COURT FILE NUMBER Q.B. No. 1884 of 2019

COURT OF QUEEN'S BENCH FOR SASKATCHEWAN

IN BANKRUPTCY AND INSOLVENCY

JUDICIAL CENTRE SASKATOON

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

AND IN THE MATTER OF A PROPOSED PLAN OF ARRANGEMENT FOR THE CREDITORS OF 101098672 SASKATCHEWAN LTD., MORRIS INDUSTRIES LTD., MORRIS SALES AND SERVICE LTD., CONTOUR REALTY INC., and MORRIS INDUSTRIES (USA) INC.

BRIEF OF LAW OF THE MONITOR, ALVAREZ & MARSAL CANADA INC.

(Sale Approval and Vesting Order and Extension of Stay of Proceedings)

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I. INTRODUCTION

1. This Brief of Law is filed in support of the application by Alvarez & Marsal Canada Inc. (the "**Monitor**"), Court-appointed Monitor of 101098672 Saskatchewan Ltd., Morris Industries Ltd., Morris Sales and Service Ltd., Contour Realty Inc., and Morris Industries (USA) Inc. (collectively, the "**Morris Group**"), for Orders:

   (a) approving, authorizing and directing Alvarez & Marsal Canada Inc. (the "**Monitor**"), in its capacity as Monitor pursuant to the Amended and Restated Initial Order granted in these proceedings by the Honourable Mr. Justice R.S. Smith on January 16, 2020 (the "**Amended and Restated Initial Order**") and the Order (Enhancement of Monitor's Powers) granted in these proceedings by the Honourable Mr. Justice R.W. Elson on February 18, 2020 (the "**EMP Order**"), to implement the sale transactions (the "**Transactions**" or the "**Proposed Transactions**") more particularly described in the Tenth Report of the Monitor dated September 15, 2020 (the "**Tenth Report**"); namely, two transactions contemplated respectively by:

      (i) an Asset Purchase Agreement dated June 30, 2020 (the "**RW Roads APA**") between Morris Industries Ltd. ("**MIL**") and Contour Realty Inc. ("**Contour**"), on one hand, and RW Roads Solutions Limited Partnership, by and through its general partner RW Roads Solutions Inc. ("**RW Roads**"), on the other, appended to the Confidential Supplement to the Seventh Report of the Monitor dated June 30, 2020 (the "**Confidential Seventh Report**"), for the sale to RW Roads of the right, title and interest of MIL and/or Contour to the assets described in the RW Roads APA (the "**RW Roads Assets**"); and

      (ii) an Asset Purchase Agreement dated June 30, 2020 (the "**SFLP APA**"; together with the RW Roads APA, the "**APAs**") between MIL, on one hand, and SuperiorFarms Solutions Limited Partnership, by and through its general partner Rite Way Mfg. Co. Ltd. ("**SFLP**"; together with RW Roads, the "**Purchasers**"), on the other, appended to the Confidential Seventh Report, for the sale to SFLP of the right, title and interest of MIL to the assets described in the SFLP Roads APA (the "**SFLP Assets**"; together with the RW Roads Assets, the "**Purchased Assets**");

   (b) vesting in the respective Purchaser all right, title and interest of MIL and/or Contour to the Purchased Assets, free and clear of all liens, charges, and encumbrances;

   (c) extending the term of the Amended and Restated Initial Order of the Honourable Mr. Justice R.S. Smith granted in these proceedings on January 16, 2020 (the "**ARI Order**"),

and the stay of proceedings provided for therein, from 11:59 p.m. Saskatchewan time on September 18, 2020 to 11:59 p.m. Saskatchewan time on November 30, 2020;

(d) approving the actions, activities and conduct of the Monitor from August 14 to September 14, 2020;

(e) approving the fees and disbursements of the Monitor and its legal counsel from August 1 to August 31, 2020;

(f) sealing the Confidential Appendices to the Tenth Report on the Court file; and

(g) granting such further and other relief as counsel may request and this Honourable Court may allow.

II. FACTS AND BACKGROUND

2. Pursuant to the EMP Order, the Monitor is empowered, *inter alia,* to take any steps reasonably incidental to certain enumerated powers described therein and to exercise statutory rights and remedies on behalf of Morris Group (paragraph 3(d)). This is the authority relied upon by the Monitor to bring applications in these proceedings on behalf of the Morris Group, including this application.

3. The facts relied upon by the Monitor in support of this application are set out in the Tenth Report of the Monitor dated September 15, 2020 (the "**Tenth Report**"), as well as the First, Second, Third, Fourth, Fifth, Sixth, Seventh, Eighth, and Ninth Reports previously filed by the Monitor in relation to these proceedings, including appendices thereto. In particular, the Monitor relies on the Confidential Appendix to the Seventh Report of the Monitor, which contains copies of the APA's and particulars of the Transactions.

III. ISSUES

4. This Brief of Law will address the following issues, namely:

(a) What is the source of the Monitor's authority to seek and implement a Sale Approval and Vesting Order in these circumstances?

(b) Is it appropriate for this Honourable Court to grant the Sale Approval and Vesting Order sought by the Monitor, having regard to the factors relevant to the exercise of this Honourable Court's discretion under section 36 of the CCAA?

(c) Is it appropriate for this Honourable Court to approve the deemed subrogation of Contour to the WEPPA claims of certain employees of MIL, in order to facilitate the expedited payment by the Monitor of WEPPA Severance Amounts and COVID Hardship Payments

to those employees whose employment is expected to be terminated upon the bankruptcy of the Companies?

(d) Have the requirements for an extension of the stay of proceedings in the ARI Order been met?

IV. ARGUMENT

A. The Monitor's Authority To Seek And Implement A Sale Approval And Vesting Order Is Found Within The EMP Order

5. Paragraph 3 of the EMP Order provides as follows [emphasis added]:

> **ENHANCEMENT OF MONITOR'S POWERS**
>
> 3. In addition to, and without limiting in any way, the powers afforded to the Monitor under the *Companies' Creditors Arrangement Act*, RSC 1985, c C-36, as amended (the "***CCAA***") and the Amended and Restated Initial Order and any other Order of this Honourable Court in these proceedings or under applicable law, the Monitor is hereby authorized and empowered to:
>
> (a) exercise such rights, powers and obligations of the Morris Group, and on behalf of the Morris Group, as the Monitor deems necessary or advisable under the following paragraphs of the Amended and Restated Initial Order, namely: paragraphs 4, 5, 6, 7, 8 ,9, 10, 11, 12, 13, 31, 32, 33, 34, 35, 36, 37, 38 and 39;
>
> (b) take any steps reasonably incidental to the exercise of the powers enumerated in paragraph 3(a) hereof or the performance of any statutory obligations;
>
> (c) if, in the Monitor's discretion, it is in the best interests of the Morris Group, to:
>
> (i) make payment in respect of certain pre-filing amounts as described in the Second Report of the Monitor; and
>
> (ii) honour pre-filing warranty credits accrued in favour of its dealers in the amounts described in the Second Report of the Monitor;
>
> (d) the right to terminate contracts (subject to section 32 of the *CCAA)*, exercise statutory rights and remedies, deal with vendors, and deliver notices on behalf of the Morris Group, and in each such case where the Monitor takes any such actions or steps, it shall be exclusively authorized and empowered to do so, to the exclusion of all other persons, including the Morris Group, and without interference with any other person.

6. Paragraph 11 of the Amended and Restated Initial Order (one of the provisions referenced in paragraph 3(a) of the EMP Order) provides as follows [emphasis added]:

> **RESTRUCTURING**

> 11. The Morris Group shall, subject to such requirements as are imposed by the CCAA and such covenants as may be contained in the Interim Lender Documents (as hereinafter defined), if any, have the right to:
>
> > (a) permanently or temporarily cease, downsize or shut down any of its Business or operations and to dispose of redundant or non-material assets not exceeding $350,000 in any one transaction or $750,000 in the aggregate, provided that any sale that is either (i) in excess of the above thresholds, or (ii) in favour of a person related to the Morris Group (within the meaning of section 36(5) of the CCAA), shall require authorization by this Court in accordance with section 36 of the CCAA;
> >
> > ...
> >
> > (c) dispose of (by sale or otherwise) redundant or non-material assets not authorized by paragraph 11 (a-b) of this Order only with the approval of the Court;
> >
> > ...
>
> all of the foregoing to permit the Morris Group to proceed with an orderly restructuring of the Business (the "**Restructuring**").

7. Section 36 of the *Companies' Creditors Arrangement Act*,[1] by requiring Court approval of any disposition outside of the ordinary course of business of the debtor company, contemplates a right to apply to the Court for such approval. That right is referred to in paragraphs 11(a) and (c) of the ARI Order, and is conferred upon the Monitor by the operation of paragraphs 3(a) and (d) of the EMP Order.

B. A Sale Approval And Vesting Order Is Appropriate

8. Section 36(3) of the CCAA sets out the factors to be considered on an application by a debtor company to dispose of assets outside of the ordinary course of business, namely:

   (a) whether the process leading to the proposed sale or disposition was reasonable in the circumstances;

   (b) whether the monitor approved the process leading to the proposed sale or disposition;

   (c) whether the monitor filed with the court a report stating that in their opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy;

   (d) the extent to which the creditors were consulted;

   (e) the effects of the proposed sale or disposition on the creditors and other interested parties; and

[1] RSC 1985, c C-36 [**CCAA**].

(f) whether the consideration to be received for the assets is reasonable and fair, taking into account their market value.

9. A review of the evidence bearing upon the six factors enumerated in section 36(3) of the CCAA yields the following conclusions.

i. The Process Leading to the Proposed Transactions Was Reasonable in the Circumstances

10. The process leading to the Transactions began with the Order (Approving Sale and Investment Solicitation Process) granted by the Honourable Mr. Justice Smith on January 16, 2020 (the "**SISP Order**"). The Sales and Investment Solicitation Process ("**SISP**") contemplated therein ultimately concluded without any party submitting a "Qualified Bid" within the meaning of the SISP. However, the SISP did identify for the Monitor two parties to whom the assets of Morris Group had significant potential interest. Subsequent to the conclusion of the SISP, the Monitor undertook extensive negotiations with these two parties (including the Purchasers).

11. The Monitor has been working with the Purchasers and with third parties for several months in order to meet the Purchasers' requirements to close the transaction. In particular:

(a) the Monitor (through its counsel) has been involved in extensive negotiations with the Retail, Wholesale and Department Store Union, Local 955 (the "**Union**") in order to reach agreement with the Union in relation to certain key matters required by the Purchasers to be satisfied as a condition precedent to the closing of the Transactions; and

(b) the Monitor has been working closely with the Purchasers and with MIL's largest customer, a network of implement dealers in Western Australia ("**McIntosh Distribution**"), in order to facilitate the manufacture and delivery of future orders by the Purchasers for McIntosh Distribution to take place in the Fall of 2020 (an aspect of the Proposed Transactions of considerable importance to the Purchasers).

ii. The Monitor Has Approved the Process Leading to the Proposed Transactions

12. Due to the EMP Order and the lack of any remaining directors or officers within Morris Group, the Monitor has been the party required to implement the process leading to the Transactions. The Monitor has, accordingly, approved this process.

iii. The Monitor Has Filed a Report Stating Its Opinion That the Proposed Transaction Will Be More Beneficial to The Creditors Than a Sale in Bankruptcy

13. The Monitor is of the opinion that the Transactions will be more beneficial to creditors than a sale or disposition in bankruptcy (see paragraph 19(h) of the Tenth Report].

14. There is no realistic scenario in which the Court declining to approve the Proposed Transactions results in a preferable outcome for the stakeholders of Morris Group. Despite its initial interest, the second potential purchaser has now backed away. As described in the Confidential Appendices to the Fifth and Sixth Reports of the Monitor, the SISP did not identify any prospective bidders who appeared to be interested in the assets of Morris Group to the same extent as the Purchasers.

iv. The Extent to Which the Creditors Were Consulted

15. Bank of Montreal, the primary secured creditor of Morris Group, supports the Proposed Transactions.

16. The Monitor has consulted on an ongoing basis with Farm Credit Canada, a secured creditor of Morris Group. Dialogue with FCC is ongoing as at the date of the preparation of this Brief of Law.

v. The Effect of the Proposed Transactions on Creditors & Other Interested Parties

17. By recovering the greatest amount which is reasonably possible in the circumstances for the assets of Morris Group, the Monitor has achieved the best, realistic outcome possible for creditors, Union members and other stakeholders.

vi. The Consideration To Be Received is Reasonable and Fair, Taking Into Account Its Market Value

18. As discussed above, the Monitor completed the SISP and performed an extensive and detailed review of all of the expressions of interest which were submitted. The Monitor negotiated extensively with the potential purchasers in order to obtain the most favourable sale transaction which is realistically possible.

19. In the Monitor's respectful submission, the market for the assets of Morris Group has been fully and fairly canvassed. The Proposed Transactions are the outcome of that process. The purchase price which the Purchasers propose to pay represents the "market speaking" as to the value of the assets of Morris Group.

C. The Deemed Subrogation Of Certain WEPPA Claims To Contour Should Be Approved

i. Rationale for Employee Payments

20. MIL's Yorkton Plant has approximately 77 remaining employees in the Union (the "**Subject Employees**"). Many of these employees have worked for MIL for decades. However, none of the prospective purchasers of the assets of Morris Group which have been identified have expressed a serious interest to purchase or operate the Yorkton Plant.

21. One of the Purchasers' conditions precedent to the closing of the Transactions is that certain aspects of MIL's relationship with the Union be addressed to the Purchasers' satisfaction.

22. Based upon the amounts owed to the creditors of Morris Group, it is clear that the secured creditors will suffer a shortfall, and that there will be no recovery for the unsecured creditors. BMO (Morris Group's senior secured creditor) has given formal notice to all parties on the Service List in these proceedings of its intention to commence an Application For Bankruptcy Order against MIL shortly after the closing of the Transactions. In these circumstances, it appears that the Subject Employees' ability to recover severance and accrued vacation pay from the proceeds of the Proposed Transactions will, due to the operation of the applicable priority scheme, be limited to the amount of $2,000.00 per employee prescribed in section 81.3 of the *Bankruptcy and Insolvency Act*.[2]

23. In the event of MIL's bankruptcy, the employees of MIL would have the right to make a claim for severance and vacation pay pursuant to the *Wage Earner Protection Program Act*.[3] Under such circumstances, Service Canada would become subrogated to the claims of the employees against MIL, including the employees' $2,000 priority claim.[4]

24. Pursuant to a Letter of Understanding negotiated between the Morris Group and the Union which is attached as a Confidential Appendix to the Tenth Report, the Monitor is proposing to make expedited payment to the Subject Employees of the following two types of payments, namely:

    (a) the amounts of severance to which the Subject Employees would be entitled pursuant to the WEPPA (the "**WEPPA Severance Amounts**"); and

    (b) an additional payment to certain of the Subject Employees in recognition of the termination of their long-term employment occurring in the current difficult employment

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[2] RSC 1985, c B-3 [**BIA**]. In order for a company to sell assets "outside of the ordinary course of business" in the midst of CCAA proceedings, the sale must be authorized by the Court under s. 36 of the CCAA. Section 36(7) states that a Court cannot authorize a sale unless the company makes the payments it would have made under s. 6(5)(a) of the CCAA, if a plan of arrangement or compromise was reached. Section 6(5)(a) provides that any compromise or arrangement must provide for the payment of amounts at least equal to the amounts that employees would have received under s. 136(1)(d) of the BIA, if the company had become bankrupt. Accordingly, by virtue of s. 36(7) and s. 6(5) of the CCAA, the BIA priority scheme with respect to employee claims for unpaid wages applies to a liquidating CCAA where assets are sold outside of the ordinary course of business, and the minimum requirements referred to in s. 6(5) of the CCAA with respect to claims by employees must be met.

Although *The Saskatchewan Employment Act*, SS 2013, c S-15.1 purports to create a security interest and a deemed trust for unpaid wages, and defines "wages" more broadly than does the BIA, those provisions cannot operate so as to alter priorities in bankruptcy: *Deloitte, Haskins & Sells Ltd. v Alberta (Workers' Compensation Board)*, [1985] 1 SCR 785, 1985 CarswellAlta 319 at paras 35-39 (WL Can); *The Guarantee Company of North America v Royal Bank of Canada*, 2019 ONCA 9 at paras 35-36, 430 DLR (4th) 434, citing *British Columbia v Henfrey Samson Belair Ltd.*, [1989] 2 SCR 24, [1989] 5 WWR 577; J.P. Sarra, Hon. G.B. Morawetz, and Hon. L.W. Houlden, *The 2019-2020 Annotated Bankruptcy and Insolvency Act* (Toronto: Thomson Reuters, 2019) at 785 (section G.117(1)).

[3] SC 2005, c 47, s 1 [**WEPPA**].

[4] *Ibid*, s 36(1).

environment created by the COVID 19 global pandemic (the "**COVID Hardship Payments**"; together with the WEPPA Severance Amounts, the "**Employee Payments**").

25. The Union is supportive of this approach being taken by the Monitor. Indeed, the agreement by the Monitor to make expedited payment of the WEPPA Severance Amounts to the Subject Employees, and to make the COVID Hardship Payments to the Subject Employees, were critical components of the agreement by the Union to enter into a Letter of Understanding with MIL and Contour in order to address the relationship of MIL to the satisfaction of the Purchasers. Without the Monitor obtaining court approval of the Monitor making expedited payment of the WEPPA Severance Payments and the COVID Hardship Payments, the Monitor will not be able to honour its obligations to the Union under the Letter of Understanding and this critical condition to the closing of the Transaction will not be satisfied.

ii. Authority For The Employee Payments

26. An early distribution to unsecured creditors (such as the Subject Employees) in priority to secured creditors is permissible where doing so results in an increase to the value of the estate as a whole.

27. In *EarthFirst Canada Inc., Re*, a payment to financially-dependent contractors constructing a windfarm for the insolvent company was ordered on the basis that the payments were necessary in order to complete the project. Madam Justice Romaine explained the rationale as follows:

> [6] The amount of the hardship fund was arrived at following discussions among EarthFirst, the Monitor, the local suppliers and contractors. The proposal recognizes the potential domino effect of a failure to fund small, local businesses that are dependant on the continued development of the Dokie Project and are essential to future construction activities and the preservation of the project's value, and the dire and harsh consequences in the surrounding communities of the inability of such businesses to meet payroll obligations. The company and the Monitor submit that payments from the fund would contribute to necessary goodwill in the area and that cooperation and support of the local community is required to ensure that the value of the project is maximized. EarthFirst also notes that, while a CCAA stay of proceedings affects many creditors, the proposed recipients of the hardship fund in this isolated community are particularly vulnerable and at risk.
>
> [7] While the nature of payments from the hardship fund is different from the issue that was before Farley, J. in *Air Canada, Re*, 2003 CarswellOnt 5296 (Ont. S.C.J. [Commercial List]) (at para. 4), and while EarthFirst is not suggesting that recipients of the fund are "critical suppliers" in the usual sense of the term, it appears to be the case that, as in *Air Canada*, the potential future benefit to the company of these relatively modest payments of pre-filing debt is considerable and of value to the estate as a whole. The decision to allow the hardship fund thus outweighs the prejudice to other creditors, justifying a departure from the usual rule.

> [8] Counsel for the Monitor noted that the payments are likely necessary in order to preserve the opportunity to complete the Dokie Project, if that option appears to be the best way to maximize recovery for creditors. It was likely the recognition of this factor that led to little opposition to the application, including from the primary secured creditor...
>
> [9] I am satisfied that the payment of these case-specific pre-filing debts in a limited amount in order to preserve the value of this CCAA-debtor's primary asset and the option of continuing its development for the benefit of all creditors is fair and reasonable in the circumstances and in accordance with the purpose and objectives of the *Companies' Creditors Arrangement Act*.[5]

28. *Earthfirst* was cited with support by Justice Brown of the Ontario Superior Court of Justice in ordering pre-payment of loyalty rewards to key customers of the insolvent company in *Re Futura Loyalty Group Inc.*:

> [13] In those two cases the courts were prepared to countenance the payment of pre-filing obligations to suppliers in order to prevent disruption to the operations of the applicant and to maximize the value of the business for purposes of the re-organization or realization process. In the *EarthFirst Canada* case the court engaged in a form of proportionality or cost-benefit analysis, weighing the cost of the pre-payments against the benefit to the estate as a whole.
>
> [14]... The most recent cash-flow projection filed by the applicant made allowance for "payments to loyalty currency providers", which included the payments in respect of the Prepaying Merchant Customers. When compared against projected inflows from the collection of receivables through to January 18, 2013 of approximately $440,000 (the only source of cash apart from the increased DIP Financing), the honouring of $108,000 in pre-paid Aeroplan Miles for the Prepaying Merchant Customers is not an insignificant amount. However, on the other side of the scale is the evidence from Futura that 75% of its revenue comes from the resale of Aeroplan Miles and under its SISP it is seeking to secure a going-concern sale of the company's business.
>
> [15] Given the importance of the ongoing resale of Aeroplan Miles to the viability of Futura as a going-concern, the benefit to the company's re-organization efforts of trying to maintain the Prepaying Merchant customers as continuing customers, and the absence of any opposition to the order sought, I conclude that it is appropriate in the circumstances to grant an order "permitting the Applicant to honour prepayments made for Aeroplan Miles by Prepaying Merchant Customers" prior to the making of the Initial Order, as requested in paragraph 5 of Futura's notice of motion. Such authorization, in my view, is consistent with and fosters the objectives of the *CCAA*.[6]

29. Further, and in any event, the Employee Payments are abundantly justified on the basis of remedying hardship suffered by employees, as was done by Justice Morawetz in *Nortel Networks Corp., Re*.[7]

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[5] 2009 ABQB 78, 1 Alta LR (5th) 31 [***EarthFirst***].

[6] 2012 ONSC 6403, 99 CBR (5th) 128.

[7] (2009), 55 CBR (5th) 68, 2009 CarswellOnt 3583 (Ont Sup Ct (Comm List)) at paras 87-88; aff'd 2009 ONCA 833 at para 43, 59 CBR (5th) 23 ("...the motion judge provided a "hardship" alleviation program funded up to $750,000, to allow payments to former

30. To the Monitor's knowledge, none of the secured creditors of Morris Group object to the Monitor making the Employee Payments.

iii. Authority For Subrogation Of The Monitor To The Subject Employees' WEPPA Claims

31. In order to pay the WEPPA Severance Amounts, Contour needs to be in a position to step into the shoes of the Subject Employees as subrogatee to advance the WEPPA claims which the Subject Employees would otherwise be entitled to advance (the "**Subrogation**").

32. Again, to the Monitor's knowledge, none of the secured creditors of the Morris Group object to the Subrogation.

33. Section 37 of WEPPA and section 67 of the *Financial Administration Act* ("**FAA**") each prevent a transaction purporting to be an assignment of a WEPPA claim from having effect.[8]

34. The Ontario Superior Court of Justice has held that section 67 of the FAA "does not apply to rights created by a court order".[9] The case in question involved certain HST refunds, and the Court characterized the relevant portion of the Order which was sought and granted as follows:

> An issue arose concerning the validity of the security taken by Castcan in respect of certain assets, specifically Harmonized Sales Tax Refunds (the "HST Refunds"). ... the Applicants propose that upon paying out the claims of the Senior Secured Creditors from the cash proceeds received on Closing, the DIP Lender will be subrogated to and/or take an assignment of the Senior Secured Creditor's claims.[10]
>
> [emphasis added]

35. In other words, the Court was not concerned about the subrogation or assignment of a Crown debt, provided that it was effected by way of a Court Order.

36. In the Monitor's respectful submission, there is an important distinction between assignment and subrogation for the purposes of the bar to assignment of Crown debts, which forms an alternative basis for this Honourable Court to approve the payment of the Employee Claims.

37. The bar is on the assignment of Crown debts, not the subrogation of Crown debts. Assignment and subrogation are two distinct legal doctrines, as explained by the British Columbia Court of Appeal:

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employees in clear need. This will have the effect of granting the "super-priority" to some. This is an acceptable result in appropriate circumstances.")

[8] RSC 1985, c F-11.

[9] *PCAS Patient Care Automation Services Inc., Re*, 2012 ONSC 3367 at paras 63-66, 91 CBR (5th) 285 [***PCAS***].

[10] *PCAS, ibid* at para 25.

> On behalf of the appellant, it is submitted that subrogation does not equate to assignment, citing *MacGillivray & Parkington on Insurance Law*, 8th ed., para. 1161, where it says:
>
> > Difference between subrogation and assignment. Both subrogation and assignment permit one party to enjoy the rights of another, but it is well-established that subrogation is not a species of assignment. Rights of subrogation vest by operation of law rather than as the product of express agreement. Whereas rights of subrogation can be enjoyed by the insurer as soon as payment is made, an assignment requires an agreement that the rights of the assured be assigned to the insurer. The insurer cannot require the assured to assign to him his rights against third parties as a condition of payment unless there is a special clause in the policy obliging the assured to do so. This distinction is of some importance, since in certain circumstances an insurer might prefer to take an assignment of an assured's rights rather than rely upon his rights of subrogation. If, for example, there was any prospect of the insured being able to recover more than his actual loss from a third party, an insurer, who had taken an assignment of the assured's rights, would be able to recover the extra money for himself whereas an insurer who was confined to rights of subrogation would have to allow the assured to retain the excess.
>
> I add here that while rights of subrogation usually arise by operation of law there is nothing to prevent those same rights arising by express agreement, as is the case here. I agree there is a very real difference between a person exercising a right of subrogation as opposed to a right arising from an assignment.[11]

38. Guarantors acquire rights of subrogation upon making payment of claims which they have guaranteed.[12] Guarantors cannot profit through their right of subrogation.[13] On the other hand, assignees may recover more than the amount that they pay an assignor.[14] This is the fundamental distinction underlying the bar on the assignment of WEPPA claims; the prevention of financially vulnerable employees' recovery being reduced by the prospect of an immediate cash payment.

39. In this case, by its signature to the Letter of Understanding, Contour has guaranteed the payment of the WEPPA Severance Amounts. Accordingly, Contour is subrogated to the rights of the respective employees to claim those amounts from Service Canada by operation of the law of subrogation. MIL's terminated employees are not prejudiced by the subrogation. To the contrary, MIL's terminated employees will achieve expedited recovery of the much-needed WEPPA

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[11] *Bank of Montreal v Guarantee Co. of North America* (1991), 8 CBR (3d) 214, 1991 CarswellBC 499 (CA) at paras 24-25 (WL Can).

[12] Kevin Patrick McGuiness, *The Law of Guarantee*, 2nd ed (Scarborough: Carswell 1996) at 411.

[13] *Ibid* at 412.

[14] *Ibid* at 412.

Severance Amounts, thereby mitigating the hardship occasioned to them by the loss of their employment during a global pandemic. Moreover, if, for whatever reason, there is a shortfall in the amount paid to MIL's employees and the amount recoverable under WEPPA, this loss will be borne by Contour (not Service Canada).

40. Similarly, Service Canada is not prejudiced by the subrogation. Service Canada has the same obligation to pay Contour the WEPPA Severance Amounts that it would have had to pay MIL's employees. The only tangible effect of the subrogation is that MIL's terminated employees will receive payment of their WEPPA claims significantly earlier than they would have received them from Service Canada under the ordinary course operation of WEPPA.

41. This point as to anticipated timing of payments to terminated employees is of critical importance to the Subject Employees. It underscores the importance of court approval of the Monitor making the Employment Payments on the terms described in the Letter of Understanding and in paragraphs 18A, 18B and 18C of the Draft Sale Approval and Vesting Order.

42. The Letter of Understanding requires the Monitor to make expedited payment of the WEPPA Severance Amounts within 72 hours of the bankruptcy of MIL. Without such a court-approved payment schedule, it typically takes a minimum of approximately two to three months for Service Canada to make payment of severance amounts to terminated employees under WEPPA.[15]

43. The expedited payment of the WEPPA Severance Amounts and the payment of the COVID Hardship Payments is intended by the Monitor to provide terminated employees of MIL with prompt relief against the hardship of their long-term employment coming to an end (due to the anticipated bankruptcy of MIL) during a global pandemic.

44. Initial discussions (through counsel) between the Monitor and Service Canada have identified a reluctance on the part of Service Canada to agree to a departure from the standard practice under WEPPA of requiring terminated employees to prepare and submit their own individual severance applications.

45. In the challenging circumstances of the global pandemic, departures from "business as usual" are often necessary in order to address economic hardship visited upon employees. That approach has been recognized by the Government of Canada in its own Canada Employment Wage Subsidy program. Rather than requiring affected employees to make hundreds of thousands of

[15] Canada, Employment and Social Development Canada, "Wage Earner Protection Program for an employee: After you've applied", (Ottawa: 29 July 2019) online: < https://www.canada.ca/en/employment-social-development/services/wage-earner-protection/employee/after-applying.html >.

individual applications for Employment Insurance claims, the Federal Government has implemented an efficient and cost-effective program which calls for employers to submit applications (rather than individual employees). The same approach makes sense here.

iv. Conclusion Regarding Subrogation And Employee Payments

46. If the Subrogation is not approved, the Purchasers will not proceed with the Transactions. The Monitor will be required to return the Purchasers' deposits and go "back to the drawing board" to find a new purchaser and new purchase terms. Those terms which will likely include a significantly lower purchase price. Meanwhile, because MIL would remain in CCAA proceedings but would not be bankrupt, the Subject Employees will not be in a position to make WEPPA claims unless and until MIL becomes bankrupt (or enters receivership) at some time in the future.

47. In other words, declining to approve the Proposed Transactions and the making by the Monitor of the Employment Payments (including the Subrogation) would be an extremely unfavourable outcome for all stakeholders.

48. Further, the legal, professional, and interim financing costs of having the Monitor continue to oversee operations of the Morris Group are significant. Declining to approve the Proposed Transactions will likely result in another sales process that could be expected to go on for several more months, which process is expected to obtain a much lower purchase price, all while the equity in the companies available to repay creditors continues to be eroded. Even this assumes that BMO, the interim financing lender, would continue to fund these proceedings if the Proposed Transactions do not proceed – and there is no guarantee that BMO would choose to do so.

D. The Requirements For An Extension Of The Stay Of Proceedings Have Been Met

49. The Court's jurisdiction to extend the stay of proceedings granted pursuant to an initial order, and the prerequisites that must be met before the Court may grant such an extension, are set out in subsections 11.02(2) and (3) of the CCAA, which provide as follows:

> **Stays, etc. — other than initial application**
>
> **(2)** A court may, on an application in respect of a debtor company other than an initial application, make an order, on any terms that it may impose,
>
> > **(a)** staying, until otherwise ordered by the court, for any period that the court considers necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in paragraph (1)(a);
> >
> > **(b)** restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(c) prohibiting, until otherwise ordered by the court, the commencement of any action, suit or proceeding against the company.

Burden of proof on application

(3) The court shall not make the order unless

(a) the applicant satisfies the court that circumstances exist that make the order appropriate; and

(b) in the case of an order under subsection (2), the applicant also satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence.

Restriction

(4) Orders doing anything referred to in subsection (1) or (2) may only be made under this section.

i. Circumstances Exist Which Make The Extension Appropriate

50. In considering whether circumstances exist that make the extension order sought appropriate, the Courts have looked to, among others, the following, non-exhaustive list of factors:

(a) whether the extension sought furthers the underlying purposes of the CCAA; namely: to avoid the social and economic losses resulting from liquidation of an insolvent company, by facilitating a plan of arrangement or compromise between the debtor company and the creditors;[16]

(b) the debtor company's progress during the previous stay period toward a restructuring;

(c) whether creditors will be prejudiced if the court grants the extension; and

(d) the comparative prejudice to the debtor company, creditors, and other stakeholders, if the stay extension were not granted.[17]

51. In the circumstances of this application, the Monitor is working to close transactions for the sale of the business assets of the Morris Group with a view to maximizing value for all stakeholders. The first ranking secured creditor, Bank of Montreal ("**BMO**"), has expressed its support for the requested extension, and continues to fund the CCAA proceedings as interim financing lender.

52. As described in the Tenth Report, the Transactions represent the best chance to maximize the value of the assets of Morris Group.

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[16] *Clothing for Modern Times Ltd., Re*, 2011 ONSC 7522 at paras 11-12, 88 CBR (5th) 239.

[17] *Federal Gypsum Co., Re*, 2007 NSSC 347 at paras 24-29, 40 CBR (5th) 80.

53. To the knowledge of the Monitor, no party is opposing the stay extension sought and no viable alternative to an extension of the stay of proceedings has been identified or brought forward by any party. No party has applied for a receivership order directed against the Morris Group. The Monitor has been operating the business of Morris Industries Ltd. since the resignation or retirement of the last remaining directors and officers in February, and is best positioned to "keep the lights on" within the Morris Group pending a sale. Any change in course at this point would jeopardize the pending sale of the assets of Morris Group and would result in a significant increase in professional fees, with no discernable benefit.

54. For all of these reasons, the Monitor respectfully submits that circumstances exist which make an Order extending the stay of proceedings appropriate.

ii. Good Faith and Due Diligence

55. The requirements of good faith and due diligence were the subject of recent comment by the Supreme Court of Canada in *9354-9186 Québec Inc. v Callidus Capital Corp.*, as follows:

> 49 The discretionary authority conferred by the *CCAA*, while broad in nature, is not boundless. This authority must be exercised in furtherance of the remedial objectives of the *CCAA*, which we have explained above. Additionally, the court must keep in mind three "baseline considerations" (at para. 70), which the applicant bears the burden of demonstrating: (1) that the order sought is appropriate in the circumstances, and (2) that the applicant has been acting in good faith and (3) with due diligence (para. 69).
>
> 50 The first two considerations of appropriateness and good faith are widely understood in the *CCAA* context. Appropriateness "is assessed by inquiring whether the order sought advances the policy objectives underlying the *CCAA*". Further, the well-established requirement that parties must act in good faith in insolvency proceedings has recently been made express in s. 18.6 of the *CCAA*, which provides:
>
> > **Good faith**
> >
> > **18.6 (1)** Any interested person in any proceedings under this Act shall act in good faith with respect to those proceedings.
> >
> > **Good faith — powers of court**
> >
> > **(2)** If the court is satisfied that an interested person fails to act in good faith, on application by an interested person, the court may make any order that it considers appropriate in the circumstances.
>
> 51 The third consideration of due diligence requires some elaboration. Consistent with the *CCAA* regime generally, the due diligence consideration discourages parties from sitting on their rights and ensures that creditors do not strategically manoeuver or position themselves to gain an advantage. The procedures set out in the *CCAA* rely on negotiations and compromise between the debtor and its stakeholders, as overseen by the supervising judge and the

> monitor. This necessarily requires that, to the extent possible, those involved in the proceedings be on equal footing and have a clear understanding of their respective rights. A party's failure to participate in *CCAA* proceedings in a diligent and timely fashion can undermine these procedures and, more generally, the effective functioning of the *CCAA* regime.
>
> 52 We pause to note that supervising judges are assisted in their oversight role by a court appointed monitor whose qualifications and duties are set out in the *CCAA*. The monitor is an independent and impartial expert, acting as "the eyes and the ears of the court" throughout the proceedings. The core of the monitor's role includes providing an advisory opinion to the court as to the fairness of any proposed plan of arrangement and on orders sought by parties, including the sale of assets and requests for interim financing.[18]
>
> [citations omitted]

56. In this case, the Monitor, an officer of this Honourable Court, is overseeing management of the debtor companies pursuant to the EMP Order. All of the Monitor's actions have been directed at maximizing value for stakeholders. There is no suggestion of which the Monitor is aware that the Monitor's conduct has not been in good faith. Further, there has been no breakdown of communication of treatment of stakeholders on unequal terms that would support a finding of a lack of due diligence as described by the Supreme Court above. To the contrary, the Monitor has fulfilled the role described by the Supreme Court of Canada – an independent party safeguarding the process and (pursuant to the EMP Order) the business of the debtor companies.

57. For all of these reasons, the available evidence establishes that the Morris Group has acted and continues to act in good faith and with due diligence.

V. CONCLUSION

58. The Monitor respectfully submits that a decision by this Honourable Court granting the Sale Approval and Vesting Order and the Stay Extension Order are a necessary and appropriate exercise of this Court's jurisdiction in the circumstances.

ALL OF WHICH is respectfully submitted at Saskatoon, Saskatchewan, this 15th day of September, 2020.

MLT AIKINS LLP

Per: _____
Jeffrey M. Lee, Q.C. and Paul Olfert
Solicitors for the Monitor, Alvarez & Marsal Canada Inc.

[18] 2020 SCC 10, 2020 CarswellQue 3772.

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9354-9186 Québec inc. and 9354-9178 Québec inc. (Appellants) and Callidus Capital Corporation, International Game Technology, Deloitte LLP, Luc Carignan, François Vigneault, Philippe Millette, Francis Proulx and François Pelletier (Respondents) and Ernst & Young Inc., IMF Bentham Limited (now known as Omni Bridgeway Limited), Bentham IMF Capital Limited (now known as Omni Bridgeway Capital (Canada) Limited), Insolvency Institute of Canada and Canadian Association of Insolvency and Restructuring Professionals (Interveners)

IMF Bentham Limited (now known as Omni Bridgeway Limited) and Bentham IMF Capital Limited (now known as Omni Bridgeway Capital (Canada) Limited (Appellants) and Callidus Capital Corporation, International Game Technology, Deloitte LLP, Luc Carignan, François Vigneault, Philippe Millette, Francis Proulx and François Pelletier Respondents and Ernst & Young Inc., 9354-9186 Québec inc., 9354-9178 Québec inc., Insolvency Institute of Canada and Canadian Association of Insolvency and Restructuring Professionals (Interveners)

Wagner C.J.C., Abella J., Moldaver J., Karakatsanis J., Côté J., Rowe J., Kasirer J.

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Sylvain Rigaud, Arad Mojtahedi, Saam Pousht-Mashhad, for Interveners, Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals

Subject: Civil Practice and Procedure; Insolvency

Headnote

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s. 11.2(5) [en. 2019, c. 29, s. 138] — considered

s. 11.7 [en. 1997, c. 12, s. 124] — referred to

s. 11.8 [en. 1997, c. 12, s. 124] — referred to

s. 18.6 [en. 1997, c. 12, s. 125] — considered

s. 22(1) — referred to

s. 22(2) — referred to

s. 22(3) — considered

s. 23(1)(d) — referred to

s. 23(1)(i) — referred to

ss. 23-25 — referred to

s. 36 — considered

Winding-up and Restructuring Act, R.S.C. 1985, c. W-11
Generally — referred to

s. 6(1) — referred to

APPEALS from a judgment of the Quebec Court of Appeal (Dutil, Schrager and Dumas JJ.A.), 2019 QCCA 171, [2019] AZ-51566416, [2019] Q.J. No. 670 (QL), 2019 CarswellQue 94 (WL Can.), setting aside a decision of Michaud J., 2018 QCCS 1040, [2018] AZ-51477967, [2018] Q.J. No. 1986 (QL), 2018 CarswellQue 1923 (WL Can.). Appeals allowed; POURVOIS contre un arrêt de la Cour d'appel du Québec (les juges Dutil, Schrager et Dumas), 2019 QCCA 171, [2019] AZ-51566416, [2019] Q.J. No. 670 (QL), 2019 CarswellQue 94 (WL Can.), qui a infirmé une décision du juge Michaud,2018 QCCS 1040, [2018] AZ-51477967, [2018] Q.J. No. 1986 (QL), 2018 CarswellQue 1923 (WL Can.). Pourvois accueillis.

***Wagner C.J. and Moldaver J.* (Abella, Karakatsanis, Côté, Rowe and Kasirer JJ. concurring):**

I. Overview

1 These appeals arise in the context of an ongoing proceeding instituted under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"), in which substantially all of the assets of the debtor companies have been liquidated. The proceeding was commenced well over four years ago. Since then, a single supervising judge has been responsible for its oversight. In this capacity, he has made numerous discretionary decisions.

2 Two of the supervising judge's decisions are in issue before us. Each raises a question requiring this Court to clarify the nature and scope of judicial discretion in *CCAA* proceedings. The first is whether a supervising judge has the discretion to bar a creditor from voting on a plan of arrangement where they determine that the creditor is acting for an improper purpose. The second is whether a supervising judge can approve third party litigation funding as interim financing, pursuant to s. 11.2 of the *CCAA*.

3 For the reasons that follow, we would answer both questions in the affirmative, as did the supervising judge. To the extent the Court of Appeal disagreed and went on to interfere with the supervising judge's discretionary decisions, we conclude that it was not justified in doing so. In our respectful view, the Court of Appeal failed to treat the supervising judge's decisions with the appropriate degree of deference. In the result, as we ordered at the conclusion of the hearing, these appeals are allowed and the supervising judge's order reinstated.

II. Facts

4 In 1994, Mr. Gérald Duhamel founded Bluberi Gaming Technologies Inc., which is now one of the appellants, 9354-9186 Québec inc. The corporation manufactured, distributed, installed, and serviced electronic casino gaming machines. It also provided management systems for gambling operations. Its sole shareholder has at all material times been Bluberi Group Inc., which is now another of the appellants, 9354-9178 Québec inc. Through a family trust, Mr. Duhamel controls Bluberi Group Inc. and, as a result, Bluberi Gaming (collectively, "Bluberi").

5 In 2012, Bluberi sought financing from the respondent, Callidus Capital Corporation ("Callidus"), which describes itself as an "asset-based or distressed lender" (R.F., at para. 26). Callidus extended a credit facility of approximately $24 million to Bluberi. This debt was secured in part by a share pledge agreement.

6 Over the next three years, Bluberi lost significant amounts of money, and Callidus continued to extend credit. By 2015, Bluberi owed approximately $86 million to Callidus — close to half of which Bluberi asserts is comprised of interest and fees.

A. Bluberi's Institution of CCAA Proceedings and Initial Sale of Assets

7 On November 11, 2015, Bluberi filed a petition for the issuance of an initial order under the *CCAA*. In its petition, Bluberi alleged that its liquidity issues were the result of Callidus taking *de facto* control of the corporation and dictating a number of purposefully detrimental business decisions. Bluberi alleged that Callidus engaged in this conduct in order to deplete the corporation's equity value with a view to owning Bluberi and, ultimately, selling it.

8 Over Callidus's objection, Bluberi's petition succeeded. The supervising judge, Michaud J., issued an initial order under the *CCAA*. Among other things, the initial order confirmed that Bluberi was a "debtor company" within the meaning of s. 2(1) of the Act; stayed any proceedings against Bluberi or any director or officer of Bluberi; and appointed Ernst & Young Inc. as monitor ("Monitor").

9 Working with the Monitor, Bluberi determined that a sale of its assets was necessary. On January 28, 2016, it proposed a sale solicitation process, which the supervising judge approved. That process led to Bluberi entering into an asset purchase agreement with Callidus. The agreement contemplated that Callidus would obtain all of Bluberi's assets in exchange for extinguishing almost the entirety of its secured claim against Bluberi, which had ballooned to approximately $135.7 million. Callidus would maintain an undischarged secured claim of $3 million against Bluberi. The agreement would also permit Bluberi to retain claims for damages against Callidus arising from its alleged involvement in Bluberi's financial difficulties ("Retained Claims").[1] Throughout these proceedings, Bluberi has asserted that the Retained Claims should amount to over $200 million in damages.

10 The supervising judge approved the asset purchase agreement, and the sale of Bluberi's assets to Callidus closed in February 2017. As a result, Callidus effectively acquired Bluberi's business, and has continued to operate it as a going concern.

11 Since the sale, the Retained Claims have been Bluberi's sole remaining asset and thus the sole security for Callidus's $3 million claim.

B. The Initial Competing Plans of Arrangement

12 On September 11, 2017, Bluberi filed an application seeking the approval of a $2 million interim financing credit facility to fund the litigation of the Retained Claims and other related relief. The lender was a joint venture numbered company incorporated as 9364-9739 Québec inc. This interim financing application was set to be heard on September 19, 2017.

13 However, one day before the hearing, Callidus proposed a plan of arrangement ("First Plan") and applied for an order convening a creditors' meeting to vote on that plan. The First Plan proposed that Callidus would fund a $2.5 million (later increased to $2.63 million) distribution to Bluberi's creditors, except itself, in exchange for a release from the Retained Claims. This would have fully satisfied the claims of Bluberi's former employees and those creditors with claims worth less than $3000; creditors with larger claims were to receive, on average, 31 percent of their respective claims.

14 The supervising judge adjourned the hearing of both applications to October 5, 2017. In the meantime, Bluberi filed its own plan of arrangement. Among other things, the plan proposed that half of any proceeds resulting from the Retained Claims, after payment of expenses and Bluberi's creditors' claims, would be distributed to the unsecured creditors, as long as the net proceeds exceeded $20 million.

15 On October 5, 2017, the supervising judge ordered that the parties' plans of arrangement could be put to a creditors' vote. He ordered that both parties share the fees and expenses related to the presentation of the plans of arrangement at a creditors' meeting, and that a party's failure to deposit those funds with the Monitor would bar the presentation of that party's plan of arrangement. Bluberi elected not to deposit the necessary funds, and, as a result, only Callidus's First Plan was put to the creditors.

C. Creditors' Vote on Callidus's First Plan

16 On December 15, 2017, Callidus submitted its First Plan to a creditors' vote. The plan failed to receive sufficient support. Section 6(1) of the *CCAA* provides that, to be approved, a plan must receive a "double majority" vote in each class of creditors — that is, a majority in *number* of class members, which also represents two-thirds in *value* of the class members' claims. All of Bluberi's creditors, besides Callidus, formed a single voting class of unsecured creditors. Of the 100 voting unsecured creditors, 92 creditors (representing $3,450,882 of debt) voted in favour, and 8 voted against (representing $2,375,913 of debt). The First Plan failed because the creditors voting in favour only held 59.22 percent of the total value being voted, which did not meet the s. 6(1) threshold. Most notably, SMT Hautes Technologies ("SMT"), which held 36.7 percent of Bluberi's debt, voted against the plan.

17 Callidus did not vote on the First Plan — despite the Monitor explicitly stating that Callidus could have "vote[d] ... the portion of its claim, assessed by Callidus, to be an unsecured claim" (Joint R.R., vol. III, at p.188).

D. Bluberi's Interim Financing Application and Callidus's New Plan

18 On February 6, 2018, Bluberi filed one of the applications underlying these appeals, seeking authorization of a proposed third party litigation funding agreement ("LFA") with a publicly traded litigation funder, IMF Bentham Limited or its Canadian subsidiary, Bentham IMF Capital Limited (collectively, "Bentham"). Bluberi's application also sought the placement of a $20 million super-priority charge in favour of Bentham on Bluberi's assets ("Litigation Financing Charge").

19 The LFA contemplated that Bentham would fund Bluberi's litigation of the Retained Claims in exchange for receiving a portion of any settlement or award after trial. However, were Bluberi's litigation to fail, Bentham would lose all of its invested funds. The LFA also provided that Bentham could terminate the litigation of the Retained Claims if, acting reasonably, it were no longer satisfied of the merits or commercial viability of the litigation.

20 Callidus and certain unsecured creditors who voted in favour of its plan (who are now respondents and style themselves the "Creditors' Group") contested Bluberi's application on the ground that the LFA was a plan of arrangement and, as such, had to be submitted to a creditors' vote.[2]

21 On February 12, 2018, Callidus filed the other application underlying these appeals, seeking to put another plan of arrangement to a creditors' vote ("New Plan"). The New Plan was essentially identical to the First Plan, except that Callidus increased the proposed distribution by $250,000 (from $2.63 million to $2.88 million). Further, Callidus filed an amended proof of claim, which purported to value the security attached to its $3 million claim at *nil*. Callidus was of the view that this valuation was proper because Bluberi had no assets other than the Retained Claims. On this basis, Callidus asserted that it stood in the position of an unsecured creditor, and sought the supervising judge's permission to vote on the New Plan with the other unsecured creditors. Given the size of its claim, if Callidus were permitted to vote on the New Plan, the plan would necessarily pass a creditors' vote. Bluberi opposed Callidus's application.

22 The supervising judge heard Bluberi's interim financing application and Callidus's application regarding its New Plan together. Notably, the Monitor supported Bluberi's position.

III. Decisions Below

A. Quebec Superior Court (2018 QCCS 1040 (C.S. Que.)) (Michaud J.)

23 The supervising judge dismissed Callidus's application, declining to submit the New Plan to a creditors' vote. He granted Bluberi's application, authorizing Bluberi to enter into a litigation funding agreement with Bentham on the terms set forth in the LFA and imposing the Litigation Financing Charge on Bluberi's assets.

24 With respect to Callidus's application, the supervising judge determined Callidus should not be permitted to vote on the New Plan because it was acting with an "improper purpose" (para. 48). He acknowledged that creditors are generally entitled to vote in their own self-interest. However, given that the First Plan — which was almost identical to the New Plan — had been defeated by a creditors' vote, the supervising judge concluded that Callidus's attempt to vote on the New Plan was an attempt to override the result of the first vote. In particular, he wrote:

> Taking into consideration the creditors' interest, the Court accepted, in the fall of 2017, that Callidus' Plan be submitted to their vote with the understanding that, as a secured creditor, Callidus would not cast a vote. However, under the present circumstances, it would serve an improper purpose if Callidus was allowed to vote on its own plan, especially when its vote would very likely result in the New Plan meeting the two thirds threshold for approval under the CCAA.
>
> As pointed out by SMT, the main unsecured creditor, Callidus' attempt to vote aims only at cancelling SMT's vote which prevented Callidus' Plan from being approved at the creditors' meeting.
>
> It is one thing to let the creditors vote on a plan submitted by a secured creditor, it is another to allow this secured creditor to vote on its own plan in order to exert control over the vote for the sole purpose of obtaining releases. [paras. 45-47]

25 The supervising judge concluded that, in these circumstances, allowing Callidus to vote would be both "unfair and unreasonable" (para. 47). He also observed that Callidus's conduct throughout the *CCAA* proceedings "lacked transparency" (at para. 41) and that Callidus was "solely motivated by the [pending] litigation" (para. 44). In sum, he found that Callidus's conduct was contrary to the "requirements of appropriateness, good faith, and due diligence", and ordered that Callidus would not be permitted to vote on the New Plan (para. 48, citing *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60, [2010] 3 S.C.R. 379 (S.C.C.) [hereinafter Century Services], at para. 70).

26 Because Callidus was not permitted to vote on the New Plan and SMT had unequivocally stated its intention to vote against it, the supervising judge concluded that the plan had no reasonable prospect of success. He therefore declined to submit it to a creditors' vote.

27 With respect to Bluberi's application, the supervising judge considered three issues relevant to these appeals: (1) whether the LFA should be submitted to a creditors' vote; (2) if not, whether the LFA ought to be approved by the court; and (3) if so, whether the $20 million Litigation Financing Charge should be imposed on Bluberi's assets.

28 The supervising judge determined that the LFA did not need to be submitted to a creditors' vote because it was not a plan of arrangement. He considered a plan of arrangement to involve "an arrangement or compromise between a debtor and its creditors" (para. 71, citing *Crystallex International Corp., Re*, 2012 ONCA 404, 293 O.A.C. 102 (Ont. C.A.), at para. 92 ("*Crystallex*")). In his view, the LFA lacked this essential feature. He also concluded that the LFA did not need to be accompanied by a plan, as Bluberi had stated its intention to file a plan in the future.

29 After reviewing the terms of the LFA, the supervising judge found it met the criteria for approval of third party litigation funding set out in *Musicians' Pension Fund of Canada (Trustee of) v. Kinross Gold Corp.*, 2013 ONSC 4974, 117 O.R. (3d) 150 (Ont. S.C.J.), at para. 41, and *Hayes v. Saint John (City)*, 2016 NBQB 125 (N.B. Q.B.), at para. 4 (CanLII). In particular, he considered Bentham's percentage of return to be reasonable in light of its level of investment and risk. Further, the supervising judge rejected Callidus and the Creditors' Group's argument that the LFA gave too much discretion to Bentham. He found that the LFA did not allow Bentham to exert undue influence on the litigation of the Retained Claims, noting similarly broad clauses had been approved in the *CCAA* context (para. 82, citing *Schenk v. Valeant Pharmaceuticals International Inc.*, 2015 ONSC 3215, 74 C.P.C. (7th) 332 (Ont. S.C.J.), at para. 23).

30 Finally, the supervising judge imposed the Litigation Financing Charge on Bluberi's assets. While significant, the supervising judge considered the amount to be reasonable given: the amount of damages that would be claimed from Callidus; Bentham's financial commitment to the litigation; and the fact that Bentham was not charging any interim fees or interest (i.e., it would only profit in the event of successful litigation or settlement). Put simply, Bentham was taking substantial risks, and it was reasonable that it obtain certain guarantees in exchange.

31 Callidus, again supported by the Creditors' Group, appealed the supervising judge's order, impleading Bentham in the process.

B. Quebec Court of Appeal (2019 QCCA 171 (C.A. Que.)) (Dutil and Schrager JJ.A. and Dumas J. (ad hoc))

32 The Court of Appeal allowed the appeal, finding that "[t]he exercise of the judge's discretion [was] not founded in law nor on a proper treatment of the facts so that irrespective of the standard of review applied, appellate intervention [was] justified" (para. 48 CanLII)). In particular, the court identified two errors of relevance to these appeals.

33 First, the court was of the view that the supervising judge erred in finding that Callidus had an improper purpose in seeking to vote on its New Plan. In its view, Callidus should have been permitted to vote. The court relied heavily on the notion that creditors have a right to vote in their own self-interest. It held that any judicial discretion to preclude voting due to improper purpose should be reserved for the "clearest of cases" (para. 62, referring to *Blackburn Developments Ltd., Re*, 2011 BCSC 1671, 27 B.C.L.R. (5th) 199 (B.C. S.C.), at para. 45). The court was of the view that Callidus's transparent attempt to obtain a release from Bluberi's claims against it did not amount to an improper purpose. The court also considered Callidus's conduct prior to and during the *CCAA* proceedings to be incapable of justifying a finding of improper purpose.

34 Second, the court concluded that the supervising judge erred in approving the LFA as interim financing because, in its view, the LFA was not connected to Bluberi's commercial operations. The court concluded that the supervising judge had both "misconstrued in law the notion of interim financing and misapplied that notion to the factual circumstances of the case" (para. 78).

35 In light of this perceived error, the court substituted its view that the LFA was a plan of arrangement and, as a result, should have been submitted to a creditors' vote. It held that "[a]n arrangement or proposal can encompass both a compromise of creditors' claims as well as the process undertaken to satisfy them" (para. 85). The court considered the LFA to be a plan of arrangement because it affected the creditors' share in any eventual litigation proceeds, would cause them to wait for the outcome of any litigation, and could potentially leave them with nothing at all. Moreover, the court held that Bluberi's scheme "as a whole", being the prosecution of the Retained Claims and the LFA, should be submitted as a plan to the creditors for their approval (para. 89).

36 Bluberi and Bentham (collectively, "appellants"), again supported by the Monitor, now appeal to this Court.

IV. Issues

37 These appeals raise two issues:

(1) Did the supervising judge err in barring Callidus from voting on its New Plan on the basis that it was acting for an improper purpose?

(2) Did the supervising judge err in approving the LFA as interim financing, pursuant to s. 11.2 of the *CCAA*?

V. Analysis

A. Preliminary Considerations

38 Addressing the above issues requires situating them within the contemporary Canadian insolvency landscape and, more specifically, the *CCAA* regime. Accordingly, before turning to those issues, we review (1) the evolving nature of *CCAA* proceedings; (2) the role of the supervising judge in those proceedings; and (3) the proper scope of appellate review of a supervising judge's exercise of discretion.

(1) The Evolving Nature of CCAA Proceedings

39 The *CCAA* is one of three principal insolvency statutes in Canada. The others are the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*"), which covers insolvencies of both individuals and companies, and the *Winding-up and Restructuring Act*, R.S.C. 1985, c. W-11 ("*WURA*"), which covers insolvencies of financial institutions and certain other corporations, such as insurance companies (*WURA*, s. 6(1)). While both the *CCAA* and the *BIA* enable reorganizations of

insolvent companies, access to the *CCAA* is restricted to debtor companies facing total claims in excess of $5 million (*CCAA*, s. 3(1)).

40 Together, Canada's insolvency statutes pursue an array of overarching remedial objectives that reflect the wide ranging and potentially "catastrophic" impacts insolvency can have (*Indalex Ltd., Re*, 2013 SCC 6, [2013] 1 S.C.R. 271 (S.C.C.), at para. 1). These objectives include: providing for timely, efficient and impartial resolution of a debtor's insolvency; preserving and maximizing the value of a debtor's assets; ensuring fair and equitable treatment of the claims against a debtor; protecting the public interest; and, in the context of a commercial insolvency, balancing the costs and benefits of restructuring or liquidating the company (J. P. Sarra, "The Oscillating Pendulum: Canada's Sesquicentennial and Finding the Equilibrium for Insolvency Law", in J. P. Sarra and B. Romaine, eds., *Annual Review of Insolvency Law 2016* (2017), 9, at pp. 9-10; J. P. Sarra, *Rescue! The Companies' Creditors Arrangement Act* 2nd ed. (2013), at pp. 4-5 and 14; Standing Senate Committee on Banking, Trade and Commerce, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (2003), at pp. 9-10; R. J. Wood, *Bankruptcy and Insolvency Law* (2nd ed. 2015), at pp. 4-5).

41 Among these objectives, the *CCAA* generally prioritizes "avoiding the social and economic losses resulting from liquidation of an insolvent company" (*Century Services*, at para. 70). As a result, the typical *CCAA* case has historically involved an attempt to facilitate the reorganization and survival of the pre-filing debtor company in an operational state — that is, as a going concern. Where such a reorganization was not possible, the alternative course of action was seen as a liquidation through either a receivership or under the *BIA* regime. This is precisely the outcome that was sought in *Century Services* (see para. 14).

42 That said, the *CCAA* is fundamentally insolvency legislation, and thus it also "has the simultaneous objectives of maximizing creditor recovery, preservation of going-concern value where possible, preservation of jobs and communities affected by the firm's financial distress ... and enhancement of the credit system generally" (Sarra, *Rescue! The Companies' Creditors Arrangement Act*, at p. 14; see also *Ernst & Young Inc. v. Essar Global Fund Limited*, 2017 ONCA 1014, 139 O.R. (3d) 1 (Ont. C.A.), at para. 103). In pursuit of those objectives, *CCAA* proceedings have evolved to permit outcomes that do not result in the emergence of the pre-filing debtor company in a restructured state, but rather involve some form of liquidation of the debtor's assets under the auspices of the Act itself (Sarra, "The Oscillating Pendulum: Canada's Sesquicentennial and Finding the Equilibrium for Insolvency Law", at pp. 19-21). Such scenarios are referred to as "liquidating CCAAs", and they are now commonplace in the *CCAA* landscape (see *Third Eye Capital Corporation v. Ressources Dianor Inc./Dianor Resources Inc.*, 2019 ONCA 508, 435 D.L.R. (4th) 416 (Ont. C.A.), at para. 70).

