

TAB 9

2009 ABQB 490
Alberta Court of Queen's Bench

SemCanada Crude Co., Re

2009 CarswellAlta 1269, 2009 ABQB 490, [2009] A.W.L.D.
3785, 180 A.C.W.S. (3d) 374, 479 A.R. 318, 57 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 SemCanada Crude
Company, SemCAMS ULC, SemCanada Energy Company, A.E. Sharp Ltd., CEG
Energy Options, Inc., 319278 Nova Scotia Company and 1380331 Alberta ULC

B.E. Romaine J.

Heard: August 5, 2009
Judgment: August 24, 2009
Docket: Calgary 0801-08510

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Brendan O'Neill, Jason Wadden for Fortis Capital Corp.
Sean Fitzgerald for Tri-Ocean Engineering Ltd.
Dean Hutchison for Crescent Point Energy Trust, Enbridge Pipelines Inc.
Caireen Hanert for Bellamount Exploration Ltd., Enersul Limited Partnership
Bryce McLean for DPH Focus Corporation
Aubrey Kauffman for BNP Paribas

Subject: Insolvency

Table of Authorities

Cases considered by B.E. Romaine J.:

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

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Canadian Airlines Corp., Re (2001), 2001 CarswellAlta 888, 2001 CarswellAlta 889, 275 N.R. 386 (note), 293 A.R. 351 (note), 257 W.A.C. 351 (note) (S.C.C.) — referred to

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Statutes considered:

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s. 503(b)(9) — referred to

Chapter 7 — referred to

Chapter 11 — referred to

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

s. 6 — referred to

s. 11(1) — referred to

s. 22(2) [rep. & sub. 2007, c. 36, s. 71] — referred to

APPLICATION for orders authorizing establishment of single class of creditors for three plans to restructure and distribute assets for purpose of considering and voting on plans.

B.E. Romaine J.:

Introduction

1 The SemCanada Group applied for various relief related to the holding of meetings of creditors to consider three plans to restructure and distribute assets of the CCAA applicants, including applications for orders authorizing the establishment of a single class of creditors for each plan for the purpose of considering and voting on the plans. I granted the applications, and these are my reasons.

Relevant Facts

2 On July 22, 2008, SemCanada Crude Company ("SemCanada Crude") and SemCAMS ULC ("SemCAMS") were granted initial Orders pursuant to s. 11(1) of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c.C-36, as amended (the "CCAA").

3 On July 30, 2008, the CCAA proceedings of SemCAMS and SemCanada Crude and the bankruptcy proceedings of SemCanada Energy Company ("SemCanada Energy") A.E. Sharp Ltd. ("AES") and CEG Energy Options, Inc. ("CEG") which had been commenced on July 24, 2008 were procedurally consolidated for the purpose of administrative convenience.

4 In addition, CCAA protection was granted to two affiliated companies, 3191278 Nova Scotia Company (A319") and 1380331 Alberta ULC ("138"). SemCanada Energy, AES, CEG, 319 and 138 are collectively referred to as the "SemCanada Energy Companies". The CCAA applicants are collectively referred to as the "SemCanada Group".

5 On July 22, 2008, SemGroup L.P. and its direct and indirect subsidiaries in the United States (the "U.S. Debtors") filed voluntary petitions to restructure under Chapter 11 of the U.S. Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware.

6 According to the second report of the Monitor, the financial problems of the SemGroup arose from a failed trading strategy and the volatility of petroleum products prices, leading to material margin calls related to large futures and options positions on the NYMEX and OTC markets, resulting in a severe liquidity crisis. SemGroup's credit facilities were insufficient to accommodate its capital needs, and the corporate group sought protection under Chapter 11 and the CCAA.

7 The SemCanada Group are indirect, wholly-owned subsidiaries of SemGroup LP. The SemCanada Group is comprised of three separate businesses:

- (a) SemCanada Crude, a crude oil marketing and blending operation;
- (b) the SemCanada Energy Companies, whose business was gas marketing, including the purchase and sale of gas to certain of its four subsidiaries as well as to SemCAMS; and
- (c) SemCAMS, whose business consists of ownership interests in large gas processing facilities located in Alberta, as well as agreements to operate these facilities.

8 SemCrude, L.P. as U.S. borrower and a predecessor company of SemCAMS as Canadian borrower, certain U.S. SemGroup corporations and Bank of America as administrative agent for a syndicate of lenders (the "Secured Lenders") entered into a credit agreement in 2005 (the "Credit Agreement"). The Credit Agreement provides four different credit facilities. There are no advances outstanding with respect to the Canadian term loan facility, but in excess of U.S. \$2.9 billion is owing under the U.S. term loan facility, the working capital loan facility and the revolver loan.

9 Five of the SemCanada Group, including SemCanada Crude, SemCanada Energy and SemCAMS, have provided a guarantee of all obligations under the Credit Agreement to the Secured Lenders, who rank as senior secured lenders, and under a US \$600 million bond indenture issued by SemGroup. The guarantee is secured by a security and pledge agreement (the "Security Agreement") signed by the five members of the SemCanada Group.

10 The SemCanada Energy Companies were liquidated or have ceased operations and no longer have significant ongoing operations. As a result of liquidation proceedings and the collection of outstanding accounts receivable, the SemCanada Energy

Companies hold approximately \$113 million in cash. An application to distribute that cash to the Secured Lenders was adjourned *sine die* on January 19, 2009: *SemCanada Crude Co., Re*, 2009 ABQB 90 (Alta. Q.B.).

11 Originally, SemCAMS and SemCanada Crude proposed to restructure their businesses as stand-alone operations without further affiliation with the U.S. Debtors and accordingly sought bids in a solicitation process undertaken in early 2009. Unfortunately, no acceptable bids were received. It also became apparent that, as SemCanada Crude's business was closely integrated with certain North Dakota transportation rights and assets owned by the U.S. Debtors, restructuring SemCanada Crude's operations on a stand alone basis would be problematic. The SemCanada Group turned to the alternative of joining in the restructuring of the entire SemGroup through concurrent and integrated plans of arrangement in both Canada and the United States.

Summary of the U.S. and Canadian Plans

12 The U.S. and Canadian plans are complex and need not be described in their entirety in these reasons. For the purpose of these reasons, the relevant aspects of the plans are as follows:

1. The disclosure statement relating to a joint plan of affiliated U.S. Debtors was approved for distribution to creditors by the U.S. Bankruptcy Court on July 21, 2009. Under the Chapter 11 process, meetings of creditors are not necessary. Voting takes place through a notice and balloting mechanism that has been approved by the U.S. Court and September 3, 2009 has been set as the voting deadline for acceptance or rejection of the U.S. plan.
2. The total distributable value of the SemGroup for the purpose of the plans is expected to be US \$2.3 billion, consisting of US \$965 million in cash, US \$300 million in second lien term loan interests and US \$1.035 billion in new common stock and warrants of the U.S. Debtors.
3. The SemCanada Group will contribute approximately US \$161 million in available cash to the U.S. plan and US \$54 million is expected to be received from SemCanada Crude relating to crude oil settlements that will occur after the effective date of the plans, being cash received from prepayments that are outstanding on the implementation date which will be replaced with letters of credit or other post-plan financing.
4. Approximately US \$50 million will be retained by the corporate group for working capital and general corporate purposes, including for the post plan cash needs of SemCAMS and SemCanada Crude.
5. Certain U.S. causes of action will be contributed to a "litigation trust" and will be distributed through the U.S. Plan, including to the Secured Lenders on their deficiency claims. No value has been placed on the litigation trust by the U.S. Debtors. The Monitor reports that it is unable to make an informed assessment of the value of the litigation trust assets as the trust is a complicated legal mechanism that will likely require the expenditure of significant time and professional fees before there will be any recovery.
6. The U.S. plan contains a condition precedent that, on the effective date of the plan, the restructured corporate group will enter into a US \$500 million exit financing facility, which will apply to all post-restructuring affiliates, including SemCAMS and SemCanada Crude, and which will allow the corporate group to re-enter the crude marketing business in the United States and to continue operations in Canada.
7. It is expected that the Secured Lenders will receive cash, second lien term loan interests and equity in priority to unsecured creditors on their secured guarantee claims of US \$2.9 billion, which will leave them with a deficiency of approximately US \$1.07 billion on the secured loans. The Secured Lenders are entitled under the U.S. Plan to a share in the litigation trust on their deficiency claim. If certain other classes of creditors do not vote to approve the U.S. plan, the Secured Lenders may also receive equity of a value up to 4.53% of their deficiency, subject to other contingencies. The Monitor reports that the Secured Lenders are thus estimated to recover approximately 57.1% of their estimated claims of US \$2.1 billion on secured working capital claims and 73.3% of their estimated claims of US \$811 million on secured revolver/term claims. The Monitor estimates that the Secured Lenders will recover no

value on their deficiency claims, assuming no reallocation of equity from other categories of debtors and no value for the litigation trust.

8. The holders of the US \$600 million bonds (the "Noteholders") are entitled to receive common shares and warrants in the restructured corporate group, plus an interest in the litigation trust and certain trustee fees, for an estimated recovery of 8.34% on their claims of US \$610 million under the U.S. plan, assuming all classes of Noteholders approve the plan and no value is given to the litigation trust. Depending on certain contingencies, the range of recovery is 0.44% to 11.02% of their claim. Noteholders are treated more advantageously under the plans than general unsecured creditors in recognition that the Senior Notes are jointly and severally guaranteed by 23 U.S. debtors and the Canadian debtors, while in most instances only one SemGroup debtor is liable with respect to each ordinary unsecured creditor. In addition, the Noteholders have waived their right to receive distributions under the Canadian plans.

9. Under the U.S. Plan, general unsecured creditors will receive common shares, warrants and an interest in the litigation trust. Depending on the level of approval, recovery levels will range from 0.08% to 8.03% on claims of US \$811 million. The Monitor reports that it expects recovery to general unsecured creditors under the U.S. Plan to be 2.09% of their claim.

10. Pursuant to section 503(b)(9) of the U.S. Bankruptcy Code, entities that provided goods to the U.S. Debtors in the ordinary course of business that were received within 20 days of the filing of Chapter 11 proceedings are entitled to a priority claim that ranks above the claims of the Secured Lenders.

11. There are 3 Canadian plans. As the Secured Lenders will be entitled to some recovery in respect of their deficiency claim and the Noteholders will be entitled to some recovery on their unsecured claim under the U.S. Plan, the Secured Lenders and the Noteholders are deemed to have waived their rights to any additional recovery under the Canadian plans for the most part. However, the votes of the Secured Lenders and the Noteholders entitled to vote on the U.S. Plan are deemed to be votes for the purpose of the Canadian plans, both with respect to numbers of parties and value of claims, and are to be included in the single class of "Affected Creditors" entitled to vote on the Canadian plans. Originally, the Canadian plans provided that the value attributable to the Secured Lenders' votes would be based on the full amount of their guarantee claim, approximately US \$2.9 billion, and not only on their deficiency claim of approximately US \$1.07 billion. Thus, the aggregate value of the Secured Lenders' voting claims would be:

a) US \$2.939 billion for the SemCAMS plan;

b) US \$2.939 billion less C \$145 million for the SemCanada Crude plan, recognizing that the Secured Lenders would be entitled to receive C \$145 million in respect of a negotiated Lenders' Secured Claim under the SemCanada Crude plan; and

c) US \$2.939 billion less C \$108 million for the SemCanada Energy plan, recognizing that the Secured Lenders will receive that amount in respect of a negotiated Lenders' Secured Claim under the SemCanada Energy plan.

At the conclusion of the classification hearing, the CCAA applicants proposed a revision to the proposed orders which stipulates that, if the approval of a plan by the creditors would be determined by the portion of the votes cast by the Secured Lenders that represents an amount of indebtedness that is greater than their estimated aggregate deficiency after taking into consideration the payments they are to receive under the U.S. plan and the Canadian plans, the Court shall determine whether the voting claim of the Secured Lenders should be limited to their estimated deficiency claim.

12. Only "Ordinary Creditors" receive any distribution under the Canadian Plans. Ordinary Creditors are defined as creditors holding "Affected Claims" other than the Secured Lenders, Noteholders, CCAA applicants and U.S. Debtors. Each plan provides that the Affected Creditors of the CCAA applicant will vote at the Creditors' Meeting as a single class.

13. The SemCAMS plan will be funded by a cash advance from SemCanada Crude and establishes two pools of cash. One pool will fund the full amount of secured claims which have not been paid prior to the implementation date of the plan up to the realizable value of the property secured, and the other pool will fund distributions to ordinary unsecured creditors. Ordinary unsecured creditors will receive cash subject to a maximum total payment of 4% of their proven claims. The Monitor estimates that the distribution will equal 4% of claims unless claims in excess of the current highest estimate are established.

14. The SemCanada Crude plan also establishes two pools of cash, one for secured claims and one for ordinary unsecured creditors. Again, the distribution to ordinary unsecured creditors is estimated to be 4% of claims unless claims in excess of the current highest estimate against SemCanada Crude are established.

15. Any cash remaining in SemCanada Crude after deducting amounts necessary to fund the above-noted payments to secured and unsecured ordinary creditors of SemCAMS and SemCanada Crude, unaffected claims and administrative costs, less a reserve for disputed claims, will be paid to the Secured Lenders through the U.S. plan as part of the payment on secured debt.

16. The SemCanada Energy distribution plan is funded from the cash received from the liquidation of the assets of the companies. It also establishes two pools of cash, one of which will be used to pay secured ordinary creditors and a one of which will be used to pay cash distributions to ordinary unsecured creditors. The Monitor estimates that the distribution to ordinary unsecured creditors will be in the range of 2.16% to 2.27% of their claims, unless claims in excess of the current maximum estimate are established. Any amounts outstanding after payment of these claims, unaffected claims and administration costs will be paid to the Secured Lenders. The proposed lower amount of recovery is stated to be in recognition of the fact that the SemCanada Energy Companies have been liquidated and have no going concern value.

17. As this summary indicates, the U.S. Plan and the Canadian plans are closely integrated and economically interdependent. Each of the plans requires that the other plans be approved by the requisite number of creditors and implemented on the same date in order to become effective. The receipt of at least \$160 million from the SemCanada Group is a condition precedent to the implementation of the U.S. Plan.

18. The Monitor reports that the SemCanada Group has indicated that there is no viable option to the proposed plans and that a formal liquidation under bankruptcy legislation would provide a lower recovery to creditors. The Monitor notes that the rationale for the treatment of the Secured Lenders and the ordinary unsecured creditors under the plans is that the Secured Lenders have valid and enforceable secured claims, and that, in the event of the liquidation of the Canadian companies, the Secured Lenders would be entitled to all proceeds, resulting in no recovery to ordinary creditors. Therefore, reports the Monitor, the CCAA plans are considered to be better than the alternative of a liquidation. The Secured Lenders derive some benefit from the plans through the preservation of the going concern value of SemCAMS and SemCanada Crude and by having a prompt distribution of funds held by the SemCanada Energy Companies.

19. The Monitor notes that the distribution to the SemGroup unsecured creditors under the U.S. plan is viewed as better than a liquidation, and that, therefore, given the effect of the U.S. Bankruptcy Code's "cram-down" provisions, it is likely that the U.S. plan will be confirmed. The Monitor comments that the proposed distribution to ordinary unsecured creditors under the CCAA plans is considered to be fair as it is comparable to and potentially slightly more favourable than the distributions being made to the U.S. ordinary unsecured creditors.

Positions of Various Parties

13 The SemCanada Group applied for orders

- a) accepting the filing of, in the case of SemCAMS and SemCanada Crude, proposed plans of arrangement and compromise, and in the case of SemCanada Energy, a proposed plan of distribution;
- b) authorizing the calling and holding of meetings of the Canadian creditors of these three CCAA applicants;
- c) authorizing the establishment of a single class of creditors for each plan for the purpose of considering and voting on the plans;
- d) approving procedures with respect to the calling and conduct of such meetings; and
- e) other non-contentious enabling relief.

14 Certain unsecured creditors of the applicants objected to the proposed classification of creditors, submitting that the Secured Lenders should not be allowed a vote in the same class as the unsecured creditors either with respect to the secured portion of their overall claim or any deficiency in their claims that would remain unpaid, and that the Noteholders should not be allowed a vote in the same class as the rest of the unsecured creditors.

15 As noted previously, the CCAA applicants proposed a revision to the proposed orders at the conclusion of the classification hearing which would allow the Court to consider whether the voting claim of the Secured Lenders should be limited to their estimated deficiency claim. The objecting creditors continued to object to the proposed classification, even if eligible votes were limited to the deficiency claim of the Secured Lenders.

Analysis

16 Section 6 of the CCAA provides that, where a majority in number representing two-thirds in value of "the creditors or class of creditors, as the case may be" vote in favour of a plan of arrangement or compromise at a meeting or meetings, the plan of arrangement may be sanctioned by the Court. There is little by way of specific statutory guidance on the issue of classification of claims, leaving the development of this issue in the CCAA process to case law. Prior decisions have recognized that the starting point in determining classification is the statute itself and the primary purpose of the statute is to facilitate the reorganization of insolvent companies: Paperny, J. in *Canadian Airlines Corp., Re* (2000), 20 C.B.R. (4th) 46 (Alta. C.A. [In Chambers]), leave to appeal refused (2000), 20 C.B.R. (4th) 46 (Alta. C.A. [In Chambers]), affirmed [2001] 4 W.W.R. 1 (Alta. C.A.), leave to appeal to SCC refused [2001] S.C.C.A. No. 60 (S.C.C.) at para. 14. As first noted by Forsyth, J. in *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 20, 64 Alta. L.R. (2d) 139, [1989] 2 W.W.R. 566 (Alta. Q.B.) at page 28, and often repeated in classification decisions since, "this factor must be given due consideration at every stage of the process, including the classification of creditors..."

17 Classification is a key issue in CCAA proceedings, as a proposed plan must achieve the requisite level of creditor support in order to proceed to the stage of a sanction hearing. The CCAA debtor seeks to frame a class or classes in order to ensure that the plan receives the maximum level of support. Creditors have an interest in classifications that would allow them enhanced bargaining power in the negotiation of the plan, and creditors aggrieved by the process may seek to ensure that classification will give them an effective veto (see *Rescue: The Companies' Creditors Arrangement Act*, Janis P. Sarra, 2007 ed. Thomson Carswell at page 234). Case law has developed from the comments of the British Columbia Court in *Woodward's Ltd., Re* (1993), 84 B.C.L.R. (2d) 206 (B.C. S.C.) warning against the danger of fragmenting the voting process unnecessarily, through the identification of principles applicable to the concept of "commonality of interest" articulated in *Canadian Airlines Corp., Re* and elaborated further in Alberta in *San Francisco Gifts Ltd., Re*, 2004 CarswellAlta 1241, [2004] A.J. No. 1062 (Alta. Q.B.), leave to appeal refused (2004), 5 C.B.R. (5th) 300 (Alta. C.A.).

18 The parties in this case agree that "commonality of interest" is the key consideration in determining whether the proposed classification is appropriate, but disagree on whether the plans as proposed with their single class of voters meet that requirement. It is clear that classification is a fact-driven inquiry, and that the principles set out in the case law, while useful in considering whether commonality of interest has been achieved by the proposed classification, should not be applied rigidly: *Canadian*

Airlines Corp., Re at para. 18; *San Francisco Gifts Ltd., Re* at para. 12; *Stelco Inc., Re* (2005), 15 C.B.R. (5th) 307 (Ont. C.A.) at para. 22.

19 Although there are no fixed rules, the principles set out by Paperny, J. in para. 31 of *Canadian Airlines Corp., Re* provide a useful structure for discussion of whether to the proposed classification is appropriate:

1. Commonality of interest should be viewed based on the non-fragmentation test, not on the identity of interest test.

20 Under the now-rejected "identity of interest" test, all members of the class had to have identical interests. Under the non-fragmentation test, interests need not be identical. The interests of the creditors in the class need only be sufficiently similar to allow them to vote with a common interest: *Woodward's Ltd., Re* at para. 8.

21 The objecting creditors submit that the creation of two classes rather than one cannot be considered to be fragmentation. The issue, however, is not the number of classes, but the effect that fragmentation of classes may have on the ability to achieve a viable reorganization. As noted by Farley, J. in para. 13 of his reasons relating to the classification of creditors in *Stelco Inc., Re*, as endorsed by the Ontario Court of Appeal:

...absent valid reason to have separate classes it would be reasonable, logical, rational and practical to have all this unsecured debt in the same class. Certainly that would avoid fragmentation - and in this respect multiplicity of classes does not mean that fragmentation starts only when there are many classes. Unless more than one class is necessary, fragmentation would start at two classes. Fragmentation if necessary, but not necessarily fragmentation.

2. The interests to be considered are the legal interests that a creditor holds qua creditor in relationship to the debtor company prior to and under the plan as well as on liquidation.

22 The classification of creditors is viewed with respect to the legal rights they hold in relation to the debtor company in the context of the proposed plan, as opposed to their rights as creditors in relation to each other: *Woodward's Ltd., Re* at para. 27, 29; *Stelco Inc., Re* at para. 30. In the proposed single classification, the rights of the creditors in the class against the debtor companies are unsecured (other than the proposed votes attributable to the secured portion of the debt of the Secured Lenders, which will be discussed separately).

23 With respect to the Secured Lenders' deficiency claim, there is a clear precedent for permitting a secured creditor to vote a substantial deficiency claim as part of the unsecured class: *Campeau Corp., Re* (1991), 10 C.B.R. (3d) 100 (Ont. Gen. Div.); *Canadian Airlines Corp., Re*, supra.

24 The classification issues in the *Campeau Corp., Re* restructuring were similar to the present issues. In *Campeau Corp., Re*, a secured creditor, Olympia & York, was included in the class of unsecured creditors for the deficiency in its secured claim, which represented approximately 88% of the value of the unsecured class. The Court rejected the submission that the legal interests of Olympia & York were different from other unsecured creditors in the class. Montgomery, J. noted at para. 16 that Olympic & York's involvement in the negotiation of the plan was necessary and appropriate given that the size of its claims would allow it a veto no matter how the classes were constituted and that its co-operation was necessary for the success of both the U.S. and Canadian plans.

25 In the same way, the size and scope of the Secured Lenders claim makes their participation in the negotiation and endorsement of the proposed plans essential. That participation does not disqualify them from a vote in the process, nor necessitate their isolation in a special class. While under the integrated plans, the Secured Lenders will receive a different kind of distribution on their unsecured deficiency claim (a share of the litigation trust), that is an issue of fairness for the sanction hearing and does not warrant the establishment of a separate class.

26 The interests of the Noteholders are unsecured. While it is true that under the integrated plans, the Noteholders would be entitled to a higher share of the distribution of assets than ordinary unsecured creditors, the rationale for such difference in treatment relates to the multiplicity of debtor companies that are indebted to the Noteholders, as compared to the position of

the ordinary unsecured creditors. That difference, while it may be subject to submissions at the sanction hearing, is an issue of fairness, and not a difference material enough to warrant a separate class for the Noteholders in this case. A separate class for the Noteholders would only be necessary if, after considering all the relevant factors, it appeared that this difference would preclude reasonable consultation among the creditors of the class: *San Francisco Gifts Ltd., Re* at para. 24.

27 The question arises whether the fact that the Secured Lenders and the Noteholders have waived their rights to recover under the Canadian plans should result in either the requirement of separate classes or the forfeiture of their right to vote on the Canadian plans at all.

