioned the CCAA order could not be asserted by the Famous Players after the stay period. If such an order could not be made the CCAA regime would prospectively be of no value even though a compromise of creditor claims might be worked out in the stay period." See also *Smoky River Coal Ltd., Re* (1999), 237 A.R. 326 (Alta. C.A.).
- 25 *Highway Properties Ltd. v. Kelly, Douglas & Co.*, [1971] S.C.R. 562 (S.C.C.).
- 26 12(a) With respect to Proofs of Claim to be filed with the Monitor by a Landlord of retail premises currently or formerly occupied by the Companies ("Landlord"), a Landlord is to value and calculate its claim ("Landlord's Claim") as being the aggregate of:
- (i) Arrears of rent, if any, owing under a lease as at January 7, 2004;
- (ii) In instances where a lease has been repudiated by the Companies (whether or not the repudiation occurred before or after January 7, 2004), the value of rent payable under the lease from the date of repudiation to the date of the Proof of Claim (if any) less any revenue received from any reletting of the premises (in whole or in part) as at the date of the Proof of Claim;
- (iii) In instances where a lease has been repudiated by the Companies (whether or not the repudiation occurred before or after January 7, 2004), the present value (using an interest factor of 3.65%) of rents payable under the lease as at the date of the Proof of Claim through to the end of the unexpired term of the lease (if any) less any revenue to be received during that time period from any reletting of the premises (in whole or in part) which has occurred prior to the date of the Proof of Claim.
- (b) For the purposes of a Landlord's Claim, where a lease contains an option in favour of the Companies authorizing the Companies to treat that lease as terminated and at an end prior to the otherwise stated termination date of that lease, the Companies shall be deemed to have exercised that option and the Landlord's Claim with respect to that lease shall be calculated having regard to the early termination date.
- 27 *Alternative Fuel Systems Inc., Re* (2004), 236 D.L.R. (4th) 155 at paras. 64-69, 2004 ABCA 31 (Alta. C.A.).
- 28 The BIA, s. 4(3)(c) definition of "related person" includes a controlling shareholder of a corporation. Section 54(3) provides that a creditor related to the debtor may vote against but not for the acceptance of a proposal.
- 29 *Northland Properties Ltd., Re* (1988), 73 C.B.R. (N.S.) 166 (B.C. S.C.), at 170. See also: *Wellington Building Corp., Re*, [1934] O.R. 653 (Ont. S.C.) and *Dairy Corp. of Canada, Re*, [1934] O.R. 436 (Ont. C.A.), referred to in *Northland Properties Ltd., Re*.
- 30 *Olympia & York Developments Ltd., Re* at para.24, per Farley J.
- 31 At para. 37.
- 32 *Jackpine Forest Products Ltd., Re*, 2004 BCSC 20 (B.C. S.C.).

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# TAB 8

2009 NSSC 163  
Nova Scotia Supreme Court

ScoZinc Ltd., Re

2009 CarswellNS 283, 2009 NSSC 163, 177 A.C.W.S. (3d) 294, 55 C.B.R. (5th) 205

**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 ScoZinc Limited

D.R. Beveridge J.

Heard: May 1, 2009

Judgment: May 1, 2009

Written reasons: May 20, 2009

Docket: Hfx 305549

Counsel: John D. Stringer, Q.C., Ben Durnford for Applicant

Robbie MacKeigan, Q.C. for Daniel Rozon

John McFarlane, Q.C. for Kamatsu

Subject: Insolvency

**Table of Authorities**

**Cases considered by D.R. Beveridge J.:**

*Fairview Industries Ltd., Re* (1991), 1991 CarswellNS 35, 11 C.B.R. (3d) 43, (sub nom. *Fairview Industries Ltd., Re* (No. 2)) 109 N.S.R. (2d) 12, (sub nom. *Fairview Industries Ltd., Re* (No. 2)) 297 A.P.R. 12 (N.S. T.D.) — considered

*Federal Gypsum Co., Re* (2007), 2007 NSSC 384, 2007 CarswellNS 630, 261 N.S.R. (2d) 314, 835 A.P.R. 314, 40 C.B.R. (5th) 39 (N.S. S.C.) — considered

*ScoZinc Ltd., Re* (2009), 2009 CarswellNS 177, 2009 NSSC 108, 52 C.B.R. (5th) 200 (N.S. S.C.) — referred to

**Statutes considered:**

*Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36

Generally — referred to

s. 4 — referred to

s. 5 — referred to

s. 11 — referred to

s. 11(4) — referred to

s. 11(6) — referred to



MOTION by company for order for meeting of creditors pursuant to ss. 4 and 5 of *Companies' Creditors Arrangement Act*, further extension of stay of proceedings granted to company under *Act*, and approval of notice of motion being given only to certain defined creditors.