43 Liquidating CCAAs take diverse forms and may involve, among other things: the sale of the debtor company as a going concern; an "en bloc" sale of assets that are capable of being operationalized by a buyer; a partial liquidation or downsizing of business operations; or a piecemeal sale of assets (B. Kaplan, "Liquidating CCAAs: Discretion Gone Awry?", in J. P. Sarra, ed., *Annual Review of Insolvency Law* (2008), 79, at pp. 87-89). The ultimate commercial outcomes facilitated by liquidating CCAAs are similarly diverse. Some may result in the continued operation of the business of the debtor under a different going concern entity (e.g., the liquidations in *Indalex* and *Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re* (1998), 5 C.B.R. (4th) 299 (Ont. Gen. Div. [Commercial List]), while others may result in a sale of assets and inventory with no such entity emerging (e.g., the proceedings in *Target Canada Co., Re*, 2015 ONSC 303, 22 C.B.R. (6th) 323 (Ont. S.C.J.), at paras. 7 and 31). Others still, like the case at bar, may involve a going concern sale of most of the assets of the debtor, leaving residual assets to be dealt with by the debtor and its stakeholders.

44 *CCAA* courts first began approving these forms of liquidation pursuant to the broad discretion conferred by the Act. The emergence of this practice was not without criticism, largely on the basis that it appeared to be inconsistent with the *CCAA* being a "restructuring statute" (see, e.g., *Royal Bank v. Fracmaster Ltd.*, 1999 ABCA 178, 244 A.R. 93 (Alta. C.A.), at paras. 15-16, aff'g 1999 ABQB 379, 11 C.B.R. (4th) 204 (Alta. Q.B.), at paras. 40-43; A. Nocilla, "The History of the Companies' Creditors Arrangement Act and the Future of Re-Structuring Law in Canada" (2014), 56 *Can. Bus. L.J.* 73, at pp. 88-92).

45 However, since s. 36 of the *CCAA* came into force in 2009, courts have been using it to effect liquidating CCAAs. Section 36 empowers courts to authorize the sale or disposition of a debtor company's assets outside the ordinary course of business.[3] Significantly, when the Standing Senate Committee on Banking, Trade and Commerce recommended the adoption

of s. 36, it observed that liquidation is not necessarily inconsistent with the remedial objectives of the *CCAA*, and that it may be a means to "raise capital [to facilitate a restructuring], eliminate further loss for creditors or focus on the solvent operations of the business" (p. 147). Other commentators have observed that liquidation can be a "vehicle to restructure a business" by allowing the business to survive, albeit under a different corporate form or ownership (Sarra, *Rescue! The Companies' Creditors Arrangement Act*, at p. 169; see also K. P. McElcheran, *Commercial Insolvency in Canada* (4th ed. 2019), at p. 311). Indeed, in *Indalex*, the company sold its assets under the *CCAA* in order to preserve the jobs of its employees, despite being unable to survive as their employer (see para. 51).

46 Ultimately, the relative weight that the different objectives of the *CCAA* take on in a particular case may vary based on the factual circumstances, the stage of the proceedings, or the proposed solutions that are presented to the court for approval. Here, a parallel may be drawn with the *BIA* context. In *Orphan Well Association v. Grant Thornton Ltd.*, 2019 SCC 5, [2019] 1 S.C.R. 150 (S.C.C.), at para. 67, this Court explained that, as a general matter, the *BIA* serves two purposes: (1) the bankrupt's financial rehabilitation and (2) the equitable distribution of the bankrupt's assets among creditors. However, in circumstances where a debtor corporation will never emerge from bankruptcy, only the latter purpose is relevant (see para. 67). Similarly, under the *CCAA*, when a reorganization of the pre-filing debtor company is not a possibility, a liquidation that preserves going-concern value and the ongoing business operations of the pre-filing company may become the predominant remedial focus. Moreover, where a reorganization or liquidation is complete and the court is dealing with residual assets, the objective of maximizing creditor recovery from those assets may take centre stage. As we will explain, the architecture of the *CCAA* leaves the case-specific assessment and balancing of these remedial objectives to the supervising judge.

(2) The Role of a Supervising Judge in CCAA Proceedings

47 One of the principal means through which the *CCAA* achieves its objectives is by carving out a unique supervisory role for judges (see Sarra, *Rescue! The Companies' Creditors Arrangement Act*, at pp. 18-19). From beginning to end, each *CCAA* proceeding is overseen by a single supervising judge. The supervising judge acquires extensive knowledge and insight into the stakeholder dynamics and the business realities of the proceedings from their ongoing dealings with the parties.

48 The *CCAA* capitalizes on this positional advantage by supplying supervising judges with broad discretion to make a variety of orders that respond to the circumstances of each case and "meet contemporary business and social needs" (*Century Services*, at para. 58) in "real-time" (para. 58, citing R. B. Jones, "The Evolution of Canadian Restructuring: Challenges for the Rule of Law", in J. P. Sarra, ed., *Annual Review of Insolvency Law 2005* (2006), 481, at p. 484). The anchor of this discretionary authority is s. 11, which empowers a judge "to make any order that [the judge] considers appropriate in the circumstances". This section has been described as "the engine" driving the statutory scheme (*Stelco Inc., Re* (2005), 253 D.L.R. (4th) 109 (Ont. C.A.), at para. 36).

49 The discretionary authority conferred by the *CCAA*, while broad in nature, is not boundless. This authority must be exercised in furtherance of the remedial objectives of the *CCAA*, which we have explained above (see *Century Services*, at para. 59). Additionally, the court must keep in mind three "baseline considerations" (at para. 70), which the applicant bears the burden of demonstrating: (1) that the order sought is appropriate in the circumstances, and (2) that the applicant has been acting in good faith and (3) with due diligence (para. 69).

50 The first two considerations of appropriateness and good faith are widely understood in the *CCAA* context. Appropriateness "is assessed by inquiring whether the order sought advances the policy objectives underlying the *CCAA*" (para. 70). Further, the well-established requirement that parties must act in good faith in insolvency proceedings has recently been made express in s. 18.6 of the *CCAA*, which provides:

> **Good faith**
>
> **18.6 (1)** Any interested person in any proceedings under this Act shall act in good faith with respect to those proceedings.
>
> **Good faith — powers of court**
>
> **(2)** If the court is satisfied that an interested person fails to act in good faith, on application by an interested person, the

> court may make any order that it considers appropriate in the circumstances.
>
> (See also *BIA*, s. 4.2; *Budget Implementation Act, 2019, No. 1*, S.C. 2019, c. 29, ss. 133 and 140.)

51 The third consideration of due diligence requires some elaboration. Consistent with the *CCAA* regime generally, the due diligence consideration discourages parties from sitting on their rights and ensures that creditors do not strategically manoeuver or position themselves to gain an advantage (*Lehndorff General Partner Ltd., Re* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]), at p. 31). The procedures set out in the *CCAA* rely on negotiations and compromise between the debtor and its stakeholders, as overseen by the supervising judge and the monitor. This necessarily requires that, to the extent possible, those involved in the proceedings be on equal footing and have a clear understanding of their respective rights (see McElcheran, at p. 262). A party's failure to participate in *CCAA* proceedings in a diligent and timely fashion can undermine these procedures and, more generally, the effective functioning of the *CCAA* regime (see, e.g., *North American Tungsten Corp. v. Global Tungsten and Powders Corp.*, 2015 BCCA 390, 377 B.C.A.C. 6 (B.C. C.A.), at paras. 21-23; *BA Energy Inc., Re*, 2010 ABQB 507, 70 C.B.R. (5th) 24 (Alta. Q.B.); *HSBC Bank Canada v. Bear Mountain Master Partnership*, 2010 BCSC 1563, 72 C.B.R. (4th) 276 (B.C. S.C. [In Chambers]), at para. 11; *Caterpillar Financial Services Ltd. v. 360networks Corp.*, 2007 BCCA 14, 279 D.L.R. (4th) 701 (B.C. C.A.), at paras. 51-52, in which the courts seized on a party's failure to act diligently).

52 We pause to note that supervising judges are assisted in their oversight role by a court appointed monitor whose qualifications and duties are set out in the *CCAA* (see ss. 11.7, 11.8 and 23 to 25). The monitor is an independent and impartial expert, acting as "the eyes and the ears of the court" throughout the proceedings (*Essar*, at para. 109). The core of the monitor's role includes providing an advisory opinion to the court as to the fairness of any proposed plan of arrangement and on orders sought by parties, including the sale of assets and requests for interim financing (see *CCAA*, s. 23(1)(d) and (i); Sarra, *Rescue! The Companies' Creditors Arrangement Act*, at pp-566 and 569).

(3) Appellate Review of Exercises of Discretion by a Supervising Judge

53 A high degree of deference is owed to discretionary decisions made by judges supervising *CCAA* proceedings. As such, appellate intervention will only be justified if the supervising judge erred in principle or exercised their discretion unreasonably (see *Grant Forest Products Inc. v. Toronto-Dominion Bank*, 2015 ONCA 570, 387 D.L.R. (4th) 426 (Ont. C.A.), at para. 98; *Bridging Finance Inc. v. Béton Brunet 2001 inc.*, 2017 QCCA 138, 44 C.B.R. (6th) 175 (C.A. Que.), at para. 23). Appellate courts must be careful not to substitute their own discretion in place of the supervising judge's (*New Skeena Forest Products Inc., Re*, 2005 BCCA 192, 39 B.C.L.R. (4th) 338 (B.C. C.A.), at para. 20).

54 This deferential standard of review accounts for the fact that supervising judges are steeped in the intricacies of the *CCAA* proceedings they oversee. In this respect, the comments of Tysoe J.A. in *Edgewater Casino Inc., Re*, 2009 BCCA 40, 305 D.L.R. (4th) 339 (B.C. C.A.) ("*Re Edgewater Casino Inc.*), at para. 20, are apt:

> ... one of the principal functions of the judge supervising the *CCAA* proceeding is to attempt to balance the interests of the various stakeholders during the reorganization process, and it will often be inappropriate to consider an exercise of discretion by the supervising judge in isolation of other exercises of discretion by the judge in endeavoring to balance the various interests. ... *CCAA* proceedings are dynamic in nature and the supervising judge has intimate knowledge of the reorganization process. The nature of the proceedings often requires the supervising judge to make quick decisions in complicated circumstances.

55 With the foregoing in mind, we turn to the issues on appeal.

B. Callidus Should Not Be Permitted to Vote on Its New Plan

56 A creditor can generally vote on a plan of arrangement or compromise that affects its rights, subject to any specific provisions of the *CCAA* that may restrict its voting rights (e.g., s. 22(3)), or a proper exercise of discretion by the supervising

judge to constrain or bar the creditor's right to vote. We conclude that one such constraint arises from s. 11 of the *CCAA*, which provides supervising judges with the discretion to bar a creditor from voting where the creditor is acting for an improper purpose. Supervising judges are best-placed to determine whether this discretion should be exercised in a particular case. In our view, the supervising judge here made no error in exercising his discretion to bar Callidus from voting on the New Plan.

(1) Parameters of Creditors' Right to Vote on Plans of Arrangement

57 Creditor approval of any plan of arrangement or compromise is a key feature of the *CCAA*, as is the supervising judge's oversight of that process. Where a plan is proposed, an application may be made to the supervising judge to order a creditors' meeting to vote on the proposed plan (*CCAA*, ss. 4 and 5). The supervising judge has the discretion to determine whether to order the meeting. For the purposes of voting at a creditors' meeting, the debtor company may divide the creditors into classes, subject to court approval (*CCAA*, s. 22(1)). Creditors may be included in the same class if "their interests or rights are sufficiently similar to give them a commonality of interest" (*CCAA*, s. 22(2); see also L. W. Houlden, G. B. Morawetz and J. P. Sarra, *Bankruptcy and Insolvency Law of Canada* (4th ed. (loose-leaf)), vol. 4, at N§149). If the requisite "double majority" in each class of creditors — again, a majority in *number* of class members, which also represents two-thirds in *value* of the class members' claims — vote in favour of the plan, the supervising judge may sanction the plan (*ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*, 2008 ONCA 587, 296 D.L.R. (4th) 135 (Ont. C.A.), at para. 34; see *CCAA*, s. 6). The supervising judge will conduct what is commonly referred to as a "fairness hearing" to determine, among other things, whether the plan is fair and reasonable (Wood, at pp. 490-92; see also Sarra, *Rescue! The Companies' Creditors Arrangement Act*, at p. 529; Houlden, Morawetz and Sarra at N§45). Once sanctioned by the supervising judge, the plan is binding on each class of creditors that participated in the vote (*CCAA*, s. 6(1)).

58 Creditors with a provable claim against the debtor whose interests are affected by a proposed plan are usually entitled to vote on plans of arrangement (Wood, at p. 470). Indeed, there is no express provision in the *CCAA* barring such a creditor from voting on a plan of arrangement, including a plan it sponsors.

59 Notwithstanding the foregoing, the appellants submit that a purposive interpretation of s. 22(3) of the *CCAA* reveals that, as a general matter, a creditor should be precluded from voting on its own plan. Section 22(3) provides:

> **Related creditors**
>
> **(3)** A creditor who is related to the company may vote against, but not for, a compromise or arrangement relating to the company.

The appellants note that s. 22(3) was meant to harmonize the *CCAA* scheme with s. 54(3) of the *BIA*, which provides that "[a] creditor who is related to the debtor may vote against but not for the acceptance of the proposal." The appellants point out that, under s. 50(1) of the *BIA*, only debtors can sponsor plans; as a result, the reference to "debtor" in s. 54(3) captures *all* plan sponsors. They submit that if s. 54(3) captures all plan sponsors, s. 22(3) of the *CCAA* must do the same. On this basis, the appellants ask us to extend the voting restriction in s. 22(3) to apply not only to creditors who are "related to the company", as the provision states, but to any creditor who sponsors a plan. They submit that this interpretation gives effect to the underlying intention of both provisions, which they say is to ensure that a creditor who has a conflict of interest cannot "dilute" or overtake the votes of other creditors.

60 We would not accept this strained interpretation of s. 22(3). Section 22(3) makes no mention of conflicts of interest between creditors and plan sponsors generally. The wording of s. 22(3) only places voting restrictions on creditors who are "related to the [debtor] company". These words are "precise and unequivocal" and, as such, must "play a dominant role in the interpretive process" (*Canada Trustco Mortgage Co. v. R.*, 2005 SCC 54, [2005] 2 S.C.R. 601 (S.C.C.), at para. 10). In our view, the appellants' analogy to the *BIA* is not sufficient to overcome the plain wording of this provision.

61 While the appellants are correct that s. 22(3) was enacted to harmonize the treatment of related parties in the *CCAA* and *BIA*, its history demonstrates that it is not a general conflict of interest provision. Prior to the amendments incorporating s. 22(3) into the *CCAA*, the *CCAA* clearly allowed creditors to put forward a plan of arrangement (see Houlden, Morawetz and Sarra, at N§33, *Red Cross*; *1078385 Ontario Ltd., Re* (2004), 206 O.A.C. 17 (Ont. C.A.)). In contrast, under the *BIA*,

only debtors could make proposals. Parliament is presumed to have been aware of this obvious difference between the two statutes (see *ATCO Gas & Pipelines Ltd. v. Alberta (Energy & Utilities Board)*, 2006 SCC 4, [2006] 1 S.C.R. 140 (S.C.C.), at para. 59; see also *Third Eye Capital Corporation*, at para. 57). Despite this difference, Parliament imported, with necessary modification, the wording of the *BIA* related creditor provision into the *CCAA*. Going beyond this language entails accepting that Parliament failed to choose the right words to give effect to its intention, which we do not.

62 Indeed, Parliament did not mindlessly reproduce s. 54(3) of the *BIA* in s. 22(3) of the *CCAA*. Rather, it made two modifications to the language of s. 54(3) to bring it into conformity with the language of the *CCAA*. First, it changed "proposal" (a defined term in the *BIA*) to "compromise or arrangement" (a term used throughout the *CCAA*). Second, it changed "debtor" to "company", recognizing that companies are the only kind of debtor that exists in the *CCAA* context.

63 Our view is further supported by Industry Canada's explanation of the rationale for s. 22(3) as being to "reduce the ability of *debtor companies* to organize a restructuring plan that confers additional benefits to *related parties*" (Office of the Superintendent of Bankruptcy Canada, *Bill C-12: Clause by Clause Analysis*, developed by Industry Canada, last updated March 24, 2015 (online), cl. 71, s. 22 (emphasis added); see also Standing Senate Committee on Banking, Trade and Commerce, at p. 151).

64 Finally, we note that the *CCAA* contains other mechanisms that attenuate the concern that a creditor with conflicting legal interests with respect to a plan it proposes may distort the creditors' vote. Although we reject the appellants' interpretation of s. 22(3), that section still bars creditors who are related to the debtor company from voting in favour of *any* plan. Additionally, creditors who do not share a sufficient commonality of interest may be forced to vote in separate classes (s. 22(1) and (2)), and, as we will explain, a supervising judge may bar a creditor from voting where the creditor is acting for an improper purpose.

(2) Discretion to Bar a Creditor From Voting in Furtherance of an Improper Purpose

65 There is no dispute that the *CCAA* is silent on when a creditor who is otherwise entitled to vote on a plan can be barred from voting. However, *CCAA* supervising judges are often called upon "to sanction measures for which there is no explicit authority in the *CCAA*" (*Century Services*, at para. 61; see also para. 62). In *Century Services*, this Court endorsed a "hierarchical" approach to determining whether jurisdiction exists to sanction a proposed measure: "courts [must] rely first on an interpretation of the provisions of the *CCAA* text before turning to inherent or equitable jurisdiction to anchor measures taken in a *CCAA* proceeding" (para. 65). In most circumstances, a purposive and liberal interpretation of the provisions of the *CCAA* will be sufficient "to ground measures necessary to achieve its objectives" (para. 65).

66 Applying this approach, we conclude that jurisdiction exists under s. 11 of the *CCAA* to bar a creditor from voting on a plan of arrangement or compromise where the creditor is acting for an improper purpose.

67 Courts have long recognized that s. 11 of the *CCAA* signals legislative endorsement of the "broad reading of *CCAA* authority developed by the jurisprudence" (*Century Services*, at para. 68). Section 11 states:

> **General power of court**
>
> **11** Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.

On the plain wording of the provision, the jurisdiction granted by s. 11 is constrained only by restrictions set out in the *CCAA* itself, and the requirement that the order made be "appropriate in the circumstances".

68 Where a party seeks an order relating to a matter that falls within the supervising judge's purview, and for which there is no *CCAA* provision conferring more specific jurisdiction, s. 11 necessarily is the provision of first resort in anchoring jurisdiction. As Blair J.A. put it in *Stelco*, s. 11 "for the most part supplants the need to resort to inherent jurisdiction" in the *CCAA* context (para. 36).

69 Oversight of the plan negotiation, voting, and approval process falls squarely within the supervising judge's purview. As indicated, there are no specific provisions in the *CCAA* which govern when a creditor who is otherwise eligible to vote on a plan may nonetheless be barred from voting. Nor is there any provision in the *CCAA* which suggests that a creditor has an absolute right to vote on a plan that cannot be displaced by a proper exercise of judicial discretion. However, given that the *CCAA* regime contemplates creditor participation in decision-making as an integral facet of the workout regime, creditors should only be barred from voting where the circumstances demand such an outcome. In other words, it is necessarily a discretionary, circumstance-specific inquiry.

70 Thus, it is apparent that s. 11 serves as the source of the supervising judge's jurisdiction to issue a discretionary order barring a creditor from voting on a plan of arrangement. The exercise of this discretion must further the remedial objectives of the *CCAA* and be guided by the baseline considerations of appropriateness, good faith, and due diligence. This means that, where a creditor is seeking to exercise its voting rights in a manner that frustrates, undermines, or runs counter to those objectives — that is, acting for an "improper purpose" — the supervising judge has the discretion to bar that creditor from voting.

71 The discretion to bar a creditor from voting in furtherance of an improper purpose under the *CCAA* parallels the similar discretion that exists under the *BIA*, which was recognized in *Laserworks Computer Services Inc., Re*, 1998 NSCA 42, 165 N.S.R. (2d) 296 (N.S. C.A.). In *Laserworks Computer Services Inc.*, the Nova Scotia Court of Appeal concluded that the discretion to bar a creditor from voting in this way stemmed from the court's power, inherent in the scheme of the *BIA*, to supervise "[e]ach step in the bankruptcy process" (at para. 41), as reflected in ss. 43(7), 108(3), and 187(9) of the Act. The court explained that s. 187(9) specifically grants the power to remedy a "substantial injustice", which arises "when the *BIA* is used for an improper purpose" (para. 54). The court held that "[a]n improper purpose is any purpose collateral to the purpose for which the bankruptcy and insolvency legislation was enacted by Parliament" (para. 54).

72 While not determinative, the existence of this discretion under the *BIA* lends support to the existence of similar discretion under the *CCAA* for two reasons.

73 First, this conclusion would be consistent with this Court's recognition that the *CCAA* "offers a more flexible mechanism with *greater* judicial discretion" than the *BIA* (*Century Services*, at para. 14 (emphasis added)).

74 Second, this Court has recognized the benefits of harmonizing the two statutes to the extent possible. For example, in *Indalex*, the Court observed that "in order to avoid a race to liquidation under the *BIA*, courts will favour an interpretation of the *CCAA* that affords creditors analogous entitlements" to those received under the *BIA* (para. 51; see also *Century Services*, at para. 24; *Nortel Networks Corp., Re*, 2015 ONCA 681, 391 D.L.R. (4th) 283 (Ont. C.A.), at paras. 34-46). Thus, where the statutes are capable of bearing a harmonious interpretation, that interpretation ought to be preferred "to avoid the ills that can arise from [insolvency] 'statute-shopping'" (*Kitchener Frame Ltd., Re*, 2012 ONSC 234, 86 C.B.R. (5th) 274, at para. 78; see also para. 73). In our view, the articulation of "improper purpose" set out in *Laserworks Computer Services Inc.* — that is, any purpose collateral to the purpose of insolvency legislation — is entirely harmonious with the nature and scope of judicial discretion afforded by the *CCAA*. Indeed, as we have explained, this discretion is to be exercised in accordance with the *CCAA*'s objectives as an insolvency statute.

75 We also observe that the recognition of this discretion under the *CCAA* advances the basic fairness that "permeates Canadian insolvency law and practice" (Sarra, "The Oscillating Pendulum: Canada's Sesquicentennial and Finding the Equilibrium for Insolvency Law", at p. 27; see also *Century Services*, at paras. 70 and 77). As Professor Sarra observes, fairness demands that supervising judges be in a position to recognize and meaningfully address circumstances in which parties are working against the goals of the statute:

> The Canadian insolvency regime is based on the assumption that creditors and the debtor share a common goal of maximizing recoveries. The substantive aspect of fairness in the insolvency regime is based on the assumption that all involved parties face real economic risks. Unfairness resides where only some face these risks, while others actually benefit from the situation .... If the *CCAA* is to be interpreted in a purposive way, the courts must be able to recognize when people have conflicting interests and are working actively against the goals of the statute.
>
> ("The Oscillating Pendulum: Canada's Sesquicentennial and Finding the Equilibrium for Insolvency Law", at p. 30

(emphasis added))

In this vein, the supervising judge's oversight of the *CCAA* voting regime must not only ensure strict compliance with the Act, but should further its goals as well. We are of the view that the policy objectives of the *CCAA* necessitate the recognition of the discretion to bar a creditor from voting where the creditor is acting for an improper purpose.

76 Whether this discretion ought to be exercised in a particular case is a circumstance-specific inquiry that must balance the various objectives of the *CCAA*. As this case demonstrates, the supervising judge is best-positioned to undertake this inquiry.

(3) The Supervising Judge Did Not Err in Prohibiting Callidus From Voting

77 In our view, the supervising judge's decision to bar Callidus from voting on the New Plan discloses no error justifying appellate intervention. As we have explained, discretionary decisions like this one must be approached from the appropriate posture of deference. It bears mentioning that, when he made this decision, the supervising judge was intimately familiar with Bluberi's *CCAA* proceedings. He had presided over them for over 2 years, received 15 reports from the Monitor, and issued approximately 25 orders.

78 The supervising judge considered the whole of the circumstances and concluded that Callidus's vote would serve an improper purpose (paras. 45 and 48). We agree with his determination. He was aware that, prior to the vote on the First Plan, Callidus had chosen not to value *any* of its claim as unsecured and later declined to vote at all — despite the Monitor explicitly inviting it do so[4] . The supervising judge was also aware that Callidus's First Plan had failed to receive the other creditors' approval at the creditors' meeting of December 15, 2017, and that Callidus had chosen not to take the opportunity to amend or increase the value of its plan at that time, which it was entitled to do (see *CCAA*, ss. 6 and 7; Monitor, I.F., at para. 17). Between the failure of the First Plan and the proposal of the New Plan — which was identical to the First Plan, save for a modest increase of $250,000 — none of the factual circumstances relating to Bluberi's financial or business affairs had materially changed. However, Callidus sought to value the *entirety* of its security at *nil* and, on that basis, sought leave to vote on the New Plan as an unsecured creditor. If Callidus were permitted to vote in this way, the New Plan would certainly have met the s. 6(1) threshold for approval. In these circumstances, the inescapable inference was that Callidus was attempting to strategically value its security to acquire control over the outcome of the vote and thereby circumvent the creditor democracy the *CCAA* protects. Put simply, Callidus was seeking to take a "second kick at the can" and manipulate the vote on the New Plan. The supervising judge made no error in exercising his discretion to prevent Callidus from doing so.

79 Indeed, as the Monitor observes, "Once a plan of arrangement or proposal has been submitted to the creditors of a debtor for voting purposes, to order a second creditors' meeting to vote on a substantially similar plan would not advance the policy objectives of the CCAA, nor would it serve and enhance the public's confidence in the process or otherwise serve the ends of justice" (I.F., at para. 18). This is particularly the case given that the cost of having another meeting to vote on the New Plan would have been upwards of $200,000 (see supervising judge's reasons, at para. 72).

80 We add that Callidus's course of action was plainly contrary to the expectation that parties act with due diligence in an insolvency proceeding — which, in our view, includes acting with due diligence in valuing their claims and security. At all material times, Bluberi's Retained Claims have been the sole asset securing Callidus's claim. Callidus has pointed to nothing in the record that indicates that the value of the Retained Claims has changed. Had Callidus been of the view that the Retained Claims had no value, one would have expected Callidus to have valued its security accordingly prior to the vote on the First Plan, if not earlier. Parenthetically, we note that, irrespective of the timing, an attempt at such a valuation may well have failed. This would have prevented Callidus from voting as an unsecured creditor, even in the absence of Callidus's improper purpose.

81 As we have indicated, discretionary decisions attract a highly deferential standard of review. Deference demands that review of a discretionary decision begin with a proper characterization of the basis for the decision. Respectfully, the Court of Appeal failed in this regard. The Court of Appeal seized on the supervising judge's somewhat critical comments relating to Callidus's goal of being released from the Retained Claims and its conduct throughout the proceedings as being incapable of grounding a finding of improper purpose. However, as we have explained, these considerations did not drive the supervising judge's conclusion. His conclusion was squarely based on Callidus' attempt to manipulate the creditors' vote to ensure that

its New Plan would succeed where its First Plan had failed (see supervising judge's reasons, at paras. 45-48). We see nothing in the Court of Appeal's reasons that grapples with this decisive impropriety, which goes far beyond a creditor merely acting in its own self-interest.

82 In sum, we see nothing in the supervising judge's reasons on this point that would justify appellate intervention. Callidus was properly barred from voting on the New Plan.

83 Before moving on, we note that the Court of Appeal addressed two further issues: whether Callidus is "related" to Bluberi within the meaning of s. 22(3) of the *CCAA*; and whether, if permitted to vote, Callidus should be ordered to vote in a separate class from Bluberi's other creditors (see *CCAA*, s. 22(1) and (2)). Given our conclusion that the supervising judge did not err in barring Callidus from voting on the New Plan on the basis that Callidus was acting for an improper purpose, it is unnecessary to address either of these issues. However, nothing in our reasons should be read as endorsing the Court of Appeal's analysis of them.

C. Bluberi's LFA Should Be Approved as Interim Financing

84 In our view, the supervising judge made no error in approving the LFA as interim financing pursuant to s. 11.2 of the *CCAA*. Interim financing is a flexible tool that may take on a range of forms. As we will explain, third party litigation funding may be one such form. Whether third party litigation funding should be approved as interim financing is a case-specific inquiry that should have regard to the text of s. 11.2 and the remedial objectives of the *CCAA* more generally.

(1) Interim Financing and Section 11.2 of the CCAA

85 Interim financing, despite being expressly provided for in s. 11.2 of the *CCAA*, is not defined in the Act. Professor Sarra has described it as "refer[ring] primarily to the working capital that the debtor corporation requires in order to keep operating during restructuring proceedings, as well as to the financing to pay the costs of the workout process" (*Rescue! The Companies' Creditors Arrangement Act*, at p. 197). Interim financing used in this way — sometimes referred to as "debtor-in-possession" financing — protects the going-concern value of the debtor company while it develops a workable solution to its insolvency issues (p. 197; *Royal Oak Mines Inc., Re* (1999), 6 C.B.R. (4th) 314 (Ont. Gen. Div. [Commercial List]), at paras. 7, 9 and 24; *Boutiques San Francisco inc., Re* [2003 CarswellQue 13882 (C.S. Que.)], 2003 CanLII 36955, at para. 32). That said, interim financing is not limited to providing debtor companies with immediate operating capital. Consistent with the remedial objectives of the *CCAA*, interim financing at its core enables the preservation and realization of the value of a debtor's assets.

86 Since 2009, s. 11.2(1) of the *CCAA* has codified a supervising judge's discretion to approve interim financing, and to grant a corresponding security or charge in favour of the lender in the amount the judge considers appropriate:

> **Interim financing**
>
> **11.2 (1)** On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, a court may make an order declaring that all or part of the company's property is subject to a security or charge — in an amount that the court considers appropriate — in favour of a person specified in the order who agrees to lend to the company an amount approved by the court as being required by the company, having regard to its cash-flow statement. The security or charge may not secure an obligation that exists before the order is made.

87 The breadth of a supervising judge's discretion to approve interim financing is apparent from the wording of s. 11.2(1). Aside from the protections regarding notice and pre-filing security, s. 11.2(1) does not mandate any standard form or terms.[5] It simply provides that the financing must be in an amount that is "appropriate" and "required by the company, having regard to its cash-flow statement".

88 The supervising judge may also grant the lender a "super-priority charge" that will rank in priority over the claims of any secured creditors, pursuant to s. 11.2(2):

Priority — secured creditors

(2) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

89 Such charges, also known as "priming liens", reduce lenders' risks, thereby incentivizing them to assist insolvent companies (Innovation, Science and Economic Development Canada, *Archived — Bill C-55: clause by clause analysis*, last updated December 29, 2016 (online), cl. 128, s. 11.2; Wood, at p. 387). As a practical matter, these charges are often the only way to encourage this lending. Normally, a lender protects itself against lending risk by taking a security interest in the borrower's assets. However, debtor companies under *CCAA* protection will often have pledged all or substantially all of their assets to other creditors. Accordingly, without the benefit of a super-priority charge, an interim financing lender would rank behind those other creditors (McElcheran, at pp. 298-99). Although super-priority charges do subordinate secured creditors' security positions to the interim financing lender's — a result that was controversial at common law — Parliament has indicated its general acceptance of the trade-offs associated with these charges by enacting s. 11.2(2) (see M. B. Rotsztain and A. Dostal, "Debtor-In-Possession Financing", in S. Ben-Ishai and A. Duggan, eds., *Canadian Bankruptcy and Insolvency Law: Bill C-55, Statute c. 47 and Beyond* (2007), 227, at pp. 228-229 and 240-50). Indeed, this balance was expressly considered by the Standing Senate Committee on Banking, Trade and Commerce that recommended codifying interim financing in the *CCAA* (pp. 100-4).

90 Ultimately, whether proposed interim financing should be approved is a question that the supervising judge is best-placed to answer. The *CCAA* sets out a number of factors that help guide the exercise of this discretion. The inclusion of these factors in s. 11.2 was informed by the Standing Senate Committee on Banking, Trade and Commerce's view that they would help meet the "fundamental principles" that have guided the development of Canadian insolvency law, including "fairness, predictability and efficiency" (p. 103; see also Innovation, Science and Economic Development Canada, cl. 128, s. 11.2). In deciding whether to grant interim financing, the supervising judge is to consider the following non-exhaustive list of factors:

Factors to be considered

(4) In deciding whether to make an order, the court is to consider, among other things,

(a) the period during which the company is expected to be subject to proceedings under this Act;

(b) how the company's business and financial affairs are to be managed during the proceedings;

(c) whether the company's management has the confidence of its major creditors;

(d) whether the loan would enhance the prospects of a viable compromise or arrangement being made in respect of the company;

(e) the nature and value of the company's property;

(f) whether any creditor would be materially prejudiced as a result of the security or charge; and

(g) the monitor's report referred to in paragraph 23(1)(b), if any.

(*CCAA*, s. 11.2(4))

91 Prior to the coming into force of the above provisions in 2009, courts had been using the general discretion conferred by s. 11 to authorize interim financing and associated super-priority charges (*Century Services*, at para. 62). Section 11.2 largely codifies the approaches those courts have taken (Wood, at p. 388; McElcheran, at p. 301). As a result, where appropriate, guidance may be drawn from the pre-codification interim financing jurisprudence.

92 As with other measures available under the *CCAA*, interim financing is a flexible tool that may take different forms or attract different considerations in each case. Below, we explain that third party litigation funding may, in appropriate cases, be one such form.

(2) Supervising Judges May Approve Third Party Litigation Funding as Interim Financing

93 Third party litigation funding generally involves "a third party, otherwise unconnected to the litigation, agree[ing] to pay some or all of a party's litigation costs, in exchange for a portion of that party's recovery in damages or costs" (R. K. Agarwal and D. Fenton, "Beyond Access to Justice: Litigation Funding Agreements Outside the Class Actions Context" (2017), 59 *Can. Bus. L. J.* 65, at p. 65). Third party litigation funding can take various forms. A common model involves the litigation funder agreeing to pay a plaintiff's disbursements and indemnify the plaintiff in the event of an adverse cost award in exchange for a share of the proceeds of any successful litigation or settlement (see *Dugal v. Manulife Financial Corp.*, 2011 ONSC 1785, 105 O.R. (3d) 364 (Ont. S.C.J.); *Musicians' Pension Fund of Canada (Trustee of)*).

94 Outside of the *CCAA* context, the approval of third party litigation funding agreements has been somewhat controversial. Part of that controversy arises from the potential of these agreements to offend the common law doctrines of champerty and maintenance.[6] The tort of maintenance prohibits "officious intermeddling with a lawsuit which in no way belongs to one" (L. N. Klar et al., *Remedies in Tort* (loose-leaf), vol. 1, by L. Berry, ed., at p. 14-11, citing *Langtry v. Dumoulin* (1885), 7 O.R. 644 (Ont. Div. Ct.), at p. 661). Champerty is a species of maintenance that involves an agreement to share in the proceeds or otherwise profit from a successful suit (*McIntyre Estate v. Ontario (Attorney General)* (2002), 218 D.L.R. (4th) 193 (Ont. C.A.), at para. 26).

95 Building on jurisprudence holding that *contingency fee* arrangements are not champertous where they are not motivated by an improper purpose (e.g., *McIntyre Estate*), lower courts have increasingly come to recognize that *litigation funding* agreements are also not *per se* champertous. This development has been focussed within class action proceedings, where it arose as a response to barriers like adverse cost awards, which were stymieing litigants' access to justice (see *Dugal*, at para. 33; *Marcotte c. Banque de Montréal*, 2015 QCCS 1915 (C.S. Que.), at paras. 43-44 (CanLII); *Houle v. St. Jude Medical Inc.*, 2017 ONSC 5129, 9 C.P.C. (8th) 321 (Ont. S.C.J.), at para. 52, aff'd 2018 ONSC 6352, 429 D.L.R. (4th) 739 (Ont. Div. Ct.); see also *Stanway v. Wyeth Canada Inc.*, 2013 BCSC 1585, 56 B.C.L.R. (5th) 192 (B.C. S.C.), at para. 13). The jurisprudence on the approval of third party litigation funding agreements in the class action context — and indeed, the parameters of their legality generally — is still evolving, and no party before this Court has invited us to evaluate it.

96 That said, insofar as third party litigation funding agreements are not *per se* illegal, there is no principled basis upon which to restrict supervising judges from approving such agreements as interim financing in appropriate cases. We acknowledge that this funding differs from more common forms of interim financing that are simply designed to help the debtor "keep the lights on" (see *Royal Oak*, at paras. 7 and 24). However, in circumstances like the case at bar, where there is a single litigation asset that could be monetized for the benefit of creditors, the objective of maximizing creditor recovery has taken centre stage. In those circumstances, litigation funding furthers the basic purpose of interim financing: allowing the debtor to realize on the value of its assets.

97 We conclude that third party litigation funding agreements may be approved as interim financing in *CCAA* proceedings when the supervising judge determines that doing so would be fair and appropriate, having regard to all the circumstances and the objectives of the Act. This requires consideration of the specific factors set out in s. 11.2(4) of the *CCAA*. That said, these factors need not be mechanically applied or individually reviewed by the supervising judge. Indeed, not all of them will be significant in every case, nor are they exhaustive. Further guidance may be drawn from other areas in which third party litigation funding agreements have been approved.

98 The foregoing is consistent with the practice that is already occurring in lower courts. Most notably, in *Crystallex*, the Ontario Court of Appeal approved a third party litigation funding agreement in circumstances substantially similar to the case at bar. *Crystallex* involved a mining company that had the right to develop a large gold deposit in Venezuela. Crystallex eventually became insolvent and (similar to Bluberi) was left with only a single significant asset: a US$3.4 billion arbitration claim against Venezuela. After entering *CCAA* protection, Crystallex sought the approval of a third party litigation funding agreement. The agreement contemplated that the lender would advance substantial funds to finance the arbitration in exchange for, among other things, a percentage of the net proceeds of any award or settlement. The supervising judge

approved the agreement as interim financing pursuant to s. 11.2. The Court of Appeal unanimously found no error in the supervising judge's exercise of discretion. It concluded that s. 11.2 "does not restrict the ability of the supervising judge, where appropriate, to approve the grant of a charge securing financing before a plan is approved that may continue after the company emerges from CCAA protection" (para. 68).

99 A key argument raised by the creditors in *Crystallex* — and one that Callidus and the Creditors' Group have put before us now — was that the litigation funding agreement at issue was a plan of arrangement and not interim financing. This was significant because, if the agreement was in fact a plan, it would have had to be put to a creditors' vote pursuant to ss. 4 and 5 of the *CCAA* prior to receiving court approval. The court in *Crystallex* rejected this argument, as do we.

100 There is no definition of plan of arrangement in the *CCAA*. In fact, the *CCAA* does not refer to plans at all — it only refers to an "arrangement" or "compromise" (see ss. 4 and 5). The authors of *Bankruptcy and Insolvency Law of Canada* offer the following general definition of these terms, relying on early English case law:

> A "compromise" presupposes some dispute about the rights compromised and a settling of that dispute on terms that are satisfactory to the debtor and the creditor. An agreement to accept less than 100¢ on the dollar would be a compromise where the debtor disputes the debt or lacks the means to pay it. "Arrangement" is a broader word than "compromise" and is not limited to something analogous to a compromise. It would include any scheme for reorganizing the affairs of the debtor: *Re Guardian Assur. Co.*, [1917] 1 Ch. 431, 61 Sol. Jo 232, [1917] H.B.R. 113 (C.A.); *Re Refund of Dues under Timber Regulations*, [1935] A.C. 185 (P.C.).
>
> (Houlden, Morawetz and Sarra, at N§33)

101 The apparent breadth of these terms notwithstanding, they do have some limits. More recent jurisprudence suggests that they require, at minimum, some compromise of creditors' rights. For example, in C*rystallex* the litigation funding agreement at issue (known as the Tenor DIP facility) was held not to be a plan of arrangement because it did not "compromise the terms of [the creditors'] indebtedness or take away ... their legal rights" (para. 93). The Court of Appeal adopted the following reasoning from the lower court's decision, with which we substantially agree:

> A "plan of arrangement" or a "compromise" is not defined in the CCAA. It is, however, to be an arrangement or compromise between a debtor and its creditors. The Tenor DIP facility is not on its face such an arrangement or compromise between Crystallex and its creditors. Importantly the rights of the noteholders are not taken away from them by the Tenor DIP facility. The noteholders are unsecured creditors. Their rights are to sue to judgment and enforce the judgment. If not paid, they have a right to apply for a bankruptcy order under the BIA. Under the CCAA, they have the right to vote on a plan of arrangement or compromise. None of these rights are taken away by the Tenor DIP.
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> (*Crystallex International Corp., Re*, 2012 ONSC 2125, 91 C.B.R. (5th) 169 (Ont. S.C.J. [Commercial List]), at para. 50)

102 Setting out an exhaustive definition of plan of arrangement or compromise is unnecessary to resolve these appeals. For our purposes, it is sufficient to conclude that plans of arrangement require at least some compromise of creditors' rights. It follows that a third party litigation funding agreement aimed at extending financing to a debtor company to realize on the value of a litigation asset does not necessarily constitute a plan of arrangement. We would leave it to supervising judges to determine whether, in the particular circumstances of the case before them, a particular third party litigation funding agreement contains terms that effectively convert it into a plan of arrangement. So long as the agreement does not contain such terms, it may be approved as interim financing pursuant to s. 11.2 of the *CCAA*.

103 We add that there may be circumstances in which a third party litigation funding agreement may contain or incorporate a plan of arrangement (e.g., if it contemplates a plan for distribution of litigation proceeds among creditors). Alternatively, a supervising judge may determine that, despite an agreement itself not being a plan of arrangement, it should be packaged with a plan and submitted to a creditors' vote. That said, we repeat that third party litigation funding agreements are not necessarily, or even generally, plans of arrangement.

104 None of the foregoing is seriously contested before us. The parties essentially agree that third party litigation funding

agreements *can* be approved as interim financing. The dispute between them focusses on whether the supervising judge erred in exercising his discretion to approve the LFA in the absence of a vote of the creditors, either because it was a plan of arrangement or because it should have been accompanied by a plan of arrangement. We turn to these issues now.

(3) The Supervising Judge Did Not Err in Approving the LFA

105 In our view, there is no basis upon which to interfere with the supervising judge's exercise of his discretion to approve the LFA as interim financing. The supervising judge considered the LFA to be fair and reasonable, drawing guidance from the principles relevant to approving similar agreements in the class action context (para. 74, citing ***Musicians' Pension Fund of Canada (Trustee of)***, at para. 41; ***Hayes***, at para. 4). In particular, he canvassed the terms upon which Bentham and Bluberi's lawyers would be paid in the event the litigation was successful, the risks they were taking by investing in the litigation, and the extent of Bentham's control over the litigation going forward (paras. 79 and 81). The supervising judge also considered the unique objectives of *CCAA* proceedings in distinguishing the LFA from ostensibly similar agreements that had not received approval in the class action context (paras. 81-82, distinguishing ***Houle***). His consideration of those objectives is also apparent from his reliance on ***Crystallex***, which, as we have explained, involved the approval of interim financing in circumstances substantially similar to the case at bar (see paras. 67 and 71). We see no error in principle or unreasonableness to this approach.

106 While the supervising judge did not canvass each of the factors set out in s. 11.2(4) of the *CCAA* individually before reaching his conclusion, this was not itself an error. A review of the supervising judge's reasons as a whole, combined with a recognition of his manifest experience with Bluberi's *CCAA* proceedings, leads us to conclude that the factors listed in s. 11.2(4) concern matters that could not have escaped his attention and due consideration. It bears repeating that, at the time of his decision, the supervising judge had been seized of these proceedings for well over two years and had the benefit of the Monitor's assistance. With respect to each of the s. 11.2(4) factors, we note that:

- the judge's supervisory role would have made him aware of the potential length of Bluberi's *CCAA* proceedings and the extent of creditor support for Bluberi's management (s. 11.2(4)(a) and (c)), though we observe that these factors appear to be less significant than the others in the context of this particular case (see para. 96);

- the LFA itself explains "how the company's business and financial affairs are to be managed during the proceedings" (s. 11.2(4)(b));

- the supervising judge was of the view that the LFA would enhance the prospect of a viable plan, as he accepted (1) that Bluberi intended to submit a plan and (2) Bluberi's submission that approval of the LFA would assist it in finalizing a plan "with a view towards achieving maximum realization" of its assets (at para. 68, citing 9354-9186 Québec inc. and 9354-9178 Québec inc.'s application, at para. 99; s. 11.2(4)(d));

- the supervising judge was apprised of the "nature and value" of Bluberi's property, which was clearly limited to the Retained Claims (s. 11.2(4)(e));

- the supervising judge implicitly concluded that the creditors would not be materially prejudiced by the Litigation Financing Charge, as he stated that "[c]onsidering the results of the vote [on the First Plan], and given the particular circumstances of this matter, *the only potential recovery* lies with the lawsuit that the Debtors will launch" (at para. 91 (emphasis added); s. 11.2(4)(f)); and

- the supervising judge was also well aware of the Monitor's reports, and drew from the most recent report at various points in his reasons (see, e.g., paras. 64-65 and fn. 1; s. 11.2(4)(g)). It is worth noting that the Monitor supported approving the LFA as interim financing.

107 In our view, it is apparent that the supervising judge was focussed on the fairness at stake to all parties, the specific objectives of the *CCAA*, and the particular circumstances of this case when he approved the LFA as interim financing. We cannot say that he erred in the exercise of his discretion. Although we are unsure whether the LFA was as favourable to Bluberi's creditors as it might have been — to some extent, it does prioritize Bentham's recovery over theirs — we nonetheless defer to the supervising judge's exercise of discretion.

108 To the extent the Court of Appeal held otherwise, we respectfully do not agree. Generally speaking, our view is that the Court of Appeal again failed to afford the supervising judge the necessary deference. More specifically, we wish to comment on three of the purported errors in the supervising judge's decision that the Court of Appeal identified.

109 First, it follows from our conclusion that LFAs can constitute interim financing that the Court of Appeal was incorrect to hold that approving the LFA as interim financing "transcended the nature of such financing" (para. 78).

110 Second, in our view, the Court of Appeal was wrong to conclude that the LFA was a plan of arrangement, and that *Crystallex* was distinguishable on its facts. The Court of Appeal held that the LFA and associated super-priority Litigation Financing Charge formed a plan because they subordinated the rights of Bluberi's creditors to those of Bentham.

111 We agree with the supervising judge that the LFA is not a plan of arrangement because it does not propose any compromise of the creditors' rights. To borrow from the Court of Appeal in *Crystallex*, Bluberi's litigation claim is akin to a "pot of gold" (para. 4). Plans of arrangement determine how to distribute that pot. They do not generally determine what a debtor company should do to fill it. The fact that the creditors may walk away with more or less money at the end of the day does not change the nature or existence of their rights to access the pot once it is filled, nor can it be said to "compromise" those rights. When the "pot of gold" is secure — that is, in the event of any litigation or settlement — the net funds will be distributed to the creditors. Here, if the Retained Claims generate funds in excess of Bluberi's total liabilities, the creditors will be paid in full; if there is a shortfall, a plan of arrangement or compromise will determine how the funds are distributed. Bluberi has committed to proposing such a plan (see supervising judge's reasons, at para. 68, distinguishing *Cliffs Over Maple Bay Investments Ltd. v. Fisgard Capital Corp.*, 2008 BCCA 327, 296 D.L.R. (4th) 577 (B.C. C.A.)).

112 This is the very same conclusion that was reached in *Crystallex* in similar circumstances:

> The facts of this case are unusual: there is a single "pot of gold" asset which, if realized, will provide significantly more than required to repay the creditors. The supervising judge was in the best position to balance the interests of all stakeholders. I am of the view that the supervising judge's exercise of discretion in approving the Tenor DIP Loan was reasonable and appropriate, despite having the effect of constraining the negotiating position of the creditors.
>
> . . . . .
>
> ... While the approval of the Tenor DIP Loan affected the Noteholders' leverage in negotiating a plan, and has made the negotiation of a plan more complex, it did not compromise the terms of their indebtedness or take away any of their legal rights. It is accordingly not an arrangement, and a creditor vote was not required. [paras. 82 and 93]

113 We disagree with the Court of Appeal that *Crystallex* should be distinguished on the basis that it involved a single option for creditor recovery (i.e., the arbitration) while this case involves two (i.e., litigation of the Retained Claims and Callidus's New Plan). Given the supervising judge's conclusion that Callidus could not vote on the New Plan, that plan was not a viable alternative to the LFA. This left the LFA and litigation of the Retained Claims as the "only potential recovery" for Bluberi's creditors (supervising judge's reasons, at para. 91). Perhaps more significantly, even if there were multiple options for creditor recovery in either *Crystallex* or this case, the mere presence of those options would not necessarily have changed the character of the third party litigation funding agreements at issue or converted them into plans of arrangement. The question for the supervising judge in each case is whether the agreement before them ought to be approved as interim financing. While other options for creditor recovery may be relevant to that discretionary decision, they are not determinative.

114 We add that the Litigation Financing Charge does not convert the LFA into a plan of arrangement by "subordinat[ing]" creditors' rights (C.A. reasons, at para. 90). We accept that this charge would have the effect of placing secured creditors like Callidus behind in priority to Bentham. However, this result is expressly provided for in s. 11.2 of the *CCAA*. This "subordination" does not convert statutorily authorized interim financing into a plan of arrangement. Accepting this interpretation would effectively extinguish the supervising judge's authority to approve these charges without a creditors' vote pursuant to s. 11.2(2).

115 Third, we are of the view that the Court of Appeal was wrong to decide that the supervising judge should have submitted the LFA together with a plan to the creditors for their approval (para. 89). As we have indicated, whether to insist

that a debtor package their third party litigation funding agreement with a plan is a discretionary decision for the supervising judge to make.

116 Finally, at the appellants' insistence, we point out that the Court of Appeal's suggestion that the LFA is somehow "akin to an equity investment" was unhelpful and potentially confusing (para. 90). That said, this characterization was clearly *obiter dictum*. To the extent that the Court of Appeal relied on it as support for the conclusion that the LFA was a plan of arrangement, we have already explained why we believe the Court of Appeal was mistaken on this point.

VI. Conclusion

117 For these reasons, at the conclusion of the hearing we allowed these appeals and reinstated the supervising judge's order. Costs were awarded to the appellants in this Court and the Court of Appeal.

Footnotes

1 Bluberi does not appear to have filed this claim yet (see 2018 QCCS 1040 (C.S. Que.), at para. 10 (CanLII)).

2 Notably, the Creditors' Group advised Callidus that it would lend its support to the New Plan. It also asked Callidus to reimburse any legal fees incurred in association with that support. At the same time, the Creditors' Group did not undertake to vote in any particular way, and confirmed that each of its members would assess all available alternatives individually.

3 We note that while s. 36 now codifies the jurisdiction of a supervising court to grant a sale and vesting order, and enumerates factors to guide the court's discretion to grant such an order, it is silent on when courts ought to approve a liquidation under the *CCAA* as opposed to requiring the parties to proceed to liquidation under a receivership or the *BIA* regime (see Sarra, *Rescue! The Companies' Creditors Arrangement Act*, at pp. 167-68; A. Nocilla, "Asset Sales Under the Companies' Creditors Arrangement Act and the Failure of Section 36" (2012) 52 *Can. Bus. L.J.* 226, at pp. 243-44 and 247). This issue remains an open question and was not put to this Court in either *Indalex* or these appeals.

4 It bears noting that the Monitor's statement in this regard did not decide whether Callidus would ultimately have been entitled to vote on the First Plan. Because Callidus did not even attempt to vote on the First Plan, this question was never put to the supervising judge.

5 A further exception has been codified in the 2019 amendments to the *CCAA*, which create s. 11.2(5) (see *Budget Implementation Act, 2019, No. 1*, s. 138). This section provides that at the time an initial order is sought, "no order shall be made under subsection [11.2](1) unless the court is also satisfied that the terms of the loan are limited to what is reasonably necessary for the continued operations of the debtor company in the ordinary course of business during that period". This provision does not apply in this case, and the parties have not relied on it. However, it may be that it restricts the ability of supervising judges to approve LFAs as interim financing at the time of granting an Initial Order.

6 The extent of this controversy varies by province. In Ontario, champertous agreements are forbidden by statute (see *An Act respecting Champerty*, R.S.O. 1897, c. 327). In Quebec, concerns associated with champerty and maintenance do not arise as acutely because champerty and maintenance are not part of the law as such (see *Pole Lite ltée c. Banque Nationale du Canada*, 2006 QCCA 557, [2006] R.J.Q. 1009 (C.A. Que.); G. Michaud, "New Frontier: The Emergence of Litigation Funding in the Canadian Insolvency Landscape" in J. P. Sarra et al., eds., *Annual Review of Insolvency Law 2018* (2019), 221, at p. 231).

1991 CarswellBC 499
British Columbia Court of Appeal

Bank of Montreal v. Guarantee Co. of North America

1991 CarswellBC 499, [1991] B.C.W.L.D. 2574, 11 W.A.C. 218, 29 A.C.W.S. (3d) 999, 5 B.C.A.C. 218, 60 B.C.L.R. (2d) 327, 8 C.B.R. (3d) 214

BANK OF MONTREAL v. GUARANTEE COMPANY OF NORTH AMERICA

Toy, Hollinrake and Goldie JJ.A.

Judgment: October 23, 1991
Docket: Doc. Vancouver CA013260

Counsel: *M.A. Clemens*, for appellant.
P.G. Foy and *S.E. Weafer*, for respondent.

Subject: Corporate and Commercial; Insolvency; Contracts

Related Abridgment Classifications

Personal property
III Choses in action
III.9 Priorities
III.9.a Between assignees

Headnote

Choses in Action --- Priorities — Between assignees

Assignments — Validity — Provision in deed of indemnity with respect to payments due to indemnitor under contracts, that party in whose favour deed made "shall be subrogated to all of the rights and properties of the Indemnitor", not constituting assignment.

O Ltd., a contractor and a customer of the plaintiff bank, executed a general assignment of book debts in favour of the plaintiff in 1976. In 1983, O Ltd. executed a deed of indemnity in favour of the defendant, a company that provided labour and material and performance bonds to contractors. The deed of indemnity provided that "the Indemnitor ... agrees in the event of any breach or default on his part in any of the provisions of said contract and/or bond that the said Company, shall be subrogated to all of the rights and properties of the Indemnitor in such contract."

In 1986, O Ltd. was unable to meet its obligations under a contract, and called on the defendant to see that the contract was completed. Later that year, the plaintiff made a demand on O Ltd. for its outstanding indebtedness. The plaintiff and O Ltd. served notices of assignment on the project owner. The defendant took the position that the deed of indemnity, coupled with the specific performance bond entered into with respect to the contract, constituted an assignment from O Ltd. to it of all moneys owing by the owner under the contract. It asserted that the assignment was a specific one not requiring registration under the *Book Accounts Assignment Act* (B.C.), that the moneys due to O Ltd. from the owner were not "book accounts" within that Act, and that the defendant gave notice of its assignment to the owner before the plaintiff did. The plaintiff's application for a declaration that it was entitled to the money was dismissed, and the plaintiff appealed.

Held:

The appeal was allowed.

The words in the deed of indemnity quoted above did not constitute an assignment; rather, they meant that the defendant was subrogated to the rights of the contractor when it came to calling for payments due under the construction contract.

Table of Authorities

Statutes considered:

Book Accounts Assignment Act, R.S.B.C. 1979, c. 32.

Financial Administration Act, R.S.C. 1985, c. F-11.

Rules considered:

British Columbia, Rules of Court (1990) —

R. 18A

Appeal from judgment of Skipp J., (1990), 4 C.B.R. (3d) 167, 42 C.L.R. 129 (B.C. S.C.) , dismissing plaintiff's application for declaration of trust with respect to moneys held by defendant.

Hollinrake J.A. **(orally) (Excerpt from the transcript):**

1 In this case a chambers judge on a R. 18A application by the plaintiff appellant dismissed its motion for judgment for a declaration that the respondent holds the sum of $40,527.05 in trust for it and for an order that the respondent pay this sum to the bank with court-ordered interest [(1990), 4 C.B.R. (3d) 167, 42 C.L.R. 129 (B.C. S.C.)].

2 Briefly, this is what happened.

3 Oord's Construction Ltd. was a customer of the Bank of Montreal and on September 30, 1976 had executed in favour of the bank a general assignment of book debts, which assignment was registered at the office of the Registrar of Companies.

4 On July 26, 1983, Oord's executed in favour of Guarantee Company of North America a deed of indemnity. Guarantee was a company who provided labour and material and performance bonds to contractors.

5 In July 1986, Oord's contracted with the R.C.M.P. to construct facilities for it in Hazelton, British Columbia. In that same month Oord's entered into separate labour and material and performance bonds with Guarantee relating to the New Hazelton contract.

6 Oord's was unable to meet its obligations under this contract and called on Guarantee to see to it that the contract was completed, which was done by Guarantee.

7 On November 20, 1986, the bank made demand on Oord's for its outstanding indebtedness, which at that time was $408,551.21. At this time, the R.C.M.P. owed Oord's for work done $48,865.

8 Both the bank and Oord's served notices of assignment on the R.C.M.P.

9 On November 21, 1986, Oord's corresponded with Guarantee and that letter said in part:

> Oord's acknowledges that it has executed a deed of indemnity dated July 26, 1983 and confirms the undertakings and agreement given by Oord's in favour of Guarantee Co. in the said deed of indemnity. In particular, without limiting the

> generality of such undertakings and agreements, Oord acknowledges the rights of Guarantee Co. as set out in paragraph 8 therein respecting the assignment granted to Guarantee Co.; and Oord's agrees that Guarantee C. has the right to give notice of the assignment to any or all of the obligees per Appendix 'A'

.

10 The R.C.M.P. paid the funds to Guarantee.

11 Guarantee's position is and was that the deed of indemnity, coupled with the specific bond for Oord's New Hazelton contract, was an assignment from Oord's to it, in this case, of all moneys owing by the R.C.M.P. under the construction contract.

12 Guarantee asserts that this assignment was a specific one not requiring registration under the *Book Accounts Assignment Act*, R.S.B.C. 1979, c. 32; that the moneys due to Oord's from the R.C.M.P. were not "book accounts" within that Act and that Guarantee gave notice of its assignment to the R.C.M.P. before the bank did. The learned chambers judge found in favour of Guarantee on all of these issues. Before us, Guarantee also asserted that the decision of the chambers judge could be upheld on the ground that Guarantee had the only valid assignment of a Crown debt. This argument is based on the assertion by Guarantee that it, and it only, gave notice within the provisions of the *Financial Administration Act*, R.S.C. 1985, c. F-11. That ground was rejected by the chambers judge. Guarantee asserts that by acknowledging the receipt of Guarantee's notice and paying the funds to it the R.C.M.P. had waived non-compliance under the *Financial Administration Act*.

13 The first issue to be decided is whether the Guarantee deed of indemnity executed by Oord's on July 26, 1983 was an assignment.

14 The chambers judge held that [at p. 172 C.B.R.]:

> this deed of indemnity constitutes a specific assignment to Guarantee of the moneys due Oord on any contract on which it has defaulted and on which contract Guarantee has issued a performance bond.

15 If the appellant succeeds on the submission that this deed of indemnity does not constitute an assignment, that is the end of the matter and the appellant must succeed on this appeal.