28 This is a unique case: a cross-border restructuring with separate but integrated and interdependent plans that are designed to comply with the restructuring legislation of two jurisdictions. As the applicants point out, the co-ordinated structure of the plans is designed to ensure that the Secured Lenders and the Noteholders receive sufficient recoveries under the U.S. plan to justify the sacrifices in recovery that result from their waiver of distributions under the Canadian plans. In considering the context of the proposed classification, it would be unrealistic and artificial to consider the Canadian plans in isolation, without regard to the commercial outcome to the creditors resulting from the implementation of the plans in both jurisdictions. Thus, the fact that the distributions to Secured Lenders and Noteholders will take place through the operation of the U.S. plan, and that the effective working of the plans require them to waive their rights to receive distributions under the Canadian plans does not deprive them of the right to an effective voice in the consideration of the Canadian plans through a meaningful vote.

29 It is not sufficient to say that the Secured Lenders and the Noteholders have a vote in the U.S. plans. The "cram down" power which exists under Chapter 11 of the U.S. Bankruptcy Code includes a "best interests test" that requires that if a class of holders of impaired claims rejects the plan, they can be "crammed down" and their claims will be satisfied if they receive property of a value that is not less than the value that the class would receive or retain if the debtor were liquidated under Chapter 7 of the U.S. Bankruptcy Code. Thus, the votes available to the Secured Lenders and the Noteholders with respect to their claims under the U.S. Plan do not give them the right available to creditors under Canadian restructuring law to vote on whether a proposed plan should proceed to the next step of a sanction hearing. There is no reason to deprive the Secured Lenders and the Noteholders of that right as creditors of the Canadian debtors, even if the distributions they would be entitled to flow through the U.S. plan. The question becomes, then, whether that right should be exercised in a class with other unsecured creditors as proposed or in a separate class.

30 It is noteworthy that the proposed single classification does not have the effect of confiscating the legal rights of any of the unsecured creditors, or adversely affecting any existing security position. It is in fact arguable that seeking to exclude the Secured Lenders and the Noteholders from the class prejudices these similarly-placed creditors by denying them a meaningful voice in the approval or rejection of the plans in Canada.

31 A number of cases suggest that the Court should also consider the rights of the parties in liquidation in determining whether a proposed classification is appropriate: *Woodward's Ltd., Re* at para. 14; *San Francisco Gifts Ltd., Re* at para. 12.

32 Under a liquidation scenario, the Secured Lenders would be entitled to nearly all of the proceeds of the liquidated corporate group, other than the relatively few secured claims that have priority. This suggests that the Secured Lenders are entitled to a meaningful vote with respect to both the U.S. plan and the Canadian plans.

3. The commonality of interests is to be viewed purposively, bearing in mind the object of the CCAA, namely to facilitate organizations 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.

33 The Ontario Court of Appeal in *Stelco Inc., Re* cautioned that, in addition to considering commonality of interest issues, the court in a classification application should be alert to concerns about the confiscation of legal rights and should avoid "a tyranny of the minority", citing the comments of Borins, J. in *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991),

86 D.L.R. (4th) 621 (Ont. Gen. Div.), where he warned against creating "a special class simply for the benefit of the opposing creditor, which would give that creditor the potential to exercise an unwarranted degree of power": *Stelco Inc., Re* at para 28.

34 Excluding of the Secured Lenders and the Noteholders from the proposed single class would allow the objecting creditors to influence the voting process to a degree not warranted by their status. It is true that if the Secured Lenders and the Noteholders are not excluded from the class, even if only the votes related to the Secured Lenders' deficiency claim are tabulated, the positive vote will likely be enough to allow the proposed plans to proceed to a sanction hearing. It is also true that the Secured Lenders and the Noteholders may have been part of the negotiations that led to the proposed plans. Neither of those factors standing alone is sufficient to warrant a separate class unless rights are being confiscated or the classification creates an injustice.

35 The structure of the classification as proposed creates in effect what was imposed by the Court in *Canadian Airlines Corp., Re*, a method of allowing the "voice" of ordinary unsecured creditors to be heard without the necessity of a separate classification, thus permitting rather than ruling out the possibility that the plans might proceed to a sanction hearing. Given that the votes of the Secured Lenders and the Noteholders on the U.S. plan will be deemed to be votes of those creditors on the Canadian plans, there will be perforce a separate tabulation of those votes from the votes of the remaining unsecured creditors. In accordance with the revision to the plans made at the end of the classification hearing, there will be a separate tabulation of the votes of the Secured Lenders relating to the secured portion of their claims and the votes relating to the unsecured deficiency.

36 The situation in this classification dispute is essentially the same as that which faced Paperny, J. in *Canadian Airlines Corp., Re*. Fragmenting the classification prior to the vote raises the possibility that the plans may not reach the stage of a sanction hearing where fairness issues can be fully canvassed. This would be contrary to the purpose of the CCAA. This is particularly an issue recognizing that the U.S. plan and the Canadian plans must all be approved in order for any one of them to be implemented. Conrad, J.A. in denying leave to appeal in *San Francisco Gifts Ltd., Re*, 2004 ABCA 386 (Alta. C.A.) at para. 9 noted that the right to vote in a separate class and thereby defeat a proposed plan of arrangement is the statutory protection provided to the different classes of creditors, and thus must be determined reasonably at the classification stage. However, she also noted that "it is important to carefully examine classes with a view of protecting against injustice": para. 10. In this case, the goals of preventing confiscation of rights and protecting against injustice favour the proposed single classification.

37 This is the "pragmatic" factor referred to in *Campeau Corp., Re* at para. 21. The CCAA judge must keep in mind the interests of all stakeholders in reviewing the proposed classification, as in any step in the process. If a classification prevents the danger of a veto of a plan that promises some better return to creditors than the alternative of a liquidating insolvency, it should not be interfered with absent good reason. The classification hearing is not the only avenue of relief for aggrieved creditors. If a plan received the minimum required level of approval by vote of creditors, it must still be approved at a hearing where issues of fairness must be addressed.

5. Absent bad faith, the motivations of the creditors to approve or disapprove [of the Plan] are irrelevant.

38 As noted in *Canadian Airlines Corp., Re* at para. 35, fragmenting a class because of an alleged conflict of interest not based on legal rights is an error. The issue of the motivation of a party to vote for or against a plan is an issue for the fairness hearing. There is no doubt that the various affected creditors in the proposed single class may have differing financial or strategic interests. To recognize such differences at the classification stage, unless the proposed classification confiscates rights, results in an injustice or creates a situation where meaningful consultation is impossible, would lead to the type of fragmentation that may jeopardize the CCAA process and be counter-productive to the legislative intent to facilitate viable reorganizations.

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.

39 The issue of meaningful consultation was addressed by both the supervising justice and the Court of Appeal in *San Francisco Gifts Ltd., Re*. In that case, Topolniski, J. noted that two corporate insiders that the proposed plan had included in the classification of affected creditors held claims that were uncompromised by the plan, that they gave up nothing, and that it "stretches the imagination to think other creditors in the class could have meaningful consultation [with them] about the Plan":

para. 49. Her decision to place these parties in a separate class was confirmed by the Court of Appeal, which commented that Topolniski, J. was "absolutely correct" to find no ability to consult "between shareholders whose debts would not be cancelled and other unsecured creditors whose debts would be": para. 14.

40 That is not the situation here. The deficiency claims of the Secured Lenders and the unsecured claims of the Noteholders are being compromised in the U.S. plan, and there is nothing to block consultations among affected creditors on the basis of dissimilarity of legal interests. While there are differences in the proposed distributions on the unsecured claims, they are not so major that they would preclude consultation.

41 The objecting creditors point to statements made by counsel for the Secured Lenders during the classification application about the alternatives to approval of the plans, which they submit indicates the impossibility of consultation. These comments were made in the context of advocacy on behalf of the proposed classification, and I do not take them as a clear statement by the Secured Lenders that they would refuse to consult with the other creditors.

Secured Portion of Secured Lenders' Claim

42 The CCAA applicants and the Secured Lenders submit that it would be unfair and inappropriate to limit the votes of the Secured Lenders in the Canadian plans to the amount of the deficiency in their secured claim, rather than the entire amount owing under the guarantee. They argue that, by endorsing the plans, the Secured Lenders have in effect elected to treat their entire claim under the guarantee as unsecured with respect to the Canadian plans, except for relatively small negotiated secured claims under the SemCanada Crude plan and the SemCanada Energy plan. They also submit that the fact that under bankruptcy law, a creditor of a bankrupt debtor is entitled to prove for the full amount of its debt in the estates of both the debtor and a bankrupt guarantor of the debt justifies granting the Secured Lenders the right to vote the full amount of the guarantee claim, even if part of the claim is to be recovered through the U.S. plan, as long as they do not actually recover more than 100 cents on the dollar.

43 It became apparent during the course of the classification hearing that it may not matter whether the plans are approved by the requisite number of creditors and value of their claims if the Secured Lenders are only entitled to vote the deficiency portion of their claims or the full amount of their claims. It was this that led to the revision in the language of the voting provisions of the plans. I defer a decision on the question of whether or not the Secured Lenders are entitled to vote the entire amount of their guarantee claims until after the vote has been conducted and the votes separately tabulated as directed. As noted by the Court of Appeal in *Canadian Airlines Corp., Re* (2000), 19 C.B.R. (4th) 33 (Alta. C.A. [In Chambers]) at para. 39, such a deferral of a voting issue is not an error of law and is in fact consistent with the purpose of the CCAA.

Recent Amendments

44 The following amendment to the CCAA that has been proclaimed in effect from September 18, 2009 sets out certain factors that may be considered in approving a classification for voting purposes:

22.2 (2) **Factors** - For the purpose of subsection (1), creditors may be included in the same class if their interests or rights are sufficiently similar to give them a commonality of interest, taking into account:

- (a) the nature of the debts, liabilities or obligations giving rise to their claims;
- (b) the nature and rank of any security in respect of their claims;
- (c) the remedies available to the creditors in the absence of the compromise or arrangement being sanctioned, and the extent to which the creditors would recover their claims by exercising those remedies; and
- (d) any further criteria, consistent with those set out in paragraphs (a) to (c), that are prescribed. (R.S.C. 2005, c. 47, s. 131, amended R.S.C. 2007, Bill C -12, c.36, s.71)

45 These factors do not change in any material way the factors that have been identified in the case law and discussed in these reasons nor would they have a material effect on the consideration of the proposed classification in this case.

Creditors with Claims in Process

46 Two creditors advised that, because their claims of secured status had not yet been resolved with the applicants and the Monitor, they were not in a position to evaluate whether or not to object to the proposed classification. The plans were revised to ensure that the votes of creditors whose status as secured creditors remains unresolved until after the meetings of creditors be recorded with votes of creditors with disputed claims and reported to the Court by the Monitor if these votes affect the approval or non-approval of the plan in question.

Conclusion

47 In summary, I have concluded that there is no good reason to exclude the Secured Lenders and the Noteholders from the single classification of voters in the proposed plans, nor to create a separate class for their votes. There are no material distinctions between the claims of these two creditors and the claims of the remaining unsecured creditors that are not more properly the subject of the sanction hearing, apart from the deferred issue of whether the Secured Lenders are entitled to vote their entire guarantee claim. No rights of the remaining unsecured creditors are being confiscated by the proposed classification, and no injustice arises, particularly given the separate tabulation of votes which enables the voice of the remaining unsecured creditors to be heard and measured at the sanction hearing. There are no conflicts of interest so over-riding as to make consultation impossible. While there are differences of interests and treatment among the affected creditors in the class, these are issues that will be addressed at the sanction hearing. Approval of the proposed classification in the context of the integrated plans is in accordance with the spirit and purpose of the CCAA.

Applications granted.

TAB 10

2005 CarswellOnt 6483
Ontario Superior Court of Justice [Commercial List]

Stelco Inc., Re

2005 CarswellOnt 6483, [2005] O.J. No. 4814, 143 A.C.W.S. (3d) 623, 15 C.B.R. (5th) 297

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

AND IN THE MATTER OF A PROPOSED PLAN OF COMPROMISE OR ARRANGEMENT WITH
RESPECT TO STELCO INC. AND THE OTHER APPLICANTS LISTED IN SCHEDULE "A"

APPLICATION UNDER THE COMPANIES' CREDITORS
ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED

Farley J.

Heard: November 9, 2005

Judgment: November 10, 2005 *

Docket: 04-CL-5306

Proceedings: affirmed *Stelco Inc., Re* (2005), 2005 CarswellOnt 6510 (Ont. C.A.)

Counsel: Michael E. Barrack, James D. Gage, Geoff R. Hall for Applicants

Kyla Mahar for Monitor

Robert Staley for Senior Debenture Holders

Ashley John Taylor (Agent) to Secured Creditors for CIT

Paul MacDonald, Andy Kent, Hilary Clarke for Converts Committee

Aubrey Kauffman for Tricap

Ken Rosenberg, Jeff Larry for USW

H. Whitely for CIBC

Steven Bosnick for USW Locals 8782, 8328

Murray Gold, Andrew Hatney for Salaried Retirees

Gale Rubenstein for Superintendent

Subject: Insolvency

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Cases considered by *Farley J.*:

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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

Pacific Coastal Airlines Ltd. v. Air Canada (2001), 2001 BCSC 1721, 2001 CarswellBC 2943, 19 B.L.R. (3d) 286 (B.C. S.C.) — referred to

Royal Bank v. Gentra Canada Investments Inc. (2000), 2000 CarswellOnt 248, 1 B.L.R. (3d) 170, 1 C.L.R. (3d) 260 (Ont. S.C.J. [Commercial List]) — referred to

Royal Bank v. Gentra Canada Investments Inc. (2001), 2001 CarswellOnt 2232, 15 B.L.R. (3d) 25, 147 O.A.C. 96 (Ont. C.A.) — referred to

Royal Oak Mines Inc., Re (1999), 1999 CarswellOnt 625, 6 C.B.R. (4th) 314 (Ont. Gen. Div. [Commercial List]) — referred to

Royal Oak Mines Inc., Re (1999), 1999 CarswellOnt 792, 7 C.B.R. (4th) 293 (Ont. Gen. Div. [Commercial List]) — referred to

San Francisco Gifts Ltd., Re (2004), 42 Alta. L.R. (4th) 352, 5 C.B.R. (5th) 92, 359 A.R. 71, 2004 ABQB 705, 2004 CarswellAlta 1241 (Alta. Q.B.) — followed

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

Sklar-Peppler 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.) — referred to

843504 Alberta Ltd., Re (2003), 2003 ABQB 1015, 2003 CarswellAlta 1786, 4 C.B.R. (5th) 306, 30 Alta. L.R. (4th) 91, 351 A.R. 222 (Alta. Q.B.) — referred to

Statutes considered:

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

Generally — referred to

s. 4 — considered

s. 5 — considered

s. 6 — considered

s. 8 — referred to

MOTION by creditors relating to terms of proposal in bankruptcy.

Farley J.:

1 Fortunately time cleared so that the motion of the Informal Independent Converts' Committee ("ConCom") which surfaced late last week — and the responding cross motion of the Informal Committee of Senior Debenture Holders ("BondCom") — could be accommodated today, less than week before the scheduled vote on Stelco Inc.'s Plan of Arrangement under the CCAA set for November 15, 2005.

2 The motion of ConCom was for an order:

(i) directing the Applicants to amend page 39 of the Notice of Proceedings and Meetings and Information Circular (the "Information Circular") with respect to the Applicants' Proposed Plan of Arrangement or Compromise (the "Proposed Plan") in the manner set out in the Draft Order to confirm that the right (if any) of the Bondholders (as hereinafter defined) to assert claims or other remedies against other creditors of Stelco Inc. ("Stelco") will be subject to the effect of the Proposed Plan (the "Bondholders Claims Statement") and that the right (if any) of the Bondholders to assert claims (the "Anti-Convert Claims") pursuant to Article 6 (the "Inter-Trustee Provisions") of the First Supplemental Trust Indenture dated January 21, 2002 between Stelco and CIBC Mellon Trust Company (the "Supplemental Trust Indenture") will be extinguished effective upon the implementation of the Proposed Plan;

(ii) declaring that, if the Proposed Plan is approved by the requisite majority of the creditors of Stelco and sanctioned by this Court, the Inter-Trustee Provisions shall, from and after the effective date of the Proposed Plan, be of no force or effect;

(iii) in the alternative, directing the Applicants to amend the Proposed Plan to provide that the Noteholders (as hereinafter defined) shall constitute a separate class of Stelco creditors for the purposes of voting on the Proposed Plan or any amended version thereof; and

(iv) such further and other relief as counsel may request and this Honourable Court may permit.

3 The cross motion of BondCom was for an Order:

2. for a declaration that, if any or all of the relief sought by the Convertible Noteholders as set out in its notice of motion dated November 4, 2005 is granted, that the Senior Debenture Holders shall constitute a separate class of Stelco Inc. ("Stelco") creditors for the purposes of voting on the Proposed Plan of Arrangement or Compromise (the "Proposed Plan") or any amended version thereof; and

3. such further and other relief as to this Honourable Court seems just.

4 No one present at this hearing disputed the proposition that it was appropriate to have the creditors vote on the Plan with the necessary benefit of clear statements of what was involved in such a vote and to eliminate therefore any ambiguities to the extent possible so that an objective creditor could make a reasoned decision. In that respect it would appear to me that the language of the Information Circular at p.39 thereof should be clarified to track that of the Meeting Order of October 4, 2005 at para. 34 thereof as to the operative element. Further it was acknowledged by everyone that the Plan itself provided that it may be amended before the vote. In that respect there would be no impediment for Stelco to adjust the language of the Plan in the sense of clarifying what its intent has been and continues to be in respect of matters affecting the debt in question and as held by those represented by the ConCom and by the BondCom. (Note: Subsequent to release of these reasons in handwritten form, I was advised on November 10, 2005 that Stelco has undertaken to make the aforesaid clarifications.)

5 I wish to emphasize that nothing in my reasons should be taken as being determinative of or affecting the relationship of the ConCom holders of debt vis-à-vis the BondCom holders of debt (that would as well encompass the holders of all Senior Debt as that term is defined in the Supplemental Trust Indenture). If those two sides are not able to work out an agreement between themselves, then they are at liberty to come to court to have that adjudicated.

6 ConCom points out that the Supplemental Trust Indenture was an agreement between Stelco and the holders of the ConCom debt, but it was not an agreement signed by the holders of the BondCom debt. While true, that would not preclude a claim of the BondCom holders based on the concept of third party beneficiary.

7 The CCAA is styled as "An act to facilitate compromises and arrangements between companies and their creditors" and its short title is: *Companies' Creditors Arrangement Act*. Ss. 4, 5 and 6 talk of compromises or arrangements between a company and its creditors. There is no mention of this extending by statute to encompass a change of relationship among the creditors

vis-à-vis the creditors themselves and not directly involving the company. See *Pacific Coastal Airlines Ltd. v. Air Canada*, [2001] B.C.J. No. 2580 (B.C. S.C.) at paras. 24-25; *Royal Bank v. Gentra Canada Investments Inc.*, [2000] O.J. No. 315 (Ont. S.C.J. [Commercial List]) at para. 41, appeal dismissed (Ont. C.A.); *843504 Alberta Ltd., Re*, [2003] A.J. No. 1549 (Alta. Q.B.) at para. 13; *Royal Oak Mines Inc., Re*, [1999] O.J. No. 709 (Ont. Gen. Div. [Commercial List]) at para. 24; *Royal Oak Mines Inc., Re*, [1999] O.J. No. 864 (Ont. Gen. Div. [Commercial List]) at para. 1.

8 ConCom points out the language of article 4.01 of the Plan:

4.01 Cancellation of Certificates

At the Effective Time, all debentures, certificates, agreements, invoices and other instruments evidencing Affected Claims against Stelco or Existing Common Shares will not entitle any holder thereof to any compensation or participation other than as expressly provided for in this Plan or in the Articles or Reorganization, respectively, and will be cancelled and null and void, and all debentures, certificates, agreements, invoices and other instruments evidencing Affected Claims against any Subsidiary Applicant will not entitle any holder thereof (other than Stelco or its successors and assignees) to any compensation or participation other than as expressly provided for in this Plan and, if in the possession or control of any Person must, at the request of Stelco, be delivered to Stelco. (emphasis added)

However this must be carefully analyzed in context. This deals with "Affected Claims against Stelco." See also in this respect articles 6.01, 6.02 and 6.05.

6.01 Effect of Plan Generally

At the Effective Time, the treatment of Affected Claims will be final and binding on the Applicants, the Affected Creditors and the trustees under the trust indentures for the Bonds (and their respective heirs, executors, administrators and other legal representatives, successors and assigns), and this Plan will constitute: (a) full, final and absolute settlement of all rights of the Affected Creditors; (b) an absolute release and discharge of all indebtedness, liabilities and obligations of or in respect of the Affected Claims against Stelco, including any interest and costs accruing thereon; (c) an absolute assignment to Stelco of all indebtedness, liabilities and obligations of or in respect of the Affected Claims against Subsidiary Applicants, including any interest and costs accruing thereon, and an absolute release and discharge of any rights of Affected Creditors in respect thereof (excluding, for greater certainty, any rights assigned to Stelco); and (d) a reorganization of the capital and change in the minimum and maximum number of directors of Stelco in accordance with the provisions of Article 3 and the Articles of Reorganization. (emphasis added)

6.02 Prosecution of Judgments

At the Effective Time, no step or proceeding may be taken in respect of any suit, judgement, execution, cause of action or similar proceeding in connection with any Affected Claim (other than by Stelco in respect of Affected Claims assigned to it pursuant to this Plan) and any such proceedings will be deemed to have no further effect against any Applicant or any of its assets and will be released, discharged, dismissed or vacated without cost to the Applicants. Any Applicant may apply to Court to obtain a discharge or dismissal, if necessary, of any such proceedings without notice to the Affected Creditor. (emphasis added)

6.05 Consents, Waivers and Agreements

At the Effective Time, each Affected Creditor will be deemed to have consented and agreed to all of the provisions of the Plan, as an entirety. Without limitation to the foregoing, each Affected Creditor (but for greater certainty, excluding Stelco in respect of Affected Claims assigned to it pursuant to this Plan) will be deemed:

- (a) to have executed and delivered to the Applicants all consents, assignments, releases and waivers, statutory or otherwise, required to implement and carry out this Plan as an entirety;

(b) to have waived any default by or rescinded any demand for payment against any Applicant that has occurred on or prior to the Plan Implementation Date pursuant to, based on or as a result of any provision, express or implied, in any agreement or other arrangement, written or oral, existing between such Affected Creditor and such Applicant with respect to an Affected Claim; and

(c) to have agreed that, if there is any conflict between the provisions, express or implied, of any agreement or other arrangement, written or oral, existing between such Affected Creditor and any Applicant with respect to an Affected Claim as at the Plan Implementation Date and the provisions of this Plan, then the provisions of this Plan take precedence and priority and the provisions of such agreement or other arrangement are amended accordingly.

(emphasis added)

This is not language which purports to, nor in my opinion does, affect relationships between creditors vis-à-vis themselves. With respect, I do not see s. 8 of the CCAA as coming into play here, nor is it necessary to have it come into play in this inter-creditor dispute which does not directly involve Stelco. No doubt it would be helpful to have Stelco clarify that aspect which ConCom has sincerely felt was ambiguous in article 4.01 of the Plan to reflect that these instruments are cancelled and null and void only as to the future (ie. that is after the Effective Time) vis-à-vis Stelco, but not as to the inter-creditor dispute or relationship. (See note above re: undertaking of Stelco.)

9 I would only note in passing that the holders of the ConCom debt freely bought into a situation governed by s. 6.2 of the Supplemental Trust Indenture which contemplated their relationship with the BondCom debt (Senior Debt) in the event of insolvency proceedings or a reorganization. Give the caveats in s. 6.3 it would not appear to me that this clause advances the argument pressed by the ConCom.

10 Therefore as to the relief request by ConCom in (i) and (ii) above, I would dismiss that part of the motion. That dismissal in no way affects the clarification of language mentioned above which would be of assistance to all concerned.