**D.R. Beveridge J.:**

1 ScoZinc brings a motion seeking an order to accomplish three things. The first is for a meeting of the creditors pursuant to ss. 4 and 5 of the *Companies' Creditors Arrangement Act*. The second is a further extension of the stay of proceedings initially ordered by this Court on December 22, 2008 and extended from time to time. The third is approval of notice of this motion being given only to certain defined creditors.

2 The company has filed an affidavit of William Felderhof referred to as his seventh affidavit, sworn April 28, 2009 and the Monitor has filed its sixth report dated April 30, 2009.

3 As part of its submissions the company notes that there is nothing in the *CCAA* which requires the Court to give prior preliminary approval of ScoZinc's proposed plan before it is presented to the creditors. It notes that the jurisprudence establishes that this approval is generally desirable prior to calling a meeting of the creditors. Some, but not all of this jurisprudence was reviewed by MacAdam J. in *Federal Gypsum Co., Re*, 2007 NSSC 384 (N.S. S.C.).

4 Justice MacAdam in *Federal Gypsum Co., Re* did refer to the two different standards that have been proposed or referred to in cases from Ontario and British Columbia. Some of these cases have expressed the view that the debtor company should establish that the plan has "a reasonable chance" that it would be accepted by the creditors. Other cases have referred to the appropriate test as simply a determination as to whether or not the proposed plan is one that would be "doomed to failure".

5 In a different context, Glube C.J.T.D. (as she then was) in *Fairview Industries Ltd., Re* (1991), 11 C.B.R. (3d) 43 (N.S. T.D.) cautioned that it would be impractical and extremely costly to continue to prepare a plan when "there is no hope that it would be approved".

6 I think it fair to say that MacAdam J., although not expressly but by necessary implication, preferred the lower standard facing a debtor company in submitting its plan to the Court for a preliminary approval. At para. 12 he wrote:

[12] In view of the relatively low threshold on the Company in seeking Court approval to have a plan of arrangement submitted to the creditors for a vote, I am satisfied the plan should proceed and the creditors should determine whether they do, or do not accept the plan as finally filed.

7 In my opinion it should not be up to the Court to second guess the probability of success of a proposed plan of arrangement. Businessmen are free to make their own views known before and ultimately at the creditors' meeting. It seems to me that the Court should only decline to give preliminary approval and refuse to order a meeting if it was of the view that there was no hope that the plan would be approved by the creditors or, if it was approved by the creditors, it would not, for some other reason, be approved by the Court.

8 The Monitor in its sixth report says that the proposed plan is reasonable under the circumstances. This opinion appears to flow from its conclusion that if the plan is rejected and the company forced into receivership or bankruptcy, unsecured creditors will not recover the amount offered in the plan and it is highly unlikely that the secured creditors will recover the amount offered to them. I see no reason to disagree with the opinion offered by the Monitor.

9 Given that opinion and in light of the terms that are set out in the proposed plan I am certainly satisfied that the plan is far from one that is doomed to failure. It is one that should be put to the creditors for their consideration. It is therefore appropriate that I exercise the discretion that is set out in ss. 4 and 5 of the *CCAA* and order a meeting of the creditors on the terms set out in the proposed meeting order.

10 With respect to the extension of the stay of proceedings, as I noted at the outset there had been an initial order of this Court under s.11 of the *CCAA*. This order was granted on December 22, 2008. It was, as required by the statute, limited to a period of 30 days. It has been extended on two previous occasions. It is now due to expire May 22<sup>nd</sup>, 2009. The meeting of the creditors is scheduled for May 21, 2009. There is a tentative return date scheduled for May 28, 2009 for the Court to consider sanctioning the plan, should it be approved by the creditors.

11 The test with respect to extending the stay of proceedings has been set out in a number of cases that have considered ss. 11(4) and (6) of the *CCAA*. These were reviewed by me in *ScoZinc Ltd., Re*, 2009 NSSC 108 (N.S. S.C.). In these circumstances there is no need to review the test and the evidence in support of that test.

12 In light of my conclusion that the company had met the threshold for ordering a meeting of the creditors under ss. 4 and 5 of the *CCAA* the appropriateness of a further extension permitting the company to return to the Court within a very short period of time following that meeting of the creditors is patently obvious. The extension is therefore granted.

13 The last issue is the approval of notice of this motion being given only to certain defined creditors. Given the number of creditors that appeared early on in the proceedings it was somewhat impractical to give notice to each of them with the volumes of materials that would be required to be produced and served. With respect to the prior motions it was required that notice be given to all creditors asserting claims against the debtor company in excess of \$100,000.00 and all creditors asserting builders liens. In addition all creditors were apprised of these proceedings by way of the mail out to each and every creditor as required by the *CCAA* leading to filing of proofs of claim. The status of the proceedings, including this motion, have been posted on the Monitor's website. I see no reason to depart from the previous practice and this aspect of the motion is also granted.

*Motion granted.*