16 The relevant clause in the deed of indemnity is cl. 8, which I reproduce in full:

> That in the event any such bond be given in connection with a contract of the Indemnitor for construction work, the Indemnitor hereby dedicates all plant and material owned or acquired by it and used the performance of such contract to the performance of the same and further agrees in the event of failure to complete or carry on such contract and to assign and does hereby assign to the Company, all right, title and interest of the Indemnitor in and to all the tools, plant, equipment and materials of every nature and description that the Indemnitor may have upon the work provided for in the said contract, or in, on or about the site thereof, including well materials purchased for or chargeable to such contract, which may be in process of construction, on storage elsewhere, or in transportation to said site; and the Indemnitor further agrees to assign and does hereby assign to said Company, all of the former's rights in and to all sub-contracts which may be entered into and any materials embraced therein appertaining to said contract; and *the Indemnitor furthers agrees in the event of any breach or default on his part in any of the provisions of said contract and/or bond that the said Company, shall be subrogated to all of the rights and properties of the Indemnitor in such contract, including deferred and reserve payments, current and earned estimates and final payments, current and earned estimates and final payments, and any and all monies and securities that may be due and payable at the time of such default on said contract or any other contract of the Indemnitor or any one or more of them on which the Company is or may become surety, or on account of extra work or materials supplied in connection therewith, or that may thereafter become due and payable on account of said contract or any other contract of the Indemnitor on which the Company is or may become surety. And the Indemnitor hereby authorized the Company to endorse in the name of the payee, and to collect any check, draft, warrant or other instrument made or issue in payment of any moneys due on such contracts and to disburse the proceeds thereof.*

[Emphasis added.]

17 The appellant submits, insofar as these funds are concerned, Guarantee is only subrogated to the rights of Oord's to claim them from the R.C.M.P. It is conceded that as between Oord's and the bank the bank is entitled to these funds under its general assignment of book debts.

18 Guarantee submits that on an overview of the evidence as a whole it is apparent that it was the intention of both Oord's and Guarantee that this deed of indemnity was an assignment of these funds. It points to the letter of November 21, 1986 from Oord's to Guarantee, in which Oord's acknowledges:

> the rights of the Guarantee Co. as set out in paragraph 8 therein respecting the assignment granted to Guarantee Co.; and Oord's agrees that Guarantee Co. has the right to give notice of the assignment to any or all of the Obligees per Appendix 'A'.

19 Citing authority, counsel for Guarantee submits that to be in law an assignment the word assignment need not be used to deem that assignment legal or equitable. He reminds us that it is much easier to find an equitable assignment than a legal one and submits that if this deed of indemnity does not create a legal assignment the court should find an equitable one. Counsel submits that dealings between the parties lead to the inference that this is an equitable assignment.

20 I found the submissions of counsel for Guarantee compelling but with respect, in my opinion, they fall on the words "shall be subrogated" in cl. 8 of the deed of indemnity.

21 I agree with the submissions made on behalf of the appellant that, insofar as these funds are concerned, cl. 8 does not constitute an assignment, rather, only subrogates Guarantee to the rights of Oord's when it comes to calling for payment of these funds by the R.C.M.P.

22 Clause 8 specifically refers to assignments of the interest of the indemnitor (Oord's) to all tools and equipment and to rights in subcontracts but when it turns to payments under the contract it says "shall be subrogated to all of the rights and properties of the indemnitor."

23 In my opinion, the closing words of cl. 8 wherein the indemnitor authorizes Guarantee to endorse in the name of the payee and to collect cheques is consistent with the right of subrogation and is inconsistent with an unqualified assignment.

24 On behalf of the appellant, it is submitted that subrogation does not equate to assignment, citing *MacGillivray & Parkington on Insurance Law*, 8th ed., para. 1161, where it says:

> Difference between subrogation and assignment. Both subrogation and assignment permit one party to enjoy the rights of another, but it is well-established that subrogation is not a species of assignment. Rights of subrogation vest by operation of law rather than as the product of express agreement. Whereas rights of subrogation can be enjoyed by the insurer as soon as payment is made, an assignment requires an agreement that the rights of the assured be assigned to the insurer. The insurer cannot require the assured to assign to him his rights against third parties as a condition of payment unless there is a special clause in the policy obliging the assured to do so. This distinction is of some importance, since in certain circumstances an insurer might prefer to take an assignment of an assured's rights rather than rely upon his rights of subrogation. If, for example, there was any prospect of the insured being able to recover more than his actual loss from a third party, an insurer, who had taken an assignment of the assured's rights, would be able to recover the extra money for himself whereas an insurer who was confined to rights of subrogation would have to allow the assured to retain the excess.

25 I add here that while rights of subrogation usually arise by operation of law there is nothing to prevent those same rights arising by express agreement, as is the case here. I agree there is a very real difference between a person exercising a right of subrogation as opposed to a right arising from an assignment.

26 I conclude that the right of Guarantee to these funds, being a subrogated one, is the same as the right of Oord's and, as

between Oord's and the bank, the bank is entitled to these funds under the general assignment of book debts.

27 I would allow the appeal.

***Toy J.A.*:**

28 I agree.

***Goldie J.A.*:**

29 I agree.

***Toy J.A.*:**

30 The appeal is allowed accordingly.

Appeal allowed.

2011 ONSC 7522, 2011 CarswellOnt 14402, 210 A.C.W.S. (3d) 575, 88 C.B.R. (5th) 329

Most Negative Treatment: Check subsequent history and related treatments.

2011 ONSC 7522
Ontario Superior Court of Justice [Commercial List]

Clothing for Modern Times Ltd., Re

2011 CarswellOnt 14402, 2011 ONSC 7522, 210 A.C.W.S. (3d) 575, 88 C.B.R. (5th) 329

In the Matter of the Notice of Intention to make a Proposal of Clothing for Modern Times Ltd.

D.M. Brown J.

Heard: December 16, 2011
Judgment: December 16, 2011
Docket: 31-1513595

Counsel: M. Poliak, H. Chaiton for Applicant
M. Forte for A. Farber & Partners Inc., the Proposal Trustee and Proposed Monitor
I. Aversa for Roynat Asset Finance
D. Bish for Cadillac Fairview
L. Galessiere for Ivanhoe Cambridge Inc., Oxford Properties Group Inc., Primaris Retail Estate Investment Trust, Morguard Investment Limited, 20 VIC Management Inc.
M. Weinczuk for 7951388 Canada Inc.

Subject: Insolvency

Related Abridgment Classifications

Bankruptcy and insolvency
XIX Companies' Creditors Arrangement Act
XIX.5 Miscellaneous

Headnote

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Miscellaneous
Continuation of Bankruptcy and Insolvency Act (BIA) proposal proceedings under Companies' Creditors Arrangement Act (CCAA) — Debtor company filed notice of intention to make proposal pursuant to s. 50.4 of BIA — Time to file proposal was running out and no further extensions of time to file proposal were available to debtor under BIA — Debtor brought motion to continue BIA proposal proceedings under CCAA — Motion granted — Debtor had not filed proposal — Continuation to enable going-concern sale of part of debtor's business would be consistent with purposes of CCAA — Debtor filed cash flow statements which showed net positive cash flow for period and that debtor had sufficient resources to continue operating in CCAA proceeding, as well as to conduct sale process without need for additional financing — Proposal Trustee regarded cash flow statements as reasonable — Previous extension orders made under s. 50.4(9) of BIA indicated that debtor established it had been acting in good faith and with due diligence.

Table of Authorities

Cases considered by *D.M. Brown J.*:

Brainhunter Inc., Re (2009), 62 C.B.R. (5th) 41, 2009 CarswellOnt 8207 (Ont. S.C.J. [Commercial List]) — referred to

Consumers Packaging Inc., Re (2001), 150 O.A.C. 384, 27 C.B.R. (4th) 197, 2001 CarswellOnt 3482, 12 C.P.C. (5th) 208 (Ont. C.A.) — considered

Nortel Networks Corp., Re (2009), 2009 CarswellOnt 4467, 55 C.B.R. (5th) 229 (Ont. S.C.J. [Commercial List]) — followed

Sierra Club of Canada v. Canada (Minister of Finance) (2002), 287 N.R. 203, *(*sub nom. *Atomic Energy of Canada Ltd. v. Sierra Club of Canada)* 18 C.P.R. (4th) 1, 44 C.E.L.R. (N.S.) 161, *(*sub nom. *Atomic Energy of Canada Ltd. v. Sierra Club of Canada)* 211 D.L.R. (4th) 193, 223 F.T.R. 137 (note), 20 C.P.C. (5th) 1, 40 Admin. L.R. (3d) 1, 2002 SCC 41, 2002 CarswellNat 822, 2002 CarswellNat 823, *(*sub nom. *Atomic Energy of Canada Ltd. v. Sierra Club of Canada)* 93 C.R.R. (2d) 219, [2002] 2 S.C.R. 522 (S.C.C.) — followed

Stelco Inc., Re (2004), 2004 CarswellOnt 4084, 6 C.B.R. (5th) 316 (Ont. S.C.J. [Commercial List]) — considered

Ted Leroy Trucking Ltd., Re (2010), *(*sub nom. *Century Services Inc. v. Canada (A.G.))* [2010] 3 S.C.R. 379, [2010] G.S.T.C. 186, 12 B.C.L.R. (5th) 1, *(*sub nom. *Century Services Inc. v. A.G. of Canada)* 2011 G.T.C. 2006 (Eng.), *(*sub nom. *Century Services Inc. v. A.G. of Canada)* 2011 D.T.C. 5006 (Eng.), *(*sub nom. *Leroy (Ted) Trucking Ltd., Re)* 503 W.A.C. 1, *(*sub nom. *Leroy (Ted) Trucking Ltd., Re)* 296 B.C.A.C. 1, 2010 SCC 60, 2010 CarswellBC 3419, 2010 CarswellBC 3420, 409 N.R. 201, *(*sub nom. *Ted LeRoy Trucking Ltd., Re)* 326 D.L.R. (4th) 577, 72 C.B.R. (5th) 170, [2011] 2 W.W.R. 383 (S.C.C.) — followed

Statutes considered:

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

Pt. III — referred to

s. 50.4 [en. 1992, c. 27, s. 19] — pursuant to

s. 50.4(9) [en. 1992, c. 27, s. 19] — considered

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

s. 10(2) — considered

s. 11.52 [en. 2005, c. 47, s. 128] — referred to

s. 11.6 [en. 1997, c. 12, s. 124] — considered

s. 11.6(a) [en. 1997, c. 12, s. 124] — pursuant to

MOTION by debtor company to continue *Bankruptcy and Insolvency Act* proposal proceedings under *Companies' Creditors Arrangement Act*.

***D.M. Brown J.*:**

I. Motion to continue BIA Part III proposal proceedings under the CCAA

1 Clothing for Modern Times Ltd. ("CMT"), a retailer of fashion apparel, filed a Notice of Intention to Make a Proposal pursuant to section 50.4 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, on June 27, 2011. A. Farber & Partners Inc. was appointed CMT's proposal trustee. At the time of the filing of the NOI CMT operated 116 retail stores from leased

locations across Canada. CMT sold fashion apparel under the trade names Urban Behavior, Costa Blanca and Costa Blanca X.

2 CMT has obtained from this Court several extensions of time to file a proposal. That time will expire on December 22, 2011. Under section 50.4(9) of the *BIA*, no further extensions are possible.

3 Accordingly, CMT moves under section 11.6(a) of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 for an order, effective December 22, 2011, continuing CMT's restructuring proceeding under the *CCAA* and granting an Initial Order, as well as approving a sale process as a going concern for part of CMT's business.

II. Key background events

4 Following the filing of the NOI, pursuant to orders of this Court, CMT conducted a self-liquidation of underperforming stores across Canada and, as well, a going-concern sale of its Urban Behavior business. The latter transaction is scheduled to close on January 16, 2012.

5 At the time of the filing of the NOI there were three major secured creditors of CMT: Roynat Asset Finance, CIC Asset Management Inc., and CMT Sourcing. The company's indebtedness to those creditors totaled approximately $28.3 million. CMT anticipates that the proceeds from the Urban Behavior transaction and the liquidation of under-performing stores will prove sufficient to repay its loan obligations to Roynat in full before the expiration of a forbearance period on January 16, 2012.

6 When CMT was last in court on November 7, 2011 it stated it intended to make a proposal to its unsecured creditors, an intention supported by the two remaining secured creditors, CIC and CMT Sourcing. Subsequently CMT met with representatives of certain landlords and commenced discussions about its proposed restructuring plan. As a result of those discussions CMT lacks the confidence that its proposal would be approved by the requisite majority of its unsecured creditors, and it does not believe that it can make a viable proposal to its creditors. Instead, CMT thinks that a going-concern sale of its Costa Blanca business would be in the best interests of stakeholders and would preserve employment for about 500 remaining employees, both full-time and hourly retail staff.

7 In its Sixth Report dated December 14, 2011 Farber agrees that a going concern sale of the Costa Blanca business would be in the best interests of CMT's stakeholders, maximize recoveries to the two secured creditors, CIC and CMT Sourcing, and preserve employment for CMT's remaining employees. Farber supports CMT's request to continue its restructuring under the *CCAA*. Farber consents to act as the Monitor under *CCAA* proceedings and to administer the proposed sale process.

III. Continuation under the CCAA

A. Principles governing motions to continue BIA Part III proposal proceedings under the CCAA

8 Continuations of *BIA* Part III proposal proceedings under the *CCAA* are governed by section 11.6(a) of that Act which provides:

> 11.6 Notwithstanding the *Bankruptcy and Insolvency Act*,
>
> > (a) proceedings commenced under Part III of the *Bankruptcy and Insolvency Act* may be taken up and continued under this Act only if a proposal within the meaning of the *Bankruptcy and Insolvency Act* has not been filed under that Part.

9 It strikes me that on a motion to continue under the *CCAA* an applicant company should place before the court evidence dealing with three issues:

(i) The company has satisfied the sole statutory condition set out in section 11.6(a) of the *CCAA* that it has not filed a proposal under the *BIA*;

(ii) The proposed continuation would be consistent with the purposes of the *CCAA*; and,

(iii) Evidence which serves as a reasonable surrogate for the information which section 10(2) of the *CCAA* requires accompany any initial application under the Act.

Let me deal with each in turn

B. The applicant has not filed a proposal under the BIA

10 The evidence shows that CMT has satisfied this statutory condition.

C. The continuation would be consistent with the purposes of the CCAA

11 In *Ted Leroy Trucking Ltd., Re*,[1] the Supreme Court of Canada articulated the purpose of the *CCAA* in several ways:

(i) To permit the debtor to continue to carry on business and, where possible, avoid the social and economic costs of liquidating its assets;[2]

(ii) To provide a means whereby the devastating social and economic effects of bankruptcy or creditor initiated termination of ongoing business operations can be avoided while a court-supervised attempt to reorganize the financial affairs of the debtor company is made;[3]

(iii) To avoid the social and economic losses resulting from liquidation of an insolvent company;[4]

(iv) To create conditions for preserving the *status quo* while attempts are made to find common ground amongst stakeholders for a reorganization that is fair to all.[5]

As the Supreme Court noted in *Century Services*, proposals to creditors under the *BIA* serve the same remedial purpose, though this is achieved "through a rules-based mechanism that offers less flexibility."[6] In the present case CMT bumped up against one of those less flexible rules — the inability of a court to extend the time to file a proposal beyond six months after the filing of the NOI.

12 The jurisprudence under the *CCAA* accepts that in appropriate circumstances the purposes of the *CCAA* will be met even though the re-organization involves the sale of the company as a going concern, with the consequence that the debtor no longer would continue to carry on the business, as is contemplated in the present case. In *Stelco Inc., Re* Farley J. observed that if a restructuring of a company is not feasible, "then there is the exploration of the feasibility of the sale of the operations/enterprise as a going concern (with continued employment) in whole or in part".[7] It also is well-established in the jurisprudence that a court may approve a sale of assets in the course of a *CCAA* proceeding before a plan of arrangement has been approved by creditors.[8] In *Nortel Networks Corp., Re* Morawetz J. set out the rationale for this judicial approach:

> The value of equity in an insolvent debtor is dubious, at best, and, in my view, it follows that the determining factor should not be whether the business continues under the debtor's stewardship or under a structure that recognizes a new equity structure. An equally important factor to consider is whether the case can be made to continue the business as a going concern.[9]

13 The evidence filed by CMT and Farber supports a finding that a continuation under the *CCAA* to enable a going-concern sale of the Costa Blanca business and assets would be consistent with the purposes of the *CCAA*. Such a sale likely would maximize the recovery for the two remaining secured creditors, CIC and CMT Sourcing, preserve employment for many of the 500 remaining employees, and provide a tenant to the landlords of the 35 remaining Costa Blanca stores. Avoidance of the social and economic losses which would result from a liquidation and the maximization of value would best be achieved outside of a bankruptcy.

D. Evidence which serves as a reasonable surrogate for CCAA s. 10(2) information

14 As the Supreme Court of Canada observed in *Century Services*, "the requirements of appropriateness, good faith, and due diligence are baseline considerations that a court should always bear in mind when exercising *CCAA* authority."[10] On an initial application under the *CCAA* a court will have before it the information specified in section 10(2) which assists it in considering the appropriateness, good faith and due diligence of the application. Section 10(2) of the *CCAA* provides:

> 10. (2) An initial application must be accompanied by
>
> (a) a statement indicating, on a weekly basis, the projected cash flow of the debtor company;
>
> (b) a report containing the prescribed representations of the debtor company regarding the preparation of the cash-flow statement; and
>
> (c) copies of all financial statements, audited or unaudited, prepared during the year before the application or, if no such statements were prepared in that year, a copy of the most recent such statement.

15 Section 11.6 of the *CCAA* does not stipulate the information which must be filed in support of a continuation motion, but a court should have before it sufficient financial and operating information to assess the viability of a continuation under the *CCAA*. In the present case CMT has filed, on a confidential basis,[11] cash flows for the period ending January 31, 2012, which show a net positive cash flow for the period and that CMT has sufficient resources to continue operating in the *CCAA* proceeding, as well as to conduct a sale process without the need for additional financing.

16 In addition, the Proposal Trustee filed on this motion its Sixth Report in which it reported on its review of the cash flow statements. Although its opinion was expressed in the language of a double negative, I take from its report that it regards the cash flow statements as reasonable.

17 Finally, the previous extension orders made by this Court under section 50.4(9) of the *BIA* indicate that CMT satisfied the Court that it has been acting in good faith and with due diligence.

E. Conclusion

18 No interested person opposes CMT's motion to continue under the *CCAA*. Its two remaining secured creditors, CIC and CMT Sourcing, support the motion. From the evidence filed I am satisfied that CMT has satisfied the statutory condition contained in section 16(a) of the *CCAA* and that a continuation of its re-structuring under the *CCAA* would be consistent with the purposes of that Act.

IV. Sale Process

19 In *Nortel Networks Corp., Re* Morawetz J. identified the factors which a court should consider when reviewing a proposed sale process under the *CCAA* in the absence of a plan:

> (a) is a sale transaction warranted at this time?
>
> (b) will the sale benefit the whole "economic community"?
>
> (c) do any of the debtors' creditors have a *bona fide* reason to object to a sale of the business?
>
> (d) is there a better viable alternative?[12]

20 No objection has been taken to CMT's proposed sale of its Costa Blanca business or the proposed sale process under the direction of Farber as Monitor. Chris Johnson, CMT's CFO, deposed that CMT is not in a position to make a viable

proposal to its creditors and has concluded that a going-concern sale of the Costa Blanca business would be the most appropriate course of action. The Proposal Trustee concurs with that assessment. In light of those opinions, an immediate sale of the Costa Blanca business would be warranted in order to attract the best bids for that business on a going-concern basis. Such a sale, according to the evidence, stands the best chance of maximizing recovery by the remaining secured creditors and preserving the employment of a large number of people. No better viable alternative has been put forward.

21 Accordingly, I approve the proposed sale process as described in paragraph 37 of the affidavit of Chris Johnson.

V. Administration Charges

22 CMT seeks approval under section 11.52 of the *CCAA* of an Administration Charge over the assets of CMT to secure the professional fees and disbursements of Farber as Monitor and its counsel, as well as the fees of Ernst & Young Orenda Corporate Finance Inc. ("E&Y"), who has been acting as CMT's financial advisor, together with its counsel. The order sought reflects, in large part, the priorities of various charges approved during the *BIA* Part III proposal process. CMT proposes that the Professionals Charge approved under the *BIA* orders and the CCAA Administration Charge rank *pari passu*, and that whereas the *BIA* orders treated as ranking fourth "the balance of any indebtedness under the Professionals Charge", the *CCAA* order would place a cap of $250,000 on such portions of the Professionals and CCAA Administration Charges.

23 No interested person opposes the charges sought.

24 I am satisfied that the charge requested is appropriate given the importance of the professional advice to the completion of the Urban Behavior transaction and the sale process for the Costa Blanca business.

VI. Order granted

25 I have reviewed the draft Initial Order submitted by CMT and am satisfied that an order should issue in that form.

26 CMT also seeks a variation of paragraph 3 of the Approval and Vesting Order of Morawetz J. made November 7, 2011 in respect of the Urban Behavior transaction to include, in the released claims, the Professionals Charge and the CCAA Administration Charge. None of the secured creditors objects to the variation sought and it is consistent with the intent of the existing language of that order. I therefore grant the variation sought and I have signed the order.

Motion granted.

Footnotes

1 2010 SCC 60 (S.C.C.).

2 *Century Services*, para. 15.

3 *Ibid*., para. 59.

4 *Ibid*., para. 70.

5 *Ibid*., para. 77.

6 *Ibid*., para. 15.

7 (2004), 6 C.B.R. (5th) 316 (Ont. S.C.J. [Commercial List]), para. 1. In *Consumers Packaging Inc., Re*, 2001 CarswellOnt 3482

(Ont. C.A.) the Court of Appeal held that a sale of a business as a going concern during a *CCAA* proceeding is consistent with the purposes of that Act.

8 See the cases collected by Morawetz J. in *Nortel Networks Corp., Re* (2009), 55 C.B.R. (5th) 229 (Ont. S.C.J. [Commercial List]), paras. 35 to 39. See also section 36 of the *CCAA*.

9 *Ibid*., para. 40.

10 *Century Services*, para. 70.

11 CMT has filed evidence explaining that disclosure of the cash flows prior to the closing of the Urban Behavior transaction would make public the proceeds expected from that transaction. I agree that such information should not be made public until the deal has closed. CMT has satisfied the principles set out in *Sierra Club of Canada v. Canada (Minister of Finance)*, [2002] 2 S.C.R. 522 (S.C.C.) and a sealing order should issue.

12 *Nortel Networks*, *supra.*, para. 49. See also *Brainhunter Inc., Re* (2009), 62 C.B.R. (5th) 41 (Ont. S.C.J. [Commercial List]), para. 13.

End of Document

Most Negative Treatment: Distinguished
Most Recent Distinguished: Banque Laurentienne du Canada c. Caron Bélanger Ernst & Young inc. | 1999 CarswellQue 2937, 23 C.B.R. (4th) 1, REJB 1999-12928, [1999] R.D.I. 381, J.E. 99-1342 | (C.S. Qué., May 27, 1999)

1985 CarswellAlta 319
Supreme Court of Canada

Deloitte, Haskins & Sells Ltd. v. Alberta (Workers' Compensation Board)

1985 CarswellAlta 319, 1985 CarswellAlta 613, [1985] 1 S.C.R. 785, [1985] 4 W.W.R. 481, [1985] A.W.L.D. 896, [1985] A.W.L.D. 897, [1985] A.W.L.D. 899, [1985] A.W.L.D. 905, [1985] A.W.L.D. 906, [1985] A.W.L.D. 942, [1985] S.C.J. No. 35, 19 D.L.R. (4th) 577, 31 A.C.W.S. (2d) 297, 38 Alta. L.R. (2d) 168, 38 Alta. L.R. (2d) 169, 55 C.B.R. (N.S.) 241, 60 N.R. 81, 63 A.R. 321, J.E. 85-602

DELOITTE HASKINS and SELLS LIMITED v. WORKERS' COMPENSATION BOARD et al.

Laskin C.J.C.*, Ritchie**, Dickson, Beetz, Estey, McIntyre, Chouinard, Lamer and Wilson JJ.

Heard: December 14, 1983
Judgment: June 13, 1985
Docket: No. 17587

Counsel: *L.N. Boddy* and *M.J. McCabe*, for appellant.
J. Carr, for respondent.
A.M. Austin, for Workers' Compensation Board of Ontario.
L.E. Clain and *C. Walsh*, for Workers' Compensation Board of New Brunswick.
G. Massing, for Workers' Compensation Board of British Columbia.
D. Kidd, for Workers' Compensation Board of the Yukon.
T.B. Smith, Q.C., and *S. Clarke*, for Attorney General of Canada.
G.D. Gillis, for Attorney General of Nova Scotia.
W. Henkel, Q.C., for Attorney General of Alberta.

Subject: Corporate and Commercial; Insolvency

Related Abridgment Classifications

Bankruptcy and insolvency
I Bankruptcy and insolvency jurisdiction
  I.1 Constitutional jurisdiction of Federal government and provinces
    I.1.c Paramountcy of Federal legislation

Bankruptcy and insolvency
X Priorities of claims
  X.2 Preferred claims
    X.2.f Workers' Compensation Board
      X.2.f.iii Statutory liens

Constitutional law
VII Distribution of legislative powers
  VII.5 Relation between federal and provincial powers
    VII.5.c Paramountcy of federal legislation

VII.5.c.iii Statutes governing labour and employment
VII.5.c.iii.C Miscellaneous

Headnote

Bankruptcy --- Bankruptcy and insolvency jurisdiction — Constitutional jurisdiction of Dominion and provinces — Paramountcy of Federal legislation

Bankruptcy --- Priorities of claims — Preferred claims — Workers' Compensation Board — Statutory liens

Preferred creditors — Crown — Workers' Compensation Board — Priorities — Assessments owed to board by bankrupt employer — Provincial statute giving secured status to such assessments — Bankruptcy Act ranking indebtedness as preferred claim — Provincial statute not applying to determine priorities on bankruptcy — Board ranking as preferred creditor only.

Constitutional law — Assessments owed to Workers' Compensation Board given secured status by provincial statute — Bankruptcy Act ranking indebtedness as preferred claim — Whether or not statutes conflict — Whether or not provincial provision inoperative.

The issue on this appeal was the interaction of s. 78(4) of the Workers' Compensation Act, 1973 (Alta.), c. 87 and s. 107(1)(*h*) of the Bankruptcy Act. Section 78(4) of the provincial statute provided that the amount due to the respondent board by an employer was a "charge upon the property or proceeds of property of the employer". The particular question arising was whether the charge created by s. 78(4) of the provincial statute made the board a secured creditor of the bankrupt employer for purposes of the opening words of s. 107(1) of the Bankruptcy Act, or whether the board's claim fell under para. (*h*) of s. 107(1) of the Bankruptcy Act. The lower courts ruled that the board was a secured creditor, and that accordingly its claim for unpaid assessments had priority over the fees of the trustee in bankruptcy. The trustee appealed.

Held:

Appeal allowed.

Per WILSON J. (MCINTYRE and LAMER JJ. concurring): Section 107(1)(*h*) of the Bankruptcy Act applies to determine priorities on a bankruptcy, and s. 78(4) of the Workers' Compensation Act has no application in such a situation. While provincial legislation can validly secure debts on the property of a debtor in a non-bankruptcy situation, once bankruptcy occurs s. 107(1) of the Bankruptcy Act determines the status and priority of the claim specifically dealt with in the section. Since the provincial legislation in this case does not purport to deal with a bankruptcy, and in light of the presumption of constitutionality, there is no need to invoke the doctrine of paramountcy. Both provisions can stand and have their own legitimate spheres of operation.

Per CHOUINARD J. (DICKSON and BEETZ JJ. concurring): Although s. 78(4) of the provincial Act is perfectly valid legislation, nothing in that Act suggests that the section would not apply in a bankruptcy situation. Rather, it is s. 107(1)(*h*) of the Bankruptcy Act which disposes of the matter. The two provisions conflict so as to render s. 78(4) inoperative.

Per ESTEY J. (dissenting): A claimant under s. 78(4) of the Workers' Compensation Act falls within the definition of "secured creditor" in s. 2 of the Bankruptcy Act. If the provincial legislation creates a charge which falls within the definition of s. 2, and if the appropriate paragraph of s. 107(1) does not reduce the status of the secured creditor to that of a preferred creditor, then the claimant is excepted from the scheme of distribution in s. 107 by the opening words of subs. (1). As Parliament has not chosen in para. (*h*) to relegate claimants in the circumstances of the respondent to a lesser status, the respondent ranks as a secured creditor.

Annotation

In this case the Supreme Court of Canada decided that a provincial statute which provided that an amount due and payable to the Workers' Compensation Board by an employer constitutes a charge upon the property or proceeds of the property of the

employer. The majority of the court held that, upon the bankruptcy of the employer, the claim of the board was not a secured claim but merely a preferred claim within para. (*h*) of s. 107(1) of the Bankruptcy Act, R.S.C. 1970, c. B-3.
The provincial legislation did not deal with a "deemed" trust but strictly with whether the claim of the Workers' Compensation Board was a secured claim within the meaning of s. 2 of the Bankruptcy Act. Accordingly, the question as to whether there was a "deemed" trust claim within the meaning of s. 47(*a*) of the Bankrutpcy Act never arose. It is for this reason that one should not assume that this case overrules the decision of the Ontario Court of Appeal in the case of *Re Phoenix Paper Products Ltd.* (1983), 44 O.R. (2d) 225, 48 C.B.R. (N.S.) 113, 1 O.A.C. 215, 3 D.L.R. (4th) 617, and other similar cases dealing with "deemed" trusts.
It is unfortunate that the Supreme Court of Canada did not go further and give some guidance not only as to charges upon the assets of a bankrupt employer, but also with respect to certain sums of money deemed to be held in trust by a bankrupt employer.

C.H. Morawetz, Q.C.

Table of Authorities

Cases considered:

Considered by majority:

Black Forest Restaurant Ltd., Re (1981), 37 C.B.R. (N.S.) 176, 121 D.L.R. (3d) 435, 47 N.S.R. (2d) 454, 90 A.P.R. 454, affirmed *(*sub nom. *Dir. of Lab. Standards of N.S. v. Trustee in Bankruptcy)* 38 C.B.R. (N.S.) 253, 126 D.L.R. (3d) 417, 47 N.S.R. (2d) 446, 90 A.P.R. 446 (C.A.) — *applied*

Clemenshaw, Re; W.C.B. v. Can. Credit Men's Trust Assn. (1962), 4 C.B.R. (N.S.) 238, 40 W.W.R. 199, 36 D.L.R. (2d) 244 (B.C.C.A.) — *referred to*

Const. Montcalm Inc. v. Minimum Wage Comm., [1979] 1 S.C.R. 754, 79 C.L.L.C. 14,190, 93 D.L.R. (3d) 641, 25 N.R. 1 — *referred to*

Davis v. W.C.B. (Alta.), 33 C.B.R. (N.S.) 146, [1980] 2 W.W.R. 349, 10 B.L.R. 59 (Alta. Q.B.) — *referred to*

Dep. Min. of Revenue (Que.) v. Rainville, [1980] 1 S.C.R. 35, *(*sub nom. *Re Bourgault; Dep. Min. of Revenue (Que.) v. Rainville)* 33 C.B.R. (N.S.) 301, *(*sub nom. *Re Bourgault)* 105 D.L.R. (3d) 270, *(*sub nom. *Bourgault v. Dep. Min. of Revenue (Que))* 30 N.R. 24 — *applied*

Gingras Auto. Ltée, Re; Les Produits de Caoutchouc Marquis Inc. v. Trottier, [1962] S.C.R. 676, 4 C.B.R. (N.S.) 123, 34 D.L.R. (2d) 751 — *referred to*

Multiple Access Ltd. v. McCutcheon, [1980] 2 S.C.R. 161, 18 B.L.R. 138, 138 D.L.R. (3d) 1, 44 N.R. 181 — *referred to*

Nelson (R.A.) Const. Ltd., Re (1965), 8 C.B.R. (N.S.) 221, 53 W.W.R. 574, 52 D.L.R. (2d) 189 (B.C.S.C.) — *referred to*

Que. North Shore Paper Co. v. C.P. Ltd., [1977] 2 S.C.R. 1054, 9 N.R. 471 — *referred to*

Royal Bank of Can. v. Larue, [1928] A.C. 187 (P.C.) — *referred to*

Smith v. R., [1960] S.C.R. 776, 33 C.R. 318, 25 D.L.R. (2d) 225, 128 C.C.C. 145 — *referred to*

W.C.B. v. Prov. Treas. of Alta. (1967), 59 W.W.R. 298, 61 D.L.R. (2d) 21, (sub nom. *W.C.B. v. R.*) — *referred to*

W.C.B. (Alta.) v. Davis (1970), 14 C.B.R. (N.S.) 248, 73 W.W.R. 495, *(*sub nom. *Re Trinel Office Products Ltd.)* 11 D.L.R. (3d) 722 (Alta. T.D.) — *referred to*

W.C.B. (B.C.) v. Kinross Mtge. Corp., 41 C.B.R. (N.S.) 1, [1982] 1 W.W.R. 87, 31 B.C.L.R. 382, 127 D.L.R. (3d) 740 — *applied*

Considered in dissent:

Black Forest Restaurant Ltd., Re (1981), 37 C.B.R. (N.S.) 176, 121 D.L.R. (3d) 435, 47 N.S.R. (2d) 454, 90 A.P.R. 454, affirmed *(*sub nom. *Dir. of Lab. Standards of N.S. v. Trustee in Bankruptcy)* 38 C.B.R. (N.S.) 253, 126 D.L.R. (3d) 417, 47 N.S.R. (2d) 446, 90 A.P.R. 446 (C.A.) — *distinguished*

Clemenshaw, Re; W.C.B. v. Can. Credit Men's Trust Assn. (1963), 4 C.B.R. (N.S.) 238, 40 W.W.R. 199, 36 D.L.R. (2d) 244 (B.C.C.A) — *applied*

Dep. Min. of Revenue (Que.) v. Rainville, [1980] 1 S.C.R. 35, *(*sub nom. *Re Bourgault; Dep. Min. of Revenue (Que.) v. Rainville)* 33 C.B.R. (N.S.) 301, *(*sub nom. *Re Bourgault)* 105 D.L.R. (3d) 270, *(*sub nom. *Bourgault v. Dep. Min. of Revenue (Que.))* 30 N.R. 24 — *distinguished*

Gingras Auto. Ltée, Re; Les Produits de Caoutchouc Marquis Inc. v. Trottier, [1962] S.C.R. 676, 4 C.B.R. (N.S.) 123, 34 D.L.R. (2d) 751 — *distinguished*

W.C.B. v. Prov. Treas. of Alta. (1967), 59 W.W.R. 298, *(*sub nom. *W.C.B. v. R.)* 61 D.L.R. (2d) 21 — *applied*

Statutes considered:

Bankruptcy Act, R.S.C. 1970, c. B-3, ss. 2 "secured creditor", 50(6), 107.

Constitution Act, 1867, s. 91(21).

Workers' Compensation Act, 1973 (Alta.), c. 87 [now 1981 (Alta.), c. W-16], s. 78(4).

Authorities considered:

Hogg, Constitutional Law of Canada (1977), p. 103.

Words and phrases considered:

secured creditor

Appeal from decision of Alberta Court of Appeal *(*sub nom. *Re Jacs Jackets & Crests Ltd.; Deloitte Haskins & Sells Ltd. v. W.C.B.)* 46 C.B.R. (N.S.) 284, [1983] 3 W.W.R. 587, 25 Alta. L.R. (2d) 57, [1983] A.W.L.D. 302, 144 D.L.R. (3d) 525, 43 A.R. 241, which affirmed trial judge's determination of priority of claims, 41 C.B.R. (N.S.) 315, [1982] A.W.L.D. 328.

***Estey J.* (dissenting):**

1 As the judgment of my colleague Wilson J. has set out the facts and the relevant provisions in the provincial and federal legislation, it is not necessary to repeat those matters here. The following constitutional question was stated by order of the Chief Justice of Canada dated 19th May 1983:

> Does s. 107(1)(h) of the *Bankruptcy Act*, R.S.C. 1970, c. B-3 conflict with s. 78(4) of *The Workers' Compensation Act*, 1973, c. 87 (Alta.), such as to render inoperative s. 78(4)?

I would dismiss the appeal on the basis of interpretation of the bankruptcy statute and therefore find it unnecessary to answer the constitutional question or indeed to inquire into the constitutional basis under either the Bankruptcy Act or the Workers' Compensation Act. The issue is not whether the Parliament of Canada could regulate the effect in law of the Alberta statute for the purposes of bankruptcy procedures but rather, has the Parliament of Canada done so with reference to a charge arising under the provincial compensation statute. The result of course amounts to the same thing as answering the constitutional question in the negative.

2 The provincial Act, s. 78(4)(*a*), clearly and validly establishes a charge against the property of a delinquent employer. The section in part states:

> (4) ... the amount due to the Board by an employer upon any assessment made under this Act...
>
> (*a*) is a charge upon the property or proceeds of property of the employer. ...

The reach of that charge in law is further elaborated on in para. (*b*) of this section where it is given priority over all "... liens, charges, mortgages or other encumbrances whatsoever". The nature of this charge having been clearly established in the law, the second and determinative question is: how is this charge treated by the Parliament of Canada in the Bankruptcy Act, as regards the distribution of the estate of a bankrupt? Section 2 of the Bankruptcy Act defines a secured creditor as follows:

> "secured creditor" means a person holding a mortgage, hypothec, pledge, charge, lien or privilege on or against the property of the debtor or any part thereof as security for a debt due or accruing due to him from the debtor, or a person whose claim is based upon, or secured by, a negotiable instrument held as collateral security and upon which the debtor is only indirectly or secondarily liable.

It is to be noted at once that in defining a secured creditor Parliament has not made any exception for charges or other security established by provincial statute either generally or specifically with reference to those statutes of the provinces which are named in s. 107 of the Act.

3 In s. 107 Parliament has established a "Scheme of Distribution" for the assets of the estate of a bankrupt. The detailed scheme is introduced as follows:

> 107. (1) *Subject to the rights of secured creditors*, the proceeds realized from the property of a bankrupt shall be applied in priority of payment as follows: ...

The scheme of distribution is entirely predicated upon the prior rights of secured creditors. There is nothing in the use of the term "secured creditors" in the opening of this plan of distribution of a bankrupt's assets to indicate that Parliament did not intend to incorporate into s. 107 the statutory definition of that term.

4 The priorities of claimants other than secured creditors is then established by paras. (*a*) to (*j*) of s. 107(1). We are here concerned with para. (*h*) which provides as follows:

> (*h*) all indebtedness of the bankrupt under any Workmen's Compensation Act, under any Unemployment Insurance Act, under any provision of the *Income Tax Act* or the *Income War Tax Act* creating an obligation to pay to Her Majesty amounts that have been deducted or withheld, *pari passu;*

It will be noted again that this subsection does not refer to charges created under the Workers' Compensation Act, nor does the subsection make any reference such as "notwithstanding any secured claim arising thereunder". Nor does Parliament refer back to the exception of secured creditors in the opening of the subsection or to the definition of "secured creditor" in s. 2. The issue, in my respectful view, is not whether the Workers' Compensation Board of a province can create the status of secured creditor which can be recognized in bankruptcy proceedings, but whether the bankruptcy procedures as laid out by the Parliament of Canada recognize a secured creditor status as created under the Workers' Compensation Act of Alberta. The natural sequence, in my view, is that the provincial statute is examined to determine the character of the status of the claim in provincial law. The federal Act is then examined to determine whether the provincial claim so established will be recognized as a secured claim or otherwise in the bankruptcy scheme adopted by Parliament.

5 The Alberta Court of Appeal some time ago in *W.C.B. v. Prov. Treas. of Alta.* (1967), 59 W.W.R. 298, *(*sub nom. *W.C.B. v. R.)* 61 D.L.R. (2d) 21, concluded that the then equivalent of s. 78(4) of the Alberta statute established a floating charge covering all of the employers' property which crystallized into a fixed charge upon perfection pursuant to the terms of the statute. Such a fixed charge created by valid legislation is clearly included in s. 2. Here the board did indeed perfect its secured claim by placing a distress warrant in the hands of the appropriate sheriff, and further by registration in the land titles office in Edmonton, prior to the assignment in bankruptcy under which the appellant has been appointed as trustee.

6 It is not surprising to find a statement by Parliament in the Bankruptcy Act which recognizes the continued existence of

substantive provisions in other law. I refer to s. 50(6):

> (6) The provisions of this Act shall not be deemed to abrogate or supersede the substantive provisions of any other law or statute relating to property and civil rights that are not in conflict with this Act, and the trustee is entitled to avail himself of all rights and remedies provided by such law or statute as supplementary to and in addition to the rights and remedies provided by this Act.

The reference to the entitlement of the trustee to avail himself of such other laws cannot be read as an indirect directive from Parliament that creditors may not do likewise.

7 It is said that this court in *Dep. Min. of Revenue (Que.) v. Rainville*, [1980] 1 S.C.R. 35, (sub nom. *Re Bourgault; Dep. Min. of Revenue (Que.) v. Rainville)* 33 C.B.R. (N.S.) 301, (sub nom. *Re Bourgault)* 105 D.L.R. (3d) 270, (sub nom. *Bourgault v. Dep. Min. of Revenue (Que.))* 30 N.R. 24, has so construed s. 107 as to reduce the respondent's charge to a preferred claim. With respect, I do not believe such to be the case. The court was there concerned with s. 107(1)(*j*) which read as follows:

> (*j*) claims of the Crown not previously mentioned in this section, in right of Canada or of any province, *pari passu* not withstanding any statutory preference to the contrary.

Parliament was there concerned with claims of the Crown not previously mentioned. The claim of the board here was, of course, mentioned in para. (*h*) ranking in priority to para. (*j*). The principal distinguishing feature between these two paragraphs is, however, the rider at the end of para. (*j*) which expressly mandates that distribution shall be "*pari passu* notwithstanding any statutory preference to the contrary". There is, of course, no such directive, express or implicit, in para. (*h*) with reference to indebtedness under any workmen's compensation legislation. Pigeon J., writing for the majority in *Rainville*, explicitly stated at p. 44 that "the case turns upon the interpretation of para. 107(1)(*j*)". Later in the judgment His Lordship stated at pp. 44-45:

> There is of course a contradiction between the reservation at the outset of the rights of secured creditors which include privileges and "notwithstanding any statutory preference..." However, it is certainly clear that the reservation is a general rule and the "notwithstanding" an exception which takes precedence wherever applicable.

There may be comments in the majority judgment which can be extended to refer to a broader base for the disposition there made by the court but, in my view, those comments are unnecessary to the decision of the case and are clearly disavowed by Pigeon J. in his several references to the precise and unique wording of para. (*j*). For example, at p. 44:

> It is abundantly clear that this was intended to put on an equal footing all claims by Her Majesty in right of Canada or of a province except in cases where it was provided otherwise, namely, para. (*c*), the levy, and para. (*h*), workmen's compensation or unemployment insurance assessments and withholdings for income tax.

and at p. 43:

> Due to the "notwithstanding", I find it even clearer in para. 107(1)(*j*) that the federal Parliament intended to deal with the preferential rights of the federal and provincial tax collectors, just as it intended in para. 107(1)(*e*) and (*f*) to define those of municipal corporations and of lessors.

8 Paragraph (*h*) was before the British Columbia Court of Appeal in *Re Clemenshaw; W.C.B. v. Can. Credit Men's Trust Assn.* (1963), 4 C.B.R. (N.S.) 238, 40 W.W.R. 199, 36 D.L.R. (2d) 244. Wilson J.A., speaking for a unanimous court, held at p. 244:

> The argument is that this allocation by Parliament to the Workmen's Compensation Board of the status of a preferred creditor of the eighth class deprives it of the position given it by provincial law as the holder of the senior charge on the property involved. I cannot accept this as correct. The rights stated in s. 95 are expressly made subject to the primary rights of secured creditors. If Parliament had intended to deprive the Workmen's Compensation Board of the position of secured creditor which is given it by s. 2(*r*) of the Bankruptcy Act, Parliament would have said so in explicit language. No member of any of the classes of persons listed in the scheme of distribution in s. 95 is to be taken, by reason of his

being named in that section, as deprived of the benefit of any security he may hold.

9 In *Rainville*, supra, Pigeon J. commented on that case by noting that the British Columbia court made no reference to an earlier case of this court (*Re Gingras Auto. Ltée.; Les Produits de Caoutchouc Marquis Inc. v. Trottier*, [1962] S.C.R. 676, 4 C.B.R. (N.S.) 123, 34 D.L.R. (2d) 751, dealing with a landlord's privilege under the Quebec Civil Code), and then added: "... and the wording of the paragraph [para. (*h*)] is also quite different", that is from para. (*j*) then before the court. It should be noted in passing that *Re Gingras* was concerned with the status of a claim by a landlord for arrears of rent under the secured creditor definition in the Bankruptcy Act. The court came to the conclusion that the landlord's claim under the Qubec Civil Code was not a secured interest which fell within the definition of secured creditor in the Bankruptcy Act. This, of course, is very different from the nature of the charge held by the respondent in these proceedings.

10 The Nova Scotia courts in *Re Black Forest Restaurant Ltd.* (1981), 37 C.B.R. (N.S.) 176, 121 D.L.R. (3d) 435, 47 N.S.R. (2d) 454, 90 A.P.R. 454 (T.D.), on appeal *(*sub nom. *Dir. of Lab. Standards of N.S. v. Trustee in Bankruptcy)* 38 C.B.R. (N.S.) 253, 126 D.L.R. (3d) 417, 47 N.S.R. (2d) 446, 90 A.P.R. 446 , concluded that a charge under the Workers' Compensation Act of Nova Scotia did not qualify under s. 107(1) of the Bankruptcy Act as a secured claim. With reference to that decision, I respectfully adopt the comments of Lieberman J.A. in the court below in the case at bar [*(*sub nom. *Re Jacs Jackets & Crests Ltd; Deloitte Haskins & Sells Ltd. v. W.C.B.)* 46 C.B.R. (N.S.) 284 at 292, [1983] 3 W.W.R. 587, 25 Alta. L.R. (2d) 57, [1983] A.W.L.D. 302, 144 D.L.R. (3d) 525, 43 A.R. 241]:

> In my view, *Dep. Min. of Revenue (Que.) v. Rainville* and *Re Black Forest* are distinguishable from the case at bar and are not authority for the proposition that a claimant whose claim falls within s. 107 cannot be a "secured creditor" even if the claim satisfied the requirements of s. 2. The Workers' Compensation Act of Nova Scotia provides that the claim of the board establishes a lien against the assets of the employer without the board having to perform an overt act, whereas in the Alberta legislation (s. 78(4)) a floating charge is created which becomes a proprietary interest only after the board has performed overt acts of filing the certificate and initiating distress proceedings. The board in this case has performed those overt acts and in my view it has caused a floating charge to be crystallized in accordance with s. 78(4) of the Workers' Compensation Act. The claim thus comes within the definition of "secured creditor" in s. 2 of the Bankruptcy Act.

11 The Nova Scotia case and the comments upon it in the court below further illustrate the proper inter-relationship between the provincial and the federal legislation where bankruptcy takes place. It is not a case where provincial legislation, by creating a secured and fixed charge, defeats a scheme of distribution under the Bankruptcy Act. It is quite the reverse. The relevant question is whether the scheme of distribution of a debtor's estate as adopted by Parliament affects the legal consequences and status of a secured charge created by provincial legislation. If the provincial legislation creates a charge which falls within the definition of s. 2, and if the appropriate paragraph under s. 107(1) does not reduce the status of the secured creditor to that of a preferred creditor, then the claimant is excepted from the distribution of s. 107 by the opening words in subs. (1). It is not because the provincial legislature has defeated or subverted the federal statutory scheme. It is because the federal scheme recognizes the provincially legislated charge which gives the claimant the status of a secured creditor. It is, in my view, quite contrary to law to translate this inter-relationship between the provincial and the federal statutes as elevating the provinces to the position where they may determine priorities in the event of a bankruptcy. This is undoubtedly the exclusive domain of the Parliament of Canada. Parliament can, as it did in para. (*j*), relegate a secured creditor to a lesser status if it chooses so to do. It has not chosen to do so in para. (*h*) and until Parliament does so, persons claiming, in the circumstances of the respondent, in my view, rank as secured creditors.

12 Accordingly I would dismiss the appeal with costs.

***Chouinard J.* (*Dickson* and *Beetz JJ.* concurring):**

13 I agree with Wilson J. that s. 78(4) of the Workers' Compensation Act and s. 107(1)(*h*) of the Bankruptcy Act can stand and have their own legitimate spheres of operation.

14 That s. 78(4) is perfectly valid legislation is, in my view, beyond dispute.

15 There is nothing in the Act, however, to suggest that s. 78(4) would not apply in a bankruptcy situation. Were it not for the Bankruptcy Act it would undoubtedly apply. It is not because of anything inherent in s. 78(4) that it has no application in a bankruptcy but because of s. 107(1)(*h*) of the Bankruptcy Act which disposes of the matter.

16 In the result I am of the view, with respect, that the constitutional question must be answered in the affirmative: s. 78(4) is inoperative in a bankruptcy situation.

17 I would otherwise dispose of the appeal in the manner proposed by Wilson J.

***Wilson J.* (*McIntyre* and *Lamer JJ.* concurring):**

18 The issue on this appeal is the interaction of s. 78(4) of the Workers' Compensation Act, 1973 (Alta.), c. 87 and s. 107(1)(*h*) of the Bankruptcy Act, R.S.C. 1970, c. B-3.

19 Section 78(4) of the Workers' Compensation Act provides:

> (4) Notwithstanding anything in any other Act, the amount due to the Board by an employer upon any assessment made under this Act or in respect of any amount that the employer is required to pay to the Board under any of its provisions or upon any judgment for that assessment or amount,
>
> (*a*) *is a charge upon the property or proceeds of property of the employer*, including moneys payable to, for or on account of the employer, within Alberta, and
>
> (*b*) has priority over all assignments by way of security, debts, liens, charges, mortgages or other encumbrances whatsoever, whenever created or to be created, except wages due to workers by their employer in cases where the exercise of the priority would deprive the workers of their wages.

20 Section 107(1)(*h*) of the Bankruptcy Act provides:

> 107.(1) *Subject to the rights of secured creditors*, the proceeds realized from the property of a bankrupt shall be applied in priority of payment as follows: ...
>
> (*h*) *all indebtedness of the bankrupt under any Workmen's Compensation Act*, under any Unemployment Insurance Act, under any provision of the *Income Tax Act* or the *Income War Tax Act* creating an obligation to pay to Her Majesty amounts that have been deducted or withheld, *pari passu;*

21 The question arising under these two provisions is whether the charge created by s. 78(4) makes the respondent board a secured creditor of the bankrupt employer for purposes of the opening words of s. 107(1) of the Bankruptcy Act or whether the respondent board's claim falls under para. (*h*) of the subsection and is postponed to the claims listed in paras. (*a*) to (*g*). The appeal proceeded upon an agreed statement of fact as follows:

> 1. At all material times to this action Jacs Jackets & Crests Ltd. was an employer in an industry within the scope of *The Workers' Compensation Act*, S.A. 1973, c. 87, and amendments thereto and was liable to pay assessments to the Board.
>
> 2. On or about January 9, 1980 the Board placed a Distress Warrant in the hands of the Sheriff of the Judicial District of Edmonton claiming unpaid assessments by Jacs Jackets & Crests Ltd. in the amount of $3,646.18 under the provisions of *The Workers' Compensation Act*.
>
> 3. On January 15, 1980 the Board also registered a Certified Statement at the Land Titles Office at Edmonton in the amount of $3,648.68 under the provisions of *The Workers' Compensation Act*.
>
> 4. On January 28, 1980 Jacs Jackets & Crests Ltd. made an assignment into bankruptcy and Deloitte Haskins and Sells Limited was appointed Trustee of the Estate.

> 5. On February 6, 1980 the Board filed a Proof of Claim in the sum of $3,657.08 as a secured creditor of Jacs Jackets & Crests Ltd. under the provisions of Section 78(4) of the *Workers' Compensation Act*.
>
> 6. The Trustee admittedly made a search of the Bankrupt's creditors under the name of "Jack's" rather than the proper name of "Jacs", both at the Land Titles Office and at the Sheriff's Office Edmonton, which revealed no creditors.
>
> 7. The Trustee then sold the assets of the Bankrupt in the amount of $11,700.00 and settled a claim of the Bank of British Columbia under a Chattel Mortgage in the amount of $8,950.00, the balance being applied to the Trustee's fees.
>
> 8. The Board filed an Objection to the final Statement of Receipts and Disbursements and the discharge of the Trustee alleging the monies received by the Trustee were distributed contrary to law and established practice.
>
> 9. The Trustee had refused or declined to pay the Board's claim and the Board applied to The Court of Queen's Bench of Alberta for Direction of Judgment in this matter.
>
> 10. There are sufficient funds available for distribution so that the question of priorities between the Board and the claimant Bank will not arise if the Judgment of the Chambers Judge is affirmed.

22 The learned chambers judge who heard the application held that the board was a secured creditor within the definition of s. 2 of the Bankruptcy Act [41 C.B.R. (N.S.) 315, [1982] A.W.L.D. 328]. That section reads as follows:

> 2. In this Act
>
> "secured creditor" means a person holding a mortgage, hypothec, pledge, charge, lien or privilege on or against the property of the debtor or any part thereof as security for a debt due or accruing due to him from the debtor, or a person whose claim is based upon, or secured by, a negotiable instrument held as collateral security and upon which the debtor is only indirectly or secondarily liable.

Accordingly, the board had priority over the claims of the trustee in bankruptcy. The Court of Appeal agreed [*(*sub nom. *Re Jacs Jackets & Crests Ltd.; Deloitte Haskins & Sells Ltd. v. W.C.B.)* 46 C.B.R. (N.S.) 284, [1983] 3 W.W.R. 587, 25 Alta. L.R. (2d) 57, [1983] A.W.L.D. 302, 144 D.L.R. (3d) 525, 43 A.R. 241]. The trustee was granted leave to appeal to this court.

23 By order of the Chief Justice of Canada dated 19th May 1983 a constitutional question was stated as follows:

> Does s. 107(1)(*h*) of the *Bankruptcy Act*, R.S.C. 1970, c. B-3 conflict with s. 78(4) of *The Workers' Compensation Act*, 1973 c. 87 (Alta.), such as to render inoperative s. 78(4)?

The Attorney General of Canada and the other intervenants were granted leave to intervene on the appeal.

24 The main ground of appeal is that the Court of Appeal was wrong in according the board secured, as opposed to preferred, status in bankruptcy. Although s. 78(4) of the Workers' Compensation Act gave the board the status of a secured creditor in a non-bankruptcy situation, the provisions of the Bankruptcy Act had to be looked to for its status in bankruptcy. Section 107(1) of that Act, a provision establishing priorities among non-secured creditors, specifically included claims such as the claim of the board in para. (*h*). In face of that specific reference, how can it be argued that such claims are secured and covered by the opening words of s. 107(1)? Counsel submits that para. (*h*) is conclusive evidence of Parliament's intention to treat such claims as unsecured. If effect is given to s. 78(4) in a bankruptcy context it will change the priority given to workers' compensation claims from priority (*h*) to a first priority as secured claims.

25 Counsel for the trustee submits that the Court of Appeal fell into error because it approached the problem of the interaction of the federal and provincial legislation in the wrong way. The federal statute, he submits, must be looked at first because it discloses Parliament's intention with respect to priorities in a bankruptcy context. If the provincial legislation is looked at first in order to establish the nature of the claim, then the policy of the Bankruptcy Act with respect to priorities could be completely defeated. Moreover, there would be no guarantee of consistency in the treatment of claims arising in different provinces. Their ranking for bankruptcy purposes would be controlled by the provincial legislatures instead of by the federal Parliament to which exclusive legislative jurisdiction in relation to "Bankruptcy and Insolvency" was given under

s. 91(21) of the Constitution Act, 1867. There are two valid laws, counsel submits, one federal and one provincial, and they are in operational conflict. In such circumstances the rule is that the federal law must prevail.

26 Counsel for the board responds that the Alberta legislature, acting within its constitutional authority in relation to "Property and Civil Rights in the Province", has conferred on the board in s. 78(4) a first charge on the property of the employer. In *W.C.B. v. Prov. Treas. of Alta.* (1967), 59 W.W.R. 298, (sub nom. *W.C.B. v. R.*) 61 D.L.R. (2d) 21, the Alberta Court of Appeal held that the board's charge under s. 78(4) is a floating charge on all the employer's property which, upon registration, crystallizes into a fixed legal charge. Accordingly, the board, if it has perfected its security by registration prior to the bankruptcy, has a secured claim. If it has not perfected its security in time, then it has a preferred claim under s. 107(1)(*h*): see *Davis v. W.C.B. (Alta.)*, 33 C.B.R. (N.S.) 146, [1980] 2 W.W.R. 349, 10 B.L.R. 59 (Alta. Q.B.).

27 Counsel for the board relies further on s. 50(6) of the Bankruptcy Act which provides:

> (6) The provisions of this Act shall not be deemed to abrogate or supersede the substantive provisions of any other law or statute relating to property and civil rights that are not in conflict with this Act, and the trustee is entitled to avail himself of all rights and remedies provided by such law or statute as supplementary to and in addition to the rights and remedies provided by this Act.

Counsel submits that this provision clearly recognizes the application and effect of provincial statutes relating to property and civil rights. The Bankruptcy Act, he says, merely defines secured creditors, it does not create them, the latter being the constitutional prerogative of the provinces.

28 Some assistance on the interaction of the federal and provincial legislation is to be derived from the authorities. The seminal case is the decision of the Privy Council in *Royal Bank of Can. v. Larue*, [1928] A.C. 187. In that case the Privy Council held that the exclusive legislative jurisdiction conferred on the federal legislature in relation to bankruptcy and insolvency enabled it to legislate the relative priorities of creditors on a bankruptcy. Although it was competent to a provincial legislature under the head of "Property and Civil Rights" to secure certain debts on property of the debtor, as soon as such provincial legislation came into conflict with federal bankruptcy legislation, the federal bankruptcy legislation prevailed. Quoting from the judgment of Viscount Cave L.C. at p. 197:

> In *Attorney-General of Ontario v. Attorney-General for Canada* ([1894] A.C. 189, 200), Lord Herschell observed that a system of bankruptcy legislation might frequently require various ancillary provisions for the purpose of preventing the scheme of the Act from being defeated, and added: "It may be necessary for this purpose to deal with the effect of executions and other matters which would otherwise be within the legislative competence of the Provincial Legislature. Their Lordships do not doubt that it would be open to the Dominion Parliament to deal with such matters as part of a bankruptcy law, and the Provincial Legislature would doubtless be then precluded from interfering with this legislation inasmuch as such interference would affect the bankruptcy law of the Dominion Parliament." Taking these observations as affording assistance in the construction of s. 91, head 21, of the Act of 1867, their Lordships are of opinion that the exclusive authority thereby given to the Dominion Parliament to deal with all matters arising within the domain of bankruptcy and insolvency enables that Parliament to determine by legislation the relative priorities of creditors under a bankruptcy or an authorized assignment.