11 Secondly, I would note that while apparently Stelco had not specifically advised as to its position, at the time of the hearing, its counsel was quite straight forward in his opening comments when he stated that Stelco had intended and always intended that its Plan (as distributed) was only to affect rights between Stelco and its Affected Creditors, and specifically Stelco had no intent to alter the relationship between its creditors in the sense of one group of creditors vis-à-vis another group (i.e. the ConCom debt vis-à-vis BondCom debt (Senior Debt)). In this latter regard he indicated that Stelco was not intending to affect whatever subordination rights there may be between these two groups. This would be in the sense that what was the situation between these two groups as a result of the Supplemental Trust Indenture, especially at s. 6, would continue to be the relationship after the Effective Time.

12 The next question is whether or not there should be separate classes for the ConCom debt and/or the BondCom debt/Senior Debt. I am of the view that the law in regard to classification is correctly set out in *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 Alberta Court of Appeal subsequent decision *Canadian Airlines Corp., Re* (2000), 261 A.R. 120 (Alta. C.A. [In Chambers]), at para. 27. See also *San Francisco Gifts Ltd., Re* (2004), 5 C.B.R. (5th) 92 (Alta. Q.B.) at para. 11, leave to appeal denied 2004 ABCA 386 (Alta. C.A.). As noted by Toplinski J. at para. 11 of San Francisco:

(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 *Resurgence Asset Management LLS v. Canadian Airlines Corp.* ("Canadian Airlines")

1. Community of interest should be viewed based on the non-fragmentation test, 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. (emphasis added)

13 I would note as well that the primary and most significant attribute of the ConCom debt and that of the BondCom debt/Senior Debt plus the trade debt vis-à-vis Stelco is that it is all unsecured debt. Thus absent valid reason to have separate classes it would be reasonable, logical, rational and practical to have all this unsecured debt in the same class. Certainly that would avoid any unnecessary fragmentation — and in this respect multiplicity of classes does not mean that that fragmentation starts only when there are many classes. Unless more than one class is necessary, fragmentation would start at two classes. Fragmentation if necessary, but not necessarily fragmentation.

14 Is it necessary to have more than one class? Firstly, it would not appear to me that as between Stelco and the unsecured creditors overall there is any material distinction. Secondly, there would not appear to me to be any confiscation of any rights (or the other side of the coin any new imposition of obligations) upon the holders of ComCom debt. The subrogation issue was something which these holders assumed on the issue of that debt. Thirdly, I do not see that there is a realistic conflict of interest. Each group of unsecured creditors including the ConCom debt holders and the BondCom debt holders has the same general interest vis-à-vis Stelco, namely to extract from Stelco through the Plan the maximum value in the sense of consideration possible (subject to the practical caution that whatever is achieved must be compatible with Stelco being able to continue in a competitive industry so that the burden of this consideration cannot be so great as to swamp the newly renovated boat which had previously been sinking). That situation is not impacted for our purposes here in this motion by the possibility that in a subsequent dispute between the ConCom holders and the BondCom holders there may be a difference of opinion as to the valuation of the consideration obtained.

15 Counsel for BondCom and Stelco raised generally the question of there possibly being a tyranny of the minority if the ConCom debt was a separate class; counsel for ConCom raised the issue of tyranny of the majority if there was not a separate class for the ConCom debt. To my mind that questions of tyranny of the majority is something which may be addressed in the sanction hearing, if one takes place, as to the fairness, reasonableness and equitableness of the Plan. See item 4 of the Paperny list in *Canadian Airlines Corp.*; see also *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 8 C.B.R. (3d) 312 (Ont. Gen. Div.) at p. 318 and *Campeau Corp., Re* (1991), 10 C.B.R. (3d) 100 (Ont. Gen. Div.) at p. 103.

16 Therefore I do not see that ConCom has made out a case for a separate class. That aspect of its motion is also dismissed.

17 Given the dismissal of the ConCom motion, the BondCom motion for a separate class for its debt becomes moot.

Motions dismissed.

Footnotes

- * Affirmed *Stelco Inc., Re* (2005), 2005 CarswellOnt 6510, 15 C.B.R. (5th) 305 (Ont. C.A.)

2005 CarswellOnt 6818
Ontario Court of Appeal

Stelco Inc., Re

2005 CarswellOnt 6818, [2005] O.J. No. 4883, 11 B.L.R. (4th) 185, 144 A.C.W.S.
(3d) 15, 15 C.B.R. (5th) 307, 204 O.A.C. 205, 261 D.L.R. (4th) 368, 78 O.R. (3d) 241

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

AND IN THE MATTER OF A PROPOSED PLAN OF COMPROMISE OR ARRANGEMENT
WITH RESPECT TO STELCO INC., AND OTHER APPLICANTS LISTED IN SCHEDULE "A"

APPLICATION UNDER THE COMPANIES' CREDITORS
ARRANGEMENT ACT, R.S.C. 1985, c. C-36 AS AMENDED

Goudge, Sharpe, Blair JJ.A.

Heard: November 14, 2005
Judgment: November 17, 2005
Docket: CA C44436, M33171

Proceedings: additional reasons at *Stelco Inc., Re* ((2005)), 2005 CarswellOnt 6510, 15 C.B.R. (5th) 305 ((Ont. C.A.)); affirmed *Stelco Inc., Re* ((2005)), 2005 CarswellOnt 6483, 15 C.B.R. (5th) 297 ((Ont. S.C.J. [Commercial List]))

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A Kauffman for Tricap Management Ltd.

Kyla Mahar for Monitor

Murray Gold for Salaried Retirees

Heath Whitley for CIBC

Steven Bosnick for U.S.W.A. Loc. 5328, 8782

Subject: Insolvency; Civil Practice and Procedure

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Cases considered by *Blair J.A.*:

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

Generally — referred to

Joint Stock Companies Arrangements Act, 1870 (33 & 34 Vict.), c. 104
Generally — referred to

ADDITIONAL REASONS to judgment reported at *Stelco Inc., Re* (2005), 2005 CarswellOnt 6510, 15 C.B.R. (5th) 305 (Ont. C.A.).

Blair J.A.:

Background

1 This appeal arises out of the reorganization of Stelco Inc., and related companies, pursuant to the *Companies' Creditors Arrangement Act* ("CCAA").¹ Stelco has been in the midst of this fractious process for approximately twenty-one months. Justice Farley has been the supervising judge throughout.

2 Stelco has presented a Proposed Plan of Compromise or Arrangement to its creditors for their approval. The vote was scheduled for Tuesday, November 15, 2005. On Thursday, November 10, a group of creditors known as the Informal Independent Converts' Committee ("the Converts' Committee") sought an order from the supervising judge, amongst other things, classifying the Subordinated Debenture Holders whom they represent as a separate class for voting purposes. Justice Farley dismissed the motion. In the face of the pending vote, the Converts' Committee sought leave to appeal on Thursday afternoon (The courts were closed on Friday, November 11, for Remembrance Day). Rosenberg J.A. dealt with the matter and directed that the application for leave, and if leave be granted, the appeal, be heard by a panel of this court on Monday, November 14, 2005.

3 This panel heard the application for leave and the appeal on Monday. We concluded that leave should be granted, but that the appeal must be dismissed, and at the conclusion of argument — and in order to clarify matters so that the vote could proceed the following day — we issued a brief endorsement with our decision, but indicating that more detailed reasons would follow.

4 The endorsement read as follows:

In our view, the appellants have not demonstrated a different legal interest from the other unsecured creditors vis à vis the debtor, nor any basis for setting aside the finding of Farley J. that there are no different practical interests such that the appellants deserve a separate class. We see no legal error or error in principle in his exercise of discretion.

Leave to appeal is granted, but the appeal must therefore be dismissed. Because of the importance of the issue for Ontario practice in this area, we propose to expand somewhat on these reasons in due course.

5 These are those expanded reasons.

Facts

6 Stelco's Proposed Plan is made to unsecured creditors only. It is not intended to affect the claims of secured creditors.

7 The Converts' Committee represents unsecured creditors who hold \$90 million of convertible unsecured subordinated debentures issued by Stelco pursuant to a Supplemental Trust Indenture dated January 21, 2002, and due in 2007. With interest, the claims of the Subordinated Debenture Holders now amount to approximately \$110 million. Those claims are subordinated to approximately \$328 million in favour of Senior Debt Holders. In addition, Stelco has unsecured trade debts totalling approximately, \$228 million. In the Proposed Plan, these three groups of unsecured creditors — the Subordinated Debenture Holders (represented by the Converts' Committee), the Senior Debt Holders, and the Trade Creditors — have all been included in the same class for the purposes of voting on the Proposed Plan or any amended version of it.

8 The Converts' Committee takes issue with this, and seeks to have the Subordinated Debenture Holders classified as a separate class of creditors for voting purposes. They argue that their interests are different than those of the Bondholders and that creditors who do not have common interests should not be classified in the same group for voting purposes. They submit,

therefore, that the supervising judge erred in law in not granting them a separate classification. In that regard, they rely upon this court's decision in *Nova Metal Products Inc. v. Comiskey (Trustee of)* (1990), 1 O.R. (3d) 289 (Ont. C.A.). They also argue that the supervising judge was wrong, on the facts contained in the record, in finding that the Subordinated Debenture Holders and the Bondholders did not have conflicting interests.

9 In making their argument about a different interest, the appellants rely upon their status as subordinated debt holders as shaped particularly by Articles 6.2 and 6.3 of the Supplemental Trust Indenture. In essence those provisions reinforce the subordinated nature of their debt. They stipulate (a) that if the Subordinated Debenture Holders receive any payment from Stelco, or any distribution from the assets of Stelco, before the Senior Debt is fully paid, they are obliged to remit any such payment or distribution to the Senior Debt Holders until the latter have been paid in full (Art. 6.2(3)), but (b) that no such payment or distribution by Stelco shall be deemed to constitute a payment on the Subordinated Debenture Holders' debt (Art. 6.3). The parties refer to these provisions as the "Turnover Payment" provisions.

10 In short, although Stelco is obliged to pay both groups of creditors in full, as between the Subordinated Debenture Holders and the Senior Debt Holders, the latter are entitled to be paid in full before the former receive anything. The Supplemental Trust Indenture makes it clear that the provisions of Article 6 "are intended solely for the purpose of defining the relative rights of [the Subordinated Debenture Holders] and the holders of the Senior Debt" (Art. 6.3).

11 The appellants contend that the Turnover Payment provisions distinguish their interests from those of the Subordinated Debenture Holders when it comes to voting on Stelco's Proposed Plan. They say that the Subordinated Debenture Holders' interest in maximizing the amounts to be made available to unsecured creditors ends once they have received full recovery, in part as a result of the Turnover Payments that the Subordinated Debenture Holders will be required to make from their portion of the funds. On the other hand, the Subordinated Debenture Holders will have an interest in seeking more because their recovery, for practical purposes, will have only begun once that point is reached.

12 The respondents submit, for their part, that the appellants are seeking a separate classification for a collateral purpose, i.e., so that they will be able to veto the Proposed Plan, or at least threaten to veto it, unless they are granted a benefit to which they are not entitled — the elimination of their subordinated position by virtue of the Turnover Payment provisions.

13 Farley J. rejected the appellants' arguments. The thrust of his decision in this regard is found in paragraphs 13 and 14 of his reasons:

[13] I would note as well that the primary and most significant attribute of the ConCom debt and that of the BondCom debt/Senior Debt² plus the trade debt vis-à-vis Stelco is that it is all unsecured debt. Thus absent valid reason to have separate classes it would be reasonable, logical, rational and practical to have all this unsecured debt in the same class. Certainly that would avoid any unnecessary fragmentation — and in this respect multiplicity of classes does not mean that that fragmentation starts only when there are many classes. Unless more than one class is necessary, fragmentation would start at two classes. Fragmentation if necessary, but not necessarily fragmentation.

[14] Is it necessary to have more than one class? Firstly, it would not appear to me that as between Stelco and the unsecured creditors overall there is any material distinction. Secondly, there would not appear to me to be any confiscation of any rights (or the other side of the coin any new imposition of obligations) upon the holders of the ConCom debt. The subrogation issue was something which these holders assumed on the issue of that debt. Thirdly, I do not see that there is a realistic conflict of interest. Each group of unsecured creditors including the ConCom debt holders and the BondCom debt holders has the same general interest vis-à-vis Stelco, namely to extract from Stelco through the Plan the maximum value in the sense of consideration possible. . . . That situation is not impacted for our purposes here in this motion by the possibility that in a subsequent dispute between the ConCom holders and the BondCom holders there may be a difference of opinion as to the variation of the consideration obtained.

14 We agree with his conclusion and see no basis to interfere with his findings in that regard.

The Leave Application

15 The principles to be applied by this court in determining whether leave to appeal should be granted to someone dissatisfied with an order made in a CCAA proceeding are not in dispute. Leave is only sparingly granted in such matters because of their "real time" dynamic and because of the generally discretionary character underlying many of the orders made by supervising judges in such proceedings. There must be serious and arguable grounds that are of real and significant interest to the parties. The court has assessed this criterion on the basis of a four-part test, namely,

- a) whether the point on appeal is of significance to the practice;
- b) whether the point is of significance to the action;
- c) whether the appeal is *prima facie* meritorious or frivolous; and
- d) whether the appeal will unduly hinder the progress of the action.

See *Stelco Inc. (Re)* (2005), 75 O.R. (3d) 5 (Ont. C.A.) at para. 24; *Country Style Food Services Inc., Re*, [2002] O.J. No. 1377, 158 O.A.C. 30 (Ont. C.A. [In Chambers]) at para. 15; *Canadian Airlines Corp., Re* (2000), 19 C.B.R. (4th) 33 (Alta. C.A. [In Chambers]) at para. 7.

16 Here, we granted leave to appeal because the proposed appeal raised an issue of significance to the practice, namely the nature of the "common interest" test to be applied by the courts for purposes of the classification of creditors in CCAA proceedings. Although the law seems to have progressed in the lower courts along the lines developed in Alberta, beginning with the decision of Paperny J. in *Canadian Airlines Corp., Re* (2000), 19 C.B.R. (4th) 12 (Alta. Q.B.), this court has not dealt with the issue since its decision in *Nova Metal Products Inc. v. Comiskey (Trustee of)*, *supra*, and the Converts' Committee argues that the Alberta line of authorities is contrary to *Nova Metal Products Inc.*

17 A brief further comment respecting the leave process may be in order.

18 The court recognizes the importance of its ability to react in a responsible and timely fashion to the appellate needs arising in the "real time" dynamics of CCAA restructurings. Often, as in the case of this restructuring, they involve a significant public dimension. For good policy reasons, however, appellate courts in Canada — including this one — have developed relatively stringent parameters for the granting of leave to appeal in CCAA cases. As noted, leave is only sparingly granted. The parameters as set out in the authorities cited above remain good law.

19 Merely because a corporate restructuring is a big one and money is no object to the participants in the process, does not mean that the court will necessarily depart from the normal leave to appeal process that applies to other cases. In granting leave to appeal in these circumstances, we do not wish to be taken as supporting a notion that the fusion of leave applications with the hearing of the appeal in CCAA restructurings — particularly in major ones such as this one involving Stelco — has become the practice. Where there is an urgency that a leave application be expedited in the public interest, the court will do so in this area of the law as it does in other areas. However, where what is involved is essentially an attempt to review a discretionary order made on the facts of the case, in a tightly supervised process with which the judge is intimately familiar, the collapsed process that was made available in this particular situation will not generally be afforded.

20 As these reasons demonstrate, however, the issues raised on this particular appeal, and the timing factor involved, warranted the expedited procedure that was ordered by Justice Rosenberg.

The Appeal

No Error in Law or Principle

21 Everyone agrees that the classification of creditors for CCAA voting purposes is to be determined generally on the basis of a "commonality of interest" (or a "common interest") between creditors of the same class. Most analyses of this approach start with a reference to *Sovereign Life Assurance Co. v. Dodd* (1892), [1891-94] All E.R. Rep. 246 (Eng. C.A.), which dealt with the classification of creditors for voting purposes in a winding-up proceeding. Two passages from the judgments in that decision are frequently cited:

At pp. 249-250 Lord Esher said:

The Act provides that the persons to be summoned to the meeting, all of whom, it is to be observed, are creditors, are persons who can be divided into different classes, classes which the Act³ recognizes, though it does not define. The creditors, therefore, must be divided into different classes. What is the reason for prescribing such a course? It is because the creditors composing the different classes have different interests, and, therefore, if a different state of facts exists with respect to different creditors, which may affect their minds and judgments differently, they must be separated into different classes.

At p. 251, Bowen L.J. stated:

The word "class" used in the statute is vague, and to find out what it means we must look at the general scope of the section, which enables the court to order a meeting of a "class of creditors" to be summoned. It seems to me that we must give such a meaning to the term 'class' as will prevent the section being so worked as to produce confiscation and injustice, and that we must confine its meaning 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 These views have been applied in the CCAA context. But what comprises those "not so dissimilar" rights and what are the components of that "common interest" have been the subject of debate and evolution over time. It is clear that classification is a fact-driven exercise, dependent upon the circumstances of each particular case. Moreover, given the nature of the CCAA process and the underlying flexibility of that process — a flexibility which is its genius — there can be no fixed rules that must apply in all cases.

23 In *Canadian Airlines Corp., Re* (2000), 19 C.B.R. (4th) 12 (Alta. Q.B.), Paperny J. nonetheless extracted a number of principles to be considered by the courts in dealing with the commonality of interest test. At para. 31 she said:

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

1. Commonality of interest should be viewed based on the non-fragmentation test, 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 company prior to and under the plan as well as on liquidation.
3. The commonality of interests are to be viewed purposively, bearing in mind the object of the C.C.C.A., namely to facilitate reorganizations if possible.
4. In placing a broad and purposive interpretation on the C.C.C.A., 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.

24 In developing this summary of principles, Paperny J. considered a number of authorities from across Canada, including the following: *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 86 D.L.R. (4th) 621 (Ont. Gen. Div.); *Norcen Energy Resources Ltd. v. Oakwood Petroleum Ltd.* (1988), 72 C.B.R. (N.S.) 20 (Alta. Q.B.); *Fairview Industries Ltd., Re*

(1991), 11 C.B.R. (3d) 71 (N.S. T.D.); *Woodward's Ltd., Re* (1993), 84 B.C.L.R. (2d) 206 (B.C. S.C.); *Northland Properties Ltd., Re* (1988), 73 C.B.R. (N.S.) 166 (B.C. S.C.); *Northland Properties Ltd., Re* (1989), 73 C.B.R. (N.S.) 195 (B.C. C.A.); *NsC Diesel Power Inc., Re* (1990), 79 C.B.R. (N.S.) 1 (N.S. T.D.); *Savage v. Amoco Acquisition Co.* (1988), 68 C.B.R. (N.S.) 154 (Alta. C.A.), (*sub nom. Amoco Acquisition Co. v. Savage*); *Wellington Building Corp., Re* (1934), 16 C.B.R. 48 (Ont. S.C.). Her summarized principles were cited by the Alberta Court of Appeal, apparently with approval, in a subsequent *Canadian Airlines Corp., Re* decision: *Canadian Airlines Corp., Re* (2000), 19 C.B.R. (4th) 33 (Alta. C.A. [In Chambers]) at para. 27.

25 In the passage from his reasons cited above (paragraphs 13 and 14) the supervising judge in this case applied those principles. In our view he was correct in law in doing so.

26 We do not read the foregoing principles as being inconsistent with the earlier decision of this court in *Nova Metal Products Inc. v. Comiskey (Trustee of)*. There the court applied a common interest test in determining that the two creditors in question ought not to be grouped in the same class of creditors for voting purposes. But the differing interests in question were not different legal interests as between the two creditors; they were different legal interests as between each of the creditors and the debtor company. One creditor (the Bank) held first security over the debtor company's receivables and the other creditor (RoyNat) held second security on those assets; RoyNat, however, held first security over the debtor's building and realty, whereas the Bank was second in priority in relation to those assets. The two creditors had differing commercial interests in how the assets should be dealt with (it was in the interests of the bank, with a smaller claim, to collect and retain the more realizable receivable assets, but in the interests of RoyNat to preserve the cash flow and have the business sold as a going concern). Those differing commercial interests were rooted in differing legal interests as between the individual creditors and the debtor company, arising from the different security held. Because of the size of its claim, RoyNat would dominate any group that it was in, and Finlayson J.A. was of the view that RoyNat, as the holder of second security, should not be able to override the Bank's legal interest as the first secured creditor with respect to the receivables by virtue of its voting rights. On the basis that there was "no true community of interest" between the secured creditors (p. 259), given their different legal interests, he ordered that the Bank be placed in a separate class for voting purposes.

27 *Nova Metal Products Inc. v. Comiskey (Trustee of)* did not deal with the issue of whether creditors with divergent interests as amongst themselves — as opposed to divergent legal interests vis-à-vis the debtor company — could be forced to vote as members of a common class. Nor did it apply an "identity of interest" test — a test that has been rejected as too narrow and too likely to lead to excessive fragmentation: see *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia*, *supra*; *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.*, *supra*; *Fairview Industries Ltd., Re*, *supra*; *Woodward's Ltd., Re*, *supra*. In our view, there is nothing in the decision in *Nova Metal Products Inc.* that is inconsistent with the evolutionary set of principles developed in the Alberta jurisprudence and applied by the supervising judge here.

28 In addition to commonality of interest concerns, a court dealing with a classification of creditors issue needs to be alert to concerns about the confiscation of legal rights and about avoiding what the parties have referred to as "a tyranny of the minority". Examples of the former include *Nova Metal Products Inc. v. Comiskey (Trustee of)*⁴ and *Wellington Building Corp., Re*, *supra*⁵. Examples of the latter include *Sklar-Peppler*, *supra*⁶ and *Campeau Corp., Re* (1991), 10 C.B.R. (3d) 100 (Ont. Gen. Div.)⁷.

29 Here, as noted earlier in these reasons, the respondents argue that the appellants are seeking a separate classification in order to extract a benefit to which they are not entitled, namely a concession that the Turnover Payment requirements of their subordinated position be extinguished by the Proposed Plan, thus avoiding their obligation to transfer payments to the Senior Debt Holders until they have been paid in full, and freeing up all of the distribution the appellants will receive from Stelco for payment on account of their own claims. On the other hand, the appellants point to this conflict between the Subordinated Debenture Holders and the Senior Debt Holders as evidence that they do not have a commonality of interest or the ability to consult together with a view to whatever commonality of interest they may have vis-à-vis Stelco.

30 We agree with the line of authorities summarized in *Canadian Airlines Corp., Re* and applied by the supervising judge in this case which stipulate that the classification of creditors is determined by their legal rights in relation to the debtor company,

as opposed to their rights as creditors in relation to each other. To the extent that other authorities at the trial level in other jurisdictions may suggest to the contrary — see, for example *NsC Diesel Power Inc., Re, supra* — we prefer the Alberta approach.

31 There are good reasons for such an approach.

32 First, as the supervising judge noted, the CCAA itself is more compendiously styled "An act to facilitate compromises and arrangements between companies and their creditors". There is no mention of dealing with issues that would change the nature of the relationships as between the creditors themselves. As Tysoe J. noted in *Pacific Coastal Airlines Ltd. v. Air Canada*, [2001] B.C.J. No. 2580 (B.C. S.C.) at para. 24 (after referring to the full style of the legislation):

[The purpose of the CCAA proceeding] is not to deal with disputes between a creditor of a company and a third party, even if the company was also involved in the subject matter of the dispute. While issues between the debtor company and non-creditors are sometimes dealt with in CCAA proceedings, it is not a proper use of a CCAA proceeding to determine disputes between parties other than the debtor company.

33 In this particular case, the supervising judge was very careful to say that nothing in his reasons should be taken to determine or affect the relationship between the Subordinate Debenture Holders and the Senior Debt Holders.

34 Secondly, it has long been recognized that creditors should be classified in accordance with their contract rights, that is, according to their respective interests in the debtor company: see Stanley E. Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act" (1947) 25 Can. Bar. Rev. 587, at p. 602.

35 Finally, to hold the classification and voting process hostage to the vagaries of a potentially infinite variety of disputes as between already disgruntled creditors who have been caught in the maelstrom of a CCAA restructuring, runs the risk of hobbling that process unduly. It could lead to the very type of fragmentation and multiplicity of discrete classes or sub-classes of classes that judges and legal writers have warned might well defeat the purpose of the Act: see Stanley Edwards, "Reorganizations under the Companies' Creditors Arrangement Act", *supra*; Ronald N. Robertson Q.C., "Legal Problems on Reorganization of Major Financial and Commercial Debtors", Canadian Bar Association — Ontario Continuing Legal Education, 5th April 1983 at 19-21; *Norcen Energy Resources Ltd. v. Oakwood Petroleum Ltd., supra*, at para. 27; *Northland Properties Ltd., Re, supra*; *Sklar-Peppler, supra*; *Woodward's Ltd., Re, supra*.

36 In the end, it is important to remember that classification of creditors, like most other things pertaining to the CCAA, must be crafted with the underlying purpose of the CCAA in mind, namely facilitation of the reorganization of an insolvent company through the negotiation and approval of a plan of compromise or arrangement between the debtor company and its creditors, so that the debtor company can continue to carry on its business to the benefit of all concerned. As Paperny J. noted in *Canadian Airlines Corp., Re*, "the Court should be careful to resist classification approaches that would potentially jeopardize viable Plans."

Discretion and Fact Finding

37 Having concluded that the supervising judge made no error in law or principle in his approach to the classification issue, we can find no error in his factual findings or in his exercise of discretion in determining that the Subordinate Debenture Holders should remain in the same class as the Senior Debt Holders and Trade Creditors in the circumstances of this case.

38 We agree that there is no material distinction between the legal rights of the Subordinated Debenture Holders and those of the Senior Debt Holders vis-à-vis Stelco. Each is entitled to be paid the monies owing under their respective debt contracts. The only difference is that the former creditors are subordinated in interest to the latter and have agreed to pay over to the latter any portion of their recovery received until the Senior Debt has been paid in full. As between the two groups of creditors, this merely reflects the very deal the Subordinated Debenture Holders bought into when they purchased their subordinated debentures. For that reason, the supervising judge was also entitled to determine that this was not a case involving any confiscation of legal rights.

39 Finally, the supervising judge's finding that there is no "realistic conflict of interest" between the creditors is supported on the record. Each has the same general interest in relation to Stelco, namely to be paid under their contracts, and to maximize the amount recoverable from the debtor company through the Plan negotiation process. We do not accept the argument that the Senior Debt Holder's efforts will be moderated in some respect because they will be content to make their recovery on the backs of the Subordinated Debenture Holders through the Turnover Payment process. In order to carry the class, the Senior Debt Holders will require the support of the Trade Creditors, whose interest is not affected by the subordination agreement. Thus the Senior Debt Holders will be required to support the maximization approach.

40 We need not deal with whether a realistic and genuine conflict of interest, produced by different legal positions of creditors vis-à-vis each other, could ever warrant separate classes, as we are satisfied that even if it could, this is not such a case.

Disposition

41 Accordingly, we would not interfere with the supervising judge's decision that the appellants had not made out a case for a separate class. The appeal is therefore dismissed.

Goudge J.A.:

I agree.

Sharpe J.A.:

I agree.

Application granted; appeal dismissed.

Footnotes

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

2 Farley J. uses the term "ConCom debt" to refer to the debt represented by the Converts' Committee (i.e., that of the Subordinated Debenture Holders), and the term "BondCom debt" to refer to that of the Senior Debt Holders.

3 *The Joint Stock Companies Arrangement Act*, 1870.

4 A second secured creditor with superior voting power was separated from a first secured creditor for voting purposes, in order prevent the former from utilising its superior voting strength to adversely affect the latter's prior security position.

5 The court refused to allow subsequent mortgagees to vote in the same class as a first mortgagee because in the circumstances the subsequent mortgagees would be able to use their voting power to destroy the priority rights and security of the first mortgagee.

6 Borins J., as he then was, warned against the dangers of "excessive fragmentation" and of creating "a special class simply for the benefit of the opposing creditor, which would give that creditor the potential to exercise an unwarranted degree of power".

7 Montgomery J. declined to grant a separate classification to a minority group of creditors who would use that classification to extract benefits to which it was not otherwise entitled.

TAB 11

CITATION: Target Canada Co. (Re), 2016 ONSC 316
COURT FILE NO.: CV-15-10832-00CL
DATE: 2016-01-15

SUPERIOR COURT OF JUSTICE - ONTARIO

RE: 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.

BEFORE: Regional Senior Justice Morawetz

COUNSEL: *Jeremy Dacks, Shawn Irving and Tracy Sandler* for 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
(the "Applicants")

Linda Galessiere and Gus Camelino for 20 VIC Management Inc. (on behalf of
various landlords), Morguard Investments Limited (on behalf of various
landlords), Calloway Real Estate Investment Trust (on behalf of Calloway REIT
(Hopedale) Inc.), Calloway REIT (Laurentian Inc.), Crombie REIT, Triovest
Realty Advisors Inc. (on behalf of various landlords), Brad-Lea Meadows Limited
and Blackwood Partners Management Corporation (on behalf of Surrey CC
Properties Inc.)

Laura M. Wagner and Mathew P. Gottlieb for KingSett Capital Inc.

Yannick Katirai and Daniel Hamson for Eleven Points Logistics Inc.

Daniel Walker for M.E.T.R.O. (Manufacture, Export, Trade, Research Office)
Incorporated / Kerson Invested Limited

Jay A. Schwartz, Robin Schwill for Target Corporation

Miranda Spence for CREIT

Jay Carfagnini, Jesse Mighton, Alan Mark and Melaney Wagner for Alvarez &
Marsal Canada Inc. in its capacity as Monitor

James Harnum for Employee Representative Counsel

Harvey Chaiton for the Directors and Officers of the Applicants

Stephen M. Raicek and *Mathew Maloley* for Faubourg Boisdriand Shopping Centre Limited and Sun Life Assurance Company of Canada

Vern W. DaRe for Doral Holdings Limited and 430635 Ontario Inc.

Stuart Brotman for Sobeys Capital Incorporated

Catherine Francis for Primaris Reit

Kyla Mahar for Centerbridge Partners and Davidson Kempner

William V. Sasso, Pharmacist Representative Counsel

Varoujan C. Arman for Nintendo of Canada Ltd., Universal Studios Canada Inc., Thyssenkrupp Elevator (Canada) Limited, RPI Consulting Group Inc.

Brian Parker for Montez (Cornerbrook) Inc., Admns Meadowlands Investment Corp, and Valiant Rental Inc.

Roger Jaipargas for Glentel Inc., Bell Canada and BCE Nexxia

Nancy Tourgis for Issi Inc.

HEARD: December 21, 2015 & December 22, 2015

SUPPLEMENTARY WRITTEN SUBMISSIONS: December 30, 2015, January 6, 2016 and January 8, 2016

ENDORSEMENT

[1] The Applicants 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 ("Target Canada") bring this motion for an order, *inter alia*:

- (a) accepting the filing of a Joint Plan Compromise and Arrangement in respect of Target Canada Entities (defined below) dated November 27, 2015 (the "Plan");

- (b) authorizing the Target Canada Entities to establish one class of Affected Creditors (as defined in the Plan) for the purpose of considering and voting on the Plan (the “Unsecured Creditors’ Class”);
- (c) authorizing the Target Canada Entities to call, hold and conduct a meeting of the Affected Creditors (the “Creditors’ Meeting”) to consider and vote on a resolution to approve the Plan, and approving the procedures to be followed with respect to the Creditors’ Meeting;
- (d) setting the date for the hearing of the Target Canada Entities’ motion seeking sanction of the Plan should the Plan be approved by the required majority of Affected Creditors of the Creditors Meeting.

[2] On January 13, 2016, the Record was endorsed as follows: “The Plan is not accepted for filing. The Motion is dismissed. Reasons to follow.”

[3] These are the reasons.

[4] The Applicants and Partnerships listed on Schedule “A” to the Initial Order (the “Target Canada Entities”) were granted protection from their creditors under the *Companies’ Creditors Arrangement Act* (“CCAA”) pursuant to the Initial Order dated January 15, 2015 (as Amended and Restated, the “Initial Order”). Alvarez & Marsal Canada Inc. was appointed in the Initial Order to act as the Monitor.¹

[5] The Target Canada Entities, with the support of Target Corporation as Plan Sponsor, have now developed a Plan to present to Affected Creditors.

[6] The Target Canada Entities propose that the Creditors’ Meeting will be held on February 2, 2016.

[7] The requested relief sought by Target Canada is supported by Target Corporation, Employee Representative Counsel, Centerbridge Partners, L.P. and Davidson Kempner,

¹ Capitalized terms not defined herein have the same meaning as set out in the Plan.

CREIT, Glentel Inc., Bell Canada and BCE Nexxia, M.E.T.R.O. Incorporated, Eleven Points Logistics Inc., Issi Inc. and Sobeys Capital Incorporated.

[8] The Monitor also supports the motion.

[9] The motion was opposed by KingSett Capital, Morguard Investments Limited, Morguard Investment REIT, Smart REIT, Crombie REIT, Triovest, Faubourg Boisbriand and Sun Life Assurance, Primaris REIT, and Doral Holdings Limited (the “Objecting Landlords”).

Background

[10] In February 2015, the court approved the Inventory Liquidation Process and the Real Property Portfolio Sale Process (“RPPSP”) to enable the Target Canada Entities to maximize the value of their assets for distribution to creditors.

[11] By the summer of 2015, the processes were substantially concluded and a claims process was undertaken. The Target Canada Entities began to develop a plan that would distribute the proceeds and complete the orderly wind-down of their business.

[12] The Target Canada Entities discussed the development of the Plan with representatives of Target Corporation.

[13] The Target Canada Entities negotiated a structure with Target Corporation whereby Target Corporation would subordinate significant intercompany claims for the benefit of remaining creditors and would make other contributions under the Plan.

[14] Target Corporation maintained that it would only consider subordinating these intercompany claims and making other contributions as part of a global settlement of all issues relating to the Target Canada Entities including a settlement and release of all Landlord Guarantee Claims where Target Corporation was the Guarantor.

[15] The Plan as structured, if approved, sanctioned and implemented will

- (i) complete the wind-down of the Target Canada Entities;

(ii) effect a compromise, settlement and payment of all Proven Claims; and

(iii) grant releases of the Target Canada Entities and Target Corporation, among others.

[16] The Plan provides that, for the purposes of considering and voting on the plan, the Affected Creditors will constitute a single class (the “Unsecured Creditors’ Class”).

[17] In the majority of CCAA proceedings, motions of this type are procedural in nature and more often than not they proceed without any significant controversy. This proceeding is, however, not the usual proceeding and this motion has attracted significant controversy. The Objecting Landlords have raised concerns about the terms of the Plan.

[18] The Objecting Landlords take the position that this motion deals with not only procedural issues but substantive rights. The Objecting Landlords have two major concerns.

Objection # 1 – Breach of paragraph 19A of the Amended and Restated Order

[19] First, in February 2015, an Amended and Restated Order was sought by Target Canada. Paragraph 19A was incorporated into the Amended and Restated Order, which provides that the claims of any landlord against Target Corporation relating to any lease of real property (the “Landlord Guarantee Claims”) shall not be determined in this CCAA proceeding and shall not be released or affected in any way in any plan filed by the Applicants.

[20] Paragraph 19A provides as follows:

19A. THIS COURT ORDERS that, without in any way altering, increasing, creating or eliminating any obligation or duty to mitigate losses or damages, the rights, remedies and claims (collectively, the “Landlord Guarantee Claims”) of any landlord against Target US pursuant to any indemnity, guarantee, or surety relating to a lease of real property, including, without limitation, the validity, enforceability or quantum of such Landlord Guarantee Claims: (a) shall be determined by a judge of the Ontario Superior Court of Justice (Commercial List), whether or not the within proceeding under the CCAA continue (without altering the applicable and operative governing law of such indemnity, guarantee or surety) and notwithstanding the provisions of any federal or provincial statutes with respect to procedural matters relating to the Landlord Guarantee Claims; provided that any landlord holding such guarantees, indemnities or sureties that has not consented to the foregoing may, within fifteen (15) days of the making of this Order, bring a motion to have the matter of the venue for

the determination of its Landlord Guarantee Claim adjudicated by the Court; (b) shall not be determined, directly or indirectly, in the within CCAA proceedings; (c) shall be unaffected by any determination (including any findings of fact, mixed fact and law or conclusions of law) of any rights, remedies and claims of such landlords as against Target Canada Entities, whether made in the within proceedings under the CCAA or in any subsequent proposal or bankruptcy proceedings under the BIA, other than that any recoveries under such proceedings received by such landlords shall constitute a reduction and offset to any Landlord Guarantee Claims; and (d) shall be treated as unaffected and shall not be released or affected in any way in any Plan filed by the Target Canada Entities, or any of them, under the CCAA, or any proposal filed by the Target Canada Entities, or any of them, under the BIA.

[21] The evidence of Target Canada in support of the requested change consisted of the Affidavit of Mark Wong, who stated at the time:

“A component of obtaining the consent of the Landlord Group for approval of the Real Property Portfolio Sales Process (“RPPSP”) was the agreement of The Target Canada Entities to seek approval of certain changes to the initial order in the form of an amended and restated initial order...[T]hese proposed changes were the subject of significant negotiation between the Landlord Group and The Target Canada Entities, with the assistance and input of the Monitor and Target Corporation.”

[22] The Monitor, in its second report dated February 9, 2015, stated:

(3.4) Counsel to the Landlord Group advised that the Real Property Portfolio Sales Process proceeding on a consensual basis as described below is conditional on the proposed changes to the initial order.

(3.5) The Monitor recommends approval of the amended and restated initial order as it reflects;

(a) revisions negotiated as among The Target Canada Entities, the Landlord Group and Target U.S. (in conjunction with revisions to the Real Property Portfolio Sales Process), with the assistance of the Monitor; and

(b) a fair and reasonable balancing of interests.

[23] Thus, Objecting Landlords contend that the agreement resulting in Paragraph 19A of the Amended and Restated Initial Order was not just a condition of the Landlord Group's agreement to the RPPSP – it was also a condition of the Landlord Group withdrawing both its opposition to the CCAA process and its intention to commence a bankruptcy application to put the Applicants into bankruptcy at the come back hearing.

[24] The Objecting Landlords contend that the Applicants now seek to file a plan that releases the Landlord Guarantee Claims. This, in their view, is a clear breach of paragraph 19A, which Target Canada sought and the Monitor supported.

Objection # 2 – Breach of paragraph 55 of the Claim Procedure Order

[25] Second, the Objecting Landlords contend that the Plan violates the Claims Procedure Order and the CCAA. They argue that the Claims Procedure Order was also settled after prolonged negotiations between the Target Canada Entities and their creditors, including the landlords and that this order sets out a comprehensive claims process for determining all claims, including landlords' claims.

[26] The Objecting Landlords contend that Paragraph 55 of the Claims Procedure Order expressly excludes Landlord Guarantee Claims and provides that nothing in the Claims Procedure Order shall prejudice, limit, or otherwise affect any claims, including under any guarantee, against Target Corporation or any predecessor tenant. Paragraph 55 also ends with the *proviso* that “[f]or greater certainty, this Order is subject to and shall not derogate from paragraph 19A of the Initial Order.”

[27] The Objecting Landlords take the position that, in clear breach of Paragraph 55 and of the Claims Procedure Order generally, the Plan provides for a set formula to determine landlord claims, including claims against Target Corporation under its guarantees. KingSett further contends that the formula not only purports to determine landlords' claims for distribution purposes, it also purports to determine their claims for voting purposes, with no ability to challenge either. KingSett contends that this violates the terms of the Claims Procedure Order that was sought by the Applicants and supported by the Monitor.

[28] In summary, the Objecting Landlords take the position that the foregoing issues are crucial threshold issues and are not merely “procedural” questions and as such the court has to determine whether it can accept a plan for filing if that plan in effect permits Target Canada to renege on their agreements with creditors, violate court orders and the CCAA.

[29] In my view the issues raised by the Objecting Landlords are significant and they should be determined at this time.

Position of Target Canada

[30] Target Canada takes the position that the threshold for the court to authorize Target Canada to hold the creditors meeting is low and that Target Canada meets this threshold.

[31] Target Canada submits that the Plan has been the subject of numerous discussions and/or negotiations with Target Corporation (leading to a structure based on Target Corporation serving as Plan Sponsor), the Monitor and a wide variety of stakeholders. Target Canada states that if approved, the Plan will effect a compromise, settlement and payment of all proven claims in the near term in a manner that maximizes and accelerates stakeholder recovery.

[32] Target Corporation, as Plan Sponsor and a creditor of Target Canada, has agreed to subordinate approximately \$5 billion in intercompany claims to the claims of other Affected Creditors. Based on the Monitor’s preliminary analysis, the Plan provides for recoveries for Affected Creditors generally in the range of 75% to 85% of their proven claims.

[33] Target Canada contends that recent case law supports the jurisdiction of the CCAA court to provide that third party claims be addressed within the CCAA and leaves it open to a debtor company to address such claims in a plan.

[34] The Plan provides that Affected Creditors will vote on the Plan as a single unsecured class. Target Canada submits that this is appropriate on the basis that all Affected Creditors have the required commonality of interest (i.e. an unsecured claim) in relation to the claims against Target Canada and the Plan will compromise and release all of their claims.

[35] Target Canada is of the view that fragmentation of these creditors into separate classes would jeopardize the ability to achieve a successful plan.

[36] The Plan values the Landlord Restructuring Period Claims of landlords whose leases have been disclaimed by applying a formula ("Landlord Formula Amount") derived from the formula provided under s. 65.2 (3) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("BIA" and "BIA Formula"). The Landlord Formula Amount enhances the BIA Formula by permitting recovery of an additional year of rent. Target Corporation intends to contribute funds necessary to pay this enhancement (the "Landlord Guarantee Top-Up Amounts") Target Canada contends that the use of the BIA Formula to value landlord claims for voting and distribution purposes has been approved in other CCAA proceedings.

[37] With respect to the Landlord Formula Amount to calculate the Landlord Restructuring Period Claims, the formula provides for, in effect, Landlord Restructuring Period Claims to be valued at the lesser of either:

- (i) rent payable under the lease for the two years following the disclaimer plus 15% of the rent for the remainder of the lease term; or
- (ii) four years rent.

[38] Target Canada further contends that the court has the jurisdiction to modify the Initial Order on Plan Implementation to permit the Target Canada Entities to address Landlord Guarantee Claims in the Plan and that it is appropriate to do so in these circumstances. This justification is based on the premise that the landscape of the proceedings has been significantly altered since the filing date, particularly in light of the material contributions that Target Corporation prepared to make as Plan Sponsor in order to effect a global resolution of issues. Further, they argue that Landlord Guarantee Creditors are appropriately compensated under the Plan for their Landlord Guarantee Claims by means of the Landlord Guarantee Creditor Top-Up amounts, which will be funded by Target Corporation. As such, Landlord Guarantee Creditors will be paid 100% of their Landlord Restructuring Period Claims, valued in accordance with the Landlord Formula Amount.

[39] The Applicants contend that they seek to achieve a fair and equitable balance in the Plan. The Applicants submit that questions as to whether the Plan is in fact balanced, and fair and reasonable towards particular stakeholders, are matters best assessed by Affected Creditors who will exercise their business judgment in voting for or against the Plan. Until Affected Creditors have expressed their views, considerations of fairness are premature and are not matters that are required to be considered by the court in granting the requested Creditors' Meeting. If the Plan is approved by the requisite majority of the Affected Creditors, the court will then be in a position to fully evaluate the fairness and reasonableness of the Plan as a whole, with the benefit of the business judgment of Affected Creditors as reflected in the vote of the Creditors' Meeting.

[40] The significant features of the Plan include:

- (i) the Plan contemplates that a single class of Affected Creditors will consider and vote on the plan.
- (ii) the Plan entitles Affected Creditors holding proven claims that are less than or equal to \$25,000 ("Convenience Class Creditors") to be paid in full;
- (iii) the Plan provides that all Landlord Restructuring Period Claims will be calculated using the Landlord Formula Amount derived from the BIA Formula;
- (iv) As a result of direct funding from Target Corporation of the Landlord Guarantee Creditor Top-Up amounts, Landlord Guarantee Creditors will be paid the full value of their Landlord Restructuring Period Claims;
- (v) Intercompany Claims will be valued at the amount set out in the Monitor's Intercompany Claims Report;
- (vi) If approved and sanctioned, the Plan will require an amendment to Paragraph 19A of the Initial Order which currently provides that the Landlord Guarantee Claims are to be dealt with outside these CCAA proceedings. The Plan provides that this amendment will be addressed at the sanction hearing once it has been determined whether the Affected Creditors support the Plan.

- (vii) In exchange for Target Corporations' economic contributions, Target Corporation and certain other third parties (including Hudson's Bay Company and Zellers, which have indemnities from Target Corporation) will be released, including in relation to all Landlord Guarantee Claims.

[41] If the Plan is approved and implemented, Target Corporation will be making economic contributions to the Plan. In particular:

- (a) In addition to the subordination of the \$3.1 billion intercompany claim that Target Corporation agreed to subordinate at the outset of these CCAA proceedings, on Plan Implementation Date, Target Corporation will cause Property LLP to subordinate almost all of the Property LLP ("Propco") Intercompany Claim which was filed against Propco in an additional amount of approximately \$1.4 billion;
- (b) In turn, Propco will concurrently subordinate the Propco Intercompany Claim filed against TCC in an amount of approximately \$1.9 billion (adjusted by the Monitor to \$1.3 billion);
- (c) Target Corporation will contribute funds necessary to pay the Landlord Guarantee Creditor Top-Up Amounts.

[42] Target Canada points out that in discussions with Target Corporation to establish the structure for the Plan, Target Corporation maintained that it would only consider subordinating these remaining intercompany claims as part of a global settlement of all issues relating to the Target Canada Entities, including all Landlord Guarantee Claims.

[43] The issue on this motion is whether the requested Creditors' Meeting should be granted. Section 4 of the CCAA provides:

4. Where a compromise or arrangement is proposed between a debtor company and its unsecured creditors or any class of them, the court may, on the application in a summary way of the company, or 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 shareholders of the company, to be summoned in such manner as the court directs.

[44] Counsel cites *Nova Metal Products* for the proposition that the feasibility of a plan is a relevant significant factor to be considered in determining whether to order a meeting of creditors. However, the court should not impose a heavy burden on a debtor company to establish the likelihood of ultimate success at the outset (*Nova Metal Products v. Comiskey (Trustee of)* (1990), 41 O.A.C. 282 (C.A.)).

[45] Counsel submit that the court should order a meeting of creditors unless there is no hope that the plan will be approved by the creditors or, if approved, the plan would not for some other reason be approved by the court (*ScoZinc Ltd.*, Re, 2009 NSSC 163, 55 C.B.R. (5th) 205).

[46] Counsel also submits that the court has described the granting of the Creditors' Meeting as essentially a "procedural step" that does not engage considerations of whether the debtors' plan is fair and reasonable. Thus, counsel contends, unless it is abundantly clear the plan will not be approved by its creditors, the debtor company is entitled to put its plan before those creditors and to allow the creditors to exercise their business judgment in determining whether to support or reject it.

[47] Target Canada takes the position that there is no basis for concluding that the Plan has, no hope of success and the court should therefore exercise its discretion to order the Creditors Meeting.