29 In *Re Gingras Auto. Ltée; Les Produits de Caoutchouc Marquis Inc. v. Trottier*, [1962] S.C.R. 676, 4 C.B.R. (N.S.) 123, 34 D.L.R. (2d) 751, Abbott J. followed *Royal Bank of Can. v. Larue*. He said at p. 678:

> The present Act, like its predecessor acts, provides that subject to the Act all debts proved in bankruptcy shall be paid *pari passu*. To the rule of absolute equality, certain exceptions are made including those provided for by s. 95. The exclusive authority given to Parliament by s. 91(21) of the *British North America Act* to deal with all matters arising within the domain of bankruptcy and insolvency, enables Parliament to determine the relative priorities of creditors under a bankruptcy: *Royal Bank v. Larue*. To the extent that such priorities may be in conflict with provincial law, the federal statute must prevail.

30 In *Dep. Min. of Revenue (Que.) v. Rainville*, [1980] 1 S.C.R. 35, (sub nom. *Re Bourgault; Dep. Min. of Revenue (Que.)*

v. Rainville) 33 C.B.R. (N.S.) 301, 105 D.L.R. (3d) 270, (sub nom. *Re Bourgault*), 30 N.R. 24 (sub nom. *Bourgault v. Dep. Min. of Revenue (Que.)*), this court had to consider the interaction of s. 30 of the Retail Sales Tax Act, R.S.Q. 1964, c. 71, and s. 107(1)(*j*) of the Bankruptcy Act. Section 30 of the Quebec statute made any sums due to the Crown under the Act "a privileged debt" ranking immediately after law costs. Section 107(1)(*j*) of the Bankruptcy Act provided:

> 107. (1) Subject to the rights of secured creditors, the proceeds realized from the property of a bankrupt shall be applied in priority of payment as follows: ...
>
> (*j*) claims of the Crown not previously mentioned in this section, in right of Canada or of any province, *pari passu* notwithstanding any statutory preference to the contrary.

31 The Deputy Minister alleged that he was a "secured creditor" within the definition of s. 2 of the Act and therefore did not fall within the purview of para. (*j*). Pigeon J., writing for the majority, found otherwise. He said at p. 44:

> Accordingly, I find that the case turns upon the interpretation of para. 107(1)(*j*). When s. 95 (now 107) of the 1949 *Bankruptcy Act* is compared with s. 51 of the 1919 *Bankruptcy Act*, it is apparent that by the new Act, Parliament has established a much more elaborate "Scheme of Distribution". Its power to legislate concerning the provincial as well as federal Crown privilege, in the case of bankruptcy, having been established by *In re Silver Brothers Ltd.* ([1932] A.C. 514), the provision clearly indicates its intention to do so and the only question remaining is as to the scope of the provision. It is abundantly clear that this was intended to put on an equal footing all claims by Her Majesty in right of Canada or of a province except in cases where it was provided otherwise, namely para. (*c*), the levy, and para. (*h*), workmen's compensation or unemployment insurance assessments and withholdings for income tax. Paragraph (*j*) ends with the following words: "*notwithstanding any statutory preference to the contrary*". The purpose of this part of the provision is obvious. Parliament intended to put all debts to a government on an equal footing; it therefore cannot have intended to allow provincial statutes to confer any higher priority. In my opinion, this is precisely what is being contended for when it is argued that, because the Quebec statute creates a privilege on immovable property effective from the date of registration, the Crown thereby becomes a "secured creditor" and thus escapes the effect of the provision which gives it only a lower priority.

32 Estey J. dissented in *Rainville* on the basis that the Deputy Minister was a secured creditor by virtue of the provincial legislation and s. 107 of the Bankruptcy Act elevated his claim over the preferred claims listed in the scheme of distribution in s. 107. Although he does not refer to the case in his reasons, the approach taken by Estey J. is similar to that taken by the British Columbia Court of Appeal in *Re Clemenshaw; W.C.B. v. Can. Credit Men's Trust Assn.* (1962), 4 C.B.R. (N.S.) 238, 40 W.W.R. 199, 36 D.L.R. (2d) 244, and adopted in *Re R.A. Nelson Const. Ltd.* (1965), 8 C.B.R. (N.S.) 221, 53 W.W.R. 574, 52 D.L.R. (2d) 189 (B.C.S.C.), in *W.C.B. (Alta.) v. Davis* (1970), 14 C.B.R. (N.S.) 248, 73 W.W.R. 495, *(*sub nom. *Re Trinel Office Products Ltd.)* 11 D.L.R. (3d) 722 (Alta. S.C.), and *Davis. v. W.C.B.*, supra.

33 Counsel for the appellant submits that *Rainville* is a judgment of the court directly in its favour. Counsel for the board distinguishes *Rainville* on the basis it was dealing with a claim under para. (*j*) of s. 107(1) as opposed to para. (*h*), and para. (*j*) ends with the phrase "notwithstanding any statutory preference to the contrary". This, he submits, makes it clear that the provincial legislation yields to the scheme of distribution under s. 107(1) as far as claims under para. (*j*) are concerned. No such overriding language appears in para. (*h*).

34 With respect, it seems to me that the "notwithstanding" language in para. (*j*) was a second string to the court's bow in *Rainville*. I think this is the significance of Pigeon J.'s comment at p. 43 of his reasons:

> Due to the "notwithstanding", *I find it even clearer in para. 107(1)(j)* that the federal Parliament intended to deal with the preferential rights of the federal and provincial tax collectors, just as it intended in para. 107(1)(*e*) and (*f*) to define those of municipal corporations and of lessors. [The italics are mine.]

35 The "notwithstanding" language reinforced the principle in *Larue* and *Gingras*, both supra, that provincial legislation yields to federal in the event of bankruptcy. I do not think the majority reasons in *Rainville* can be divorced from the wider

principle and made to rest solely on the "notwithstanding" provision. I am supported in this view by the judgment of Cowan C.J.T.D. in *Re Black Forest Restaurant Ltd.* (1981), 37 C.B.R. (N.S.) 176, 121 D.L.R. (3d) 435, 47 N.S.R. (2d) 454, 90 A.P.R. 454 (T.D.). The Chief Justice said at p. 191:

> The claim of the Worker's Compensation Board is specifically referred to in s. 107(1)(*h*) and is not removed from the scope of that paragraph by the opening words of s. 107(1) preserving the rights of secured creditors. It is entitled to the priority provided for by s. 107(1)(*h*) and is not entitled to the statutory security or priority which s. 125 of the Workers' Compensation Act purports to create, and which would be valid and effective in the absence of bankruptcy of the employer.

And at p. 192:

> The result, in my opinion, is that so long as there is no bankruptcy, full effect must be given to statutory provisions such as those contained in the Labour Standards Code of this province and in the Workers' Compensation Act of this province, which create liens and charges on property ranking ahead of pre-existing interests such as those created by mortgages or assignments of book debts, affecting the property said to be subject to the statutory liens and charges. However, when bankruptcy occurs, the provisions of s. 107 of the Bankruptcy Act take effect and the scheme of distribution of the property of the bankrupt coming into the hands of the trustee must be followed. The statutory liens and charges, to the extent to which they are affected by the provisions of s. 107, cease to be of any force and effect. The rights of secured creditors, whose security arises apart from such statutes, are preserved and may be enforced against the property charged by way of security. The creditors for whose benefit the statutory liens and charges were created are no longer entitled to enforce those statutory liens and charges, except to the extent permitted by s. 107, and their claims are dealt with in the priority set out in s. 107.

36 The Chief Justice was affirmed in the Nova Scotia Court of Appeal, sub nom. *Dir. of Lab. Standards of N.S. v. Trustee in Bankruptcy* (1981), 38 C.B.R. (N.S.) 253, 126 D.L.R. (3d) 417, 47 N.S.R. (2d) 446, 90 A.P.R. 446. Jones J.A., speaking for the court, said at p. 260:

> In view of these remarks I fail to see how it can be argued that *Re Clemenshaw* can still be considered a valid interpretation of s. 107(1) of the Bankruptcy Act. Mr. Justice Pigeon made it abundantly clear that priorities of provincial claims must be determined in accordance with s. 107(1) of the Bankruptcy Act notwithstanding any statutory preference to the contrary. Debts under the Workers' Compensation Act fall under s. 107(1)(*h*) of the Act. Claims for wages are governed by s. 107(1)(*d*). With deference, it is not open to the province to provide any higher or more extensive priority for wages in view of the express provisions contained in that clause. It is clear from *Rainville* that the provincial Crown cannot claim as a secured creditor under the Bankruptcy Act, notwithstanding the form of the provincial legislation, where the claim is governed by s. 107(1) of the Bankruptcy Act. In my view, the claims in the present case fall under s. 107(1) and accordingly the appeals must be dismissed with costs.

37 The Court of Appeal of British Columbia, sitting as a panel of five, followed *Black Forest* in *W.C.B. of B.C. v. Kinross Mtge. Corp.*, 41 C.B.R. (N.S.) 1, [1982] 1 W.W.R. 87, 31 B.C.L.R. 382, 127 D.L.R. (3d) 740, and agreed with the Nova Scotia courts that its own earlier decision in *Re Clemenshaw* must be taken to have been overruled by this court in *Rainville*.

38 I believe that these authorities are determinative of the issue before us on this appeal and that the basis on which the Alberta Court of Appeal sought to distinguish them is an untenable one. I refer to the following excerpt from the reasons of Lieberman J.A. [46 C.B.R. (N.S.) at 292]:

> In my view, *Dep. Min. of Revenue (Que.) v. Rainville* and *Re Black Forest* are distinguishable from the case at bar and are not authority for the proposition that a claimant whose claim falls within s. 107 cannot be a "secured creditor" even if the claim satisfied the requirements of s. 2. The Workers' Compensation Act of Nova Scotia provides that the claim of the board establishes a lien against the assets of the employer without the board having to perform an overt act, whereas in the Alberta legislation (s. 78(4)) a floating charge is created which becomes a proprietary interest only after the board has performed overt acts of filing the certificate and initiating distress proceedings. The board in this case has performed those overt acts and in my view it has caused a floating charge to be crystallized in accordance with s. 78(4) of the

> Workers' Compensation Act. The claim thus comes within the definition of "secured creditor" in s. 2 of the Bankruptcy Act.

39 With respect, the issue in *Rainville* and *Re Black Forest* was not whether a proprietary interest has been created under the relevant provincial legislation. It was whether provincial legislation, even if it did create a proprietary interest, could defeat the scheme of distribution under s. 107(1) of the Bankruptcy Act. These cases held that it could not, that while the provincial legislation could validly secure debts on the property of the debtor in a non-bankruptcy situation, once bankruptcy occurred s. 107(1) determined the status and priority of the claims specifically dealt with in the section. It was not open to the claimant in bankruptcy to say: By virtue of the applicable provincial legislation I am a secured creditor within the meaning of the opening words of s. 107(1) of the Bankruptcy Act and therefore the priority accorded my claim under the relevant paragraph of s. 107(1) does not apply to me. In effect, this is the position adopted by the Court of Appeal and advanced before us by the respondent. It cannot be supported as a matter of statutory interpretation of s. 107(1) since, if the section were to be read in this way, it would have the effect of permitting the provinces to determine priorities on a bankruptcy, a matter within exclusive federal jurisdiction.

40 How then should the constitutional question stated by the Chief Justice be answered? Does s. 107(1)(*h*) of the Bankruptcy Act conflict with s. 78(4) of the Workers' Compensation Act so as to render the latter provision inoperable? I do not believe so. Section 78(4) does not purport to deal with a bankruptcy situation and, by virtue of the presumption of constitutionality, the provincial legislature is presumed to be legislating within its competence rather than outside it. Faced with the choice of construing the provincial legislation in a way which would cause it to invade the federal sphere, thereby attracting the doctrine of paramountcy, or construing it in accordance with the presumption of constitutionality, I prefer the latter course. I believe also that it accords better with the more recent authorities on the scope of the paramountcy doctrine.

41 In *Smith v. R.*, [1960] S.C.R. 776, 33 C.R. 318, 25 D.L.R. (2d) 225, 128 C.C.C. 145, Martland J. expressed the view at p. 800 that the doctrine of paramountcy only applies so as to render provincial legislation inoperative when "compliance with one law involves breach of the other". This approach was continued in *Const. Montcalm Inc. v. Minimum Wage Comm.*, [1979] 1 S.C.R. 754, 79 C.L.L.C. 14,190, 93 D.L.R. (3d) 641, 25 N.R. 1, where Beetz J. stated at p. 780 that "it was incumbent upon *Montcalm* to establish that it could not comply with provincial law without committing a breach of the federal Act" and that "*Montcalm* had to prove that federal and provincial law were in actual conflict for the purposes of this case". In Beetz J.'s view a person challenging provincial legislation on the basis of the paramountcy doctrine must establish an inevitable conflict between the two pieces of legislation in the particular situation: it was not enough that the two provisions might on one reading conflict.

42 This approach has most recently been re-affirmed by Dickson J. (as he then was) in *Multiple Access Ltd. v. McCutcheon*, [1982] 2 S.C.R. 161, 18 B.L.R. 138, 138 D.L.R. (3d) 1, 44 N.R. 181. He states at p. 191:

> In principle, there would seem to be no good reasons to speak of paramountcy and preclusion except where there is actual conflict in operation as where one enactment says "yes" and the other says "no"; "the same citizens are being told to do inconsistent things"; compliance with one is defiance of the other.

I do not believe that this is the case here. I think rather that the applicable principle is the one stated by Laskin C.J.C. in *Que. North Shore Paper Co. v. C.P.L.*, [1977] 2 S.C.R. 1054 at 1065, 9 N.R. 471, to the effect that "if the provincial legislation is of general application, it will be construed so as not to apply to such enterprises", i.e., those within federal competence.

43 As Professor Hogg points out in his text Constitutional Law of Canada (1977), the narrower the definition of conflict, the broader the scope within which valid provincial legislation can operate: the broader the definition of conflict, the greater the impact of the paramountcy doctrine to cut it down. He states at p. 103:

> When are two laws deemed to be inconsistent (or) conflicting so as to attract the doctrine of paramountcy? The question has profound implications for the scope of judicial review and for the balance of power in the federal system. Given the overriding force of federal law, a wide definition of inconsistency will result in the defeat of provincial laws in "fields" which are "covered" by federal law; a narrow definition, on the other hand, will allow provincial laws to survive so long as they do not "expressly contradict" federal law. The wide definition is the course of juridicial activism in favour of central power; the narrow definition is the course of judicial restraint, leaving all but the irreconcilable conflicts to be

resolved in the political arena.

44 I believe that the trend of the more recent authorities favours a restrictive approach to the concept of "conflict" and a construction of impugned provincial legislation, where this is possible, so as to avoid operational conflict with valid federal legislation. Where this is done both provisions can stand and have their own legitimate spheres of operation. In this sense I find no conflict between s. 107(1) of the Bankruptcy Act and s. 78(4) of the Workers' Compensation Act. I would accordingly answer the question as framed by stating that s. 107(1)(*h*) of the Bankruptcy Act applies to determine priorities on a bankruptcy and s. 78(4) of the Workers' Compensation Act has no application in such a situation.

45 I would allow the appeal and grant the appellant its costs throughout to be taxed on the appropriate scale.

Appeal allowed.

Footnotes

[*] Laskin C.J.C. and Ritchie J. did not take part in this judgment.

[**] Laskin C.J.C. and Ritchie J. did not take part in this judgment.

2009 ABQB 78
Alberta Court of Queen's Bench

EarthFirst Canada Inc., Re

2009 CarswellAlta 142, 2009 ABQB 78, [2009] A.W.L.D. 984, 174 A.C.W.S. (3d) 618, 1 Alta. L.R. (5th) 311

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 EarthFirst Canada Inc.

B.E.C. Romaine J.

Heard: January 28, 2009
Judgment: February 3, 2009
Docket: Calgary 0801-13559

Counsel: Howard A. Gorman, Randal Van de Mosselaer for EarthFirst Canada Inc.
A. Robert Anderson, Q.C. for Monitor, Ernst & Young Inc.
Brian P. O'Leary, Q.C., Doug S. Nishimura, Trevor A. Batty for WestLB AG
Jeffrey Thom, Q.C. for IDL Projects Ltd.
Susan Robinson-Burns for Synergy Engineering Ltd.
Benjamin La Borie for Gisborne Industrial Construction Ltd.
V. Philippe (Phil) Lalonde for Interoute Construction Ltd.

Subject: Insolvency; Environmental

Related Abridgment Classifications

Bankruptcy and insolvency
XIX Companies' Creditors Arrangement Act
  XIX.3 Arrangements
    XIX.3.b Approval by court
      XIX.3.b.i "Fair and reasonable"

Headnote

Bankruptcy and insolvency --- Proposal — Companies' Creditors Arrangement Act — Arrangements — Approval by court — "Fair and reasonable"
Corporation was developer of renewable wind energy and was under protection of Companies' Creditors Arrangement Act ("Act") — Corporation applied for order establishing hardship fund to be used to allow payment of pre-filing obligations owing to suppliers in community — Application granted — Local businesses would face bankruptcy if accounts receivable owed by corporation went unpaid — Payments would be considered interim distribution under future plan of arrangement and would be reflected in any final distribution to creditors — Decision to allow hardship fund outweighed prejudice to other creditors — Payments would be limited to bare bone payments to keep suppliers in business — Failure to fund small local businesses that were dependant on continued development of wind farm project could have harsh consequences in surrounding communities — Payment of case specific pre-filing debts would preserve corporation's primary asset, was fair and reasonable in circumstances and in accordance with purpose and objective of Act.

Table of Authorities

Cases considered by *B.E.C. Romaine J.*:

Air Canada, Re (2003), 2003 CarswellOnt 5296, 47 C.B.R. (4th) 163 (Ont. S.C.J. [Commercial List]) — considered

Smoky River Coal Ltd., Re (2000), [2000] 10 W.W.R. 147, 297 A.R. 1, 83 Alta. L.R. (3d) 127, 19 C.B.R. (4th) 281, 2000 CarswellAlta 830, 2000 ABQB 621 (Alta. Q.B.) — referred to

Statutes considered:

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

APPLICATION by corporation under *Companies' Creditors Arrangement Act* protection for establishment of hardship fund.

***B.E.C. Romaine J.*:**

Introduction

1 EarthFirst Canada Inc., a corporation under the protection of an initial order granted under the *Companies' Creditors Arrangement Act*, R.S.C. 1985 c. C-36, as amended, sought to establish a "hardship fund" that would be used to allow it to pay pre-filing obligations owing to certain suppliers and contractors operating in the community near which EarthFirst is developing a wind farm project. I authorized the establishment of this fund, and these are the reasons for my decision.

Background

2 EarthFirst is a publicly-traded developer of renewable wind energy in Canada. It has several projects under development and the most advanced is a wind farm under construction at Dokie Ridge in northeast British Columbia. This project is to be developed in two phases, with the first involving the construction of eight turbines and the second involving a further 40 turbines.

3 EarthFirst's financial difficulties arose primarily from cost overruns on the Dokie Project, combined with difficulties in completing re-financing and/or restructuring initiatives, exacerbated by the general tightening of credit markets.

4 The Dokie Project is located in a remote area of British Columbia close to three first nations' communities. The development has involved local contractors and suppliers whose viability is significantly dependant on this project. Some of these local contractors and suppliers have significant account receivable balances owing from EarthFirst, and some have not received payment from EarthFirst for several months. Certain creditors face immediate financial difficulty, including the inability to fund payroll and purchase critical supplies to continue operations. If some relief is not available, these local operations face bankruptcy.

5 EarthFirst, with the aid and support of the Monitor, proposed the establishment of a fund of $1.5 million to be disbursed in payment of some pre-filing claims of certain local suppliers who are in significant financial difficulty. Payments from the hardship fund are to be at the discretion of EarthFirst's Chief Restructuring Officer and subject to the approval of the Monitor. Such payments are to be considered an interim distribution under a future plan of arrangement and will be reflected in any final distribution to creditors.

6 The amount of the hardship fund was arrived at following discussions among EarthFirst, the Monitor, the local suppliers and contractors. The proposal recognizes the potential domino effect of a failure to fund small, local businesses that are dependant on the continued development of the Dokie Project and are essential to future construction activities and the preservation of the project's value, and the dire and harsh consequences in the surrounding communities of the inability of

such businesses to meet payroll obligations. The company and the Monitor submit that payments from the fund would contribute to necessary goodwill in the area and that cooperation and support of the local community is required to ensure that the value of the project is maximized. EarthFirst also notes that, while a CCAA stay of proceedings affects many creditors, the proposed recipients of the hardship fund in this isolated community are particularly vulnerable and at risk.

7 While the nature of payments from the hardship fund is different from the issue that was before Farley, J. in *Air Canada, Re*, 2003 CarswellOnt 5296 (Ont. S.C.J. [Commercial List]) (at para. 4), and while EarthFirst is not suggesting that recipients of the fund are "critical suppliers" in the usual sense of the term, it appears to be the case that, as in Air Canada, the potential future benefit to the company of these relatively modest payments of pre-filing debt is considerable and of value to the estate as a whole. The decision to allow the hardship fund thus outweighs the prejudice to other creditors, justifying a departure from the usual rule.

8 Counsel for the Monitor noted that the payments are likely necessary in order to preserve the opportunity to complete the Dokie Project, if that option appears to be the best way to maximize recovery for creditors. It was likely the recognition of this factor that led to little opposition to the application, including from the primary secured creditor. The opposition that was expressed related to a lack of certainty over which unsecured creditors would benefit. While the Monitor would not commit to full public disclosure of the recipients of the hardship fund, which might provoke the precise financial embarrassment and consequential business failure that payments from the fund are intended to prevent, the company and the Monitor were clear that payments would be limited to bare-bone payments "essential to keeping the lights of the recipient company on": *Smoky River Coal Ltd., Re*, 2000 CarswellAlta 830 (Alta. Q.B.) at para. 40.

9 I am satisfied that the payment of these case-specific pre-filing debts in a limited amount in order to preserve the value of this CCAA-debtor's primary asset and the option of continuing its development for the benefit of all creditors is fair and reasonable in the circumstances and in accordance with the purpose and objectives of the *Companies' Creditors Arrangement Act*.

Application granted.

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2007 NSSC 347
Nova Scotia Supreme Court

Federal Gypsum Co., Re

2007 CarswellNS 629, 2007 NSSC 347, 163 A.C.W.S. (3d) 689, 261 N.S.R. (2d) 299, 40 C.B.R. (5th) 80, 835 A.P.R. 299

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 the Applicant, Federal Gypsum Company

A.D. MacAdam J.

Heard: November 5, 2007
Oral reasons: November 5, 2007
Written reasons: January 29, 2008
Docket: S.H. 285667

Counsel: Maurice P. Chaisson, Graham Lindfield for Federal Gypsum Company
Carl Holm, Q.C. for BDO Dunwoody Goodman Rosen Inc.
Thomas Boyne, Q.C. for Royal Bank of Canada
Robert Sampson, Robert Risk for Enterprise Cape Breton Corporation, Cape Breton Growth Fund Corporation
Michael Pugsley for Her Majesty in Right of the Province of Nova Scotia (Nova Scotia Economic Development), Nova Scotia Business Incorporated
Michael Ryan, Q.C., Michael Schweiger for Black & McDonald Limited

Subject: Insolvency; Civil Practice and Procedure

Related Abridgment Classifications

Bankruptcy and insolvency
XIX Companies' Creditors Arrangement Act
XIX.2 Initial application
XIX.2.b Grant of stay
XIX.2.b.vii Extension of order

Headnote

Bankruptcy and insolvency --- Proposal — Companies' Creditors Arrangement Act — Miscellaneous issues
Debtor was granted stay of proceedings for 30 days pursuant to s. 11 of Companies' Creditors Arrangement Act ("CCAA") — Debtor wished to arrange debtor in possession ("DIP") financing, which was essentially new financing that required existing secured creditors to subordinate their interests — Bank was sole secured creditor that objected to DIP financing — Debtor was granted approval to arrange DIP financing to extent of $350,000 — Debtor was subsequently granted extension of time for filing plan of arrangement along with extension of stay termination date — Debtor wished to increase DIP financing with view to paying off bank — Debtor brought application for permission to increase DIP financing to $1,500,000 and for further extension of stay termination date — Application granted in part — Stay termination date was extended but increase in DIP financing was to be limited to $475,000 with no priority to be given to paying off bank — While debtor's net sales had declined, debtor had also incurred lower expenses and used less of authorized DIP financing than had been projected — Debtor's failure to meet projected sales was concern but information and evidence on file offered positive

indications — Debtor was not shown to be in its death throes — Prejudice to creditors was evident but perhaps not so fatal as certain demise of company in absence of further DIP financing and extension of time — Bank's secured position had apparently not deteriorated substantially thus far — Extension of time and additional DIP financing would enable debtor to continue in operation while plan of arrangement was considered and voted on by creditors — Favouring bank was not justified as success of restructuring was not dependent on permitting repayment of this single creditor.

Table of Authorities

Cases considered by *A.D. MacAdam J.*:

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

Cansugar Inc., Re (2004), 2004 CarswellNB 9, 2004 NBQB 7 (N.B. Q.B.) — considered

Dylex Ltd., Re (1995), 31 C.B.R. (3d) 106, 1995 CarswellOnt 54 (Ont. Gen. Div. [Commercial List]) — considered

Hunters Trailer & Marine Ltd., Re (2000), 2000 ABQB 952, 2000 CarswellAlta 1776, 5 C.B.R. (5th) 64 (Alta. Q.B.) — considered

Hunters Trailer & Marine Ltd., Re (2001), 2001 CarswellAlta 964, 94 Alta. L.R. (3d) 389, 27 C.B.R. (4th) 236, [2001] 9 W.W.R. 299, 2001 ABQB 546, 295 A.R. 113 (Alta. Q.B.) — considered

Inducon Development Corp., Re (1991), 8 C.B.R. (3d) 306, 1991 CarswellOnt 219 (Ont. Gen. Div.) — considered

Juniper Lumber Co., Re (2000), 2000 CarswellNB 130, 226 N.B.R. (2d) 115, 579 A.P.R. 115 (N.B. C.A.) — considered

Lehndorff General Partner Ltd., Re (1993), 17 C.B.R. (3d) 24, 9 B.L.R. (2d) 275, 1993 CarswellOnt 183 (Ont. Gen. Div. [Commercial List]) — referred to

Manderley Corp., Re (2005), 2005 CarswellOnt 1082, 10 C.B.R. (5th) 48 (Ont. S.C.J.) — considered

San Francisco Gifts Ltd., Re (2005), 2005 ABQB 91, 2005 CarswellAlta 174, 10 C.B.R. (5th) 275, 42 Alta. L.R. (4th) 377, 378 A.R. 361 (Alta. Q.B.) — considered

Simpson's Island Salmon Ltd., Re (2006), 2006 CarswellNB 420, 2006 NBQB 244, 24 C.B.R. (5th) 13, 300 N.B.R. (2d) 165, 782 A.P.R. 165 (N.B. Q.B.) — considered

Simpson's Island Salmon Ltd., Re (2006), 302 N.B.R. (2d) 10, 784 A.P.R. 10, 24 C.B.R. (5th) 17, 2006 CarswellNB 453, 2006 NBQB 279 (N.B. Q.B.) — considered

Statutes considered:

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

s. 11 — considered

s. 11(3) — considered

s. 11(4) — considered

s. 11(6) — considered

s. 11(6)(a) — considered

APPLICATION by debtor for permission to increase debtor in possession financing to $1.5 million and for extension of stay termination date.

***A.D. MacAdam J.*:**

1 Federal Gypsum Company, (herein "the Company" or "the Applicant"), having been granted a stay of proceedings pursuant to S. 11 of the *Companies Creditors Arrangement Act*, R.S.C. 1985, c. C-25 (herein "*CCAA*"), and, subsequently approval of arrangements for debtor in possession (herein "DIP") financing and an Order providing for extension of the Stay Termination Date set out in the initial Order, now applies for approval of arrangements for additional DIP financing.

2 The initial Stay Order provided for a 30-day Stay of Proceedings pursuant to s. 11(3) of the *CCAA*. The initial DIP financing application authorized DIP financing in the principal sum of $350,000.00. The time for filing the Plan of Arrangement under the *CCAA* and the Stay Termination Date were extended to November 29, 2007 at 4:00 p.m, by Order dated October 23, 2007. The Order also provided that "the Company shall file an Application before this Honourable Court relating to the consideration of further debtor in possession financing for a hearing on November 5, 2007 at 9:30 a.m." The Order also stipulated that the extension of the Stay Termination Date to November 29, 2007 was "subject to the right of the creditors of the Company to request a review and reconsideration" of the October 23 Order on the application for further DIP financing.

3 The Company now seeks an increase in the DIP financing from the original authorized $350,000.00 to $1,500,000.00.

4 Appearing on the Company's application were a number of secured creditors, including the Royal Bank of Canada, (herein "Royal Bank"), Cape Breton Growth Corporation, (herein "CBGC"), and Enterprise Cape Breton Corporation, (herein "ECBC"), (herein collectively referred to as the "Federal Crown Corporations"); Nova Scotia Business Inc. (herein "NSBI") and Nova Scotia — Office of Economic Development (herein "NSOED") (herein collectively referred to as the "Nova Scotia Crown Corporations"), each of whom hold, or purport to hold, first secured charges on some of the assets of the Company, as do the Federal Crown Corporations; and Black & McDonald Limited, (herein "BML") who purport to hold a subordinate secured charge on assets of the Company.

The CCAA

5 The relevant provisions of Section 11 of the *CCAA* are as follows:

> 11. (1) **Powers of court —** Notwithstanding anything in the *Bankruptcy and Insolvency Act* or the *Winding-up Act*, where an application is made under this Act in respect of a company, the court, on the application of any person interested in the matter, may, subject to this Act, on notice to any other person or without notice as it may see fit, make an order under this section.
>
> (2) **Initial Application** — An application made for the first time under this section in respect of a company, in this section referred to as an 'initial application' shall be accompanied by a statement indicating the projected cash flow of the company and copies of all financial statements, audited or unaudited, prepared during the year prior to the application, or where no such statements were prepared in the prior year, a copy of the most recent such statement.
>
> (3) **Initial application court orders** — A court may, on an initial application in respect of a company, make an order on such terms as it may impose, effective for such period as the court deems necessary not exceeding thirty days,
>
> > (a) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (1);
> >
> > (b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(c) prohibiting, until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company.

(4) **Other than initial application court orders —** A court may, on an application in respect of a company other than an initial application, make an order on such terms as it may impose,

(a) staying, until otherwise ordered by the court, for such period as the court deems necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (1);

(b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(c) prohibiting, until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company.

(5) **Notice of orders** — Except as otherwise ordered by the court, the monitor appointed under section 11.7 shall send a copy of any order made under subsection (3), within ten days after the order is made, to every known creditor who has a claim against the company of more than two hundred and fifty dollars.

(6) **Burden of proof on application** — The court shall not make an order under subsection (3) or (4) unless

(a) the applicant satisfies the court that circumstances exist that make such an order appropriate; and

(b) in the case of an order under subsection (4), the applicant also satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence.

The Law

6 The purpose of the CCAA was commented on by Justice Turnbull of the New Brunswick Court of Appeal in *Juniper Lumber Co., Re*, [2000] N.B.J. No. 144 (N.B. C.A.), at para. 1:

> The principal purpose of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the 'CCAA'), 'is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors to the end that the company is able to continue in business ... When a company has recourse to the C.C.A.A. the court is called upon to play a kind of supervisory role to preserve the status quo and to move the process along to the point where a compromise or arrangement is approved or it is evident that the attempt is doomed to failure.' See Arrangements Under the Companies' Creditors Arrangement Act by Goldman, Baird and Weinszok (1991), 1 C.B.R. (3d) 135 at p. 201 where the authors cite Thackray; J. approvingly quoting Gibbs, J.A. from the cases cited on that page. In New Brunswick, the Court of Queen's Bench is defined by the CCAA as the Court to play the 'kind of supervisory role.' The CCAA has a remedial purpose and, therefore, must be interpreted in a broad and liberal fashion. See pages 137-138 in the article previously cited. More often than not time is critical. And, in order to maintain a status quo while attempts are made to determine if a successful compromise or arrangement can be reached, the courts are granted certain powers in s. 11 to hold creditors at bay.

7 Justice Glennie of the New Brunswick Court of Queen's Bench in *Simpson's Island Salmon Ltd., Re*, 2006 NBQB 279 (N.B. Q.B.), at para. 20, after referencing *Juniper Lumber Co.*, referred to *Lehndorff General Partner Ltd., Re*, [1993] O.J. No. 14 (Ont. Gen. Div. [Commercial List]), at paras. 5 and 6, where Farley, J. said:

> The CCAA is intended to facilitate compromises and arrangements between companies and their creditors as an alternative to bankruptcy and, as such, is remedial legislation entitled to a liberal interpretation. It seems to me that the

> purpose of the statute is to enable insolvent companies to carry on business in the ordinary course or otherwise deal with their assets so as to enable a plan of compromise or arrangement to be prepared, filed and considered by their creditors and the court. In the interim, a judge has a great discretion under the CCAA to make order so as to effectively maintain the status quo in respect of an insolvent company while it attempts to gain the approval of its creditors for the proposed compromise or arrangement which will be to the benefit of both the company and its creditors. ...
>
> The CCAA is intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both. Where a debtor company realistically plans to continue operating or to otherwise deal with its assets but it requires the protection of the court in order to do so and it is otherwise too early for the court to determine whether the debtor company will succeed, relief should be granted under the CCAA. ...

Background

(A) The Initial Application

8 On the initial application, the Court having been satisfied the company met the requirements for the filing under the *CCAA*, in that it was, on the evidence tendered, "insolvent" and had total claims exceeding $5,000,000.00, and being further satisfied that the burden stipulated in s. 11(6) had been met, an Order providing for a Stay of Proceedings was issued.

(B) The Initial DIP Financing

9 Shortly after the Stay Order was issued, the Company filed the application for the initial DIP financing in the sum of $350,000.00. Counsel for the company acknowledged the omission in the CCAA of any specific authorization sanctioning DIP financing and granting "super-priority" over existing secured, as well as unsecured, debt. Counsel referenced the legal principles cited by Justice C. Campbell in *Manderley Corp., Re* (2005), 10 C.B.R. (5th) 48 (Ont. S.C.J.), at para 18 where he observes:

> The operative legal principles are set out in the following quotations from Houlden & Morawetz' *Bankruptcy & Insolvency Analysis* (Carswell, 2004), section N16 — Stay of Proceedsings[sic] — CCAA — at page 18:
>
> > Although the C.C.A.A. makes no provision for DIP financing, it seems to be well established that, under its inherent powers, the court may give a priority for such financing and for professional fees incurred in connection with the working out of a C.C.A.A. plan.
> >
> > For the court to authorize DIP financing, there must be cogent evidence that the benefit of the financing clearly outweighs the prejudice to the lenders whose security is being subordinated to the financing: ...
> >
> > The court can create a priority for the fees and expenses of a court-appointed monitor ranking ahead of secured creditors so long as they are reasonably incurred in connection with the restructuring of the debtor corporation and there is a reasonable prospect of a successful restructuring: ...

10 At para 19 Justice Campbell continues:

> In *Skydome Corp., Re*, 1998 CarswellOnt 5922, 16 C.B.R. (4th) 118 (Ont. Gen. Div. [Commercial List]), Blair J. (as he then was) dealt with the issue of 'super-priority' financing in the context of the specific use to be made of the funds where he was satisfied that the priority accorded the DIP financing would not prejudice the secured creditors. At paragraph 13 he said:
>
> > I am satisfied that the Court has the authority either under s. 8 of the CCAA or under its broad discretionary powers in such proceedings, to make such an order. This is not a situation where someone is being compelled to advance further credit. What is happening is that the creditor's security is being weakened to the extent of its reduction in

> value. It is not the first time in restructuring proceedings where secured creditors — in the exercise of balancing the prejudices between the parties which is inherent in these situations — have been asked to make such a sacrifice. Cases such as *Re Westar Mining Ltd.* (1992), 14 C.B.R. (3d) 88 (B.C.S.C.) are examples of the flexibility which courts bring to situations such as this. ...

11 To similar effect Wachowich J. in *Hunters Trailer & Marine Ltd., Re* (2001), 295 A.R. 113 (Alta. Q.B.), noted, at para. 32, the necessity to balance the benefit of such financing with the potential prejudice to the existing secured creditors. Justice Glennie in *Simpson's Island Salmon Ltd., Re*, *supra*, at paras. 16-19 held:

> In order for DIP financing with super-priority status to be authorized pursuant to CCAA, there must be cogent evidence that the benefit of such financing clearly outweighs the potential prejudice to secured creditors whose security is being eroded. See *United Used Auto & Truck Parts Ltd., Re*, [1999] B.C.J. No. 2754(B.C.S.C. [In Chambers]), affirmed [2000] B.C.J. No. 409 (B.C. C.A.)
>
> DIP financing ought to be restricted to what is reasonably necessary to meet the debtors urgent needs while a plan of arrangement or compromise is being developed.
>
> I am satisfied on the evidence before me that Simpson's Island and Tidal Run have a viable basis for restructuring. The amount of the DIP facility has been restricted to what is necessary to meet short-term needs until harvest.
>
> A Court should not authorize DIP financing pursuant to the CCAA unless there is a reasonable prospect that the debtor will be able to make an arrangement with its creditors and rehabilitate itself. In this case the Monitor has advised the Court that there is a reasonable prospect that Simpson's Island and Tidal Run will be able to make such arrangements with their creditors.

12 In his written submission counsel for the company, in reference to the three issues for review outlined by Justice Glennie, commented that "[e]ssentially, the court must engage in the balancing act that is the hallmark of DIP financing, as declared by C. Campbell, J. in *Manderley* at para. 27, weighing the benefit and prejudice referred to by Glennie, J."

13 The secured creditors, with the exception of the Royal Bank, neither consented nor strenuously objected to the initial DIP financing sought by the Company. The Royal Bank, on the other hand, objected, on the basis that the funding of the ongoing operations of the company could very well be at the expense of its security on the receivables and inventory. Nevertheless, having balanced prejudice to the secured creditors, in this instance particularly to the Royal Bank, and the benefit of providing financing to enable the Company to pursue a Plan of Arrangement, and on being satisfied the sought-for DIP financing and resulting super-priority were reasonably necessary to meet the Company's immediate needs and there was a reasonable prospect the Company would be able to make arrangements with its creditors and thereby rehabilitate itself, this Court allowed the application.

(C) The First Extension

14 At the expiration of the initial Stay Termination date, the Company applied for an extension, which application was generally opposed by the secured creditors. The Application included a further Affidavit by one of the Directors and Officers of the Company, as well as a further report from the Monitor. In para. 4.7, the Monitor reported:

> Having met with Federal and its legal counsel, and having had preliminary discussions with them as to the general principles and format of a Plan of Arrangement, and having considered the progress made in financing and sales opportunities, and having had initial discussions with senior secured creditors, the Monitor concludes that Federal has acted, and continues to act, in good faith and with due diligence and, if given sufficient time by This Honorable (sic)Court, should be able to file a Plan of Arrangement under CCAA that will have a significant chance of being successful.

15 Included among the Monitor's recommendations was the observation that the Company "... must make an application

for an increase in the DIP financing level and such other matters as may relate thereto".

16 In *Cansugar Inc., Re*, 2004 NBQB 7 (N.B. Q.B.), at paras 8 and 9, Justice Glennie in respect to applications for extension of stay termination dates, after referencing ss. 11(4) and (6) of the CCAA, stated:

> In *The 2004 Annotated Bankruptcy & Insolvency Act*, Houlden & Morawetz state at page 1126:
>
> > To obtain an extension, the application must establish three preconditions:
> >
> > (a) the circumstances exist that make the order appropriate;
> >
> > (b) that the applicant has acted and continues to act in good faith; and
> >
> > (c) that the applicant has acted and continues to act with due diligence.
>
> In my opinion, the requirements of section 11(6) of the C.C.A.A. have been satisfied in this case. The continuation of the stay is supported by the overriding purpose of the C.C.A.A., which is to allow an insolvent company a reasonable period of time to reorganize and propose a plan of arrangement to its creditors and the Court, and to prevent maneuvers for positioning among creditors in the interim.

17 In support of the application for the extension, counsel referenced para. 17 of the Affidavit of Mr. Simpson, where he states that:

> An extension of the Stay of Termination Date would allow the Company to accomplish the following:
>
> > (a) continue with its recent efforts to improve sales, which are expected to yield positive results;
> >
> > (b) provide for additional debtor-in-possession financing to service the Company's cash flow needs in the short and medium term until the Plan is presented to the Company's stakeholders;
> >
> > (c) complete the appraisal of the assets of the Company;
> >
> > (d) complete cash flow forecasts and income statement and balance sheet projections for the 2008, 2009 and 2010 years; and
> >
> > (e) finalize the elements of the Plan.

18 At para 18 Mr. Simpson continues:

> I believe that if the Stay Termination Date is not extended, some of the creditors of the Company will commence proceedings against the Company in relation to the enforcement of their security. Such proceedings would be highly prejudicial to the interests of the Company and would significantly impair the Company's ability to complete a successful restructuring.

19 Mr. Simpson's Affidavit, in outlining the present circumstances and the efforts of the company since the date of the initial order, also states that the Company "... is presently formulating a plan to present to its various stakeholders- including its creditors". Counsel notes the Company is arranging for an appraisal of its assets and negotiating with a lender to provide additional financing during the "near and medium term". Counsel suggests these factors demonstrate that:

> ... the Company has been proceeding diligently and in good faith since the Initial Order to assemble the elements of a plan to be presented to its stakeholders. There will be several elements to this plan and the Company requires additional time to bring these elements together. The Company's majority shareholder is motivated by the single goal of putting together a plan which will ensure the survival of the Company and, in so doing, protect, to the fullest extent possible, the interests of the stakeholders as a whole.

20 Counsel references *San Francisco Gifts Ltd., Re*, 2005 ABQB 91 (Alta. Q.B.), where, at para. 28, Topolniski. J. comments on the supervisory role of the Court on such an application:

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

21 The application for an extension of the Stay Termination Date was opposed on the basis that the performance by the Company did not generate confidence it had turned the corner and was likely to survive. The objecting creditors viewed the performance of the Company as further prejudicing their position in respect to the secured positions they held on the various assets of the company. They took this view, notwithstanding the Monitor's assessment that the Company, by its actions, appeared to be acting in good faith and with due diligence and moving forward towards the preparation of a Plan of Arrangement, and that the actual net cashflow of the Company was not adverse to the cashflow plan as presented on the initial Order. On the Application for the Stay Extension, counsel for the Nova Scotia Crown Corporations did not object to the extended Stay, but expressed a concern about the proposed increase in the DIP financing.

22 Considering the position of the creditors and the representations on behalf of the Company, the Stay Termination Date was extended to November 29, 2007 with the proviso that on the Application for further DIP financing the creditors could request a review and reconsideration of the extension.

Issue

23 At issue is whether the Company's application for approval of Arrangements for additional DIP financing should be approved, including the proposed payout of the Royal Bank operating loan, and whether the Court should reconsider the extension of the Stay Termination Date to November 29, 2007.

The Present Applications

Reconsidering the Extension of the Stay Termination Date

24 In respect to the Company's application to extend the Stay Termination Date, counsel on behalf of the Royal Bank had indicated the Bank's opposition both in writing and in oral submission. Counsel noted the burden of proof was on the Applicant. Counsel for the Company suggested circumstances existed that made it appropriate to extend the initial Order, in that the Applicant had acted, and continued to act in good faith and with due diligence. In this respect counsel refers to *Inducon Development Corp., Re* (1991), 8 C.B.R. (3d) 306 (Ont. Gen. Div.), where Farley, J. observed :

> The good faith and due diligence of the Applicant are not questioned.

25 On the reconsideration application, counsel for the Royal Bank acknowledged that neither the good faith nor due diligence of the Applicant were questioned, but said the Company had failed to show circumstances that made it appropriate to extend the initial Order. Counsel suggested that to cover the losses for the first seven months of 2007 the Company would have to increase its net sales by over 65%, and if one were to include all expenses and only the repayment of $1,000,000.00

per year on the total liabilities of more than $32,000,000.00, the Applicant would have to increase its net sales by 92%. Counsel noted the difficulties the Company has had in marketing its products and that in fact there has been a "decrease in sales from expected levels with a resulting decrease in accounts receivables". Counsel added that in the Monitor's second report he indicated sales were over $150,000.00 less than budget and expressed concern about the trend in sales. Counsel submitted that there is no evidence of a plan, referring again to reasons of Justice Farley in *Inducon Development Corp.*, *supra*, where he stated:

> [W]hile it is desirable to have a formalized plan when applying, it must be recognized as a practical matter that there may be many instances where only an outline is possible. I think it inappropriate, absent most unusual and rare circumstances, not to have a plan outline at a minimum, in which case then I would think that there would be a requisite for the germ of a plan.

26 Counsel for the Royal Bank suggested it is inappropriate to continue CCAA protection where the Company does not have, "at the least, a minimum outline of a plan".

27 In response to the Company's suggestion that the creditors "will not be materially prejudiced as the company continues to operate ....", Counsel said there is real prejudice, including:

> (a) interference with the rights of secured creditors to deal with their security and to maximize their recovery;
>
> (b) changing market conditions and the loss of potential purchasers of the assets;
>
> (c) deterioration in the value of assets through on-going use;
>
> (d) in the case of Royal Bank of Canada, the eroding of and loss of its security interest through the collection and use of accounts receiveable [sic] to fund the operations of the Applicant during the Stay;
>
> (e) costs of professionals in maintaining these proceedings, which in the case of the Applicant are recognized to be as great as $300,000;
>
> (f) professionals costs to the creditors; and
>
> (g) delay with regard to unsecured creditors in recognizing losses and the decisions that they must make in dealing with their own creditors on a go forward basis.

28 Counsel notes as unique the reality that the Company has never been profitable, whereas in many of the cases where *CCAA* orders are granted, the Companies have been in business for some period of time and, through circumstances, have suffered adversity which may be overcome through forgiveness and restructuring of debt obligations and the injection of equity to enable them to return to a state of profitability. The Company, counsel suggests, has never generated enough sales to even meet its operating expenses. Counsel adds that no evidence has been presented to the Court to indicate such a level of sales can be reached. As a result, counsel concludes, the Company has no reasonable expectation of reaching the required level of sales.

29 Notwithstanding the forceful submission of counsel for the Royal Bank, it is clear that although net sales have declined, the Company has also incurred lower expenses and has used less of the authorized DIP financing than had been projected in the cashflow projections filed on the initial DIP financing application. Like with the Monitor, I am concerned with the failure of the Company to meet the projected sales. There are, however, some positive indications from the information filed in the Monitor's report and outlined in the Affidavit of Rhyne Simpson, Jr., President and a Director of the Applicant. I am not satisfied the Company has reached the stage of "the last gasp of a dying company" or is in its "death throes ", although clearly any Plan of Arrangement will require compromise and cooperation between the Company and its stakeholders. During the course of submissions, counsel for the Company acknowledged that if additional DIP financing was not obtained the inevitable consequence would be the demise of the Company. The effect on the Company of terminating the extension of the Termination Date, as it relates to the opportunity for the preparation and presentation of a Plan of

Arrangement, is evident. The prejudice to the creditors, although evident, is perhaps not so fatal. Although not necessarily indicative of the position of the Royal Bank, should, in due course, the Company fail, nevertheless on the financial information filed by the Monitor from information obtained from the Company's officers, it would not appear that there has been a substantial deterioration in the Royal Bank's secured position to date.

30 As a consequence I am prepared to grant the Order continuing the Stay Termination Date until November 29th, 2007, provided the Company is successful on the application for additional DIP financing.

The Additional DIP Financing

31 On the Application to extend the Stay Termination Date and to set the date for filing the Plan of Arrangement, counsel for the Company acknowledged that if the Company was unsuccessful in obtaining approval of arrangements for additional DIP financing, notwithstanding the extension, the Company would not be able to continue in operation while preparing and presenting to its creditors its proposed Plan of Arrangement. On the Application for the $1,500,000.00 DIP financing, the Monitor appointed on the initial application, in his third report to the Court, indicated the purpose was to replace the previous DIP lender, pay out the Royal Bank working capital loan, and provide additional DIP funds to allow the Company to continue operations and provide time to finalize and file a Plan of Arrangement for consideration by the creditors. The Monitor reported that its weekly cashflow projections, as prepared by the Company, indicated the requirement for DIP financing for the week of November 26, 2007 would be approximately $83,000.00 in excess of the present DIP financing approval limit. The report further indicated that beyond the Stay Termination Date of November 29, 2007 the requirement for DIP financing would increase significantly in the month of December 2007.

32 With the sole exception of the Royal Bank, the secured creditors oppose the application for additional DIP financing. The Royal Bank, in view of the stipulated intention to use the additional DIP financing to pay down its working capital loan, leaving only a second loan secured on certain leases, does not oppose the additional DIP financing. Absent the provision for repayment of its working capital loan, it is clear from the representations of counsel, both on this and earlier applications, that the Royal Bank would not consent to nor support the request for additional DIP financing.

33 On the application, counsel for the Company advised that the proposed DIP lender had stipulated certain changes in the terms of the proposed financing to require the first DIP lender to advance the remainder of the amounts authorized under the initial DIP Order and that the full amount of $350,000.00 be subordinated to its charge. There were changes relating to the "borrowing base" for the loans and a requirement that the priority of the "Administration Charge", which priority was provided for in the initial Order, was not to exceed the sum of $75,000.00. During the course of the application counsel also advised that other changes had been approved by the DIP lender, including verification of the amount upon which the lender was entitled to charge fees over and above the interest provided for in the offer of financing.

34 Counsel for the applicant, referencing the comment by C. Campbell, J. in *Manderley Corp., Re*, *supra*, at para 27, acknowledged the Court must engage in "the balancing act that is the hallmark of DIP financing". He notes Justice Glennie applied this balancing in considering the approval of super-priority funds, beyond those initially requested, when, in *Simpson's Island Salmon Ltd., Re*, 2006 NBQB 244 (N.B. Q.B.), at para 9, he declared:

> As stated by MacKenzie J.A. in *United Used Auto & Truck Parts Ltd., Re* (2000), 16 C.B.R. (4th) 141 (B.C. C.A.):
>
> > [12] ... the CCAA's effectiveness in achieving its objectives is dependent on a broad and flexible exercise of jurisdiction to facilitate a restructuring and continue the debtor as a going concern in the interim.
> >
> > [28] The object of the CCAA is more than the preservation and realization of assets for the benefits of creditors, as several courts have underlined. In *Chef Ready Foods*, Giggs J.A. said that the primary purpose is to facilitate an arrangement to permit the debtor company to continue in business and to hold off creditors long enough for a restructuring plan to be prepared and submitted for approval. The court has a supervisory role and the monitor is appointed 'to monitor the business and financial affairs of the company' for the court.

35 Justice Glennie was concerned with an application for an increase in the "Administrative Charge", for which priority was granted, to the advisors retained to formulate and present the restructuring plan. He determined that failure to grant the increase would result in the applicants no longer being able to continue their attempts at restructuring. He referred to the decision of Justice Wachowich, also in respect to an administrative charge, in *Hunters Trailer & Marine Ltd.*, *supra*, denying an increase in the amount of DIP financing. He found the applicant had not met the onus under s. 11(6) (a) of the *CCAA* to establish that a stay would be appropriate in the circumstances. At para 10 he observed:

> In my view, the evidence provided by Hunters does not show that the benefits of DIP financing will clearly outweigh potential prejudice to the Objecting Creditors. While DIP financing is the only means for Hunters to continue operating, it is impossible to conclude that this short-term benefit will culminate in Hunters' financial recovery, due to a number of deficiencies in the evidence.

36 Justice Wachowich continued by identifying particular deficiencies such as the absence of appraisals, the absence of current financial information on the Company, the absence of verification of the Company's cashflow projections by the Monitor and uncertainty as to the value of one of the major assets. Counsel suggests that in the present instance these deficiencies do not exist, in that an appraisal has been obtained, the current financial information is available on an ongoing basis, and the Monitor is being provided with continuing opportunities to verify the Company's cashflow projections and has done so. Counsel also suggests the other deficiency noted by Justice Wachowich, the uncertainty as to the value of a major asset, is not an issue in the current circumstance.

37 Counsel for the Company, suggesting that DIP financing "is merely prolonging the inevitable", cites para. 13 of *Hunters Trailer & Marine Ltd., Re*, 2000 ABQB 952 (Alta. Q.B.):

> Another consideration in assessing the benefit of DIP financing is that even if Hunters' projected cashflows are accurate, they show a continuing net deficit, suggesting that the benefit of DIP financing is merely prolonging the inevitable Even as of September 2001, following the months when the volume of Recreational Vehicle ('RV') sales is highest, Hunters expects a cash flow deficit. After September, the RV sales will slow down significantly as Hunters enters the low season, so cash flow is not likely to increase after September. Hunters can expect continuing difficulties in meeting operating expenses well into the foreseeable future. The sources of Hunters' cash flow problems, as identified by Blair Bondar, the company president, will likely continue to exist. Mr. Bondar states that RV sales have decreased as a result of, in part, increasing gas prices, a weak Canadian dollar, and increased competition. Hunters has no control over these systemic problems, and there is no evidence or reason to believe that they will be resolved in the foreseeable future. As a result, I am not convinced that the cash flow projections themselves are accurate. The Monitor does not verify the accuracy or reasonableness of the projections. Therefore, it is impossible to conclude that the DIP financing will benefit Hunters and its creditors in the long run.

38 Counsel says the current circumstance can be distinguished for a number of reasons, including that the projected cashflow statements "do not disclose uninterrupted deficits, and those deficits that exist for the most part are minimal." Counsel's submission continues:

> ... The sources of the Company's cash flow problems are not expected to continue to exist, or at least to have as severe an effect as they did during the month of October, as noted at paragraph 25 of the Additional DIP Affidavit. Finally, as noted above, the Monitor has verified the reasonableness of the Company's cash flow projections. All of the above circumstances suggest, contrary to those facing Wachowich J. in *Hunters* (2000) (*supra)*, that additional DIP financing will benefit the Company and its creditors in the long run, as those funds will allow the Company to take advantage of the opportunities presented, and thereby ultimately bolster its efforts to finalize and present a viable restructuring plan. It is submitted that none of the myriad reasons by Wachowich J. for denying further DIP financing are present in the current situation.

39 Counsel suggests the additional DIP financing is a necessary cost of ensuring there can be a meaningful discussion between the stakeholders about the restructuring plan. Counsel recognizes that any protection afforded by the CCAA, with its attended super-priority, will necessarily have a prejudicial effect on the Company's creditors. As counsel suggests, what must

be examined is whether such prejudice is more than outweighed by the prejudice to the Company and its stakeholders should the requested DIP financing be denied, given that, as counsel suggests, "it would most likely have to cease operations in that instance." Counsel suggests the Affidavit filed in support of the Application "provides clear evidence of improving prospects for the Company, as well as considerable effort on its part to build a sustainable business, the ultimate goal of the *CCAA* restructuring process". Having considered the Monitor's reports and filed documents, including affidavits, together with the representations of Counsel, I am satisfied it is appropriate to continue CCAA protection to enable the Company to finalize preparation of the Plan and its presentation to the creditors. In view of the need for additional DIP financing to enable the Company to continue in operation, while the Plan is considered and voted upon by the creditors, the Company is granted approval for additional DIP financing.

Payout of the Royal Bank

40 Counsel for the Company's submission recognized the possibility that some of the secured creditors would object to the application and, in particular, to the proposed buy-out of the Royal Bank's operating line of credit. Counsel referenced the comments of Farley, J. in *Dylex Ltd., Re* (1995), 31 C.B.R. (3d) 106 (Ont. Gen. Div. [Commercial List]), to the effect that the mere fact a significant secured creditor objects to such financing should in no way preclude the Court's ability to approve DIP financing. Counsel then references *Hunters Trailer & Marine Ltd., Re* (2001), 295 A.R. 113 (Alta. Q.B.), at para 32, where the Court stated that "if super-priority cannot be granted without the consent of secured creditors, the protection of the CCAA effectively would be denied a debtor company in many cases."

41 Counsel's submission continues:

> ... the specific issue of the Court's ability to approve an agreement between a CCAA debtor and one or more, though less than all, of its creditors was recently reviewed by the Alberta Court of Appeal in Re. Calpine Canada Energy Ltd. 2007 ABCA 266. As C. O'Brien J.A. noted,
>
> > The power to approve such transactions during the stay is not spelled out in the CCAA. As has often been observed, the statute is skeltal. The approval power in such instances is usually said to be found either in the broad powers under section 11(4) to make orders other than on an initial application to effectuate the stay, or in the court's inherent jurisdiction to fill in gaps in legislation so as to give effect to the objects of the CCAA, including the survival program of the debtor until it can present a plan: Re Dylex Ltd., (1995), 31 C.B.R. (3d) 106 at para 8 (Ont. Gen. Div.)
>
> In the result the Court of Appeal upheld the ruling of B.E. Romaine J. at the Court of Queen's Bench: 2007 ABQB 504 (Alta. Q.B.). As Justice Romaine set out,
>
> > ... Settling with one or two claimants will invariably have an effect on the size of the estate available for other claimants. The test of whether such an adjustment results in fair and reasonable requires the Court to look to the benefits of the settlement to the creditors as a whole, to consider the prejudice, if any, to the objecting creditors specifically and to ensure that rights are not unilaterally terminated or unjustly confiscated without the agreement or approval of the affected creditor.
> >
> > . . . . .
> >
> > ... It is clear from the case law that Court approval of settlements and major transactions can and often is given over the objections of one or more parties. The Court's ability to do this is a recognition of its authority to act in the greater good consistent with the purpose and spirit and with the confines of the legislation.

42 In his Affidavit filed on this application, Mr. Simpson, at para. 16, deposes:

> The Company is pursuing this repayment so as to afford the best chance of success for its restructuring plan (the 'Plan') when it is presented to creditors, and thereby the best chance of a reasonable resolution. Throughout the Company's proceedings under the CCAA to this point, the Royal Bank has been consistently vocal in its opposition to the restructuring process. It is most likely that the Royal Bank's continued participation in the process will only hinder it, necessitating the use of further time and the expenditure of additional costs in order to ultimately achieve a fair

> restructuring, a result that will be most beneficial to the Company, and given the limited alternatives, most beneficial to the creditors as a whole. It is for these reasons that the Company considers repayment of the operating facility to be in the best interests of all stakeholders.

43 After referencing para 16 of Mr. Simpson's Affidavit, Counsel suggests that in view of the Royal Bank's opposition to the process, and in view of the serious discussions and negotiations that will occur between the Company and its creditors:

> ... For the attainable and beneficial goal of a successful restructuring to be achieved, it is the Company's position that the Royal Bank should likely be removed from active participation through the retirement of its operating line, and that this Court is empowered to do so either under s. 11(4) of the CCAA or by way of its inherent jurisdiction.

44 On being examined, Mr. Simpson indicated, in response to the question why provide for the payout of the Royal Bank operating line, that it would "make life easier, but is not necessary". To similar effect, counsel for the Company in his oral submission acknowledged that the rejection of the proposal to pay out the Royal Bank operating line would not appear to be fatal to the proposed restructuring. In the circumstances, it is clear that the success of the restructuring and the Plan is not dependent on permitting the repayment of this single creditor. As such, there is really no justification for favouring the Royal Bank by authorizing the repayment of its operating line from the DIP financing. The request to pay out the Royal Bank operating line is therefore denied.