[48] Counsel to Target Canada submits that the flexibility of the CCAA allows the Target Canada Entities to apply a uniform formula for valuing Landlord Restructuring Period Claims for voting and distribution purposes, including Landlord Guarantee Claims, in the interests of ensuring expeditious distributions to all Affected Creditors

[49] Counsel contends that if each Landlord Restructuring Period Claim had to be individually calculated based on the unique facts applicable to each lease, including future prospects for mitigation and uncertain collateral damage, the resulting disputes would embroil disputes between landlords and the Target Canada Entities in lengthy proceedings. Counsel contends that the issue relating to the Landlord Guarantee Claims is more properly a matter of

the overall fairness and reasonableness of the Plan and should be addressed at the sanction hearing.

[50] The Plan also contemplates releases for the benefit of Target Corporation and other third parties to recognize the material economic contribution that have resulted in favourable recoveries for Affected Creditors. These releases, Target Canada contends, satisfy the well established test for the CCAA court to approve third party releases. (*ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*, (2008) 42 C.B.R. (5th) 90 (Ont. S.C.J. [Commercial List], affirmed 2008 ONCA 587, (sub nom. *Re Metcalfe & Mansfield Alternative Investments II Corp.*))

[51] Likewise, the issue of Third Party Claims and Third Party Releases is a matter that can be addressed at sanction.

[52] With respect to the amendment to Paragraph 19A of the Initial Order, counsel submits that since the date of the Initial Order, and since this paragraph was included in the Initial Order, the landscape of the restructuring has shifted considerably, most notably in the form of the economic contributions that are being offered by Target Corporation, as Plan Sponsor.

[53] The Target Entities propose that on Plan Implementation, Paragraph 19A of the Initial Order will be deleted. Counsel submits that the court has the jurisdiction to amend the Initial Order through its broad jurisdiction under s. 11 of the CCAA to make any order that it considers appropriate in the circumstances and further, the court would be exercising its discretion to amend its own order, on the basis that it is just and appropriate to do so in these particular circumstances. Counsel submits that the requested amendment is essential to the success of the Plan and to maximize and expedite recoveries for all stakeholders. Further, the notion that a post-filing contract cannot be amended despite subsequent events fails to do justice to the flexible and “real time” nature of a CCAA proceeding.

[54] As such, counsel contends that no further information is necessary in order for the landlords to determine whether the Plan is fair and reasonable and they are in a position to vote for or against the Plan.

Position of the Objecting Landlords

[55] At the outset of this proceeding, Target Canada, Target Corporation and Target Canada's landlords agreed that Landlord Guarantee Claims would not be affected by any Plan. In exchange, several landlords with Landlord Guarantee Claims agreed to withdraw their opposition to Target Canada proceeding with the liquidation under the CCAA and the RPPSP.

[56] Counsel to the landlords submit that 10 months after having received the benefit of the landlords not opposing the RPPSP and the continuation of the CCAA, Target Canada seeks the court's approval to unequivocally renege on the agreement that violates the Amended Order by filing a Plan that compromises Landlord Guarantee Claims.

[57] The Objecting Landlords also contend that the proposed plan violates the Amended Order and the Claims Procedure Order by purporting to value the landlords' claims, including all Landlord Guarantee Claims, using a formula.

[58] Objecting Landlords take the position that they have claims against Target Canada as a result of its disclaimer of long term leases, guaranteed by Target Corporation, in excess of the amount that the Plan values these claim. One example is the claim of KingSett. KingSett insists they have a claim of at least \$26 million which has been valued for Plan purposes at \$4 million plus taxes.

[59] The Objecting Landlords submit that the court cannot and should not allow a plan to be filed that violates the court's orders and agreements made by the Applicant. Further, if the motion is granted, the CCAA will no longer allow for a reliable process pursuant to which creditors can expect to negotiate with an Applicant in good faith. Counsel contends that the amendment of the Initial Order to buttress the agreement between the parties not to compromise the Landlord Guarantee Claims was intended to strengthen, not weaken, the landlords' ability to enforce Target Canada and Target Corporation's contractual obligation not to file a plan that compromises Landlord Guarantee Claims and it would be a perverse outcome for the court to hold otherwise.

[60] With respect to claims procedure, the Claims Procedure Order provides in Paragraph 32 that a claim that is subject to a dispute “shall” be referred to a claims officer of the court for adjudication. The Objecting Landlords submit that the Claims Procedure Order reaffirms the agreement between Target Canada, Target Corporation and the Landlord Group with respect to Landlord Guarantee Claims; they refer to Paragraph 55 which specifically provides that nothing in the order shall prejudice, limit, bar, extinguish or otherwise affect any rights or claims, including under any guarantee or indemnity, against Target Corporation or any predecessor tenant.

[61] Counsel for the Objecting Landlords submit that the Plan provides the basis for Target Corporation to avoid its obligation to honour guarantees to landlords, which Target Corporation agreed would not be compromised as part of the CCAA proceedings. Counsel contends that the Plan seeks to use the leverage of the “Plan Sponsor” against the creditors to obtain approval to renege on its obligations. This, according to counsel, amounts to an economic decision by Target Corporation in its own financial interest.

[62] In support of its proposition that the court cannot accept a plan’s call for a meeting where the plan cannot be sanctioned, counsel references *Crystallix International Corp.*, Re, 2013 ONSC 823, 2013 CarswellOnt 3043 [Commercial List]. Counsel submits that the court should not allow the Applicants to file a plan that from the outset cannot be sanctioned because it violates court orders or is otherwise improper.

[63] In this case, counsel submits that the Plan cannot be accepted for filing because it violates Paragraph 19A of the Amended Order and Paragraph 55 of the Claims Procedure Order. The Objecting Landlords stated as follows:

Paragraph 19A of the Amended Order is unequivocal. Landlord Guarantee Claims:

- (a) shall not be determined, directly or indirectly, in the CCAA proceeding;
- (b) shall be unaffected by any determination of claims of landlords against Target Canada; and,

(c) shall be treated as unaffected and shall not be released or affected in any way in any Plan filed by Target Canada under the CCAA.

Likewise, the Claims Procedure Order, as amended, clearly provides that:

(a) disputed creditors' claims shall be adjudicated by a Claims Officer or the Court;

(b) creditors have until February 12, 2016 to object to intercreditor claims; and,

(c) the claims process shall not affect Landlord Guarantee Claims and shall not derogate from paragraph 19A of the Amended Order.

There is no dispute that the Plan that Target Canada now seeks to file violates these terms of the Amended Order and the Claims Procedure Order...

[64] With respect to the issue of Paragraph 19A, counsel submits that this provision benefits Target Canada's creditors who have guarantees from Target Corporation. Further, under the plan, these creditors gain nothing from subordination of Target Corporation's intercompany claim, which only benefits creditors who did not obtain guarantees from Target Corporation. Counsel referred to *Alternative Fuel Systems Inc.*, Re, 2003 ABQB 745, 20 Alta. L.R. (4th) 264, aff'd 2004 ABCA 31, 346 A.R. 28, where both courts emphasized the importance of following a claims procedure and complying with ss. 20(1)(a)(iii) to determine landlord claims.

[65] Accordingly, counsel submits that barring landlord consent at the claims process stage of the CCAA proceeding, the court cannot unilaterally impose a cookie cutter formula to determine landlord claims at the plan stage.

Analysis

[66] Target Canada submits that the threshold for the court to authorize Target Canada to hold the creditors meeting is low and that Target Canada meets this threshold.

[67] In my view, it is not necessary to comment on this submission insofar as this Plan is flawed to the extent that even the low threshold test has not been met.

[68] Simply put, I am of the view that this Plan does not have even a reasonable chance of success, as it could not, in this form, be sanctioned.

[69] As such, I see no point in directing Target Canada to call and conduct a meeting of creditors to consider this Plan, as proceeding with a meeting in these circumstances would only result in a waste of time and money.

[70] Even if the Affected Creditors voted in favour of the Plan in the requisite amounts, the court examines three criteria at the sanction hearing:

- (i) Whether there has been strict compliance with all statutory requirements;
- (ii) Whether all materials filed and procedures carried out were authorized by the CCAA;
- (iii) Whether the Plan is fair and reasonable.

(See *Re Quintette Coal Ltd.* (1992), 13 C.B.R. (3d) 146 (B.C.S.C.); *Re Dairy Corp. of Canada Ltd.*, [1934] O.R. 436 (Ont. S.C.); *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 17 C.B.R. (3d) 1 (Ont. Gen. Div.); *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 175 (B.C.S.C.) at p. 182, aff'd (1989), 73 C.B.R. (N.S.) 195 (B.C.C.A.); *Re BlueStar Battery Systems International Corp.* (2000), 25 C.B.R. (4th) 216 (Ont. S.C.J. [Commercial List])).

[71] As explained below, the Plan cannot meet the required criteria.

[72] It is incumbent upon the court, in its supervisory role, to ensure that the CCAA process unfolds in a fair and transparent manner. It is in this area that this Plan falls short. In considering whether to order a meeting of creditors to consider this Plan, the relevant question to consider is the following: Should certain landlords, who hold guarantees from Target Corporation, a non-debtor, be required, through the CCAA proceedings of Target Canada, to

release Target Corporation from its guarantee in exchange for consideration in the Plan in the form of the Landlord Formula Amount?

[73] The CCAA proceedings of Target Canada were commenced a year ago. A broad stay of proceedings was put into effect. Target Canada put forward a proposal to liquidate its assets. The record establishes that from the outset, it was clear that the Objecting Landlords were concerned about whether the CCAA proceedings would be used in a manner that would affect the guarantees they held from Target Corporation.

[74] The record also establishes that the Objecting Landlords, together with Target Canada and Target Corporation, reached an understanding which was formalized through the addition of paragraph 19A to the Initial and Restated Order. Paragraph 19A provides that these CCAA proceedings would not be used to compromise the guarantee claims that those landlords have as against Target Corporation.

[75] The Objecting Landlords take the position that in the absence of paragraph 19A, they would have considered issuing bankruptcy proceedings as against Target Canada. In a bankruptcy, landlord claims against Target Canada would be fixed by the BIA Formula and presumably, the Objecting Landlords would consider their remedies as against Target Corporation as guarantor. Regardless of whether or not these landlords would have issued bankruptcy proceedings, the fact remains that paragraph 19A was incorporated into the Initial and Restated Order in response to the concerns raised by the Objecting Landlords at the motion of the Target Corporation, and with the support of Target Corporation and the Monitor.

[76] Target Canada developed a liquidation plan, in consultation with its creditors and the Monitor, that allowed for the orderly liquidation of its inventory and established the sale process for its real property leases. Target Canada liquidated its assets and developed a plan to distribute the proceeds to its creditors. The proceeds are being made available to all creditors having Proven Claims. The creditors include trade creditors and landlords. In addition, Target Corporation agreed to subordinate its claim. The Plan also establishes a Landlord Formula Amount. If this was all that the Plan set out to do, in all likelihood a meeting of creditors would be ordered.

[77] However, this is not all that the plan accomplishes. Target Canada proposes that paragraph 19A be varied so that the Plan can address the guarantee claims that landlords have as against Target Corporation. In other words, Target Canada has proposed a Plan which requires the court to completely ignore the background that led to paragraph 19A and the reliance that parties placed in paragraph 19A.

[78] Target Canada contends that it is necessary to formulate the plan in this matter to address a change in the landscape. There may very well have been changes in the economic landscape, but I fail to see how that justifies the departure from the agreed upon course of action as set out in paragraph 19A. Even if the current landscape is not favourable for Target Corporation, this development does not justify this court endorsing a change in direction over the objections the Objecting Landlords.

[79] This is not a situation where a debtor is using the CCAA to compromise claims of creditor. Rather, this is an attempt to use the CCAA as a means to secure a release of Target Corporation from its liabilities under the guarantees in exchange for allowing claims of Objecting Landlords in amounts calculated under the Landlord Formula Amount. The proposal of Target Canada and Target Corporation clearly contravenes the agreement memorialized and enforced in paragraph 19A.

[80] Paragraph 19A arose in a post-CCAA filing environment, with each interested party carefully negotiating its position. The fact that the agreement to include paragraph 19A in the Amended and Restated Order was reached in a post-filing environment is significant (see *The Trustees of the Labourers' Pension Fund of Central and Eastern Canada v. Sino-Forest Corporation*, 2015 ONSC 4004, 27 C.B.R. (6th) 134 at paras. 33-35). In my view, there was never any doubt that Target Canada and Target Corporation were aware of the implications of paragraph 19A and by proposing this Plan, Target Canada and Target Corporation seek to override the provisions of paragraph 19A. They ask the court to let them back out of their binding agreement after having received the benefit of performance by the landlords. They ask the court to let them try to compromise the Landlord Guarantee Claims against Target Corporation after promising not to do that very thing in these proceedings. They ask the court to let them eliminate a court order to which they consented without proving that they having

any grounds to rescind the order. In my view, it is simply not appropriate to proceed with the Plan that requires such an alteration.

[81] The CCAA process is one of building blocks. In this proceedings, a stay has been granted and a plan developed. During these proceedings, this court has made number of orders. It is essential that court orders made during CCAA proceedings be respected. In this case, the Amended Restated Order was an order that was heavily negotiated by sophisticated parties. They knew that they were entering into binding agreements supported by binding orders. Certain parties now wish to restate the terms of the negotiated orders. Such a development would run counter to the building block approach underlying these proceedings since the outset.

[82] The parties raised the issue of whether the court has the jurisdiction to vary paragraph 19A. In view of my decision that it is not appropriate to vary the Order, it is not necessary to address the issue of jurisdiction.

[83] A similar analysis can also be undertaken with respect to the Claims Procedure Order. The Claims Procedure Order establishes the framework to be followed to quantify claims. The Plan changes the basis by which landlord claims are to be quantified. Instead of following the process set forth in the Claims Procedure Order, which provides for appeal rights to the court or claims officer, the Plan provides for quantification of landlord claims by use of Landlord Formula Amount, proposed by Target Canada.

[84] In my view, it is clear that this Plan, in its current form, cannot withstand the scrutiny of the test to sanction a Plan. It is, in my view, not appropriate to change the rules to suit the applicant and the Plan Sponsor, in midstream.

[85] It cannot be fair and reasonable to ignore post-filing agreements concerning the CCAA process after they have been relied upon by counter-parties or to rescind consent orders of the court without grounds to do so.

[86] Target Canada submits that the foregoing issues can be the subject of debate at the sanction hearing. In my view, this is not an attractive alternative. It merely postpones the inevitable result, namely the conclusion that this Plan contravenes court orders and cannot be

considered to be fair and reasonable in its treatment of the Objecting Landlords. In my view, this Plan is improper (see *Crystallex*).

Disposition

[87] Accordingly, the Plan is not accepted for filing and this motion is dismissed.

[88] The Monitor is directed to review the implications of this Endorsement with the stakeholders within 14 days and is to schedule a case conference where various alternatives can be reviewed.

[89] At this time, it is not necessary to address the issue of classification of creditors' claim, nor is it necessary to address the issue of non-disclosure of the RioCan Settlement.

Regional Senior Justice G.B. Morawetz

Date: January 15, 2016

TAB 12

1993 CarswellBC 555
British Columbia Supreme Court

Woodward's Ltd., Re

1993 CarswellBC 555, 20 C.B.R. (3d) 74, 39 A.C.W.S. (3d) 981, 84 B.C.L.R. (2d) 206

**Re COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36; Re
COMPANY ACT, R.S.B.C. 1979, c. 59; Re WOODWARD'S LIMITED, WOODWARD
STORES LIMITED and ABERCROMBIE & FITCH CO. (CANADA) LTD.**

Tysoe J. [in Chambers]

Heard: April 13, 14 and 15, 1993

Judgment: April 20, 1993

Docket: Doc. Vancouver A924791

Counsel: *Michael A. Fitch, Susan M. Eyre and D. Geoffrey Cowper*, for Woodward's Ltd., Woodward Stores Ltd. and Abercrombie & Fitch Co. (Canada) Ltd.

Paul J. Pearlman, for Hans Andriessen and certain other terminated employees.

James E. Howell, for R. Longine and certain other terminated employees.

Vincent Morgan, for Royal Trust Corp. of Canada.

Digby R. Leigh, for National Bank Leasing.

Douglas B. Hyndman, for North American Trust Co.

B.A.R. Smith, Q.C., for Triple Five Corp. Ltd.

William E.J. Skelly, for Bucci Investment Corp. and Prospero International Realty Inc.

Douglas I. Knowles and Clayton W. Caverly, for Cambridge Shopping Centres Ltd.

Sean Donovan, for Neptune Foods.

Robert G. Kuhn and Nicolas A. Blom, for Park Royal Shopping Centre Ltd. and others.

Robert P. Sloman, for Laing Properties.

Gordon K. Mitchell and L.M. Candido, for Oakbridge Centre Holdings Inc. and others.

Alan H. Brown, for General Electric Capital Canada Inc.

James P. Taylor, Q.C., Scott A. Turner and Michael Harquail, for Zellers Inc.

Subject: Corporate and Commercial; Insolvency

Table of Authorities

Cases considered:

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*

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

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

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.) — *considered*

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

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

229531 B.C. Ltd., Re (1989), 72 C.B.R. (N.S.) 310 (B.C. S.C.) — *considered*

Statutes considered:

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

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

Joint Stock Companies Arrangement Act, 1870 (U.K.), 33 & 34 Vict., c. 104.

Application for order approving classes of creditors designated in plan of arrangement under *Companies' Creditors Arrangement Act*.

Tysoe J. [In Chambers]:

Introduction

1 The Petitioners ("Woodward's") apply for an order approving the classes of creditors designated in their plan of arrangement under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "CCAA") filed on April 7, 1993 (the "Reorganization Plan"). Woodward's proposes to hold meetings of these classes of creditors during the first part of May 1993 for the purpose of voting on the Reorganization Plan.

2 The classes of creditors designated by the Reorganization Plan are Secured Creditors, Noteholders, Landlords and General Creditors. Each of these terms is defined in the Reorganization Plan. There is no issue as to the appropriateness of classes of secured creditors, noteholders, landlords and general creditors. The question is whether or not there should be additional classes.

3 The definitions in the Reorganization Plan of the classes of creditors are as follows:

"Secured Creditors" means the Secured Trustee as holder of the Secured Notes;

"Noteholders" means the A & F Debentureholders, the Stores Debentureholders, the 9% Noteholders and the 10% Noteholders;

"Landlord" means any landlord, head lessor, sublessor or owner of premises which has entered into any Lease with any member of the Woodward's Group and includes any mortgagee or successor in title of such premises who has taken possession of such premises or is collecting rent in respect of such premises as well as any party who has taken an assignment of rents or assignment of lease in respect of such premises, whether as security or otherwise; provided, however, that if more than one person would otherwise come within this definition of Landlord in respect of any particular Lease, the rights and claims of all such persons in respect of such Lease will be dealt with collectively under this Plan and each reference herein to such Landlord shall be construed as a collective reference to all such persons;

"General Creditors" means all persons with unsecured claims for any Indebtedness against Woodward's Group as at the General Creditor Meeting Date, including the Pre-Filing Trade Creditors, Employee Creditors, the Landlords and the Equipment Financiers but, for the Landlords and the Equipment Financiers, only to the extent of their claims to be dealt with

in the General Creditor class as provided herein, and specifically excluding Post-Filing Trade Creditors, the Noteholders and the holders of the Unaffected Obligations.

4 The additional classes that have been proposed are as follows:

(a) employees of Woodward's that have been terminated since the commencement of these proceedings on December 11, 1992 (these employees made a formal application for separate classification);

(b) Royal Trust Corporation of Canada which holds a debenture creating a fixed charge against certain equipment purchased by Woodward's with the financing provided by Royal Trust;

(c) equipment financiers (which could include Royal Trust);

(d) creditors of Woodward Stores Limited (the "Operating Company") that hold the guarantee or joint covenant of its holding company, Woodward's Limited (the "Holding Company");

(e) one of more classes of landlords whose leases are being repudiated.

5 There is the potential that two parties having agreements to lease with Woodward's will want to make submissions that they should be in a separate or different class. These parties were only served with the Petition in this proceeding recently and it was agreed that my ruling would not affect their ability to make submissions at a subsequent time. It was also agreed that General Electric Capital Canada Inc. would not be bound by my ruling and could make submissions that it should be in a separate or different class or that it should be considered to be a holder of an Unaffected Obligation.

6 I will return to the positions of the various parties but I think it will be useful to first review the authorities setting forth the general principles applicable to the issue of creditor classification.

General Principles

7 The starting point of the case authorities is the decision of the English Court of Appeal in *Sovereign Life Assurance Co. v. Dodd*, [1892] 2 Q.B. 573 (C.A.) where Lord Esher said the following at pp. 579-80 in relation to the meeting of creditors to consider a plan of arrangement under the *Joint Stock Companies Arrangement Act*:

The Act 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.

Bowen L.J. made the following comments at p. 583:

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 or classes 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 a view to their common interest.

8 There has been some jurisprudence over the years regarding creditor classification but, like the jurisprudence on other issues under the CCAA, it has intensified over the past five to ten years. One of the earlier cases of the present wave of jurisprudence dealing with creditor classification is *Norcen Energy Resources Ltd. v. Oakwood Petroleum Ltd.* (1988), 72 C.B.R. 20 (Alta. Q.B.). In that case Forsyth J. rejected the argument that different secured creditors should be placed in separate classes because they held separate security over different assets or because the relative values of their security were different. The Court rejected

the "identity of interest" approach, which involves each class only containing creditors with identical interests. Instead, the Court followed the approach which I will call the "non-fragmentation" approach. This approach avoids the creation of a multiplicity of classes by including creditors with different legal rights in the same class as long as their legal rights are not so dissimilar that it is not possible for them to vote with a common interest. This is essentially the approach that was suggested by Bowen L.J. in the passage from the *Sovereign Life* quoted above (although his words have been incorrectly attributed to Lord Esher in at least one case authority and one article).

9 The approach taken in the *Oakwood Petroleums* case has been specifically adopted by the B.C. Court of Appeal in *Northland Properties Ltd., Re* (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada*) (1989), 73 C.B.R. (N.S.) 195 (B.C. C.A.). In the lower court decision in that case the Court considered the similarities and dissimilarities of various mortgagees holding mortgages against different properties and concluded that they should be in the same class. Dealing with the points of dissimilarity, Trainor J. said as follows at p. 192 of (1988), 73 C.B.R. (N.S.) 175 (B.C. S.C.):

The points of dissimilarity are that they are separate properties and that there are deficiencies in value of security for the loan, which vary accordingly for particular priority mortgagees. Specifically with respect to Guardian and Excelsior, they are both in a deficiency position.

Now, either of the reasons for points of dissimilarity, if effect was given to them, could result in fragmentation to the extent that a plan would be a realistic impossibility. The distinction which is sought is based on property values, not on contractual rights or legal interests.

10 After the Court of Appeal in *Northland Properties* quoted the above passage, it said the following (at p. 203):

I agree with that, but I wish to add that in any complicated plan under this Act, there will often be some secured creditors who appear to be oversecured, some who do not know if they are fully secured or not, and some who appear not to be fully secured. This is a variable cause arising not by any difference in legal interests, but rather as a consequence of bad lending, or market values, or both.

11 As the B.C. Court of Appeal has specifically adopted the reasoning in *Oakwood Petroleums*, the approach which I have called the "non-fragmentation" approach is the one to be followed in British Columbia. As will be seen shortly, the "non-fragmentation" approach has also been preferred over the "identity of interest" approach by the Ontario courts.