Conclusion

45 The extension of the Stay to November 29, 2007 is confirmed and the Company is authorized to drawn down DIP financing in the sum of $475,00.00. The request to pay out the Royal Bank from the DIP financing is denied.

Application granted in part.

End of Document

2012 ONSC 6403, 2012 CarswellOnt 14263, 223 A.C.W.S. (3d) 14, 99 C.B.R. (5th) 128

2012 ONSC 6403
Ontario Superior Court of Justice [Commercial List]

Futura Loyalty Group Inc., Re

2012 CarswellOnt 14263, 2012 ONSC 6403, 223 A.C.W.S. (3d) 14, 99 C.B.R. (5th) 128

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

In the Matter of a Plan of Compromise or Arrangement of The Futura Loyalty Group Inc. Applicant

D.M. Brown J.

Heard: November 13, 2012
Judgment: November 13, 2012
Docket: CV-12-9882-00CL

Counsel: S. Reid for Applicant
G. Azeff, A. Iqbal for Monitor, Harris & Partners Limited
J. Desjardins for DirectCash Payments Inc.
D. Pearlman for Aimia Canada Inc.

Subject: Insolvency; Civil Practice and Procedure; Corporate and Commercial

Related Abridgment Classifications

Bankruptcy and insolvency
XIX Companies' Creditors Arrangement Act
XIX.2 Initial application
XIX.2.a Procedure
XIX.2.a.iii Notice

Bankruptcy and insolvency
XIX Companies' Creditors Arrangement Act
XIX.2 Initial application
XIX.2.h Miscellaneous

Headnote

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Initial application — Miscellaneous
Debtor's main source of revenues was from selling Aeroplan Miles to merchants as customer reward programme — Some merchants purchased discounted Miles by prepaying debtor — Court made initial order for protection — Debtor applied for order permitting it to honour merchant prepayments made prior to initial order — Application granted — Order was consistent with and fostered objectives of Companies' Creditors Arrangement Act — Ongoing resale of Miles was essential to debtor's viability as going concern — Honouring prepayments would assist debtor's reorganization efforts to maintain merchants as customers — Order was not opposed by monitor or secured creditors.

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Initial application — Procedure — Notice
Debtor's main source of revenues was from selling Aeroplan Miles to merchants as customer reward programme — Some merchants purchased discounted Miles by prepaying debtor — Court made initial order for protection — Debtor applied to vary order by deferring notice to prepaying merchants — Application dismissed — Transparency was foundation upon which

Companies' Creditors Arrangement Act rested — Initial order had already been posted on monitor's website and notice was published in newspaper — There was no principled basis upon which to exclude one group of creditors — Risk that some merchants would cancel their participation in reward programme was inherent in proceedings under Act — It was up to debtor to persuade its customers that it was in their long-term interests not to abandon it.

Table of Authorities

Cases considered by *D.M. Brown J.*:

EarthFirst Canada Inc., Re (2009), 1 Alta. L.R. (5th) 311, 2009 ABQB 78, 2009 CarswellAlta 142 (Alta. Q.B.) — followed

Eddie Bauer of Canada Inc., Re (2009), 2009 CarswellOnt 3657, 55 C.B.R. (5th) 33 (Ont. S.C.J. [Commercial List]) — followed

Futura Loyalty Group Inc., Re (2012), 2012 CarswellOnt 12842, 2012 ONSC 5896 (Ont. S.C.J. [Commercial List]) — referred to

Nortel Networks Corp., Re (2009), 2009 CarswellOnt 4467, 55 C.B.R. (5th) 229 (Ont. S.C.J. [Commercial List]) — considered

Statutes considered:

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

s. 11 — considered

s. 11.02(2) [en. 2005, c. 47, s. 128] — referred to

s. 11.2 [en. 1997, c. 12, s. 124] — considered

s. 23 — considered

s. 23(1)(a)(ii)(B) — considered

APPLICATION by debtor to vary initial order under *Companies' Creditors Arrangement Act* and for additional relief.

***D.M. Brown J.*:**

I. Overview of orders sought under the CCAA

1 By Initial Order made October 16, 2012 [2012 CarswellOnt 12842 (Ont. S.C.J. [Commercial List])], the applicant, The Futura Loyalty Group Inc., obtained the protection of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36. By order made October 26, 2012, another judge of this Court approved a proposed Sale and Investor Solicitation Process and granted other relief. Futura now moves for orders (i) extending the Stay Period until January 18, 2013, (ii) increasing the DIP Facility from $175,000 to $300,000, (iii) permitting it to honour prepayments made for Aeroplan Miles by Prepaying Merchant Customers, and (iv) varying the Initial Order to defer giving notice under section 23 of the *CCAA* to Prepaying Merchant Customers.

II. Extending the Stay Period and increasing the DIP Facility

2 Futura seeks an extension of the Stay Period in order to enable it to work on the SISP which, it hopes, will result in either a going-concern sale or new investment implemented through a plan of compromise or arrangement. The Monitor supports the request and, in its Second Report dated November 9, 2012, expressed the view that Futura has acted and continues to act in good faith and with due diligence. DirectCash Payments Inc., which holds first ranking secured debt of about $300,000, also supported the extension, as did Aimia Canada. I am satisfied that the evidence disclosed that Futura has acted, and is acting, in good faith and with due diligence and the requested extension is necessary to implement the SISP. The updated cash flow forecast filed by Futura shows that with the increase in the DIP Facility, the applicant has sufficient cash to carry on its operations until January 18, 2013. Pursuant to *CCAA* s. 11.02(2) I grant the extension of the Stay Period until January 18, 2013.

3 As to the proposed increased in the DIP Facility, Futura has demonstrated the need for such an increase in order to maintain its operations until the end of the Stay Period. The parties present, including the secured creditor, supported the proposed increase. The evidence filed by the applicant and the Monitor satisfies the requirements of *CCAA* s. 11.2, and I approve the requested increase in the DIP Facility.

III. Prepaying Merchant Customers: request to honour prepayments made prior to the Initial Order

4 As described by David Campbell, Futura's CEO, in his affidavit sworn November 9, 2012, Futura provides "loyalty solutions" for its customers. Its major customer reward program involves selling Aeroplan Miles to merchants under an Aeroplan Coalition Program. Over 75% of the applicant's revenues are generated by the resale of Aeroplan Miles pursuant to the Aeroplan Coalition Program.

5 Under that Program, Merchant Customers of Futura typically pay the applicant monthly, in arrears, for Aeroplan Miles they have issued to their customers in that month. However, prior to the filing of its application under the *CCAA*, Futura on occasion offered Merchant Customers the opportunity of buying Aeroplan Miles at volume discounts. The Merchant Customers would purchase those discounted Aeroplan Miles by pre-paying Futura.

6 Mr. Campbell deposed that as of the date of the Initial Order ten (10) Prepaying Merchant Customers had prepaid to Futura approximately $108,000 for 2.5 million Aeroplan Miles. Futura has calculated that it pays out approximately $20,000 a month to Aeroplan on account of those pre-paid Miles.

7 Futura seeks an order of this Court permitting it to honour prepayments made for Aeroplan Miles by those Prepaying Merchant Customers. Mr. Campbell deposed:

> Although payment to Aeroplan on behalf of Prepaying Merchant Customers for prepayments made prior to the date of the Initial Order could be considered to be payment for the benefit of the Prepaying Merchant Customers as unsecured creditors of the Applicant, such payments are necessary in order to maintain the *status quo* and to ensure the continuous ongoing operations of the Applicant's business and the preservation of the Applicant's brand in the marketplace. This would enhance the likelihood of a going-concern sale by the Applicant that would maximize value for the benefit of all creditors.

Mr. Campbell also pointed out that Futura had made a similar request in its October 26 motion to allow the continuous payment of Futura Reward Payments; the court approved that request in its October 26 Order.

8 In its Second Report the Monitor supported Futura's request for an authorization order:

> Futura and the Monitor share the view that such payments are necessary in order to maintain the *status quo*, ensure the continuous ongoing operations of Futura's business and preserve its brand in the marketplace.

9 DirectCash and Aimia Canada supported the relief sought by Futura.

10 Section 11 of the *CCAA* authorizes a court to "make any order that it considers appropriate in the circumstances", "subject to the restrictions set out in this Act". As Morawetz J. observed in *Nortel Networks Corp., Re*, the "*CCAA* is

intended to be flexible and must be given a broad and liberal interpretation to achieve its objectives..."[1] Although counsel could not point me to a case in which a court had permitted an applicant to satisfy a pre-filing credit or claim enjoyed by a customer outside of the *CCAA* claims process, some precedent exists for permitting the payment of pre-filing obligations in the case of non-critical suppliers.

11 In both *Eddie Bauer of Canada Inc., Re* [2009 CarswellOnt 3657 (Ont. S.C.J. [Commercial List])][2] and *EarthFirst Canada Inc., Re*[3] the courts considered requests to approve payments to creditors in respect of pre-filing obligations. In the *Eddie Bauer* case Morawetz J. granted the approval writing:

> [22] The proposed order also provides that the Applicants shall be entitled but not required to pay amounts owing for goods and services actually supplied to the Applicants prior to the date of the Order. The RSM Report comments on this point. *The Eddie Bauer Group is of the view that operations could be disrupted and its vendor relationships adversely impacted if it does not have the ability to pay pre-filing obligations to certain vendors and it further believes that the value of its business will be maximized if it can pay its pre-filing creditors. RSM has reviewed this issue and is supportive of this provision as the Eddie Bauer Group believes it is a necessary provision* and the DIP Lenders are supportive of the Restructuring Proceedings. The relief requested in these proceedings is consistent with the relief sought in the Chapter 11 Proceedings. This provision is unusual but, in the circumstances of this case, appears to be reasonable.
>
> (emphasis added)

12 In *EarthFirst Canada* Romaine J. approved the creation of a "hardship fund" to pay prefiling obligations owed to certain suppliers and contractors of the applicant. The evidence in that case revealed that some suppliers and contractors in a remote community had become quite dependent upon the applicant's wind farm project and, if they were not paid, they would "face immediate financial difficulty". Romaine J. wrote:

> [7] While the nature of payments from the hardship fund is different from the issue that was before Farley, J. in *Re Air Canada*, 2003 CarswellOnt. 5296 (at para. 4), and while EarthFirst is not suggesting that recipients of the fund are "critical suppliers" in the usual sense of the term, it appears to be the case that, as in *Air Canada*, the potential future benefit to the company of these relatively modest payments of pre-filing debt is considerable and of value to the estate as a whole. The decision to allow the hardship fund thus outweighs the prejudice to other creditors, justifying a departure from the usual rule.

13 In those two cases the courts were prepared to countenance the payment of pre-filing obligations to suppliers in order to prevent disruption to the operations of the applicant and to maximize the value of the business for purposes of the re-organization or realization process. In the *EarthFirst Canada* case the court engaged in a form of proportionality or cost-benefit analysis, weighing the cost of the pre-payments against the benefit to the estate as a whole.

14 The present case does not involve a request to make payments to suppliers for pre-filing obligations, but concerns a somewhat analogous request to make payments which would satisfy pre-filing credits enjoyed by some important customers. The kind of cost-benefit reasoning undertaken in the *Eddie Bauer* and *EarthFirst* cases offers some guidance. My Reasons granting the Initial Order stated that the book value of Futura's assets was approximately $1.35 million. The most recent cash-flow projection filed by the applicant made allowance for "payments to loyalty currency providers", which included the payments in respect of the Prepaying Merchant Customers. When compared against projected inflows from the collection of receivables through to January 18, 2013 of approximately $440,000 (the only source of cash apart from the increased DIP Financing), the honouring of $108,000 in pre-paid Aeroplan Miles for the Prepaying Merchant Customers is not an insignificant amount. However, on the other side of the scale is the evidence from Futura that 75% of its revenue comes from the resale of Aeroplan Miles and under its SISP it is seeking to secure a going-concern sale of the company's business.

15 Given the importance of the ongoing resale of Aeroplan Miles to the viability of Futura as a going-concern, the benefit to the company's re-organization efforts of trying to maintain the Prepaying Merchant customers as continuing customers, and the absence of any opposition to the order sought, I conclude that it is appropriate in the circumstances to grant an order "permitting the Applicant to honour prepayments made for Aeroplan Miles by Prepaying Merchant Customers" prior to the

making of the Initial Order, as requested in paragraph 5 of Futura's notice of motion. Such authorization, in my view, is consistent with and fosters the objectives of the *CCAA*.

16 Futura submitted a draft order which contained different language of authorization. I informed counsel that the revised language was vague and imprecise, and I would not approve it. Paragraph 5 of Futura's notice of motion was short, sweet and to the point, so the language of the draft order Futura submits for my consideration must reflect that precision.

IV. Dispensing with notice to Prepaying Merchant Customers

17 The Prepaying Merchant Customers were not given notice of this motion. I have made the order authorizing the honouring of their prepayments in any event because it is to their benefit. Futura requests that I vary the *CCAA* s. 23 notice provision in my Initial Order in order to "defer notice to Prepaying Merchant Customers". Again, the Monitor, DirectCash Payments and Aimia Canada support the applicant's request.

18 Section 23(1)(a)(ii)(B) of the *CCAA* requires a monitor, within five days after the making of an initial order, to send, in the prescribed manner, "a notice to every known creditor who has a claim against the company of more than $1,000 advising them that the order is publicly available". In this case the Monitor has not sent such notice to the Prepaying Merchant Customers.

19 Why is that so? No explanation was offered by the Monitor in its Second Report. I am disappointed that none was. In oral submissions Monitor's counsel stated that the Monitor only learned from the applicant on October 27, 2012 that the Prepaying Merchant Customers were creditors of the applicant. Mr. Campbell, in his affidavit, did not explain why it took the applicant almost two weeks after the Initial Order to recognize the Prepaying Merchant Customers as creditors and to so inform the Monitor.

20 Why does the applicant not want the Monitor to give *CCAA* s. 23 notices to the creditor Prepaying Merchant Customers? In his affidavit Mr. Campbell deposed:

> Direct notification of the *CCAA* Proceedings to the Prepaying Merchant Customers could cause them to cancel their participation in the Aeroplan Coalition Program, which would have a detrimental effect on the ongoing operation and value of the Applicant's business.
>
> Since the Applicant is seeking an order allowing it to continue to honour prepayments made under the Aeroplan Coalition Program in the ordinary course, and since a going concern sale of this business may be achieved, it is not currently necessary, and could be detrimental to the Applicant's business, to provide such merchants with direct notice of the CCAA Proceedings at this time. If a going concern sale of its Aeroplan Coalition Program cannot be achieved, such that the Prepaying Merchant Customers may be affected by this proceeding, the Applicant will give notice to such merchants at the relevant time.

In its Second Report the Monitor echoed the position of Futura.

21 I recognize that the October 26 Order contained a variation of the paragraph 43 Initial Order notice provision to exempt, from the Monitor's statutory duty to give notice of this proceeding, "claimants under the Futura Rewards Program". No reasons accompanied that order, so I am unable to understand the basis for the granting of that variation.

22 I am not prepared to vary the Initial Order to excuse the Monitor from providing the requisite creditor notice to the Prepaying Merchant Customers under section 23(1)(a)(ii)(B) of the *CCAA*. Transparency is the foundation upon which *CCAA* proceedings rest - a debtor company encounters financial difficulties; it seeks the protection of the *CCAA* to give it breathing space to fashion a compromise or arrangement for its creditors to consider; in order to secure that breathing space, the *CCAA* requires the debtor to provide its creditors, in a court proceeding, with the information they require in order to make informed decisions about the compromises or arrangements *of their rights* which the debtor may propose. As a general proposition, open windows, not closed doors, characterize *CCAA* proceedings.

23 In the present case the Monitor published, as ordered, a notice in the Globe and Mail shortly after the Initial Order was

made and, as ordered, established a website to which the Initial Order was posted. Given that the Monitor has given general public notice of these proceedings as ordered by this Court, I cannot see any principled basis upon which to excuse the Monitor from giving specific notice to one group of creditors — the Prepaying Merchant Customers.

24 Mr. Campbell deposed that giving notice to the Prepaying Merchant Customers "could cause them to cancel their participation in the Aeroplan Coalition Program". Initiating *CCAA* proceedings always carries some risk that the applicant's suppliers or customers may re-think doing business with the debtor. One of the tasks of a debtor's management is to persuade suppliers or customers that in the long-run it would be better to hang in with the debtor than to abandon it. Such persuasion must be done in every *CCAA* proceeding; this one is no different.

25 For those reasons I decline to grant the applicant's request to vary the notice provisions of the Initial Order.

V. Summary

26 By way of summary, I grant the applicant an extension of the Stay Period until January 18, 2013, an increase in the DIP Facility to $300,000, and permission to honour prepayments made for Aeroplan Miles by Prepaying Merchant Customers. I also approve the First and Second Reports of the Monitor and the actions and activities of the Monitor described therein.

Application granted in part.

Footnotes

1 (2009), 55 C.B.R. (5th) 229 (Ont. S.C.J. [Commercial List]), para. 47.

2 2009 CanLII 32699

3 2009 ABQB 78 (Alta. Q.B.)

Most Negative Treatment: Check subsequent history and related treatments.

2019 ONCA 9
Ontario Court of Appeal

The Guarantee Company of North America v. Royal Bank of Canada

2019 CarswellOnt 300, 2019 ONCA 9, 144 O.R. (3d) 225, 302 A.C.W.S. (3d) 20, 430 D.L.R. (4th) 434, 44 E.T.R. (4th) 1, 67 C.B.R. (6th) 29, 86 C.L.R. (4th) 1, 9 P.P.S.A.C. (4th) 193

The Guarantee Company of North America and The Attorney General of Ontario (Respondent / Intervener / Appellants) and Royal Bank of Canada, A-1 Asphalt Maintenance Ltd. (Receiver of), IUOE Local 793 and LIUNA Local 837, and LIUNA Local 183 (Applicant / Respondents / Respondents in Appeal)

Alexandra Hoy A.C.J.O., Doherty, Robert Sharpe, Roberts, Fairburn JJ.A.

Heard: October 16, 2018
Judgment: January 14, 2019
Docket: CA C65041, C65042

Proceedings: reversing *Royal Bank of Canada v. A-1 Asphalt Maintenance Ltd.* (2018), 77 C.L.R. (4th) 149, 2018 CarswellOnt 2567, 2018 ONSC 1123, 57 C.B.R. (6th) 103, Conway J. (Ont. S.C.J. [Commercial List])

Counsel: Josh Hunter, Hayley Pitcher, for Appellant, Attorney General of Ontario
Matthew B. Lerner, Scott M.J. Rollwagen, for Appellant, The Guarantee Company of North America
Sam Babe, Miranda Spence, for Respondent, Royal Bank of Canada
Raymond M. Slattery, for Respondent, A-1 Asphalt Maintenance Ltd. (Receiver of)
Paul Cavalluzzo, Alex St. John, for Intervener, LIUNA Local 183

Subject: Estates and Trusts; Family; Insolvency; Property

Related Abridgment Classifications

Bankruptcy and insolvency
VIII Property of bankrupt
VIII.5 Trust property
VIII.5.e Miscellaneous

Headnote

Bankruptcy and insolvency --- Property of bankrupt — Trust property — Miscellaneous
A Ltd., engaged in paving business, filed Notice of Intention to make proposal under Bankruptcy and Insolvency Act ("BIA") — It failed to file proposal and was deemed bankrupt — It had four major ongoing paving projects — Receiver was ordered to establish Paving Projects Account for receipts from paving projects and general post-receivership account — Funds of $675,372.27 ("Funds") were received from city and town and deposited into Paving Projects Account — Amount represented debts owing to A Ltd. at time Notice of Intention was filed — Motion judge found that funds were not excluded from A Ltd.'s estate available for distribution to creditors — Creditor and Attorney General of Ontario appealed — Appeal allowed — Order set aside — By operation of s. 67(1)(a) of BIA, funds satisfied requirements for trust at law and so were not property of A Ltd. available for distribution to A Ltd.'s creditors — Balance of motion concerning creditor's priority dispute with unions remitted to Superior Court for disposition — Section 8 of Construction Lien Act ("CLA") created deemed statutory trust and imposed statutory trust obligations on contractor or subcontractor — To qualify as "trust" excluded from A

Ltd.'s property for distribution to creditors pursuant to s. 67(1)(a) of BIA, deemed statutory trust created must satisfy general principles of trust law: certainty of intention, certainty of subject matter and certainty of object — Section 8(1) trust must be seen as integral part of CLA's scheme of holdbacks, liens and trusts which protect rights and interests of those engaged in construction industry — Motion judge erred by finding that requirement of certainty of subject matter was not met in this case — Amounts owed by city and town on account of paving projects were debts — Debt was chose in action which can properly be subject matter of trust — At moment of A Ltd.'s bankruptcy, trust created by s. 8(1) of CLA was imposed on debts owed by city and town to A Ltd. — Motion judge also erred by ruling that because money paid to satisfy individual debts owing to A Ltd. on account of paving projects had been commingled with money paid to satisfy other paving project debts in Paving Projects Account, requisite certainty of subject matter was not made out — Evidence clearly established that funds paid for each paving project were readily ascertainable and identifiable — They were commingled only to extent they had all been paid into same account but they had not been converted to other uses and they did not cease to be traceable to specific project for which they had been paid — Commingling of this kind did not deprive trust property of required element of certainty of subject matter.

Table of Authorities

Cases considered by *Robert Sharpe J.A.*:

Alberta (Attorney General) v. Moloney (2015), 2015 SCC 51, 2015 CSC 51, 2015 CarswellAlta 2091, 2015 CarswellAlta 2092, [2015] 12 W.W.R. 1, 29 C.B.R. (6th) 173, *(*sub nom. *Moloney v. Administrator, Motor Vehicle Accident Claims Act (Alta.))* 476 N.R. 318, 85 M.V.R. (6th) 37, 22 Alta. L.R. (6th) 287, 391 D.L.R. (4th) 189, [2015] 3 S.C.R. 327, *(*sub nom. *Moloney v. Administrator, Motor Vehicle Accident Claims Act (Alta.))* 606 A.R. 123, *(*sub nom. *Moloney v. Administrator, Motor Vehicle Accident Claims Act (Alta.))* 652 W.A.C. 123 (S.C.C.) — referred to

Alternative granite & marbre inc., Re (2009), 2009 SCC 49, 2009 CarswellQue 10706, 2009 CarswellQue 10707, *(*sub nom. *Dep. Min. Rev. Quebec v. Caisse populaire Desjardins de Montmagny)* 2009 G.T.C. 2036 (Eng.), [2009] G.S.T.C. 154, *(*sub nom. *9083-4185 Québec Inc. (Bankrupt), Re)* 394 N.R. 368, 60 C.B.R. (5th) 1, 312 D.L.R. (4th) 577, *(*sub nom. *Quebec (Revenue) v. Caisse populaire Desjardins de Montmagny)* [2009] 3 S.C.R. 286 (S.C.C.) — referred to

Angus v. Port Hope (Municipality) (2017), 2017 ONCA 566, 2017 CarswellOnt 10123, 28 E.T.R. (4th) 169, 64 M.P.L.R. (5th) 202 (Ont. C.A.) — considered

B.M.P. Global Distribution Inc. v. Bank of Nova Scotia (2009), 2009 SCC 15, 2009 CarswellBC 809, 2009 CarswellBC 810, 386 N.R. 296, 304 D.L.R. (4th) 292, [2009] 8 W.W.R. 428, 268 B.C.A.C. 1, 452 W.A.C. 1, 58 B.L.R. (4th) 1, 94 B.C.L.R. (4th) 1, [2009] 1 S.C.R. 504 (S.C.C.) — considered

Bank of Montreal v. Kappeler (2017), 2017 ONSC 6760, 2017 CarswellOnt 18016 (Ont. S.C.J. [Commercial List]) — referred to

British Columbia v. Henfrey Samson Belair Ltd. (1989), 75 C.B.R. (N.S.) 1, [1989] 2 S.C.R. 24, 34 E.T.R. 1, [1989] 5 W.W.R. 577, 59 D.L.R. (4th) 726, 97 N.R. 61, 38 B.C.L.R. (2d) 145, 2 T.C.T. 4263, [1989] 1 T.S.T. 2164, 1989 CarswellBC 351, 1989 CarswellBC 711 (S.C.C.) — followed

British Columbia v. National Bank of Canada (1994), 99 B.C.L.R. (2d) 358, [1995] 2 W.W.R. 305, 119 D.L.R. (4th) 669, 30 C.B.R. (3d) 215, 6 E.T.R. (2d) 109, 52 B.C.A.C. 180, 86 W.A.C. 180, 1994 CarswellBC 639, 2 G.T.C. 7348 (B.C. C.A.) — distinguished

British Columbia v. National Bank of Canada (1995), 34 C.B.R. (3d) 302 (note), 9 E.T.R. (2d) 117 (note), 9 B.C.L.R. (3d) xxxi (note), 126 D.L.R. (4th) vii (note), [1995] 9 W.W.R. lxxix (note), 63 B.C.A.C. 159 (note), 104 W.A.C. 159 (note), 196 N.R. 240 (note) (S.C.C.) — referred to

Citadel General Assurance Co. v. Lloyds Bank Canada (1997), 152 D.L.R. (4th) 411, 1997 CarswellAlta 823, 1997 CarswellAlta 824, *(*sub nom. *Citadel General Life Assurance Co. v. Lloyds Bank Canada)* 206 A.R. 321, *(*sub nom. *Citadel General Life Assurance Co. v. Lloyds Bank Canada)* 156 W.A.C. 321, 19 E.T.R. (2d) 93, 35 B.L.R. (2d) 153, 47 C.C.L.I. (2d) 153, [1997] 3 S.C.R. 805, 219 N.R. 323, [1999] 4 W.W.R. 135, 66 Alta. L.R. (3d) 241 (S.C.C.) —

considered

Deloitte, Haskins & Sells Ltd. v. Alberta (Workers' Compensation Board) (1985), [1985] 1 S.C.R. 785, 19 D.L.R. (4th) 577, [1985] 4 W.W.R. 481, 60 N.R. 81, 38 Alta. L.R. (2d) 169, 63 A.R. 321, 55 C.B.R. (N.S.) 241, 1985 CarswellAlta 319, 1985 CarswellAlta 613, 38 Alta. L.R. (2d) 168 (S.C.C.) — referred to

Dietrich Steel Ltd. v. Shar-Dee Towers (1987) Ltd. (1999), 1999 CarswellOnt 266, 170 D.L.R. (4th) 475, 42 O.R. (3d) 749, 119 O.A.C. 69, 45 C.L.R. (2d) 178 (Ont. C.A.) — considered

Duraco Window Industries (Sask.) Ltd. v. Factory Window & Door Ltd. (Trustee of) (1995), [1995] 9 W.W.R. 498, 34 C.B.R. (3d) 196, 23 C.L.R. (2d) 239, *(*sub nom. *Factory Window & Door Ltd. (Bankrupt), Re)* 135 Sask. R. 235, 1995 CarswellSask 210, 34 C.B.R. (3d) 197 (Sask. Q.B.) — considered

Ernst & Young Inc. v. Guarantee Co. of North America (2016), 2016 CarswellAlta 660, 2016 CarswellAlta 661 (S.C.C.) — referred to

Fanshawe College of Applied Arts and Technology v. AU Optronics Corp. (2016), 2016 ONCA 131, 2016 CarswellOnt 2177, 129 O.R. (3d) 391 (Ont. C.A.) — referred to

GMAC Commercial Credit Corp. - Canada v. TCT Logistics Inc. (2005), 2005 CarswellOnt 636, 7 C.B.R. (5th) 202, *(*sub nom. *TCT Logistics Inc. (Bankrupt), Re)* 194 O.A.C. 360, 74 O.R. (3d) 382 (Ont. C.A.) — distinguished

Gorman v. Karpnale Ltd. (1991), [1991] 2 A.C. 548, [1991] 3 W.L.R. 10, [1992] 4 All E.R. 512 (U.K. H.L.) — considered

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APPEAL by creditor and attorney general from decision reported at *Royal Bank of Canada v. A-1 Asphalt Maintenance Ltd.* (2018), 2018 ONSC 1123, 2018 CarswellOnt 2567, 57 C.B.R. (6th) 103, 77 C.L.R. (4th) 149 (Ont. S.C.J. [Commercial List]), in which motion judge found that funds were not excluded from A Ltd.'s estate available for distribution to creditors.

***Robert Sharpe J.A.*:**

1 This appeal arises from a priority dispute between certain creditors and employees of a bankrupt company, A-1 Asphalt Maintenance Ltd. ("A-1"). The issue is whether the funds owing to or received by a bankrupt contractor and impressed with a statutory trust created by s. 8(1) of the *Construction Lien Act* R.S.O. 1990, c. C. 30 ("*CLA*") are excluded from distribution to the contractor's creditors, pursuant to s. 67(1)(a) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*").

2 As I will explain, to decide this issue it is necessary to give careful consideration to several decisions of the Supreme Court of Canada, in particular, *British Columbia v. Henfrey Samson Belair Ltd.*, [1989] 2 S.C.R. 24 (S.C.C.), and to the decision of this court in *GMAC Commercial Credit Corp. - Canada v. TCT Logistics Inc.* (2005), 74 O.R. (3d) 382 (Ont. C.A.).

3 For the following reasons, I conclude that *Henfrey* contemplates provincially created statutory trusts preserving assets from distribution to ordinary creditors under the *BIA*, s. 67(1)(a), provided the statutory trust satisfies the general principles of trust law. The general principles of trust law require certainty of intention to create a trust and certainty of subject matter in addition to certainty of object. I conclude that the statutory trust created by the *CLA*, s. 8(1) satisfies the requirement for certainty of intention to create a trust. I reject the contention that by creating the required element of certainty of intention, the *CLA*, s. 8(1) creates an operational conflict between the *CLA*, s. 8(1) and the *BIA*, s. 67(1)(a), triggering the doctrine of federal paramountcy. I conclude that debts for a project subject to the *CLA* are choses in action that supply the required certainty of subject matter. I further conclude that the commingling of *CLA* funds from various projects does not mean that the required certainty of subject matter was not present because the funds remained identifiable and traceable.

Facts

4 A-1 is an Ontario corporation, engaged in the paving business. A-1 filed a Notice of Intention to make a proposal under the *BIA* on November 21, 2014. It subsequently failed to file a proposal and was deemed bankrupt on December 22, 2014.

5 At the time of A-1's bankruptcy, it had four major ongoing paving projects, three with the City of Hamilton (the "City") and one with the Town of Halton Hills (the "Town"). All four contracts had outstanding accounts receivable for work performed by A-1. The bankruptcy judge directed the Receiver to establish a "Paving Projects Account" and a general post-receivership account. The order provided that all receipts from the four paving projects were to be deposited into the Paving Projects Account. It also provided that the "segregation of receipts by the Receiver between the two Post Receivership Accounts shall be without prejudice to the existing rights of any party and shall not create any new rights in favour of any party." A subsequent order directed that receipts from other paving projects were also to be deposited in the Paving Projects Account.

6 The City and the Town paid $675,372.27 (the "Funds") to the Receiver, who deposited the Funds into the Paving Projects Account. That amount represented debts owing to A-1 by the City and the Town when A-1 filed its Notice of Intention to make a proposal. While the Receiver commingled the trust funds received from A-1's various paving projects in the Paving Projects Account, the allocation of the funds in the Paving Projects Account to each specific project is identifiable because of the Receiver's careful accounting.

7 It is common ground that the Funds are "trust funds" within the meaning of s. 8 of the *CLA*, which provides:

> 8 (1) All amounts,
>
> (a) owing to a contractor or subcontractor, whether or not due or payable; or
>
> (b) received by a contractor or subcontractor,
>
> on account of the contract or subcontract price of an improvement constitute a trust fund for the benefit of the subcontractors and other persons who have supplied services or materials to the improvement who are owed amounts by the contractor or subcontractor.
>
> (2) The contractor or subcontractor is the trustee of the trust fund created by subsection (1) and the contractor or subcontractor shall not appropriate or convert any part of the fund to the contractor's or subcontractor's own use or to any use inconsistent with the trust until all subcontractors and other persons who supply services or materials to the improvement are paid all amounts related to the improvement owed to them by the contractor or subcontractor.

8 There is a priority dispute between:

(1) Royal Bank of Canada, ("RBC"), as a secured creditor of A-1 pursuant to a general security agreement;

(2) Guarantee Company of North America ("GCNA"), a bond company and secured creditor of A-1 that had paid out twenty *CLA* lien claims (totalling $1,851,852.39) to certain suppliers and subcontractors of A-1 and is subrogated to those claims; and

(3) certain employees that worked on the Four Projects, as represented by LIUNA Local 183 and IUOE Local 793 (together, the "Unions") (claiming a total of $511,949.14).

9 RBC takes the position that the Funds form part of A-1's estate available to creditors. GCNA and the Unions take the position that the Funds were s. 8(1) *CLA* trust funds that must be excluded from A-1's property on bankruptcy, pursuant to s. 67(1)(a) of the *BIA*. That section provides:

67 (1) The property of a bankrupt divisible among his creditors shall not comprise

(a) property held by the bankrupt in trust for any other person;

. . .

10 The Receiver brought a motion for advice and directions to resolve the priority dispute and served a Notice of Constitutional Question identifying the potential conflict between the *CLA* and *BIA*. The Attorney General of Ontario intervened in response.

11 On the motion, it was common ground that if the Funds were not trust funds, pursuant to s. 67(1)(a), RBC and GCNA would share the remaining funds pro rata as secured creditors. The Unions could make a claim to any remaining funds under s. 136(1)(d) of the *BIA*.

Decision of the motion judge: *Royal Bank of Canada v. A-1 Asphalt Maintenance Ltd.*, 2018 ONSC 1123, 57 C.B.R. (6th) 103 (Ont. S.C.J. [Commercial List])

12 The motion judge delivered a handwritten endorsement at the conclusion of argument holding that the Funds were not excluded from A-1's estate available for distribution to creditors.

13 She noted that the constitutional issue of the validity of provincial statutory trusts in bankruptcy had been resolved by the Supreme Court of Canada in *British Columbia v. Henfrey Samson Belair Ltd.* That case held that trusts established by provincial law that meet the general principles of the law of trusts will be excluded from the bankrupt's estate pursuant to s. 67(1)(a) of the *BIA*. It is common ground that those principles are certainty of intention, object and subject matter.

14 The motion judge stated that she was not suggesting that the statutory trust created by the *CLA* could never be recognized as "a true trust for purposes of the *BIA*". However, the motion judge concluded that on the facts of this case GCNA had failed to establish sufficient certainty of subject matter and that the Funds were not therefore held in trust within the meaning of s. 67(1)(a). She reached that conclusion for two reasons. First, she stated, at para. 6, that the "funds owed to A-1 by the City/Town are not necessarily identifiable, do not necessarily come from any particular fund or account and are simply payable by the City/Town from its own revenues or other sources". Second, she found, at para. 7, that once the Funds were paid, "there was no established means for [A-1] to hold these monies separate from other funds and maintain their character as trust funds". The orders of the bankruptcy judge were "completely neutral" and "did not create any rights nor did they take away any rights, as explicitly stated in the orders".

15 The motion judge was of the view that *GMAC Commercial Credit Corp. - Canada v. TCT Logistics Inc.* required a form of segregation of funds to maintain a trust. She relied on that case to reject the proposition that the Receiver's careful accounting records that were capable of identifying the funds in the Paving Projects Account could establish certainty of subject matter. As the amounts owing for the various projects had been commingled, the absence of segregation was sufficient to destroy the certainty of subject matter required under the general principles of trust law.

16 The motion judge concluded that the s. 67(1)(a) exemption for property held in trust did not apply. She therefore found that GCNA was only entitled to a *pro rata* share of the Funds as a secured creditor and that the Unions were entitled to their share as unsecured creditors.

Issues

17 The following issues arise on this appeal:

1. Can a statutory deeming provision give rise to certainty of intention?

2. Were the debts of the City and the Town choses in action that supplied the required certainty of subject matter for a trust?

3. Did commingling of the Funds mean that the required certainty of subject matter was not present?

4. Does RBC's security interest have priority even if the trust created by s. 8(1) of the *CLA* survives in bankruptcy?

Analysis

Statutory Trusts

18 As a preliminary matter, it will be helpful to define the terminology involving statutory trusts. In *Henfrey*, McLachlin J. referred to a "deemed statutory trust": p. 34. A "deemed statutory trust" is a trust that legislation brings into existence by constituting certain property as trust property and a certain person as the trustee of that property. The legislation purports to deem the trust into existence independently of the subjective intentions of or actions taken by the trustee. For example, the legislation at issue in *Henfrey*, s. 18 of the *Social Service Tax Act*, R.S.B.C. 1979, c. 388, established that a merchant who collected sales tax was "deemed to hold it in trust" for the provincial Crown. Deemed statutory trusts may be in favour of either the Crown or private parties: *GMAC*, para. 14. The subject matter of deemed statutory trusts also varies. Some statutes establish a trust over specific sums of property owing to or received by the trustee. In contrast, other statutes purport to establish a general floating charge over the assets of the trustee for the sum of the trust moneys.

19 Even if a statute does not deem a trust into existence, it may impose a "statutory trust obligation," namely an obligation on a person to hold in trust certain property: *GMAC*, paras. 13, 17, 21-22. Statutes that create deemed statutory trusts often also impose statutory trust obligations, such as an obligation to segregate the trust property or hold it in a trust account: *GMAC*, at para. 17.

20 Section 8 of the *CLA* both creates a deemed statutory trust and imposes statutory trust obligations on the contractor or subcontractor. The language of s. 8 makes clear that it deems a trust into existence independently of the trustee's actions or intentions. Section 8(1) provides that the amounts in ss. 8(1)(a) and (b) "*constitute* a trust fund" and s. 8(2) establishes that the contractor or subcontractor "*is* the trustee of the trust fund *created by subsection (1)*." (emphasis added) Thus, s. 8(1) purports to deem a trust into existence independently of any actions by the contractor or subcontractor. Section 8(2) also imposes a statutory trust obligation on the contractor or subcontractor not to appropriate or convert any part of the trust fund until all subcontractors and suppliers have been fully paid for their work.

Positions of the Parties

21 It is common ground on this appeal that to qualify as a "trust" that is excluded from A-1's property for distribution to creditors pursuant to s. 67(1)(a) of the *BIA*, the deemed statutory trust created by s. 8(1) of the *CLA* must satisfy the general principles of trust law: *Henfrey*. The general principle of trust law we must consider is that to establish a trust, three elements must be present, certainty of intention, certainty of subject matter, and certainty of object: see Eileen E. Gillese, *The Law of Trusts*, 3rd ed. (Toronto: Irwin Law, 2014), at pp. 41-47.

22 GCNA, supported by the Attorney General of Ontario and LIUNA Local 183, submits that the three certainties are present in s. 8(1). Certainty of intention is clear from the language of the statute that the amounts specified "constitute a trust fund". Certainty of object is spelled out as the statute specifies that the trust fund is "for the benefit of the subcontractors and other persons who have supplied services or materials to the improvement who are owed amounts by the contractor or subcontractor". Certainty of subject matter is made out as the statute clearly specifies that the subject of the trust is "all amounts owing to a contractor or subcontractor" and "all amounts received by a contractor or subcontractor...on account of the contract or subcontract price of an improvement".

23 RBC disputes both certainty of intention and certainty of subject matter.

(1) Can a statutory deeming provision give rise to certainty of intention?

24 The motion judge did not deal with the issue of certainty of intention in her reasons. She appears to have assumed that it was created by s. 8(1). However, on appeal, RBC's principal argument to uphold the motion judge's decision is that s. 8(1) cannot supply that element. RBC argues that under the general principles of trust law, it is necessary to prove that the settlor had the actual subjective intention to create a trust.

25 RBC's argument in relation to certainty of intention appears to rest upon a broad proposition, namely, that the three elements of certainty of subject matter, object and, in particular, intention, must be established on facts independent of any statutory deeming provisions.

26 This argument requires some consideration of the relationship between the provincial power to legislate in relation to property and civil rights in the province (*Constitution Act, 1867*, s. 92(13)) and the federal head of power in relation to bankruptcy and insolvency (*Constitution Act, 1867*, s. 91(21)).

(a) Constitutional Validity of s. 8(1) of the CLA.

27 While RBC did not explicitly challenge the constitutional validity of s. 8(1) and accepted that it applies outside of the bankruptcy context, it did assert that the purpose of s. 8(1) is to alter priorities upon bankruptcy. The implication of RBC's argument about the purpose of s. 8(1) of the *CLA* is that the provision is unconstitutional because its pith and substance fits within the federal power of bankruptcy and insolvency in s. 91(21) of the *Constitution Act, 1867*.

28 There is no issue that the *CLA* as a whole is valid provincial legislation in relation to property and civil rights in the province. The *CLA* aims to ensure that parties who supply services and materials to construction projects are paid by creating an integrated scheme of holdbacks, liens and trusts. This scheme protects subcontractors who are vulnerable due to their lack of privity of contract with the owner who benefits from the improvements they perform. Holdbacks require the owner and other contractors to withhold payments in order to ensure that funds are available to pay subcontractors and suppliers. Liens give subcontractors and suppliers the right to assert a claim directly against the property they have improved. Trusts protect the interests of subcontractors and suppliers by protecting funds owing to or received by those to whom they have supplied their services or materials.

29 In support of its submission that the purpose of the s. 8(1) statutory trust is to alter priorities in bankruptcy, RBC cites statements from two documents prepared by Ontario's Ministry of the Attorney General prior to the Legislature's enactment of the *CLA* in 1983: *Discussion Paper on the Draft Construction Lien Act* (Toronto: Ministry of the Attorney General, November 1980) and the *Report of the Attorney General's Advisory Committee on the Draft Construction Lien Act* (Toronto: Ministry of the Attorney General, April 1982). In particular, RBC relies on the statement in the *Report of the Attorney General's Advisory Committee*, at p. xxxiv, suggesting that the primary purpose of the s. 8(1) trust is to "prevent contract monies from being misappropriated, and protect those monies from the claims of other creditors in the event of a bankruptcy".

30 While the s. 8(1) trust may have the effect of protecting construction contract monies in the event of bankruptcy, I cannot agree that s. 8(1) is in pith and substance legislation in relation to bankruptcy and insolvency. The statement in the

Report of the Attorney General's Advisory Committee is admissible but "must not be given inappropriate weight": Ruth Sullivan, *Sullivan on the Construction of Statutes* (6th ed) (Toronto: LexisNexis, 2014) at para. 23.58. A broader and more general protective purpose has been recognized both in academic writing and in the decisions of this court. Kevin McGuinness, "Trust Obligations Under the *Construction Lien Act*" (1994) 15 C.L.R. 208, at p. 227, states that the purpose of the s. 8(1) trust is to "isolate the contract moneys as they flow down the construction pyramid" and serve to preserve that pool of funds "during the period while payments are trickling down the pyramid to the persons ultimately entitled to the money concerned". As this court explained in *Dietrich Steel Ltd. v. Shar-Dee Towers (1987) Ltd.* (1999), 42 O.R. (3d) 749 (Ont. C.A.), at p. 755, these statutory trusts "exist by statute at each level of the construction pyramid for the benefit of those adding value to the land involved". They are "super-imposed" on the contacts entered into by the "owner, contactor and subcontractors...for the benefit of all those on the next level in the pyramid below the trustee". Similarly, in *Sunview Doors Ltd. v. Academy Doors & Windows Ltd.*, 2010 ONCA 198, 101 O.R. (3d) 285 (Ont. C.A.), at para. 99, this court explained:

> The object of the Act is to prevent unjust enrichment of those higher up in the construction pyramid by ensuring that money paid for an improvement flows down to those at the bottom. In seeking to protect persons on the lower rungs from financial hardship and unfair treatment by those above, the Act is clearly remedial in nature.... The purpose of s. 8 is to impress money owing to or received by contractors or subcontractors with a statutory trust, a form of security, to ensure payment of suppliers to the construction industry.

31 RBC argues that the trust provisions are separate and independent from other provisions of the *CLA*. This submission fails to recognize that the trust provisions complement the other *CLA* remedies even outside of bankruptcy or insolvency. As this court stated in *Sunview Doors*, at para. 51, citing the Supreme Court's decision in *Minneapolis-Honeywell Regulator Co. v. Irvine & Reeves Ltd.*, [1955] S.C.R. 694 (S.C.C.), at p. 696, the legislature enacted the trust provisions because it recognized that the lien provisions only provided a partial form of security to suppliers. The lien provisions failed to protect suppliers at the bottom of the pyramid in situations where the owner of the land had already paid the contractor. The trust provisions complement the lien provisions by providing security to suppliers at the bottom of the pyramid in these situations.

32 I agree with the Attorney General of Ontario and LIUNA Local 183 that the s. 8(1) trust must be seen as an integral part of the scheme of holdbacks, liens and trusts, designed to protect the rights and interests of those engaged in the construction industry and to avoid the unjust enrichment of those higher up the construction pyramid. That purpose exists outside the bankruptcy context. As Slatter J.A. recognized in *Iona Contractors Ltd. (Receiver of) v. Guarantee Co. of North America*, 2015 ABCA 240, 387 D.L.R. (4th) 67 (Alta. C.A.), leave to appeal dismissed, (2016), [2015] S.C.C.A. No. 404 (S.C.C.), the trust provisions of construction lien legislation cannot be seen in isolation and are part of a comprehensive package to protect construction subcontractors: paras. 21-22. Any effects that s. 8(1) may have on protecting contract monies in the event of bankruptcy are purely incidental and do not detract from the provision's provincial pith and substance: see *Lacombe*, at para. 36. Accordingly, the s. 8(1) trust is a matter that is the proper subject of legislation relating to property and civil rights in the province: *John M.M. Troup Ltd. v. Royal Bank*, [1962] S.C.R. 487 (S.C.C.), at p. 494.

(b) Does the doctrine of paramountcy apply?

33 As valid provincial legislation, the *CLA* benefits from a presumption of constitutionality and should be interpreted to avoid conflict with federal legislation where possible. If there is conflict, the doctrine of paramountcy applies, the federal legislation prevails and the provincial legislation is inoperative. Paramountcy is triggered by a conflict between provincial and federal legislation, namely, where there is an operational conflict such that it is impossible to comply with both laws or where the operation of the provincial law frustrates the purpose of the federal enactment: *Alberta (Attorney General) v. Moloney*, 2015 SCC 51, [2015] 3 S.C.R. 327 (S.C.C.), at para. 18.

34 Determining whether there is operational conflict requires analyzing how s. 8(1) of the *CLA* intersects with the *BIA*. The *BIA* is valid federal legislation dealing with bankruptcy and insolvency. It has the dual purpose of ensuring the orderly and equitable distribution of the assets in the event of insolvency and enabling the rehabilitation of those who have suffered bankruptcy: *Husky Oil Operations Ltd. v. Minister of National Revenue*, [1995] 3 S.C.R. 453 (S.C.C.), at para. 7. A central element of the *BIA*'s regime for the orderly and equitable distribution of assets is a scheme that stipulates what property is available for distribution to creditors and provides for an appropriate ranking of priorities among creditors.

35 The *BIA* establishes a national regime of insolvency and bankruptcy law. Parliament has the authority under s. 91(21) to define terms in the *BIA* without reference to provincial law: *Husky Oil*, at para. 32. As McLachlin J. held in *Henfrey*, the definition of "trust" which is operative for the purposes of the *BIA* is that of Parliament, not the provincial legislatures: p. 35. I agree with the motion judge's conclusion that *Henfrey* "squarely addressed" the paramountcy issue. *Henfrey* held that Parliament only intended s. 67(1)(a) of the *BIA* to apply to trusts arising under general principles of law, namely trusts that meet the three certainties: p. 34.

36 It follows that if a province purports to legislate into existence a trust that lacks one or more of the three certainties, the trust will not survive in bankruptcy: *Henfrey*, at p. 35. A provincial deemed statutory trust that lacks one or more of the three certainties would be in operational conflict with the meaning of trust in s. 67(1)(a). Section 67(1)(a) would include the property subject to the deemed statutory trust in the property of the bankrupt divisible among its creditors but the provincial deemed statutory trust would remove the property from the bankrupt's estate. This would make it impossible for the receiver to comply with both the *BIA* and the provincial legislation deeming the trust into existence. By virtue of paramountcy, the provincial legislation in question would be inoperative in bankruptcy.

37 The question is whether allowing the *CLA* to establish certainty of intention is contrary to *Henfrey*. If it is, then the deemed statutory trust under s. 8(1) lacks certainty of intention, the statutory deemed trust is in operational conflict with s. 67(1)(a) of the *BIA* as interpreted by *Henfrey*, the paramountcy doctrine applies, and the s. 8(1) *CLA* trust is inoperative in bankruptcy.

38 In my view, *Henfrey* contemplates and requires courts to look to the deeming language of a statute to determine whether there is certainty of intention. Accordingly, no conflict between the s. 8(1) *CLA* trust and the *BIA* arises, and the paramountcy doctrine is not triggered, on the basis that the deemed statutory trust lacks certainty of intention. I reach this conclusion for five reasons, which I outline below.

(i) It is appropriate to look to provincial statutory law to determine the content of BIA categories

39 First, it is appropriate to look to provincial statutory law to determine whether a trust satisfies the three certainties required under *Henfrey*.

40 RBC submits that allowing a statute to supply certainty of intention would run contrary to the policy concern expressed in *Henfrey* about avoiding a "differential scheme of distribution" from province to province: *Henfrey*, at p. 33.

41 I would reject this submission. The Supreme Court has recognized that the application of the national regime of insolvency and bankruptcy will vary to some extent from province to province due to differences in provincial law in relation to property and civil rights: *Husky Oil*, at para. 38. Because property and civil rights are determined by provincial law, the *BIA* cannot and does not operate as a water-tight compartment. Its application to a significant degree depends upon provincial law definitions of various forms of property. As stated in *Husky Oil* at para. 30, the *BIA* "is contingent on the provincial law of property for its operation" and "is superimposed on those provincial schemes when a debtor declares bankruptcy." This means that "provincial law necessarily affects the 'bottom line'" in bankruptcy, and this, said the court, "is contemplated by the [*BIA*] itself."

42 Accordingly, it is appropriate to look to provincial law to determine whether a trust satisfies the three certainties required for it to operate in bankruptcy. The *BIA* refers to but does not define what is meant by "a trust", yet the category of "trust" is recognized by the *BIA*'s scheme of priorities. As the Supreme Court of Canada stated in *Husky*, it is the "substance of the interest created" by the provincial law that is "relevant for the purpose of applying the *Bankruptcy Act*": at para. 40. Section 72 of the *BIA* contemplates the integration of the *BIA* with provincial legislation by providing that the *BIA* "shall not be deemed to abrogate or supersede the substantive provisions of any other law or statute relating to property or civil rights that are not in conflict with [the *BIA*]." The Supreme Court has held that this provision demonstrates that Parliament intends provincial law to continue to operate in the bankruptcy and insolvency context unless it is inconsistent with the *BIA*: *Saskatchewan (Attorney General) v. Lemare Lake Logging Ltd.*, 2015 SCC 53, [2015] 3 S.C.R. 419 (S.C.C.), at para. 49.

43 In my view, the rules, principles and concepts of provincial law must include provincial statutory law. There is nothing in the *BIA* that would exclude provincial statutory law from consideration. This means that a court dealing with bankruptcy

will necessarily apply provincial statutory law relating to property and civil rights.

(ii) Henfrey contemplates that the statute can supply certainty of intention

44 Second, *Henfrey* itself contemplates that the statute deeming the trust into existence can provide the required certainty of intention. At issue in *Henfrey* was whether the deemed statutory trust created by s. 18 of the *Social Service Tax Act* gave the province priority over the claims of secured and other creditors in bankruptcy. The Act required a merchant to collect the sales tax, *deemed* the tax collected to be held in trust and *deemed* the taxes collected "to be held separate from and form no part of the person's money, assets or estate, whether or not" these tax monies were held in a segregated account. The merchant in *Henfrey* went into bankruptcy and the province claimed priority over other creditors by virtue of the deemed statutory trust. The issue was whether the deemed statutory trust was a "trust" that removed the property from the estate of the bankrupt available for general distribution to creditors pursuant to s. 47(a) of the *Bankruptcy Act*, R.S.C. 1970, c. B-3 (what is now s. 67(1)(a) of the *BIA*).

45 Writing for the 6-1 majority, McLachlin J. recognized, at p. 32, "the principle that provinces cannot create priorities under the *Bankruptcy Act* by their own legislation". McLachlin J. added, at p. 33:

> To interpret s. 47(*a*) as applying not only to trusts as defined by the general law, but to statutory trusts created by the provinces lacking the common law attributes of trusts, would be to permit the provinces to create their own priorities under the *Bankruptcy Act* and to invite a differential scheme of distribution on bankruptcy from province to province.

46 McLachlin J. concluded, at p. 34, "that s. 47(*a*) should be confined to trusts arising under general principles of law..." Applying that proposition to the case before her, she found, at p. 34:

> *At the moment of collection of the tax, there is a deemed statutory trust. At that moment the trust property is identifiable and the trust meets the requirements for a trust under the principles of trust law*. The difficulty in this, as in most cases, is that the trust property soon ceases to be identifiable. The tax money is mingled with other money in the hands of the merchant and converted to other property so that it cannot be traced. At this point it is no longer a trust under general principles of law. In an attempt to meet this problem, s. 18(1)(*b*) states that tax collected shall be deemed to be held separate from and form no part of the collector's money, assets or estate. But, as the presence of the deeming provision tacitly acknowledges, the reality is that after conversion the statutory trust bears little resemblance to a true trust. There is no property which can be regarded as being impressed with a trust. Because of this, s. 18(2) goes on to provide that the unpaid tax forms a lien and charge on the entire assets of the collector, an interest in the nature of a secured debt. [emphasis added]

47 This passage supports the proposition that provinces can create trusts by statute that will survive bankruptcy by legislating the requirements for a trust under the general principles of trust law. When the tax in *Henfrey* was collected, the requirements for a trust under the principles of trust law were met. Had the province been able to assert its claim at that moment, before conversion of the trust property, it would have succeeded.

48 RBC does not accept that *Henfrey* supports the proposition that a statute can establish any of the three certainties. RBC points out that in *Henfrey*, it was "conceded that the statute establishes certainty of intention and of object" (at p. 44, per Cory J. dissenting). The reasons in *Henfrey* do not explain the basis for this concession. However, RBC contends that the merchant's subjective intent to create a trust must have been inferred from the fact that, as required by statute, the merchant had registered with the province and that registration amounted to an intentional act from which an intention to create a trust may be inferred.

49 I find this argument unpersuasive for two reasons. First, it played no role in the majority's reasons, a fact that RBC conceded in oral argument. As GCNA submitted in oral argument, if the majority wanted to adopt the position RBC is arguing for, it would have said so directly. Second, even if the merchant's intention was relevant, the merchant had no choice. If he wanted to carry on business as a merchant in British Columbia, he had to register and he had to collect the tax. By doing so, he was simply complying with the law. It seems to me entirely artificial to suggest that his actions were any

more voluntary than the actions of a contractor under Ontario's *CLA* regime who is deemed by statute to be a trustee of certain funds and required by statute not to convert or appropriate them.

50 As Gillese explains, at p. 42: "To satisfy the certainty of intention requirement, the court must find an intention that the trustee is placed under an imperative obligation to hold property on trust for the benefit of another". The essential point is that the trustee is placed under an imperative obligation. I can see no reason in principle why that imperative obligation cannot be created by statute for the purposes of s. 67(1)(a) of the *BIA*.

51 GCNA's position finds support in the decision of Slatter J.A. in *Iona Contractors*. At issue in that case were holdback funds, impressed with a statutory trust under Alberta's *Builders' Lien Act*, R.S.A. 2000, c. B-7, s. 22. After carefully considering *Husky Oil*, *Henfrey* and several other cases dealing with the interaction of the *BIA* and provincial law, Slatter J.A. at para. 35, rejected the contention that as statutory trusts are "in one sense 'involuntary'", they cannot qualify as trusts "arising under general principles of law". He found that proposition to be incompatible with *Henfrey* where McLachlin J. stated, at p. 34, that at the moment the tax was collected, "the trust meets the requirements for a trust under the principles of trust law". Slatter J.A. added, at para. 36:

> In most statutory trust situations, only the third certainty will be in play. Certainty of intention and certainty of objects will usually be satisfied by the terms of the statute. If the statute uses the word "trust", the intention is clear...Usually the intended beneficiary of the trust will also be obvious. The only potential for uncertainty is over the assets that are covered by the trust. [citation omitted]

(iii) The CLA trust neither creates an operational conflict nor engages the Henfrey policy concerns

52 Third, the s. 8(1) *CLA* trust neither creates an operational conflict with the *BIA* nor engages the *Henfrey* policy concerns. I draw this conclusion because the s. 8(1) trust neither attempts to create a general floating charge over all of the bankrupt's assets nor attempts to obtain a higher priority for the provincial Crown.

53 RBC's argument centres on the policy concern about provinces reordering priorities in the *BIA*. RBC submits that the *Henfrey* court was concerned to prevent a province from elevating the priority of a Crown claim by deeming it to be a trust claim: *Henfrey*, at p. 33. RBC maintains that the court resolved this concern by holding that the provincial Crown could only obtain a higher priority by benefiting from rights that could be "obtained by anyone under general rules of law": *Henfrey*, at pp. 31-32, quoting *Rainville c. Québec (Sous-ministre du Revenu)* (1979), [1980] 1 S.C.R. 35 (S.C.C.), at p. 45. RBC argues that this excludes consideration of statutory intention because private parties cannot legislate certainty of intention into existence like the provincial Legislature can.

54 There is a well-established line of cases holding that an operational conflict arises where the application of provincial legislation would reorder the priorities prescribed by Parliament in the *BIA*. The leading case is *Husky Oil*, where a provincial statute deemed a debtor of a bankrupt to be a guarantor of money owed by the bankrupt to the Worker's Compensation Board. If the debtor was called upon to pay, it could set-off the amount it paid against the debt it owed to the bankrupt. As this had the effect of diverting funds from the bankrupt's estate to pay the Board it created an operational conflict with the *Bankruptcy Act*, R.S.C. 1985, c. B-3, and was held to be inoperative. Similarly, Québec statutes that deemed debts for unpaid provincial taxes or worker's compensation claims to be "privileged" conflicted with the priority given the debt in the *Bankruptcy Act*, R.S.C. 1970, c. B-3, and were therefore inoperative: *Rainville*; *Québec (Commission de la santé & de la sécurité du travail) c. Banque fédérale de développement*, [1988] 1 S.C.R. 1061 (S.C.C.). In another case, a provincial statute that created a charge on all an employer's property for unpaid Worker's Compensation claims conflicted with the priority the *Bankruptcy Act*, R.S.C. 1970, c. B-3 gave to such a claim and was therefore inoperative: *Deloitte, Haskins & Sells Ltd. v. Alberta (Workers' Compensation Board)*, [1985] 1 S.C.R. 785 (S.C.C.).

55 In my opinion, these cases do not support RBC's contention that provincial legislation cannot supply the three certainties of a trust, including certainty of intention. None of those cases involved a statutory trust conferring a trust interest in specific property related to a valid scheme under provincial legislation. Nor did those cases involve a deemed statutory trust in favour of private parties. In each case, the effect of the provincial statute was to give the province or a provincial agency a general charge and priority over all of the property of the bankrupt. That created an operational conflict with the

BIA scheme of priorities and, under the doctrine of paramountcy, the provincial law was inoperative.