12 There have been two recent cases that are particularly relevant because they deal with employees, landlords and equipment lessors in circumstances that are similar to the situation at hand. The first of these cases is *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 8 C.B.R. (3d) 312 (Ont. Gen. Div.) where one of the proposed classes consisted of all creditors other than two secured creditors, including holders of unsecured debentures, terminated employees, landlords whose leases had been repudiated and equipment lessors whose leases were to be repudiated (although the report does not specifically say it, I assume that the proposed class also included the general trade creditors). The Court rejected the argument of one of the landlords that there should be a separate class of creditors consisting of the landlords and the equipment lessors. Borins J. utilized the "non-fragmentation" approach as illustrated by the following passage on pp. 317-318:

In my view, an important principle to consider in approaching ss. 4 and 5 of the C.C.A.A. is that followed in *Re Wellington Building Corp.*, 16 C.B.R. 48, [1934] O.R. 653, [1934] 4 D.L.R. 626 (S.C.), in which it was emphasized that the object of ss.4 and 5 is not confiscation but is to enable compromises to be made for the common benefit of the creditors as creditors, or for the common benefit of some class of creditors as such. To this I would add that recognition must be given to the legislative intent to facilitate corporate reorganization and that in the modern world of large and complicated business enterprises the excessive fragmentation of classes could be counter-productive to the fulfilment of this intent. In this regard, to approach the classification of creditors on the basis of identity of interest, as suggested by counsel for H & R Properties, would in some instances result in the multiplicity of classes, which would make any re-organization difficult, if not impossible, to achieve. In my view, in placing a broad and purposive interpretation upon the provisions

of the C.C.A.A. the court should take care to resist approaches which would potentially fragment creditors and thereby jeopardize potentially viable plans of arrangement, such as the plan advanced in this application.

13 The other recent decision is *Grafton-Fraser Inc. v. Canadian Imperial Bank of Commerce* (1992), 90 D.L.R. (4th) 285 (Ont. Gen. Div.). In that case Houlden J.A. approved the classification of creditors into secured creditors, landlords and unsecured creditors. It appears from the report that the plan contemplated that some leases would be repudiated and there would be rent reductions in respect of certain of the continuing premises. I am told that the final plan of Grafton-Fraser Inc. did not include the landlords with continuing leases at reduced rental rates in the same class as the landlords whose leases were repudiated, but the decision of Houlden J.A. appears to be predicated on the fact that the two types of landlords would be in the same class. It had been argued that the landlords should be in the same class as the unsecured creditors. Houlden J.A. felt that it was appropriate to have the landlords in a separate class for two reasons; namely, there would be great difficulty in ascertaining the amounts of the claims of the landlords and the plan enjoined the landlords from exercising their contractual and statutory remedies.

14 Before I apply the general principles outlined above to the circumstances of this case, I wish to add some comments regarding the classification of creditors. The case authorities focus on the differences in the legal rights of the creditors in determining whether their interests are sufficiently similar or dissimilar to warrant creditors being placed in the same class or separate classes. I agree that it is the legal rights of the creditors that must be considered and that other external matters that could influence the interests of a creditor are not to be taken in account. However, it is my view that the legal rights should not be considered in isolation and that they must be considered within the context of the provisions of the reorganization plan. It would be appropriate to segregate two sets of creditors with similar legal interests into separate classes if the plan treats them differently. Conversely, it may be appropriate to include two sets of creditors with different legal rights in the same class if the plan treats them in a fashion that gives them a commonality of interest despite their different legal rights. In addition, when the Court is assessing whether there is a sufficient commonality of interest to include two sets of creditors in the same class, it is necessary in my view to examine their legal rights within the context of the potential failure of the reorganization plan. The treatment of the two sets of creditors under the plan should be compared to the rights they would have in the event of the failure of the plan (i.e., bankruptcy or other liquidation).

Terminated Employees

15 The first set of creditors that submitted that it should be in a separate class is the group of former employees of Woodward's who were terminated after December 11, 1992, the date of commencement of these CCAA proceedings. These former employees all have claims against Woodward's for damages as a result of Woodward's failure to give them reasonable notice of termination. The Reorganization Plan includes the terminated employees in the class of General Creditors which also includes the trade suppliers and other unsecured claims of the Operating Company. The Reorganization Plan proposes that the General Creditors receive 37% of the principal amounts of their proven claims.

16 The two counsel acting for former employees on this application submitted that their clients should comprise a separate class of creditors for several reasons. They say that the terminated employees are largely middle-aged, long service employees with limited education who have little prospect of finding alternate employment. They point to the fact that the courts recognize the difference between a contract of employment and an ordinary commercial contract. They further make reference to the fact that the trade suppliers will be selling merchandise to the reorganized company and that they will have a potentially continuing relationship which may influence the manner in which they vote on the plan. Finally, they say that the trade suppliers have the ability to "write off" their losses and that they will receive different income tax treatment in respect of their losses than the terminated employees.

17 In arguing that the terminated employees should form their own class, counsel relied on the article *Reorganizations under the Companies' Creditors Arrangement Act* (1947) 25 Can. Bar Rev. 587 by Stanley E. Edwards. This article has been relied upon extensively by the courts in interpreting the CCAA. However, the article has not been followed with respect to the classification of creditors. Mr. Edwards proposes the "identity of interest" approach which was not been adopted by the Alberta, British Columbia and Ontario courts. The preferred approach is the "non-fragmentation" approach.

18 The legal rights of the terminated employees are the same as the legal rights of the trade suppliers. They are both creditors with unsecured claims against the Operating Company (the secured and preferred amounts payable to employees under provincial legislation and the *Bankruptcy and Insolvency Act* have already been paid to the terminated employees). In a bankruptcy or other liquidation they would both receive the same pro rata amount of their claims. They are to receive the same pro rata amount of their claims under the Reorganization Plan.

19 The fact that there is a recognized difference between contracts of employment and ordinary commercial contracts is not relevant because the contracts of employment of the terminated employees have come to an end. The terminated employees have claims for damages against Woodward's for wrongful dismissal. Once the amount of damages for an employee has been agreed upon or determined by the Court, the difference between the two types of contracts becomes historical and the employee has the same rights as any other unsecured creditor. The differences between the two types of contracts may result in the employees receiving higher amounts of damages but the differences do not warrant the terminated employees being entitled to a higher distribution than the other unsecured creditors.

20 I am satisfied that there is a sufficient commonality of interest between the terminated employees and the other members of the General Creditors class that they should be included in the same class.

Equipment Financiers and Royal Trust Corporation of Canada

21 It is convenient to deal with the submissions of the equipment lessors and Royal Trust at the same time because if Royal Trust is not put in a class of its own, its alternate position was that it should be included in a class with the equipment lessors.

22 The term "Equipment Financiers" is defined in the Reorganization Plan. In brief, the term means any person who has provided financing for the acquisition or installation of office equipment or trade fixtures and who has retained a security interest by way of a lease or a security instrument. Woodward's has notified or will be notifying certain equipment financiers that it no longer requires their equipment. These equipment financiers will then have a claim against Woodward's for damages resulting from the repudiation of their contractual arrangements. It is these equipment financiers who wish to be in a separate class. The Reorganization Plan proposes that the terminated equipment financiers be treated as General Creditors and that they receive 37% of the amounts of their claims. The amount of each claim would presumably be the discounted value of future payments owing by Woodward's to the equipment financier less the present value of the equipment.

23 Most of the equipment financiers are parties that bought the equipment and are leasing it to Woodward's on a normal type of term lease. The equipment financiers who are lessors include National Bank Leasing, North American Trust Company and Royal Bank Leasing. Royal Trust also falls within the definition of "Equipment Financier" but it is not a lessor. It financed the acquisition by Woodward's of certain equipment by way of a traditional financing arrangement. It loaned money to Woodward's on a term basis and it took security in the form of a debenture creating a fixed charge against the equipment that it financed.

24 In other contexts under the CCAA the treatment of equipment leases in relation to the treatment of security documents causes me considerable doubts. Should equipment leases be treated the same as security instruments in all or some cases? Does it make a difference whether the lease is classified as an operating lease or a capital lease? Should the extent of depreciation of the subject asset be taken into account? Fortunately these questions can be left for another time because they do not need to be resolved in order to deal with the classification issue.

25 Lessors and debentureholders do have different legal rights but the question to be answered is whether the different rights result in a lack of commonality of interest. In a bankruptcy a lessor is entitled to retake possession of the leased goods upon default and, if the lease is worded properly, the lessor is entitled to prove as an unsecured creditor for its damages. In the case of a debentureholder in a bankruptcy situation, the debentureholder has the right to cause the charged assets to be sold and it is entitled to prove as an unsecured creditor for the deficiency on its loan. In most cases the damages of the lessor and the deficiency on the debentureholder's loan will be equivalent; namely, the difference between the present value of the monies that are owed and the value of the leased goods or the charged assets. Hence, the rights of an equipment lessor and the rights of a debentureholder with a fixed charge on financed equipment in a bankruptcy situation are roughly the same. The equipment

lessors and Royal Trust are being treated the same under the Reorganization Plan. Therefore, there is a sufficient commonality of interest for Royal Trust to be included in the same class as the equipment lessors.

26 Some submissions were made with respect to the priority between Royal Trust and The R-M Trust Company which is the sole Secured Creditor under the Reorganization Plan. I do not accept the contention that Royal Trust has priority over The R-M Trust Company on any of Woodward's assets other than the ones that are covered by the fixed charge in favour of Royal Trust.

27 The question then becomes whether the equipment financiers (including Royal Trust) belong in a separate class or in the class of General Creditors. This is an example of why the legal rights of the parties must be examined within the context of the Reorganization Plan. In isolation the rights of the equipment financiers and the rights of unsecured creditors are very different. But the treatment of the two groups in the Reorganization Plan could affect their interests.

28 If the Reorganization Plan provided that Woodward's was to retain the financed equipment and the equipment financiers were to be paid the same proportion of their indebtedness as the unsecured creditors, the equipment financiers would be entitled to be included in a different class from the unsecured creditors. They would be losing their proprietary or security rights in the equipment and they would be receiving the same pro rata distribution as unsecured creditors who do not have same rights. However, that is not what the Reorganization Plan is proposing.

29 The Reorganization Plan does not affect any of the proprietary or security rights of the equipment financiers. Woodward's is allowing the equipment financiers to fully exercise those rights outside of the Reorganization Plan. All the Reorganization Plan is purporting to affect are the claims of the equipment financiers for damages or the deficiencies on loans. These claims are unsecured claims and there is no reason why they should be treated any differently than the claims of unsecured creditors. There is a sufficient commonality of interest between the unsecured creditors and the equipment financiers with respect to their unsecured claims for damages or the deficiencies on loans. It is appropriate to include the equipment financiers in the class of General Creditors with respect to these claims.

30 This classification of the equipment financiers is consistent with the decision in *Sklar-Peppler, supra*, where the Ontario Court of Justice approved the grouping of equipment lessors in the same class as the unsecured creditors.

Holders of Guarantees or Joint Covenants

31 The class of General Creditors is comprised of creditors of the Operating Company. However, at least two of these creditors hold a guarantee or joint covenant of the Holding Company. National Bank Leasing holds a guarantee from the Holding Company and the debenture held by Royal Trust is a joint debenture from the Operating Company and the Holding Company. For ease of reference I will refer to a creditor holding a guarantee or joint covenant of the Holding Company as the holder of a guarantee and such reference shall also include the holder of a joint covenant.

32 The Holding Company does not own any tangible assets. Other than the shares in the Operating Company, the only asset owned by the Holding Company is an inter-company account owed to it by the Operating Company. This inter-company account means that upon the bankruptcy or other liquidation of the Operating Company, the Holding Company would be an unsecured creditor entitled to share on a pro rata basis in distributions to the unsecured creditors of the Operating Company. If the Holding Company was also to be liquidated, the money received on account of the inter-company receivable would be distributed to the creditors of the Holding Company, including creditors of the Operating Company with guarantees from the Holding Company and other unsecured creditors if sufficient monies were available to fully satisfy the secured and preferred creditors of the Holding Company. The result is that unsecured creditors of the Operating Company with guarantees from the Holding Company may receive more money than the other unsecured creditors of the Operating Company in the event of bankruptcies or other liquidations of the two companies.

33 On April 16, 1993 the Monitor appointed in these proceedings issued a report confirming that upon a liquidation of the two companies, the unsecured creditors of the Holding Company would receive a distribution. The Monitor estimates a liquidation distribution for the unsecured creditors of the Holding Company to be in the range from 2% to 12%.

34 The distinction between the interests of the unsecured creditors of the Operating Company and the interests of the unsecured creditors of the Holding Company is recognized in the classification of the creditors in the Reorganization Plan. The unsecured creditors of the Holding Company are included in the class of Noteholders which is a different class from the General Creditors, the class that includes the unsecured creditors of the Operating Company. It is proposed in the Reorganization Plan that the Noteholders receive 32% of their indebtedness.

35 The Reorganization Plan ignores the fact that the holders of guarantees are unsecured creditors of both companies. It proposes that they receive the same 37% proportion of their indebtedness as the other General Creditors and their status as creditors of the Holding Company is not reflected.

36 In view of the fact that the holders of guarantees do have different legal rights from the other members of the class of General Creditors, it is necessary to decide whether the rights are so dissimilar that they cannot vote on the Reorganization Plan with a common interest. It was submitted by counsel for Woodward's that there is a common interest because the holders of guarantees will still receive more under the Reorganization Plan than they will be paid upon a liquidation of the two companies. I do not think that this is sufficient to create a commonality of interest with the other members in the class of General Creditors who have lesser legal rights. To the contrary, I believe that this is an example of what Bowen L.J. had in mind in the *Sovereign Life* case, *supra*, when he used the term "confiscation". By being a minority in the class of General Creditors, the holders of guarantees can have their guarantees confiscated by a vote of the requisite majority of the class who do not have the same rights. The holders of guarantees could be forced to accept the same proportionate amount as the other members of the class and to receive no value in respect of legal rights that they uniquely enjoy and that would have value in a liquidation of the two companies.

37 The passage from *Sklar-Pepler* quoted above made reference to the decision in *Re Wellington Building Corp.*, *supra* [(1934), 16 C.B.R. 48 (Ont. S.C.)]. In that case the Court was asked to approve a scheme of arrangement under the CCAA that had one class of secured creditors which included boldholders, lienholders, third mortgagee and fourth mortgagees. The Court refused to approve the scheme on the basis that there should have been more than one class of secured creditors. Kingstone J. said the following at p. 54 of 16 C.B.R.:

... it was necessary under the Act that they should vote in classes and that three-fourths of the value of each class should be obtained in support of the scheme before the Court could or should approve of it. Particularly is this the case where the holders of the senior securities' (in this case the bondholders') rights are seriously affected by the proposal as they are deprived of the arrears of interest on their bonds if the proposal is carried through. It was never the intention under the Act, I am convinced, to deprive creditors in the position of the bondholders of their right to approve as a class by the necessary majority of a scheme propounded by the company which would permit the holders of junior securities to put through a scheme inimicable to this class and amounting to confiscation of the vested interest of the bondholders.

38 In *Re 229531 B.C. Ltd.* (1989), 72 C.B.R. (N.S.) 310 (B.C. S.C.) the Court refused to approve a plan of arrangement under the CCAA for numerous reasons. One of the reasons was that a guarantee held by one creditor was to be released as a result of the reorganization plan and the creditor was to receive the same proportionate distribution as all of the other unsecured creditors. In other words, the guarantee was being confiscated by the vote of other creditors who did not enjoy the same rights as the creditor which held the guarantee.

39 If it was clear that no monies would be available to unsecured creditors upon a liquidation of the Holding Company, the legal rights of the holders of the guarantees would have no practical value and there would then be no objection to their inclusion in the class of General Creditors. There is also a point where the prospects of the unsecured creditors of the Holding Company receiving any monies upon its liquidation would be so uncertain that the commonality of interest between the holders of the guarantees and the other members of the class of General Creditors would not be affected. However, I am not satisfied in this case that such prospects are so uncertain that the holders of guarantees should be forced to be in the same class as the other unsecured creditors of the Operating Company. In making this statement, I note that the unsecured creditors of the Holding Company are to receive 32% of their indebtedness under the Reorganization Plan.

40 I should stress that it is important in my view that there is only one difference between the rights of the holders of the guarantees and the rights of the other members of the class of General Creditors. It is clear that the one additional right enjoyed by the holders of the guarantees is not being given any value under the Reorganization Plan. The result could be different if the other members of the class of General Creditors had additional rights that were not enjoyed by the holders of the guarantees. There could be a trade-off between the rights that were not commonly shared and the groups could have a sufficient commonality of interest to be included in the same class. Here, there is no potential trade-off between the two groups and the one additional right of the holders of the guarantees is being confiscated without compensation.

41 Counsel for Woodward's suggested that the issue of the guarantees be left to the fairness hearing (i.e., the hearing to consider the sanctioning of the Reorganization Plan). As I believe that the holders of guarantees have a sufficiently different legal right to warrant a separate classification, it follows that I would consider the Reorganization Plan to be unfair to them if they are included in the class of General Creditors. I should not order meetings for the creditors to vote on the Reorganization Plan when I know that those meetings would be fruitless because I would refuse to approve the outcome of the meetings.

Landlords

42 Counsel for Triple Five Corporation Limited submitted that there should be two classes of landlords, one class consisting of landlords with anchor tenants whose leases are being repudiated and the other class consisting of the remaining landlords. Counsel for Bucci Investment Corporation and Prospero International Realty Inc. submitted that there should be three classes of landlords, one class consisting of landlords with anchor tenants whose leases are being repudiated, a second class consisting of landlords without anchor tenants whose leases are being repudiated and the third class consisting of the remaining landlords.

43 Counsel for Triple Five Corporation Limited put forward three reasons in support of his position. A fourth reason was also put forward initially but it was withdrawn and reserved for the fairness hearing. The three reasons are as follows:

(a) a repudiation of a lease by an anchor tenant will cause the landlord to be in breach of other contractual obligations and the consequences of such a repudiation go beyond the liquidated damages that result from the repudiation of a lease by a tenant other than an anchor tenant;

(b) there is no precedent for the selective repudiation of leases under the CCAA and Woodward's has chosen not to utilize the proposal provisions of the *Bankruptcy and Insolvency Act* that now has a procedure for the repudiation of leases;

(c) Zellers Inc. (and its parent, The Hudson's Bay Company) is a stranger to the relationship between Woodward's and its creditors and its involvement in Woodward's reorganization (by way of a merger with the reorganized company) requires a higher degree of fairness.

44 In my view, none of these reasons is a valid justification for the creation of a separate class of landlords:

(a) the additional consequences of a repudiation by an anchor tenant flow from external considerations and the different consequences to different landlords does not result from different legal rights existing between the landlords and Woodward's. As was held in *Northland Properties, supra*, separate creditor classification must be based on a difference in legal interests or rights;

(b) *Sklar-Peppler, supra*, and *Grafton-Fraser, supra*, are both examples of reorganizations involving repudiations of leases. The fact that the *Bankruptcy and Insolvency Act* now specifically provides for the repudiation of leases does not mean that a reorganization involving lease repudiation cannot be attempted under the CCAA and it certainly does not mean that there should be separate classes of landlords;

(c) the aspect of fairness is a matter to be considered on the application for the Court to sanction the Reorganization Plan. The application is commonly called the fairness hearing. There is nothing in the involvement of Zellers Inc. that requires the creation of separate classes for landlords.

45 Counsel for Bucci and Prospero did not put forward any independent grounds for the creation of separate landlord classes. His point was that if there was justification for the creation of a separate class for landlords with anchor tenants whose leases were being repudiated, there was equal justification for the creation of a separate class for the other landlords whose leases were being repudiated.

46 There was one point that bothered me about the grouping of all the landlords into a single class. In addition to including landlords whose leases were being repudiated, the class includes landlords who are having their leases partially repudiated by the unilateral reduction in the amount of leased space and landlords who are having the rent under their leases unilaterally reduced. Both of these two groups of landlords would be having a continuing relationship with Woodward's. Unlike the trade suppliers, the continuing relationship between these landlords and Woodward's is based on legal rights. I was concerned that the continuing legal relationship between these landlords and Woodward's may give them a different interest from interests of the landlords whose leases are being wholly repudiated. For example, the continuing landlords may be more willing to vote in favour of the Reorganization Plan because they will be able to recoup some of their losses from the profits generated out of the continuing relationship with Woodward's. The answer to my concern is that the rent under all of the continuing leases is to be adjusted to market rent. The landlords whose leases are being repudiated will also be leasing their premises to new tenants at market rent. Accordingly, the landlords with continuing leases will not have any advantage over the other landlords and there will be sufficient commonality of interest to include all of the landlords in one class.

47 During submissions I queried whether the landlords should be included in the class of General Creditors. At first blush a landlord whose lease is being repudiated is in the same position as the other unsecured creditors of the Operating Company. The reason why it is appropriate for the Landlords to be in a different class is that they receive different treatment under the Reorganization Plan. The General Creditors are to be paid 37% of their claims while the Landlords are to be paid an amount equal to six months' rent. One reason for the different treatment is the fact that it is very difficult to properly quantify the claims of the Landlords and the efforts of the Landlords to mitigate their damages will not be known prior to the implementation of the Reorganization Plan. This rationale was accepted in *Grafton-Fraser, supra*, where the Court approved a separate classification for the landlords. Another justification for the different treatment is the fact that the *Bankruptcy and Insolvency Act* provides that landlords whose leases are repudiated are entitled to compensation equal to six months' rent.

48 In the *Grafton-Fraser* case, *supra*, the Court approved a landlord class which, at least at the time of the decision, appeared to include both landlords with repudiated leases and landlords with continuing leases at reduced rental rates.

49 It is my view that there is sufficient commonality of interest among the landlords for all of them to be included in a single class. I am reinforced in my decision by the positions of the other landlords represented by counsel at the hearing. Mr. Kuhn, Mr. Knowles and Mr. Mitchell, who each represent landlords in each of the three proposed landlord classes, all supported the single class for the landlords and that position in itself demonstrates that the landlords do have a commonality of interest.

Conclusion

50 I approve the classes of creditors designated in the Reorganization Plan with the exception that the class of General Creditors should not include creditors of the Operating Company who hold guarantees or joint covenants from the Holding Company. I dismiss the application of the terminated employees for separate classification and I reject the other submissions for separate classifications.

Order accordingly.

TAB 13

1991 CarswellOnt 220

Ontario Court of Justice (General Division), Commercial List

Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia

1991 CarswellOnt 220, 31 A.C.W.S. (3d) 93, 86 D.L.R. (4th) 621, 8 C.B.R. (3d) 312

**SKLAR-PEPPLER FURNITURE CORPORATION v. BANK OF NOVA
SCOTIA, 949073 ONTARIO INC., H & R PROPERTIES LIMITED,
SHERMIC INC., JOANTE INVESTMENTS LTD., CANADIAN EQUIPMENT
LEASING (A DIVISION OF TRIATHLON LEASING INC.), PITNEY
BOWES LEASING (A DIVISION OF PITNEY BOWES OF CANADA LTD.),
MICHAEL WEINIG AG and all other affected creditors of applicant**

Borins J.

Judgment: October 31, 1991

Docket: Doc. B301/91

Counsel: *Barbara Grossman*, for applicant and for respondent 949073 Ontario Inc.

L. Crozier and Catherine Francis, for H & R Properties Ltd.

Kent E. Thomson, for Bank of Nova Scotia.

Subject: Corporate and Commercial; Insolvency

Table of Authorities

Cases considered:

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 — *referred to*

Wellington Building Corp., Re, 61 C.B.R. 48, [1934] O.R. 653, [1934] 4 D.L.R. 626 (S.C.) — *applied*

Statutes considered:

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

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

s. 2

s. 3

s. 4

s. 5

s. 6

s. 11

Winding-Up Act, R.S.C. 1985, c. W-11.

Application for relief under *Companies' Creditors Arrangement Act*.

Borins J.:

1 This is an application brought by Sklar-Peppler Furniture Corp. (subsequently referred to as "Sklar") pursuant to ss. 4, 5 and 11 of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (subsequently referred to as "C.C.A.A.") for the relief contained in the draft order annexed to the notice of application.