56 The amendments Parliament has made to s. 67 of the *BIA* confirm the distinction that I have drawn between provincial legislation that creates a priority in favour of the province and the type of statutory trust at issue in this case. In 1992, Parliament amended s. 67 to add s. 67(2), a provision that deals with deemed trusts: *An Act to amend the Bankruptcy Act and to amend the Income Tax Act in consequence thereof*, S.C. 1992, c. 27, s. 33. Section 67(2) provides that subject to certain exceptions set out in s. 67(3), "any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty" shall not exclude the property under s. 67(1)(a) unless it would be excluded "in the absence of that statutory provision". The Supreme Court has held that this amendment reflects Parliament's intention to rank the Crown with ordinary creditors in most bankruptcy scenarios: *Alternative granite & marbre inc., Re*, 2009 SCC 49, [2009] 3 S.C.R. 286 (S.C.C.) [hereinafter Desjardins], at paras. 12-15. It is significant that Parliament singled out deemed trusts in favour of the Crown for exclusion from the protection s. 67(1)(a) offers and left untouched deemed trusts in favour of other parties.

57 Nor is the policy concern about the reordering of priorities in favour of the province that the *Henfrey* court identified relevant to the trust that s. 8(1) of the *CLA* creates.

58 *Husky Oil* holds that an intention to intrude into the federal sphere of bankruptcy is not required for provincial legislation to be inapplicable. Provinces are not entitled to indirectly improve the priority of a claim and the provincial legislation will be inapplicable if its effect is to conflict with the order of priorities in the *BIA*. Accordingly, the fact that the purpose of s. 8(1) is not to intrude into the federal sphere of bankruptcy or to alter priorities is not determinative.

59 The concern in *Husky Oil* is with provincial attempts to "create a general priority": para. 34. The majority explained *Deloitte Haskins* and *Henfrey* as cases in which the province had sought to create a "general priority...which had the *effect* of altering bankruptcy priorities." (emphasis in original)

60 As the majority in *Husky Oil* noted, the problem in *Henfrey* was that the effect of the statute was to attach the label "trust" to all of the debtor's assets. The statute did not give the province a trust claim in relation to a specific fund or in relation to specific property but rather a priority based upon what amounted to a general charge to the extent of its claim over all the merchant's assets: *Husky Oil*, at paras. 27, 35-36, 40. The province's claim was not based upon a trust that complied with the general principles of trust law but rather on a provincially created priority that was incompatible with Parliament's scheme under the *BIA*.

61 The deemed statutory trust that s. 8(1) of the *CLA* creates benefits private parties in the Ontario construction industry, not the provincial Crown. Ontario is thus not creating any "personal preference" for itself: *Henfrey*, at p. 32, quoting *Rainville*, at p. 45. To the contrary, any subcontractor or supplier in the construction industry can obtain trust protection under s. 8(1) in accordance with the "general rules of law" that the *CLA* establishes. Significantly, the passage from *Rainville* that *Henfrey* quotes refers to "a builder's privilege" as a security interest that "may be obtained by anyone under general rules of law": *Henfrey*, at p. 32, quoting *Rainville*, at p. 45. The builder's privilege was a security interest that Québec legislation, Article 2013 of the *Civil Code of Lower Canada*, created over immoveable property in favour of construction industry participants who performed work on that property. It arose independently of the subjective intentions of the parties in the construction transaction, and was thus similar to the deemed statutory trust that s. 8(1) of the *CLA* creates.

62 Moreover, s. 8(1) of the *CLA* impresses specific property with the trust and does not create a general priority. The court in *Henfrey* referred to "cases where no specific property impressed with a trust can be identified" as raising policy considerations that weighed against protecting such deemed statutory trusts under the predecessor provision to s. 67(1)(a) of the *BIA*: p. 33. However, the trust that s. 8(1) of the *CLA* creates does not attempt to create a general floating charge over the bankrupt's assets that would constitute a prohibited "general priority." Instead, it impresses specific property — the funds owing to or received by the contractor or subcontractor — with the trust.

63 Accordingly, I conclude that there is no operational conflict between s. 8(1) of the *CLA* and the *BIA*. I agree with and adopt as applicable to the case at bar Slatter J.A.'s conclusion in *Iona Contractors*, at para. 37:

> ...[T]he provisions of s. 22 meet the requirements of a common law trust. There is no deliberate attempt to reorder priorities in bankruptcy, and the province is not attempting to achieve indirectly what it cannot do directly. These considerations, coupled with the fact that the trust provisions of s. 22 are merely a collateral part of a complex regime

> designed to create security for unpaid subcontractors, leads to the conclusion that there is no operational conflict.

The decision of the British Columbia Supreme Court in *0409725 B.C. Ltd., Re*, 2015 BCSC 561, 3 P.P.S.A.C. (4th) 278 (B.C. S.C.), at para. 22, is to a similar effect:

> Applying the analysis of McLachlin J in *Henfrey*, certainty of intention is sufficiently provided by the statute in the circumstances of this case. That conclusion in no way intrudes into federal jurisdiction, and indeed, all parties conducted themselves on that basis.

(iv) The CLA trust does not frustrate the purpose of the BIA

64 There is no frustration of the purpose of the *BIA* that would render s. 8(1) of the *CLA* inoperative. I agree with LIUNA Local 183 that excluding s. 8(1) *CLA* trust funds from distribution to A-1's creditors is consistent with the objective of the *BIA* to provide for the equitable distribution of the bankrupt's remaining assets. As I have already mentioned, the purpose of the *CLA* trust is to create a "closed system" to protect those suppliers and contractors down the construction pyramid and to ensure that the funds are not diverted prior to reaching their beneficial owner. The *CLA* scheme is directed at equity and at preventing the "unjust enrichment of those higher up in the construction pyramid": *Sunview Doors Ltd.*, at para. 99. To allow s. 8(1) *CLA* trust funds to be distributed to creditors of a bankrupt contractor would provide an "unexpected and unfair windfall" to those creditors: *see Norame Inc., Re*, 2008 ONCA 319, 90 O.R. (3d) 303 (Ont. C.A.), at para. 18.

(v) The cases RBC relies on are distinguishable

65 Fifth, the cases that RBC relies upon are distinguishable.

66 RBC submits that this court held in *GMAC* that deemed statutory trusts can never survive in bankruptcy.

67 At issue in *GMAC* was a regulation, *Load Brokers*, O. Reg. 556/92, under the *Truck Transportation Act*, R.S.O. 1990, c. T.22. Section 15 of the *Load Brokers* regulation stated that load brokers "shall hold in trust" money received by the load broker on account of carriage charges and "shall" maintain separate trust accounts for such funds. TCT, the bankrupt, had failed to maintain separate accounts, and a priority dispute arose between the carriers who claimed a trust and TCT's secured creditor.

68 RBC relies on para. 17 of the *GMAC* decision. There, the court stated that a "consistent line of cases from the Supreme Court of Canada," including *Henfrey*, "excludes statutory deemed trusts from the ambit of s. 67(1)(a)." The court also stated that Parliament had only elected to carve out exceptions from this exclusion for certain deemed trusts in favour of the Crown by enacting s. 67(3). Accordingly, it concluded that even if s. 15 of the Regulation created a deemed trust in addition to a mere statutory trust obligation, this trust would not be a trust under s. 67(1)(a) of the *BIA*.

69 In my view, the passage that RBC relies on from *GMAC* is distinguishable for the following three reasons.

70 First, the passage from *GMAC* that RBC relies on was not a necessary basis for the court's decision. The court in fact declined to decide whether s. 15 of the Regulation even created a deemed statutory trust: para. 17. It instead decided the case on the basis that commingling destroyed the required element of certainty of subject matter, an issue discussed later in these reasons: *GMAC*, paras. 18-20.

71 Second, the statements in para. 17 of *GMAC* must be read in light of the court's previous discussion of the holding in *Henfrey*. At para. 15, the *GMAC* court described *Henfrey* as holding that deemed statutory trusts do not operate in bankruptcy only if they "do not conform to general trust principles." Thus, the court did not intend to state that deemed statutory trusts are never operative in bankruptcy. Indeed, as I will explain later in these reasons, the *Load Brokers* regulation did not create a deemed statutory trust but merely a statutory trust obligation that TCT did not comply with.

72 Third, the court's reliance on ss. 67(2) and (3) of the *BIA* must be read in light of the Supreme Court's subsequent

interpretation of those provisions in *Desjardins*. The *GMAC* court took the view that Parliament intended to allow only certain deemed statutory trusts in favour of the Crown to survive in bankruptcy by enacting s. 67(3). The court thus seems to have assumed that Parliament intended to only protect deemed statutory trusts in favour of the Crown and not those in favour of private parties. Such an assumption runs contrary to *Desjardins*, where the Supreme Court held that Parliament enacted ss. 67(2) and (3) to limit the Crown's priority and rank the Crown with ordinary creditors in most bankruptcy scenarios: at paras. 12-15. Properly interpreted, s. 67(2) thus excludes deemed statutory trusts in favour of the Crown that would otherwise qualify as trusts under *Henfrey* principles from protection under s. 67(1)(a). Section 67(3) sets out an exception to this exclusion. The s. 67(2) exclusion does not apply to deemed statutory trusts in favour of private parties, which may thus qualify as trusts under s. 67(1)(a) if they satisfy the requirements of *Henfrey*.

73 RBC also relies on *British Columbia v. National Bank of Canada* (1994), 119 D.L.R. (4th) 669 (B.C. C.A.), leave to appeal refused, [1995] S.C.C.A. No. 18 (S.C.C.), where the court stated, at p. 685, that provincial legislation cannot "create the facts necessary to establish a trust under general principles of trust law". The court accordingly rejected the province's argument that the provincial legislation supplied certainty of intention.

74 However, this blanket statement from *National Bank* cannot be reconciled with *Henfrey* itself. The effect of taking this statement at face value would be that provincial deemed statutory trusts could never exist in bankruptcy. However, as *Iona Contractors* recognized, *Henfrey* affirmed that provincial statutory trusts can survive in bankruptcy and that the statute at issue in *Henfrey* did create a valid trust at the moment of collection: *Iona Contractors*, at para. 35, citing *Henfrey*, at p. 34.

75 Moreover, *National Bank* is distinguishable on the facts. The statute at issue in that case, the *Tobacco Tax Act*, R.S.B.C. 1979, c. 404, s. 15, purported to create a lien and charge in favour of the provincial crown in respect of amounts collected for a tobacco tax "on the entire assets" of the person and "having priority over all other claims of any person". That plainly could not survive under the general principles of trust law because it lacked certainty of subject matter and is precisely the type of charge that has been held to interfere with the *BIA* scheme: see *Husky Oil*, at paras. 35-36, 41. As McLachlin J. stated in *Henfrey*, such a general floating charge in fact "tacitly acknowledges" that there is no certainty of subject matter: p. 34.

76 In addition, RBC relies on two Saskatchewan Court of Queen's Bench decisions which purported to apply *Henfrey* to find that deemed statutory trusts for the construction industry, established by Saskatchewan's *The Builders' Lien Act*, S.S. 1984-85-86, c. B-7.1, did not operate in bankruptcy: see *Duraco Window Industries (Sask.) Ltd. v. Factory Window & Door Ltd. (Trustee of)* (1995), 34 C.B.R. (3d) 196 (Sask. Q.B.); *Roscoe Enterprises Ltd. v. Wasscon Construction Inc.* (1998), 161 D.L.R. (4th) 725 (Sask. Q.B.). However, the court in *Duraco* only reached this conclusion because it interpreted *Henfrey* as requiring courts to analyze whether the three certainties were met "without regard" to the terms of the statute: at para. 9. The court then held that the deemed trust did not survive in bankruptcy because the parties did not subjectively intend to create a trust: paras. 11-13. The *Roscoe* court simply followed the *Duraco* court's analysis: at paras. 25-31. For the reasons stated above, this is a misreading of *Henfrey*. The court in *Henfrey* did look to the terms of the statute when it analyzed whether the deemed statutory trust satisfied the general principles of trust law: p. 34.

77 RBC also cites *Ivaco Inc., Re* (2006), 83 O.R. (3d) 108 (Ont. C.A.), leave to appeal granted, (2007), [2006] S.C.C.A. No. 490 (S.C.C.), appeal discontinued on October 31, 2007, at para. 46, where this court described a deemed statutory trust as "a legal fiction". There again, however, the statutory "trust" was a fiction as it amounted to nothing more than a general floating charge on all assets and could not satisfy the general principles of trust law.

(vi) Conclusion

78 I conclude, accordingly, that *Henfrey* contemplates that a provincial statute can supply the required element of certainty of intention for a statutory trust and that the trust created by the *CLA*, s. 8(1) does not give rise to an operational conflict with the *BIA*, s. 67(1)(a). Accordingly, the doctrine of paramountcy does not apply.

(2) Were the debts of the City and the Town choses in action that supplied the required certainty of subject matter for a trust?

79 As I have mentioned, the problem frequently encountered with deemed statutory trusts is that while they use the label

"trust", they do not actually create a trust but rather purport to confer a priority over all of the bankrupt's assets. For the following reasons, I conclude that the motion judge erred by finding that the requirement of certainty of subject matter was not met in this case.

80 Gillese explains the requirement for certainty of subject matter as follows, at p. 43:

> It must be possible to determine precisely what property the trust is meant to encompass. The subject matter is ascertained when it is a fixed amount or a specified piece of property; it is ascertainable when a method by which the subject matter can be identified is available from the terms of the trust or otherwise.

To a similar effect is this court's decision in *Angus v. Port Hope (Municipality)*, 2017 ONCA 566, 28 E.T.R. (4th) 169 (Ont. C.A.), at para. 112, leave to appeal refused, (2018), [2017] S.C.C.A. No. 382 (S.C.C.).

81 The motion judge ruled that because the funds the City and the Town owed to A-1 "do not come from any particular fund or account and were simply payable by the City/Town from its own revenues or other sources", the requisite certainty of subject matter to establish a trust at common law was absent.

82 The amounts owed by the City and the Town on account of the paving projects were debts. It is well-established that a debt is a chose in action which can properly be the subject matter of a trust. In *Citadel General Assurance Co. v. Lloyds Bank Canada*, [1997] 3 S.C.R. 805 (S.C.C.), at para. 29, the court stated: "A debt obligation is a chose in action and, therefore, property over which one can impose a trust". This proposition is supported by the decision of the House of Lords in *Gorman v. Karpnale Ltd.*, [1991] 3 W.L.R. 10 (U.K. H.L.). See also Donovan W.M. Waters, Mark R. Gillen & Lionel D. Smith, *Waters' Law of Trusts in Canada*, 4th ed. (Toronto: Carswell, 2012), at p. 161.

83 It follows that it does not matter that neither the City nor the Town had created segregated accounts or specifically earmarked the source of the funds they would use to pay the debts they owed for the paving projects. The statutory trust attaches to the property of the contractor or subcontractor, namely the debt, not to the funds the debtor will use to pay that debt.

84 Section 8(1) embraces "all amounts, owing to a contractor or subcontractor, whether or not due or payable". That language designated precisely what property the trust is meant to encompass. A-1 owned those debts. They constituted choses in action which are a form of property over which a trust may be imposed. It follows that at the moment of A-1's bankruptcy, the trust created by s. 8(1) was imposed on the debts owed by the City and the Town to A-1.

(3) Did commingling of the Funds mean that the required certainty of subject matter was not present?

85 In my respectful view, the motion judge erred by ruling that because the money paid to satisfy the individual debts owing to A-1 on account of the paving projects had been commingled with the money paid to satisfy other paving project debts in the Paving Projects Account, the requisite certainty of subject matter was not made out.

86 The evidence clearly establishes that the funds paid for each paving project were readily ascertainable and identifiable. They were commingled only to the extent they had all been paid into the same account but they had not been converted to other uses and they did not cease to be traceable to the specific project for which they had been paid.

87 Commingling of this kind does not deprive trust property of the required element of certainty of subject matter. Commingling of trust money with other money can destroy the element of certainty of subject matter, but only where commingling makes it impossible to identify or trace the trust property.

88 McLachlin J. explained this in ***Henfrey*** when she stated in relation to the deemed statutory trust imposed on money collected by a merchant under British Columbia's *Social Service Tax Act* that the trust attached the moment the tax is collected. Accordingly, "[i]f the money collected for tax is identifiable or traceable, then the true state of affairs conforms with the ordinary meaning of 'trust' and the money is exempt from distribution to creditors" in the merchant's bankruptcy: pp. 34-35. McLachlin J. went on to explain that the problem with deemed statutory trusts is that very often, the trust property "ceases to be identifiable": p. 34. She then stated, at pp. 34-35, that the property ceases to be identifiable in the following

circumstances:

> ”The tax money is mingled with other money in the hands of the merchant *and converted to other property so that it cannot be traced*. At this point it is no longer a trust under general principles of law ... [If] the money has been converted to other property and cannot be traced, there is ‘no property...held in trust’ under [the predecessor provision to s. 67(1)(a) of the *BIA*]”. [emphasis added]

89 Subsequent jurisprudence confirms this statement of the law. In *Husky Oil*, the majority confirmed that *Henfrey* identified the key question as whether the trust property could be identified and traced: para. 25. This court also followed McLachlin J.’s statement of the law in *Graphicshoppe Ltd., Re* (2005), 78 O.R. (3d) 401 (Ont. C.A.), where Moldaver J.A. (as he then was) stated, at para. 123:

> For present purposes, I am prepared to accept that *Henfrey Samson* falls short of holding that co-mingling of trust and other funds is, by itself, fatal to the application of s. 67(1)(a) of the *BIA*. Once however, the trust funds have been converted into property that cannot be traced, that is fatal. And that is what occurred here.

90 The motion judge considered herself bound by the decision of this court in *GMAC* to find that any commingling of trust property was fatal to certainty of subject matter. In fairness to the motion judge, I agree that there are *dicta* in *GMAC* that could be taken to support that proposition, and it appears that it has been read in the same way in other cases: *Bank of Montreal v. Kappeler*, 2017 ONSC 6760 (Ont. S.C.J. [Commercial List]), at para. 3, and *Royal Bank of Canada v. Atlas Block Co.*, 2014 ONSC 3062, 15 C.B.R. (6th) 272 (Ont. S.C.J.), at paras. 35-36. However, for the following reasons, it is my view that GMAC should not be read as standing for the proposition that any commingling will be fatal to the existence of a trust.

91 As described previously, the issue in *GMAC* concerned s. 15 of the *Load Brokers* regulation, which required load brokers to hold in trust for carriers’ money received by the load broker on account of carriage charges and to maintain separate accounts for such funds. TCT, the bankrupt, had failed to maintain separate accounts, and a priority dispute arose between the carriers who claimed a trust and TCT’s secured creditor. The court held that, as TCT had not maintained a separate account but had commingled the money it received for carriage charges, there was no trust for the purposes of s. 67(1)(a) of the *BIA*. The court stated, at para. 19: “Once the purported trust funds are co-mingled with other funds, they can no longer be said to be ‘effectively segregated’ for the purpose of constituting a trust at common law”. Significantly, the authority cited for that proposition is *Henfrey*, and the court goes on to cite the same passage from *Henfrey* that I have referred to above, at para. 44, stating that when the “tax money is mingled with other money in the hands of the merchant and converted to other property so that it cannot be traced”, it ceases to be subject to any trust. The *GMAC* court went on to state, at para. 20, that the facts before the court were not distinguishable from those of *Henfrey* and that the legal result must also be the same.

92 In my view, *GMAC* is distinguishable from the case at bar.

93 First, the *Load Brokers* regulation at issue in *GMAC* did not create a deemed statutory trust. Admittedly, the *GMAC* court did not find it necessary to decide this point: para. 17. However, this conclusion clearly follows from examining the text of s. 15 of the regulation and comparing it to other provisions that create deemed statutory trusts. The regulation did not use deeming language such as found in s. 18 of the *Social Service Tax Act* at issue in *Henfrey*. Instead, it used the obligatory language of “shall,” stating that the load broker “shall” hold in trust money received and “shall” maintain a trust account. This language indicates the regulation obligates the load broker to take steps that will bring a trust into existence but the regulation itself does not bring the trust into existence.

94 This distinction between deemed statutory trusts and statutory trust obligations explains the result in *GMAC*. The regulation only obligated the load broker to hold the funds received in a separate account. If TCT complied with this obligation, that would give rise to a trust. However, TCT did not comply with this obligation and instead deposited all funds received into a single account. Accordingly, TCT did not perform the actions required to create a trust. The fact that the monies TCT received may have been capable of being traced due to the computerized accounting records it maintained does not alter the conclusion that no trust arose. As GCNA submitted in oral argument, while tracing is available once a trust

exists, tracing is incapable of creating a trust.

95 The distinction between deemed statutory trusts and mere statutory trust obligations also explains why a trust did attach to moneys received by the receiver on behalf of TCT following the receiver's appointment. The receiver had deposited payments received into a separate account pursuant to court orders: *GMAC*, para. 33. The court found that the receiver was required to comply with s. 15 of the regulation and hold the funds on trust: *GMAC*, para. 36. Accordingly, the court found that that the payments the receiver collected were held on trust because the receiver was required to comply with the regulation and did in fact comply with it by holding the funds in a separate account: *GMAC*, para. 38. The receiver's action of complying with the statutory trust obligation by depositing the funds into a separate account thus brought the trust into existence.

96 In contrast, s. 8(1) of the *CLA* operates quite differently than s. 15 of the *Load Brokers* regulation. It does impose a deemed statutory trust rather than merely create a statutory trust obligation on the contractor to hold money on trust in a separate account. Section 8(1) declares that the amounts owing to the contractor "constitute a trust fund" independently of the contractor's subjective intention or actions. The s. 8(1) trust is imposed from the time the moneys are owed to the contractor, not just after they are received. Accordingly, the fact that ss. 8(1) and (2) did not require the segregation of amounts received is not determinative because the statute itself, not the act of complying with a statutory obligation to segregate funds, created the trust.

97 Second, the statement that once the purported trust funds are commingled with other funds they cease to be trust funds must be read in the light of the fact that when making it, the court was explicitly following *Henfrey*. In *Henfrey*, as I have explained, McLachlin J. made it clear that it was only when commingling is accompanied by conversion and tracing becomes impossible that the required element of certainty of subject matter is lost.

98 In my view, *GMAC* should not be read as standing for the proposition that all deemed statutory trusts cease to exist if there is any commingling of the trust funds.

99 I am fortified in that conclusion by a considerable body of authority in addition to *Henfrey* that stands for the proposition that commingling alone will not destroy the element of certainty of subject matter under the general principles of trust law. I have already mentioned *Graphicshoppe* where this court clearly rejected that proposition. A.H. Oosterhoff, Robert Chambers & Mitchell McInnes, *Oosterhoff on Trusts: Text, Commentary and Materials*, 8th ed. (Toronto: Carswell, 2014), at pp. 207-208, states that when trust property is deposited into a mixed account, "the trust is not necessarily defeated. The rules of tracing allow the beneficiary to assert a proprietary interest in the account." In *B.M.P. Global Distribution Inc. v. Bank of Nova Scotia*, 2009 SCC 15, [2009] 1 S.C.R. 504 (S.C.C.), the Supreme Court held that mixing of the funds does not necessarily bar recovery and that it is possible to trace money into bank accounts as long as it is possible to identify the funds: at para. 85. The funds are identifiable if it can be established that the money deposited in the account was the product of, or substitute for, the original thing: at para. 86. As the Alberta Court of Queen's Bench recently held, in *Imor Capital Corp v. Horizon Commercial Development Corp*, 2018 ABQB 39, 56 C.B.R. (6th) 323 (Alta. Q.B.), at para. 58:

> ...[the bankrupt's] co-mingling of trust funds with its own is not fatal to the trust. It must be determined whether, despite the co-mingling, the trust funds can be identified or traced.

The following cases are to the same effect: *Hallett's Estate, Re* (1880), 13 Ch. D. 696 (Eng. C.A.); *Kayford Ltd., Re* (1974), [1975] 1 W.L.R. 279 (Eng. Ch. Div.); *Kel-Greg Homes Inc., Re*, 2015 NSSC 274, 365 N.S.R. (2d) 274 (N.S. S.C.), at paras. 51-59; *0409725 B.C. Ltd.*, at paras. 24-34; *Kerr Interior Systems Ltd., Re*, 2009 ABCA 240, 54 C.B.R. (5th) 173 (Alta. C.A.), at para. 18.

(4) Does RBC's security interest have priority even if the trust created by s. 8(1) of the CLA survives in bankruptcy?

100 On appeal, RBC submits that its security interest takes priority over the deemed statutory trust in s. 8(1) of the *CLA* even if this court finds that the *CLA* trust is valid under s. 67(1)(a) of the *BIA*. RBC relies on the Supreme Court's decision in *Royal Bank v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411 (S.C.C.) in support of this argument. In that case, the majority found that a bank's security interest under the *Bank Act*, S.C. 1991, c. 46 and the *Personal Property Security Act*, S.A. 1988, c. P-4.05 took priority over a deemed statutory trust in favour of the federal Crown established by ss. 227(4) and (5) of the

Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.).

101 RBC did not advance this argument before the motion judge. Nor did RBC introduce its general security agreement with A-1 into the record.

102 Accordingly, I would decline to consider this argument. A respondent on appeal cannot seek to sustain an order on a basis that is both an entirely new argument and in relation to which it might have been necessary to adduce evidence before the lower court: see *Perka v. R.*, [1984] 2 S.C.R. 232 (S.C.C.), at p. 240; *Fanshawe College of Applied Arts and Technology v. AU Optronics Corp.*, 2016 ONCA 131, 129 O.R. (3d) 391 (Ont. C.A.), at para. 9. RBC's proposed argument is both new and requires evidence that RBC has not adduced. In both *Sparrow Electric* and *GMAC*, the court considered the specific provisions of the security agreement in determining whether the security attached to the trust funds: see *Sparrow Electric*, at paras. 71-72, 90; *GMAC*, at para. 26. This court is unable to consider the specific provisions of RBC's security agreement with A-1 because it is not part of the record.

Disposition

103 For these reasons, I would allow the appeal, set aside the order below and make an order:

1. That by operation of s. 67(1)(a) of the *BIA*, the Funds satisfy the requirements for a trust at law and so are not property of A-1 available for distribution to A-1's creditors; and

2. That the balance of the motion concerning GCNA's priority dispute with the Unions be remitted to the Superior Court for disposition.

104 GCNA is entitled to costs awarded against RBC fixed at $30,000 for the motion and at $45,000 for this appeal, both amounts inclusive of disbursements and taxes.

***Alexandra Hoy A.C.J.O.*:**
I agree

***Doherty J.A.*:**
I agree

***Roberts J.A.*:**
I agree

***Fairburn J.A.*:**
I agree

Appeal allowed; order set aside.

End of Document

2009 CarswellOnt 3583
Ontario Superior Court of Justice [Commercial List]

Nortel Networks Corp., Re

2009 CarswellOnt 3583, [2009] O.J. No. 2558, 178 A.C.W.S. (3d) 305, 55 C.B.R. (5th) 68, 75 C.C.P.B. 233

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 NORTEL NETWORKS CORPORATION, NORTEL NETWORKS LIMITED, NORTEL NETWORKS GLOBAL CORPORATION, NORTEL NETWORKS INTERNATIONAL CORPORATION AND NORTEL NETWORKS TECHNOLOGY CORPORATION (Applicants)

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

Morawetz J.

Heard: April 21, 2009
Judgment: June 18, 2009
Docket: 09-CL-7950

Counsel: Barry Wadsworth for CAW, George Borosh et al
Susan Philpott, Mark Zigler for Nortel Networks Former Employees
Lyndon Barnes, Adam Hirsh for Nortel Networks Board of Directors
Alan Mersky, Mario Forte for Nortel Networks et al
Gavin H. Finlayson for Informal Nortel Noteholders Group
Leanne Williams for Flextronics Inc.
Joseph Pasquariello, Chris Armstrong for Monitor, Ernst & Young Inc.
Janice Payne for Recently Severed Canadian Nortel Employees ("RSCNE")
Gail Misra for CEP Union
J. Davis-Sydor for Brookfield Lepage Johnson Controls Facility Management Services
Henry Juroviesky for Nortel Terminated Canadian Employees Steering Committee
Alex MacFarlane for Official Unsecured Creditors Committee
M. Starnino for Superintendent of Financial Services

Subject: Insolvency; Labour; Public

Related Abridgment Classifications

Bankruptcy and insolvency
XIX Companies' Creditors Arrangement Act
XIX.2 Initial application
XIX.2.e Proceedings subject to stay
XIX.2.e.vi Miscellaneous

Labour and employment law
I Labour law
I.1 Labour relations boards
I.1.b Jurisdiction
I.1.b.i General principles

Headnote

Bankruptcy and insolvency --- Proposal — Companies' Creditors Arrangement Act — Miscellaneous issues
Telecommunications company entered protection under Companies' Creditors Arrangement Act — Company ceased making secured payments — Former employees and union brought motion for continued benefits — Motion dismissed — Poor financial performance of company, which was insolvent, was important consideration — Proceedings were at early stage and no classification of creditors had occurred — Company had breached terms of collective agreement with union, and to former employees not covered by agreement — Claims were unsecured — Section 11.3 of Act could not operate to force payment of claim, as underlying services were provided before initial order — Key factor was not payment obligation arose but rather when services performed — Section 11.3 should be construed narrowly.

Labour and employment law --- Labour law — Labour relations boards — Jurisdiction — General principles
Telecommunications company entered protection under Companies' Creditors Arrangement Act — Company ceased making secured payments — Former employees and union brought motion for continued benefits — Motion dismissed — Section 11.3 of Act could not operate to force payment of claim, as underlying services were provided before initial order — Court had jurisdiction to consider matter — Act may deal with matters which otherwise would be considered under labour legislation — No reason to treat claims of employees differently from unsecured creditors — Claims subject to stay.

Table of Authorities

Cases considered by *Morawetz J.*:

Bilodeau v. McLean (1924), [1924] 2 W.W.R. 631, 34 Man. R. 239, [1924] 3 D.L.R. 410, 1924 CarswellMan 48 (Man. C.A.) — referred to

Crystalline Investments Ltd. v. Domgroup Ltd. (2004), 2004 SCC 3, 2004 CarswellOnt 219, 2004 CarswellOnt 220, 184 O.A.C. 33, 16 R.P.R. (4th) 1, 43 B.L.R. (3d) 1, [2004] 1 S.C.R. 60, 70 O.R. (3d) 254 (note), 46 C.B.R. (4th) 35, 234 D.L.R. (4th) 513, 316 N.R. 1 (S.C.C.) — followed

Dayco (Canada) Ltd. v. C.A.W. (1993), 1993 CarswellOnt 883, 1993 CarswellOnt 978, 14 Admin. L.R. (2d) 1, *(*sub nom. *Dayco (Canada) Ltd. v. CAW-Canada)* [1993] 2 S.C.R. 230, *(*sub nom. *Dayco (Canada) Ltd. v. C.A.W.-Canada)* 102 D.L.R. (4th) 609, 63 O.A.C. 1, 152 N.R. 1, 13 O.R. (3d) 164 (note), *(*sub nom. *Dayco v. C.A.W.)* 93 C.L.L.C. 14,032 (S.C.C.) — referred to

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Mine Jeffrey inc., Re (2003), 35 C.C.P.B. 71, 2003 CarswellQue 90, 40 C.B.R. (4th) 95, [2003] R.J.D.T. 23, *(*sub nom. *Syndicat national de l'amiante d'Asbestos c. Mine Jeffrey inc.)* [2003] R.J.Q. 420 (Que. C.A.) — considered

Mirant Canada Energy Marketing Ltd., Re (2004), 1 C.B.R. (5th) 252, 2004 CarswellAlta 352, 2004 ABQB 218, 36 Alta. L.R. (4th) 87 (Alta. Q.B.) — referred to

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

Smoky River Coal Ltd., Re (2001), 2001 ABCA 209, 2001 CarswellAlta 1035, 205 D.L.R. (4th) 94, [2001] 10 W.W.R. 204, 28 C.B.R. (4th) 127, 95 Alta. L.R. (3d) 1, 299 A.R. 125, 266 W.A.C. 125 (Alta. C.A.) — referred to

TQS inc., Re (2008), 2008 QCCA 1429, 2008 CarswellQue 7132, 45 C.B.R. (5th) 1 (Que. C.A.) — considered

Werchola v. KC5 Amusement Holdings Ltd. (2002), 2002 CarswellSask 670, 2002 SKQB 339, 224 Sask. R. 29 (Sask. Q.B.) — referred to

Woodward's Ltd., Re (1993), 17 C.B.R. (3d) 236, 79 B.C.L.R. (2d) 257, 1993 CarswellBC 530 (B.C. S.C.) — considered

Statutes considered:

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

s. 11 — considered

s. 11.3 [en. 1997, c. 12, s. 124] — considered

Employment Standards Act, 2000, S.O. 2000, c. 41
Generally — referred to

s. 5 — considered

Labour Relations Act, 1995, S.O. 1995, c. 1, Sched. A
Generally — referred to

Wage Earner Protection Program Act, S.C. 2005, c. 47, s. 1
Generally — referred to

Words and phrases considered:

services

The ordinary meaning of "services" [in the *Companies' Creditors Arrangement Act,* R.S.C. 1985, c. C-36] must be considered in the context of the phrase "services,...provided after the order is made". On a plain reading, it contemplates, in my view, some activity on behalf of the service provider which is performed after the date of the Initial Order. The CCAA contemplates that during the reorganization process, pre-filing debts are not paid, absent exceptional circumstances and services provided after the date of the Initial Order will be paid for the purpose of ensuring the continued supply of services.

MOTIONS by union and former employees for order allowing for continuation of benefits from company under protection of *Companies Creditors' Arrangement Act.*

***Morawetz J.*:**

1 The process by which claims of employees, both unionized and non-unionized, have been addressed in restructurings initiated under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "CCAA") has been the subject of debate for a number of years. There is uncertainty and strong divergent views have been expressed. Notwithstanding that employee claims are ultimately addressed in many CCAA proceedings, there are few reported decisions which address a number of the issues being raised in these two motions. This lack of jurisprudence may reflect that the issues, for the most

part, have been resolved through negotiation, as opposed to being determined by the court in the CCAA process - which includes motions for directions, the classification of creditors' claims, the holding and conduct of creditors' meetings and motions to sanction a plan of compromise or arrangement.

2 In this case, both unionized and non-unionized employee groups have brought motions for directions. This endorsement addresses both motions.

Union Motion

3 The first motion is brought by the National Automobile, Aerospace, Transportation and General Workers Union of Canada (CAW - Canada) and its Locals 27, 1525, 1530, 1535, 1837, 1839, 1905, and/or 1915 (the "Union") and by George Borosh on his own behalf and on behalf of all retirees of the Applicants who were formerly represented by the Union.

4 The Union requests an order directing the Applicants (also referred to as "Nortel") to recommence certain periodic and lump sum payments which the Applicants, or any of them, are obligated to make pursuant to the CAW collective agreement (the "Collective Agreement"). The Union also seeks an order requiring the Applicants to pay to those entitled persons the payments which should have been made to them under the Collective Agreement since January 14, 2009, the date of the CCAA filing and the date of the Initial Order.

5 The Union seeks continued payment of certain of these benefits including:

(a) retirement allowance payments ("RAP");

(b) voluntary retirement options ("VRO"); and

(c) termination and severance payments.

6 The amounts claimed by the Union are contractual entitlements under the Collective Agreement, which the Union submits are payable only after an individual's employment with the Applicants has ceased.

7 There are approximately 101 former Union members with claims to RAP. The current value of these RAP is approximately $2.3 million. There are approximately 180 former unionized retirees who claim similar benefits under other collective agreements.

8 There are approximately 7 persons who may assert claims to VRO as of the date of the Initial Order. These claims amount to approximately $202,000.

9 There are also approximately 600 persons who may claim termination and severance pay amounts. Five of those persons are former union members.

Former Employee Motion

10 The second motion is brought by Mr. Donald Sproule, Mr. David Archibald and Mr. Michael Campbell (collectively, the "Representatives") on behalf of former employees, including pensioners, of the Applicants or any person claiming an interest under or on behalf of such former employees or pensioners and surviving spouses in receipt of a Nortel pension, or group or class of them (collectively, the "Former Employees"). The Representatives seek an order varying the Initial Order by requiring the Applicants to pay termination pay, severance pay, vacation pay and an amount equivalent to the continuation of the benefit plans during the notice period, which are required to be paid to affected Former Employees in accordance with the *Employment Standards Act*, *2000* S.O. 2000 c.41 ("ESA") or any other relevant provincial employment legislation. The Representatives also seek an order varying the Initial Order by requiring the Applicants to recommence certain periodic and lump sum payments and to make payment of all periodic and lump sum payments which should have been paid since the Initial Order, which the Applicants are obligated to pay Former Employees in accordance with the statutory and contractual

obligations entered into by Nortel and affected Former Employees, including the Transitional Retirement Allowance ("TRA") and any pension benefit payments Former Employees are entitled to receive in excess of the Nortel Networks Limited Managerial and Non-negotiated Pension Plan (the "Pension Plan"). TRA is similar to RAP, but is for non-unionized retirees. There are approximately 442 individuals who may claim the TRA. The current value of TRA obligations is approximately $18 million.

11 The TRA and the RAP are both unregistered benefits that run concurrently with other pension entitlements and operate as time-limited supplements.

12 In many respects, the motion of the Former Employees is not dissimilar to the CAW motion, such that the motion of the Former Employees can almost be described as a "Me too motion".

Background

13 On January 14, 2009, the Applicants were granted protection under the CCAA, pursuant to the Initial Order.

14 Upon commencement of the CCAA proceedings, the Applicants ceased making payments of amounts that constituted or would constitute unsecured claims against the Applicants. Included were payments for termination and severance, as well as amounts under various retirement and retirement transitioning programs.

15 The Initial Order provides:

(a) that Nortel is entitled but not required to pay, among other things, outstanding and future wages, salaries, vacation pay, employee benefits and pension plan payments;

(b) that Nortel is entitled to terminate the employment of or lay off any of its employees and deal with the consequences under a future plan of arrangement;

(c) that Nortel is entitled to vacate, abandon or quit the whole but not part of any lease agreement and repudiate agreements relating to leased properties (paragraph 11);

(d) for a stay of proceedings against Nortel;

(e) for a suspension of rights and remedies vis-à-vis Nortel;

(f) that during the stay period no person shall discontinue, repudiate, cease to perform any contract, agreement held by the company (paragraph 16);

(g) that those having agreements with Nortel for the supply of goods and/or services are restrained from, among other things, discontinuing, altering or terminating the supply of such goods or services. The proviso is that the goods or services supplied are to be paid for by Nortel in accordance with the normal payment practices.

Position of Union

16 The position of the CAW is that the Applicants' obligations to make the payments is to the CAW pursuant to the Collective Agreement. The obligation is not to the individual beneficiaries.

17 The Union also submits that the difference between the moving parties is that RAP, VRO and other payments are made pursuant to the Collective Agreement as between the Union and the Applicants and not as an outstanding debt payable to former employees.

18 The Union further submits that the Applicants are obligated to maintain the full measure of compensation under the Collective Agreement in exchange for the provision of services provided by the Union's members subsequent to the issuance

of the Initial Order. As such, the failure to abide by the terms of the Collective Agreement, the Union submits, runs directly contrary to Section 11.3 of the CCAA as compensation paid to employees under a collective agreement can reasonably be interpreted as being payment for services within the meaning of this section.

19 Section 11.3 of the CCAA provides:

> No order made under section 11 shall have the effect of
>
> (a) prohibiting a person from requiring immediate payment for goods, services, use of leased or licensed property or other valuable consideration provided after the order is made; or
>
> (b) requiring the further advance of money or credit.

20 In order to fit within Section 11.3, services have to be provided after the date of the Initial Order.

21 The Union submits that persons owed severance pay are post-petition trade creditors in a bankruptcy, albeit in relation to specific circumstances. Thus, by analogy, persons owed severance pay are post-petition trade creditors in a CCAA proceeding. The Union relies on *Smoky River Coal Ltd., Re*, 2001 ABCA 209 (Alta. C.A.) to support its proposition.

22 The Union further submits that when interpreting "compensation" for services performed under the Collective Agreement, it must include all of the monetary aspects of the Collective Agreement and not those specifically made to those actively employed on any particular given day.

23 The Union takes the position that Section 11.3 of the CCAA specifically contemplates that a supplier is entitled to payment for post-filing goods and services provided, and would undoubtedly refuse to continue supply in the event of receiving only partial payment. However, the Union contends that it does not have the ability to cease providing services due to the *Labour Relations Act, 1995*, S.O. 1995, c. 1. As such, the only alternative open to the Union is to seek an order to recommence the payments halted by the Initial Order.

24 The Union contends that Section 11.3 of the CCAA precludes the court from authorizing the Applicants to make selective determinations as to which parts of the Collective Agreement it will abide by. By failing to abide by the terms of the Collective Agreement, the Union contends that the Applicants have acted as if the contract has been amended to the extent that it is no longer bound by all of its terms and need merely address any loss through the plan of arrangement.

25 The Union submits that, with the exception of rectification to clarify the intent of the parties, the court has no jurisdiction at common law or in equity to alter the terms of the contract between parties and as the court cannot amend the terms of the Collective Agreement, the employer should not be allowed to act as though it had done so.

26 The Union submits that no other supplier of services would countenance, and the court does not have the jurisdiction to authorize, the recipient party to a contract unilaterally determining which provisions of the agreement it will or will not abide by while the contract is in operation.

27 The Union concludes that the Applicants must pay for the full measure of its bargain with the Union while the Collective Agreement remains in force and the court should direct the recommencement and repayment of those benefits that arise out of the Collective Agreement and which were suspended subsequently to the filing of the CCAA application on January 14, 2009.

Position of the Former Employees

28 Counsel to the Former Employees submits that the court has the discretion pursuant to Section 11 of the CCAA to order Nortel to recommence periodic and lump-sum payments to Former Employees in accordance with Nortel's statutory and contractual obligations. Further, the RAP payments which the Union seeks to enforce are not meaningfully different from

those RAP benefits payable to other unionized retirees who belong to other unions nor from the TRA payable to non-unionized former employees. Accordingly, counsel submits that it would be inequitable to restore payments to one group of retirees and not others. Hence, the reference to the "Me too motion".

29 Counsel further submits that all employers and employees are bound by the minimum standards in the ESA and other applicable provincial employment legislation. Section 5 of the ESA expressly states that no employer can contract out or waive an employment standard in the ESA and that any such contracting out or waiver is void.

30 Counsel submits that each province has minimum standards employment legislation and regulations which govern employment relationships at the provincial level and that provincial laws such as the ESA continue to apply during CCAA proceedings.

31 Further, the Supreme Court of Canada has held that provincial laws in federally-regulated bankruptcy and insolvency proceedings continue to apply so long as the doctrine of paramountcy is not triggered: See *Crystalline Investments Ltd. v. Domgroup Ltd.*, [2004] 1 S.C.R. 60 (S.C.C.).

32 In this case, counsel further submits that there is no conflict between the provisions of the ESA and the CCAA and that paramountcy is not triggered and it follows that the ESA and other applicable employment legislation continues to apply during the Applicants' CCAA proceedings. As a result counsel submits that the Applicants are required to make payment to Former Employees for monies owing pursuant to the minimum employment standards as outlined in the ESA and other applicable provincial legislation.

Position of the Applicants

33 Counsel to the Applicants sets out the central purpose of the CCAA as being: "to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors to the end that the company is able to continue in business". (*Pacific National Lease Holding Corp., Re*, [1992] B.C.J. No. 3070 (B.C. S.C.), aff'd by (1992), 15 C.B.R. (3d) 265 (B.C. C.A. [In Chambers])), and that the stay is the primary procedural instrument used to achieve the purpose of the CCAA:

> ...if the attempt at a compromise or arrangement is to have any prospect of success, there must be a means of holding the creditors at bay. Hence the powers vested in the court under Section 11 (*Pacific National Lease Holding Corp. (Re)*, *supra*).

34 The Applicants go on to submit that the powers vested in the court under Section 11 to achieve these goals of the CCAA include:

> (a) the ability to stay past debts; and
>
> (b) the ability to require the continuance of present obligations to the debtor.

35 The corresponding protection extended to persons doing business with the debtor is that such persons (including employees) are not required to extend credit to the debtor corporation in the course of the CCAA proceedings. The protection afforded by Section 11.3 extends only to services provided after the Initial Order. Post-filing payments are only made for the purpose of ensuring the continued supply of services and that obligations in connection with past services are stayed. (See *Mirant Canada Energy Marketing Ltd., Re*, [2004] A.J. No. 331 (Alta. Q.B.)).

36 Furthermore, counsel to the Applicants submits that contractual obligations respecting post employment are obligations in respect of past services and are accordingly stayed.

37 Counsel to the Applicants also relies on the following statement from *Mirant*, *supra*, at paragraph 28:

> Thus, for me to find the decision of the Court of Appeal in Smokey River Coal analogous to Schaefer's situation, I would need to find that the obligation to pay severance pay to Schaefer was a clear contractual obligation that was necessary for Schaefer to continue his employment and not an obligation that arose from the cessation or termination of services. In my view, to find it to be the former would be to stretch the meaning of the obligation in the Letter Agreement to pay severance pay. It is an obligation that arises on the termination of services. It does not fall within a commercially reasonable contractual obligation essential for the continued supply of services. Only is his salary which he has been paid falls within that definition.

38 Counsel to the Applicants states that post-employment benefits have been consistently stayed under the CCAA and that post-employment benefits are properly regarded as pre-filing debts, which receive the same treatment as other unsecured creditors. The Applicants rely on *Mine Jeffrey inc., Re*, [2003] Q.J. No. 264 (Que. C.A.) ("*Jeffrey Mine*") for the proposition that "the fact that these benefits are provided for in the collective agreement changes nothing".

39 Counsel to the Applicants submits that the Union seeks an order directing the Applicants to make payment of various post-employment benefits to former Nortel employees and that the Former Employees claim entitlement to similar treatment for all post-employment benefits, under the Collective Agreement or otherwise.

40 The Applicants take the position the Union's continuing collective representation role does not clothe unpaid benefits with any higher status, relying on the following from *Jeffrey Mine* at paras. 57 - 58:

> Within the framework of the restructuring plan, arrangements can be made respecting the amounts owing in this regard.
>
> The same is true in the case of the loss of certain fringe benefits sustained by persons who have not provided services to the debtor since the initial order. These persons became creditors of the debtor for the monetary value of the benefits lost further to Jeffrey Mines Inc.'s having ceased to pay premiums. The fact that these benefits are provided for in the collective agreements changes nothing.

41 In addition, the Applicants point to the following statement of the Quebec Court of Appeal in *TQS inc., Re*, 2008 QCCA 1429 (Que. C.A.) at paras. 26-27:

> [Unofficial translation] Employees' rights are defined by the collective agreement that governs them and by certain legislative provisions. However, the resulting claims are just as much [at] risk as those of other creditors, in this case suppliers whose livelihood is also threatened by the financial precariousness of their debtor.
>
> The arguments of counsel for the Applicants are based on the erroneous premise that the employees are entitled to a privileged status. That is not what the CCAA provides nor is it what this court decided in *Syndicat national de l'amiante d'Asbestos inc. c. Mine Jeffrey inc.*

42 Collectively, RAP payment and TRA payments entail obligations of over $22 million. Counsel to the Applicants submits that there is no basis in principle to treat them differently. They are all stayed and there is no basis to treat any of these two unsecured obligations differently. The Applicants are attempting to restructure for the final benefit of all stakeholders and counsel submits that its collective resources must be used for such purposes.

Report of the Monitor

43 In its Seventh Report, the Monitor notes that at the time of the Initial Order, the Applicants employed approximately 6,000 employees and had approximately 11,700 retirees or their survivors receiving pension and/or benefits from retirement plans sponsored by the Applicants.

44 The Monitor goes on to report that the Applicants have continued to honour substantially all of the obligations to active employees. The Applicants have continued to make current service and special funding payments to their registered pension plans. All the health and welfare benefits for both active employees and retirees have been continued to be paid since

the commencement of the CCAA proceedings.

45 The Monitor further reports that at the filing date, payments to former employees for termination and severance as well as the provisions of the health and dental benefits ceased. In addition, non-registered and unfunded retirement plan payments ceased.

46 More importantly, the Monitor reports that, as noted in previous Monitor's Reports, the Applicants' financial position is under pressure.

Discussion and Analysis

47 The acknowledged purpose of the CCAA is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors to the end that the company is able to continue in business. (See *Pacific National Lease Holding Corp., Re*, [1992] B.C.J. No. 3070 (B.C. S.C.), aff'd by (1992), 15 C.B.R. (3d) 265 (B.C. C.A. [In Chambers]), at para. 18 citing *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 4 C.B.R. (3d) 311 (B.C. C.A.), at 315). The primary procedural instrument used to achieve that goal is the ability of the court to issue a broad stay of proceedings under Section 11 of the CCAA.

48 The powers vested in the court under Section 11 of the CCAA to achieve these goals include the ability to stay past debts; and the ability to require the continuance of present obligations to the debtor. (*Woodward's Ltd., Re* (1993), 17 C.B.R. (3d) 236 (B.C. S.C.).

49 The Applicants acknowledged that they were insolvent in affidavit material filed on the Initial Hearing. This position was accepted and is referenced in my endorsement of January 14, 2009. The Applicants are in the process of restructuring but no plan of compromise or arrangement has yet to be put forward.

50 The Monitor has reported that the Applicants are under financial pressure. Previous reports filed by the Monitor have provided considerable detail as to how the Applicants carry on operations and have provided specific information as to the interdependent relationship between Nortel entities in Canada, the United States, Europe, the Middle East and Asia.

51 In my view, in considering the impact of these motions, it is both necessary and appropriate to take into account the overall financial position of the Applicants. There are several reasons for doing so:

(a) The Applicants are not in a position to honour their obligations to all creditors.

(b) The Applicants are in default of contractual obligations to a number of creditors, including with respect to significant bond issues. The obligations owed to bondholders are unsecured.

(c) The Applicants are in default of certain obligations under the Collective Agreements.

(d) The Applicants are in default of certain obligations owed to the Former Employees.

52 It is also necessary to take into account that these motions have been brought prior to any determination of any creditor classifications. No claims procedure has been proposed. No meeting of creditors has been called and no plan of arrangement has been presented to the creditors for their consideration.

53 There is no doubt that the views of the Union and the Former Employees differ from that of the Applicants. The Union insists that the Applicants honour the Collective Agreement. The Former Employees want treatment that is consistent with that being provided to the Union. The record also establishes that the financial predicament faced by retirees and Former Employees is, in many cases, serious. The record references examples where individuals are largely dependent upon the employee benefits that, until recently, they were receiving.

54 However, the Applicants contend that since all of the employee obligations are unsecured it is improper to prefer

retirees and the Former Employees over the other unsecured creditors of the Applicants and furthermore, the financial pressure facing the Applicants precludes them from paying all of these outstanding obligations.

55 Counsel to the Union contends that the Applicants must pay for the full measure of its bargain with the Union while the Collective Agreement remains in force and further that the court does not have the jurisdiction to authorize a party, in this case the Applicants, to unilaterally determine which provisions of the Collective Agreement they will abide by while the contract is in operation. Counsel further contends that Section 11.3 of the CCAA precludes the court from authorizing the Applicants to make selective determinations as to which parts of the Collective Agreement they will abide by and that by failing to abide by the terms of the Collective Agreement, the Applicants acted as if the Collective Agreement between themselves and the Union has been amended to the extent that the Applicants are no longer bound by all of its terms and need merely address any loss through the plan of arrangement.

56 The Union specifically contends that the court has no jurisdiction to alter the terms of the Collective Agreement.

57 In addressing these points, it is necessary to keep in mind that these CCAA proceedings are at a relatively early stage. It also must be kept in mind that the economic circumstances at Nortel are such that it cannot be considered to be carrying on "business as usual". As a result of the Applicants' insolvency, difficult choices will have to be made. These choices have to be made by all stakeholders.

58 The Applicants have breached the Collective Agreement and, as a consequence, the Union has certain claims.

59 However, the Applicants have also breached contractual agreements they have with Former Employees and other parties. These parties will also have claims as against the Applicants.

60 An overriding consideration is that the employee claims whether put forth by the Union or the Former Employees, are unsecured claims. These claims do not have any statutory priority.

61 In addition, there is nothing on the record which addresses the issue of how the claims of various parties will be treated in any plan of arrangement, nor is there any indication as to how the creditors will be classified. These issues are not before the court at this time.

62 What is before the court is whether the Applicants should be directed to recommence certain periodic and lump sum payments that they are obligated to make under the Collective Agreement as well as similar or equivalent payments to Former Employees.

63 It is necessary to consider the meaning of Section 11.3 and, in particular, whether the Section should be interpreted in the manner suggested by the Union.

64 Counsel to the Union submits that the ordinary meaning of "services" in section 11.3 includes work performed by employees subject to a collective agreement. Further, even if the ordinary meaning is plain, courts must consider the purpose and scheme of the legislation, and relevant legal norms. Counsel submits that the courts must consider the entire context. As a result, when interpreting "compensation" for services performed under a collective agreement, counsel to the Union submits it must include all of the monetary aspects of the agreement and not those made specifically to those actively employed on any particular given day.

65 No cases were cited in support of this interpretation.

66 I am unable to agree with the Union's argument. In my view, section 11.3 is an exception to the general stay provision authorized by section 11 provided for in the Initial Order. As such, it seems to me that section 11.3 should be narrowly construed. (See Ruth Sullivan, *Sullivan on the Construction of Statutes*, 5th ed. (Markham, Ont.: LexisNexis Canada Inc., 2008) at 483-485.) Section 11.3 applies to services provided after the date of the Initial Order. The ordinary meaning of "services" must be considered in the context of the phrase "services,...provided after the order is made". On a plain reading, it contemplates, in my view, some activity on behalf of the service provider which is performed after the date of the Initial Order. The CCAA contemplates that during the reorganization process, pre-filing debts are not paid, absent exceptional

circumstances and services provided after the date of the Initial Order will be paid for the purpose of ensuring the continued supply of services.

67 The flaw in the argument of the Union is that it equates the crystallization of a payment obligation under the Collective Agreement to a provision of a service within the meaning of s. 11.3. The triggering of the payment obligation may have arisen after the Initial Order but it does not follow that a service has been provided after the Initial Order. Section 11.3 contemplates, in my view, some current activity by a service provider post-filing that gives rise to a payment obligation post-filing. The distinction being that the claims of the Union for termination and severance pay are based, for the most part, on services that were provided pre-filing. Likewise, obligations for benefits arising from RAP and VRO are again based, for the most part, on services provided pre-filing. The exact time of when the payment obligation crystallized is not, in my view, the determining factor under section 11.3. Rather, the key factor is whether the employee performed services after the date of the Initial Order. If so, he or she is entitled to compensation benefits for such current service.

68 The interpretation urged by counsel to the Union with respect to this section is not warranted. In my view, section 11.3 does not require the Applicants to make payment, at this time, of the outstanding obligations under the Collective Agreement.

69 The Union also raised the issue as to whether the court has the jurisdiction to order a stay of the outstanding obligations under Section 11 of the CCAA.

70 The Union takes the position that, with the exception of rectification to clarify the intent of the parties, the court has no jurisdiction at common law or in equity to alter the terms of a contract between parties. The Union relies on *Bilodeau v. McLean*, [1924] 3 D.L.R. 410 (Man. C.A.); *Dusener v. Myles*, [1963] S.J. No. 31 (Sask. Q.B.); *Hiesinger v. Bonice*, [1984] A.J. No. 281 (Alta. Q.B.); *Werchola v. KC5 Amusement Holdings Ltd.*, 2002 SKQB 339 (Sask. Q.B.) to support its position.

71 The Union extends this argument and submits that as the court cannot amend the terms of a collective agreement, the employer should not be allowed to act as though it had been.

72 As a general rule, counsel to the Union submits, there is in place a comprehensive regime for the regulation of labour relations with specialized labour-relations tribunals having exclusive jurisdiction to deal with legal and factual matters arising under labour legislation and no court should restrain any tribunal from proceeding to deal with such matters.

73 However, as is clear from the context, these cases referenced at [70] are dealing with the ordinary situation in which there is no issue of insolvency. In this case, we are dealing with a group of companies which are insolvent and which have been accorded the protection of the CCAA. In my view, this insolvency context is an important distinguishing factor. The insolvency context requires that the stay provisions provided in the CCAA and the Initial Order must be given meaningful interpretation.

74 There is authority for the proposition that, when exercising their authority under insolvency legislation, the courts may make, at the initial stage of a CCAA proceeding, orders regarding matters, but for the insolvent condition of the employer, would be dealt with pursuant to provincial labour legislation, and in most circumstances, by labour tribunals. In *Pacific National Lease Holding Corp., Re* (1992), 15 C.B.R. (3d) 265 (B.C. C.A. [In Chambers]), the issue involved the question whether a CCAA debtor company had to make statutory severance payments as was mandatory under the provincial employment standards legislation. MacFarlane J.A. stated at pp. 271-2:

> It appears to me that an order which treats creditors alike is in accord with the purpose of the CCAA. Without the provisions of that statute the petitioner companies might soon be in bankruptcy, and the priority which the employees now have would be lost. The process provided by the CCAA is an interim one. Generally, it suspends but does not determine the ultimate rights of any creditor. In the end it may result in the rights of employees being protected, but in the meantime it preserves the status quo and protects all creditors while a reorganization is being attempted.
>
> . . . . .
>
> This case is not so much about the rights of employees as creditors, but the right of the court under the CCAA to serve not only the special interests of the directors and officers of the company but the broader constituency referred to in *Chef Ready Foods Ltd.*, *supra*. Such a decision may invariably conflict with provincial legislation, but the broad purpose of

the CCAA must be served.

75 The *Jeffrey Mine* decision is also relevant. In my view, the *Jeffrey Mine* case does not appear to support the argument that the Collective Agreement is to be treated as being completely unaffected by CCAA proceedings. It seems to me that it is contemplated that rights under a collective agreement may be suspended during the CCAA proceedings. At paragraphs 60 - 62, the court said under the heading Recapitulation (in translation):

> The collective agreements continue to apply like any contract of successive performance not modified by mutual agreement after the initial order or not disclaimed (assuming that to be possible in the case of collective agreements). Neither the monitor nor the court can amend them unilaterally. That said, distinctions need to be made with regard to the prospect of the resulting debts.
>
> Thus, unionized employees kept on or recalled are entitled to be paid immediately by the monitor for any service provided after the date of the order (s. 11.3), in accordance with the terms of the original version of the applicable collective agreement by the union concerned. However, the obligations not honoured by Jeffrey Mine Inc. with regard to services provided prior to the order constitute debts of Jeffrey Mine Inc. for which the monitor cannot be held liable (s. 11.8 CCAA) and which the employees cannot demand to be paid immediately (s. 11.3 CCAA).
>
> Obligations that have not been met with regard to employees who were laid off permanently on October 7, 2002, or with regard to persons who were former employees of Jeffrey Mine Inc. on that date and that stem from the collective agreements or other commitments constitute debts of the debtor to be disposed of in the restructuring plan or, failing that, upon the bankruptcy of Jeffrey Mine Inc.

76 The issue of severance pay benefits was also referenced in *Printwest Communications Ltd. v. Saskatchewan Cooperative Financial Services Ltd.*, 2005 SKQB 331 (Sask. Q.B.) at paras. 11 and 15. The application of the Union was rejected:

> ...The claims for severance pay arise from the collective bargaining agreement. But severance pay does not fall into the category of essential services provided during the organization period in order to enable Printwest to function.
>
> . . . . .
>
> If the Union's request should be accepted, with the result that the claims for severance pay be dealt with outside the plan of compromise - and thereby be paid in full - such a result could not possibly be viewed as fair and reasonable with respect to other unsecured creditors, who will possibly receive only a small fraction of the amounts owing to them for goods and services provided to Printwest in good faith. Thus, the application of the Union in this respect must be rejected.

Disposition

77 At the commencement of an insolvency process, the situation is oftentimes fluid. An insolvent debtor is faced with many uncertainties. The statute is aimed at facilitating a plan of compromise or arrangement. This may require adjustments to the operations in a number of areas, one of which may be a downsizing of operations which may involve a reduction in the workforce. These adjustments may be painful but at the same time may be unavoidable. The alternative could very well be a bankruptcy which would leave former employees, both unionized and non-unionized, in the position of having unsecured claims against a bankrupt debtor. Depending on the status of secured claims, these unsecured claims may, subject to benefits arising from the recently enacted *Wage Earner Protection Program Act*, be worth next to nothing.

78 In the days ahead, the Applicants, former employees, both unionized and non-unionized may very well have arguments to make on issues involving claims processes (including the ability of the Applicants to compromise claims), classification, meeting of creditors and plan sanction. Nothing in this endorsement is intended to restrict the rights of any party to raise these issues.

79 The reorganization process under the CCAA can be both long and painful. Ultimately, however, for a plan to be sanctioned by the court, the application must meet the following three tests:

(i) there has to be strict compliance with all statutory requirements and adherence to previous orders of the court;

(ii) nothing has been done or purported to be done that is not authorized by the CCAA;

(iii) the plan is fair and reasonable. *Sammi Atlas Inc., Re* (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List])

80 At this stage of the Applicants' CCAA process, I see no basis in principle to treat either unionized or non-unionized employees differently than other unsecured creditors of the Applicants. Their claims are all stayed. The Applicants are attempting to restructure for the benefit of all stakeholders and their resources should be used for such a purpose.

81 It follows that the motion of the Union is dismissed.

82 The Applicants also raised the issue that the Union consistently requested the right to bargain on behalf of retirees who were once part of the Union and that the concession had not been granted. Consequently, the retirees' substantive rights are not part of the bargain between the unionized employees and the employer. Counsel to the Applicants submitted that the union may collectively alter the existing rights of any employee but it cannot negatively do so with respect to retirees' rights.

83 The Union countered that the rights gained by a member of the bargaining unit vest upon retirement, despite the fact that a collective agreement expires, and are enforceable through the grievance procedure.

84 Both parties cited *Dayco (Canada) Ltd. v. C.A.W.*, [1993] 2 S.C.R. 230 (S.C.C.) in support of their respective positions.

85 In view of the fact that this motion has been dismissed for other reasons, it is not necessary for me to determine this specific issue arising out of the *Dayco* decision.

86 The motion of the Former Employees was characterized, as noted above, as a "Me too motion". It was based on the premise that, if the Union's motion was successful, it would only be equitable if the Former Employees also received benefits. The Former Employees do not have the benefit of any enhanced argument based on the Collective Agreement. Rather, the argument of the Former Employees is based on the position that the Applicants cannot contract out of the ESA or any other provincial equivalent. In my view, this is not a case of contracting out of the ESA. Rather, it is a case of whether immediate payout resulting from a breach of the ESA is required to be made. In my view, the analysis is not dissimilar from the Collective Agreement scenario. There is an acknowledgment of the applicability of the ESA, but during the stay period, the Former Employees cannot enforce the payment obligation. In the result, it follows that the motion of the Former Employees is also dismissed.

87 However, I am also mindful that the record, as I have previously noted, makes reference to a number of individuals that are severely impacted by the cessation of payments. There are no significant secured creditors of the Applicants, outside of certain charges provided for in the CCAA proceedings, and in view of the Applicants' declared assets, it is reasonable to expect that there will be a meaningful distribution to unsecured creditors, including retirees and Former Employees. The timing of such distribution may be extremely important to a number of retirees and Former Employees who have been severely impacted by the cessation of payments. In my view, it would be both helpful and equitable if a partial distribution could be made to affected employees on a timely basis.

88 In recognition of the circumstances that face certain retirees and Former Employees, the Monitor is directed to review the current financial circumstances of the Applicants and report back as to whether it is feasible to establish a process by which certain creditors, upon demonstrating hardship, could qualify for an unspecified partial distribution in advance of a general distribution to creditors. I would ask that the Monitor consider and report back to this court on this issue within 30 days.

89 This decision may very well have an incidental effect on the Collective Agreement and the provisions of the ESA, but it is one which arises from the stay. It does not, in my view, result from a repudiation of the Collective Agreement or a contracting out of the ESA. The stay which is being recognized is, in my view, necessary in the circumstances. To hold otherwise, would have the effect of frustrating the objectives of the CCAA to the detriment of all stakeholders.

Motions dismissed.

Most Negative Treatment: Application/Notice of Appeal
Most Recent Application/Notice of Appeal: Nortel Networks Corp., Re | 2009 CarswellOnt 8462 | (S.C.C., Dec 23, 2009)

2009 ONCA 833
Ontario Court of Appeal

Nortel Networks Corp., Re

2009 CarswellOnt 7383, 2009 ONCA 833, [2009] O.J. No. 4967, 184 A.C.W.S. (3d) 300, 2010 C.L.L.C. 210-005, 256 O.A.C. 131, 59 C.B.R. (5th) 23, 77 C.C.P.B. 161, 99 O.R. (3d) 708

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

In the Matter of a Plan of Compromise or Arrangement of Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation

Donald Sproule, David D. Archibald and Michael Campbell on their own behalf and on behalf of Former Employees of Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation (Appellants) and Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation, the Board of Directors of Nortel Networks Corporation and Nortel Networks Limited, the Informal Nortel Noteholder Group, the Official Committee of Unsecured Creditors and Ernst & Young Inc. in its capacity as Monitor (Respondents)

National Automobile, Aerospace, Transportation and General Workers Union of Canada (CAW-Canada) and its Locals 27, 1525, 1530, 1535, 1837, 1839, 1905 and/or 1915, George Borosh and other retirees of Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation (Appellants) and Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation, the Board of Directors of Nortel Networks Corporation and Nortel Networks Limited, the Informal Nortel Noteholder Group, the Official Committee of Unsecured Creditors and Ernst & Young Inc. in its capacity as Monitor (Respondents)

S.T. Goudge, K.N. Feldman, R.A. Blair JJ.A.

Heard: October 1, 2009
Judgment: November 26, 2009*
Docket: CA C50986, C50988

Proceedings: affirming *Nortel Networks Corp., Re* (2009), 2009 CarswellOnt 3583, 55 C.B.R. (5th) 68, 75 C.C.P.B. 233 (Ont. S.C.J. [Commercial List])

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Benjamin Zarnett for Monitor, Ernst & Young Inc.
Gavin H. Finlayson for Informal Nortel Noteholder Group

Thomas McRae for Nortel Canadian Continuing Employees
Massimo Starnino for Superintendent of Financial Services
Alex MacFarlane, Jane Dietrich for Official Committee of Unsecured Creditors

Subject: Insolvency; Constitutional; Employment; Public; Corporate and Commercial; Civil Practice and Procedure

Related Abridgment Classifications

Bankruptcy and insolvency
XIX Companies' Creditors Arrangement Act
XIX.5 Miscellaneous

Constitutional law
VII Distribution of legislative powers
VII.5 Relation between federal and provincial powers
VII.5.c Paramountcy of federal legislation
VII.5.c.iii Statutes governing labour and employment
VII.5.c.iii.C Miscellaneous

Headnote

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Miscellaneous
Telecommunications company entered protection under Companies' Creditors Arrangement Act — Company ceased making secured payments — Motion by former employees and union for continued benefits as well as severance and termination pay was dismissed — Trial judge found poor financial performance of company, which was insolvent, was important consideration — Trial judge found proceedings were at early stage and no classification of creditors had occurred — Trial judge found company had breached terms of collective agreement with union, and to former employees not covered by agreement — Trial judge found claims were unsecured — Trial judge found s. 11.3 of Act could not operate to force payment of claim, as underlying services were provided before initial order — Trial judge found s. 11.3 should be construed narrowly — Union and former employees made separate appeals, which were heard together — Appeals dismissed — Trial judge was correct that stay was necessary — Stay provisions are important part of restructuring process under Act — Periodic payments were not for services rendered, and were not excluded by s. 11.3(a) of Act — Fact that rights to payment were vested and could be enforced under earlier collective agreements indicated they were not for current services — Fact that at time of hearing business was likely to be sold rather than restructured did not affect order.

Constitutional law --- Distribution of legislative powers — Relation between federal and provincial powers — Paramountcy of federal legislation — Statutes governing labour and employment — Miscellaneous
Telecommunications company entered protection under Companies' Creditors Arrangement Act — Company ceased making secured payments — Motion by former employees and union for continued benefits as well as severance and termination pay was dismissed — Trial judge found poor financial performance of company, which was insolvent, was important consideration — Trial judge found proceedings were at early stage and no classification of creditors had occurred — Trial judge found company had breached terms of collective agreement with union, and to former employees not covered by agreement — Trial judge found claims were unsecured — Trial judge found s. 11.3 of Act could not operate to force payment of claim, as underlying services were provided before initial order — Trial judge found key factor was not payment obligation arose but rather when services performed — Trial judge found s. 11.3 should be construed narrowly — Union and former employees made separate appeals, which were heard together — Appeals dismissed — Trial judge was correct that stay was necessary — CCAA overrides provincial Employment Standards Act which requires immediate payment of termination and severance obligations — Paramountcy doctrine dictated that intent of parliament to freeze debt obligations through Act would be frustrated if stay order did not apply to statutory termination and severance payments regarding past services.

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s. 11(3) — considered

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s. 11(5) — referred to

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s. 11.3(a) [en. 1997, c. 12, s. 124] — considered

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APPEALS by union and former employees from judgment reported at *Nortel Networks Corp., Re* (2009), 2009 CarswellOnt 3583, 55 C.B.R. (5th) 68, 75 C.C.P.B. 233 (Ont. S.C.J. [Commercial List]), dismissing motion for continued payments under collective agreement.

***S.T. Goudge, K.N. Feldman JJ.A.*:**

1 On January 14, 2009, the Nortel group of companies (referred to in these reasons as "Nortel") applied for and was granted protection under the *Companies' Creditors Arrangement Act*, R.S.C. 1985 c. C-36, ("*CCAA*").

2 In order to provide Nortel with breathing space to permit it to file a plan of compromise or arrangement with the court, that order provided, *inter alia*, a stay of all proceedings against Nortel, a suspension of all rights and remedies against Nortel, and an order that during the stay period, no person shall discontinue, repudiate, or cease to perform any contract or agreement with Nortel.

3 The CAW-Canada ("Union") represents employees of Nortel at two sites in Ontario. The Union and Nortel are parties to a collective agreement covering both sites. On April 21, 2009, the Union and a group of former employees of Nortel ("Former Employees") each brought a motion for directions seeking certain relief from the order granted to Nortel on January 14, 2009. On June 18, 2009, Morawetz J. denied both motions.

4 The Union and the Former Employees both appealed from that decision. Their appeals were heard one after the other on October 1, 2009. The appeal of the Former Employees was supported by a group of Canadian non-unionized employees, whose employment with Nortel continues. Nortel was supported in opposing the appeals by the board of directors of two of the Nortel companies, an informal Nortel noteholders group, and the Official Committee of Unsecured Creditors of Nortel.

5 We will address each of the two appeals in turn.

The Union Appeal

Background

6 The collective agreement between the Union and Nortel sets out the terms and conditions of employment of the 45 employees that have continued to work for Nortel since January 14, 2009. The collective agreement also obliges Nortel to make certain periodic payments to unionized former employees who have retired or been terminated from Nortel. The three kinds of periodic payments at issue in this proceeding are monthly payments under the Retirement Allowance Plan ("RAP"), payments under the Voluntary Retirement Option ("VRO"), and termination and severance payments to unionized employees who have been terminated or who have severed their employment at Nortel.

7 Since the January 14, 2009 order, Nortel has continued to pay the continuing employees their compensation and benefits as required by the collective agreement. However, as of that date, it ceased to make the periodic payments at issue in this case.

8 The Union's motion requested an order directing Nortel to resume those periodic payments as required by the collective agreement. The Union's argument hinges on s. 11.3(a) of the *CCAA*. At the time this appeal was argued, it read as follows:[1]

> 11.3 No order made under section 11 shall have the effect of
>
> (a) prohibiting a person from requiring immediate payment for goods, services, use of leased or licensed property or other valuable consideration provided after the order is made.

9 The Union's argument before the motion judge was that the collective agreement is a bargain between it and Nortel that ought not to be divided into separate obligations and therefore the "compensation" for services performed under it must include all of Nortel's monetary obligations, not just those owed specifically to those who remain actively employed. The Union argued that the contested periodic payments to Former Employees must be considered part of the compensation for

services provided after January 14, 2009, and therefore exempted from the order of that date by s. 11.3(a) of the *CCAA*.

10 The motion judge dismissed this argument. The essence of his reasons is as follows at para. 67:

> The flaw in the argument of the Union is that it equates the crystallization of a payment obligation under the Collective Agreement to a provision of a service within the meaning of s. 11.3. The triggering of the payment obligation may have arisen after the Initial Order but it does not follow that a service has been provided after the Initial Order. Section 11.3 contemplates, in my view, some current activity by a service provider post-filing that gives rise to a payment obligation post-filing. The distinction being that the claims of the Union for termination and severance pay are based, for the most part, on services that were provided pre-filing. Likewise, obligations for benefits arising from RAP and VRO are again based, for the most part, on services provided pre-filing. The exact time of when the payment obligation crystallized is not, in my view, the determining factor under section 11.3. Rather, the key factor is whether the employee performed services after the date of the Initial Order. If so, he or she is entitled to compensation benefits for such current service.

11 The Union challenges this conclusion.

12 In this court, neither the Union nor any other party argues that Nortel's obligation to make the contested periodic payments should be decided by arbitration under the collective agreement rather than by the court.

13 Nor does the Union argue that any of the unionized former employees, who would receive these periodic payments, have themselves provided services to Nortel since the January 14, 2009 order.

14 Rather, the Union reiterates the argument it made at first instance, namely that these periodic payments are protected by s. 11.3(a) of the *CCAA* as payment for service provided after the January 14, 2009 order was made by the Union members who have continued as employees of Nortel.

15 In our opinion, this argument must fail.

Analysis

16 Two preliminary points should be made. First, as the motion judge wrote at para. 47 of his reasons, the acknowledged purpose of the *CCAA* is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors, to the end that the company is able to continue in business. The primary instrument provided by the *CCAA* to achieve its purpose is the power of the court to issue a broad stay of proceedings under s. 11. That power includes the power to stay the debt obligations of the company. The order of January 14, 2009 is an exercise of that power, and must be read in the context of the purpose of the legislation. Nonetheless, it is important to underline that, while that order stays those obligations, it does not eliminate them.

17 Second, we also agree with the motion judge when he stated at para. 66:

> In my view, section 11.3 is an exception to the general stay provision authorized by section 11 provided for in the Initial Order. As such, it seems to me that section 11.3 should be narrowly construed.

18 Because of s. 11.3(a) of the *CCAA*, the January 14, 2009 order cannot stay Nortel's obligation to make immediate payment for the services provided to it after the date of the order.

19 What then does the collective agreement require of Nortel as payment for the work done by its continuing employees? The straightforward answer is that the collective agreement sets out in detail the compensation that Nortel must pay and the benefits it must provide to its employees in return for their services. That bargain is at the heart of the collective agreement. Indeed, as counsel for the Union candidly acknowledged, the typical grievance, if services of employees went unremunerated, would be to seek as a remedy not what might be owed to former employees but only the payment of compensation and benefits owed under the collective agreement to those employees who provided the services. Indeed, that

package of compensation and benefits represents the commercially reasonable contractual obligation resting on Nortel for the supply of services by those continuing employees. It is that which is protected by s. 11.3(a) from the reach of the January 14, 2009 order: see *Mirant Canada Energy Marketing Ltd., Re* (2004), 36 Alta. L.R. (4th) 87 (Alta. Q.B.).

20 Can it be said that the payment required for the services provided by the continuing employees of Nortel also extends to encompass the periodic payments to the former employees in question in this case? In our opinion, for the following reasons the answer is clearly no.

21 The periodic payments to former employees are payments under various retirement programs, and termination and severance payments. All are products of the ongoing collective bargaining process and the collective agreements it has produced over time. As Krever J.A. wrote regarding analogous benefits in *Metropolitan Toronto Police Services Board v. Ontario (Municipal Employees Retirement Board)* (1999), 45 O.R. (3d) 622 (Ont. C.A.), at 629, it can be assumed that the cost of these benefits was considered in the overall compensation package negotiated when they were created by predecessor collective agreements. These benefits may therefore reasonably be thought of as deferred compensation under those predecessor agreements. In other words, they are compensation deferred from past agreements but provided currently as periodic payments owing to former employees for prior services. The services for which these payments constitute "payment" under the *CCAA* were those provided under predecessor agreements, not the services currently being performed for Nortel.

22 Moreover, the rights of former employees to these periodic payments remain currently enforceable even though those rights were created under predecessor collective agreements. They become a form of "vested" right, although they may only be enforceable by the Union on behalf of the former employees: see *Dayco (Canada) Ltd. v. C.A.W.*, [1993] 2 S.C.R. 230 (S.C.C.), at 274. That is entirely inconsistent with the periodic payments constituting payment for current services. If current service was the source of the obligation to make these periodic payments then, if there were no current services being performed, the obligation would evaporate and the right of the former employees to receive the periodic payments would disappear. It would in no sense be a "vested" right.

23 In summary, we can find no basis upon which the Union's position can be sustained. The periodic payments in issue cannot be characterized as part of the payment required of Nortel for the services provided to it by its continuing employees after January 14, 2009. Section 11.3(a) of the *CCAA* does not exclude these payments from the effect of the order of that date.

24 The Union's appeal must be dismissed.

The Former Employees' Appeal

Background

25 The Former Employees' motion was brought by three men as representatives of former employees including pensioners and their survivors. On the motion their claim was for an order varying the Initial Order to require Nortel to pay termination pay, severance pay, vacation pay, an amount for continuation of the Nortel benefit plans during the notice period in accordance with the *Employment Standards Act, 2000*, S.O. 2000, c. 41 ("*ESA*") and any other provincial employment legislation. The representatives also sought an order varying the Initial Order to require Nortel to pay the Transitional Retirement Allowance ("TRA") and certain pension benefit payments to affected former employees. The motion judge described the motion by the former employees as "not dissimilar to the CAW motion, such that the motion of the former employees can almost be described as a "Me too motion."

26 After he dismissed the union motion, the motion judge turned to the "me too" motion of the former employees. The former employees wanted to achieve the same result as the unionized employees. The motion judge described their argument as based on the position that Nortel could not contract out of the *ESA* of Ontario or another province. However, as he noted, rather than trying to contract out, it was acknowledged that the *ESA* applied, except that immediate payment of amounts owing as required by the *ESA* were stayed during the stay period under the Initial Order, so that the former employees could not enforce the acknowledged payment obligation during that time. The motion judge concluded that on the same basis as the union motion, the former employees' motion was also dismissed.

27 For the purposes of the appeal, the former employees narrowed their claim only to statutory termination and severance claims under the *ESA* that were not being paid by Nortel pursuant to the Initial Order, and served a Notice of Constitutional Question. The appellant asks this court to find that judges cannot use their discretion to order a stay under the *CCAA* that has the effect of overriding valid provincial minimum standards legislation where there is no conflict between the statutes and the doctrine of paramountcy has not been triggered.

28 Neither the provincial nor the federal governments responded to the notice on this appeal.

29 Paragraphs 6 and 11 of the Initial Order (as amended) provide as follows:

> 6. THIS COURT ORDERS that each of the Applicants, either on its own or on behalf of another Applicant, *shall be entitled but not required to pay* the following expenses whether incurred prior to, on or after the date of this Order:
>
> > (a) all outstanding and future wages, salaries and employee benefits (including but not limited to, employee medical and similar benefit plans, relocation and tax equalization programs, the Incentive Plan (as defined in the Doolittle affidavit) and employee assistance programs), current service, special and similar pension benefit payments, vacation pay, commissions and employee and director expenses, in each case incurred in the ordinary course of business and consistent with existing compensation policies and arrangements;
>
> 11. THIS COURT ORDERS that each of the Applicants shall have the right to:
>
> . . .
>
> > (b) terminate the employment of such of its employees or temporarily lay off such employees as it deems appropriate *and to deal with the consequences thereof in the Plan or on further order of the Court*.
>
> . . .
>
> all of the foregoing to permit the Applicants to proceed with an orderly restructuring of the Business.
>
> [Emphasis added.]

30 Pursuant to these paragraphs, from the date of the Initial Order, Nortel stopped making payments to former employees as well as employees terminated following the Initial Order for certain retirement and pension allowances as well as for statutory severance and termination payments. The *ESA* sets out obligations to provide notice of termination of employment or payment in lieu of notice and severance pay in defined circumstances. By virtue of s. 11(5), those payments must be made on the later of seven days after the date employment ends or the employee's next pay date.

31 As the motion judge stated, it is acknowledged by all parties on this motion that the *ESA* continues to apply while a company is subject to a *CCAA* restructuring. The issue is whether the company's provincial statutory obligations for virtually immediate payment of termination and severance can be stayed by an order made under the *CCAA*.

32 Sections 11(3), dealing with the initial application, and (4), dealing with subsequent applications under the *CCAA* are the stay provisions of the Act. Section 11(3) provides:

> 11. (3) A court may, on an initial application in respect of a company, make an order on such terms as it may impose, effective for such period as the court deems necessary not exceeding thirty days,
>
> > (a) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection 1; [the Bankruptcy and Insolvency Act and the Winding Up Act]
> >
> > (b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company;

> (c) prohibiting, until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company.

Analysis

33 As earlier noted, the stay provisions of the *CCAA* are well recognized as the key to the successful operation of the *CCAA* restructuring process. As this court stated in *Stelco Inc., Re* (2005), 75 O.R. (3d) 5 (Ont. C.A.) at para. 36:

> In the CCAA context, Parliament has provided a statutory framework to extend protection to a company while it holds its creditors at bay and attempts to negotiate a compromised plan of arrangement that will enable it to emerge and continue as a viable economic entity, thus benefiting society and the company in the long run, along with the company's creditors, shareholders, employees and other stakeholders. The s. 11 discretion is the engine that drives this broad and flexible statutory scheme...

34 Parliament has carved out defined exceptions to the court's ability to impose a stay. For example, s. 11.3(a) prohibits a stay of payments for goods and services provided after the initial order, so that while the company is given the opportunity and privilege to carry on during the *CCAA* restructuring process without paying its existing creditors, it is on a pay-as-you-go basis only. In contrast, there is no exception for statutory termination and severance pay.[2] Furthermore, as the respondent Boards of Directors point out, the recent amendments to the *CCAA* that came into force on September 18, 2009 do not address this issue, although they do deal in other respects with employee-related matters.

35 As there is no specific protection from the general stay provision for *ESA* termination and severance payments, the question to be determined is whether the court is entitled to extend the effect of its stay order to such payments based on the constitutional doctrine of paramountcy: *Crystalline Investments Ltd. v. Domgroup Ltd.*, [2004] 1 S.C.R. 60 (S.C.C.) at para. 43.

36 The scope, intent and effect of the operation of the doctrine of paramountcy was recently reviewed and summarized by Binnie and Lebel JJ. in *Canadian Western Bank v. Alberta*, [2007] 2 S.C.R. 3 (S.C.C.) at paras. 69-75. They reaffirmed the "conflict" test stated by Dickson J. in *Multiple Access Ltd. v. McCutcheon*, [1982] 2 S.C.R. 161 (S.C.C.):

> In principle, there would seem to be no good reasons to speak of paramountcy and preclusion except where there is actual conflict in operation as where one enactment says "yes" and the other says "no"; "the same citizens are being told to do inconsistent things"; compliance with one is defiance of the other. [p. 191]

37 However, they also explained an important proviso or gloss on the strict conflict rule that has developed in the case law since *Multiple Access*:

> Nevertheless, there will be cases in which imposing an obligation to comply with provincial legislation would in effect frustrate the purpose of a federal law even though it did not entail a direct violation of the federal law's provisions. The Court recognized this in Bank of Montreal v. Hall, [1990] 1 S.C.R. 121, in noting that Parliament's "intent" must also be taken into account in the analysis of incompatibility. The Court thus acknowledged that the impossibility of complying with two enactments is not the sole sign of incompatibility. The fact that a provincial law is incompatible with the purpose of a federal law will also be sufficient to trigger the application of the doctrine of federal paramountcy. This point was recently reaffirmed in Mangat and in *Rothmans, Benson & Hedges Inc. v. Saskatchewan*, [2005] 1 S.C.R. 188, 2005 SCC 13. (para. 73)

38 Therefore, the doctrine of paramountcy will apply either where a provincial and a federal statutory provision are in conflict and cannot both be complied with, or where complying with the provincial law will have the effect of frustrating the purpose of the federal law and therefore the intent of Parliament. Binnie and Lebel JJ. concluded by summarizing the operation of the doctrine in the following way:

> To sum up, the onus is on the party relying on the doctrine of federal paramountcy to demonstrate that the federal and

> provincial laws are in fact incompatible by establishing either that it is impossible to comply with both laws or that to apply the provincial law would frustrate the purpose of the federal law. (para. 75)

39 The *CCAA* stay provision is a clear example of a case where the intent of Parliament, to allow the court to freeze the debt obligations owing to all creditors for past services (and goods) in order to permit a company to restructure for the benefit of all stakeholders, would be frustrated if the court's stay order could not apply to statutory termination and severance payments owed to terminated employees in respect of past services.

40 The record before the court indicates that the motion judge made the initial order and the amended order in the context of the insolvency of a complex, multinational conglomerate as part of co-ordinated proceedings in a number of countries including the U.S. In June 2009, an Interim Funding and Settlement Agreement was negotiated which, together with the proceeds of certain ongoing asset sales, is providing funds necessary in the view of the court appointed Monitor, for the ongoing operations of Nortel during the next few months of the *CCAA* oversight operation. This funding was achieved on the basis that the stay applied to the severance and termination payments. The Monitor advises that if these payments were not subject to the stay and had to be funded, further financing would have to be found to do that and also maintain operations.

41 In that context, the motion judge exercised his discretion to impose a stay that could extend to the severance and termination payments. He considered the financial position of Nortel, that it was not carrying "business as usual" and that it was under financial pressure. He also considered that the *CCAA* proceeding is at an early stage, before the claims of creditor groups, including former employees and others have been considered or classified for ultimate treatment under a plan of arrangement. He noted that employees have no statutory priority and their claims are not secured claims.

42 While reference was made to the paramountcy doctrine by the motion judge, it was not the main focus of the argument before him. Nevertheless, he effectively concluded that it would thwart the intent of Parliament for the successful conduct of the *CCAA* restructuring if the initial order and the amended order could not include a stay provision that allowed Nortel to suspend the payment of statutory obligations for termination and severance under the *ESA*.

43 The respondents also argued that if the stay did not apply to statutory termination and severance obligations, then the employees who received these payments would in effect be receiving a "super-priority" over other unsecured or possibly even secured creditors on the assumption that in the end there will not be enough money to pay everyone in full. We agree that this may be the effect if the stay does not apply to these payments. However, that could also be the effect if Nortel chose to make such payments, as it is entitled to do under paragraph 6 (a) of the amended initial order. Of course, in that case, any such payments would be made in consultation with appropriate parties including the Monitor, resulting in the effective grant of a consensual rather than a mandatory priority. Even in this case, the motion judge provided a "hardship" alleviation program funded up to $750,000, to allow payments to former employees in clear need. This will have the effect of granting the "super-priority" to some. This is an acceptable result in appropriate circumstances.

44 However, this result does not in any way undermine the paramountcy analysis. That analysis is driven by the need to preserve the ability of the *CCAA* court to ensure, through the scope of the stay order, that Parliament's intent for the operation of the *CCAA* regime is not thwarted by the operation of provincial legislation. The court issuing the stay order considers all of the circumstances and can impose an order that has the effect of overriding a provincial enactment where it is necessary to do so.

45 Morawetz J. was satisfied that such a stay was necessary in the circumstances of this case. We see no error in that conclusion on the record before him and before this court.

46 Another issue was raised based on the facts of this restructuring as it has developed. It appears that the company will not be restructured, but instead its assets will be sold. It is necessary to continue operations in order to maintain maximum value for this process to achieve the highest prices and therefore the best outcome for all stakeholders. It is true that the basis for the very broad stay power has traditionally been expressed as a necessary aspect of the restructuring process, leading to a plan of arrangement for the newly restructured entity. However, we see no reason in the present circumstances why the same analysis cannot apply during a sale process that requires the business to be carried on as a going concern. No party has taken the position that the *CCAA* process is no longer available because it is not proceeding as a restructuring, nor has any party taken steps to turn the proceeding into one under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3.

47 The former employee appellants have raised the constitutional question whether the doctrine of paramountcy applies to give to the *CCAA* judge the authority, under s. 11 of the Act, to order a stay of proceedings that has the effect of overriding s. 11(5) of the *ESA*, which requires almost immediate payment of termination and severance obligations. The answer to this question is yes.

48 We note again that the question before this court was limited to the effect of the stay on the timing of required statutory payments under the *ESA* and does not deal with the inter-relation of the *ESA* and the *CCAA* for the purposes of the plan of arrangement and the ultimate payment of these statutory obligations.

49 The appeal by the former employees is also dismissed.

***R.A. Blair J.A.*:**
I agree.

Appeals dismissed.

Footnotes

* A corrigendum issued by the court on December 8, 2009 has been incorporated herein.

1 The analogous section to the former s. 11.3(a) is now found in s. 11.01(a) of the recently amended *CCAA*.

2 The issue of post-initial order employee terminations, and specifically whether any portion of the termination or severance that may be owed is attributable to post-initial order services, was not at issue in this motion. In *Windsor Machine & Stamping Ltd., Re*, [2009] O.J. No. 3195 (Ont. S.C.J. [Commercial List]), decided one month after this motion, the issue was discussed more fully and Morawetz J. determined that it could be decided as part of a post-filing claim. Leave to appeal has been filed.

2012 ONSC 3367
Ontario Superior Court of Justice [Commercial List]

PCAS Patient Care Automation Services Inc., Re

2012 CarswellOnt 7248, 2012 ONSC 3367, 216 A.C.W.S. (3d) 551, 91 C.B.R. (5th) 285

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 PCAS Patient Care Automation Services Inc. and 2163279 Ontario Inc. Applicants

D.M. Brown J.

Heard: June 5-6, 2012
Judgment: June 9, 2012
Docket: CV-12-9656-00CL

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B. O'Neill for Castcan Investments (secured creditor)
R.M. Slattery for Royal Bank of Canada (secured creditor)
M. Laugesen, G. Finlayson for Successful Bidder, DashRx, LLC
C. Besant for Walgreen Co.
A. Scotchmer for Lanworks Inc.
P. Saunders for himself and other shareholders
B. Jaffe for Merge, a potential bidder
S-A. Wilson for Dan Brintnell, a shareholder

Subject: Insolvency; Corporate and Commercial; Estates and Trusts

Related Abridgment Classifications

Bankruptcy and insolvency
XIX Companies' Creditors Arrangement Act
XIX.5 Miscellaneous

Headnote

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Miscellaneous
Section 67 of Financial Administration Act (FAA) does not apply to rights created by court order, including lending charge granted over all of company's property pursuant to s. 11.2(1) of Companies' Creditors Arrangement Act (CCAA) — Lender's charge created by order under CCAA is not transaction under s. 67 of FAA.

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Bank of Montreal v. i Trade Finance Inc. (2011), 17 P.P.S.A.C. (3d) 250, 77 C.B.R. (5th) 231, 332 D.L.R. (4th) 193,

*(*sub nom. *i Trade Finance Inc. v. Webworx Inc.)* 416 N.R. 166, *(*sub nom. *i Trade Finance Inc. v. Webworx Inc.)* 276 O.A.C. 141, *(*sub nom. *i Trade Finance Inc. v. Bank of Montreal)* [2011] 2 S.C.R. 360, 2011 CarswellOnt 3306, 2011 CarswellOnt 3307, 2011 SCC 26 (S.C.C.) — considered

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— referred to

Statutes considered:

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

s. 6(5)(a) — considered

s. 11 — considered

s. 11.2(1) [en. 2005, c. 47, s. 128] — referred to

s. 36(1) — considered

s. 36(2) — considered

s. 36(3) — considered

s. 36(6) — considered

s. 36(7) — considered

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

Financial Administration Act, R.S.C. 1985, c. F-11
s. 67 — considered

APPLICATION by debtor companies under *Companies' Creditors Arrangement Act* for orders approving agreement of purchase and sale between debtor companies and purchaser, vesting purchased assets in purchaser and distributing sale proceeds, together with related orders including termination of proceedings under Act.

***D.M. Brown J.*:**

I. Request for sale approval, vesting and distribution orders under the CCAA

1 PCAS Patient Care Automation Services Inc. and 2163279 Ontario Inc. move under the *Companies' Creditors Arrangement Act* for orders approving the agreement of purchase and sale between the Applicants and DashRx, LLC ("DashRx") dated May 29, 2012 (the "Purchase Agreement"), vesting the Purchased Assets in DashRx and distributing the sale proceeds, together with certain other related orders, including the termination of this *CCAA* proceeding.

2 At the continuation of the hearing on June 6, 2012, I granted the requested orders. These are my reasons for so doing.

II. The proposed sale

A. The sales and investor solicitation process

3 The Applicants are healthcare technology companies which were developing an automated pharmacy dispensing platform. They were in the pre-commercialization phase of operations and encountered financing difficulties. The Initial Order under the *CCAA* was made by Morawetz J. on March 23, 2012; it appointed PricewaterhouseCoopers Inc. as Monitor.

4 The subsequent history of this matter is set out my previous Reasons.[1]

5 On May 14, 2012, I approved a sale and investor solicitation process ("SISP"). The Applicants developed the SISP with the assistance of the Monitor, the Monitor's agent, PricewaterhouseCoopers Corporate Finance Inc. ("PwCCF") and the DIP Lender. The SISP sought to maximize stakeholder value either through (i) a going concern sale of the Applicants' business and assets or (ii) new investment and a plan of compromise or arrangement. The SISP set out the procedural and substantive requirements for a qualified purchase or investment bid (a "Qualified Bid").

6 A feature of the approved SISP was the DIP Lender's "stalking horse" bid under which the DIP Lender would pay the Stalking Horse Price by a release of the DIP Indebtedness and the assumption of the outstanding senior secured claims. The terms of the Stalking Horse Bid were not required to be emulated in other Qualified Bids; the Stalking Horse Bid served to set a floor price in the SISP. The Stalking Horse Agreement was posted in the Applicants' data-room.

7 The SISP was conducted by the Applicants with the support and assistance of the Monitor. Under the terms of the SISP, bids were due by 12:00 p.m. on May 24, 2012. Two bids, including the DashRx bid, were received before the Bid Deadline, and one further bid was received on May 24, 2012, but after the Bid Deadline. These three bids were reviewed in a series of meetings held by the Applicants, the DIP Lender, the Monitor and their counsel on May 24 and May 25, 2012.

8 In a Confidential Appendix to its Seventh Report the Monitor described the financial terms of each bid and disclosed the materials filed by each bidder, as well as the written communications with each bidder.

B. The Unsuccessful Bids

9 As described in detail in the evidence, the bid submitted by Unsuccessful Bidder 1 was received the evening of May 24, but provided no cash consideration to the Applicants. On the evening of May 25, 2012, Applicants' counsel sent a letter to Unsuccessful Bidder 1 advising that its bid was not a Qualified Bid and that certain additional details would need to be provided before it could be considered a Qualified Bid. Unsuccessful Bidder 1 did not respond to the request for clarification and its bid was not treated as a Qualified Bid.

10 By letter dated May 23 Unsuccessful Bidder 2 offered to buy PCAS for cash. On May 23 the Applicants wrote to Unsuccessful Bidder 2 about how it would need to alter its bid to satisfy the requirements for a Qualified Bid in the SISP. Notwithstanding follow-up communications, Unsuccessful Bidder 2 did not respond to the Applicants' inquiries until Sunday, May 27, 2012 and it did not provide any material new information. The bid by Unsuccessful Bidder 2 therefore was not treated as a Qualified Bid under the SISP.

C. The Successful Bid

The purchaser

11 DashRx is a Delaware limited liability corporation formed by a large, California-based investment fund to purchase the assets of the Applicants. The fund's Investment Manager has approximately US$500 million in assets under management, almost exclusively in the health care and pharmaceutical sectors.

12 On May 24, 2012, prior to the bid deadline, DashRx submitted a version of the Purchase Agreement. It was the only bid received in the form of a formal asset purchase agreement. DashRx also remitted a cash deposit to the Monitor.

13 The Investment Manager had been performing due diligence and engaging in talks with the Applicants for several months prior to the commencement of the *CCAA* proceedings with an aim to investing in or purchasing PCAS. A major U.S. retail pharmacy chain, Walgreen Co. is participating in the Successful Bid as a substantial investor in DashRx. Walgreen was the potential large U.S. customer identified in previous evidence in this proceeding.

14 The Monitor requested that it be allowed to reveal the name of the Investment Manager; the latter expressed a strong preference that its identity not be disclosed. Against that background the Monitor reported that it had requested independent

evidence of the financial position of the Investment Manager:

> [T]he Monitor has received additional information regarding the Investment Manager and is satisfied that the Purchaser should have the financial wherewithal to close the transaction. The Purchaser and Walgreens have shown their commitment by jointly paying the deposit and agreeing to fund the operating needs of the Company to June 6, 2012 (with a cap of $250,000). The Monitor also notes that Walgreens' participation provides another source of financial support to the Purchaser.

15 By May 27, 2012, following further negotiations and an enhancement of the DashRx bid to permit some recovery for unsecured creditors, the material terms of the DashRx Purchase Agreement were settled to a point that the Applicants, in consultation with the DIP Lender and the Monitor, were prepared to recognize the Purchase Agreement as a Qualified Bid, as a bid superior to the Stalking Horse Bid, and to identify it as the Successful Bid under the SISP, subject to final negotiation of the APA.

16 The Purchase Agreement was finalized, executed and delivered by the parties on June 1, 2012. DashRx committed to provide $250,000 to fund the Applicants' operations from May 31, 2012 until closing on June 6. That funding was received on May 31, 2012.

Purchased and Excluded Assets

17 Under the Purchase Agreement the purchaser will acquire Purchased Assets on an "as is, where is" basis. Certain tax credit entitlements are treated as Excluded Assets.

The purchase price and consideration

18 The consideration payable under the Purchase Agreement is a combination of the assumption of secured liabilities, cash, and the issuance of secured and unsecured convertible promissory notes to the Applicants' creditors, including unsecured creditors. The Applicants do not expect that there will be any surplus proceeds from the transaction for PCAS shareholders.

19 The cash portion of the purchase price is designated for:

> (i) distribution in payment of all statutory priority claims, comprised of approximately $235,000 in accrued and unpaid vacation pay;
>
> (ii) distribution to the DIP Lender to be used by the DIP Lender:
>
> > a. first, to obtain the consent of the Senior Secured Creditors, RBC and Castcan, to the discharge of their security interests and charges over the Purchased Assets and to obtain their consent for the issuance of an approval and vesting order in respect of the Sale Agreement; and,
> >
> > b. as to the balance, in partial satisfaction of the DIP Indebtedness;
>
> (iii) payment of the amounts payable under the court-approved key employee retention plan; and
>
> (iv) payment of $100,000 to the Applicants, in trust for a trustee in bankruptcy to be appointed in respect of the Applicants, and the other direct and indirect subsidiaries of PCAS, to pay for the costs of administering their anticipated bankruptcies

20 The non-cash portion of the purchase price in the transaction will be comprised of:

(i) the assumption of the secured obligations to IBM;

(ii) interest-bearing promissory notes issued in favour of the DIP Lender, secured against the assets of DashRx and ranking junior only to the secured assumed obligations to IBM ("Secured Note"); and,

(iii) interest-bearing unsecured promissory notes issued to the Applicants, in trust, for the pool of unsecured creditors of the Applicants ("Unsecured Note").

21 At the commencement of the hearing on June 5 one unsecured creditor, Lanworks, raised concerns about the lack of transparency regarding the terms of the Unsecured Notes. The details of the terms of the Notes had been placed in the Monitor's Confidential Appendix. Prior to the resumption of the hearing on June 6 Lanworks was provided with information about the terms of the Unsecured Note, as a result of which Lanworks indicated that it neither consented to nor opposed the orders sought. The terms of the Secured and Unsecured Notes were finalized by the time of the continuation of the hearing on June 6.

Proposed releases

22 In its Seventh Report the Monitor noted that under the terms of the Purchase Agreement certain claims against former employees of the Applicants were included in the Purchased Assets and the Agreement required the Applicants to deliver a broad release in favour of the Purchaser and related parties. The Monitor observed that the releases were negotiated as part of the comprehensive arrangements in respect of the transactions contemplated by the Agreement.

Proposed occupancy agreements

23 A condition of the Sale Agreement was that PCAS provided DashRx with post-Closing occupancy and access to the Applicants' leased premises at 2440 Winston Park Drive. DashRx will pay all rent and other occupancy costs and will indemnify the Applicants. The Applicants are seeking approval of, and authorization to enter into, an occupancy agreement with DashRx.

III. The proposed distribution of sale proceeds

24 The Applicants seek an order under which the sale proceeds would be distributed to the following persons or groups:

(i) To use $235,315 to satisfy statutory priority claims relating to employee accrued and unpaid vacation pay claims;

(ii) To pay the cash component of the purchase price to the DIP Lender to be used by the DIP Lender (i) to obtain the consent of the secured creditors, RBC and Castcan Investments Inc., to discharge their security interests and charges over the Purchased Assets and (ii) as to the balance, to make partial repayment of the DIP Lending Facility;

(iii) To distribute $261,000 to the beneficiaries of the KERP Charge; and,

(iv) To pay $100,000 to PwC, the proposed Trustee in Bankruptcy, for fees in connection with the anticipated bankruptcies of the Applicants.

Payment to the DIP Lender

25 The only parties claiming interests in priority to the DIP Lender are IBM, RBC and Castcan. The Purchaser will

assume the liability for IBM. As to RBC and Castcan, at the time the DIP Lending Facility was put in place the DIP Lender negotiated a Pari Passu Agreement with RBC and Castcan. An issue arose concerning the validity of the security taken by Castcan in respect of certain assets, specifically Harmonized Sales Tax Refunds (the "HST Refunds"). I will discuss that issue in more detail below. For present purposes, suffice it to say that the Applicants propose that upon paying out the claims of the Senior Secured Creditors from the cash proceeds received on Closing, the DIP Lender will be subrogated to and/or take an assignment of the Senior Secured Creditor's claims. The Applicants are expected to receive sizable tax credit entitlements within a matter of weeks. Those entitlements are Excluded Assets under the Purchase Agreement. As a result, any claims on them will not be vested out by operation of the proposed Approval and Vesting Order.

26 Against this background the Applicants seek an order authorizing and directing them, and any Trustee, to distribute to the DIP Lender amounts equal to any specified tax credit entitlements received. Such distributions would enable the DIP Lender to recoup part of the purchase price it will flow through to one of the Senior Secured Creditors — Castcan - on Closing.

27 If the aggregate amount of all tax credit entitlements received by the Applicants/Trustee post-Closing and distributed to the DIP Lender end up being less than the aggregate amount that the DIP Lender paid to RBC and Castcan out of the cash proceeds of the Transaction on Closing, then the DIP Lender will be issued an Additional Secured Note to cover the difference. The amount of the Additional Secured Note will come out of the pool of funds otherwise set aside for the unsecured creditors of the Applicants. The Unsecured Note therefore will be less than the total pool of possible proceeds for unsecured creditors, and an additional Unsecured Note will be issued to the Trustee for the benefit of the unsecured creditors once the face amount of the Additional Secured Note is known.

28 Although the DIP Indebtedness is not being paid out in full on Closing, the DIP Lender has consented to the payments of cash on account of the KERP and the future costs of bankruptcy estate administration.

29 Under the Initial Order the Directors' Charge ranked ahead of the KERP Charge. The Applicants asked the Court to terminate the Directors' Charge. Those benefiting from the Directors' Charge did not oppose that request.

KERP employees

30 The KERP originally benefitted twenty employees and allowed for a total maximum allocation of $500,000. The KERP was to be paid in the following installments: (i) 20% upon the raising of $8,000,000 for funding the DIP Facility, and PCAS receiving the authorization of this Court to borrow up to or in excess of that amount; (ii) 20% at the midway mark of the SISP; and, (iii) the balance of 60% upon the earliest of (i) the closing of a sale of all or substantially all of the assets, property and undertaking of the Applicants, or (ii) Court approval and sanction of a plan of arrangement or compromise in the *CCAA* Proceedings.

31 The commitment under the DIP Facility never reached $8 million, so the initial payment was not made. The second scheduled 20% payment was made on May 25, 2012. Payment of the 60% balance will be made from the cash proceeds on closing. Due to attrition, only sixteen employees remain in the KERP. The final 60% installment payable from the transaction proceeds will total $242,100, resulting in total KERP payments of $322,800.

IV. Positions of the Parties

32 The Senior Secured Creditors supported the orders sought by the Applicants. The Monitor recommended that the Court grant the orders. As noted, one unsecured creditor, Lanworks, sought to obtain further information and, on so doing, advised that it neither consented to nor opposed the orders sought. No other creditors appeared on the return of the motion.

33 The hearing of the motion started at 4:45 p.m. on June 5, 2012. At that time Mr. Peter Saunders, a shareholder, stated that he appeared on behalf of himself and other shareholders. He read a statement which expressed concern about the bidding process, and Mr. Saunders indicated that he and other shareholders would be meeting with counsel at 8:00 a.m. on June 6. Over the opposition of the Applicants and the Purchaser, I adjourned the hearing to June 6 at 10:00 a.m.

34 On June 6 Mr. Saunders returned, but without counsel. Ms. Wilson appeared for the first time on behalf of another shareholder, Mr. Dan Brintnell, and asked to make submissions. Also, Mr. Jaffe appeared on behalf of a potential bidder, Merge, which had not participated in the SISP and asked for leave to submit an offer. What then transpired was described in the following portions of my handwritten endorsement of June 6:

> This is the continuation of the approval/vesting/distribution motion commenced yesterday @ 4:45 p.m. At yesterday's hearing I asked questions of counsel for the applicants, Monitor and DIP lender on certain points and was provided answers.
>
> . . .
>
> Yesterday Mr. Peter Saunders, a shareholder, on behalf of himself and some other SHs, read a statement dated June 5/12 expressing concern about the bidding process. Mr. Saunders indicated they would be meeting counsel today @ 8 a.m. I adj'd the matter to 10 a.m. today to facilitate that meeting. This morning Mr. Saunders advised that counsel was unable to meet them; they plan to meet this afternoon. Mr. Saunders indicated that their counsel would like a 5-day adjm't of this motion.
>
> I will not grant the requested adjm't. By reasons dated May 14/12 I approved the SISP. By reasons dated May 28 I granted an extension of the stay until June 6. Both Reasons made clear the urgent nature of the SISP in the particular circumstances of these companies. No appeal was taken from, nor stay sought in respect of, either order. The public portion of the present motion materials provide detailed information about the conduct of the SISP and the bids. The portions sought to be sealed meet the test in *Sierra Club*. From previous motions I am aware that the applicants have communicated frequently with shareholders; the Monitor has posted all materials on its website.
>
> I am satisfied in the circumstances reasonable notice of this motion and the SISP has been given to all affected parties. The shareholders have not previously participated; that was their choice. It is unreasonable for them to seek to adjourn matters at this stage. The applicants run out of money tomorrow; the shareholders offer no concrete alternative.
>
> After writing these Reasons, on my return to Court, I was advised by counsel for Merge that they only learned of the sale process on May 30 and now wish to tender an Offer. I did not accept the Offer. The SISP was an open and transparent process. The OCA in *Soundair* spoke about the need to maintain the integrity of a court-approved sale process.[2] I am not prepared to accept an offer at this late stage. I note [that] Merge did not have counsel at yesterday's hearing.
>
> Ms. Wilson appeared for a SH, Dan Brintnell. After obtaining instructions, Ms. Wilson advised she had no further submissions.

V. Analysis of the proposed sale transaction

A. Guiding legal principles

35 In most circumstances resort is made to the *CCAA* to "permit the debtor to continue to carry on business and, where possible, avoid the social and economic costs of liquidating its assets" and to create "conditions for preserving the *status quo* while attempts are made to find common ground amongst stakeholders for a reorganization that is fair to all". The reality, however, is that "reorganizations of differing complexity require different legal mechanisms." This has led courts to recognize that the *CCAA* may be used to sell substantially all of the assets of a debtor company to preserve it as a going concern under new ownership, or to wind-up or liquidate it.[3]

36 The portions of section 36 of the *CCAA* relevant to this proposed sale to a non-related person are as follows:

> 36. (1) A debtor company in respect of which an order has been made under this Act may not sell or otherwise dispose of assets outside the ordinary course of business unless authorized to do so by a court. Despite any requirement for shareholder approval, including one under federal or provincial law, the court may authorize the sale or disposition even if shareholder approval was not obtained.

(2) A company that applies to the court for an authorization is to give notice of the application to the secured creditors who are likely to be affected by the proposed sale or disposition.

(3) In deciding whether to grant the authorization, the court is to consider, among other things,

(a) whether the process leading to the proposed sale or disposition was reasonable in the circumstances;

(b) whether the monitor approved the process leading to the proposed sale or disposition;

(c) whether the monitor filed with the court a report stating that in their opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy;

(d) the extent to which the creditors were consulted;

(e) the effects of the proposed sale or disposition on the creditors and other interested parties; and

(f) whether the consideration to be received for the assets is reasonable and fair, taking into account their market value.

(6) The court may authorize a sale or disposition free and clear of any security, charge or other restriction and, if it does, it shall also order that other assets of the company or the proceeds of the sale or disposition be subject to a security, charge or other restriction in favour of the creditor whose security, charge or other restriction is to be affected by the order.

(7) The court may grant the authorization only if the court is satisfied that the company can and will make the payments that would have been required under paragraphs 6(4)(*a*) and (5)(*a*) if the court had sanctioned the compromise or arrangement.

B. Consideration of the factors

Was notice of the application given to the secured creditors who are likely to be affected by the proposed sale or disposition?

37 The applicants have satisfied this requirement. The Purchaser will assume the liability owing to IBM Canada. The other two secured creditors, RBC and Castcan, support the proposed transaction.

The reasonableness of the process leading to the proposed sale

38 The SISP was approved by this Court by order made May 14, 2012. In my Reasons of that date I stated:

> Given the extensive efforts to date by management of the applicants to solicit interest in the business and given the liquidity crunch facing the applicants, I was satisfied that the proposed SISP would result, in the specific circumstances of this case, in a fair, transparent and commercially efficacious process which should allow a sufficient opportunity for interested parties to come forward with a superior offer and thereby optimize the chances of securing the best possible price for the assets up for sale or the best possible investment in the continuing operations of the applicants. For those reasons I approved the SISP.[4]

39 Although the applicants took the lead in running the SISP, the evidence disclosed that the Monitor was involved in all stages of the process.

40 Before the commencement of these *CCAA* proceedings, members of the PCAS Board of Directors had engaged in separate dialogues with a significant number of parties who were interested in either investing in the DIP Lender to provide financing to the Applicants, purchasing the assets of the Applicants, or buying PCAS. During the SISP PCAS, with the assistance of PwCCF and the Monitor, (i) ran an electronic due diligence data-room, (ii) identified 184 potential bidders from

around the globe and contacted 164 of them, (iii) developed a "teaser" which was circulated to 121 of the identified parties, as well as a confidential information memorandum which was posted to the data room and sent to the all of the 18 interested parties who had executed a non-disclosure agreement, (iv) conducted site tours at its Premises, with the Monitor in attendance, for seven potential bidders, (v) developed a non-reliance letter for Qualified Bidders to sign in order to be able to review third-party review of the PCAS technology prepared for the Board and facilitated meetings with the authors of the Technology Review at the request of two potential bidders.

41 In its Sixth Report dated May 28, 2012 the Monitor described in detail the steps taken up until that point of time in conducting the SISP. The Monitor provided updated information in its Seventh Report dated June 1, 2012. In its Confidential Appendix to the Seventh Report the Monitor presented detailed, un-redacted information about the bids which were tendered, the resulting communications with the bidders, and its comparative evaluation of the bids.

42 I am satisfied that the SISP run by the Applicants, with the extensive involvement of the Monitor, complied with the terms of the SISP approved in my May 14 Order.

43 As mentioned, on the continuation of the approval hearing on June 6 counsel appeared for a potential bidder, Merge, seeking to submit an offer on behalf of his client. In *Royal Bank v. Soundair Corp.*, in the context of an approval motion for a sale by a court-appointed receiver, Galligan J. considered the approach which a court should take where a second offer was made after a receiver had entered into an agreement of purchase and sale. He cited two judgments by Saunders J. which had held that the court should consider the second offer, if constituting a "substantially higher bid",5 and Galligan J.A. continued:

> What those cases show is that the prices in other offers have relevance only if they show that the price contained in the offer accepted by the receiver was so unreasonably low as to demonstrate that the receiver was improvident in accepting it. I am of the opinion, therefore, that if they do not tend to show that the receiver was improvident, they should not be considered upon a motion to confirm a sale recommended by a court-appointed receiver. If they were, the process would be changed from a sale by a receiver, subject to court approval, into an auction conducted by the court at the time approval is sought. In my opinion, the latter course is unfair to the person who has entered bona fide into an agreement with the receiver, can only lead to chaos, and must be discouraged.
>
> If, however, the subsequent offer is so substantially higher than the sale recommended by the receiver, then it may be that the receiver has not conducted the sale properly. In such circumstances, the court would be justified itself in entering into the sale process by considering competitive bids. However, I think that that process should be entered into only if the court is satisfied that the receiver has not properly conducted the sale which it has recommended to the court.[5]

44 In the present case I departed from the process described in the *Soundair* case and declined to accept Merge's offer for consideration. The facts in *Soundair* are quite distinguishable. In the *Soundair* case the second bidder had secured a court order permitting it to make an offer. By contrast, in the present case the court had approved a SISP which set a May 24, 2012 bid deadline. All other bids complied, or came very close to complying, with that court-approved deadline. Merge contended that it did not learn of the bidding process until May 30, a week after the bid deadline. The prompt posting of all court orders on the Monitor's website, when combined with Merge's delays in pursuing an offer after learning of this proceeding make it completely unreasonable for Merge to expect that a court would grant it leave to submit an offer for consideration. The court-approved SISP would be stood on its head were that allowed.

45 Moreover, as was apparent from the Monitor's detailed narration of the consideration given to the bids which were filed on or just after the court-approved bid deadline, time was spent during the SISP process for discussions amongst the Applicants, the Monitor and the bidders to ascertain whether their bids constituted Qualified Bids. The stay of proceedings in this case was set to expire on June 6, the date Merge came forth in court with its offer. The only cash available for Applicants' operations through to June 6 was the advance of $250,000 by the Purchaser to the Applicants on May 31. The Applicants stated that they would be out of funds by day's end on June 6 or early on June 7. Consequently, there was no realistic prospect that any offer tendered on June 6 could receive a measured consideration while the companies continued to operate.

46 Finally, Merge did not tender its offer at the commencement of the approval motion on June 5. Its counsel made no submissions that day nor signed the counsel sheet. The only reason I adjourned the hearing to June 6 was to afford some shareholders a brief opportunity to consult with counsel. I made it clear on the record on June 5 that hearing from those

shareholders was the only order of business for June 6. Merge did not come forth until the resumption of the hearing on June 6. In those circumstances it was difficult to treat Merge's proffer of a bid as a serious one.

47 In sum, the compliance of the Applicants with the court-approved SISP and the unreasonableness of the timing of Merge's offer led me to conclude that the process leading to the proposed sale was reasonable.

Did the Monitor approve the process leading to the proposed sale or disposition?

48 In its Fifth Report dated May 11, 2012 the Monitor recommended approving the SISP.

Did the Monitor file with the court a report stating that in its opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy?

49 In its Seventh Report the Monitor set out at some length its views about the proposed sale transaction:

> The Monitor is of the view that the transaction contemplated by the APA meets the factors set out in section 36(3) of the *CCAA*. As previously described in the Fifth Report and the Sixth Report, the Monitor is of the view that an expedited SISP was likely the only viable process to maximize the value of the Company for the benefit of its stakeholders given the Company's dire liquidity situation.
>
> The APA provides for a going concern sale of the Company's business that maintains some Canadian operations and should allow for some continued employment.
>
> The Company and the DIP Lender developed the SISP in consultation with Monitor and, in the Monitor's view, the Company implemented a fair, transparent and efficient SISP in the circumstances in accordance with the Orders of this Court and the Court's reasons for decision dated May 14, 2012. Given the Company's liquidity situation, the necessity of implementing an expedited SISP and the bids received, it is the Monitor's view that the price obtained for the Company's assets is fair and reasonable in the circumstances. In addition, as reported in the Second Report, the Monitor is of the view that it is unlikely that a Trustee would have been able to appropriately take possession, market and sell the technology, intellectual property and other assets of the Company as a result of the Company having effectively no cash, limited accounts receivable and few unencumbered assets available to be monetized quickly in liquidation.

The Monitor recommended approving the Successful Bid.

To what extent were the creditors consulted?

50 The record disclosed that discussions had taken place with the secured creditors. Appropriate notice was given by the Applicants of all steps taken to seek approval of the DIP Lending Facility, the various extensions of the stay and approval of the SISP. As noted, only one unsecured creditor appeared at the approval hearing and its information questions were answered.

What are the effects of the proposed sale or disposition on the creditors and other interested parties?

51 As summarized by the Monitor in its Seventh Report:

> The APA does not provide for any recovery for the Company's shareholders. The APA provides as follows:
>
> a) statutory priority claims are paid in full in cash.
>
> b) The beneficiaries of the KERP are to be paid in full and in cash.
>
> c) The claim of the DIP Lender will be partially satisfied through a combination of cash and interest bearing

secured notes convertible at maturity into cash or common shares of the Purchaser.

d) The Company's unsecured creditors will receive their pro rata share of a pool of interest bearing unsecured notes convertible at maturity into cash or common shares of the Purchaser.

e) The Company will assume the Assumed Liability [IBM].

In addition, the APA also provides funding for a bankruptcy of the Company or a continuation of the CCAA Proceedings in respect of the Company. As described in further detail below, it is anticipated that the Company will be assigned into bankruptcy and that the entitlement of the unsecured creditors to the unsecured convertible notes will be determined through the statutory claims process provided under the *Bankruptcy and Insolvency Act* ... It is anticipated that one unsecured note will be provided to a trustee in bankruptcy to be appointed in respect of the Company.