2 The essential nature of the relief requested is the maintenance of the status quo in regard to the business operations conducted by Sklar by preventing any of its creditors from taking proceedings against it under the *Bankruptcy Act*, R.S.C. 1985, c. B-3 and the *Winding-Up Act*, R.S.C. 1985, c. W-11, or commencing or continuing any lawsuit or related proceedings against Sklar until further order of the court, pending the consideration of a plan of compromise or arrangement between Sklar and the classes of its creditors affected by the proposed plan.

3 Before the court is the proposed plan. It is a most comprehensive document, 39 pages in length, to which is appended an additional 33 pages containing information referred to in the plan, including the classification of creditors for the purpose of voting in respect to the approval of the plan as required by s. 6 of the Act. The urgent nature of this application, with the resulting need to provide an early decision in respect to it, as well as a limited time available to me since the conclusion of submissions late yesterday, do not permit me to review in detail the provisions of the plan. However, I am able to say that I have examined in detail the plan and the evidence before the court and, subject to what follows, I would have had no hesitation in granting the order as sought because the order and the plan, in my view, provide a compelling example of the very situation to which the C.C.A.A. is intended to address. The proposed plan exemplifies the policy and objectives of the Act as it proposes a regime for the court-supervised re-organization of the applicant company intended to avoid the devastating social and economic effects of a creditor-initiated termination of its ongoing business operations and enabling the company to carry on its business in a manner in which it is intended to cause the least possible harm to the company, its creditors, its employees and former employees and the communities in which it carries on and carried on its business operations.

4 Two of the named respondents, the Bank of Nova Scotia and 949073 Ontario Inc., are the major creditors of Sklar and their combined indebtedness is about \$60,000,000. The bank is a secured creditor and 949073 Ontario Inc. is an unsecured creditor which is the guarantor of a debt of Sklar and which has given security to the bank. Counsel for the bank advised the court of the bank's strong support for the order sought by Sklar. The applicant is indebted to trade and other secured creditors in the aggregate amount of about \$10,500,000. There are six other named respondents. Three of these respondents are the landlords of premises under lease to Sklar which Sklar, as part of its proposed re-organization, can no longer afford and which, therefore, it no longer requires for what it hopes will be its continuing business operations. Two of the other three respondents are lessors of equipment to Sklar, the continued use of which Sklar also considers to be uneconomical. The sixth respondent is a conditional-sales vendor of certain equipment purchased by Sklar.

5 On October 24, 1991, Sklar delivered a notice to each of the three realty landlords advising them that due to its financial situation it was unable to continue to occupy the leased premises, that it has vacated the premises in question and that it would make delivery of the keys to the premises and expressing the view that each landlord would take appropriate steps to protect its interest and secure the leased premises. Each of the landlords replied to the notice stating, inter alia, that Sklar's letter constituted a repudiation of its lease.

6 As for the respondents, Mr. Hess was in attendance as a representative of Michael Weinig AG and through counsel for the applicant advised the court that Michael Weinig AG neither opposed nor consented to the granting of the order. A similar position was taken by two realty lessors, Shermic Inc. and Joante Investments Ltd., who appeared respectively by counsel and a representative. Nothing was heard from the remaining two equipment lessors, Triathlon Leasing Inc. and Pitney Bowes of Canada Ltd. The only opposition to the granting of the order was that of the realty lessor H & R Properties Ltd. As I will explain,

as I understand, the principal objections of H & R Properties Ltd. are not to the plan as such, but are in respect to the way in which certain provisions of the plan purport to interfere with its contractual rights as landlord and its remedies against Sklar consequent to its repudiation of the lease and in respect to the classification of creditors for the purposes of the vote required to consider the approval or rejection of the plan.

7 However, before I discuss the submissions made by counsel for H & R Properties, there are some observations which I wish to make by way of background. Sklar is a long-established company, which has carried on the business of manufacturing and marketing wooden furniture and upholstered furniture for many years in southern Ontario. A subsidiary carries on its business in the United States. Until its financial circumstances caused the company to reduce its operations, it formerly employed approximately 212 people in Hanover and 60 people in Toronto. It now employs about 400 people in Whitby, and about 200 people are employed by the American subsidiary, in operations which it purposes to continue if the plan is approved.

8 Since late 1989 Sklar has experienced financial difficulties and is now insolvent. Among the reasons for its insolvency are the combined effects of economic recession, the introduction of free trade, the strong Canadian dollar, the high volume of bankruptcies among Canadian furniture manufacturers and the effects of the Goods and Services Tax on consumer spending. It has already introduced economic measures designed to deal with its financial problems. If the plan is not approved, the Bank of Nova Scotia will enforce its security. This will result in Sklar's bankruptcy, which in turn will result in its remaining employees losing their jobs and no funds being available to satisfy the claims of unsecured creditors, including terminated employees. The plan provides for a fund of \$1.5 million to pay, on a pro rata basis, the amounts due to the over 1,000 unsecured creditors to whom the proposed plan will be mailed and who will be given the opportunity to vote, in person or by proxy, with respect to its approval or rejection. Sklar has issued the debentures necessary to qualify it as a debtor company within the meaning of ss. 2 and 3 of the C.C.A.A. Although an issue was raised as to whether H & R Properties Ltd. is an unsecured creditor within s. 2 of the Act, I am satisfied that under the broad definition of unsecured creditor contained in the Act in the cases in which I have considered the question, H & R Properties is an unsecured creditor both in respect to the outstanding rent which is now owed to it by Sklar, and any contingent claim for unliquidated damages to which it may become entitled as a result of Sklar's apparent repudiation of its lease.

9 This brings me to the objections raised by counsel for H & R Properties in their submissions. There are two main objections, which are, in a sense, related. The first objection relates to para. 20 of the draft order, which stipulates that H & R Properties is an "Affected Creditor" as defined in the order and the plan and provides that the claims of every such creditor include claims for contingent and unliquidated claims arising, inter alia, under any lease. The first objection relates as well to the provisions of para. 26 of the plan, which states that if the plan is approved, realty leases will be terminated as of the date the order is granted, and the lessors "will be treated insofar as the situation permits in a manner equivalent to treatment to which they would be entitled if the company had gone into bankruptcy" on the date the order is granted. The second objection relates to the classification of the creditors in the plan. The plan provides for two classes of creditors. The first class was comprised of the two secured creditors, Bank of Nova Scotia and 949073 Ontario Inc. The second class contains all other affected creditors, numbering over 1,000, and includes the holders of debentures issued by the company, all terminated employees of the company, the three realty lessors and the three equipment lessors.

10 In considering the objections raised by H & R Properties, I wish to emphasize that while I have read the authorities provided by counsel for all parties, time has not permitted me to discuss and analyze them in these reasons. I have, however, in an appendix to my reasons, listed the authorities provided by counsel for all parties. I have also read the helpful article by D.H. Goldman, D.E. Baird and M.A. Weinczok, "Arrangements Under the *Companies' Creditors Arrangement Act*" (1991) 1 C.B.R. (3d) 135, in which the authorities are reviewed.

11 With respect to the first objection, I am satisfied that on the broad interpretation which the authorities have placed on s. 11 of the C.C.A.A. and the discretionary powers which it provides to the court in considering an application under the C.C.A.A. and the purposes of the legislation, the provisions of para. 20 of the draft order are appropriate to avoid impairment to the ability of Sklar to continue its business operations during the period while the plan of compromise or arrangement is under consideration. To the extent that it is appropriate to comment on para. 26 of the plan, I see nothing inappropriate in its terms. However, the plan is yet to be approved by the creditors and it is only after it has been approved by them that it is, in

my view, appropriate for the court, in considering whether or not court approval is to be given, to comment specifically on a proposed plan except, of course, in regard to the classification of creditors and its probability of success or failure in relation to the circumstances of the application.

12 The second objection concerns the classification of creditors. This objection emanates from the fact that H & R Properties is displeased with the impact of the plan and in particular para. 26 on any claims which it might have for future rent subsequent to the date its lease with Sklar is terminated. It fears that because it is in a class with over 1,000 creditors the negative vote which one presumes it proposes to cast against the plan will be meaningless and the plan will be approved. It, therefore, submits that a third class of creditors should be established consisting of the three realty lessors and the other three respondents. It submits that because there is no community of interest between itself and the other creditors, the applicant is attempting to isolate it by placing it in a class in which it does not belong and to thereby force upon it conditions which it feels are unacceptable.

13 The subject of the appropriate classification of creditors has attracted considerable attention over the past decade. The earlier cases and the recent cases are discussed at pp. 157-169 of the article to which I have referred. In my view, an important principle to consider in approaching ss. 4 and 5 of the C.C.A.A. is that followed in *Re Wellington Building Corp.*, 16 C.B.R. 48, [1934] O.R. 653, [1934] 4 D.L.R. 626 (S.C.), in which it was emphasized that the object of ss. 4 and 5 is not confiscation but is to enable compromises to be made for the common benefit of the creditors as creditors, or for the common benefit of some class of creditors as such. To this I would add that recognition must be given to the legislative intent to facilitate corporate re-organization and that in the modern world of large and complex business enterprises the excessive fragmentation of classes could be counter-productive to the fulfilment of this intent. In this regard, to approach the classification of creditors on the basis of identity of interest, as suggested by counsel for H & R Properties, would in some instances result in the multiplicity of classes, which would make any re-organization difficult, if not impossible, to achieve. In my view, in placing a broad and purposive interpretation upon the provisions of the C.C.A.A. the court should take care to resist approaches which would potentially fragment creditors and thereby jeopardize potentially viable plans of arrangement, such as the plan advanced in this application.

14 In *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, Finlayson J.A. discussed the factors to be considered in the classification of shareholders. Based upon the factors considered by him, and agreed with by Doherty J.A. in his dissenting reasons, and the factors discussed in the various cases reviewed in the article, I am not persuaded that a separate class should be created consisting of the realty lessors, the equipment lessors and the conditional-sales vendor. Not every difference in the nature of a debt due to a creditor or a group of creditors warrants the creation of a separate class. What is required is some community of interest and rights which are not so dissimilar as to make it impossible for the creditors in the class to consult with a view toward a common interest. I do not see any reason for lessors, simply because they are lessors, to constitute a separate class of creditors. In reaching this conclusion I have also considered that para. 26 of the plan does take into account the rights given to landlords under the *Bankruptcy Act*, R.S.C. 1985, c. B-3 and incorporates these rights into the plan. By the same token it would be improper to create a special class simply for the benefit of the opposing creditor, which would give that creditor the potential to exercise an unwarranted degree of power. The proposed plan is not for the exclusive benefit of H & R Properties but is intended to be for the benefit of all of the creditors. In my view, it presents a realistic proposal of compromise and reorganization which has a probable chance of success if presented to the creditors for their consideration.

15 Accordingly, the order will go as asked.

Application under C.C.A.A. granted.

TAB 14

[IN THE COURT OF APPEAL.]

C. A.

1892

July 6

SOVEREIGN LIFE ASSURANCE COMPANY v. DODD.

Company—Winding-up—Set-off—Mutual Credits or Dealings—Life Insurance Company—Action by Company for Money Lent—Policy not matured at Commencement of Winding-up, but matured at Date of Action—Release—Bankruptcy Act, 1883 (46 & 47 Vict. c. 52), s. 38—Joint Stock Companies Arrangement Act, 1870 (33 & 34 Vict. c. 104), s. 2.

The defendant in 1879 effected with the plaintiffs two policies of life insurance for 1000*l.*, each upon his own life, from the date thereof to May 7, 1888, by which policies the plaintiffs contracted that in the event of the defendant being alive on that day they would then pay the moneys assured to the defendant. In April and June, 1887, the defendant obtained two loans of 570*l.* and 600*l.* respectively from the plaintiffs upon mortgage of the policies. In August, 1887, a petition was presented for the winding-up of the plaintiff company, and a provisional liquidator was appointed. The defendant continued to pay to the plaintiffs the premiums upon the policies down to May 7, 1888; but the moneys assured by the policies were never paid to him. In July, 1889, a winding-up order was made. In April, 1890, an arrangement under the Joint Stock Companies Act, 1870, was entered into between the plaintiff company and the Sun Life Assurance Company, whereby it was provided that the policies of the plaintiff company should be transferred to the Sun Company, and that the holders of policies in the plaintiff company should, in full satisfaction of all claims upon the plaintiffs, accept certain reduced payments from the Sun Company. A meeting of policy-holders was summoned under s. 2 of the Act, at which a statutory majority agreed to the arrangement, but the defendant did not himself assent to it; it was in June, 1890, duly sanctioned by the Court. In December, 1890, the plaintiffs brought an action against the defendant to recover the amount of the loans, and the defendant sought to set off against the plaintiffs' claim the sums which, but for the winding-up, would have been payable to him upon the policies:—

Held, that the defendant was entitled to the set-off.

By s. 2 of the Joint Stock Companies Arrangement Act, 1870, where an arrangement is proposed between a company in the course of being wound up and "the creditors of such company, or any class of such creditors," the Court may order that a meeting of "such creditors or class of creditors" shall be summoned, and if a majority in number, representing three-fourths in value of "such creditors or class of creditors," agree to the arrangement, it shall, if sanctioned by an order of the Court, be binding on "all such creditors or class of creditors, as the case may be," and also on the liquidator and contributories of the company.

The persons summoned to the meeting under the above section were the policy-holders of the company, and no separate meeting was summoned of those whose policies had, as distinct from those whose policies had not, matured:—

Held, that the insured persons, whose policies had matured formed a distinct

C. A. class of creditors from those whose policies had not matured ; that a separate
1892 meeting of such class ought to have been held under the Act in order to make
the arrangement binding upon the members of that class ; and that the arrange-
ment did not, therefore, operate as a release by the defendant of his claim against
the plaintiffs.

SOVEREIGN
LIFE
ASSURANCE
COMPANY
v.
DODD.

APPEAL from a judgment of Charles, J. (1)

The action was brought to recover the amount of two loans of 570*l.* and 600*l.*, with interest. The facts, which were not in dispute, were as follows :—

On February 5, 1879, the defendant effected with the plaintiffs two policies of 1000*l.*, each upon his own life, from the date thereof to May 7, 1888, whereby the amount assured was to be payable to him if he was living on May 7, 1888, or to his executors if he died within the term of the insurance. On September 10, 1880, he obtained from the plaintiffs a loan of 320*l.*, and in April, 1887, an additional sum of 250*l.* was advanced to him by the plaintiffs, making altogether 570*l.*, which sum was secured by a mortgage to the secretary of the plaintiff company of the first of the two policies above mentioned. In June, 1887, 600*l.* was advanced by the company on a similar mortgage of the second policy.

On August 5, 1887, a petition to wind up the plaintiff company was presented ; and on September 2, 1887, a provisional liquidator was appointed. On September 5, the secretary forwarded receipts to the defendant for his premiums. “ The petition,” he wrote, “ is to be heard on Wednesday next ; the object, I am informed, being to obtain a scheme for reduction of contracts.” No arrangement, however, was made at that time for any scheme, and after the lapse of nearly two years, namely, on July 30, 1889, a winding-up order was made, and on September 17, 1889, a liquidator was appointed. Meanwhile, on May 7, 1888, the money insured by the defendant’s policies became due to him. He had regularly paid all the premiums, which were payable quarterly, both before and after the date of the petition to wind-up.

On April 11, 1890, a deed of arrangement was entered into between the plaintiff company and the Sun Life Assurance Com-

pany under the Joint Stock Companies Arrangement Act, 1870 (33 & 34 Vict. c. 104), which was sanctioned by the Court on June 14, 1890. A meeting of policy-holders was summoned, under s. 2 of the Act, to agree to the arrangement; but no separate meeting was summoned of those whose policies had, as distinct from those whose policies had not, matured. (1) The defendant did not assent to the arrangement; but at the meeting a majority, representing three-fourths in value, did assent. The deed recited, among other things, that it would be advantageous, in the opinion of the liquidator, to the persons claiming in the liquidation, to effect an arrangement under which the policies held by them on August 4, 1887, should be transferred on agreed terms to some other office, and that the liquidator considered that the terms of the agreement thereafter expressed would, if sanctioned by the Court, be for the benefit of the persons interested; and then provided, in clause 1, for the issue of new policies by the Sun Life Assurance Company to policy-holders whose policies, if subsisting, would not have matured by August 4, 1890, guaranteeing, first, "the payment on death, or other time specified in the said policy, of the reduced sum set against the policy-holder's name in the thirteenth column of the second schedule thereto;" and, secondly, the payment at such times as aforesaid of a certain dividend, payable out of the assets of the Sovereign Life Assurance Company.

By clause 2 it was provided that, "As to policies of the Sovereign Company, which, but for the said winding-up order,

C. A.

1892

SOVEREIGN
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(1) By s. 2 of the Joint Stock Companies Arrangement Act, 1870 (33 & 34 Vict. c. 104): "Where any compromise or arrangement shall be proposed between a company which is . . . in the course of being wound up . . . and the creditors of such company, or any class of such creditors, it shall be lawful for the Court, in addition to any other of its powers, on the application in a summary way of any creditor or the liquidator, to order that a meeting of such creditors or class of creditors shall be

summoned in such manner as the Court shall direct; and if a majority in number representing three-fourths in value of such creditors or class of creditors present either in person or by proxy at such meeting shall agree to any arrangement or compromise, such arrangement or compromise shall, if sanctioned by an order of the Court, be binding on all such creditors or class of creditors, as the case may be, and also on the liquidator and contributories of the said company."

C. A. would have matured between August 4, 1887, and August 4,
1892 1890 the Sun Company will, within one month after proof
SOVEREIGN of death and title, make the same reduced payments to the
LIFE representatives of such policy-holders or their assigns, and on
ASSURANCE the same terms and conditions, as if such policy had been a sub-
COMPANY sisting policy, and had matured after August 4, 1890.”
v.
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By clause 7 it was provided that, as the consideration for the obligations imposed on the Sun Company, the liquidator would from time to time pay over or transfer to the Sun Company all such parts of the assets of the Sovereign Company as would be properly applicable to meet the claims of the policy-holders of the Sovereign Company who were such on August 4, 1887.

Clause 11 provided as follows: “If this agreement is sanctioned by the Court, all policy-holders of the Sovereign Company who were such on August 4, 1887, shall accept the provisions hereof in full satisfaction of all claims on the Sovereign Company and the assets thereof.” The deed further provided that the winding-up should be continued so far as might be necessary to settle the rights of all parties.

The reduced sums which, under clause 2 of the deed of arrangement, were set against the defendant's name in the thirteenth column of the second schedule thereto, were 26*l.* in respect of each of his two policies; and the estimated dividends, payment of which was guaranteed to him out of the assets of the plaintiffs by the Sun Company, amounted to 24*l.* on each policy.

In December, 1890, the plaintiffs by their liquidator brought this action against the defendant to recover the sum of 1345*l.* 19*s.* 5*d.*, being the amount of the above-mentioned two loans and interest thereon. The defendant pleaded a set-off of the 2000*l.* which was payable to him by the plaintiffs in respect of his two policies on May 7, 1888. He also counter-claimed for the difference between the money so due on the policies and the amount of the loans; but the counter-claim was not insisted upon at the trial.

The learned judge held that the defendant was entitled to the set-off (1), and the plaintiffs appealed.

(1) [1892] 1 Q. B. 405.

Buckley, Q.C., and *Hull*, (*H. Tindal Atkinson*, with them), for the plaintiffs, argued as in the Court below, and contended, in addition, that it was unnecessary under the Act of 1870 to call a separate meeting of the class of policy-holders whose policies had matured, as the whole body of policy-holders formed only one class of creditors, whether their policies had matured or not.

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Crump, Q.C., and *Morton Smith*, for the defendant, were not called upon.

LORD ESHER, M.R. I am of opinion that this appeal must be dismissed. The plaintiff company, which is in liquidation, has brought an action by its liquidator to recover money lent by the company to the defendant before the liquidation, and the defendant sets up as a defence a right of set-off against the company or the liquidator, or both of them. In that state of facts it is argued, first, that the defendant has no right of set-off at all; and, secondly, that the claim upon which he relies has been released.

The first point which we have to consider is, what will destroy the right of set-off; when an action of debt is brought, will the fact of the plaintiff being in liquidation or bankrupt (the action being brought by the liquidator or trustee) of itself destroy the right, and drive the defendant into bankruptcy to prove his claim? Let us try what the rights of the parties would have been under the old law in such a case. A trustee brings an action to recover a debt due; a set-off is pleaded, and it is suggested that it would have been a good replication that the bankrupt could only pay 1s. in the pound, thus wiping out the set-off or reducing it to 1s. in the pound. It is enough to say that such a thing was never heard of. A set-off can only be set up where an action is brought; what is the right of the defendant after an action is commenced against him? Clearly it is to set off a debt due to him from the plaintiff; if the debt due to him is of the same kind as that in respect of which he is being sued, he can set it off. The right of set-off depends on the existence of a debt due to the defendant, and the fact of his debtor being a bankrupt does not prevent the set-off arising, though it prevents his obtaining in the bankruptcy more than his share of the assets;

C. A. the whole debt is still in existence. Therefore, where an action
1892 is brought by a trustee in bankruptcy, he is in within the terms
SOVEREIGN of the statute of set-off, and the defendant can set off a debt due
LIFE to him from the bankrupt. What is the result of a plea of set-
ASSURANCE off? It is not a counter-claim or a cross-action, but a plea in
COMPANY bar; and therefore, in cases where the plea is made out, although
v. it may be true that when the action was brought the defendant
DODD. was a debtor of the plaintiff, yet, the plaintiff being the defend-
Lord Esher, M.R. ant's debtor to the same amount, the plaintiff's claim is barred.
Bankruptcy, therefore, makes no difference to the right of
set-off.

Now, the cases in which a debt could be set off in bankruptcy were limited, and many difficulties arose; but the subject was dealt with by s. 39 of the Bankruptcy Act, 1869, and s. 38 of the Bankruptcy Act, 1883, which enlarged the subject-matter of the plea of set-off; they made, however, no alteration in the result of a set-off, and a debt can, therefore, now be treated as a set-off which could not have been so treated under the old law, and when pleaded and proved it is still a bar to the action. We have, therefore, to see whether, when this action was brought, the defendant had a right to set off this debt. Now, when an action is brought by a company, through its liquidator, to recover a sum of money lent, the defendant may answer that the claim is true, but that the company is indebted to him in an equal or larger sum, which he has a right to set off against the claim. Was the company so indebted to the defendant in the present case? At the time when the action was brought the date for payment of the policies had arrived; the company was, therefore, then indebted to the defendant, who had a claim against them for a liquidated and ascertained amount, the sums insured by the policies. The company was indebted to him, and he to the company; but the winding-up prevented him from getting payment of the 2000*l.*, though he could prove in the winding-up in respect of it. The winding-up had no effect upon his right to plead a set-off; he had, therefore, a right to plead that the plaintiffs were indebted to him in a sum of 2000*l.*, and claim to set that sum off against the plaintiffs' claim, though he could not, of course, actually recover the 2000*l.* from the plaintiffs.

It seems to me clear that in this case the defendant had a right to plead a set-off, which, if proved, was a bar to the action; and it is immaterial whether it would have been a set-off before the statute (though I incline to think that it was), for I have no doubt that it comes within the terms of the section.

It is said that the decision in *Ex parte Price, In re Lankester* (1), is to a contrary effect; but the distinguishing feature of that case is, as was pointed out in *In re Asphaltic Wood Pavement Co., Lee and Chapman's Case* (2), that there was no action at all, and that the Court was only considering the rights of proof in bankruptcy. Had there been no action in the present case, and had the proceedings been in bankruptcy, it is unnecessary to consider what would then have been the rights of the defendant; we have to consider his rights in the action only, and in that point of view his set-off is so great as to bar the plaintiffs' claim. That is in accordance with the judgment in the *Asphaltic Wood Pavement Company's Case* (2); and it is not in conflict with the decision in *Ex parte Price, In re Lankester*. (1) The defendant, therefore, is entitled to the benefit of his set-off, unless the plaintiffs can say that the debt had been released as against them, and that the defendant had assented to take, and had taken, somebody else as his debtor. This question depends on what was done at the meeting of creditors, and whether what was there done bound the defendant, and bound him to the extent of releasing the plaintiffs from their liability; the time at which the action was brought is the date to which we must look for the purpose of determining this question.