Is the consideration to be received for the assets reasonable and fair, taking into account their market value?

52 In its Seventh Report the Monitor expressed its view that "the price obtained for the Company's assets is fair and reasonable in the circumstances". In the *Soundair* case Galligan J.A. stated:

> At the outset, I think that the fact that the OEL offer was the only acceptable one available to the receiver on March 8, 1991, after ten months of trying to sell the airline, is strong evidence that the price in it was reasonable.[6]

So, too, in this case. Although no valuation was filed in respect of the companies' assets, the evidence filed on previous motions disclosed that the applicants had made efforts for many months prior to initiating *CCAA* proceedings to secure further investment in or the sale of the companies. The state of the companies, and the potential business opportunity they offered, were extensively known. Notwithstanding the short SISP, the Monitor reported that contact was made with a large number of potentially interested parties. Only three bids resulted. Of those three, two were not treated as Qualified Bids. The record, especially the Monitor's Confidential Appendix, supported the selection of the DashRx offer as the Successful Bid. Against the backdrop of those efforts, I concluded that the proposed purchase price was fair and reasonable.

Does the proposed transaction satisfy the requirements of section 36(7) of the CCCA?

53 The applicants did not sponsor a pension plan for its employees. With the payment of the statutory priority claims from the proceeds of sale, obligations under section 6(5)(a) of the *CCAA* will be satisfied.

C. Conclusion

54 In sum, the proposed Purchase Agreement met the specific factors enumerated in section 36(3) of the *CCAA* and, when looked at as a whole in the particular circumstances of this case, represented a fair and reasonable transaction.[7] For those reasons I authorized the proposed Purchase Agreement and granted the vesting order which was sought.

VI. Analysis of the proposed distribution

55 The distribution of the sale proceeds proposed by the Applicants, and supported by the Monitor, was straight-forward, save for one issue — the validity of Castcan's security in respect of HST Refunds.

A. The Castcan security issue described

56 In its Seventh Report the Monitor described the Pari Passu Agreement which the DIP Lender had negotiated with two secured creditors, RBC and Castcan, at the time of putting in place the DIP Lending Facility:

> The Monitor has been advised that the DIP Lender entered into an agreement with Castcan and others, whereby the DIP

> Lender agreed that its claims against the Company would be subordinate to the claims of Castcan (the "Pari Passu Agreement"). Pursuant to the Pari Passu Agreement, Castcan has the right to be repaid in full before the DIP Lender receives any consideration for the amounts it advanced under the DIP Facility... The Monitor has been advised that the DIP Lender has agreed that its position will also be subordinate to RBC, as provided for in the Initial Order.
>
> Although the Purchaser was willing to assume the liabilities owed to RBC and Castcan, they both advised that they were not willing to become creditors of the Purchaser and wanted to be paid in cash in full on closing. In order to accommodate the secured creditors' requests, the DIP Lender has agreed to pay RBC and Castcan in full in cash from the amount payable to the DIP Lender pursuant to the terms of the APA. As a result of that payment, the DIP Lender will be subrogated to or take an assignment of the positions of RBC and Castcan in respect of their validly perfected and secured positions, subject to the lack of clarity in the law in respect of the Castcan Loan and Security discussed below.

57 The lack of clarity in the law in respect of the Castcan Loan stemmed from the assignment of Crown debts, on a full recourse basis, made in the March 6, 2012 Factor Agreement between Castcan and the Applicants. The Crown debts assigned to Castcan included certain Scientific Research and Experimental Development ("SR&ED") refundable tax credit entitlements, Ontario Innovation Tax Credit ("OITC") refunds and harmonized sales tax ("HST") refunds. The Applicants executed a GSA in favour of Castcan to secure the obligations owing to Castcan, including those under the Factor Agreement.

58 Counsel to the Monitor provided an opinion that the assignment of the SR&ED Tax Credits and the OITC Tax Credits under the Factor Agreement was valid and the security granted in each GSA in respect of such assignments was valid and enforceable.

59 Section 67 of the *Financial Administration Act (Canada)*, R.S.C. 1985, c. F-11 (the "*FAA*") provides as follows:

> Except as provided in this Act or any other Act of Parliament,
>
> (a) a Crown debt is not assignable; and
>
> (b) no transaction purporting to be an assignment of a Crown debt is effective so as to confer on any person any rights or remedies in respect of that debt.

In light of that section, counsel to the Monitor advised that the HST Refunds might not be assignable and that the security granted in respect of the HST Refunds might not be valid and enforceable because no provision in the *Excise Tax Act* (Canada) or the *FAA* exempted the HST Refunds from section 67 of the *FAA*.

60 Castcan took the position that certain provisions in the Factor Agreement entitled it, in any event, to receive the HST Refunds. The Monitor commented on part of the argument advanced by Castcan:

> Section 12 of the Factor Agreement provides that if any right or entitlement that, as a matter of law is not assignable, the Company will: (a) co-operate with Castan to provide the benefits of these Non-Assignable Rights to Castcan, including, holding them in trust; (b) enforce any rights of Castcan arising from these Non-Assignable Rights; (c) take all actions to ensure that the value of these Non-Assignable Rights are preserved; and (d) pay over to Castcan all monies collected in respect of these Non-Assignable Rights. One interpretation is that the obligations set out in Section 12 of the Factor Agreement with respect to the HST Refunds are enforceable and are secured by the GSAs. Another interpretation is that Section 12 simply gives rise to a claim in equity against the Company and that such an equitable claim may not be secured by the GSAs.
>
> The Monitor is of the view that there is strong argument that Castcan has a claim against the Company for unjust enrichment and, to the extent of such unjust enrichment, a Court may order that a constructive trust applies to the monies advanced by Castcan in respect of the HST Refunds.
>
> Given the provisions of the FAA and existing case law, counsel to the Monitor has advised that it cannot conclude with certainty that the obligations in the Factor Agreement in favour of Castcan with respect to the HST Refunds are secured

> by the GSAs. Accordingly, the Monitor is of the view that it is unclear whether any payment by the Company to Castcan in respect of the HST Refunds should be made in priority to other creditors.
>
> The Monitor is of the view that the equities clearly favour paying Castcan the full amount owed to it under the Factor Agreement, including the amounts in respect of the HST Refunds. The Monitor notes that Castcan paid $1,000,000 to the Company in good faith on a full recourse basis at a time when the Company was in dire need of liquidity. The vast majority of the amounts paid by Castcan were used to fund the Company's payroll. In the Monitor's view, it would be inequitable for the Company or any of its creditors to get a windfall at the expense of a creditor that provided value to the Company as a result of lack of clarity in the existing law and the wording of the Factor Agreement.

61 The Applicants proposed that upon paying out the claims of the Senior Secured Creditors from the cash proceeds received on closing, the DIP Lender would be subrogated to and/or take an assignment of the Senior Secured Creditor's claims. The Applicants also sought an order which provided, in part, that they, or the proposed Trustee, pay to the DIP Lender any tax credit entitlements received in respect of the HST Refund, notwithstanding section 67 of the *FAA*. The Monitor explained the rationale for this request:

> The DIP Lender is of the view that since there is likely no secondary market for the secured convertible notes, the net present value of the secured convertible notes is less than the face value of such notes. As a result, the DIP Lender is taking the position that the consideration it is receiving is insufficient to satisfy the full amount of the DIP Lender's claim against the Company. The DIP Lender is also of the view that the DIP Lender's Charge should continue to secure the obligations owing to the DIP Lender as a result of its shortfall after distribution of the proceeds to it on closing of the transaction contemplated by the APA. The Monitor supports the DIP Lender's views.
>
> The DIP Lender is also of the view that the value of the notes should be discounted by an amount that is at least as great as the amount of the HST Refunds in order to permit the proceeds of the HST Refunds once received by the estate to be paid to the DIP Lender on account of its DIP Charge. The Monitor supports the DIP Lender's views with respect to the DIP Lender's Charge. Accordingly, the Monitor is of the view that the DIP Lender's Charge should remain effective over all of the Excluded Assets until such time as such refunds are received and become proceeds of the estate and the DIP Lender is repaid in full.
>
> The parties with an economic interest in the proceeds of the transaction and the Tax Credit Entitlements have agreed to the arrangement with the DIP Lender described above with respect to the HST Refunds. Such an arrangement will permit the DIP Lender to satisfy its obligations under the Pari Passu Agreement while still receiving the consideration that was agreed to be paid to it pursuant to the APA.

B. Legal analysis

62 Section 67 of the *FAA* provides that "no transaction purporting to be an assignment of a Crown debt is effective" except as provided in that Act or any other federal Act. In *Marzetti v. Marzetti* the Supreme Court of Canada held that under section 67 "a purported assignment of a Crown debt is rendered absolutely ineffective, as between debtor and creditor, and as between assignor and assignee."[8] The Court of Appeal, in *Profitt v. A.D. Productions Ltd. (Trustee of)*, held that purported assignments of federal sales tax refunds were invalid.[9]

63 In their factum the Applicants pointed to several cases which they contended might limit the application of the decisions in *Marzetti* and *Profitt*.[10] Castcan had submitted to the Monitor that several provisions of the Factor Agreement operated to give it priority to the HST Refund notwithstanding the *Marzetti* and *Profitt* decisions. I did not need to address those points to decide the motion. Assuming, for purposes of argument, the ineffectiveness of Castcan's security as it related to the HST Refund, that refund would constitute property of the Applicants. Pursuant to the Initial Order the DIP Lender was granted a charge on the "Property" of the Applicants which was defined as the Applicants' "current and future assets, undertakings and properties of every nature and kind whatsoever, and wherever situate including all proceeds thereof". The "Property" of the applicants included their entitlement to the HST Refund. Accordingly, in the event of a failure of Castcan's security, the DIP Lender would be entitled to the HST Refund.

64 Section 67 of the *FAA* does not prevent such a result since it only renders ineffective any "*transaction* purporting to be an assignment of a Crown debt". The DIP Lender's Charge created by the Initial Order was not such a "transaction". As the Supreme Court of Canada pointed out in *Bank of Montreal v. i Trade Finance Inc.*, rights which result from a court order are not rights stemming from a "transaction".[11] Section 67 of the *FAA* does not apply to rights created by a court order, including a DIP lending charge granted over all of a company's property pursuant to section 11.2(1) of the *CCAA*.

65 Since the DIP Lender would be entitled to the HST Refund in the event of a defect in Castcan's security, it was open to the DIP Lender to agree, with Castcan, as a matter of contract, that Castcan should receive full payout as contemplated by the Pari Passu Agreement.

66 As to the Applicants' request for an order that they, or the proposed Trustee, pay to the DIP Lender any tax credit entitlements received in respect of the HST Refund, I was satisfied that it was appropriate to exercise my discretion under section 11 of the *CCAA* to make such an order. I accepted the Monitor's view that the DIP Lender was entitled to be repaid in full upon the conclusion of the *CCAA* proceedings and that its charge should continue to secure the obligations to it as a result of the shortfall after distribution of the transaction proceeds. The use of the Secured Note to repay the DIP Lender entails a risk that the DIP Lender might not receive full repayment of its DIP Lending Facility. Consequently, I accepted the Monitor's view that it would be appropriate to discount the value of the note by an amount equal to the HST Refund. Such a result promotes, in part, the remedial purposes of the *CCAA* by ensuring that DIP lenders, whose role often is critical to the successful completion of a re-organization, can advance interim financing with the reasonable assurance of receiving repayment of their DIP loans.

67 As to the distribution of $100,000 of the sales proceeds to fund bankruptcy proceedings involving the Applicants, I accepted the Monitor's view that since no further funds existed to continue the *CCAA* proceedings, a bankruptcy would serve as the most cost effective and efficient way in which to complete the winding-up of the companies' affairs, including establishing a mechanism to determine the quantum for unsecured claims.

68 For those reasons I approved the distribution of the sale proceeds proposed by the Applicants, as well as the related orders terminating the *CCAA* proceedings upon the Monitor filing its discharge certificate and approving the Monitor's Seventh Report and the activities described therein.

VII. Sealing order

69 The information contained in the Confidential Appendix to the Monitor's Seventh Report clearly met the criteria for a sealing order set out in *Sierra Club of Canada v. Canada (Minister of Finance)*.[12] In order to protect the integrity of the SISP and the proposed sales transaction, I granted an order that the appendix be sealed until the completion of the Purchase Agreement transaction.

Application granted.

Footnotes

1 April 20, 2012 (2012 ONSC 2423 (Ont. S.C.J. [Commercial List])); May 5, 2012 (2012 ONSC 2714 (Ont. S.C.J. [Commercial List])); May 8 (2012 ONSC 2778 (Ont. S.C.J. [Commercial List])); May 14, 2012 (2012 ONSC 2840 (Ont. S.C.J. [Commercial List])); May 28, 2012 (2012 ONSC 3147 (Ont. S.C.J. [Commercial List])).

2 *Royal Bank v. Soundair Corp.* (1991), 4 O.R. (3d) 1 (Ont. C.A.). See in particular the Reasons of Galligan J.A. at pp. 7d to 10c.

3 See the cases summarized in *First Leaside Wealth Management Inc., Re*, 2012 ONSC 1299 (Ont. S.C.J. [Commercial List]), para. 32.

4 2012 ONSC 2840 (Ont. S.C.J. [Commercial List]), para. 19. 5 *Selkirk, Re* (1986), 58 C.B.R. (N.S.) 245 (Ont. S.C.); *Beauty Counsellors of Canada Ltd., Re* (1986), 58 C.B.R. (N.S.) 237 (Ont. S.C.)

5 *Soundair*, *supra.*, pp. 9h-10c.

6 *Soundair*, *supra.*, p. 8g.

7 *White Birch Paper Holding Co., Re*, 2010 QCCS 4915 (C.S. Que.), paras. 48 and 49.

8 [1994] 2 S.C.R. 765 (S.C.C.), para. 99.

9 (2002), 32 C.B.R. (4th) 94 (Ont. C.A.), para. 28.

10 *Cargill Ltd. v. Ronald (Trustee of)* (2007), 32 C.B.R. (5th) 169 (Man. Q.B.); *McKay & Maxwell Ltd., Re* (1927), 8 C.B.R. 534 (N.S. T.D.); *Christensen, Re* (1961), 2 C.B.R. (N.S.) 324 (Ont. S.C.); *Front Iron & Metal Co., Re.* (1980), 36 C.B.R. (N.S.) 317 (Ont. Bktcy.).

11 [2011] 2 S.C.R. 360 (S.C.C.), para. 30. See also, *Torstar Corp. v. ITI Information Technology Institute Inc.* (2002), 36 C.B.R. (4th) 114 (N.S. S.C. [In Chambers]), paras. 29 and 32.

12 [2002] 2 S.C.R. 522 (S.C.C.).

End of Document

Companies' Creditors Arrangement Act (R.S.C. (Revised Statutes of Canada), 1985, c. C-36)
Act current to 2020-08-11 and last amended on 2019-11-01.

PART III

General (continued)

Agreements (continued)

Collective agreements

33 (1) If proceedings under this Act have been commenced in respect of a debtor company, any collective agreement that the company has entered into as the employer remains in force, and may not be altered except as provided in this section or under the laws of the jurisdiction governing collective bargaining between the company and the bargaining agent.

Application for authorization to serve notice to bargain

(2) A debtor company that is a party to a collective agreement and that is unable to reach a voluntary agreement with the bargaining agent to revise any of the provisions of the collective agreement may, on giving five days notice to the bargaining agent, apply to the court for an order authorizing the company to serve a notice to bargain under the laws of the jurisdiction governing collective bargaining between the company and the bargaining agent.

Conditions for issuance of order

(3) The court may issue the order only if it is satisfied that

(a) a viable compromise or arrangement could not be made in respect of the company, taking into account the terms of the collective agreement;

(b) the company has made good faith efforts to renegotiate the provisions of the collective agreement; and

(c) a failure to issue the order is likely to result in irreparable damage to the company.

No delay on vote

(4) The vote of the creditors in respect of a compromise or an arrangement may not be delayed solely because the period provided in the laws of the jurisdiction governing collective bargaining between the company and the bargaining agent has not expired.

Claims arising from termination or amendment

(5) If the parties to the collective agreement agree to revise the collective agreement after proceedings have been commenced under this Act in respect of the company, the bargaining agent that is a party to the agreement is deemed to have a claim, as an unsecured creditor, for

an amount equal to the value of concessions granted by the bargaining agent with respect to the remaining term of the collective agreement.

Order to disclose information

(6) On the application of the bargaining agent and on notice to the person to whom the application relates, the court may, subject to any terms and conditions it specifies, make an order requiring the person to make available to the bargaining agent any information specified by the court in the person's possession or control that relates to the company's business or financial affairs and that is relevant to the collective bargaining between the company and the bargaining agent. The court may make the order only after the company has been authorized to serve a notice to bargain under subsection (2).

Parties

(7) For the purpose of this section, the parties to a collective agreement are the debtor company and the bargaining agent that are bound by the collective agreement.

Unrevised collective agreements remain in force

(8) For greater certainty, any collective agreement that the company and the bargaining agent have not agreed to revise remains in force, and the court shall not alter its terms.

2005, c. 47, s. 131.

Certain rights limited

34 (1) No person may terminate or amend, or claim an accelerated payment or forfeiture of the term under, any agreement, including a security agreement, with a debtor company by reason only that proceedings commenced under this Act or that the company is insolvent.

Lease

(2) If the agreement referred to in subsection (1) is a lease, the lessor may not terminate or amend the lease by reason only that proceedings commenced under this Act, that the company is insolvent or that the company has not paid rent in respect of any period before the commencement of those proceedings.

Public utilities

(3) No public utility may discontinue service to a company by reason only that proceedings commenced under this Act, that the company is insolvent or that the company has not paid for services rendered or goods provided before the commencement of those proceedings.

Certain acts not prevented

(4) Nothing in this section is to be construed as

(a) prohibiting a person from requiring payments to be made in cash for goods, services, use of leased property or other valuable consideration provided after the commencement of proceedings under this Act;

(b) requiring the further advance of money or credit; or

(c) [Repealed, 2012, c. 31, s. 421]

Provisions of section override agreement

(5) Any provision in an agreement that has the effect of providing for, or permitting, anything that, in substance, is contrary to this section is of no force or effect.

Powers of court

(6) On application by a party to an agreement or by a public utility, the court may declare that this section does not apply — or applies only to the extent declared by the court — if the applicant satisfies the court that the operation of this section would likely cause the applicant significant financial hardship.

Eligible financial contracts

(7) Subsection (1) does not apply

(a) in respect of an eligible financial contract; or

(b) to prevent a member of the Canadian Payments Association from ceasing to act as a clearing agent or group clearer for a company in accordance with the *Canadian Payments Act* and the by-laws and rules of that Association.

Permitted actions

(8) The following actions are permitted in respect of an eligible financial contract that is entered into before proceedings under this Act are commenced in respect of the company and is terminated on or after that day, but only in accordance with the provisions of that contract:

(a) the netting or setting off or compensation of obligations between the company and the other parties to the eligible financial contract; and

(b) any dealing with financial collateral including

(i) the sale or foreclosure or, in the Province of Quebec, the surrender of financial collateral, and

(ii) the setting off or compensation of financial collateral or the application of the proceeds or value of financial collateral.

Restriction

(9) No order may be made under this Act if the order would have the effect of staying or restraining the actions permitted under subsection (8).

Net termination values

(10) If net termination values determined in accordance with an eligible financial contract referred to in subsection (8) are owed by the company to another party to the eligible financial contract, that other party is deemed to be a creditor of the company with a claim against the company in respect of those net termination values.

Priority

(11) No order may be made under this Act if the order would have the effect of subordinating financial collateral.

2005, c. 47, s. 131; 2007, c. 29, s. 109, c. 36, ss. 77, 112; 2012, c. 31, s. 421.

Obligations and Prohibitions

Obligation to provide assistance

35 (1) A debtor company shall provide to the monitor the assistance that is necessary to enable the monitor to adequately carry out the monitor's functions.

Obligation to duties set out in section 158 of the *Bankruptcy and Insolvency Act*

(2) A debtor company shall perform the duties set out in section 158 of the *Bankruptcy and Insolvency Act* that are appropriate and applicable in the circumstances.

2005, c. 47, s. 131.

Restriction on disposition of business assets

36 (1) A debtor company in respect of which an order has been made under this Act may not sell or otherwise dispose of assets outside the ordinary course of business unless authorized to do so by a court. Despite any requirement for shareholder approval, including one under federal or provincial law, the court may authorize the sale or disposition even if shareholder approval was not obtained.

Notice to creditors

(2) A company that applies to the court for an authorization is to give notice of the application to the secured creditors who are likely to be affected by the proposed sale or disposition.

Factors to be considered

(3) In deciding whether to grant the authorization, the court is to consider, among other things,

(a) whether the process leading to the proposed sale or disposition was reasonable in the circumstances;

(b) whether the monitor approved the process leading to the proposed sale or disposition;

(c) whether the monitor filed with the court a report stating that in their opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy;

(d) the extent to which the creditors were consulted;

(e) the effects of the proposed sale or disposition on the creditors and other interested parties; and

(f) whether the consideration to be received for the assets is reasonable and fair, taking into account their market value.

Additional factors — related persons

(4) If the proposed sale or disposition is to a person who is related to the company, the court may, after considering the factors referred to in subsection (3), grant the authorization only if it is satisfied that

(a) good faith efforts were made to sell or otherwise dispose of the assets to persons who are not related to the company; and

(b) the consideration to be received is superior to the consideration that would be received under any other offer made in accordance with the process leading to the proposed sale or disposition.

Related persons

(5) For the purpose of subsection (4), a person who is related to the company includes

(a) a director or officer of the company;

(b) a person who has or has had, directly or indirectly, control in fact of the company; and

(c) a person who is related to a person described in paragraph (a) or (b).

Assets may be disposed of free and clear

(6) The court may authorize a sale or disposition free and clear of any security, charge or other restriction and, if it does, it shall also order that other assets of the company or the proceeds of the sale or disposition be subject to a security, charge or other restriction in favour of the creditor whose security, charge or other restriction is to be affected by the order.

Restriction — employers

(7) The court may grant the authorization only if the court is satisfied that the company can and will make the payments that would have been required under paragraphs 6(5)(a) and (6)(a) if the court had sanctioned the compromise or arrangement.

Restriction — intellectual property

(8) If, on the day on which an order is made under this Act in respect of the company, the company is a party to an agreement that grants to another party a right to use intellectual property that is included in a sale or disposition authorized under subsection (6), that sale or disposition does not affect that other party's right to use the intellectual property — including the other party's right to enforce an exclusive use — during the term of the agreement, including any period for which the other party extends the agreement as of right, as long as the other party continues to perform its obligations under the agreement in relation to the use of the intellectual property.

2005, c. 47, s. 131; 2007, c. 36, s. 78; 2017, c. 26, s. 14; 2018, c. 27, s. 269.

Date modified:

2020-08-19

Companies' Creditors Arrangement Act (R.S.C. (Revised Statutes of Canada), 1985, c. C-36)
Act current to 2020-05-04 and last amended on 2019-11-01.

PART I

Compromises and Arrangements (continued)

Court may give directions

7 Where an alteration or a modification of any compromise or arrangement is proposed at any time after the court has directed a meeting or meetings to be summoned, the meeting or meetings may be adjourned on such term as to notice and otherwise as the court may direct, and those directions may be given after as well as before adjournment of any meeting or meetings, and the court may in its discretion direct that it is not necessary to adjourn any meeting or to convene any further meeting of any class of creditors or shareholders that in the opinion of the court is not adversely affected by the alteration or modification proposed, and any compromise or arrangement so altered or modified may be sanctioned by the court and have effect under section 6.

R.S., c. C-25, s. 7.

Scope of Act

8 This Act extends and does not limit the provisions of any instrument now or hereafter existing that governs the rights of creditors or any class of them and has full force and effect notwithstanding anything to the contrary contained in that instrument.

R.S., c. C-25, s. 8.

PART II

Jurisdiction of Courts

Jurisdiction of court to receive applications

9 (1) Any application under this Act may be made to the court that has jurisdiction in the province within which the head office or chief place of business of the company in Canada is situated, or, if the company has no place of business in Canada, in any province within which any assets of the company are situated.

Single judge may exercise powers, subject to appeal

(2) The powers conferred by this Act on a court may, subject to appeal as provided for in this Act, be exercised by a single judge thereof, and those powers may be exercised in chambers during term or in vacation.

R.S., c. C-25, s. 9.

Form of applications

10 (1) Applications under this Act shall be made by petition or by way of originating summons or notice of motion in accordance with the practice of the court in which the application is made.

Documents that must accompany initial application

(2) An initial application must be accompanied by

(a) a statement indicating, on a weekly basis, the projected cash flow of the debtor company;

(b) a report containing the prescribed representations of the debtor company regarding the preparation of the cash-flow statement; and

(c) copies of all financial statements, audited or unaudited, prepared during the year before the application or, if no such statements were prepared in that year, a copy of the most recent such statement.

Publication ban

(3) The court may make an order prohibiting the release to the public of any cash-flow statement, or any part of a cash-flow statement, if it is satisfied that the release would unduly prejudice the debtor company and the making of the order would not unduly prejudice the company's creditors, but the court may, in the order, direct that the cash-flow statement or any part of it be made available to any person specified in the order on any terms or conditions that the court considers appropriate.

R.S., 1985, c. C-36, s. 10; 2005, c. 47, s. 127.

General power of court

11 Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.

R.S., 1985, c. C-36, s. 11; 1992, c. 27, s. 90; 1996, c. 6, s. 167; 1997, c. 12, s. 124; 2005, c. 47, s. 128.

Relief reasonably necessary

11.001 An order made under section 11 at the same time as an order made under subsection 11.02(1) or during the period referred to in an order made under that subsection with respect to an initial application shall be limited to relief that is reasonably necessary for the continued operations of the debtor company in the ordinary course of business during that period.

2019, c. 29, s. 136.

Rights of suppliers

11.01 No order made under section 11 or 11.02 has the effect of

(a) prohibiting a person from requiring immediate payment for goods, services, use of leased or licensed property or other valuable consideration provided after the order is made; or

(b) requiring the further advance of money or credit.

2005, c. 47, s. 128.

Stays, etc. — initial application

11.02 (1) A court may, on an initial application in respect of a debtor company, make an order on any terms that it may impose, effective for the period that the court considers necessary, which period may not be more than 10 days,

(a) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*;

(b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(c) prohibiting, until otherwise ordered by the court, the commencement of any action, suit or proceeding against the company.

Stays, etc. — other than initial application

(2) A court may, on an application in respect of a debtor company other than an initial application, make an order, on any terms that it may impose,

(a) staying, until otherwise ordered by the court, for any period that the court considers necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in paragraph (1)(a);

(b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(c) prohibiting, until otherwise ordered by the court, the commencement of any action, suit or proceeding against the company.

Burden of proof on application

(3) The court shall not make the order unless

(a) the applicant satisfies the court that circumstances exist that make the order appropriate; and

(b) in the case of an order under subsection (2), the applicant also satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence.

Restriction

(4) Orders doing anything referred to in subsection (1) or (2) may only be made under this section.

2005, c. 47, s. 128, 2007, c. 36, s. 62(F); 2019, c. 29, s. 137.

Stays — directors

11.03 (1) An order made under section 11.02 may provide that no person may commence or continue any action against a director of the company on any claim against directors that arose before the commencement of proceedings under this Act and that relates to obligations of the company if directors are under any law liable in their capacity as directors for the payment of those obligations, until a compromise or an arrangement in respect of the company, if one is filed, is sanctioned by the court or is refused by the creditors or the court.

Exception

(2) Subsection (1) does not apply in respect of an action against a director on a guarantee given by the director relating to the company's obligations or an action seeking injunctive relief against a director in relation to the company.

Persons deemed to be directors

(3) If all of the directors have resigned or have been removed by the shareholders without replacement, any person who manages or supervises the management of the business and affairs of the company is deemed to be a director for the purposes of this section.

2005, c. 47, s. 128.

Persons obligated under letter of credit or guarantee

11.04 No order made under section 11.02 has affect on any action, suit or proceeding against a person, other than the company in respect of whom the order is made, who is obligated under a letter of credit or guarantee in relation to the company.

2005, c. 47, s. 128.

11.05 [Repealed, 2007, c. 29, s. 105]

Member of the Canadian Payments Association

11.06 No order may be made under this Act that has the effect of preventing a member of the Canadian Payments Association from ceasing to act as a clearing agent or group clearer for a company in accordance with the *Canadian Payments Act* or the by-laws or rules of that Association.

2005, c. 47, s. 128, 2007, c. 36, s. 64.

Date modified:

2020-05-14

Financial Administration Act (R.S.C. (Revised Statutes of Canada), 1985, c. F-11)
Act current to 2020-08-11 and last amended on 2020-07-01.

PART IV.1

Stability and Efficiency of the Financial System (continued)

Entity other than corporation

60.4 (1) If, in the Minister's opinion, it is necessary to promote the stability or maintain the efficiency of the financial system in Canada, the Minister may, during the period beginning on the day on which this subsection comes into force and ending on September 30, 2020, with the Governor in Council's authorization, establish an entity, other than a corporation, on any terms and conditions that the Minister considers appropriate.

Payments out of C.R.F.

(2) The Minister may make payments to the entity out of the Consolidated Revenue Fund, at the times and in the manner that the Minister considers appropriate.

Loans to entity

(3) The Minister may, out of the Consolidated Revenue Fund, lend money to the entity on any terms and conditions that the Minister may fix.

2020, c. 5, s. 28; 2020, c. 6, s. 10.

PART V

Public Property

Transfers, etc., of public property

61 (1) Subject to any other Act of Parliament, no transfer, lease or loan of public property shall be made except under the *Federal Real Property and Federal Immovables Act* in the case of federal real property or a federal immovable as defined in that Act, or under subsection (2) in the case of other public property.

Regulations

(2) The Governor in Council, on the recommendation of the Treasury Board, may authorize or make regulations authorizing the transfer, lease or loan of public property other than federal real property and federal immovables as defined in the *Federal Real Property and Federal Immovables Act*.

R.S., 1985, c. F-11, s. 61; 1991, c. 50, s. 27; 2001, c. 4, s. 160; 2015, c. 3, s. 93(F).

Management of public property

62 The deputy head of every department shall maintain adequate records in relation to public property for which the department is responsible and shall comply with regulations of the Treasury Board governing the custody and control of public property.

R.S., c. F-10, s. 53.

PART VI

Public Accounts

Accounts of Canada

63 (1) Subject to regulations of the Treasury Board, the Receiver General shall cause accounts to be kept in such manner as to show

(a) the expenditures made under each appropriation;

(b) the revenues of Canada; and

(c) the other payments into and out of the Consolidated Revenue Fund.

Assets and liabilities

(2) The Receiver General shall cause accounts to be kept to show such of the assets and direct and contingent liabilities of Canada and shall establish such reserves with respect to the assets and liabilities as, in the opinion of the President of the Treasury Board and the Minister, are required to present fairly the financial position of Canada.

Accounts in Canadian currency

(3) The accounts of Canada shall be kept in the currency of Canada.

R.S., 1985, c. F-11, s. 63; 1999, c. 31, s. 111(F).

Submission of Public Accounts to Parliament

64 (1) A report, called the Public Accounts, shall be prepared by the Receiver General for each fiscal year and shall be laid before the House of Commons by the President of the Treasury Board on or before December 31 next following the end of that fiscal year or, if the House of Commons is not then sitting, on any of the first fifteen days next thereafter that the House of Commons is sitting.

Contents of Public Accounts

(2) The Public Accounts shall be in such form as the President of the Treasury Board and the Minister may direct, and shall include

(a) a statement of

(i) the financial transactions of the fiscal year,

(ii) the expenditures and revenues of Canada for the fiscal year, and

(iii) such of the assets and liabilities of Canada as, in the opinion of the President of the Treasury Board and the Minister, are required to show the financial position of Canada as at the termination of the fiscal year;

(b) the contingent liabilities of Canada;

(c) the opinion of the Auditor General of Canada as required under section 6 of the *Auditor General Act*; and

(d) such other accounts and information relating to the fiscal year as are deemed necessary by the President of the Treasury Board and the Minister to present fairly the financial transactions and the financial position of Canada or as are required by this Act or any other Act of Parliament to be shown in the Public Accounts.

R.S., 1985, c. F-11, s. 64; 1999, c. 31, s. 112(F).

Ministers to provide records, etc.

65 For the purpose of the keeping of the accounts of Canada under section 63 and the preparation of the Public Accounts under section 64, the Receiver General may, from time to time, subject to such regulations as the Treasury Board may make, send a notice to each appropriate Minister requesting such records, accounts or statements or other information as is specified in the notice and each appropriate Minister shall, within such reasonable time as is specified in the notice, provide the Receiver General with the records, accounts or statements or other information requested.

R.S., c. F-10, s. 56; R.S., c. 11(2nd Supp.), s. 1; 1976-77, c. 34, s. 23; 1980-81-82-83, c. 170, s. 16.

Quarterly financial reports

65.1 (1) Every department shall cause to be prepared, in the form and manner provided for by the Treasury Board, a quarterly financial report for each of the first three fiscal quarters of each fiscal year.

Contents

(2) The report shall contain

(a) a financial statement for the fiscal quarter and the period from the start of the fiscal year to the end of that fiscal quarter;

(b) comparative financial information for the preceding fiscal year; and

(c) a statement outlining the results, risks and significant changes in relation to operations, personnel and programs.

Report to be made public

(3) The appropriate Minister shall cause the report to be made public within 60 days after the end of the fiscal quarter to which the report relates.

Regulations

(4) The Treasury Board may, by regulation, exempt a department from the requirement set out in subsection (1) or provide that any of the content referred to in subsection (2) be excluded from its report.

2009, c. 31, s. 58.

PART VII

Assignment of Crown Debts

Definitions

66 In this Part,

appropriate paying officer, in relation to a Crown debt, means the paying officer who makes the payments in respect of that debt; (*agent payeur compétent*)

contract means a contract involving the payment of money by the Crown; (*marché*)

Crown means Her Majesty in right of Canada; (*Sa Majesté*)

Crown debt means any existing or future debt due or becoming due by the Crown, and any other chose in action in respect of which there is a right of recovery enforceable by action against the Crown; (*créance sur Sa Majesté*)

paying officer means any person designated as such by regulation; (*agent payeur*)

prescribed means prescribed by regulation. (*Version anglaise seulement*)

R.S., 1985, c. F-11, s. 66; 1999, c. 31, s. 113(F).

General prohibition

67 Except as provided in this Act or any other Act of Parliament,

(a) a Crown debt is not assignable; and

(b) no transaction purporting to be an assignment of a Crown debt is effective so as to confer on any person any rights or remedies in respect of that debt.

R.S., c. F-10, s. 80.

Date modified:

2020-08-19

Wage Earner Protection Program Act (S.C. (Statutes of Canada) 2005, c. 47, s. 1)
Act current to 2020-08-11 and last amended on 2019-07-29.

Administration (continued)

Financial Provisions (continued)

Subrogation

36 (1) If a payment is made under this Act to an individual in respect of eligible wages, Her Majesty in right of Canada is, to the extent of the amount of the payment, subrogated to any rights the individual may have in respect of the eligible wages against

(a) the bankrupt or insolvent employer; and

(b) if the bankrupt or insolvent employer is a corporation, a director of the corporation.

Notice to Minister

(1.1) Unless the Minister directs otherwise, an individual who received a payment under this Act shall notify the Minister, in writing, of any action or other proceeding, other than the one in respect of which the individual received the payment, to recover eligible wages, including an action or other proceeding that is commenced by another person or organization and of which the individual is aware. The notice shall contain any information prescribed by regulation.

Notice to Minister — decision or order

(1.2) Unless the Minister directs otherwise, an individual who received a payment under this Act shall also notify the Minister, in writing, of any final decision or order, of which they are aware, respecting the recovery of eligible wages. The notice shall contain any information prescribed by regulation.

Maintaining an action

(2) For the purposes of subsection (1), Her Majesty in right of Canada may maintain an action in the name of the individual or Her Majesty in right of Canada.

2005, c. 47, s. 1 “36”; 2007, c. 36, s. 93; 2018, c. 27, s. 646.

Payment to Her Majesty in right of Canada

36.1 (1) If, under a court judgment or for any other reason, a trustee, receiver or any other person is required to pay eligible wages to an individual who the trustee, receiver or other person has reason to believe has received a payment under this Act, the trustee, receiver or other person shall

(a) ascertain whether Her Majesty in right of Canada is subrogated to any rights the individual may have in respect of the eligible wages; and

(b) if Her Majesty in right of Canada is subrogated, pay to Her Majesty the amount in respect of which Her Majesty is subrogated before making any payment to the individual in respect of eligible wages.

Components of wages

(2) A trustee, receiver or other person who makes a payment under paragraph (1)(b) shall provide the Minister with information respecting the components of wages to which the payment relates.

2018, c. 27, s. 647.

Amount not assignable

37 An amount that is payable under this Act is not capable of being assigned, charged, attached, anticipated or given as security and any transaction appearing to do so is void or, in Quebec, null.

2005, c. 47, s. 1 “37”; 2007, c. 36, s. 93.

Offences and Penalties

Offences

38 (1) Every person commits an offence who

(a) makes a false or misleading entry, or omits to enter a material particular, in any record or book of account that contains information that supports an application under this Act;

(b) in relation to an application under this Act, makes a representation that the person knows to be false or misleading;

(c) in relation to an application under this Act, makes a declaration that the person knows to be false or misleading because of the nondisclosure of facts;

(d) being required under this Act to provide information, does not provide it or makes a representation that the person knows to be false or misleading;

(e) obtains a payment under this Act by false pretence;

(f) being the payee of any cheque issued as a payment under this Act, knowingly negotiates or attempts to negotiate it knowing that the person is not entitled to the payment or any part of the payment; or

(g) participates in, consents to or acquiesces in an act or omission mentioned in any of paragraphs (a) to (f).

Trustees and receivers

(2) Every person who fails to comply with any of the requirements of subsection 21(1), (3) or (4) commits an offence.

Limitation of prosecutions

(3) A prosecution for an offence under subsection (1) or (2) may be commenced at any time within six years after the day on which the subject matter of the prosecution arose.

Due diligence

(4) No person may be convicted of an offence under subsection (2) if the person establishes that they exercised due diligence to prevent the commission of the offence.

2005, c. 47, s. 1 “38”; 2007, c. 36, s. 93.

Obstruction

39 (1) Every person commits an offence who delays or obstructs a person in the exercise of their powers or the performance of their duties under this Act.

Limitation of prosecutions

(2) A prosecution for an offence under subsection (1) may be commenced at any time within two years after the day on which the subject matter of the prosecution arose.

2005, c. 47, s. 1 “39”; 2007, c. 36, s. 93.

Punishment

40 Every person who is guilty of an offence under section 38 or 39 is liable on summary conviction to a fine of not more than $5,000 or to imprisonment for a term of not more than six months, or to both.

Regulations

Regulations

41 The Governor in Council may make regulations generally for carrying out the purposes of this Act, including regulations

(a) prescribing amounts for the purposes of subsection 2(1);

(b) prescribing reasons for the purposes of paragraph 5(a);

(c) defining *controlling interest* and *managerial position* for the purposes of section 6;

(d) prescribing an amount for the purposes of subsection 7(1);

(e) respecting the allocation of payments to the different components of wages;

(f) respecting the period during which and the manner in which applications for payments are to be made under section 8;

(g) respecting the period during which and the manner in which a review may be requested under section 11 or 32.1;

(h) prescribing the classes of individuals that the trustee or receiver is not required to inform under paragraph 21(1)(c) or to whom they are not required to provide information under paragraph 21(1)(d);

(i) respecting the information that is to be provided by trustees and receivers to the Minister and to individuals for the purposes of paragraph 21(1)(d) and respecting the period during which and the manner in which that information is to be provided;

(j) respecting the period during which and the manner in which the information referred to in paragraph 21(1)(c) and subsections 21(3) and (4) is to be provided;

(k) prescribing fees and expenses for the purposes of section 22.1 and the circumstances in which they are to be paid; and

(l) prescribing the period during which and the manner in which the Minister must be notified under subsection 36(1.1) or (1.2) and the information that must be contained in the notice.

2005, c. 47, s. 1 “41”; 2007, c. 36, s. 94; 2009, c. 2, s. 347; 2017, c. 20, s. 381; 2018, c. 27, s. 648; 2018, c. 27, s. 652.

Review of Act

Review

42 Within five years after the day on which this section comes into force, the Minister must cause a review of this Act and its administration and operation to be conducted, and cause a report on the review to be laid before each House of Parliament on any of the first 15 days on which that House is sitting after the review is completed.

Date modified:

2020-08-19

Government of Canada Gouvernement du Canada

Wage Earner Protection Program for an employee: After you've applied

6. After you've applied

Service Canada aims to issue a decision letter within 35 days of receiving all necessary information to complete your file. Submitting a complete application will help with timely processing.

Service Canada will issue a letter to you and the trustee/receiver explaining the payment decision. A letter is also issued to both parties if your application is denied.

Note: Trustees/receivers have 45 days after the date of the bankruptcy/receivership to provide Service Canada information on you and amounts owed. The 35-day processing time starts after all required information is received.

If you do not receive your decision letter within 35 days of applying, please contact the Wage Earner Protection Program to check the status of your application. You will need to provide your Social Insurance Number (SIN).

Requesting a review of your decision

If you disagree with Service Canada's decision regarding your eligibility, you may request a Ministerial review of the decision.

The written request must be made within 30 days from the date you were informed of the Service Canada decision using the WEPP form – Request for review by Minister. In requesting a review, you may submit new information that could impact the decision.

In conducting the Ministerial review, the trustee/receiver may be contacted for further documentation, information or clarification.

Service Canada will issue a letter to you and the trustee/receiver explaining the review decision.

Requesting an appeal

If you are not satisfied with the Ministerial review decision, you may appeal the decision on a question of law or jurisdiction only.

The written appeal must be made within 60 days from the date you were informed of the Ministerial review decision. Unlike the review process, new facts or evidence cannot be introduced.

The Canada Industrial Relations Board (CIRB) is responsible for the adjudication of appeals under the *Wage Earner Protection Program Act*. Appeals must be submitted directly to the Board. For more information, please visit the CIRB website or call 1-800-575-9696.

WEPP overpayments

If you are informed that you have received a higher WEPP payment than what you are entitled to (WEPP overpayment), it is important that you repay any amounts owed immediately in order to prevent interest from accruing. Even if you request a review of a decision on an overpayment, interest will continue to accrue. Interest accrued on WEPP overpayments can only be waived if there is a change in decision.

Once you have repaid any WEPP overpayment, you should advise Employment Insurance (EI) of the actual WEPP amounts you were entitled as it may affect your EI entitlement.

You must report your WEPP payment to EI by using the EI Telephone reporting service or Internet reporting service. Employment Insurance agents will contact you should they require additional information.

WEPP and family support orders or agreements

A garnishment is the lawful transfer of money owed by a third party (for example the federal government) to the person who is in default of a debt, such as family support payments.

Your WEPP payments may be garnished if Justice Canada is required by the *Family Orders and Agreement Enforcement Assistance Act* to intercept them. If you have not paid amounts owed as required by a family support order agreement, some or all of your WEPP payments may be redirected by garnishment.

Please visit the Provincial and Territorial family maintenance enforcement programs page of the Justice Canada's website for more information.

You can also call the Automated Information System Toll-free at 1-800-267-7777 (TTY: 1-800-267-7676).

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THE LAW OF GUARANTEE

A Treatise on Guarantee, Indemnity and the Standby Letter of Credit

Second Edition

by

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(2) Subrogation

7.11 A surety who is called upon to perform the principal's obligation is subrogated to the full rights to which the creditor is entitled against the debtor.[42] For instance, a surety who pays a judgment in respect of the guaranteed debt is entitled to an assignment of the judgment[43] and also any securities held in respect of the guaranteed obligation.[44] As discussed in Chapter 8, the surety's rights against the principal are not truly subrogatory, as they are independent rights to which the surety is entitled. The surety is entitled to proceed against the principal in his own name. In contrast, where the surety pays the creditor in full and the creditor is entitled to claim against some person other than the debtor in respect of the breach by the principal (as, for instance, a right of claim based upon the negligence of a professional employed to monitor the performance of the principal) the surety is subrogated to that right of claim. This is a true right of subrogation, and thus any such claim must be brought in the name of the creditor.[45]

7.12 A distinction exists between the assignment of, and the subrogation of a person to, a right belonging to another person. Both assignment and subrogation permit one person to acquire and enjoy the benefit of a right belonging to another person. However, rights of subrogation normally arise by operation of law[46] rather than by contract. Rights of subrogation take effect automatically upon payment (as,

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42 See, for instance, *Kin Tye Loong v. Seth*, [1920] 2 W.W.R. 450 (P.C.) at 455; *R. v. O'Bryan* (1900), 7 Ex. C.R. 19; *O'Connor v. Malone* (1852), 4 Ir. Jur. 205. See also the *Mercantile Law Amendment Act*, R.S.O. 1990, c. M.10, s. 2; *Mercantile Law Amendment Act, 1856*, c. 97 (U.K.). And see generally: J.J. Hlafesake, "The Nature and Extent of Subrogation Rights of Fidelity Insurers Against Officers and Directors of Financial Institutions" (1986) 47 U. Pittsburg L.R. 727.

43 *Smith v. Burn* (1880), 30 U.C.C.P. 630; *Cockburn v. Gillespie* (1865), 11 Gr. 465; see also *Embling v. McEwan* (1872), 3 V.R.(L) 52 (Vic.).

44 *Drew v. Lockett* (1863), 32 Beav. 499, 45 E.R. 196; *Imperial Bank v. London & St. Katharine Dry Docks Co.* (1877), 5 Ch.D. 195. The nature and terms of the surety's rights to be subrogated to the position of the creditor are discussed in greater detail later in this Chapter and in Chapters 8, 9 and 10. As to the time when these various subrogatory rights arise, see, generally: *Re Miller*, [1957] 2 All E.R. 266; *Re Howe* (1871), 6 Ch. App. 838 at 841; *Re British Power Traction*, [1910] 2 Ch. 470; see also *Jones v. Hill* (1893), 14 N.S.W.L.R. 303; *Ontario (Attorney General) v. Railway Passengers Assurance Co.* (1918), 43 O.L.R. 108 (C.A.); *Merchants Bank v. McKay* (1888), 15 S.C.R. 672; *Boone v. Martin* (1920), 47 O.L.R. 205; *Re Victor Varnish Co.* (1907), 16 O.L.R. 338 (H.C.); *Standard Brands Ltd. v. Fox* (1972), 29 D.L.R. (3d) 167, affirmed (1973), 44 D.L.R. (3d) 69 (N.S. C.A.); *Independent Order of Foresters v. Lethbridge Northern Irrigation District*, [1944] 1 W.W.R. 206 (Alta. C.A.); *Drager v. Allison* (1958), 13 D.L.R. (2d) 204 (Sask. C.A.); *Household Finance Corp. v. Foster*, [1949] 1 D.L.R. 840 (Ont. C.A.); *Mather v. Bank of Ottawa* (1919), 46 O.L.R. 499 (C.A.). A guarantor of part of the debt of the principal is entitled to be subrogated to the rights of the creditor to a proportionate extent of the securities and other rights held or enjoyed by the creditor in respect of the whole debt: *Ward v. National Bank of New Zealand* (1889), 8 N.Z.L.R. 10. In *Re Victor Varnish Co.* (1907), 16 O.L.R. 338 (H.C.), it was held that a surety who had paid a bank creditor could not be subrogated to the security rights which the bank had acquired under s. 88 (now s. 178) of the *Bank Act* (Canada).

45 *Prince Albert (City) v. Underwood, McLelland & Associates*, [1969] S.C.R. 305.

46 There is debate as to whether the right is founded in common law or in equity.

for instance, by an insurer) by the person entitled to be subrogated, without any further step being required on the part of the person to whom the right originally belonged. In contrast, an assignment requires either an instrument executed by, or at least some agreement on the part of, the part of the assignor. Any consideration given by an assignee is sufficient to make an assignment binding on an assignor, and the assignment will be effective to the full extent agreed. In contrast, subrogation arises only where the rights to which it relates have been satisfied by the person claiming to be subrogated.[47]

7.13 Ordinarily acts of the creditor prejudicing the surety's right of subrogation will release the surety from liability only to the extent of any prejudice actually suffered; the guarantee otherwise remains enforceable. However, in an extreme case the effect of the prejudice may be sufficient to entitle the surety to be discharged in full. For instance, in *Moase Produce Ltd. v. Royal Bank*,[48] Mitchell J. found that the creditor bank had tricked a corporate principal into believing that it had accepted the company's reorganization plan when all the while the bank was secretly planning a receivership. After the guarantee had been obtained from the sureties and they had invested additional cash in the corporate principal, the bank gave the corporation no time at all to put its rescue plan into effect. It appointed a receiver without notice or warning. It was found that the bank also acted with deliberate, illegal and complete disregard for the sureties. The sureties sought declarations that they were no longer liable on their guarantees. In finding in their favour, Mitchell J. said:

> I would hold that both plaintiffs are entitled to such a declaration. . . . The precipitous action of the defendant completely destroyed the goodwill and viability of Moase Produce, thereby materially impairing the value of the security it held for the company's indebtedness. . . . The intervention of the receiver resulted in significant under-realization on the company's assets; e.g. virtually all the potato inventory was lost. As a result, the guarantors' equitable rights of subrogation and indemnity were substantially destroyed. Due to the fact that the bank acted illegally and committed intentional acts of trespass and conversion, it cannot rely on the protective clauses contained in the guarantees or the debenture to preserve its rights.[49]

(3) Securities in Favour of the Creditor

7.14 The sureties rights of subrogation are not limited to the rights *in personam* to which the creditor is entitled. It is an ancient principle,[50] founded upon the equitable

47 *Bank of Montreal v. Guarantee Co. of North America* (1991), 47 C.L.R. 267 (B.C. C.A.), *per* Hollinrake J.A. at 271.

48 (1987), 64 C.B.R. (N.S.) 191 (P.E.I. S.C.).

49 *Ibid.* at 193-94.

50 *Morgan v. Seymour* (1638), 1 Rep. Ch. 120, 21 E.R. 525 (Ch.); *Swain v. Wall* (1641), 1 Rep. Ch. 149, 21 E.R. 534 (Ch.), *per* Hutton J.

doctrine of marshaling, by the surety of the gu of all securities that the the debt in order to en The surety will be rele cannot, by reason of v condition as they were debt.[55] If the creditor d neglect a security to creditor is bound to c diced.[56] The surety's ri tive of whether the su became a surety.[57] A s same rights as the cre entitled to the benefit

51 The term "marshaling with respect to the as number of claims. In (2d) 30 (Ont. Gen. D (at 34):

> Marshaling is an ec fund of a debtor fr the same debtor. . . of the funds, but if circumstances the tions must prevail (a) the claim must (b) the two funds (c) the two funds

52 *Bauer v. Bank of Mo* [1989] 4 W.W.R. 1 D.L.R. (4th) 132 (N

53 In *Dixon v. Steel*, [1 the surety to take ar arises at the time wh

54 See, for instance, *Ex* John 663, 70 E.R. 5 Cas. 1 (H.L.).

55 *Wulff v. Jay* (1872),

56 *Taylor v. Bank of N Traders Finance Co* (P.E.I. S.C.), *per* Fi

57 See, for instance, *L Fox & Co. v. Nortl* (C.A.); *Merchants* Ch. D. 615.

CARSWELL

THE 2019-2020 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

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to levy. However, s. 136(1)(c) has no relevance for levy payable on the claims of secured creditors. As pointed out *supra* G§111 "Priority of Claims, Generally — (3) Secured Creditors", the scheme of distribution set out in ss. 136-47 has no application to secured creditors: *Re 157637 Canada Inc.* (1996), 48 C.B.R. (3d) 90 (C.S. Qué.). For payment of levy on secured claims, see *post* G§167 "Levy Payable to Superintendent — (3) Secured Creditors" and Directive No. 10R.

G§116 — Priority of Pension Related Claims

Effective July 7, 2008, statutory provisions provide a priority over all assets for the payment of normal pre-filing pension contributions, not including any unfunded pension liabilities, in bankruptcies and receiverships. As well, Division I proposals and *CCAA* plans that do not provide for these payments are not to be approved by the court unless the parties to the pension plan have entered into an agreement approved by the relevant pension regulator: ss. 60(1.5), 60(1.6), 81.5 and 81.6, *BIA*.

The Ontario Superior Court of Justice provided directions to a receiver on the appropriate reserves required for normal cost and wind-up deficiencies for both hourly and salaried plans of the debtor. The plan administrator had made claims under s. 81.6 of the *BIA* and under the *Pension Benefits Act (PBA)*. The receiver was authorized and directed to conduct a sales process in respect of a property and the proceeds were insufficient to satisfy the debtor's obligations to its secured creditors. The debtor was the employer under, and the administrator of, two defined benefit pension plans, the hourly and salaried plans. The debtor had previously stopped operations and virtually all of its employees were laid off; and the Superintendent of Financial Services had issued notice that it intended to wind up the hourly plan and refused to register the salaried plan. The receiver was appointed several months after the Superintendent's orders, and an administrator was appointed for the plans. Justice Newbould noted that the amount of the claims asserted by the administrator depended in part on whether the wind-up date for the hourly plan could be changed from an initial date in the order to a date recommended by the administrator, almost two years later. Newbould J. concluded that the process whereby the Superintendent was being asked to change the wind-up date for the hourly plan was stayed by the receivership order. Here, Justice Newbould saw no purpose in lifting the stay to permit consideration by the Superintendent to change the wind-up date of the hourly plan, as the initial date was a final order and there would be substantial prejudice to a creditor if the stay were lifted. In this case, the security granted to secured lenders took place well before the steps taken by the Superintendent to wind up the hourly plan and revoke the salaried plan and the beneficiaries of a *PBA* deemed trust had priority only over an account or inventory and its proceeds: *G.E. Canada Equipment Financing G.P. v. Northern Sawmills Inc.*, 2012 CarswellOnt 15077, 95 C.B.R. (5th) 46, 2012 ONSC 6664, 100 C.C.P.B. 182 (Ont. S.C.J. [Commercial List]).

G§117 — Claims of Wage-Earners for Arrears of Wages

(1) — Generally

Under s. 136(1)(d), the preference for wages is restricted to wages earned in the six months preceding the bankruptcy, $2,000 in amount, and $1,000 for the expenses of a travelling salesperson. Effective July 7, 2008, s. 81.3 grants employees with wage and related claims a priority for unpaid wage claims of up to $2,000, to be paid out of the proceeds of current assets, which includes cash, inventory, and accounts receivable, ahead of secured creditors.

If a provincial statute purports to give a higher priority to wages than that conferred by s. 136(1)(d), the provincial legislation is inapplicable: wages have only the priority conferred

by s. 136(1)(d): *A.A. Electric Ltd. v. Bank of British Columbia* (1978), 27 C.B.R. (N.S.) 298, 89 D.L.R. (3d) 157 (Alta. T.D.); *Robinson, Little & Co. (Trustee of) v. Saskatchewan (Minister of Labour)* (1989), 76 C.B.R. (N.S.) 193 (Sask. C.A.); *Re Richmac Interiors Ltd.*, 25 C.B.R. (3d) 31, 16 Alta. L.R. (3d) 403, [1994] 4 W.W.R. 719 (Q.B.).

Provincial legislation that imposes personal liability on a director or officer of a corporation for unpaid wages of employees of the corporation cannot be used to give employees a preferred claim in the bankruptcy of a director or officer of the corporation, since the provincial legislation is in operational conflict with. s. 136(l)(d) of the *BIA* which alone determines the status and priority of wage claims in a bankruptcy. Section 136(1)(d) only creates a preferred claim for unpaid wages in the bankruptcy of the employer-corporation. In the bankrupt estates of the directors and officers, the unpaid wage claims are only unsecured claims: *Re James* (2000), 32 C.B.R. (4th) 250, 2002 CarswellBC 513 (C.A.); *Re George* (2001), 29 C.B.R. (4th) 208, 2001 CarswellSask 691 (Sask. Q.B.); affirmed (2002), 2002 CarswellSask 205, 33 C.B.R. (4th) 240 (Sask. Q.B.).

In interpreting the provisions of the *BIA*, the courts have said that s. 136(1)(d) should be given a liberal interpretation: *Re Specialty Bags Co.* (1923), 3 C.B.R. 617; affirmed 4 C.B.R. 276 (Ont. C.A.); *Re Vancouver Dress Co.*, 13 C.B.R. 66, [1931] 3 W.W.R. 220 (B.C. S.C.); *Re Sexton* (1930), 12 C.B.R. 45, 66 O.L.R. 133 (Ont. C.A.); *Re Corson Shoe Co.*, [1924] 1 D.L.R. 555 (Ont. S.C.).

Bankruptcy has the effect of terminating contracts of employment: *Re Kemp Products Ltd.* (1978), 27 C.B.R. (N.S.) 1; *Rizzo & Rizzo Shoes Ltd. (Receiver of) v. Rizzo & Rizzo Shoes Ltd. (Trustee of)* (1991), 8 C.B.R. (3d) 291 (Alta. Q.B.); *British Columbia (Director of Employment Standards) v. Eland Distributors Ltd. (Trustee of)*, [1996] 7 W.W.R. 652. Although employment is terminated by bankruptcy, the termination of the employee/employer relationship between the bankrupt employer and the employees does not necessarily terminate benefits to which the employees are entitled by virtue of statutory schemes. Statutes providing such benefits are to be given a liberal interpretation so as to achieve their objectives. Notwithstanding the bankruptcy of an employer, a Labour Board can find that a purchaser of assets from a trustee is on the facts of the case a successor employer: *Saan Stores Ltd. v. Nova Scotia (Labour Relations Board)* (1999), 9 C.B.R. (4th) 109, 172 D.L.R. (4th) 134 (N.S. C.A.); *GMAC Commercial Credit Corp. - Canada v. TCT Logistics Inc.* (2006), 2006 CarswellOnt 4621, 2006 CarswellOnt 4622, [2006] 2 S.C.R. 123, 22 C.B.R. (5th) 163 (S.C.C.).

The Supreme Court of Canada in *Re Rizzo & Rizzo Shoes Ltd.* (1998), 154 D.L.R. (4th) 193, held that the termination of employment by bankruptcy gave rise under relevant provincial legislation to a claim by an employee as an unsecured creditor for termination pay (including vacation pay due thereon) and severance pay.

In *Re Optenia Inc.* (2002), 37 C.B.R. (4th) 308, 2002 CarswellOnt 3904 (Ont. S.C.J.), contracts of employment between the debtor company and employees provided for payment of substantial damages if the employment contracts were terminated without "just cause". "Just cause" was defined as meaning any grounds at common law for which an employer was entitled to summarily dismiss an employee. The debtor company made an assignment in bankrupt, principally to protect the interests of employees. It was held that termination by bankruptcy did not constitute "just cause", and the employees were therefore entitled to file claims as unsecured creditors for damages as provided in the contracts. Some of the employment contracts provided for termination if frustration occurred. The court held that frustration did not apply since the filing of the assignment was done to accommodate and protect the interests of employees. The bankruptcy was therefore self-induced and self-induced frustration does not excuse non-performance of a contract.