Now, as to the meeting, we have to consider the persons who must be summoned to it, and who are to be dealt with as different classes; that is, we must consider the state of affairs at the date of the meeting, for the persons to attend it are those who have a right to attend it at that time, and it is that state of affairs, and not the position of things at the date of the original contract, that we must look at. The Act 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

(1) Law Rep. 10 Ch. 648.

(2) 30 Ch. D. 216.

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O. A. it does not define them. This, therefore, must be done: they
 1892 must be divided into different classes. What is the reason for
 SOVEREIGN such a course? It is because the creditors composing the dif-
 LIFE ferent classes have different interests; and, therefore, if we find a
 ASSURANCE different state of facts existing among different creditors which
 COMPANY may differently affect their minds and their judgment, they
 v. must be divided into different classes.
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In the present case, the persons who had notice of the meeting were policy-holders—that is to say, policy-holders whose policies had to be dealt with. But the defendant was not a policy-holder at all; his policies had been fulfilled, and he was a creditor for the amount of the policies, and could have sued the company for money due; he had a vested cause of action, the policy-holders had none; and it is obvious that he could not consider the matter with the same mind and from the same point of view as the policy-holders who were summoned to the meeting. I do not say that, when there is nothing left to be done but the payment of the money, a person in the defendant's position may not be said properly to be in the same class as others who are creditors of the society; but, at any rate, he cannot fall within the same class as those whose policies have not matured. The defendant, therefore, belongs to a different class from those persons who were summoned as policy-holders, for his policies had not to be dealt with in any way; they had already matured; he has, therefore, not been summoned to the meeting, and what was done there does not bind him. The judgment of the learned judge in the Court below must be affirmed; he was right in holding that the section applied so as to enlarge the subject-matter of a plea of set-off. As I have already intimated, I think that apart from the statute there would have been a set-off; but, if the right depends upon the statute, I entirely agree with the judgment of Charles, J., that the defence is available to the defendant, and is a bar to the action.

BOWEN, L.J. I am of the same opinion. The action is for money lent, and the defendant seeks to rely upon the defence that he is entitled as against the company to treat as a set-off money due on policies granted by the company to him, which

policies accrued due on May 7, 1888. At that date a petition to wind up the company had already been presented; the defendant had paid all the premiums on the policies both before and after the date of the presentation of the winding-up petition, and on the day when the policies matured there was a large sum of money owing to him by the company. What was the defendant's position on that day? The company was being wound up, for the winding-up order, though not then made, dated back when made to the presentation of the petition, and the defendant was in the position of a person who had effected a policy and assigned it to the company as security for a loan, and also of a person who was entitled to say that 2000*l.* was owed to him by the company. It is true that he could not successfully prosecute an action for the 2000*l.* against the company because of the winding-up; but he was entitled to prove against the company for the value of his claim. His case is, therefore, distinguished from that of other policy-holders whose policies had not matured; he had gone on paying his premiums after the winding-up until the date when his policies became due, and his claim on his policies had therefore a fixed and ascertained value; this operated to his benefit, and the case has considerable resemblance to *Macfarlane's Claim*, *In re Northern Counties of England Fire Insurance Co.* (1), and *In re Bridges, Hill v. Bridges.* (2) Further, the defendant had the company's money in his pocket, and was entitled to make use of a counter-claim, or, more correctly, a set-off, against any action which the company might bring against him to recover the money; he could not sue the company or counter-claim against them in the strictest sense of the term because of the liquidation; but he could say that the transactions had resulted in mutual debts, and that he had a right to set off the debt of the company to him against his own debt to the company. That was his position when his policies matured, and he could be in no worse position when the company brought their action; he was entitled to set up his defence of set-off, which is so large in amount as to be a bar to the company's claim. That being so, I agree with the Master of the Rolls that it is unnecessary to consider what would have been the position

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(1) 17 Ch. D. 337.

(2) 17 Ch. D. 342.

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of the parties had there been only bankruptcy proceedings and no action had been brought. What is there to prevent the defendant's right of set-off in this action? Certainly not the winding-up, which has not altered the position and rights of the parties in this respect. As far as I can see, this is a good set-off at law; but if it were not a good legal set-off by reason of the existence of an assignment of the policies to the secretary of the company, it would, at all events, be a good set-off in equity.

The operation of s. 39 of the Act of 1869 and s. 38 of the Act of 1883 has been to enlarge, not the effect of a set-off, but the meaning of the term. This is clear from the decision in *In re Asphaltic Wood Pavement Co.* (1), and is especially clear in the judgment of Cotton, L.J., which is cited at some length by Charles, J., in his judgment now appealed against. It is said, however, that the decision in *Ex parte Price, In re Lankester* (2), is inconsistent with that case, and covers the present one; but I am unable to agree with that contention. The case of *Ex parte Price, In re Lankester* (2), dealt only with the doctrine of mutual rights in relation to the proof of a set-off in a winding-up, not in a case where an action had been brought; and the Court was dealing with the valuation of current policies subsisting at the time of the accrual of the right of set-off which was under consideration. In the present case, however, the policy had ceased or matured, and we are dealing with the rights of a person who is entitled to the full value of the policy. There is, therefore, in the present case, either a mutual debt or a mutual dealing; and unless there has been a release of the defendant's claim against the plaintiffs, the latter are out of court.

This question of a release depends, first, upon the construction of the document; secondly, upon the effect of the statute on that document. I feel grave doubt whether the term "policy-holder" includes those persons who have been policy-holders, but whose policies have matured not by death but by the happening of the stipulated event; but it is unnecessary to decide that question if we think that under the Act of 1870 the deed of arrangement did not bind dissentient creditors. What is the proper construction of that statute? It makes the majority of the creditors

(1) 30 Ch. D. 216.

(2) Law Rep. 10 Ch. 648.

or of a class of creditors bind the minority; it exercises a most formidable compulsion upon dissentient, or would-be dissentient, creditors; and it therefore requires to be construed with care, so as not to place in the hands of some of the creditors the means and opportunity of forcing dissentients to do that which it is unreasonable to require them to do, or of making a mere jest of the interests of the minority. If we are to construe the section as it is suggested on behalf of the plaintiffs it ought to be construed, we should be holding that a class of policy-holders whose interests are uncertain may by a mere majority in value override the interests of those who have nothing to do with futurity, and whose rights have been already ascertained. It is obvious that these two sets of interests are inconsistent, and that those whose policies are still current are deeply interested in sacrificing the interests of those whose policies have matured. They are bound by no community of interest, and their claims are not capable of being ascertained by any common system of valuation. Are we, then, justified in so construing the Act of Parliament as to include these persons in one class? 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 a view to their common interest. If that be so, in considering the deed of arrangement made with the company which took over the business of the Sovereign, we must so construe it as not to include in one class those whose policies had already ripened into debts, and those whose policies might not ripen into debts for years to come; for the position of a person like the defendant, who had an ascertained sum of 2000*l.* due to him from the company, was entirely different from that of those policy-holders whose future was entirely uncertain. It was, therefore, not right to summon as members of one and the same class those who had an absolute bar against any claim of the company and those who had not. I think, therefore, that

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there was no release of the defendant's claim against the plaintiffs, and that the appeal must be dismissed. I am not sorry to have had the opportunity of calling attention to s. 2 of the Act of 1870, which is constantly utilized, and often, I think, very carelessly and unjustly.

KAY, L.J. I am of the same opinion. My judgment depends upon the facts of the case, which are very peculiar and may possibly never recur. The defendant took out two policies on the same day in a form which gave his representatives a right to recover the amount if he died before May 7, 1888, and made it payable on that day to him if he were then alive. There were two events in which he or his representatives became entitled to the money, subject to the premiums being kept up. The defendant afterwards mortgaged the policies to the company to secure moneys lent to him, and the company have brought this action to recover the moneys so lent. The form of the policy shews that the capital funds of the company alone were liable for the amount insured, and the effect of this, as appears from *In re State Fire Insurance Co.* (1), is not to create a charge on the funds; it amounts to a condition that the company will only be liable in case they have sufficient funds to pay the amount of the policy. Then on August 5, 1887, there was a winding-up petition; and on September 2 a provisional liquidator was appointed. The time for the maturing of the defendant's policies was drawing near, and the premiums were paid by him to the provisional liquidator. On May 7, 1888, the policies matured. No winding-up order had then been made, and the defendant was entitled to the debt of 2000*l.* owing by the company to him. It is said that the debt was not owing to the defendant because he had executed an assignment of his policies to a trustee for the company, and so mortgaged them to secure advances from the company, and therefore there was no liability on the part of the latter to the defendant, who was not entitled to a re-assignment of the policies until he had paid off the amount of the advances. On July 30, 1889, the winding-up order was made, and this related back to August 5, 1887, the date of the winding-up petition. Then a

(1) 1 D. J. & S. 634.

long time elapsed; and on April 11, 1890, a deed of arrangement was entered into, which is relied upon as a release. The company has now brought this action to recover the moneys lent, and the defendant claims to be entitled to a set-off for the moneys due on the policies, basing his claim chiefly upon the fact of the transaction amounting to a mutual credit or dealing within s. 38 of the Bankruptcy Act, 1883. It is not denied that when the policies matured the company had sufficient funds to pay them. They were, therefore, then indebted to the defendant in the full amount of these policies.

The case of *Ex parte Price, In re Lankester* (1), is the only decision which has been cited to us as throwing any difficulty in the way of the defendant's set-off; but there is a very broad distinction between the two cases; in that case a proof was tendered by the company in the bankruptcy of the assured, and an attempt was made on behalf of the trustee in bankruptcy to avail himself of the mutual credit clause, because at the date of the bankruptcy the bankrupt was entitled to a current policy which had not matured; in other words, the bankrupt was indebted to the company, and tried to set off what was not due, but the value of what might become due upon the policy. In the present case, however, the claim which the defendant seeks to set off had already accrued due; it was a sum ascertained and liquidated; this makes all the difference. I do not in any way desire to dissent from the decision in *Ex parte Price, In re Lankester* (1), but it is distinguishable on the ground I have indicated from the present case, which more nearly approaches the case of *In re Asphaltic Wood Pavement Co.* (2) There was a clear debt due upon these policies when the present action was brought; and I think we may discard the argument founded upon the fact that there had been an assignment of the policies to the company, for there will be a set-off in equity in cases where, but for some such circumstance as this assignment, there would have been a legal set-off. The company were liable to the defendant for the amount of the policies, subject of course to their charge upon the policies for the advances, and I think that in this action the defendant probably had a set-off against

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(1) Law Rep. 10 Ch. 648.

(2) 30 Ch. D. 216.

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the company wholly independent of the section. If, however, he had not, there was clearly a mutual dealing between the company and the assured which entitled the latter to have the accounts between them taken, and to bring in his claim against the company under the mutual credit clause.

Then comes the question under the deed of arrangement, which makes provision for the liquidation of current policies, and clause 2 of which provides for policies "which but for the said winding-up order would have matured between August 4, 1887, and August 4, 1890." The expression "would have matured" is a loose one, and does not apply to a case where the policy has matured on a fixed date which the assured has outlived. Then, by clause 11, all policy-holders who were policy-holders on August 4, 1887, are to accept the provisions of the deed in full satisfaction of their claims on the plaintiff company. Without deciding whether this clause is binding on any particular policy-holder, I am not satisfied that it amounts to a release of the defendant's claim against the company. He claims to set off his claim against that of the company; can it be contended that clause 11 operates to deprive a man of an existing right of set-off? I think not; and, as the defendant had such an existing right, I do not think that this clause applies.

I also agree that it is exceedingly doubtful whether this deed relates at all to a policy-holder in the position of the defendant. There never was a separate meeting of the class of policy-holders to which he belonged, and he ought not to have been mixed up with those whose policies had not matured. It is not contested that his policies had matured; the sum secured by them was due, and he had a claim to set off that sum in order to liquidate the sum due from him to the company. I think, therefore, that this deed of arrangement cannot be treated as a release by him of the debt due from the company.

Appeal dismissed.

Solicitor for plaintiffs: J. Robinson.

Solicitor for defendant: N. Jourdain.

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TAB 15

THE 2015 ANNOTATED BANKRUPTCY AND INSOLVENCY ACT

Including
General Rules under the Act
Orderly Payment of Debts Regulations
Companies' Creditors Arrangement Act
CCAA Regulations and Forms
Farm Debt Mediation Act
Wage Earner Protection Program Act
Directives and Circulars

Dr. Janis P. Sarra, B.A., M.A., LL.B., LL.M., S.J.D.
of University of British Columbia
Faculty of Law and the Ontario Bar

The Honourable Geoffrey B. Morawetz, B.A., LL.B.
of the Superior Court of Justice

The Honourable L. W. Houlden, B.A., LL.B.
1922-2012, formerly a Judge of the Court of Appeal for Ontario

STATUTES OF CANADA ANNOTATED

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A cataloguing record for this publication is available from Library and Archives Canada.

ISSN 1197-8503

ISBN 978-0-7798-6541-3 (2015 edition)

Printed in the United States by Thomson Reuters.

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22.1 Class — creditors having equity claims — Despite subsection 22(1), creditors having equity claims are to be in the same class of creditors in relation to those claims unless the court orders otherwise and may not, as members of that class, vote at any meeting unless the court orders otherwise.

2007, c. 36, s. 71

N§149 — Classification of Creditors

The CCAA contemplates that the plan will be approved by the various classes of secured or unsecured creditors affected by it. Section 22(1) specifies that a debtor company may divide its creditors into classes for the purpose of a meeting to be held to vote on a proposed plan of compromise or arrangement relating to the company and, if the debtor company does so, it is to apply to the court for approval of the division before the meeting is held. Under s. 22(2), the court is to consider the following factors: creditors may be included in the same class if their interests or rights are sufficiently similar to give them a commonality of interest, taking into account (a) the nature of the debts, liabilities or obligations giving rise to their claims; (b) the nature and rank of any security in respect of their claims; (c) the remedies available to the creditors in the absence of the compromise or arrangement being sanctioned, and the extent to which the creditors would recover their claims by exercising those remedies; and (d) any further criteria, consistent with those set out in paragraphs (a) to (c), that are prescribed. These criteria are essentially a codification of previous caselaw and thus the cases below continue to be relevant in terms of the courts' reasoning.

The primary responsibility for making the classification is on the debtor company: *Re Hellenic Trust Ltd.*, [1975] 3 All E.R. 382, 119 Sol. Jo. 845, [1976] 1 W.L.R. 123 (S.C.).

Classification of creditors must be crafted with the underlying purpose of the CCAA in mind, namely facilitation of the reorganization of an insolvent company through the negotiation and approval of a plan of compromise or arrangement between the debtor company and its creditors, so that the debtor company can continue to carry on its business to the benefit of all concerned. In addition to commonality of interest concerns, the Ontario Court of Appeal held that a court dealing with a classification of creditors issue needs to be alert to concerns about the confiscation of legal rights and about avoiding what the parties have referred to as "a tyranny of the minority". The classification of creditors is determined by their legal rights in relation to the debtor company, as opposed to their rights as creditors in relation to each other: *Re Stelco Inc.* (2005), 2005 CarswellOnt 6818, 15 C.B.R. (5th) 307 (C.A.).

The reason for dividing creditors into different classes is that creditors have different interests, and they should only be permitted to bind other creditors who have the same interest; however, the classification must not be so fine that it renders it impossible to get a plan approved. Class "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 interests": *Sovereign Life Assur. Co. v. Dodd*, [1892] 2 Q.B. 573, 41 W.R. 4, 36 Sol. Jo. 644, 4 R 17 (C.A.); *Savage v. Amoco Acquisition Co.* (1988), 68 C.B.R. (N.S.) 154, 59 Alta. L.R. (2d) 260, 40 B.L.R. 188, 87 A.R. 321 (C.A.); leave to appeal to S.C.C. refused (1988), 70 C.B.R. (N.S.) xxxii (note).

In making the classification, the court is concerned with what the claimant holds, not with who holds the claim. However, the court ordered that the vote of the creditor should be separately recorded and tabulated so that the court could, if the creditors voted to accept the plan, consider the matter on the application to sanction the plan in deciding whether the plan was fair and reasonable: *Re Canadian Airlines Corp.* (2000), 19 C.B.R. (4th) 12, 2000 CarswellAlta 623 (Alta. Q.B.); application for leave to appeal dismissed (2000), 2000 CarswellAlta 503, 19 C.B.R. (4th) 33 (C.A. [In Chambers.]).

In *Re Oblats de Marie Immaculée du Manitoba* (2004), 2004 CarswellMan 104, 1 C.B.R. (5th) 279 (Man. Q.B.), the Federal Crown was a creditor in a CCAA plan proposal and also a co-defendant in a class action commenced by former residents of a First Nations residential school. The plan provided that the plaintiffs in the class action and the Federal Crown be grouped in the same class. The court found that there was no commonality of interest and that this attempt at classification was “a blatant effort to compromise” the Crown’s claim as the single largest creditor, without allowing the Crown an appropriate say in the vote.

A creditor that claimed a common lien over tapes prepared with respect to the production of a television series was not entitled to be classified with the senior secured creditor banks on the basis that the property on which the lien was asserted was not that valuable, and it was not unfair or unreasonable to exclude the creditor from the senior secured creditor category: *Minds Eye Entertainment Ltd. v. Royal Bank* (2003), 2003 CarswellSask 921, 1 C.B.R. (5th) 85 (Sask. Q.B.).

The classification of classes of secured creditors must take into account variations tailored to the situations of various creditors within a particular class. Equality of treatment, as opposed to equitable treatment, is not a necessary, nor even a desirable goal: *Re Keddy Motor Inns Ltd.* (1992), 13 C.B.R. (3d) 245, 6 B.L.R. (2d) 116, 90 D.L.R. (4th) 175, 110 N.S.R. (2d) 246, (sub nom. *Keddy Motor Inns Ltd., Re (No. 4)*) 299 A.P.R. 246 (C.A.).

In *Re Steinberg Inc.* (1993), 23 C.B.R. (3d) 243, 1993 CarswellQue 39 (C.S. Qué.), the plan classified unsecured creditors into six sub-classes. One sub-class, those under \$1,000, was to be paid in full; the court found nothing improper in this arrangement, finding that the sub-classification was not unreasonable or inequitable. It also held that it was unnecessary to obtain a majority vote of each sub-class, but a majority vote of the entire class was sufficient.

Where the term lenders, both Crown corporations, objected to the classification of the operating lender in a separate class, arguing that two classes of secured creditors would create fragmentation and was contrary to the “commonality of interest” principle, the court observed that if the debtor were liquidated, the operating lender would recover the full amount of its operating loan, while there would be a substantial shortfall in respect to the term lenders, and there was also a very real difference in the nature of the assets on which they were secured: *Re Federal Gypsum Co.* (2007), 2007 CarswellNS 630, 40 C.B.R. (5th) 39 (N.S. S.C.) (December 14, 2007).

The Ontario Superior Court held that it was appropriate that all creditors be placed in a single class as the plan was, in essence, an offer to all investors that must be accepted by or made binding on all investors. The plan treated all asset backed commercial paper (ABCP) holders equitably, and while the risks differed among traditional assets, ineligible assets, and synthetic assets, the calculation of the differing risks and corresponding interests had been taken into account consistently across all of the ABCP in the plan. Campbell J. was also satisfied that fragmentation of classes would have rendered it excessively difficult to have obtained approval of a CCAA plan, which was contrary to the purpose of the CCAA. He also took into account the commonality of interest approach in deciding that the proposed classification was, at this stage, appropriate: *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.* (2008), 2008 CarswellOnt 2652, 42 C.B.R. (5th) 90 (Ont. S.C.J. [Commercial List]).

Justice Romaine of the Alberta Court of Queen’s Bench noted that classification is a key issue in CCAA proceedings as the debtor seeks to frame a class or classes in order to ensure that the plan receives the maximum level of support; creditors have an interest in classifications that would allow them enhanced bargaining power in the negotiation of the plan; and creditors aggrieved by the process may seek to ensure that classification will give them an effective veto. The starting point in determining classification is the statute; the primary pur-

pose of the CCAA is to facilitate the reorganization of the insolvent debtor. Romaine J. referenced the principles set out in *Re Canadian Airlines Corp.* and amendments to the CCAA proclaimed in force September 18, 2009 that set out factors to consider in approving a classification for voting purposes. Creditors may be included in the same class if their interests or rights are sufficiently similar to give them a commonality of interest, taking into account: (a) the nature of the debts, liabilities or obligations giving rise to their claims; (b) the nature and rank of any security in respect of their claims; (c) the remedies available to the creditors in the absence of the compromise or arrangement being sanctioned, and the extent to which the creditors would recover their claims by exercising those remedies; and (d) any further criteria, consistent with those set out in paragraphs (a) to (c), that are prescribed. Justice Romaine held that these factors did not change in any material way the factors that have been identified in case law, nor would they have had a material effect on consideration of the proposed classification in this case. Romaine J. concluded that there was no good reason to exclude the secured lenders and noteholders from the single classification of voters. There were no material distinctions between the claims of the two creditors and the claims of the remaining unsecured creditors that were not more properly the subject of the sanction hearing, apart from the deferred issue of whether the secured lenders were entitled to vote their entire guarantee claim: *Re SemCanada Crude Co.* (2009), 2009 CarswellAlta 1269, 57 C.B.R. (5th) 205 (Alta. Q.B.).

The British Columbia Supreme Court sanctioned a plan of arrangement over the objections of a major unsecured creditor. The objecting unsecured creditor contended that the major secured creditor should not have been permitted to vote its deficiency claim and assigned claims in the general creditor class. Masuhara J. noted that the objecting creditor had not objected to the secured creditor voting its assigned votes earlier in the proceedings. The court had not been provided with any evidence to establish that the secured creditor somehow controlled shares of the debtor and there was no evidence that the creditor's arrangement with the debtor was anything but an arm's-length debt financing. It was an arm's-length creditor, and although it had initiated the CCAA proceedings, the CRO and the monitor, both court officers, had been appointed to oversee the debtor and provide the appropriate level of independence: *HSBC Bank Canada v. Bear Mountain Master Partnership* (2010), 2010 CarswellBC 2962, 72 C.B.R. (5th) 276 (B.C. S.C. [In Chambers]).

N§150 — Criteria for Determining Class

Section 22(2) sets out the factors that must be considered in dividing creditors into classes, including the nature of the debts, liabilities or obligations giving rise to their claims; the nature and rank of any security in respect of the claims; the remedies available to the creditors in the absence of the compromise being sanctioned and the extent to which the creditors would recover their claims by exercising those remedies, and any further criteria consistent with these criteria that may be prescribed.

Commonality of interest should be viewed based on the non-fragmentation test; the interests to be considered are the legal interest that a creditor holds *qua* creditor in relationship to the debtor company prior to and under the plan; the commonality of interests are to be viewed purposively, bearing in mind the object of the CCAA; in placing a purposive interpretation on the CCAA, the court should be careful to resist classification approaches that would potentially jeopardize viable plans; absent bad faith, the motivations of creditors to approve or disapprove of the plan are irrelevant; the requirement of creditors being able to consult together means being able to assess their legal entitlement as creditors; since the CCAA is to be given a liberal interpretation, classification hearings should be dealt with on a fact specific basis and the court should avoid rigid rules of general application; and finally, in determin-

**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., *et al.***

Applicants

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

**ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)**

PROCEEDING COMMENCED AT
TORONTO

**BOOK OF AUTHORITIES
OF THE APPLICANTS**

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

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